

Institutions of International Development

- Understanding Poverty
- The World Bank Group
- Other Institutions of International Development
- Development & Private Enterprise

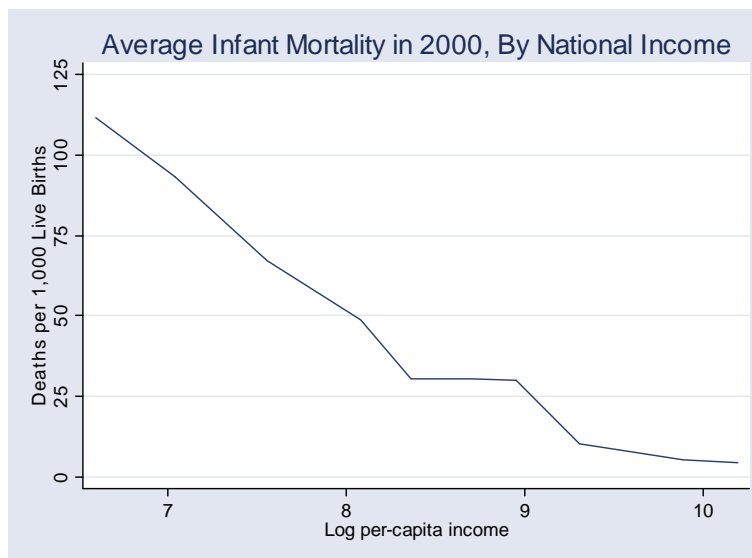
Institutions of International Development

- Understanding Poverty
 - The Nature of Poverty
 - Market Failures & Poverty Traps

The Nature of Poverty

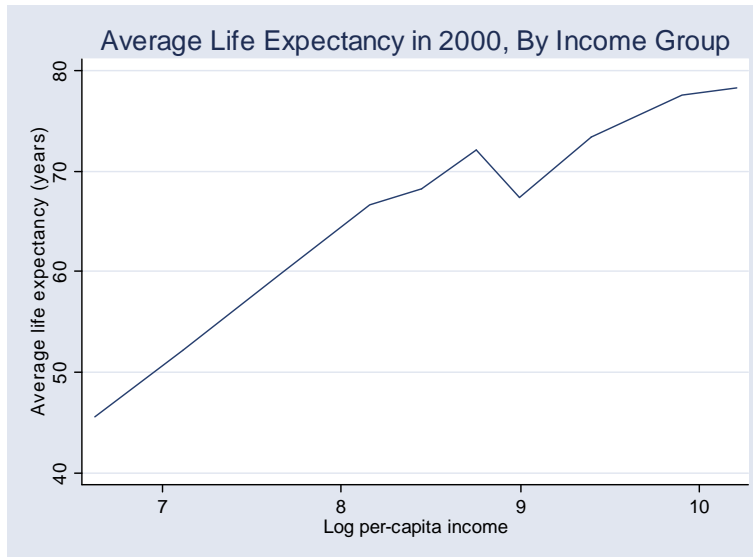
- Extreme poverty is common
 - Sala-i-Martin (2002): 1.2 billion people live on less than \$2 per day
- Low incomes highly correlated with many problems
 - Infant mortality
 - Disease
 - Famine
 - War
 - Human rights
- Direction of causation not always clear, but the “economic development” imperative is clearly associated with improving quality of life on many non-economic dimensions

Infant Mortality



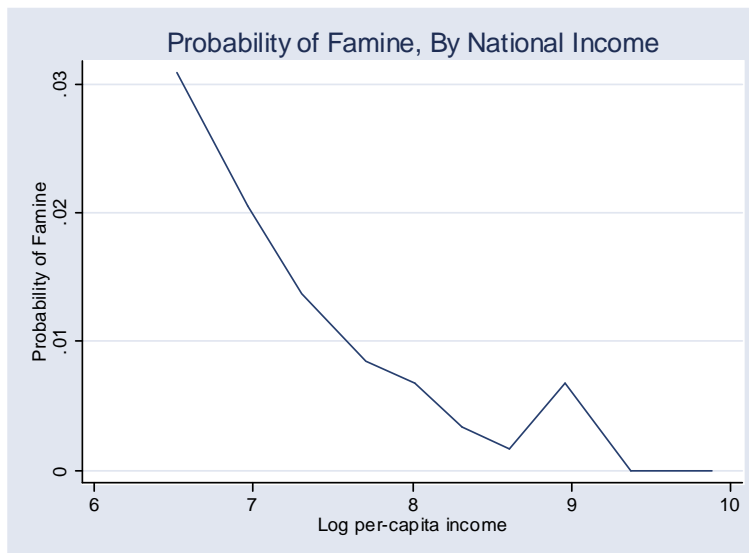
Data Source: The World Bank's *World Development Indicators*

