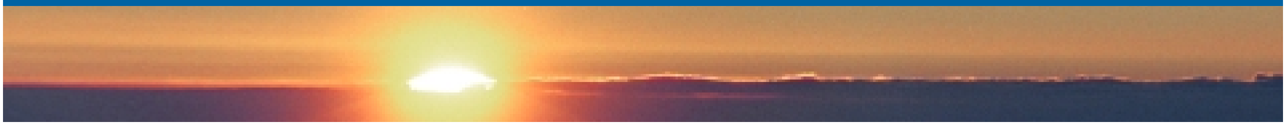


The Changing Development Landscape

The development landscape in the early twenty-first century will be shaped by globalization and localization. Although these forces offer poor countries unprecedented opportunities for growth, they may prove politically and economically destabilizing unless institutional frameworks are strengthened.

Shahid Yusuf

SINCE the birth of the modern nation-state, countries have gone back and forth between seeking closer integration with the rest of the world (globalization) and retreating into isolationism and protectionism, while local groups have sought greater autonomy (localization). However, despite the long history of globalization and localization, their impact has been weak and fleeting, until now. The dramatic acceleration of globalization and localization and the enduring changes they have brought about distinguish the closing decades of the twentieth century from earlier periods. The response of nation-states to these two forces will determine whether incomes in poor countries converge with those in industrial countries and whether efforts to banish poverty are successful.

Why globalization?

Globalization entered the discourse on development in the early 1980s, with the publication of John Naisbitt's book, *Megatrends: Ten New Directions Transforming Our Lives*. The word is now common currency and denotes both positive developments, such as the integration of markets for goods and factors of production, and negative developments, such as damage to the environment and the increasing exposure of countries to external shocks that can precipitate banking and currency crises. The growth of international trade and of factor movements was as swift in the first 10 years of the twentieth century as in the century's last decade, but the current phase of globalization is of a different order, in particular because of the increasing share of tradables now exported, advances in technology, changes in the composition of capital flows, and the larger role of international agencies, nongovernmental organizations (NGOs), and transnational corporations. The completion of the Uruguay Round of trade talks in 1994 was a milestone: trade barriers were lowered; the ambit of trade liberalization was expanded to include services, intellectual property rights, agricultural commodities, and textiles; and the new rules of the game that grew out of the talks were anchored in the World Trade Organization (WTO).

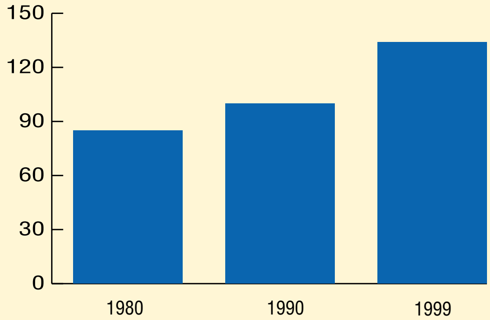
In the 1980s, many countries—industrial as well as developing—began dismantling controls on capital movements and adopting policies that encouraged foreign direct investment. Declining transport costs and impressive advances in communications technologies and information processing boosted the integration of goods and capital markets. The adoption of common rules to regulate banking and financial reporting decreased information asymmetry and lent further momentum to globalization, as did the creation of the World Wide Web and international coalescence around product standards such as ISO 9000.

As countries began to welcome foreign direct investment and transacting business over long distances grew easier, companies

Chart 1

Countries are joining the WTO in increasing numbers

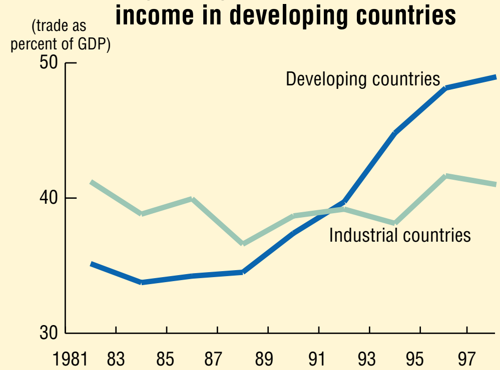
(number of member countries in GATT/WTO)



Source: World Trade Organization, *Annual Report* (Geneva), various years.

