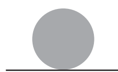

COMMENTARY

The World Development Report: Development Theory and Policy

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I had responsibility, to varying degrees, for five different *World Development Reports* (*WDRs*). The first, on the role of the state, was begun by my predecessor; the next two, *Knowledge for Development* and *Entering the 21st Century*, I saw through from beginning to end; and the final two, *Attacking Poverty* and *Building Institutions for Markets*, were initiated while I was chief economist but completed after I left.

Many of the *WDRs* that had gone before focused on a particular aspect of development, a particular sector—education, health, agriculture. I saw the *WDR* as an opportunity to redefine broader views about development.

One of the hardest struggles—and I was only partially successful—was to change the concept of the *WDR*. Traditionally, it has summarized "received wisdom." The goal was to summarize the received wisdom in a few, easily understood "messages." The messages, in turn, were intended to set the policy agenda: they were messages that World Bank staff could bring to developing countries around the world. I was worried about this approach for several reasons. It smacked too much of a "one-size-fits-all" cookie-cutter approach—unless the messages were so anodyne as to be almost meaningless. And I was very much of the view that the role of outside advisers was to share experiences and general principles. Democratic development required that each country make its own decisions—in the

simple way we put it, "the country was in the driver's seat." Our role was to help the country think through these decisions.

In this perspective, the objective of the *WDR* was to begin a global dialogue, a democratic conversation about some of the most contentious issues in development. It did not bother me that we might not know the right answer. Indeed, it bothered me more that we sometimes pretended to know more than we did. To me, the role of an outside adviser was more to ask the right questions—or to help those in the developing countries ask those questions—than to give the right answer.

The Role of the *WDR* in Thinking about Development More Broadly

To me, then, the *WDR* was an instrument to begin the change in thinking about development. Even before I came to the Bank, I was convinced that the Washington Consensus doctrines represented the wrong approach, at least for many countries. The economic theories on which the Washington Consensus rested had long been discredited. My own work on imperfect and asymmetric information and incomplete markets had contributed to undermining the theoretical foundations. And the World Bank's own report on the East Asian Miracle—on which I had worked—had shown that the most successful countries had not followed these recipes (World Bank 1993). But a gap remained between these insights from modern economic research and the perspectives of many policy makers.[1] I knew that many people in the Bank still believed in those ideas, and I saw the *WDR* as a way of beginning a global conversation—inside and outside the Bank. Not surprisingly, as each *WDR* went through the process of development within the Bank, difficulties were encountered. Many were uncomfortable with the ideas; many with the underlying economic analysis, which often exposed the limitations of models that had traditionally been relied on by those within the Bank; and many more were uncomfortable with the policy conclusions that emanated from the analyses.

1. I used the keynote addresses to the Annual Bank Conference on Development Economics in the first two years that I served as chief economist to focus attention on that gap—and to work to reduce it (see Stiglitz 1998a, 1999).

But the controversies were, perhaps, even more tense at the level of the Board. We touched on raw nerves. For the first time, we began to question the positions taken by the United States or other Group-of-Seven countries. To me, it was clear: we were international civil servants representing the interests of the developing countries. Inevitably, sometimes that would go against the position of the United States, whose policies were often driven by special interests. I was perhaps more aware of this than previous chief economists, who had come from academia. I had come directly from serving as chairman of the Council of Economic Advisers under President Bill Clinton. I had seen these special interests at work. The council had argued, on a number of occasions, against the positions taken by the U.S. Treasury and the U.S. trade representative. At the time, I was lucky, because the U.S. executive director, Jan Percy, was also focused on the concerns of the developing countries, and she was sufficiently influential within the administration that she could push back against Treasury, when necessary.

Knowledge for Development

Some examples illustrate. In the 1998 *WDR* on knowledge, we had to discuss, if ever so briefly, the role of intellectual property. I had opposed Trade-Related Aspects of Intellectual Property Rights (TRIPS), the intellectual property provision of the Uruguay Round, when I was on the Council of Economic Advisers.[2] So, too, had the U.S. Office of Science and Technology Policy. We thought it was bad for U.S. science, for global science, and for developing countries. I had seen firsthand how TRIPS was shaped, not by the concerns of U.S. science, but by our pharmaceutical and entertainment industries. I had no illusions: it was special-interest legislation. But my concerns about the adverse effects on developing countries were strengthened after I came to the World Bank. It was increasingly clear that what separated developing countries from developed countries was not just a gap in resources but a gap in knowledge, and it was imperative that this gap be closed. I had come to that view when I participated some years earlier in the World Bank's study on East Asia.[3] The unprecedented success of these

2. Part of my opposition was in fact based on my own research on the determinants of technological progress. It was simply not true (as the advocates of stronger intellectual property rights seem to claim) that stronger intellectual property rights lead to faster innovation and growth.

