Development Research: Directions for a New Century

The world has recorded improvements on many fronts since the UN was created in 1945. Although many countries have made rapid and substantial advances in human development, progress has been very unevenly spread – within as well as between countries. It is a paradox that in this era of globalization, for many people on the planet the United Nations’ goals of peace and prosperity remain as elusive as ever. Global inequality continues to rise and around 1.3 billion people are estimated to live in severe poverty.

This issue of Work in Progress focuses on some of the pressing development challenges at the turn of the century. Giovanni Andrea Cornia initially outlines the evolving context for development and identifies three frontiers of development research:

(i) peace, governance and development – especially the prevention of humanitarian emergencies through better development policies;
(ii) globalization and development – principally the unfinished agenda of poverty eradication;
(iii) technological change and development – particularly the impact of information and communications technologies (ICT) on productivity and growth.

The other papers in the newsletter provide details of specific United Nations University research projects in these critical areas.

Secretary-General Highlights UNU/WIDER Work on Inequality and Conflict

“A study recently completed by the United Nations University shows that countries that are afflicted by war typically also suffer from inequality among domestic social groups. It is this, rather than poverty, that seems to be the critical factor. The inequality may be based on ethnicity, religion, national identity or economic class, but it tends to be reflected in unequal access to political power that too often forecloses paths to peaceful change.”

Kofi A. Annan, Secretary-General of the United Nations


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Between the end of World War II and the mid-1970s, humanity made significant forward strides. Decolonization led to the creation of many independent states, and global conflict was avoided. Technological innovation combined with rapid expansion in trade and considerable investment, especially in human capital, resulted in rapid economic growth and human progress.

Progress was achieved under a surprisingly wide variety of political and economic systems. In most cases this progress was facilitated by "modernizing" nation-states and, at the international level, by a new system of global governance including the IMF, World Bank, GATT and the UN. Despite setbacks considerable progress was made in famine prevention, the protection of human rights, social development, the provision of development finance and monetary stability.

Changes over the last 20 years have profoundly modified and in some dimensions radically changed this situation. Rapid population growth due to improvements in survival, together with inattention to the environmental dimensions of development, intensified pressure on the world’s natural resources. Many countries have experienced a sharp rise in income inequality, often, as in the case of Latin America, from already high levels. Nuclear war poses less of a threat, but the number of internal wars has risen reflecting failures in democratization and development. The international community has struggled to cope with the resulting humanitarian emergencies.

What has caused these changes? Shifts in ideology are certainly a factor. The collapse of state socialism in Eastern Europe and the Former Soviet Union (FSU) sharply reduced the credibility of state intervention as the main means for economic development and welfare provision. The dominant paradigm has shifted towards liberalization, democratization, the globalization of trade and capital movements, and privatization (hereafter LDGP); a shift facilitated by the information technology (IT) revolution.

Much of this change is welcome. A bigger world market offers more export and growth opportunities to developing countries that already have good human and physical infrastructure, a diversified economy, flexibility and a capacity to innovate. Until its recent crisis, Asia’s living standards had risen dramatically. Democracy has spread to Latin America. However, globalization’s benefits have largely bypassed most African and transition economies. The volatility of commodity prices, and their long-term downward trend, seems to have increased under LDGP. Open economies are more vulnerable to volatile capital flows and instability in their exchange rates, problems whose resolution requires international action. These forces have fuelled the rise in income inequality, making it less easy to achieve poverty reduction through economic growth. Illegal migration and capital flight from the poorer or less stable regions have increased. Thus, though the world economy has grown, the unbalanced nature of its growth has left 1.3 billion people in dire poverty. Nowhere has the LDGP process been more traumatic than in Eastern Europe and the FSU where sharp increases in poverty, inequality, mortality and instability have occurred.

In the absence of a global regulatory framework, increases in factor and product mobility, falling transport costs, and deregulation have eased the trade in drugs, weapons, illegal migrants and other “global public bads.” Greater openness has also encouraged “downward bidding” among developing countries to attract foreign investment thereby eroding tax revenues, weakening labour standards and undermining environmental protection. The IT revolution facilitates trade, tourism, capital flows and information exchange. But its effects on social exclusion and income distribution are likely to be less favourable.

By and large private actors, and especially the multinational corporations with their immense resources, drive LDGP. As such, LDGP lacks an explicit political ideology to maintain peace.
promote social justice and ensure minimum basic living standards. It is also biased against collective institutions and public action at both the national and international levels. This is evident from the unevenness of international responses to humanitarian crisis – compare, for example, Angola and Kosovo – as well as the growing regulatory gap in the areas of environmental protection, short-term capital flows, the multilateral trading system, as well as labour and tax standards. Balancing the gains from liberalizing world markets with the maintenance of world peace, human development, and the sustainable management of the world’s resources is therefore required. This should be the basis of a new global message.

### Researching a Changing World

Some of the new problems associated with the changes of the last twenty years are now clearly evident. Others can be merely glimpsed. What are the most important areas for research? Broadly, three sets of issues define the frontiers for development research.

First, urgent questions of peace and governance remain. The prevention of humanitarian emergencies through better development policies is surely crucial. Taking **ex ante** action to prevent humanitarian crisis through broad-based growth, lowering horizontal inequality and better policies in the field of public economics is less costly than **ex post** crisis management based on complex military interventions followed by costly reconstruction. LDGP itself is likely to increases the forces breaking states apart, and secessions are often violent. Improving our understanding of post-conflict reconstruction is thus important, in particular how to avoid recreating the past development strategies that may have fuelled conflict and/or recession in the first place. These and other key questions remain unanswered.

Global economic management constitutes the second frontier of research questions. At the forefront of this set is the unfinished agenda of poverty eradication. Despite the emergence of new challenges, much of today’s poverty is still traceable to very limited progress in rural poverty and land reform, the lack of credit and insurance markets, Africa’s marginalization, and the low coverage of basic social services. Poverty is meanwhile increasing as a result of new factors, in particular liberalization and globalization.

While local initiatives will prove crucial to poverty’s eradication, finding a solution also implies global action. “Ungoverned globalization” is dangerous. Elaborating new macroeconomic, development and regulatory frameworks is essential, as is a re-examination of the theoretical underpinnings of present policies. We need to formulate a new development paradigm, incorporating the lessons of past development strategies (Western, Asian, social-democratic) but reformulating them in such a way that they address the opportunities and constraints of the new global economy. In this regard, the impact of privatization and regulation, the role of taxation and public expenditure in poverty alleviation; and the impact of different property rights regimes on microeconomic incentives and growth are all key research areas.

How best to build such a framework is still an open question. Clearly, many avoidable mistakes were made in the transition economies due to overconfidence among promoters of LDGP. The results, aside from the few more successful transition economies of Central Europe, have turned out to be bitterly disappointing. The factors/policies responsible for the success/failure of transition, its social impact (including that in China), and conditions for the development of a new private sector remain largely unresolved and need fresh research.

Above all we need to get a grip on the relationship between globalization and development. At best, globalization is a catchall phrase; we don’t yet fully understand the processes that it describes. Many aspects of this phenomenon remain unexplored, in particular: the impact of the globalization of financial markets and the spread of financial contagion; growing legal and illegal labour flows across borders and policies for international migration; globalization’s contribution to the trend of rising inequality in many regions, and its implications for eradicating poverty (see above); and the integration of the weakest nations into the globalized world economy.

Technological change, and its global impact, makes up the third research frontier. Given the accelerating pace of progress in information and communications technologies, it is of utmost importance to identify the impact of these technologies on productivity, economic growth, consumer welfare, the labour market, education and social exclusion. ICT will change the future of work, in ways that we do not yet understand. The implications for the organization of work, labour market institutions and leisure are especially important. Technology is a “global public good.” Its transfer from the developed world to the developing world could transform the latter and accelerate progress in poverty reduction. But for this to happen, and for it to be equitable, requires changes in the current property rights regime and patenting system. Urgent attention to this issue is necessary.

