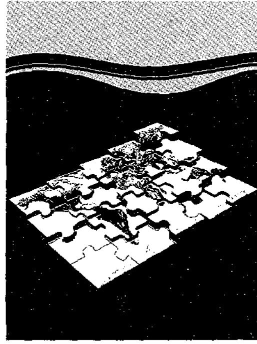


Overview

Development is the most important challenge facing the human race. Despite the vast opportunities created by the technological revolutions of the twentieth century, more than 1 billion people, one-fifth of the world's population, live on less than one dollar a day—a standard of living that Western Europe and the United States attained two hundred years ago.

The task is daunting, but by no means hopeless. During the past forty years many developing countries have achieved progress at an impressive pace. Many have achieved striking gains in health and education. Some have seen their average incomes rise more than fivefold—a rate of progress that is extraordinary by historical standards. So if nothing else were certain, we would know that rapid and sustained development is no hopeless dream, but an achievable reality.

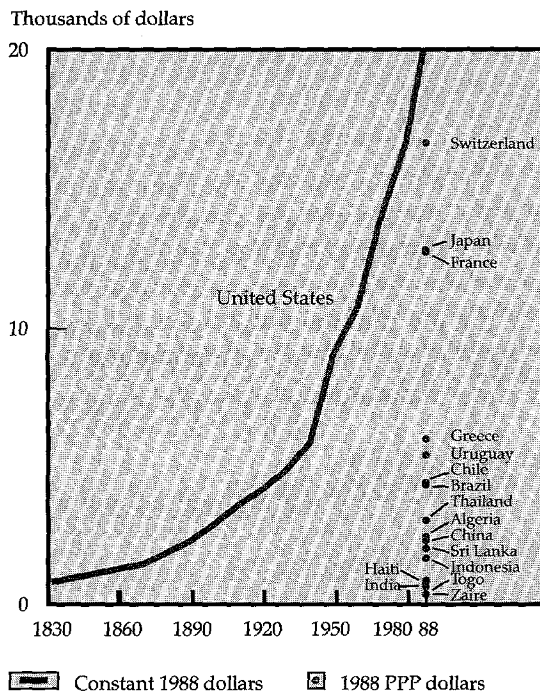
Nonetheless, many countries have done poorly, and in some living standards have actually fallen during the past thirty years. That is why poverty remains such a formidable problem and why substantial economic progress has yet to touch millions of people. The sharp contrast between success and failure is the starting point for *World Development Report 1991*. Why have country experiences been so different? What must developing countries do if the productivity and well-being of their people are to increase rapidly during the next decade? What can the international community do to spur development and alleviate poverty? These questions are all the more pressing because nearly 95 percent of the increase in the world's labor force during the next twenty-five years will occur in the developing world.

The processes driving economic development are by no means fully understood. But much can be learned from experience. History shows, above all, that economic policies and institutions are crucial. This is encouraging, because it implies that the countries which have failed to prosper can do better. But it is also challenging, because it obliges governments everywhere (not just in developing countries) as well as the multilateral agencies to take account of the factors that have promoted development and put them to work.

A central issue in development, and the principal theme of the Report, is the interaction between governments and markets. This is not a question of intervention versus laissez-faire—a popular dichotomy, but a false one. Competitive markets are the best way yet found for efficiently organizing the production and distribution of goods and services. Domestic and external competition provides the incentives that unleash entrepreneurship and technological progress. But markets cannot operate in a vacuum—they require a legal and regulatory framework that only governments can provide. And, at many other tasks, markets sometimes prove inadequate or fail altogether. That is why governments must, for example, invest in infrastructure and provide essential services to the poor. It is not a question of state or market: each has a large and irreplaceable role.

A consensus is gradually forming in favor of a "market-friendly" approach to development. The Report describes the various elements of this strategy, and their implementation in a wide variety of country contexts. It goes further. It stresses the complementary ways markets and governments

Figure 1 Per capita income: selected countries in 1988 compared with the United States, 1830-1988



Note: Countries were selected on the basis of data availability
Sources: For United States, World Bank data and Maddison, background paper; for other countries, Summers and Heston 1991.

can pull together. If markets can work well, and are allowed to, there can be a substantial economic gain. If markets fail, and governments intervene cautiously and judiciously in response, there is a further gain. But if the two are brought together, the evidence suggests that the whole is greater than the sum. When markets and governments have worked in harness, the results have been spectacular, but when they have worked in opposition, the results have been disastrous.

The world economy in transition

The technological changes of this century have enabled countries to use their resources much more productively than ever before. Living conditions have improved beyond recognition, not just in industrial countries but also in most developing countries. The pace of this improvement has seemed to accelerate with time. It took the United Kingdom sixty years to double its real income per person, starting in 1780. Many developing countries matched the achievement within twenty years, after World War II.