Chart 2

Trade is growing much faster than national income in developing countries



Source: World Bank, 1999, *World Development Indicators* (Washington).
Note: Trade is the sum of exports and imports of goods and services.

were motivated to reorganize their activities; they sliced up the value-added chain and established production facilities in different markets. This proliferation of production networks has allowed firms to specialize, focus their research efforts, and leverage their scarce managerial and marketing skills; it has also reinforced the openness resulting from trade liberalization and the removal of barriers to capital mobility.

Even with these changes, globalization might not have taken off were it not for a seismic shift in attitudes. Countries worldwide have moved to market-based economies and democratic forms of government, the decisive events being the tearing down of the Berlin Wall in 1989 and the spread of democracy during the early 1990s. This broadening of political participation is feeding centrifugal pressures within nations.

The 1990s could be called the decade of globalization. The General Agreement on Tariffs and Trade (GATT) had 102 members in 1990; its successor, the WTO, had 134 members in 1999 (Chart 1). Trade in goods and services has grown twice as fast as GDP during the 1990s (Chart 2), with the share of developing countries in total international trade climbing from 23 percent to 29 percent. All forms of capital are circulating more widely and in far larger amounts than ever before. For instance, developing countries received $155 billion (net) of foreign direct investment in 1998, 16 times the amount they received in 1990 (Chart 3). The scale of global production networks is revealed by the extent of trade that flows through them—about one-third of the total. Another, less attractive—but equally significant—consequence of globalization has been the rapid spread of pathogenic substances and pollutants that affect all people on the planet.

Localization and its causes

Globalization has forced the nation-state to focus its attention on supranational issues and increasingly circumscribed its choices. At the same time, localization is forcing states to take note of subnational dynamics and accommodate local demands. Several hundred books have been written on globalization, but localization still occasions a furrowed brow. What is this phenomenon?

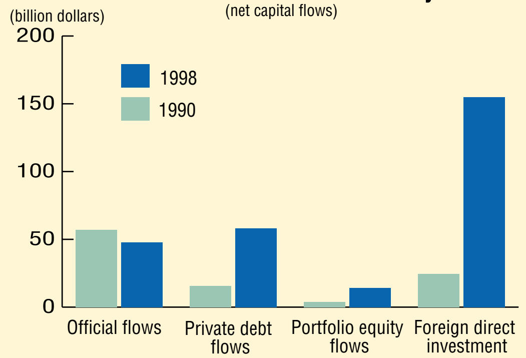
Localization is the demand for autonomy and political voice expressed by regions and communities. It has many causes. Dissatisfaction with the ability of the state to deliver on promises of development is one. The strength of local and ethnic identity—reinforced by education, better communications, and the rising concentration of people in urban areas—is another. A third cause, in a world where globalization is leveling cultural differences, is the desire to deepen a sense of belonging to a place. And a fourth is the sharpening competition between subnational units in an open environment, combined with the reluctance of richer communities to share resources with their less well off neighbors.

The pull of local identity is strikingly manifested by the doubling of the number of nation-states—from 96 in 1960 to 192 in 1998—a development that derived additional impetus from the geopolitical changes that followed the end of the Cold War. Furthermore, the demand for political voice is striking firm roots. As Nobel laureate Amartya Sen observed in 1999, "while democracy is not as yet universally practical nor indeed uniformly accepted in the general climate of world opinion, democratic governance has now achieved the status of being taken as generally right." In 1980, only 12 of the world's 48 largest countries had national elections. Today, 34 hold both national and local elections.

The political and functional decentralization of both large and small states is another manifestation. Half the countries that decentralized politically also devolved major functional responsibilities—for example, primary and secondary education in Poland, and primary health care and local road maintenance in the Philippines. Often, this devolution has raised the subnational share of public expenditures: for example, from 1987 to 1996, it increased from 11 percent to 30 percent in Mexico and from 21 percent to 50 percent in South Africa.