Peace and governance, the management of the global economy, and the implications of ICT offer us a menu of key issues that need to be addressed. The world has changed in ways that few of us would have predicted twenty-five years ago. While much of this change is positive, more malign developments – in particular the rise in internal conflicts and the rise in global inequality – need our urgent attention both as researchers and as practitioners.
Underdevelopment, Transition and Reconstruction (UTR) in Sub-Saharan Africa
By Tony Addison

Reconstruction for Broad-Based Development
Reconstructing Africa’s war damaged economies is an urgent task. This is especially so in a group of countries – Angola, Eritrea, Ethiopia, Guinea-Bissau, and Mozambique – which must also complete their economic and political transition from state socialism. Somalia, which shares their common history, must eventually be rebuilt. All of these countries must address their deep problems of underdevelopment and poverty. The challenges are therefore three-fold: to overcome underdevelopment, to make the transition from state socialism, and to reconstruct economies and societies.

Although socialism was influential across post-independence Africa, UTR countries drew more explicitly on Marxism-Leninism and the Soviet development model. With the aim of accelerating growth, enterprises and property were nationalized and controls were established. Their socialist experiments were very short in comparison to those of Eastern Europe or the Former Soviet Union, but the economic and social damage was still extensive. The result was a fatal over-centralization of political and economic power, and a slide into conflict exacerbated and fuelled by the politics of the cold war.

Somalia collapsed into a turmoil from which it is yet to recover. Mozambique has made the most progress and, until their border war this year, Eritrea and Ethiopia were both moving forward. Angola faces urgent reconstruction problems but progress has been slow, and a return to outright war cannot be ruled out. Guinea-Bissau was knocked off course by a military revolt in 1998. Progress has therefore been tentative in the UTR group, and their future prospects depend on whether they can find political settlements that will enable economic development to go forward.

War, and the uncertainty associated with it, distorts economies; investments with long-term returns, mainly in production activities such as agriculture and manufacturing, are cut back, and the economy becomes dominated by activities with short-term returns, such as commerce in cities and safe areas. Natural resource sectors may continue to operate, however, when protected by their location (for example, offshore oil and gas) and when combatants seek to preserve them as the “prize” for capturing the state.

Past failure to achieve broad-based growth contributed to conflict. This implies that reconstruction cannot simply entail the recreation of the pre-conflict economy. Policies, public expenditures, and institutions must be changed, often fundamentally. For this reason the agendas of reconstruction and economic reform (transition) cross over. Well-designed reforms can contribute to reconstruction and vice versa. But too often there is a mismatch between the reform and reconstruction programmes, and the ground for broad-based development is not secured.

Communities, Entrepreneurs and States
Aid is important, but success ultimately depends on the actions of three sets of national actors: communities, entrepreneurs, and states. The problem is that communities are impoverished, private sectors are underdeveloped, and state capacities are weak.

For communities, the main challenges are to deal with the immediate post-war humanitarian and security problems and, equally important, to accelerate programmes for longer-term poverty reduction. Regarding the humanitarian and security issues, the tasks are to resettle displaced populations, disarm and demobilize ex-combatants and assist their reintegration, reduce the level of violence (by filling the security gap and decommissioning weapons), remove land mines which disrupt community livelihoods, and protect food security while phasing out food aid and increasing targeted support.

Regarding longer-term poverty reduction, the future pattern of growth is determined by (i) the distribution of human and social capital, access and control over natural capital (including land tenure) and access to physical infrastructure, (ii) the policy framework which determines the returns to household investments, and (iii) the quality of institutions, including the legal framework. State socialism and conflict altered every aspect of the pattern of growth, and transition and reconstruction alters it again. Focusing public policy more effectively on poverty reduction, in

Other UNU/WIDER Research on Conflict
The Wave of Emergencies of the Last Decade: Causes, Extent, Predictability and Response.
This completed project, co-directed by Professors Wayne Nafziger, Frances Stewart, and Raimo Viyrynen, investigated why there has, over the last decade, been an upsurge in internal conflict. The project finds that conflict is directly related to inequality between social groups, state failure, economic decline and economic shocks. The study recommends that to prevent conflict, the international community should give more priority to appropriate development policies, meaningful forms of foreign aid, and stronger state and civil society institutions. The findings have received widespread media coverage, and were heavily cited in the “Report of the Secretary-General on the Work of the Organization” to the General Assembly, Fifty-fourth Session.

Available free from UNU/WIDER or on the Internet at www.wider.unu.edu/pb2.pdf
particular on core services of most benefit to the poor, is therefore an urgent task. To support this, the relationship between donors and governments should be changed in order to focus more on monitoring social outputs and less on unworkable policy conditionalities (and to direct aid to governments committed to poverty reduction). Greater investment in collecting social data is needed to understand the impact of reconstruction and transition on communities.

Turning to the second key actor, entrepreneurs, we can see that a new private sector is being created in UTR countries following decontrol and privatization. Overcoming investor uncertainty is a key task; this can persist and limit investment despite a fall in actual country risks. Angola and Mozambique are so far the largest recipients of foreign investment in UTR countries. But the impact of Mozambique’s large investment programme is virtually unknown, while foreign investment in Angola is confined to the oil sector, which has few links to the rest of the economy.

Privatization is proceeding at different speeds across UTR countries. Privatization in the financial sector is especially important; reconstruction requires a financial sector capable of mobilizing and intermediating savings into private investment. Recapitalizing the banking sector is expensive, and requires private capital, which implies privatization. Political influence can create unsound banks and better financial regulation is needed. But the phenomenon of “straddling,” in which political leaders invest in commercial enterprises, endangers the independence of financial regulation, and can distort the privatization process. Privatization in the agricultural sector has seen the non-transparent privatizations of state farms and the denial of community rights and some inconsistencies between privatization and agricultural policy reform. Encouraging more private investment in agricultural marketing is especially important for food security and rural poverty reduction.

The third national actor is the state. A developmental state must be constructed. This is a set of democratically accountable institutions capable of effective policy design and implementation. If this is successful, the new state will look very different to the former state structures, and it is unlikely to be “minimal.” The onus is therefore on democratic governments to prove that they provide value for money to communities and entrepreneurs. The new state agenda will remain a wish list unless it is properly financed, which it is not at present. Reconstruction expenditures are high, revenues are low (war reduced tax bases) and distorted (over dependence on trade taxes). Countries are severely indebted; almost all Africa’s conflict/post-conflict countries are classified as “Heavily Indebted Poor Countries” (HIPC’s). The fiscal peace dividend is small (at least in the early years) and the high level of insecurity in Africa keeps military budgets high. Budgetary institutions are weak at mobilizing revenues and allocating them to priorities, and non-transparency and the improper use of public funds must be reduced.

As a result of these problems, and the sheer scale of reconstruction expenditures, fiscal deficits before grants are very high. Nobody seriously questions the principle of fiscal prudence, but the IMF’s fiscal policy conditionalities may be over-restrictive; certainly many other donor agencies believe that this is the case. This leaves many investments with high social returns on the shelf, implying slower growth and poverty reduction. A much longer time frame is therefore necessary to evaluate fiscal policy in an economy under reconstruction.

The IMF’s caution in part arises from the observation that real aid flows are in decline, and it therefore advises governments to move to a fiscal position in which any downturn in aid will not affect their recurrent, as opposed to their capital, spending. However, it is still possible for aid flows to individual countries to maintain their present levels or rise, and this is in fact the way the donor community is moving in seeking to redirect aid to countries committed to broad-based development. The IMF’s fiscal policy conditionality, when it is over-restrictive, works against the new aid paradigm. Moreover, over-tight fiscal policy can lead to the use of distorting taxes that undermine reconstruction, it can work against improvements in budgeting, and it may be incompatible with democratization.

Towards a Better Future

With the exception of Mozambique – whose reconstruction is now well underway – the UTR countries face a difficult future. There are now glimmers of peace in Somalia; warlord power is diminishing as communities grow tired of never-ending insecurity. But whether the Somali State will be reconstructed – indeed whether a unified Somali state is desirable – remains an open question. Guinea-Bissau has been buffeted by repeated political shocks, and its economy is exceptionally fragile, even by the standards of low-income Africa. For the moment, Eritrea and Ethiopia seem intent on mutual destruction, although hopefully both countries will realize that neither can go forward without a vibrant, and peaceful, regional economy. Angola’s tragedy may reach closure over the next few years; its humanitarian crisis is presently among the world’s worst.