Life Expectancy



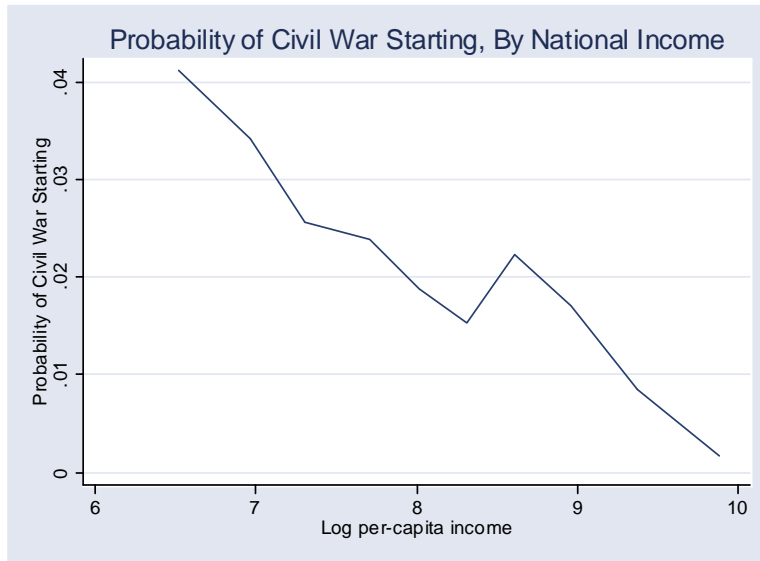
Data Source: The World Bank's *World Development Indicators*

Famine



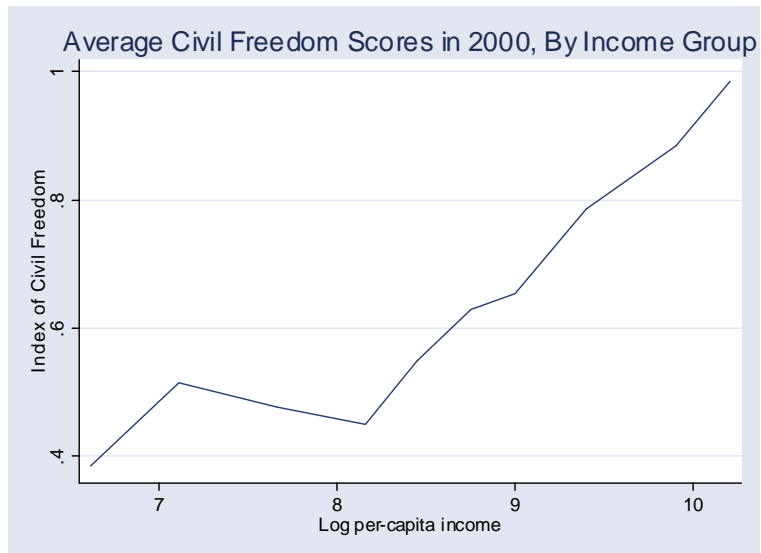
Data Source: *OFDA/CRED International Disaster Database*

Civil War



Data Source: *Correlates of War Project*, University of Michigan

Human Rights



Data Source: *Freedom House*

Market Failures & Poverty Traps

- Recall: Diminishing returns to capital suggests poor countries should catch up to rich countries (“absolute convergence”)

Average Growth Rate (per-capita, PPP)

	1950-1980	1980s	1990s
Regions			
Asia	3.4%	3.5%	3.1%
Latin America	2.3%	0.2%	1.7%
Sub-Saharan Africa	1.5%	-0.2%	-0.3%
Western Europe	3.4%	2.2%	2.0%
USA	2.3%	2.0%	2.2%