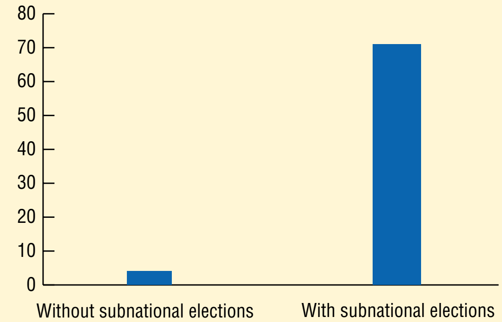
Decentralization is occurring in countries around the world (Chart 4). In the Middle East and North Africa, Jordan,

Chart 3
Private capital flows to developing countries have increased dramatically
(net capital flows)



Source: World Bank, 1999, *Global Development Finance* (Washington).
Note: Private debt flows include bank loans and bonds. Korea is included in the figures for developing countries.

Chart 4
All but a few democracies have decentralized some political power
(number of countries)



Source: Freedom House, 1998, *Freedom in the World*, reprinted in World Bank, 1999, *World Development Report 1999/2000* (Washington).

Lebanon, Morocco, and Tunisia have all elected local governments. In Eastern Europe and Central Asia, the rights and responsibilities of subnational governments are enshrined in the constitutions not only of large countries such as Russia and Ukraine but also of smaller nations, including Albania, Bosnia, Bulgaria, Croatia, Georgia, Hungary, Kazakhstan, and Tajikistan. Other small countries in the region—such as the Baltics and the Kyrgyz Republic—have taken significant steps to strengthen local government. In Africa, 25 of the 38 countries that held national elections in the 1990s also held local elections—and some of those countries, such as Cape Verde and Mauritius, are very small. In Latin America, every country will soon have elected mayors. Even outside the large federations of Argentina, Brazil, Colombia, and Mexico, local governments account for 20 percent of government expenditures in eight other countries for which data are available.

One phenomenon driving localization and contributing to the emerging sense of local identity is urbanization. As we enter the twenty-first century, half of the world's population is living in urban areas. As recently as 1975, this share was just over a third; by 2025 it will rise to almost two-thirds. The fastest change will occur in developing countries, where almost three-fourths of future generations will live in urban areas. While urbanization is beginning to slow in the higher-income countries of Eastern Europe, Latin America, and the Middle East, it is just beginning in Africa and Asia. Urban populations are expected to grow by almost 1.5 billion people over the next 20 years. The pace of urbanization and the sheer numbers involved will pose one of the major development challenges of the next century.

Globalization and localization enhance the prospects for rapid and sustainable growth in developing countries. The increased availability and more efficient allocation of resources, freer circulation of knowledge, more open and competitive milieus, and improved governance could all contribute to faster growth. But there are also risks. Globalization entails greater exposure to capital volatility—as the financial crisis that erupted in 1997 demonstrated. Decentralizing measures introduced to satisfy local demands may lead to macroeconomic instability if fiscal imprudence by subnational entities is not vigorously disciplined. Moreover, although the concentration of industry and skills in growing urban areas could raise living standards in these areas, the promise of these "agglomeration economies" could prove elusive in the absence of national policies designed to curb the spread of poverty, violence, and squalor.

Benefiting from change

Globalization and localization demand a multifaceted response. And, thanks to recent strides in development thinking, a pragmatic agenda of institution building and policies to exploit the gains and contain the risks from these forces has been defined. At many levels, institutions will be decisive in making sustainable development a reality.

Institutions—political, economic, and social—are collections of formal and informal rules that are instrumental in a variety of ways. For example, at the subnational level, electoral and other social institutions determine how people organize and make their influence felt. Rules for fiscal decentralization establish how responsibilities will be divided up between central and subnational governments. In addition, various national and local institutions set the terms for public and private partnerships.

Supranational institutions also play a vital role in numerous arenas—forging national and international commitment to agreed-upon objectives, coordinating the actions of the international community, regulating certain activities, and ensuring that countries comply with international standards and regulations. From a crowded field one can cite the WTO, the Basel Committee on Banking Supervision's banking accords, and the Montreal Protocol, an international pact to control emissions of ozone-damaging substances.

