This book originated in a set of lectures that I gave in Munich, Germany, in November 2002, on the occasion of my appointment as Distinguished Fellow at the Centre for Economic Studies at Ludwig-Maximilian University. It is part of the annual series of those lectures published by the MIT Press. Jean-Jacques Dethier and Halsey Rogers, two of my close colleagues at the World Bank, have collaborated with me throughout the research and writing of this book.

Although the ideas offered here were presented in the lectures, they have evolved in many ways since the lectures were given. They have also grown from the three authors’ many years of work on development economics and are reflected in our publications over that time. In addition, the ideas were strongly influenced by the three and a half years I spent as chief economist and senior vice president at the World Bank (from spring 2000 to autumn 2003) and by the six years before that when I was chief economist at the European Bank for Reconstruction and Development (EBRD). While this book is influenced by my having spent a decade in international institutions, it is not a book about either the EBRD or the World Bank. It is a book about development, drawing on experience way beyond those two institutions.

The book retains the style of a set of lectures. It is not a treatise and does not attempt to be exhaustive on the subjects it examines. The purpose is to present the ideas in a structured way and to point to some of the evidence underpinning them. My departure from the World Bank in autumn 2003, to work at the U.K. Treasury, led us to offer the book as it is now rather than continue developing and revising it as we otherwise might have done. There are some parts, especially in lecture III, which are more technical than others, but the reader who is less enthusiastic about this kind of material can skip it without detracting from the understanding of the main arguments of the book.
The Opportunity and Agenda for Development

The past twenty-five years have been remarkable. In the late 1970s China emerged from the nightmare of the Cultural Revolution and embarked on reforms initiated by Deng Xiao Ping. As a result more than 1 billion people—one-fifth of earth’s population—have experienced a period of sustained growth and poverty reduction that has no precedent in human history. In the late 1980s the Berlin Wall came down, setting 400 million people in Central and Eastern Europe and the former Soviet Union on a transition from communism and a command economy to, for most, democracy and a market economy. By 2004 the European Union was welcoming as members many countries once separated from the rest of Europe by an iron curtain. India’s growth began to pick up in the 1980s, and in the early 1990s it initiated far-reaching economic change. Today India is seeing growth and poverty reduction on a scale that would have been dismissed as highly improbable by many analysts in the 1970s and early 1980s. Twenty-five years ago just one-third of the world’s countries could be described as democratic; now that share is closer to two-thirds.

Remarkable too has been the improvement in living standards, including those related to health and education. In the past forty years the average life expectancy in developing countries increased from the mid-forties to the mid-sixties—whereas the move from the mid-twenties to the mid-forties took from the early 1800s to the mid-1900s. Over the past thirty years the share of illiterate people in the developing world declined from around one-half to one-quarter, with particularly strong progress for girls and women. And in the last quarter-century the number of people living on less than $1 a day fell by about 200 million, the first sustained drop since the early nineteenth century—or, indeed, since as far back as we can construct data. This decrease has occurred at a time when the population of the developing world rose by 1.5 billion.

Sadly, such progress has not been universal: far too many people have been left out. In rich countries, mortality for children under age five is 7 deaths per 1,000, but in poor countries the average is 84 deaths per 1,000—and in sub-Saharan Africa, it is a shocking 162 deaths per 1,000. Half the women over age fifteen in South Asia and sub-Saharan Africa are illiterate. More than 1 billion people in developing countries lack access to safe water for drinking and personal hygiene. Since the 1950s nearly one-quarter of the world’s croplands, pastures, forests, and woodlands have been degraded, with one-sixth so severely...
degraded that it is too costly to reverse. Sub-Saharan Africa has suffered seemingly endless tragedy: the scourge of HIV/AIDS, failings in the battles against malaria and tuberculosis, the devastation of widespread conflict. This region has also seen little or no growth in average incomes for the past forty years.

Reaching those left behind presents many challenges, including overcoming disillusionment in countries where growth has failed to take root despite difficult reforms. Although developing countries still have substantial barriers to trade, they cut average tariffs in half between 1980 and 1998 (from 15 to 7 percent), and inflation has been brought under control. Yet many Latin American and sub-Saharan countries have not seen the expected results in terms of growth and poverty reduction.