3. A version of our report was published as *The East Asian Miracle* (World Bank 1993).

countries was based on their closing the knowledge gap through heavy investments in education and technology. I reformulated that idea in my Prebisch lecture (Stiglitz 1998b) on development as transformation, and it is a view I have continued to develop with my colleague Bruce Greenwald.[4] It was a view that was strongly shared by the president, Jim Wolfensohn, who saw the Bank as a knowledge bank. But TRIPS made access to knowledge more difficult, adding new impediments in the struggle to close the knowledge gap.

In the *WDR*, we called for a more balanced view of intellectual property rights, recognizing that the "optimal" system for developing countries would be different from that for more developed countries. That call has now been taken up in the World Intellectual Property Organization, where the developing countries have called for a development-oriented intellectual property regime. In the decade since the *WDR* on knowledge, the limitations of America's intellectual property regime have come to be recognized even in the United States, and there are increasing calls for reform (see, for instance, Stiglitz 2006: chapter 4; see also Stiglitz 2004b, 2007).

I anticipated, though, that we would encounter trouble from the United States even with our carefully phrased call for a balanced intellectual property regime. But I also knew that we should be criticized by developing countries for not being more critical of TRIPS. We did our homework, consulting extensively with various executive directors. So when the United States launched its expected attack, saying that the *WDR* should take a stronger stance in favor of "stronger" intellectual property rights, several developing countries were prepared to launch a counterattack, urging us to take a more critical stance. So effective was their attack that the United States staged a hasty retreat.

Corruption

My first *WDR* also engendered a political controversy, because it raised, for the first time, the issue of corruption. This *WDR*, like most of the other *WDRs*, reflected both my interests and concerns and those of the Bank president. The year before coming to the Bank, I had given a keynote

4. In particular, we have asked, how can one design an economy (society) to best enhance its learning capacities? See Greenwald and Stiglitz (2006).

address (Stiglitz 1997a) at the Annual Bank Conference on Development Economics on the issue of the balance between market and government (see also Stiglitz 1997b).

In my work on the economics of the public sector, I had helped develop the market failures approach to the role of government (see Atkinson and Stiglitz 1980; Stiglitz 1986): markets often failed to yield efficient (let alone socially just) outcomes; well-structured government interventions could make everyone better off. I had attempted to identify what the government should do and how it should do it. While I was at the Council of Economic Advisers, I became involved in another project: Vice President Al Gore's initiative on "Reinventing Government," which tried to make government more efficient, more effective, and more responsive to citizens' wants and needs. If one believed (as I did) that the government had an important role, it was important for the government to perform its role well.

My own research (and that of others) had ended the theoretical debate about Adam Smith's invisible hand: markets were not, in general, efficient (see Greenwald and Stiglitz 1986; for a more general interpretation, see Stiglitz 1991). But many conservatives responded that, while government *might* effect a Pareto improvement, in practice, governments typically made things worse. Clearly, *sometimes* they did so, but also, in the most successful countries, the government had played an important role. However, if the government was to play the role it should in helping to create a fair and efficient society, one had to do what one could to improve the efficiency and effectiveness of the public sector.

In developing countries, one of the factors impeding the effectiveness of the public sector was corruption. The Bank's charter precluded the Bank from getting engaged in *political* matters, and some on the Board viewed corruption as a matter of politics—not economics. I had thought that the boundary was less clear than it seemed. To me, the issue of privatization of social security was an intensely political matter; so too was the issue of whether central banks should focus exclusively on inflation. There had been intense political fights on these issues in the United States—in which the Clinton administration seemed to take the opposite view from that taken by the World Bank and the International Monetary Fund (IMF). The administration's research on corruption showed that corruption

affected economic growth, and economic policies (such as wages paid to civil servants) affected the level of corruption. This research demonstrated that corruption was well within the remit of the Bank. The *WDR*, and the research that went into it, thus had a profound effect on the direction of Bank and IMF policy: after Paul Wolfowitz became president, the Bank seemed to behave as if corruption was *the* most important development issue. Although the Bank clearly went overboard, and although there was undoubtedly some corruption in the corruption agenda, that *WDR*'s effects on the Bank and on the broader developmental dialogue were deep and long lasting.