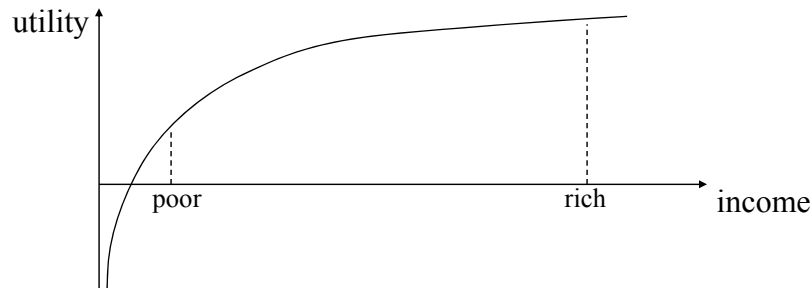
- Why do so many countries fail to catch up?

Market Failures & Poverty Traps

- We have focused on the several, central market failures (property rights, contractual failures, corruption, political stability) to explain national economic failures
- Are there other, special obstacles posed for the very poor?
 - Credit constraints
 - Health
 - Cultural norms
- Poverty trap: when a very poor person cannot overcome certain obstacles without an *outside intervention*
- Strategic implications
 - Understanding workforce in poor countries
 - Understanding goals of development agency partners

Credit Constraints I: Risk Aversion

- The poorer you are, the more risk averse you are
 - Risking \$10 if you have \$1,000,000
 - Risking \$10 if you have \$10
- Diminishing marginal utility of income



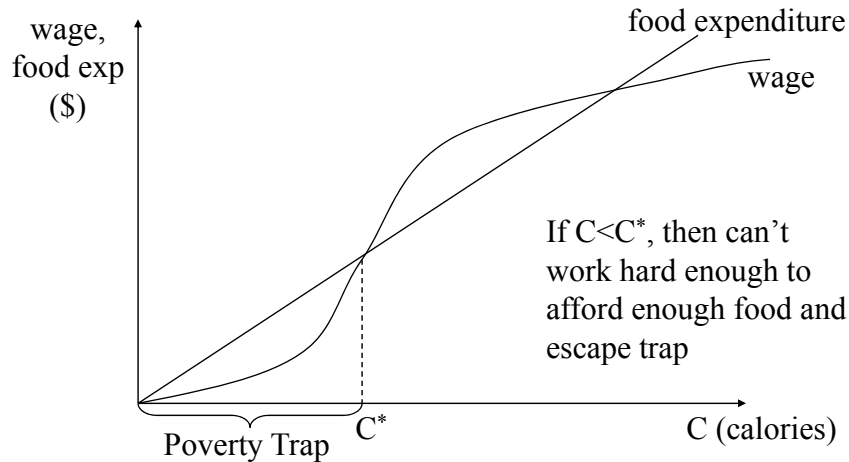
- The poor are too risk averse to undertake many investments

Credit Constraints II: Willingness to Lend

- Problem #1: Collateral
 - The poorer you are, the less you can offer as collateral
 - The less your collateral, the less willing the lender
- Problem #2: Monitoring
 - Small loans mean little income for lender, but monitoring to ensure repayment is still expensive
- Conclusion: Market failures in credit market for very poor
 - Convergence requires investment
 - But the very poor find it difficult to invest (risk, collateral, monitoring)
 - Entrepreneurship difficult
 - ⇒ Need special interventions (e.g. Microcredit initiatives)

A Nutritional Poverty Trap?

- Need food to be productive at work
- Need to be productive at work to afford food



Health and Poverty Traps

- Econometric studies provide little formal evidence for such nutritional poverty traps (Deaton & Subramanian 1996)
- But strong evidence that
 - Worker productivity \uparrow with nutrition (Strauss 1986)
 - Nutrition \uparrow with income (Deaton & Subramanian 1996)
 - Childhood health has permanent effects (Strauss et al 1998) \Rightarrow Employers who improve health of employees may see win-win outcomes (“efficiency wages” & health clinics)
- Health & credit constraints
 - Cannot borrow (or insure) to offset bad health event
 - Temporary problem may have permanent consequences
 - Sell physical capital, land, shift children from school
 - e.g. *A Quiet Violence* (Hartman & Boyce 1983)

Human Capital & Poverty Traps

- Empirical observation: College+ educated workers in rich countries are, collectively, vastly more productive than college+ workers in poor countries (Caselli & Coleman 2006, Jones 2010)
- Workers don't choose deep, specialized skills
 - *Missing complementary specialists*; e.g. no point becoming expert heart surgeon if no access to expert anesthesiologists
 - *Missing expert instruction*; e.g. hard to become expert heart surgeon without access to existing, expert heart surgeons