The Doha round of trade talks of the World Trade Organization, launched in November 2001, put developing countries’ needs at the top of the agenda. Yet more than three years later, there is a real possibility that developed countries will retreat into protectionism. Developed countries continue to impose substantial obstacles on imports from developing countries, despite pledges to remove or reduce them. High-income countries provide more than $300 billion a year in domestic agricultural subsidies—six times the amount of aid to developing countries—and block or discourage agricultural exports from developing countries in many other ways. Developed countries have tariffs and quotas on textile imports that cost developing countries an estimated 27 million jobs. Other tariffs and nontariff barriers further undermine manufacturing and employment in developing-country industries. Thus even as developed countries preach the benefits of trade to developing countries, they erect barriers to trade.

While we should not be under any illusions about the magnitude of development challenges, we have a special opportunity to do something about them. With accumulated evidence from our successes and failures, we understand better than ever before what works and what does not in development strategies and assistance. We have the resources to make more of a difference than at any other time in human history. There is growing understanding that the development of poor countries and people is not only a moral imperative; it is also in the interests of all the world’s citizens.

The optimism that accompanied the arrival of a new millennium generated an unprecedented international commitment to promoting development and fighting poverty, a commitment manifested most clearly in the Millennium Declaration adopted at the United Nations
in 2000. The Millennium Development Goals (MDGs) contained in that declaration provide a framework for measuring progress toward honoring that commitment. They offer specific targets for reducing income poverty; improving health, education, and the status of women and girls; protecting the environment; and strengthening international development cooperation. At the United Nations Conference on Financing for Development in Monterrey, Mexico, in spring 2002 and again at the World Summit on Sustainable Development in Johannesburg, South Africa, in August 2002, leaders of many nations committed themselves—and held themselves mutually accountable—to finding ways to achieve these goals. One purpose of this book is to contribute to a better understanding of the opportunity created by the events of recent years and how we can rise to the challenge of achieving the great advances in development embodied in our commitments. The slow progress in the year and a half since Johannesburg underscores the importance of sharing and deepening this understanding.

The understanding that we seek requires careful reflection on the experience of development, what the analytics of development can offer, and where further study should go. This book argues that this reflection must take us to a much more dynamic theory of development—one that looks at the underlying dynamics, the processes of structural change, and the meaning of development itself. Contributing to and helping to chart this new approach is the second purpose of this book. Taking this approach involves an extended, difficult work program. But it also provides a way of looking at development that, while building on what we know, generates a more productive perspective than was prevalent a few years ago.

This approach leads to a strategy and analytical structure that not only offer new perspectives and a new research agenda but also help shape a program for action now. This book makes no attempt to provide an exhaustive account of where this new approach will take us in developing ideas. And while the arguments are evidence based, the book does not provide extensive detail on the evidence supporting them.

My Journey

This book, and the lectures on which it is based, reflect my experiences over thirty-five years of study and work on development economics. My empirical research journey though the landscape of development
began in 1969 in the tea gardens of smallholders in Kenya. It continued in the wheat fields of India, where I spent many months in 1974 and 1975 living in the northern Indian village of Palanpur. My collaborators on Palanpur (Christopher Bliss, Jean Drèze, Peter Lanjouw, and Naresh Sharma) and I have been returning over the years. Looking back, Palanpur has probably been the strongest influence on my understanding of development. Watching the village change over thirty years provides insights that would never be available from aggregated analysis of macroeconomic statistics, however lengthy and intense.

One might ask why someone trained as a mathematical economist would go tramping around in fields. The answer is that I believed that sound theory was not only intellectually rewarding but, when combined with serious evidence and reflected in policy, it also had the power to improve lives. Work in the field strengthened that belief, and my experiences in Kenya and India foreshadowed lessons that would recur often in later work. First, successful development requires both a dynamic private sector and an active and efficient public sector to provide a climate conducive to investment and growth. Second, if our goal is to live in a world without poverty, we must take action to empower poor people to participate in that growth.

