Commentary

The World Bank and the Evolving Political Economy of Development

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Shahid Yusuf's essay on 30 years of *World Development Reports* (*WDRs*) is a masterful overview of what has at the same time been 30 years of development economics at the World Bank. I will first focus on one key aspect of the overview: the evolution of the political economy of development economics at the World Bank, influenced, of course, by my own perceptions of the 1980s and 1990s, two decades I spent at the World Bank. I will then turn to the future and to one key dimension that I think has been missing in the *WDRs*.

There is no doubt that development economics at the World Bank, and with it the *WDRs*, have been and will continue to be influenced by the political and intellectual environment of the times. The Executive Board does influence the management and the staff, not only because it has some "decision powers" over policies and strategies but also, and perhaps even more, because positive recognition by the board is a sought-after prize, and criticism is perceived as a big setback. Positive recognition by the president of the institution and by the chief economist is also something very valuable, influencing careers and promotions. The ideological and intellectual orientations of the president and of the chief economist clearly influence the work of economists at the World Bank.

Shahid Yusuf stresses these influences in his overview, showing how development economics at the World Bank and the content of the *WDRs* moved from strong faith in planning and in the role of the state, along with the quantitative models championed by Hollis Chenery and his colleagues in the late 1970s, to the structural adjustment approach of the 1980s and early 1990s. This period coincides broadly with what are often called the Reagan-Thatcher years, marked by much greater emphasis on the market, on "getting prices right," and on both liberalization (particularly trade liberalization) and privatization. The second half of the 1990s saw renewed emphasis on poverty reduction and on the need for proactive poverty-reducing social policies, particularly after James Wolfensohn took over as president in 1996, with Bill Clinton in the White House and Tony Blair soon after at 10 Downing Street. I agree with much of Yusuf's analysis, but I do believe it somewhat exaggerates the influence politics and ideology have had in the two-plus decades reviewed.

Several factors make it difficult for any particular political ideology to "take over" the World Bank—and I believe that is a very fortunate state of affairs. Moreover, although the influence of the U.S. and U.K. treasuries is, of course, very important, particularly on big programs, it is less so regarding the economic work done and the many and very decentralized interactions that take place with member countries. Although its headquarters are in Washington, D.C., and English is clearly the language in which World Bankers work, the World Bank is, both by the composition of its staff and by the very nature of the business it conducts, a truly international institution. In decades past, no small group of governments has easily been able to direct the work of the thousands of economists and other professionals who make up the staff. Over many decades, the institution has—as have many other institutions—developed its own "DNA," which is deeply rooted in the experience staff members gain around the world and the interactions staff members have with professionals and citizens in places as diverse as Brazil, China, the Arab Republic of Egypt, India, Malawi, Nigeria, and Vietnam, to name just a few.

The Executive Board also is—and has been—a very diverse body. Much of the world is represented and expresses itself. It is true that the voting weights are outdated and do not today reflect the realities of the 21st century. A significant change in the "weights" countries have at the Bank is overdue and is essential for the overall legitimacy of the institution. Nonetheless, diversity of voice exists, and different coalitions form and then dissolve over time, depending on the topic at hand or the particular period concerned. A good and articulate executive director from a smaller country can have substantial intellectual influence. Finally, presidents and senior managers have visions and have shown leadership, but to be successful, they must also convince the staff, listen to the accumulated experience, and be open to feedback.

In my experience, the driving force of the changes in emphasis so well described by Shahid Yusuf in the 30 *WDRs* reviewed, as well as in the content of development economics at the World Bank, has been more the evolution of academic thinking than of politics as such. That aspect, too, is emphasized in the essay, but I would stress it even more. Since Robert McNamara and Hollis Chenery, the institution's strongest links have always been to the academic work on development, and the *WDRs* themselves are expressions of that link. For example, the work done at Princeton introducing relative prices and price-sensitive demand and supply functions into the older, rigid Leontief input-output models was adopted by the Development Research Center of the World Bank and facilitated a more market-oriented approach to development policy. That academic work imported into and championed by the World Bank in the late 1970s turned planning models into policy and market simulation models, which were later widely used to analyze the structural adjustment policies of the 1980s. Both continuity and strong interaction with academia existed throughout that process, with political ideology playing a lesser role. As another example, one can mention the very wide use of domestic resource cost estimates and effective protection rates to measure the social costs of price distortions and trade policies, which owed more to the academic work ongoing at the time than to ideology. Two Bank chief economists were, with Béla Balassa (also a senior presence at the World Bank throughout the late 1970s and 1980s), intellectual originators of these concepts; however, Anne Krueger was politically right of center, whereas the late Michael Bruno was close to the Israeli Labor Party.