Decentralizing political and economic power, minimizing macro-economic shocks, and preventing conflict through broad-based development are all crucial. This requires hard choices over resource allocations and public policy. But these choices are a great deal easier to make than those involved in ending a conflict and initiating reconstruction. Ex ante action – good economic policy – is always better and cheaper than ex post crisis management.
Introduction
This research programme focuses on behaviour within groups in developing countries. Groups include governments (central and local), community and voluntary organizations and families, as well as privately owned firms (large and small). Intra-group activities greatly exceed inter-group activities in the modern economy, intra-firm transactions of multinational corporations accounting for as much as a quarter of manufacturing trade; the public sector for a third or more of national income; and within family activities perhaps the equivalent of over half of measured income. Within-group behaviour is of enormous importance in determining the equity and efficiency of resource allocation.

There is abundant, if casual, evidence that some groups function well, from the perspective of equity, efficiency and well-being, while others function poorly according to one or all of these criteria. The aim of the programme is to identify ways of influencing such group behaviour in directions that improve functioning, with a particular focus on equity and well-being. Groups include a large array of heterogeneous types. For the project we chose to focus on three broad areas – health services, producer organizations and NGOs directed towards improving the position of women.

Economic interactions among individuals can be divided into within and between group activities, where groups are collections of individuals involved in coordinated and purposive activity. Membership of a group involves individuals defining themselves as insiders and others as outsiders. However, the construction of group boundaries is often a fluid and ongoing process. Between-group activities are typically mediated by the market, while within-group activities, by definition, occur outside the market. But networks, alliances of firms etc. often form so that within-group are not always clearly distinguished from between-group activities.

Groups evolve historically, coming together sometimes for social reasons, sometimes to fight common causes, sometimes to produce (or consume) goods collectively. Many groups have primarily non-economic functions – e.g., sports clubs or religious organizations. The focus here is on groups with economic functions. But the distinction is often not clear cut. Not only can most group functions (including social ones) be counted as producing some economic “output,” but also groups that come together for non-economic reasons may acquire economic functions, while economic groups often spawn “non-economic” activities.

Group behaviour is influenced both by the general environment in which the group operates and by its own rules of operation, with interactions between the two. Our aim is to explore how these two influences affect group behaviour, through theoretical analysis and empirical case studies.

Types of Group Functions
Group functions may be categorized into two main types – efficiency and claims functions. Efficiency functions are those that compensate for a variety of market failures. These correspond to the New Institutional Economics (NIE) view of groups. Major market imperfections leading to the formation of groups include:

- Indivisibilities and imperfect information leading to high transactions costs. Given indivisibilities of production or consumption and high transactions costs, individuals cannot produce certain goods and services efficiently for themselves. The project’s empirical work investigates the Farmers’ Associations in the Republic of Korea and Taiwan which have historically provided services to small producers that would have been too expensive to provide individually because of indivisibilities.
- Externalities associated with non-excludability so that group or collective action is needed to produce public goods. Groups formed to manage common pool resources are examples – the project analyses forestry groups in South Asia.
- Imperfect and often asymmetric information giving rise to risk and uncertainty; groups are formed for risk pooling, as a type of collective insurance – the project is looking at health insurance schemes as an example.

Another important category is claims functions, where a group is formed to advance the claims of its members to power/resources. This is the explicit role of such organizations as associations of the landless, Trade Unions, or producer cartels. Where “claims” function groups represent the relatively poor and unprivileged their activities are liable to improve income distribution in the society at large; but where they represent the privileged (e.g., cartels of firms) they may worsen income distribution.

Many groups combine claims and efficiency functions. For example, many local organizations both provide public goods and act as pressure groups for their members. Some groups start with one function, and then begin to contribute to the other. For example, the Coffee Federation was initiated for efficiency reasons but has come to represent the claims of coffee producers.

Individual Action and Group Objectives
A critical aspect of group functioning is how individual action is kept in line with group objectives. We define this as the consistency problem. Where it is not solved, groups become ineffective. For example, cooperatives or public sector institutions may be used by members/workers to serve their private interests and consequently fail to meet group objectives. Ways in which the consistency problem is solved depends on the mode of operation of the group. Three modes can be identified: power/control (or P/C) where one or a group of dominant actors determine what the rest will do in a hierarchical way, enforcing this by threats of various types. A second mode consists of the use of material incentives, i.e., quasi-market operations (or M), where people are
persuaded to act according to group objectives to maximize their material rewards. A third mode consists of voluntary cooperation (or COOP), to achieve group objectives. This may result from people seeing cooperation as in their long-run interests (a form of long-term reciprocity), because of altruism, because they identify with the group, or because they share group goals.

The nature of individual motivation is clearly important to the prevalence and effectiveness of alternative modes of group functioning. In so far as homo economicus is a correct depiction of human motivation, as often claimed in economics, then material incentives would seem to be the most effective mode, and cooperation would seem to be an unrealistic option. However, studies of human motivation show that there is neither theoretical nor empirical support for the homo economicus model. Other aspects of motivation, including altruism, community (or affilia), commitment, sympathy, and identity have both theoretical and empirical justification. All of these make cooperative action feasible. It is argued that motivation is at least partly endogenous, influenced by societal norms and incentives. Thus homo economicus can be promoted, and more cooperative forms of behaviour reduced, if the material incentives model of behaviour dominates in society, and vice versa.

The society within which groups operate is likely to affect them in important ways. First, norms of the community are significant influences on the norms members bring with them to the group. In addition, economic and social relationships in society, including property and employment relations, class and ethnic strife, provide the backdrop against which groups are formed, affecting their objectives, power and potential. Hence analysis of the functioning of particular groups should not look at them in isolation but must include the economic and social context.

**Tentative Conclusions on Group Functioning**

Preliminary analysis in the light of the findings of the case studies, as well as a review of other empirical work, points to some tentative conclusions about group functioning:

1. Actual groups invariably combine elements of all three modes of operation, but one or other is often dominant. Claims groups are more likely to be characterized as cooperative, with elements of power/control. Efficiency groups more often combine power/control and material incentives, but they too invariably have some cooperative aspects. In fact, exclusive reliance on power/control or material incentives is quite inefficient because of the strong monitoring and sanctions required.

2. Groups can be highly effective in solving problems of externalities (e.g., forestry groups in South Asia; fishermen in Senegal; cooperatives in Mongolia); they can disseminate information, reduce uncertainty and improve the enforcement of contracts (e.g. the Coffee Federation in Colombia, producers associations in Ghana, and Farmers Associations in the Republic of Korea and Taiwan); and they can effectively promote claims (e.g., sex-workers in Calcutta, women’s groups in Bangladesh, and forestry groups in South Asia).

3. Group success in achieving their own objectives can be due to a variety of factors:
   - homogeneity in membership (e.g., class antagonism, or regional identity);
   - an active outside agent (e.g., the state or a marketing intermediary);
   - explicit exclusion of certain categories from membership (e.g., men in Bangladesh women’s groups, and landowners in Brazilian producers’ associations);
   - technical factors that can be important in determining whether the group will be efficient economically (e.g., among fishermen in Senegal);
   - norms supported and reinforced by society (e.g., in the case of the health services, and among forestry groups in South Asia);
   - non-economic, identity-forming activities, (e.g., sex workers in Calcutta).

4. Groups are not invariably efficiency or equity promoting. For outright failures we have to look beyond our own sample, which was chosen to encompass groups that were thriving. However, some of the fishermen’s groups in Senegal failed because the technical conditions were unfavourable. Some Mongolian groups failed in the post-collectivist era because economic and institutional conditions became unfavourable. Moreover, some groups promoted efficiency but not equity – for example, the forestry groups in S. Asia made the position of non-members (often women) worse than before. Although both the Korean and Taiwanese Farmers’ Associations contributed to efficiency promotion, the Korean Farmers’ Associations appear to have been less egalitarian and efficiency-promoting than the Taiwanese ones.

5. Elements of cooperation provide an essential underpinning for all efficient groups. In more egalitarian groups, cooperation tends to be more dominant (though the direction of causality is unclear and probably goes both ways). When material incentives displaces cooperation, there are efficiency losses as well as gains. Both efficiency and equity may worsen – this was illustrated in Mongolia, among the Ugandan NGOs, and drawing on developments in New Zealand.

6. Norms and incentives prevalent at a macro-level are extremely influential for group functioning. Efficiency groups, in particular, tend to follow macro-norms. Claims groups often challenge them.