The real income gap between the industrial countries and some developing countries, notably those in East Asia, has narrowed dramatically since World War II. But the gap between the industrial countries and the developing countries of other regions has widened. The 1980s were a difficult decade for most countries—though per capita income in China and India, the most populous countries, and Asia as a whole, grew substantially. In the past quarter century, per capita income grew little in such countries as Argentina, Jamaica, Nigeria, and Peru; in Nicaragua, Uganda, Zaire, and Zambia, it declined. Many poor countries have per capita real incomes that are much lower than that of the United States at the beginning of the nineteenth century (Figure 1). However, the gaps between rich and poor in infant mortality and life expectancy have narrowed more quickly—thanks to the spread of medical technology, environmental sanitation, better nutrition, education, and the natural limits to achievement in such indicators (Figure 2).

The crucial question for the future is whether national and international policies will permit the potential created by technological progress to be exploited. Sustainable development requires peace. War and its aftermath in the Middle East have cast a cloud of uncertainty over that region. Ethnic strife, civil wars, and international conflicts, as well as natural disasters, continue to destroy the fragile base of development in many parts of the world. By conservative estimates, wars have been directly responsible for 20 million deaths since 1950. That includes more than 12 million deaths from civil wars in the developing world. Far and away, the most important cause of famine in developing countries in recent years has been not inadequate agricultural output or poverty, but military conflict.

Rapid development also requires that economic integration expand for all. The boundaries that separate national markets for goods, capital, and labor have continued to be eroded. Worldwide trade has expanded by more than 6 percent a year since 1950, which is more than 50 percent faster than the growth of output. Global integration in trade, investment, factor flows, technology, and communication has been tying economies together. But it remains to be seen whether this trend will continue.

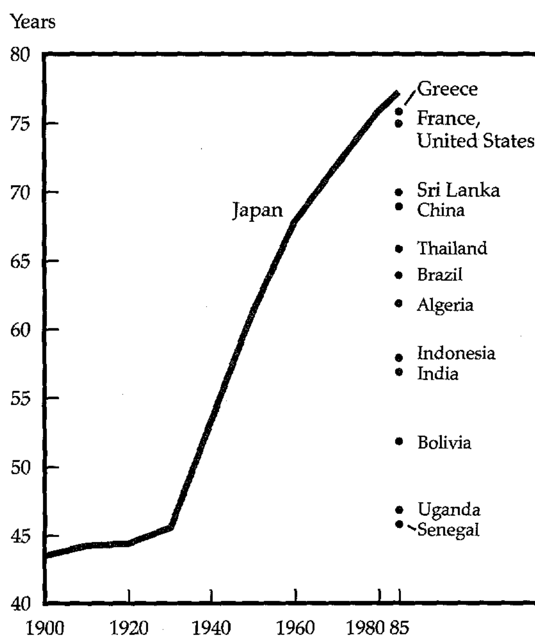
Increasing exposure to external influences undoubtedly puts the developing countries at risk. High industrial-country fiscal deficits, potentially high international interest rates, weaknesses in the financial institutions in the United States, deterioration of some aspects of the financial situation in Japan, and protracted and inconclusive negotiations in the Uruguay Round of trade talks will all take their toll. But global integration in the flow of goods, services, capital, and labor also brings enormous benefits. It promotes competition and efficiency, and it gives poor countries access to basic knowledge in medicine, science, and engineering.

Sustained development depends on global conditions and especially on country policies. Recently, countries in Eastern Europe embarked on ambitious programs of economic reform. The Soviet Union grappled with difficulties of economic and political transformation. A number of developing countries initiated policy improvements similar to the earlier ones elsewhere. Democracy swept through Eastern Europe as well as parts of the developing world.

The staff of the World Bank has made projections for the world economy in the 1990s. If there are no major adverse shocks and generally good policies, average per capita real incomes in the industrial countries might grow by about 2.5 percent a year (Table 1). This could be achieved with an inflation rate of 3-4 percent and a real interest rate of about 3 percent. If world trade expands more than 5 percent a year and recent policy reforms continue and are consolidated, per capita real incomes in the developing countries might grow by roughly 3 percent a year. Better or worse external conditions could raise or lower this outcome by 0.5-1.0 percentage point. More extreme scenarios (for example, substantially lower growth rates in industrial countries) are plausible, but not likely, particularly during a period as long as a decade.

Country studies which support these projections suggest that, under more vigorous and comprehensive reforms, the developing countries' long-term income growth could be improved by

Figure 2 Life expectancy at birth: selected countries in 1985 compared with Japan, 1900-85



Note: Countries were selected on the basis of data availability.
Sources: World Bank data; United Nations 1991.

Table 1 Growth of real GDP per capita, 1965–2000
(average annual percentage change, unless noted)

Group	Population, 1989 (millions)	1965–73	1973–80	1980–89	Projection for 1990s[a]
Industrial countries	773	3.7	2.3	2.3	1.8-2.5
Developing countries	4,053	3.9	2.5	1.6	2.2-2.9
Sub-Saharan Africa	480	2.1	0.4	−1.2	0.3-0.5
East Asia	1,552	5.3	4.9	6.2	4.2-5.3
South Asia	1,131	1.2	1.7	3.0	2.1-2.6
Europe, Middle East, and North Africa	433	5.8	1.9	0.4	1.4-1.8
Latin America and the Caribbean	421	3.8	2.5	−0.4	1.3-2.0
Developing countries weighted by population[b]	4,053	3.0	2.4	2.9	2.7-3.2

a. Projected on the basis of the two main scenarios (baseline and downside) discussed in Chapter 1.
b. Using population shares as weights when aggregating GDP growth across countries.
Sources: World Bank data and World Bank 1991a.