More recently, the academic work on the role of institutions in development and labor markets, as well as on the microeconomics of information and market structure, has strongly affected the economic work at the World Bank after the mid-1980s and the *WDRs* in the 1990s. Chief economists such as Stanley Fischer, Larry Summers, Joseph Stiglitz, Nicholas Stern, and François Bourguignon have clearly been impressive academics, and their academic and policy analysis achievements brought them to their positions more than any political or ideological bent they may have had. This is not to say that all economic work at the Bank has been of the highest quality. Too much of it has allowed simplistic and, yes, sometimes "politically correct" cookie-cutter prescriptions to pass as analysis. But it has been the creative and academically grounded work that in the end earned recognition and respect.

I am not sure how strong a difference exists between Shahid Yusuf and myself in assessing the weight of the different influences on the *WDRs*. But I do want to stress the power of the link between academia and economics at the World Bank, the strong institutional DNA built over decades with a value system emphasizing analytical skills and academic recognition, and the difficulty of linking the choice and role of chief economists in a simple way to primarily political or ideological factors.

It is interesting to note that the United Nations Development Programme's *Human Development Reports* (*HDRs*) provide another example of how an institution's DNA and intellectual tradition cut across the tenures of chief executives with very different political homes. The *HDRs*, which have succeeded in providing tough competition to the *WDRs* in terms of influence and attention, have from the start emphasized poverty reduction, income distribution, and the role of public policy. And yet the *HDRs* were launched under William H. Draper, appointed with the then determining influence of the U.S. Republican administration of the late 1980s.

The second point I would like to make, looking at 30 years of *WDRs,* relates to the almost exclusive focus on the "country" or "nation-state" as the unit of analysis. It is true that the first *WDRs* contained global projections that later were spun off and became the *Global Economic Prospects* series, but only a very weak link exists between the projections and the development policy analysis contained in the *WDRs*. The latter is country focused, and the international economy, as such, is not in the forefront of analysis. This country focus does, in fact, faithfully reflect what is practiced by most academic economists when they run growth regressions or when they do case study work trying to distill the lessons of development policy experience. The unit of observation is almost always the country, without much attention to the international system within which country policies have to operate.

The importance of export orientation, openness to trade, human capital policies, investment rates, or financial sector policies is most often analyzed giving individual countries equal weights as units of observation. China and Lesotho each constitute one observation point per year of available data when regressions are run. This equal-weight and nation-state-focused nature of much of comparative development economics has at least two weaknesses. The first weakness relates to the relevance of the findings. Suppose, for example, that one finds that total factor productivity growth is more important than capital accumulation in explaining differences in growth performance—except for India and China, which are, in Yusuf's words, "accumulating physical capital and pouring it into industry at a feverish pace." Should one then turn the statement around and say that capital accumulation is the dominant factor for half of the developing world because these two giants account for about half of the population of developing countries? To what extent should size matter when drawing conclusions? This question has no easy answer; it presents theoretical and empirical challenges. Nevertheless, I do think that the fact that much data come by country units should not make us forget the extreme size differences involved.

Another dimension of this problem relates to policy space. The degree of freedom of the policy maker and the effects policies can have are clearly affected by the world economic environment, but more so for smaller countries and very open economies. Take an example that is currently particularly relevant. It is well known in theory that international capital mobility constrains monetary policy. The nature and effects of policy responses by the Brazilian, South African, or Turkish central banks to the crisis level challenges that emerged in 2008 greatly depend on the interest rate policies of the Federal Reserve and of the European Central Bank. Analyzing macroeconomic or structural policies of particular countries without putting them explicitly in a global context is increasingly difficult. Systemic international developments affect most elements of development policy, including labor market, agricultural, tax, energy, trade, and financial sector policies. Given the degree of interdependence that characterizes the 21st-century world, country-focused analysis increasingly must be complemented by analysis of the world economy as a system. What may be needed is a kind of hierarchical analysis, where local development; national development; regional development (Africa, Latin America, the Middle East, and so on); and global development are parts of a systemic approach that tries to capture what matters at what level and what freedom of action policy makers have at these various levels.

Some *WDRs* have gone beyond the country as the basic unit of analysis, including the 2009 *WDR* on spatial issues. An explicitly multilevel approach could mark a new start for the *WDRs* and respond to the realities of the new global world of the 21st century. The *WDR* planned for 2010 on the topic of development and climate change, chosen by Bob Zoellick, could become a path-breaker in that respect. Clearly, climate is a global issue and a global public good. The importance of climate-related policies for development can be analyzed only in an explicitly multilevel framework, where global, regional, and country-level policies interact to determine outcomes that cut across national boundaries.