It is too soon for us to draw policy conclusions from this project, but from the above discussion it is clear that the project has important implications for macro as well as micro policy-making.
Bureaucratic Structure and Performance: New Evidence from Africa

By Julius Court, Petra Kristen and Beatrice Weder

Introduction
Governments’ administrative competence is an important factor for explaining the differences in growth among developing countries. In particular, there is a long-standing argument that weak institutions have contributed to low economic performance in Sub-Saharan Africa. However, in studies of bureaucratic performance in Africa the empirical evidence has been largely limited to case studies. There is only one quantitative study of bureaucratic capacity at the global level1 covering 35 countries, and only four were from Africa. This project further developed the Rauch-Evans framework and applied it specifically to Africa. This note presents the preliminary findings of the work. It outlines the statistical findings on the relationship between bureaucratic structure and performance based on the analysis of the larger bureaucracy database. It also provides some detailed findings of a survey in 20 African countries, the first time that such an extensive cross-country survey on these issues has been undertaken in the region.

Why Bureaucracies Matter
The emphasis on bureaucratic quality stems from a number of sources. Theoretical support particularly comes from the classic work of Weber. Case-study evidence highlights that in contrast to the “crisis of governance” in Africa, the bureaucracy is seen to have played a critical supportive role during the period of rapid growth in East Asia. More recently, evidence in the 1997 World Development Report has led to a much more widespread appreciation of the importance of state quality for economic development.

The development of country risk ratings has enabled institutional issues to be included in cross-country growth regressions. Of specific interest for this paper, the risk rating agencies have included a number of measures of bureaucratic performance, such as “corruption” and “bureaucratic delay.” Analyses have found that better bureaucratic performance is associated with growth in per capita income. However, although the cross-country statistical evidence reinforces the idea that differential governmental performance may have an impact on economic growth, it tells us little about what kind of institutional characteristics are associated with lower levels of corruption or “red tape.”

Replacing patronage systems with a professional bureaucracy is thought to be a necessary (though not sufficient) condition for a state to be “developmental.” There are a number of ways bureaucratic structure is thought to affect performance. (i) Having certain entry requirements and (ii) paying reasonable wages should lead to a pool of talented officials entering the bureaucracy. (iii) The status of the bureaucracy within the country is also important. (iv) Internal promotion can lead to benefits associated with stability and (v) if based on merit, should also lead to incentives to perform well.

Preliminary Findings
Based on the new data on bureaucratic capacity for 20 African countries, the preliminary findings of the project fall in two parts. First, the new data has enabled the construction of a significantly larger bureaucracy dataset (now comprising 50 countries) for statistical analysis. Second, it allowed us to systematically compare evidence of bureaucratic quality across Africa. This is important because, despite the lack of systematic data, there has been a clear tendency in the literature to generalize about the weakness of political institutions on the continent.

Bureaucratic Structure and Performance
The regression analysis focused on the relationship between bureaucratic structure and performance. The structural indicators were chosen from issues investigated in the survey. The performance indicators were “corruption” and the “bureaucratic quality,” using data from the International Country Risk Guide (ICRG), and “public sector efficiency” and “quality of policy implementation,” using data from the 1997 World Development Report.

In particular, four issues emerged as significant in the regressions and warrant further investigation:

- **Relative wages:** This describes the level of wages in the bureaucracy as a proportion of private sector levels.
- **Private sector employment:** This indicator refers to the degree that higher officials in the core economic agencies spend proportions of their careers in the private sector. However, it often has the unexpected sign, i.e. bureaucracies where there is more back-and-forth between the public and the private sector tend to perform worse. This is certainly a very interesting finding and will merit closer attention.
- **Agency power:** This describes the influence the core economic agencies have in formulating new economic policies.
- **Resilience:** This indicator rates whether incumbents of top positions in the civil service are likely to be moved to positions of lesser importance when political leadership changes.

Evidence on African Bureaucracies
Although the survey analysis is still preliminary, the findings raise a number of interesting issues relating to the literature on political institutions in Africa. A few key issues are outlined below.

1 Rauch, J. and Evans, P., Bureaucratic Structure and Bureaucratic Performance in Less Developed Countries, mimeo, July 1997.
the continent are very misleading. Although the findings do make for grim reading in some cases, the key point is that there is a great degree of diversity in bureaucratic structure and performance across the region. In particular, the survey highlights that certain countries, such as Mauritius, Botswana, Eritrea, Namibia and Tunisia, perform well.

Improving Countries (and Potential Sources of Lessons) - The findings of the survey also suggest that improvement is not as impossible as would be suggested by the tone of much of the literature on Africa. Certain countries have been able to improve their performances in different structural characteristics and in overall performance. Mauritius, Botswana and Namibia, for example, have steadily improved. Eritrea clearly emerges, prior to the recent dispute with Ethiopia, as one of the countries that improved dramatically and stands out for further investigation. These point to potential sources of lessons from within the region, which is significant because much of the literature has advocate looking to the high-growth countries in East Asia for lessons.

Ownership and Role in Policy Formulation - There has been concern about aid dependency and the lack of ownership of development strategies in the region. The survey indicated that bureaucrats across the continent felt that economic policy is formulated outside the country, particularly by the BWIs. This lack of ownership in terms of economic policy formulation is worrying for long-term development prospects.

Corruption - Corruption is at the top of national and international policy agendas. The level of bribery seems to have increased for Africa as a whole and it is a serious issue in some countries. But the preliminary results indicate that the situation is less bleak than many perceive; it is a minor issue in some countries and has improved in some previously troubled countries.

Conclusion and Next Steps
Recent reform efforts promoted by the BWIs have used conditionality and support for institutional reform to try to spur improvements in governance in Africa. The final analysis of the survey should provide evidence to test whether these efforts have borne fruit and what are some of the steps that might be taken. However, the preliminary assessment seems mixed. The “steady improvers” – Botswana, Mauritius, Tunisia and Namibia – primarily seem to have advanced on their own without significant assistance from the BWIs. Change in Eritrea, a “dramatic improver,” also seems unrelated to BWI policies. The BWI “favourites” of Uganda and Ghana have improved slightly in some respects, but still do not score particularly well. The situation there has deteriorated steadily for two of the most troubled countries in the survey. However, these have recently had potentially important changes; a new President in Nigeria and civil service reform in Kenya. It would be valuable to carry out the survey again in the near future to assess whether the situation in these, and other countries, has changed.
Globalization and the Obstacles to the Successful Integration of Small Vulnerable Economies

By S. Mansoob Murshed

Globalization at present, as in the past, appears to benefit the countries of the North more than the South. Even within the South, the benefits are heavily skewed in favour of a few. It is estimated that 11 developing countries account for 66% of total developing country exports and receive the lion’s share of inflows of foreign direct investment (FDI). For many developing countries, the benefits of globalization remain distant and elusive. Nevertheless, new rules of the game and the environment of accelerated globalization, prevalent since about 1980, leaves them vulnerable in novel ways. Among these are volatile international capital markets as well as developments in the arrangements for conducting multilateral trade and technology transfer.

To a great extent, the obstacles to the successful participation of vulnerable developing economies in the international system are rooted in the causes of their underdevelopment and poor economic performance. One approach stresses pure geographical position as a factor governing long-term economic development, and the ability to benefit from globalization. Tropical location hinders economic growth due its lower agricultural productivity and higher disease burden. Also coastal regions are said to enjoy higher relative growth potential than landlocked areas. The broader literature on the role of location, agglomeration effects, and the new economic geography does have important policy implications for the development of infrastructure and institutions to counteract locational disadvantages.

There is also a considerable body of literature stressing the importance of institutions and good governance in promoting economic development. The absence of a well-functioning governance system and institutional capital may be said to generate greater transaction costs to economic activity. Another influential idea is that of social capital. It provides the bridge between states and markets in matters affecting productivity, though it should be noted that social capital is not always beneficial.

Examination of the data shows that the share of many developing economies in world trade has fallen, especially in Sub-Saharan Africa. This is prima facie evidence that some countries are being marginalized in the process of globalization. Therefore, a central policy parameter determining success in the globalized market place may be the degree of trade openness. Openness implies less protectionism and the absence of a bias against more outward-looking economic development. Some studies suggest that economies that are more open will enjoy faster growth than relatively closed economies. In the final analysis, an open trade regime may be a necessary condition for successful integration and participation in the globalized economy, but openness in itself is not sufficient to guarantee results.