Poverty

Every 10 years, the Bank has been doing a *WDR* on poverty. The Bank had helped focus attention on the large number of people in poverty—a focus that increased with the Millennium Development Goals enunciated just as I was leaving the Bank. The *WDR* was a natural follow-up to work we had been doing, called *Voices of the Poor* (Narayan and others 1999, 2000; Narayan and Petesch 2002). We had asked, "What aspects of their lives contributed most to the suffering of the poor?" We discovered—not surprisingly—that the poor were concerned not only about their lack of income but also about their lack of security and lack of voice. We had concluded that the exclusive focus on income (as in the 1990 *WDR*) was wrong, and under the direction of Ravi Kanbur, we decided to take a broader perspective. Not surprisingly, again, the approach drew political criticism—including from the U.S. secretary of treasury (and former World Bank chief economist), Lawrence Summers.

The debate was part of a broader development controversy. Some argued for trickle-down economics: countries should maximize growth, and that would be the most effective way of reducing poverty. Most of those within the Bank had moved away from that view. The evidence was overwhelming that growth did not *necessarily* reduce poverty. Trickle-down economics did not *necessarily* work. If growth was accompanied by increasing inequality, poverty could actually increase. The problem was that many of the Washington Consensus policies that the Bank and the IMF had argued for in the past had contributed to—or had at least been associated with—increasing inequality. And that was especially true of policies like capital

market liberalization, which the U.S. Treasury had advocated. Such policies had not led to any or much increased growth[5] but had led to more instability, and the greater instability had led to more inequality—which was particularly pronounced in the context of the East Asian crisis.

To be sure, one could not have sustained poverty reduction without growth, which was why we had begun to focus on poverty-reducing growth strategies. The Comprehensive Development Strategies on which the Bank was then focusing[6] called attention to important complementarities that had often been missed in the past: trade liberalization might, for instance, by itself lead to more poverty, because jobs were destroyed faster than they were created. Only if accompanied by policies to enhance access to credit and technology might trade liberalization lead to reduced poverty.

Thus, the 2000/2001 *WDR* suggested not only that the policies being pushed by the U.S. Treasury might be bad for poverty in the narrow income sense, but also that they were even worse if poverty was more broadly conceived. For if capital market liberalization or trade liberalization was associated with greater economic instability, then the insecurity to which it gave rise might contribute even more to the worsening plight of those at the bottom.

Other policy controversies were also directly implicated. The Washington Consensus policies had argued for privatization of social security, but private social security accounts left individuals exposed to the vagaries of the market (all too evident in the 2008 market crash) and did not even insulate against the risks of inflation. Unionization and collective bargaining, part of the core labor standards around which broad global consensus existed, had attempted to increase worker security. Yet Washington Consensus policies had often argued for greater labor market flexibility, code words for eliminating or reducing hard-fought-for social protections. Although the evidence and the theory of the effects of such policies on growth or stability were ambiguous (Stiglitz, Easterly, and Islam 2001; see also Stiglitz and

5. This view has now become accepted even by the IMF (see Prasad and others 2003; Stiglitz and Ocampo 2008; Stiglitz and others 2006). My theoretical work had explained why that might be so (see, for example, Stiglitz 2004a).

6. The intellectual foundations of these strategies were, in part at least, provided by my Prebisch lecture (Stiglitz 1998b).

Rey 1993), such policies clearly may contribute to greater poverty in the broader sense.

Similarly, one of the criticisms of IMF (and, to a lesser extent, World Bank) loans, with their extensive conditionalities, is that they undermined democratic processes—reducing the scope for the voice of those affected. But such policies could be criticized as contributing to "poverty" in the broader sense, which recognizes the role of voice.

Our commitment to giving more voice to those in the developing countries—and making the *WDR* a vehicle through which democratic dialogue on development issues would be engendered—was reflected in the process of writing the *WDR*. We had organized extensive consultations throughout the world, posting each draft of the *WDR* on the Internet. This approach served us well in the ensuing controversy.