1.5–2 percentage points—on average, about twice the improvement from better external conditions. What, in detail, those reforms might be is the subject of the body of the Report. These projections also contain a warning: if recent reforms are reversed, the outcome might easily be much worse.

Paths to development

The challenge of development, in the broadest sense, is to improve the quality of life. Especially in the world's poor countries, a better quality of life generally calls for higher incomes—but it involves much more. It encompasses, as ends in themselves, better education, higher standards of health and nutrition, less poverty, a cleaner environment, more equality of opportunity, greater individual freedom, and a richer cultural life. This Report is concerned primarily with economic development, in itself a broad idea. Any notion of strictly economic progress must, at a minimum, look beyond growth in per capita incomes to the reduction of poverty and greater equity, to progress in education, health, and nutrition, and to the protection of the environment.

Thinking on development has shifted repeatedly during the past forty years. Progress has not moved along a straight line from darkness to light. Instead there have been successes and failures, and a gradual accumulation of knowledge and insight. On some matters, a fairly clear understanding has emerged, but many questions still remain contentious and unanswered.

Climate, culture, and natural resources were once thought to be the keys to economic development. Rapid industrialization, using explicit and implicit taxes on agriculture to fund industrial investment, was for many years a much-favored strategy. After the Great Depression and through the 1960s, most policymakers favored import substitution combined with fostering infant industries. In its day this view was endorsed, and the strategy supported, by external aid and finance agencies.

These views have not stood the test of time. Now there is clearer evidence, from both developing and industrial countries, that it is better not to ask governments to manage development in detail. Discriminatory taxes on agriculture have almost always turned out to be taxes on growth. Economic isolation behind trade barriers has proved costly. Retarding competition and interfering with prices, deliberately or accidentally, have very often proved counterproductive.

As the importance of openness and competition has been realized, the conviction has grown that they are insufficient by themselves. Investing in people, if done right, provides the firmest foundation for lasting development. And the proper economic role of government is larger than merely standing in for markets if they fail to work well. In defining and protecting property rights, providing effective legal, judicial, and regulatory systems, improving the efficiency of the civil service, and protecting the environment, the state forms the very core of development. Political and civil liberties are not, contrary to a once-popular view, inconsistent with economic growth.

As a matter of arithmetic, the growth of output can be accounted for as the growth of capital and labor and changes in the productivity of those inputs. Productivity has grown much more slowly in developing countries than in industrial countries. In the nearly seventy countries examined for the Report, changes in the use of capital made a large contribution to changes in output. But the key to explaining the differences in the growth of output from country to country is the growth of productivity.

Growing productivity is the engine of development. But what drives productivity? The answer is technological progress, which is in turn influenced by history, culture, education, institutions, and policies for openness in developing and industrial countries. Technology is diffused through investment in physical and human capital and through trade. Strong evidence links productivity to investments in human capital and the quality of the economic environment—especially the extent to which markets are distorted.

The Report looks at several indexes of market distortion, such as the parallel-market premium on the exchange of foreign currency and restrictions on trade. Far more economies have had severely distorted price systems than only moderately or slightly distorted ones. Most of the countries with severely distorted prices did poorly in output growth and productivity. At the opposite extreme, the few economies that had relatively undistorted price systems did well. In the middle the results are more ambiguous: some economies were successful, but others did much less well. In general, a relatively undistorted price system, other things being equal, has a better chance of promoting growth than a heavily distorted one. A range of evidence also suggests what can be gained by reducing interventions in the market. For instance, various degrees of reforms in Chile, China, Ghana, India, Indonesia, the Republic of

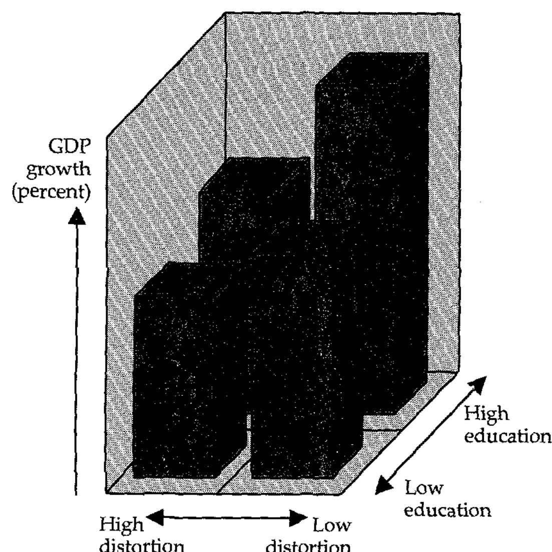
Korea, Mexico, Morocco, and Turkey during the 1980s were generally followed by improvements in economic performance.