The post-Uruguay Round trading framework is wider in scope compared to the old GATT system. The extended coverage includes, inter alia: trade in services via GATS (general agreement to trade in services); the transfer of technology via rules governing domestic content requirements in TRIMs (trade-related

Other UNU/WIDER Research Projects in the Area of Global Governance

New Roles and Functions for the UN and the BWIs.
This ongoing project, directed by Professor Deepak Nayyar, examines the new challenges facing international organizations. The Keynesian message of full employment, and creation of world regulatory institutions to ensure monetary stability, development assistance, trade promotion and technical assistance provided a clear inspiration to the architects of the United Nations (UN) and the Bretton Woods Institutions (BWIs). Despite some failures, the UN and BWIs achieved important results. However, more recently, the world has undergone fundamental changes, particularly as national economies have become ever more closely integrated through flows of trade, finance, investment, people, and the revolution in communication technology. Much of this change is welcome. But it has created new problems for which systemic solutions have not yet been found. The project will attempt to make specific proposals for a new global message – that the gains from liberalizing world markets must be carefully balanced with the maintenance of world economic stability, human development, and the sustainable management of the planet’s resources.

EMU and its Impact on Europe and the Developing Countries.
This ongoing project, directed by Professor Charles Wyplosz, investigates how the introduction of the single European currency will affect economic integration and social conditions in Europe, as well as the functioning of the international financial system, and therefore conditions in developing and transition economies. The loss of national monetary instruments and the restriction imposed on fiscal policies will deeply affect the way member governments think about, and implement, their economic policies. The new European Central Bank (ECB) will also have to establish its own approach to complex issues. At stake is the functioning of the international financial system. But, developing countries also worry about what is in store for them. Little work has been devoted to this latter issue, so a new effort is warranted.
investment measures; TRIPs (trade-related intellectual property rights); and subsidies. Various items are being placed on the WTO high-level agenda for the forthcoming Seattle meeting to launch the next Round that could be inimical to developing country interests, particularly the more vulnerable ones. For example, the environment and the incorporation of labour standards into the exports of the South are being discussed. For vulnerable developing countries, compliance with some of these standards could render their exports uncompetitive.

Small and vulnerable economies have become caught up in the wave of accelerated globalization sweeping through the world in the last two decades. Globalization can present new opportunities for the South. However, besides being intrinsically vulnerable, they face new constraints in the processes of trade, technology transfer, investment and international finance. Economic policymaking powers of the nation-state are considerably attenuated in the present globalized context. But societies and states do retain some residual room for manoeuvre over the pace at which they embrace the full implications of globalization.

This ongoing research project will address, among others, the following issues:

- Linking the short-term and long-term characteristics that affect the ability of small, vulnerable economies to benefit from globalization. Long-term characteristics include the human capital stock, resource endowment, physical infrastructure, geographical attributes and institutional characteristics. Short-term features include risk variables and other policy parameters.
- Problems posed by misgovernance and the paucity of institutional capital.
- The role of social capital in determining success in globalized markets.
- The potential of intra-South FDI. Small and vulnerable economies receive little in the form of financial flows from the North except aid and limited FDI in the context of mining and tourism.
- Problems in WTO negotiation and accession.
- Issues related to labour standards governing exports from small vulnerable economies.

Investigating these issues should enable the project to put forward a set of strategic policy recommendations for ways small, vulnerable countries can realize the benefits of globalization.

Other UNU/WIDER Research Projects on Financial Issues

**Financial Contagion: How does it spread, how can it be stopped?**
This ongoing project, directed by Professor Yung Chul Park, examines why international capital markets have proved volatile and susceptible to contagion, such as the financial turbulence that hit many East Asian countries in 1997 and subsequently spread to other parts of the world including Russia and Brazil. Emerging market economies suffered most from the volatility and contagion. Although there is a voluminous and growing literature on financial contagion, there is little agreement on the operational definition, channels of transmission, or causes of contagion. The research will look to define the problem, identify the causes of contagion, analyse whether the crisis was contagious regionally or globally, and examine how it spread, and how it was eventually halted. Policy conclusions and recommendations will be geared to governments and financial markets, as well as the IMF and the World Bank.

**Short-term Capital Movements and Balance of Payments Crises.**
This completed project, directed by Professors S. Griffith-Jones and M. Montes, analysed the policy and development challenges that short-term capital flows pose for economies in the wake of their efforts to liberalize their domestic financial systems and open their capital accounts. It evaluated the variety of policy responses and institutional features at the country and the international level with the intention of identifying policy pitfalls and reform recommendations in dealing with cross-border capital flows. The project emphasized the decisive impact that an appropriate approach to capital account and financial liberalization plays in avoiding a crisis such as that seen in Mexico in 1994 and now in Asia. The project design and the resulting output highlighted the importance of resisting unsustainable capital inflows, insulating the domestic financial system from short-term capital movements, and paying attention to prudential supervision of banks.
Rising Inequality in an Era of Liberalization and Globalization
By Giovanni Andrea Cornia

Challenging the Washington Consensus
Since the late 1980s, the international community has increasingly made the eradication of poverty its foremost development objective. Simultaneously, a new economic paradigm, widely known as the “Washington Consensus,” has been promoted. This emphasizes macroeconomic stability, market liberalization, privatization and the use of market solutions in the provision of public goods. Combined with a reduction in barriers to world trade, foreign investment, and portfolio flows, the Washington Consensus has helped to accelerate the pace of globalization.

The new poverty focus, together with the Washington Consensus, makes large claims. Liberalization will promote the convergence of the living standards of the poorer countries with those of the most advanced, thereby reducing world poverty. Moreover, it is claimed that the policies are, by and large, distributionally neutral, that the distribution of income is broadly stable over the long run, and that there is only a weak link between inequality and growth. Thus while ostensibly focusing on poverty, the approach is largely blind to inequality.

However, these conclusions can be challenged. Globally, there is still only limited convergence between the developing and developed worlds. Only China and a few East and South East Asian countries have grown fast enough to converge towards the income per capita of the developed countries. For the rest, including the transitional economies, the income gap between nations is now bigger than in 1980 or 1960. Moreover, inequality has increased within countries, particularly the transition economies.

Why Has Inequality Risen?
To dig deeper, we must first look to the “usual suspects”: land concentration, natural resources, unequal access to education, and urban bias. Agriculture’s economic weight has declined almost everywhere over the last 40 years. Moreover, at least 27 land reforms were carried out, resulting in a sharp fall in land rents. Thus, while rural incomes still depend on land access, land concentration’s impact on total income inequality has become less important. Likewise, while dependence on natural resources is often associated with inequality, this is of declining importance globally.

What of access to education? Research on Latin America confirms that differences in educational achievement are significant in explaining income inequality. Globally, income education may have deteriorated with the introduction or increase in user charges starting in the 1980s. Certainly, slow progress in improving enrolment and retention rates in many low-income countries is likely to have widened educational inequality, pushing income inequality higher.

The many adjustment programmes of the 1980s and 1990s aimed to improve agriculture’s terms of trade and close the urban-rural income gap, thus reversing urban bias. While there is considerable cross-country variation in the impact of these measures, indirect evidence suggests that poverty and inequality did not worsen in the 1980s in rural Latin America, and that the urban-rural gap was reduced in SSA. The gap between mean incomes in rural and urban areas may therefore have narrowed. In other cases – most notably China – the initial narrowing of the urban-rural gap was reversed and accompanied by increasing regional inequality.

Overall, therefore, the usual suspects are unlikely to explain inequality’s sharp rise over the last twenty years. For sure, investment in basic education, land reform, and rural development are still as urgent as they always were, but policies and trends do not suggest that traditional factors explain inequality’s recent rise.

New Factors in the Rise in Inequality
Many ascribe rising inequality to the acceleration in technological advance. For certain, the IT revolution has raised the demand for skills, thereby weakening the relative bargaining position of unskilled labour. Yet, comparing South Korea and Brazil in the 1960–70s and Canada and the US in the 1980s–90s shows that inequality rose in Brazil and the US, but not in the Republic of Korea and Canada, because the latter invested heavily in...
secondary and higher education (and subsidised it). Hence, it is not a foregone conclusion that IT investment is necessarily driving inequality’s rise, certainly not in developing countries with their small service sectors.