The U.S. Treasury demanded that the income aspect of poverty be given primacy. This demand went against the global consensus that had been generated in the process of our global discussions. Ravi Kanbur's resignation created a global furor. The Bank had to give weight to the process by which the *WDR* had been written, including the large number of consultations with scholars, government officials, and nongovernmental organizations in developing countries and in the development community. In the end, the Bank was forced to accept as the final draft a version that was close to that *before* the U.S. Treasury had unilaterally demanded its invasive changes.

Institutions

The 2000/2001 report was undoubtedly the most controversial *WDR*. But almost every *WDR* involved internal debate and discussion—precisely because the *WDRs* involved issues of importance where important differences of opinion existed.

Under Wolfensohn, the Bank had moved beyond projects to policies—and beyond policies to institutions. As the 1997 *WDR* emphasized, the public sector made a difference. But some governments—and some governmental institutions—were more successful than others. Some were less corrupt or corruptible than others. Within economics, the awarding of the Nobel prize to Doug North highlighted the importance of institutions.

But what makes for good institutions? And how can we create them? During the East Asian crisis, there was much discussion of the weaknesses of the East Asian institutions—financial institutions, financial regulatory bodies, corporate governance. Many were told to imitate U.S. institutions. Since then, confidence in what makes for good institutions has weakened. The Enron and WorldCom scandals highlighted weaknesses in accounting, financial institutions, and corporate governance in the United States. But the subsequent passage of the Sarbanes-Oxley Act gave renewed confidence in the institutions of the United States: its public institutions had faced up to the underlying weaknesses in corporate governance and had taken action. I was more skeptical. I had argued that perhaps the most fundamental flaw had to do with stock options, which provided incentives for bad accounting and short-sighted behavior (Stiglitz 2003b). But nothing was done. I and others had worried too about the bonus system that had encouraged excessive risk taking and the lack of regulation. I had worried that securitization was increasing problems of information asymmetries and decreasing the quality of lending (Stiglitz 2003a). Few would say today that the institutions of the U.S. financial sector—its rating agencies, its regulatory authorities, or its commercial or investment banks—are exemplary.

Although these ambiguities formed a backdrop to the heated debates in the formulation of the *WDR*, the real controversy concerned the role of institutions: did they "fill in" for market failures, or did they often help to preserve existing inequalities, frequently giving rise to inefficiencies in the attempt to do so? My own research had shown that the naive view that nonmarket institutions helped to remedy market failures (for example, by providing insurance when markets failed to do so) was wrong or at least needed to be more nuanced. Nonmarket institutions could actually be dysfunctional, enlarging market inefficiencies (Arnott and Stiglitz 1991).

But the distributional critique of institutions was, in a sense, even more fundamental.

Urbanization

Not all the *WDRs*—even those that raised big issues—were controversial. As we ended the 20th century and looked toward the next, we decided to use the 1999/2000 *WDR* to focus on some of the big megatrends and, in particular, on urbanization. Historically, most people living in developing

countries have lived in the rural sector. And even today, the vast majority of those in poverty live there. Yet there have been large migrations from the rural to the urban sector, and in some places (such as China), such rapid development of some parts of the rural sector has occurred that it has become urbanized.

Urbanization—and development urbanization—bring their own advantages (ideas can spread more rapidly) and problems (especially with respect to housing, the environment, and transportation). This *WDR* helped push forward the thinking that will be needed if these problems are to be addressed.

The *WDR* and Specific Policy Issues

Although to me the most exciting aspect of the *WDR* has been the role it has played in rethinking basic issues of development, in doing so, it has helped the rethinking of numerous specific issues. I mention four that were highlighted in the *WDRs* with which I was involved. Sometimes a case for a particular policy was built up over several years—and over several *WDRs*.

Primary versus Secondary Education

The Bank had long emphasized the role that education (including female education) played in development. It had—rightly, I think—emphasized primary education. It had done so because many developing countries spent large fractions of their education budgets on tertiary education, of benefit only to the elites. But the Bank had, we concluded, gone too far. The countries that succeeded best in development (those in East Asia) had also invested heavily in higher education. They had realized that one had to close the knowledge gap, which required individuals with high levels of education.