Is this view really consistent with the remarkable achievements of the East Asian economies, or with the earlier achievements of Japan? Why, in these economies, were interventions in the market such as infant-industry protection and credit subsidies associated with success, not failure? First, these governments disciplined their interventions with international and domestic competition. This meant that interventions had to be carried out competently, pragmatically, and flexibly; if one failed, it was likely to be removed. Instead of resisting market competition, governments tried to anticipate it—and when they were proved wrong, they were quick to undo the harm. Second, these governments, on the whole, were careful to ensure that intervention did not end up distorting relative prices unduly: in trade, they successfully neutralized the bias against exports that is usually a by-product of protection. Third, their intervention was more moderate than in most other developing countries. In that respect, these economies refute the case for thoroughgoing dirigisme as convincingly as they refute the case for laissez-faire.

In several respects, government intervention is essential for development. What then are the conditions under which government intervention is likely to help, rather than hinder? Economic theory and practical experience suggest that interventions are likely to help provided they are market-friendly. That means:

- *Intervene reluctantly.* Let markets work unless it is demonstrably better to step in. Certain actions involving public goods readily pass this test in principle because the private sector does not usually carry them out: spending on basic education, infrastructure, the relief of poverty, population control, and environmental protection. Certain other actions usually fail the test. For instance, it is usually a mistake for the state to carry out physical production, or to protect the domestic production of a good that can be imported more cheaply and whose local production offers few spillover benefits.
- *Apply checks and balances.* Put interventions continually to the discipline of the international and domestic markets. The Republic of Korea withdrew its support for the heavy chemicals industry when market performance showed that the policy was failing.
- *Intervene openly.* Make interventions simple, transparent, and subject to rules rather than official discretion. Prefer, for example, tariffs to quantitative controls.

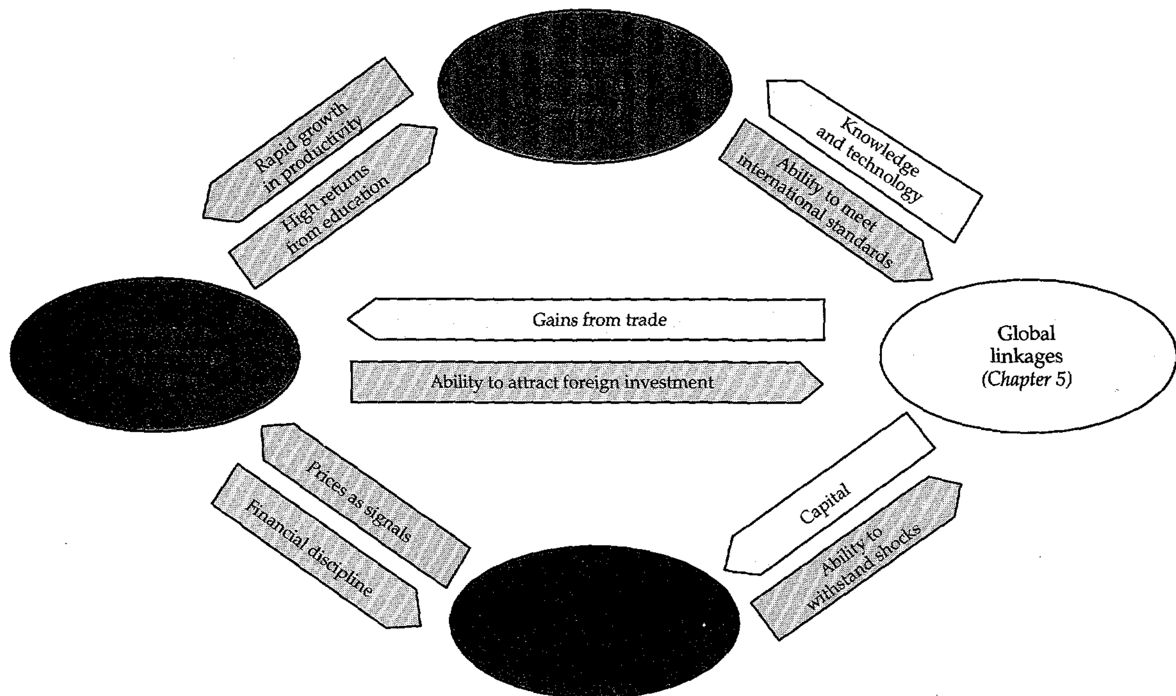
Figure 3 Policy distortion, education, and growth in GDP, sixty developing economies, 1965-87



Note: High distortion reflects a foreign exchange premium of more than 30 percent; low distortion, a premium of 30 percent or less. Education is measured by the average years of schooling, excluding postsecondary schooling, of the population age fifteen to sixty-four. High education is defined here as more than 3.5 years; low education, 3.5 years or less. For the derivation of data, see Table 2.4.
Sources: International Currency Analysis, Inc., various years; World Bank data.