A more likely explanation, at least in the developing countries, is the extent of stabilization and structural adjustment over the last two decades. Excessively deflationary programmes, and the associated public expenditure cuts, have in many cases reduced human capital investment, with the poor least able to cope. A shift in factor shares from labour to capital has compounded the tendency for inequality to rise under adjustment (although somewhat mitigated by the reduction in urban bias noted earlier). While the end of hyperinflation is generally pro-poor, stabilization programmes that focus on rapid demand compression generally exacerbate poverty.

Trade liberalization has also been part of the adjustment story. While old trade theory predicts that inequality will fall in developing countries which liberalize, new theory and some new evidence suggests that inequality now rises post-liberalization. The import of world class technology – or the shift to high-tech exports requiring highly educated labour – raises the returns to skilled labour and reduces the demand for locally abundant unskilled (if literate) labour. Indeed, recent trade liberalization in Latin America has been associated with increased wage inequality, as the adoption of imported new technologies renders the tradable sector less intensive in unskilled or semi-skilled labour.

The distributional impact of financial liberalization has been largely ignored. Interest payments on public debt rose rapidly, reaching levels close to 15 per cent of GDP in the early-to-mid 1990s in middle- and high-income countries with large debt stocks. The rise in financial rents has been disequalizing. In developing countries tax incidence is regressive or proportional while the ownership of government bonds is highly concentrated (in Turkey, for example). Financial deregulation has created a new class of rentiers, and redistributed income to bondholders via the budget.

Recent evidence points also to the correlation between financial crises and earnings inequality, particularly in countries with weak labour institutions. The liberalization of labour markets since the 1980s has certainly eroded the bargaining power of labour. The fall in unionization in the US accounted for about 20 per cent of the total increase in earnings inequality. In Eastern Europe, Latin America and the US, the fall in minimum wages relative to average wages has raised earnings inequality. In contrast, earnings concentration did not increase in countries with collective bargaining institutions, adequate minimum wages and social protection systems.

Finally, implementation of the Washington Consensus has seen the erosion of the redistributive role of the State. This manifests itself in the reduced role for the tax system in achieving income distribution objectives, cuts in the level of public expenditures and adverse changes in their composition. Moving to “fine targeting” of public services and cash transfers has compounded the problem. While it may reduce leakages to the non-poor, in practice fine targeting typically excludes many of the deserving poor from benefits.

The Role of Redistribution in Achieving Rapid Poverty Reduction
We have argued that the traditional causes of inequality (land concentration, urban bias, inequality in education) explain an important part of the variation in cross-country inequality. However, UNU/WIDER research suggests that the increase over time in inequality in two-thirds of the countries in the WIID sample is generated by new factors.

In its rush to promote ill-designed privatization and premature financial- and capital-account liberalization (when regulatory capacity is weak), the Washington Consensus has contributed to rising inequality. Moreover, inattention to the decline in aid expenditures and adverse changes in their composition. Moving to “fine targeting” of public services and cash transfers has compounded the problem. While it may reduce leakages to the non-poor, in practice fine targeting typically excludes many of the deserving poor from benefits.

UNU/WIDER Research on Living Standards, Poverty and Inequality

Land Distribution, Land Reform and Economic Growth. This completed project, co-directed by Professors Alain de Janvry, Elisabeth Sadoulet, and Jean-Philippe Platteau, reviewed experiences with land reform in developing countries. The project examined the various paths that are open to households in achieving access to land. The project finds that direct access to land by women in Africa can be increased by enhancing their bargaining position through education and reform of inheritance rights. The project also finds that effective community management of land requires community titling, and other measures to devise accountable rules of governance. The project also evaluates a range of other issues, including new experiments with negotiated “land reforms” in Latin America and South Africa.

New Models of Provision and Financing of Public Goods. This completed project, co-directed by Professor Germano Mwabu and Dr. Cecilia Ugaz, examines the provision of “public and merit good” such as health, education, sanitation and other social services in developing countries. The provision of these goods was adversely affected in the 1980s by recession and by radical changes in economic and social policies. The study finds that state involvement in provision is desirable to prevent exclusion of the most vulnerable segments of the population. The research also finds that the room for reallocating resources is limited, and that greater co-ordination and regulation of service delivery is necessary to harness diversification. Among other issues analysed in the project is the question of decentralization in service delivery; this is presently in vogue among donors, but can be difficult to implement in practice.
Income Distribution and Social Structure during the Transition

By Vladimir Mikhalev

Transition to the market economy in Eastern Europe and the Former Soviet Union (FSU) has been associated with high economic costs and profound changes from largely egalitarian social structures to greater inequality and social stratification. Major social consequences of the transition include a decline in living standards for the majority, the appearance of unemployment, radical shifts in the distribution of assets, increases in earnings inequality, and changes in welfare regimes (in many cases associated with a decline in major social benefits). These factors lead to a re-ranking of relative income positions and social status of many social and professional groups. One of the most important outcomes has been the increasing social distance between the “winners” and “losers” of the reforms.

The reform process has produced increasing poverty and the concentration of wealth in the hands of the few. The countries of the FSU have reached particularly high levels of inequality, mirroring the pattern in Latin America. In Bulgaria, Russia and other countries of the FSU poverty engulfs a third, and in some cases half, of the population. Poverty has affected pensioners, but even more so children living in large and single-parent families. The bulk of the poor are, however, drawn from low-income adults and the unemployed. In contrast, a small group consists of members of the nomenclatura, enterprise managers and younger professionals who have adjusted to the new situation, and who form new economic and political elites.

This UNU/WIDER project analyses trends and causes of social stratification with the aim of formulating economic and social policy approaches conducive to poverty alleviation, social integration and social cohesion. The main objectives of the project are: to identify determinants of social change (in particular, factors of social mobility, causes of inequality and poverty); to understand emerging patterns of social stratification; to analyse diverging individual country development; and to formulate economic and social policy approaches and priorities.

A fundamental finding of the study is that the rise in income inequality is the most important new factor determining emerging class divisions in transitional societies. The former socialist (communist) countries experienced transition from a status-based society, under state socialism, to a class based society under the market economy. Pre-transitional societies were stratified into “status groups” rather than into classes; status in pre-transitional societies was determined by the possession of “social capital” rather than economic capital, by social networks rather than market power. Transition to the market economy brought about distinctive social classes (as opposed to status groups) defined by economic interests in pursuit of the possession of assets, goods and opportunities for income as major determinants of life chances. At the same time post-communist economies remain mixed systems where markets continue to co-exist with redistributive mechanisms and reciprocity-based relationships.

Macroeconomic and social sector reforms have had a deep impact on social structures while differences in transition strategies largely explain inter-country divergence in social stratification. Key components of the economic transformation having a direct impact on social stratification include transformational recession, high inflation and deflationary shocks which caused a general fall in living standards and increases in income inequality. Social polarization is further enhanced by privatization leading to an unequal distribution of assets, and by changes in labour markets which cause unequal employment opportunities.

Economic Theories and Strategies of the Transition.

This completed project, co-directed by Professors Giovanni Andrea Cornia and Vladimir Popov, aimed at establishing broad comparisons between the economic policies and patterns of development of nearly all economies in transition, both European and Asian. The major conclusion of the project is that the Washington Consensus understanding of factors affecting performance during transition is inaccurate and incomplete. In assessing performance, it turns out that the speed of liberalization is of secondary importance compared to the institutional capacity of the state.

The Political Economy of Post-communist Transformations: From Output Collapse to Sustainable Development.

This completed project, directed by Professor Grzegorz Kolodko, investigated the causes of output contraction following transition from a political economy viewpoint. The research concludes that savings and investment efficiency is crucial for recovery and sustainable development in transition economies. This requires institution building and thus an active role for government and international institutions.

Economic Shocks, Social Stress and the Demographic Impact.

This completed project, co-directed by Professor Giovanni Andrea Cornia and Dr. Renato Paniccia, investigates why, over the last nine years, most nations of Central/Eastern Europe, and the former Soviet Union have been afflicted by an unprecedented mortality crisis. The project provides strong new evidence that the main sources of this increased mortality in Russia are not to be found in ecological degradation, poverty, malnutrition, deterioration in lifestyles, or alcohol consumption. Rather anxiety and stress-raising events related to adverse changes in the labour market are chiefly to blame. The project also demonstrates that there are concrete policies (such as in the Czech Republic) which can substantially reduce the transition-related mortality increases.
opportunities and greater earnings inequality. Simultaneously, the administrative vacuum created by the collapse of the state led to the erosion of the social security system, informalization of the economy, and thus to a worsening of the position of socially vulnerable.