Health

The 1993 *WDR* focused on health. Health is an important determinant of productivity. Access to health care is an important determinant of health, but knowledge about health is as, or even more, important, one of the points emphasized in the 1998/99 *WDR*. For instance, many people in

developing countries suffer from inadequate nutrition, but even within their existing budgets, such countries could do better. Knowledge about how to avoid dehydration was critical in preventing a large fraction of children's deaths from diarrhea. Knowledge about where to place latrines in relation to sources of drinking water could prevent many gastrointestinal diseases.

Social Insurance

The 1997 *WDR* argued that developing countries suffered as often from too little government action, from a failed state, as they did from too much government. The 1998/99 *WDR* helped to explain one pervasive source of market failure of particular importance in developing countries: imperfect information. This is of especial importance in helping to explain the absence of insurance markets. Finally, the 2000/2001 *WDR* emphasized the importance of security—including health and economic security—as an aspect of poverty.

Together, these three *WDRs* provided a compelling case for government action in the area of social insurance—an area to which the Bank was paying increasing attention, especially in the context of the problems arising from the East Asian crisis and the transition from communism to a market economy.

The debate on this issue within the Bank has not been easy, with some arguing for a more limited role than others do.[7] Although the Bank had pushed many countries to privatize their social security systems, the outcomes of some of the privatizations were less than fully satisfactory. The problems in transition were not trivial. Because the government was deprived of essential cash flows, severe fiscal problems were artificially created, in some cases contributing to severe economic crises. Argentina is an admittedly controversial case in point. Many blamed its crisis on its fiscal problems, but had it not privatized its social insurance system, its budget would have been nearly in balance. Transaction costs turned out to be large. And the imposition of burdens of risk on individuals was far from trivial. When the United States had a national debate on privatization of its social security system, support was overwhelming for keeping it public; in

7. A sense of the debate is given by *New Ideas About Old Age Security* (Holzmann and Stiglitz 2001), and especially chapter 1 (Orszag and Stiglitz 2001).

the 2008 crash, there was a national sigh of relief that social security had not been privatized.

Access to Finance

The standard economic model that ignores information imperfections may work well in some countries in some sectors; it does not work well in most sectors in most developing countries. That was one of the important messages of the 1998/99 *WDR*.[8]

The 2000/2001 *WDR* emphasized that growth might be necessary to reduce poverty, but it was not sufficient. One had to look for growth policies that alleviated poverty and enhanced equality. In the case of some policies, a trade-off between growth and equality may not even exist. One example is providing universal education. Making sure that every child can live up to his or her potential reduces poverty, enhances equality, and promotes growth.

So, too, does access to finance. Standard economic models denied the possibility of credit rationing. Yet modern economic theories, based on the economics of information, highlighted in the 1998/99 *WDR*, explain why it is likely to occur and why alternative ways of providing finance, such as the peer-monitoring microcredit schemes pioneered by the 2006 winner of the Nobel prize, Muhammad Yunus and the Grameen Bank and the Bangladesh Rural Advancement Committee, are likely to be far more effective (see also Stiglitz 1990).

The Bank has taken an increasingly active role in promoting microcredit and access to finance, an agenda to which the 1998/99 *WDR* may have contributed.

Concluding Remarks

Throughout its history, the *WDR* has played an active role in shaping thought and policy, both within the World Bank and in the wider development community. It was sometimes overly ambitious, hoping to be able to summarize in a few clear messages the received wisdom on a key aspect

8. Like most *WDRs*, this one was built on extensive work done within the World Bank in earlier years (see, for instance, Hoff, Braverman, and Stiglitz 1993).

of development. The world is too often too complicated for that to be done. When the *WDR* did so, it risked reemphasizing the obvious or what was well accepted, or conducting the discussion at such a high level of abstraction as to be of limited use. Occasionally, it became the publication vehicle for official Bank doctrines—a summary of beliefs of the moment. Even here, it served a helpful role, at least for students of the evolution of economic thought, for they could see how thinking about development evolved over the years.

But to me, at least, its greatest contributions occurred when it helped to frame controversial issues, when it pushed the boundaries of thinking, when it opened up new frontiers—thinking about issues that had previously received too little attention—when it sparked a global debate. In those cases, the *WDR*'s effect was not only immediate, but also likely to be long lasting.