The complementarity of a sound policy climate and market-friendly interventions is one of the most encouraging lessons of development experience. Analysis suggests, for example, that there may be an interaction between different forms of investment (human, physical, and infrastructure) and the quality of policies (Figure 3). Among a sample of sixty developing economies during the period 1965-87, those with distorted policies and a low level of education grew, on the average, by 3.1 percent a year. The economies that had either higher levels of education or fewer policy distortions did better, growing at 3.8 percent a year. But the countries that had both—that is, a higher level of education and fewer distortions—grew at 5.5 percent a year. There also seems to be such a complementarity between increasing physical capital and economic policies. This research does not by

Figure 4 The interactions in a market-friendly strategy for development



itself show causation, but it suggests that the results from moving forward on several fronts at once can be exceptionally good.

Elements of a market-friendly approach

The Report looks at the relation between governments and markets under four broad headings: human development, the domestic economy, the international economy, and macroeconomic policy. These areas of activity are interrelated. A relatively undistorted domestic economy rewards those who build up their human capital more generously than does a distorted one; at the same time, education makes the domestic economy more productive by speeding the adoption of new technology. To take another example, a stable macroeconomy helps the domestic price system because it clears away the fog of inflation. But microeconomic efficiency also makes it easier to keep inflation low: with fewer unviable enterprises, there will be less need for subsidies to swell the public sector deficit. All four sets of actions are worth doing in their own right. But because of such linkages, the results will probably be disproportionately strong if done together (see Figure 4).

Investing in people

The economic returns from public and private investments in people are often extremely high. Markets in developing countries cannot generally be relied upon to provide people—especially the poorest—with adequate education (especially primary education), health care, nutrition, and family planning services.

Rapid population growth is a crucial concern in some countries such as Bangladesh and in some parts of the world such as the Sahel. The growth of the population typically slows as people's education and incomes grow and they move to cities. Yet in many countries, investments in education, health, and family planning have been necessary, in addition to income growth, to reduce fertility and slow the pace of population growth. Effective family planning programs have informed people of the private and social costs of high fertility, encouraged couples to reduce family size, and helped to meet the demand for contraceptives. Such programs have worked best in countries that have also instituted policies to improve education for women and increase their opportunities for work in the modern sector.

Many governments are investing far too little in human development. In Brazil and Pakistan rapid growth alone was insufficient to improve the social indicators substantially. In Chile and Jamaica, however, these indicators improved even in periods of slow growth. Among low-income countries, Guinea and Sri Lanka have the same per capita income, but average life expectancy is some two-thirds longer in Sri Lanka. Among middle-income countries, Brazil and Uruguay have similar per capita incomes, but infant mortality is two-thirds lower in Uruguay. By some estimates Shanghai has a lower infant mortality rate and longer life expectancy than New York City.

In addition to increasing the quantity of human investment, governments must improve its quality. Too often, capital investments go forward with inadequate provision for the recurrent expenditures they entail, which results in wasteful underutilization. And expenditures are frequently poorly targeted and involve a great deal of leakages. There is a need to reduce heavy subsidies for higher education and to spend much more on primary education, from which the returns are relatively higher. The case for a similar switch in spending from expensive curative health care systems to primary systems is also strong.

More care is required to ensure that public programs reach their intended beneficiaries. Examples of well-designed and well-targeted social expenditures include a program to increase primary school enrollment in Peru; the provision of rural health facilities in the state of Kerala in India; efforts to reduce infant mortality in Malaysia; and health programs to raise life expectancy in Chile, China, and Costa Rica. There are useful opportunities for partnership with the private sector. Involving the private sector permits services to be delivered more effectively, as in the cases of education in Kenya, the Philippines, and Zimbabwe; and of health care in Rwanda and Zambia.

The climate for enterprise

Domestic and external competition has very often spurred innovation, the diffusion of technology, and an efficient use of resources. Japan, the Republic of Korea, Singapore, the United States, and Europe's most successful economies have all established global competitive advantage through the rigors of competition. Conversely, systems of industrial licensing, restrictions on entry and exit, inappropriate legal codes concerning bankruptcy and employment, inadequate property rights, and price controls—all of which weaken the forces of competition—have held back technological change and the growth of productivity.

Examples of such restrictions at various times include Argentina's policy of favoring incumbent firms for new industrial investment; barriers to entry or exit in many African countries, China, India, and Eastern Europe; sheltered national markets for parts of Europe's computer industry; extensive price regulations in Brazil, the Arab Republic of Egypt, and Indonesia; capacity licensing in India and Pakistan; and state control of selected industries in almost all developing countries. When regulatory reforms to correct the obstacles have been undertaken—as in Ghana, India, Indonesia, and recently many other countries—they have paid off.