In its *World Development Report 1999/2000*, the World Bank explores the avenues for institutional change with reference to the major issues the world will confront in the early twenty-first century—such as macroeconomic instability in developing countries as they become better integrated into the world's economy; climate change; political, fiscal, and functional decentralization; and rapid urbanization. As the report indicates, the opportunities of globalization and localization will not be seized, nor the risks contained, without institutional initiatives on many fronts. A few examples discussed at greater length in the report illustrate this.

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The future course of trade liberalization will strongly influence growth in developing countries. (See "The World Trading System: The Road Ahead," by Simon Evenett, in this issue.) But to fully benefit from trade liberalization, countries will need to sustain their commitment to openness, ensure that regional trade agreements enhance longer-term welfare gains, discipline the use of nontariff impediments to trade such as antidumping measures, and expand rule-based trade regimes to cover agricultural products, certain light manufactures—textiles, for example—and services, all of which have a large and increasing significance for the economies of low- and middle-income countries.

Although international financial integration may have been slowed temporarily by the East Asia crisis of 1997–98, the process has already shown signs of reviving. But it is important that we remember the lessons learned from this crisis and all of the other crises of the past decade, which have inflicted large human and financial costs. The most important is that gaps in the institutional infrastructure make financial systems extremely fragile. These are exacerbated by shortcomings in financial regulation, in the management of short-term capital flows, and in regional and international coordination of policies aimed at reducing financial volatility. Many developing countries also lack an institutional framework conducive to foreign direct investment and therefore lose out on the many benefits such flows could provide.

The Montreal Protocol, which established rules for phasing out the production of ozone-damaging chlorofluorocarbons worldwide, is a good example of a coordinated initiative by the international community. Its success will hinge on the transfer of resources and technology from industrial to developing countries and the efficacy of monitoring techniques.

Controlling climate change and curbing the loss of biodiversity will require international institutions of equal robustness. In the case of climate change, several initiatives—the Framework Convention for Climate Change, the Joint Implementation Scheme, and the Clean Development Mechanisms—are already in place. But these are only first steps in what is sure to be a long and difficult road.

Localization—the decentralization of authority to subnational entities—has major implications for development. (See "From Centralized to Decentralized Governance," by William Dillinger and Marianne Fay, in this issue.) Whether the results are positive will depend on the sequencing of reforms and the types of rules that are adopted. In fact, making embryonic democracies work and using decentralization to improve the quality of services requires a hierarchy of institutions. For instance, electoral rules determine the nature of local representation at the national level and the distribution of power between the executive and other branches. Similarly, local election rules can be designed to increase voter participation and even out representation across social and income groups. Fiscal rules can buttress political autonomy by assigning revenue bases and responsibilities and prescribing revenue-sharing arrangements between the center and the localities.

Institutional development is also urgently needed to make cities livable as well as economically competitive. Rules governing land use, housing, and investment in urban infrastructure are critical. Although the public sector is likely to remain the most important player in urban planning and delivery of basic services, throughout the world partnerships between the public sector, NGOs, and private entities have become an important source of capital, skills, management, and initiative. Public-private partnerships rely upon a framework of formal and tacit rules that create the environment for enduring business relationships. In the United States, Florida's transformation into a dynamic state owes much to the power of partnerships (Kanter). Informal networks are responsible for the growth of industrial clusters like the shoe industry of the Sinos Valley in Brazil and the surgical instrument industry in Sialkot, Pakistan (Schmitz).

All change courts risk. The East Asian crisis was a stark reminder of the downside of globalization, while Brazil's state-induced fiscal crises demonstrate the risk of localization. But, at the same time, the forces of globalization and localization are providing much of the stimulus for development. We must therefore strive to minimize the risks and to ensure that development is stable and sustainable. As the *World Development Report 1999/2000* shows, the road leading to such a future is paved with good institutions. F&D

This article summarizes some of the key issues discussed in the World Bank's World Development Report 1999/2000: Entering the 21st Century *(New York: Oxford University Press for the World Bank).*

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