I spent a good part of my professional life in various academic positions at Oxford University, the University of Warwick, the Massachusetts Institute of Technology, the Ecole Polytechnique, the Indian Statistical Institute, and the London School of Economics, which remains my intellectual home. I also had the pleasure of teaching at the People’s University of Beijing in the first half of 1988 and am now an honorary professor there. What I discovered firsthand in China, and through my study of the Chinese economic transition, were the huge dynamic returns that can come from removing obstacles to market-driven development and the importance of adapting and building on existing institutions as well as building new ones. Indeed, the Chinese often remind us that fostering development requires taking cultural factors into account.

After my time in China, I spent six years focused on the transition economies of Europe and Central Asia as chief economist at the EBRD. In those economies, investment climate problems were paramount. Firms suffered from bureaucratic harassment and both grand and petty corruption, which reduced rewards to entrepreneurship and diverted energies into rent seeking and self-protection. The tragic experience of much of the former Soviet Union in the 1990s tells us that
government must take direct action to create a good investment climate for the private sector rather than withdrawing and hoping that such a climate will emerge in the resulting vacuum. Government must also recognize and act on the costs of change, particularly for poor people. In addition, the former Soviet Union provides striking evidence that behaviors, not just institutions and policies, are crucial to economic performance. The experience of much of Central and Eastern Europe outside the former Soviet Union, while difficult, has been much more positive, largely because new and liberated states and polities have functioned much better.

In 2000 I became chief economist at the World Bank. My experience there sharpened the many lessons I had learned and helped me build from them a strategy for development. This strategy rests on two pillars: building an investment climate that facilitates investment and growth and empowering and investing in poor people so that they participate in that growth. As it unfolds in this book, I hope that this strategy sounds plausible—indeed, almost obvious. And I hope to show that it leads directly to policy. But this strategy and its policy implications are fairly new and not universally accepted. When I received the great honor of the invitation to give the Munich lectures in autumn 2002, it was this approach to development that I wanted to set forth. The elaboration of the ideas presented there is the substance of this book.

Although the strategy proposed in this book does not directly contradict other approaches to development, it differs strongly from many in its direction and emphasis. It is very different from the command economy, central planning, and protectionism models popular in the 1950s and 1960s. It is also very different from the dogmatic and naive market fundamentalism of much of the 1980s and 1990s, where some analysts appeared to believe that all government had to do was get out of the way and leave everything to markets. And it is not a middle way, built from bits and pieces of those two misguided approaches. Further, it is not an extension of the redistribution with growth story told in the mid-1970s by Hollis Chenery and others, which emphasized accumulation, human capital, and labor intensity.

This book’s focus is elsewhere. It emphasizes growth and development as dynamic processes that are shaped by, as well as shape, history, learning, and institutions. It is not simply about aggregates; it emphasizes the importance of change—changing structures, behaviors, and institutions. Central to the story is empowering and investing
in people. Empowerment, an idea that runs through the book and is developed at some length, goes beyond assets to the influences and constraints on behavior arising both socially and internally, in terms of an individual’s perception of what is appropriate and possible. Empowerment is an idea that should be central to discussions of development policy, both as an end and means of development.

Neither is this book’s strategy akin to the Washington consensus, as originally defined by John Williamson (1990), which emphasizes fiscal discipline, market-determined exchange and interest rates, protection of property rights, liberalization, privatization, openness to trade, and redirection of public spending toward education, health, and public infrastructure. There is nothing fundamentally wrong with the principles that Williamson articulated—as far as they go. Indeed, it would be dangerous to reject them. But that story leaves out so much of what is important that it is in many ways dangerously misleading. It says little about governance and institutions, the role of empowerment and democratic representation, the importance of country ownership (that is, involvement in the design of and commitment to policies) for effective policy, or the social costs and pace of transformation. Just as it learned from the failures of central planning, the development community has learned the hard way—through the setbacks of structural adjustment programs in developing countries in the 1980s and the transition in Central and Eastern Europe and the former Soviet Union in the 1990s—that these elements are at the heart of the development challenge. It has also learned the dangers of simplistic dogmatism of the market kind. And all too often, poor people have incurred the costs of the learning process.