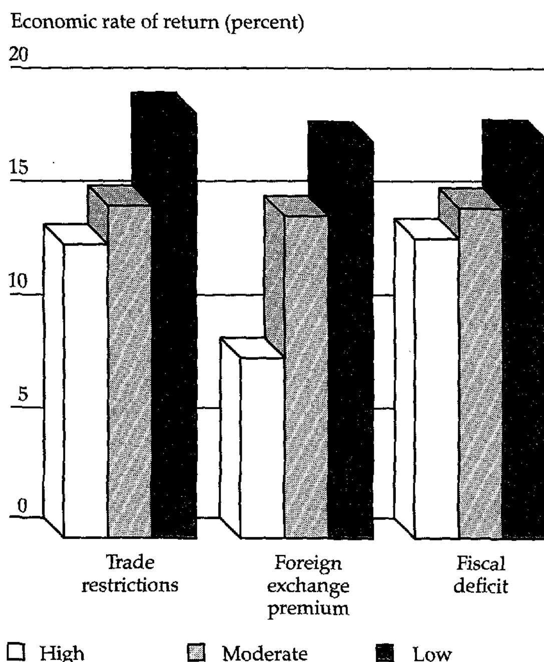
An efficient domestic economy also requires public goods of correspondingly high quality. These include, most fundamentally, a regulatory framework to ensure competition, and legal and property rights that are both clearly defined and conscientiously protected. It also requires investment in infrastructure, such as irrigation and feeder roads, which have proven to provide high returns. The returns from research and development in agriculture, for instance, can be extremely high: witness maize in Peru, rubber in Malaysia, wheat in Chile and Pakistan, and cotton in Brazil.

Domestic policy should confront entrepreneurs with the information that is embodied in prices, and it should then equip them (by means of investments in infrastructure and institutions) to respond. A detailed study of the World Bank's investment projects in developing countries confirms that market incentives work. The rate of return to public and private sector projects implemented under policies that do little to distort prices is consistently higher than under policies that result in more distortions (Figure 5). A substantial improvement in policy is associated with a 5–10 percentage point increase in the rate of return for projects, or a 50–100 percent increase on average. Also evident are the general positive effects of institution-building and investing in infrastructure on returns from projects. Again, this confirms that good policies and investments (including external financing) are complementary.

Integration with the global economy

When international flows of goods, services, capital, labor, and technology have expanded quickly, the pace of economic advance has been rapid. Openness to trade, investment, and ideas has

Figure 5 Rates of return for projects financed by the World Bank and the IFC under different policies and conditions



Note: Calculated for 1,200 public and private projects. A high foreign exchange premium is more than 200 percent; moderate, 20-200 percent: low, less than 20 percent. A high fiscal deficit is more than 8 percent of GNP; moderate, 4-8 percent; low, less than 4 percent. For explanation of trade restrictions, see the technical note for Chapter 4 at the end of the main text.
Source: World Bank data.

been critical in encouraging domestic producers to cut costs by introducing new technologies and to develop new and better products. A high level of protection for domestic industry, conversely, has held development back by decades in many places. The effect of import competition on firms in, for instance, Chile and Turkey, and the effect of greater competition in export markets on firms in Brazil, Japan, and the Republic of Korea confirm the decisive contribution to efficiency that the external economy can make.

The international flow of technology has taken many forms: foreign investment; foreign education; technical assistance; the licensing of patented processes; the transmission of knowledge through labor flows and exposure to foreign goods markets; and technology embodied in imports of capital, equipment, and intermediate inputs. Policies to promote these flows include greater openness to investment and to trade in goods and services. Nontariff barriers, which are especially distorting, need to be phased out, and tariffs reduced, often substantially.

Governments also need to play a more positive role. To get the most out of technology transfer, appropriate education and on-the-job training will be required. As in Japan and the Republic of Korea, government agencies and industry associations can collaborate to gather and disseminate information on technology, and to help develop quality control for exports.

Governments in the *industrial countries* have a responsibility—if not to the developing world, then to their own people—to grant exporters in the developing countries access to their markets. Without such access, reforms in the developing countries may go to waste. For several decades, the industrial countries had been reducing their tariffs; in the 1980s, however, nontariff barriers were steadily raised. Between 1966 and 1986, the share of imports to countries that belong to the Organisation for Economic Co-operation and Development (OECD) that were affected by nontariff measures is estimated to have doubled. In 1986, more than 20 percent of imports from the developing countries were covered by "hard-core" measures alone. Freeing trade within regions—as in the case of Europe's Project 1992, the United States-Canada Free Trade Agreement of 1989, and the proposed free trade agreement for Canada, Mexico, and the United States—is beneficial. But it remains to be seen whether regional blocs will support or hinder the goal of a more open global trading system. At any rate, a renewed commitment to the General Agreement on Tariffs and Trade (GATT), together with a greater willingness by all countries to undertake unilateral trade reform, is highly desirable.

The macroeconomic foundation

A stable macroeconomic foundation is one of the most important public goods that governments can provide. Experience shows that when government spending has expanded too far, the result has often been large deficits, excessive borrowing or monetary expansion, and problems in the financial sector, which have been quickly followed by inflation, chronic overvaluation of the currency, and loss of export competitiveness. Excessive borrowing can also lead to domestic and external debt problems, and to the crowding out of private investment. Restoring the confidence of the private sector is now a basic aspect of efforts to spur re-

newed growth and generate employment in several countries with a history of macroeconomic instability, including Argentina, Bolivia, Côte d'Ivoire, and Ghana.