The pattern of social stratification apparent in transitional societies is now becoming apparent. Its characteristics are as follows. First, there is a new elite. It is especially important to investigate who are the new capitalists and what is the nature of emerging capitalism. Second, there is a new middle class. Despite the widespread perception that there is no middle class in post-communist societies, there is evidence of a rapid growth in the new commercial, managerial, and professional middle class. Third, despite these trends, the most numerous group includes the bulk of the working class (blue-collar workers), farmers and peasants, and the state sector workers. This is the base stratum of society. Finally, there are socially deprived and marginalized groups.

Attempts to assess the size of the social classes in transitional societies face serious methodological and data problems. The available data suggest, for example, that in the case of Russia about 6 per cent of Russians belong to the “rich” or upper class, and 29 per cent to the middle class. The rest, 65 per cent of the population, represent the base stratum of the society. A part of this majority (8 per cent) has been affected by poverty, and constitutes the most severely deprived social group. Many in this social group are characterized by long-term rather than short-term poverty, which is much more widespread.

The processes of social stratification in transitional countries are very diverse, and such diversity is an important aspect of the study. The major difference lies between the slowly reforming economies of the FSU experiencing very high inequality and social polarization, and the Central European countries that have had smaller increases in income disparity, following successful reforms resulting in the early resumption of economic growth. For purposes of comparative analysis the UNU/WIDER study selects seven archetypal cases differing in sets of initial conditions, reform strategies, the role of the state, patterns of income distribution and evolving social structures. These country case studies include Russia, Ukraine, Poland, Czech Republic, Romania, Uzbekistan, and Kyrgyzstan. Six of these seven countries can be considered as pairs having very similar initial conditions, but following different reform strategies and/or exhibiting different macroeconomic and social results. These pairs are: Russia and Ukraine; Poland and Czech Republic; Uzbekistan and Kyrgyzstan.

Findings from this comparative analysis show that the social structures of Central European countries in transition did not experience extreme polarization. While a re-ranking of social status is certainly underway, the gap between the elite and the rest of the society is less marked, and the severely deprived group is not as substantial as in the FSU. Substantial segments of the professional and intellectual class, especially amongst the younger age group, have made a successful entry into the market economy. Conversely, the social structure of Russia and some other countries in the FSU is characterized by the emergence of an extremely wealthy and powerful economic elite, coupled with the impoverishment and deprivation of broad strata of the population. An extremely skewed income and asset distribution impedes the formation of a middle class, and generally the losers from the transition largely outnumber the small and heterogeneous groups of winners. Corruption and crime in the FSU is more widespread than in Central Europe.

An additional objective of the UNU/WIDER study is to draw conclusions relevant for social policy, and suggest policy options conducive to social integration and social cohesion. The discussion here concerns the trade-offs between large rises in income inequality, growth and poverty alleviation. Priority needs to be given to active social policy promoting economically gainful employment and investment in the human capital. But there is also a need for optimal public transfers and income distribution policies aimed at poverty alleviation, social integration and social cohesion compatible with objectives of economic development.
Improving the Development Potential of Resource Abundant Countries

By Richard M. Auty

Between 1960 and 1990 the per capita incomes of the resource-poor countries grew two to three times as fast as those of the resource-abundant countries and the gap in the growth rates widened significantly from the 1970s. Crop-led growth is inherently slower than manufacturing-led growth, but the difference in growth rates is much wider than would be expected. Moreover, after the 1960s, the mineral-driven economies have grown the slowest, even though they have higher growth potential than the non-mineral economies because their capacity to invest and to import is enhanced by the mineral exports. Two models capture the contrasting development trajectories under resource paucity and abundance. They are the sequenced industrialization model, which is strongly associated with a poor natural resource endowment, and the staple trap model that is associated with resource abundance.

Resource-Poor Endowments and the Sequenced Industrialization Model

The resource-deficient countries are less prone than resource-abundant countries to policy failure that leads to growth collapses. Resource-deficient countries tend to pursue a sequenced industrialization path whose main features are:

- The early abandonment of closed trade policies in favour of reforms that foster labour-intensive manufactured exports. This reflects the early realization that as development proceeds the primary sector shrinks in relative importance, so that resource rents that are initially low and in relative decline cannot be expected to support slow-maturing infant industry. Rather, competitive manufacturing is required, in line with the resource-deficient country’s comparative advantage in cheap labour.

- The rapid expansion of labour-intensive exports triggered by the reform absorbs surplus labour so that the comparative advantage shifts into capital-intensive and skill-intensive goods and then into R&D-intensive products. Skill accumulation accelerates and genuine saving (a measure of environmental sustainability) remains strongly positive. The competitive diversification renders the economy resilient to external shocks.

- The distribution of income remains relatively equitable due to early pressure to redistribute assets (notably land); the speedy elimination of surplus rural labour following trade policy reform; and the narrowing of the skill premium due to the rapid accumulation of human capital.

- There is also evidence that “Boseropian” pressures may cause resource-deficient countries to move earlier and faster through the demographic cycle so that they benefit from favourable trends in the worker/dependency ratio as population growth decelerates. This boosts the rates of saving and investment and may account for one-third of the faster growth of the resource-poor Northeast Asian countries.

Basically, a resource-poor endowment constrains policy choice, fosters effective investment and provides less scope than resource abundance does for cumulative policy error.

Resource Abundance and the Staple Trap Model

The development trajectory of most, but not all, of the resource-abundant countries falls into a staple trap and exhibits the following key characteristics:

- A longer initial dependence on primary product exports causes these countries to leapfrog the labour-intensive stage of the sequenced industrialization model and to move earlier into capital-intensive industry.

- Fears of Dutch disease and unemployment encourage trade policy closure so that manufacturing matures slowly and economic diversification is retarded. The economy is distorted, investment falls short of the levels achieved by the resource-poor countries and, worse, the efficiency of investment declines markedly.

- The leapfrogging of the labour-intensive stage of the sequenced industrialization model also amplifies income inequality as a pool of cheap rural labour depresses wages and human capital accumulates slowly because protected import substitution industry provides fewer incentives to acquire skills than competitive manufacturing does.

- The vulnerability of such a distorted economy to even mild shocks is high. The basic flaw in resource abundant economies is the relaxation of market discipline and the resulting misallocation of resources.

- The resource rents encourage rent-seeking behaviour and lengthen the period under which distortions accumulate. This entrenches vested interests that benefit from trade closure and capture the policy so that governments resist the politically unpopular real depreciation of the exchange rate that is required in order to sustain growth. Instead they either borrow from abroad or squeeze the primary sector further so that incentives are depressed and competitiveness wanes even further and a growth collapse becomes more likely.

Policy Implications

The historical evidence suggests that the association between resource abundance and economic development is not a deterministic one. Moreover, short-run models of the response to booms suggest resource-abundant countries can follow the sequenced industrialization path, especially if their primary exports are peasant farm crops that have socio-economic linkages that disperse the resource rents widely through the economy. However, policy plays the critical role and is governed by the type of political state, which in turn is linked to the natural resource endowment. Benevolent autonomous developmental states have
both the authority and the incentive to pursue coherent economic policies that raise social welfare. Such states are strongly associated with the extremely resource-poor countries of Northeast Asian, albeit not exclusively so. It is likely that land scarcity lowers tolerance for rent extraction and unequal land distribution, creating social tensions that realign the political state with the interests of the poor majority.

In contrast, resource abundance fosters contests over the distribution of the rents. The appeasement of powerful interests lowers the autonomy of the state and reduces its capacity to pursue welfare-enhancing policies. Under these circumstances, the recovery of resource-abundant countries from a growth collapse may take at least a generation because it requires not only policy reform and the rebuilding of economic infrastructure but also the reconstruction of the trust and institutions that reduce transaction costs.