Any intellectual journey is influenced by other thinkers and colleagues in addition to direct experience. Here, the influences of Joseph Schumpeter and Albert Hirschman, in their approaches to entrepreneurship and innovation and dynamic processes, and Amartya Sen, on the objectives of development, will be clear to most readers. And it is very much in the spirit of John Maynard Keynes, the intellectual and in many ways practical founder of the Bretton Woods institutions (the World Bank and International Monetary Fund), in that it sees good theory as contributing directly to changing the world and the importance of institutions and international collaboration in so doing. Looking back, I am struck that the first books my supervisor, and strong influence, James Mirrlees encouraged me to read were by Schumpeter and Keynes. I have also been strongly influenced by those
I have collaborated with over the years on public economics and development, notably Tony Atkinson and Mervyn King (during my London School of Economics years) on public economics, Ehtisham Ahmad on public finance in developing countries, and my Palanpur colleagues.

**Action and Research**

The overarching lesson I have drawn from my varied experiences and influences is that development is a dynamic process of changing structures, behaviors, and institutions and that this process can be influenced, shaped, and driven by better policies and understanding—with powerful benefits, particularly for poor people. Growth theory, development economics, and public economics offer a solid foundation for analyzing development as change, but we need to go much further than those theories take us in important areas: changing structures and institutions, changing preferences and behaviors, and the processes of learning.

The real story of the development process is too complex to be captured by standard theories of growth, many of which represent economic activity using simple aggregates and focus only on steady states. Anyone who has spent time in the developing world will appreciate that there is little steady about it. A more fruitful approach is to focus on the processes and structures that drive the decisions of households, firms, and farms. Such an approach looks at what really works (or does not) on the ground. It sees growth as a process of structural change and of learning. Like most other successful conceptual and theoretical frameworks, it cannot abandon simplicity if it is to have traction in shaping policy. The key is to focus on the right issues.

Action and research based on these ideas should be designed to guide public efforts to reduce poverty and improve well-being in developing countries. The challenge is to turn the solemn commitments contained in the Millennium Declaration into effective actions commensurate with the scale of the challenge. The strategy offered in this book can provide guidance in developing a framework for action and show us where we have more to learn.

The prospects for success depend on two factors. The first is an acceleration of learning. We cannot, however, wait for more learning before taking action. We know enough to act effectively now. Moreover, acting and learning at the same time are the essence of what development is all about.
The second factor determining the success or failure of our actions is political leadership and commitment. Developing countries must play the lead role in shaping their futures, creating locally owned strategies that reflect their priorities. But the responsibility for success is not theirs alone. Leaders of developed countries will not have the political space to deliver on their commitments unless they make development a central domestic issue. A fundamental ethical case can be made for all of us to play our part in overcoming suffering wherever it occurs. Poverty anywhere is a responsibility everywhere. We share our existence as human beings and share a single planet.

Less altruistic, but also relevant, is the incentive of enlightened self-interest. Five billion of the world’s 6 billion people live in developing countries. They are the growing markets and producers of the future. Developed countries have every incentive to help ensure that developing countries achieve strong growth. In an integrated world, we can all benefit from having trading partners with growing economies. Further, problems of crime, terrorism, illegal drugs, and communicable disease feed on the hopelessness of extreme deprivation and collapsed states. Yet their effects are not confined to poor societies.

Beyond simple moral imperatives to help our fellow human beings and enlightened self-interest, we should surely be thinking of the kind of world, economy, and society we should be building for our children. Will it be a world of cooperation, mutual responsibility, and prosperity broadly shared? Or will it be one of conflict, narrow-mindedness, and wealth for just a few?

We are at a special moment in human history—one replete with risks and opportunity. We have the understanding and resources to win the fight against poverty and make a profound change in the world where we all live. But we must move from commitment to delivery. That will not happen without both strong leadership and the engagement of people around the world. These, in turn, will require strong evidence of what works and what does not. However we look at it, if we are to take this historical opportunity to fight poverty, no one has a greater responsibility than those of us who study economic development.

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