Fiscal and financial instability have sometimes been partly inflicted on governments by external events—or by internal shocks such as civil wars or natural disasters. But governments can choose how to respond to such pressures. In such countries as Côte d'Ivoire, Mexico, Kenya, and Nigeria, the response to a temporary economic upswing was an unsustainable increase in public spending. Countries such as Botswana, Chile, Colombia, Indonesia, the Republic of Korea, Malaysia, Mauritius, and Thailand have managed to keep their macroeconomic policies on course, and their broader economic performance has benefited accordingly.

A government can maintain a prudent fiscal policy by looking carefully at the division of economic tasks between the government and the private sector. That, as the Report argues, is desirable in any case. In reappraising their spending priorities, implementing tax reform, reforming the financial sector, privatizing state-owned enterprises, and using charges to recover the cost of some state-provided services, governments can meet the goals of microeconomic efficiency and macroeconomic stability at the same time.

Developing countries are also affected by the macroeconomic policies of the *industrial countries,* especially when these policies reduce the supply of global savings relative to their demand and raise real interest rates. An adequate supply of external capital (concessional and nonconcessional) is essential—which calls for strong efforts by the World Bank and other multilateral agencies, as well as bilateral sources. The decline in voluntary private lending to developing countries needs to be reversed. The debt crisis remains an obstacle to growth. Overcoming it requires the implementation of comprehensive adjustment programs and return to regular creditworthiness; expanding the number of countries covered by commercial-debt and debt-service reduction; more concessional rescheduling for the poorest debtor countries; expansion of debt forgiveness and deepening the concessionality of other debt relief measures by official bilateral lenders; and an increase in equity and quasi-equity investment.

Rethinking the state

The approach to development that seems to have worked most reliably, and which seems to offer most promise, suggests a reappraisal of the respective roles for the market and the state. Put simply, governments need to do less in those areas where markets work, or can be made to work, reasonably well. In many countries, it would help to privatize many of the state-owned enterprises. Governments need to let domestic and international competition flourish. At the same time, governments need to do more in those areas where markets alone cannot be relied upon. Above all, this means investing in education, health, nutrition, family planning, and poverty alleviation; building social, physical, administrative, regulatory, and legal infrastructure of better quality; mobilizing the resources to finance public expenditures; and providing a stable macroeconomic foundation, without which little can be achieved.

Government intervention to protect the environment is necessary for sustainable development. Industrial countries as well as developing countries face serious problems of environmental degradation. In addition to air and water pollution, sustained development is threatened by the depletion of forests, soil, village ponds, and pastures. Appropriate policies include proper pricing of resources, clearer property rights and resource ownership, taxes and controls on pollution, and investment in production alternatives. The experience of many countries suggests that market reforms can also help to protect the environment. But specific environmental actions are needed. Finding the least costly way to confront environmental ills is a high priority.

What might prevent a realignment of the roles of state and market? Will the political and social structures permit it to be implemented? Is it more or less likely to go forward under governments that are accountable to their people and that defend political and civil liberties? It has often been argued that a democratic polity makes economic development more difficult to achieve. Reform almost always comes at the expense of certain vested interests, and macroeconomic stabilization usually means at least a temporary rise in unemployment. The claim is that only authoritarian governments can make the hard choices.

This is patently false. The evidence from large samples of countries does not go so far as to show that individual freedoms by themselves spur economic growth, but it offers no support at all for the view that they hold growth back. Neither does it endorse the notion that authoritarian governments, on average, show greater promise for achieving rapid growth. And looking beyond growth to the other elements of economic develop-

ment, the lesson of experience is even less equivocal: political freedoms, and civil liberties—such as a free press and the free flow of information—seem to be associated with progress in health and education in large groups of countries.

The interactions between political systems and economic policies are complex. Clearly, economic policies are not chosen in a vacuum. All but the most repressive governments need to retain a measure of popular support for their actions. Often this support has been bought with an assortment of damaging policy interventions (such as high tariffs, currency overvaluation, and industrial licensing) as well as corruption and wasteful public spending. Military spending remains high in many industrial as well as developing countries. Among the latter, it is well in excess of the combined public expenditures on education and health in many countries such as Angola, Chad, Iraq, the Democratic People's Republic of Korea, Uganda, or Zaire. Insecure authoritarian governments have been at least as prone as democratic ones to go down this path. At the end of it, all too often, lies an economic and political crisis that sets development back years.

Many countries have suffered a vicious circle of harmful interventions that entrench special interests and lead to rent-seeking and the "capture" of the state. Governments sometimes intervene in the market to address political instability and other political constraints. But the result is that all too often, the combination of pervasive distortions and predatory states leads to development disasters. Reversing this process requires political will and a political commitment to development. Implementing the economic reforms considered in this Report is one way to confront the political constraints on development.

Reform must look at institutions. The establishment of a well-functioning legal system and judiciary, and of secure property rights, is an essential complement to economic reforms. Reform of the public sector is a priority in many countries. That includes civil service reform, rationalizing public expenditures, reforming state-owned enterprises, and privatization. Related economic reforms include better delivery of public goods, supervision of banks, and legislation for financial development. Strengthening these institutions will increase the quality of governance and the capacity of the state to implement development policy and enable society to establish checks and balances.