Resource abundance renders the transition to a market economy more difficult. One reason is that foreign investment in the resource sector intensifies the post-transition rebound of the real exchange rate so that Dutch disease effects retard diversification into competitive job-intensive activity. In addition, resource rents feed corruption where institutional capital is weak. Finally, the rents facilitate the postponement of reform and slow reformers experience deeper output and revenue losses. To the extent that the IMF macro model of policy reform neglects the role of initial conditions, including not only natural capital, but also institutional capital and obsolete produced capital as well, it generates flawed reform policies.

Resource abundant Malaysia confirms that policy counts and that a growth collapse is avoidable. However, Malaysia displayed a capacity to manage latent social tensions that is rare in resource abundant economies. Concern for income inequality in Malaysia led to tacit agreement between the two dominant ethnic groups that economic growth was a pre-requisite for poverty alleviation. A conscious effort was therefore made to diversify the economy and to avoid both trade policy closure and the repression of economic incentives. Effective reform requires institutional mechanisms to promote this outcome.

**UNU/WIDER Research on Economic Policy**

**The Impact of Liberalization on Key Markets in Sub-Saharan Africa.**

This completed project, co-directed by Professors Giovanni Andrea Cornia and Nguyuru Lipumba, assesses whether recent liberalization measures have contributed to the restoration of broad-based development in Sub-Saharan Africa. Specifically the project analysed the impact of the liberalization of foreign exchange markets on the balance of payments, inflation, and the domestic financial sector. The project also addressed the appropriate sequencing of financial sector reforms. The liberalization of foreign exchange and financial markets has been implemented within the framework of the Washington Consensus. The main conclusion of this project is that this approach has not provided a coherent linkage between the short-term objectives of stabilizing the macro-economy, or the achievement of allocative efficiency, and the long-term objectives of broad-based growth and poverty reduction. True progress requires the establishment of an institutional framework that provides incentives for the development of infrastructure, and one that is capable of harnessing domestic saving and managing loanable funds efficiently. This requires an appreciation of the complementarity between the state and private sectors.

**The Welfare and Efficiency Impact of the Privatization of Utilities and Social Services in Latin America.**

This project, directed by Dr Cecilia Ugaz, examines the wave of privatization that has taken place throughout Latin America over the last decade, and which affects a vast array of activities, from public utilities to health and education. By the late 1980s, the public sector delivery of services was increasingly perceived as being inefficient and the financing of services had become a burden on the public purse. This project’s objective is to try to examine the effects on consumer’s welfare of the privatization of contrasting public services, some of them with merit goods characteristics. The project will consider natural monopolies such as water and electricity, as well as private goods such as education and health care. The project will analyse the conditions necessary for efficient regulation, and how regulation helps to create synergetic relations between the state and non-state sectors. The project intends to draw lessons from the experience of developed countries such as the UK, and to compare recent developments in the case of selected Latin American countries.
Information Technology and Economic Growth
By Matti Pohjola

The UNU/WIDER study entitled Information Technology, Productivity and Economic Growth: Implications for Economic Development shows that in recent years the use of information technology in the production of goods and services has had a strong influence on economic growth in industrial and newly industrialized countries. Computers and peripherals have accounted for 8–9 per cent of the annual GDP growth in the United States, 16 per cent in Finland, 19 per cent in Singapore and 32 per cent in the Republic of Korea. Admittedly, however, developing countries seem to have neither invested in IT nor benefited from such investments to the same extent as industrial countries. There is concern that information is becoming a factor, like income and wealth, by which countries are classified as rich and poor. To prevent this from happening, developing countries need to formulate national Information Technology (IT) strategies to promote the use of these technologies.

Case-studies on the Republic of Korea and Singapore demonstrate that the political leaders of these newly industrialized countries have actively promoted the use of information and communication technology as a tool for economic development since the late 1970s. In Singapore, for example, the national strategy has consisted of state intervention in Information and Communication Technology (ICT) infrastructure and manpower development as well as of using the public sector as a lead user in deploying new ICT.

The UNU/WIDER study gives rise to the following conclusions on the components to be included in national IT strategies. First, investment in physical capital is a key factor in economic growth in both developed and developing countries. Investment in information technology correlates positively with economic growth in industrial countries, but this correlation is not statistically significant in developing countries. To be able to reap the benefits from investment in IT, developing countries have to build up a mature stock of physical infrastructure which enhances and amplifies the effects of IT.

Second, exporting firms in developing countries must adopt information technology to remain competitive in the world market. Most of these countries may not yet need computers for production activities but do need them for communicating with their customers in industrial countries. Also, the ongoing globalization of the world economy tends to amplify the importance of IT use, since information and communication systems provide the link to international capital markets and to international technology and production networks. IT technologies provide developing countries with better access to the global innovation network enhancing the diffusion of R&D from industrial to developing countries. Moreover, multinational companies are in the process of linking their design, procurement, manufacturing, logistics and marketing through Internet-based technologies. Electronic commerce will reduce the importance of physical distance and transportation costs as barriers to entry into international product markets, making it possible for even small firms to market their products and services around the world. The ability to use information technology improves the capabilities of firms in developing countries to participate international markets, in facing the competition from multinational companies or in developing partnerships with them.

The use of IT is indeed so widely spread that no single country can ignore any longer investing in these technologies if it wants to improve the standard of living of its citizens. The recent surge in IT investment in industrial countries is associated with the joint development of hardware and specific software for use on the Internet. The observed increase in the 1990s in the contribution of IT to productivity and economic growth is associated with the increased networking of computers through the Internet. Consequently, investment in the communications and information infrastructure enabling efficient utilization of the Internet, electronic mail and electronic commerce must receive a high priority in the national IT strategy of any country, developed or developing.

There are two relatively non-expensive ways for governments in developing countries to promote the use of information technology. The first one is to eliminate the barriers to use by lowering taxes, tariffs and other trade barriers on computer imports and by encouraging competition in telecommunications. The second way is for governments to become sophisticated IT users themselves. The point here is not to spend much scarce resources on information technology but to develop advanced applications of the technology and to become a model for the private sector. Any policies, be they for cultural, political or other reasons, which limit the access to global information networks are likely to retard economic growth.

The third component of the national IT strategy is the education of employees. The study shows that all business firms as well as other organizations in the developed or developing countries will face the same challenge of transforming the workplace to make these organizations function efficiently in an environment of the fast diffusion of IT. This means that training in school and, more importantly, within the workplace is a crucial means of upgrading the skills of workers so that they can adapt their technical but also behavioural and interpersonal skills to the adoption of new technologies. Training school teachers and investing in IT infrastructure in schools is important since this creates a new generation of employees who are comfortable with modern information technology. The benefits from information technology in schools, businesses and governments cannot, of course, be realized without people who understand this technology and are able to adapt it to the needs of local users. Consequently, developing countries must also invest in the training of IT professionals: computer scientists, engineers, programmers and analysts.

The fourth policy conclusion is related to the education of consumers. Training and education are important not only in providing skills for work and production but also in providing a sufficiently strong demand base for knowledge products. This can be achieved through government policies which make consumer
attitudes more favourable to knowledge products and which reduce the hedonic costs of their use. Besides providing education and training for their citizens, governments can themselves become sophisticated users of information technology. By developing advanced applications of IT and by becoming a model for the private sector, governments can alter consumer attitudes and lower their costs of adopting IT.

The final policy conclusion concerns production of information technology. Globalization of the IT market makes it difficult for most developing countries to benefit from IT production. Attempting to enter the computer hardware and components market through protectionist policies is not likely to succeed, and will impose a high cost to users by raising the prices of IT. Instead of investing heavily in the creation a hardware industry, most developing countries should focus on production close to use, that is, on production and use in the computer software and information services industries. This market segment is the fastest growing part of the IT industry and offers many opportunities for small niche players. Firms in developing countries could concentrate on production that meets the needs of local languages, culture and business environments.

In conclusion, investment in infrastructure, physical capital and education is the key to economic development. This is, of course, an old policy prescription in the economics of development. What is new in the analyses presented in this study is the view that the information technology content of these investments should be high. The use of IT is so widely spread in the world economy that no single country can ignore any longer the needs to invest in these technologies if it wants to improve the standard of living of its citizens.

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The United Nations University World Institute for Development Economics Research (UNU/WIDER), located in Helsinki, Finland, is the first research and training centre established by the United Nations University. Through its research and related activities, UNU/WIDER seeks to raise unconventional and frontier issues and to provide insights and policy advice aimed at boosting the economic and social development of the poorest nations.
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