Experience also suggests that a relatively equitable distribution of income and assets broadens the base of political support for difficult changes. But caution is needed. Redistribution through distorting prices (such as subsidized credit) can be damaging, and the benefits in any case often go to the less needy. Many of the policies recommended in this Report would tilt the distribution of income in favor of the poor. Reducing trade protection generally promotes exports and raises the incomes of the poor by supporting labor-intensive activities, for instance, as does spending more on primary education and preventive health care, improving the functioning of labor markets, and enhancing labor mobility. Some countries could improve equity by reforming their highly regressive tax systems. Land reform can also be beneficial, as in China, Japan, and the Republic of Korea, although its feasibility in many other countries has been questioned. Subsidies, targeted to the poor, for the consumption of basic food, may be needed. Everywhere, well-designed safety nets are essential to protect the most vulnerable from the short-term costs of reform.

The speed and sequencing of policy reform have often been decisive. Again, it is hazardous to generalize. Swift reforms may help to neutralize the resistance of interest groups opposed to change; or more gradual reforms may allow time to address their concerns. But countries such as Ghana, Indonesia, the Republic of Korea, Mexico, and Turkey seem to show that packages of comprehensive reform, with at least some bold changes made at the start of the program, are more likely to succeed. Comprehensive reforms can make heavy demands on the administrative capacity of governments. Some argue that moving too quickly can raise unemployment, skew the distribution of income, and promote the overrapid depletion of natural resources. But the social cost of failing to reform can be very great, as Argentina, Côte d'Ivoire, Peru, and Eastern Europe all found out in the 1980s. Swift and comprehensive reforms, with measures to reduce poverty and protect the environment directly, will usually be the right way forward.

Priorities for action

The recent slowdown in many industrial countries and renewed economic uncertainty have cast a cloud over the global prospects for development. The task is formidable: for many of the world's poorest countries, decades of rapid growth will be needed to make inroads on poverty. And priorities and constraints vary widely across countries at different stages of development. Yet the opportunity

for rapid development is greater today than at any time in history. International links, in the form of trade and flows of information, investment and technology, are stronger now than forty years ago. Medicine, science, and engineering have all made great strides; the benefits are available worldwide. And policymakers have a better understanding than before of the options for development.

To seize this opportunity, industrial countries, developing countries, and external aid and lending agencies need to act. The *industrial countries* need to

- Roll back restrictions on trade. The Uruguay Round of trade talks must not be allowed to fail. Nontariff barriers to trade need to be dismantled. Developing countries would benefit from being granted unrestricted access to industrial-country markets—some $55 billion in additional export earnings, or as much as they receive in aid.
- Reform macroeconomic policy. Reduced fiscal deficits, stable financial systems, stable currencies, low and stable interest rates, and steady non-inflationary growth would transform the climate for development in the rest of the world.

The *industrial countries and multilateral agencies,* including the World Bank can strengthen development prospects by enhancing the quantity and quality of external financial assistance. They need to

- Increase financial support. More external financing, both concessional and nonconcessional, would greatly strengthen the development effort. Many developing countries continue to struggle with heavy burdens of external debt. Further progress in extending debt relief to the middle- and low-income countries is needed.
- Support policy reform. Additional financing will be far more effective when it supports sound domestic policies. Experience shows that it pays lenders and borrowers alike to ensure that investments and market-friendly policies go together.
- Encourage sustainable growth. The global community has a great responsibility to take common action to protect the earth's environment, and to support the control of environmental degradation in developing countries.

But the developing countries' prospects are principally in their own hands. Domestic reforms ensure the benefits of better external conditions. The *developing countries* need to

- Invest in people. Governments must spend more, and more efficiently, on primary education, basic health care, nutrition, and family planning. That requires shifts in spending priorities; greater efficiency and better targeting of expenditures, and in some cases greater resource mobilization.
- Improve the climate for enterprise. Governments need to intervene less in industrial and agricultural pricing, to deregulate restrictions to entry and exit, and to focus instead on ensuring adequate infrastructure and institutions.
- Open economies to international trade and investment. This calls for far fewer nontariff restrictions on trade and investments, substantially lower tariffs, and a decisive move away from discretionary forms of control.
- Get macroeconomic policy right. Macroeconomic policy needs to ensure that fiscal deficits are low and inflation kept in check. Appropriate, market-based incentives for saving and investment are essential if domestic resources are to play their essential part in financing development.

In each of these areas, the challenge to policymakers is to exploit the complementarities between state and market. They can transform the outlook for economic development by having the state intervene less where it may (for example, in production), and more where it must (for example, in environmental protection), by strengthening institutions and capabilities, by finding nondistortionary ways to promote equity, and by fostering checks and balances in governments.

Succeeding in development is indeed the most pressing of all the challenges that now confront the human race. Incomplete though our understanding still is, enough has been learned in the past forty years to point the way. Strategies in which governments support rather than supplant competitive markets offer the best hope for meeting the challenge of development.