Trap: if start with no skilled expertise, hard to acquire

- Multinational role/advantage:
 - (i) Create demand for deep, specialized skills
 - (ii) Pay less for these workers
- } Recall Hyderabad example

Cultural Norms & Poverty Traps

- Basic Rights
 - Opportunities severely limited for some groups
 - e.g. women, race/ethnic/religious groups
 - Don't invest if likely to be excluded, expropriated, or worse
- Collective reputations
 - Your reputation weighed against group reputation
 - Can't escape group reputation => don't bother to try
 - e.g. corruption; persistent stereotypes
- Group learning
 - Learn best practices through observation
 - Tradition "works", new ideas are risky
 - Social norms persist
 - e.g. traditional medicine; crop choices

Missing Women

- The ratio of men to women appears to be too high in much of the developing world (Sen 1992)
 - Sen compares sex ratio at birth with sex ratio in population
 - Estimates 100 million “missing women” worldwide
 - Greater than death toll of WWI and WWII combined
- Methodological debates and improvements
 - More boys are born than girls, but women tend to live longer, so age structure of population must be considered
 - More sophisticated studies tend to find numbers in line with Sen’s estimates (Klausen et al 2002, Gupta 2005)
- Cultural norms that favor investment in boys over girls may lead to neglect (or worse) with extreme consequences

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The World Bank Group

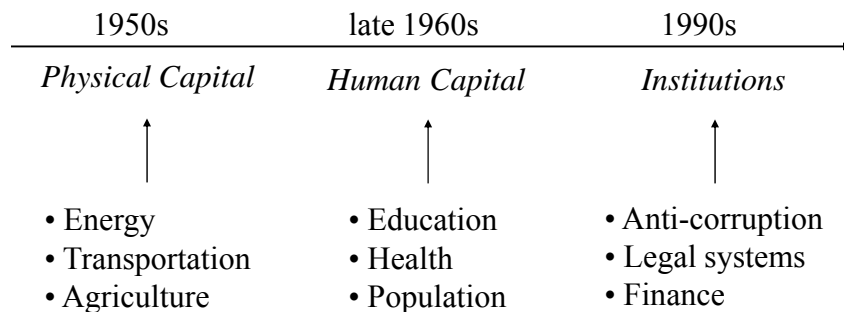
- The last leg of the “three-legged stool” envisioned in Bretton Woods in 1944
 - World Bank (IBRD)
 - IMF
 - ITO

- The World Bank’s central mission: *to alleviate poverty*

- Four main institutions within World Bank Group
 - { International Bank for Reconstruction and Development (IBRD)
 - { International Development Association (IDA)
 - { International Finance Corporation (IFC)
 - { Multilateral Investment Guarantee Agency (MIGA)

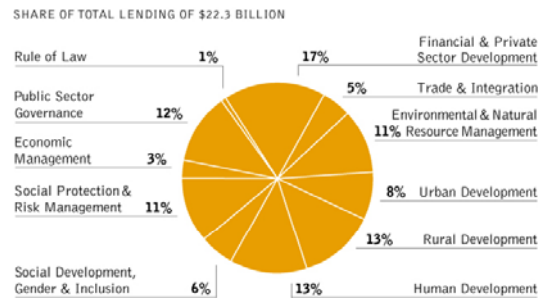
The World Bank Group: Evolution of Goals

- Type of investments
 - Expands over time to encompass wide array of problems



The “World Bank”: the IBRD & IDA

- IBRD & IDA provide finance for *government projects*
 - IBRD: low to middle income countries (cheap loans)
 - IDA: very poorest countries (very cheap loans)



- Strategically (no direct financing for businesses, but...)
 - Big source of *contracts* for private firms
 - Big potential source of *leverage* for private firms

The IFC

- The IFC provides finance for *private enterprises*
- Goal
 - Support business projects with high social rates of return that would not be funded from private sources
- Specific roles
 - Provide direct financing: debt or equity
 - Limit non-market risk through reputation & leverage
 - Encourage participation of other investors
 - Provides advisory services
- Approves ~ \$5 billion for ~ 250 new projects every year (~ \$20 million per project on average)

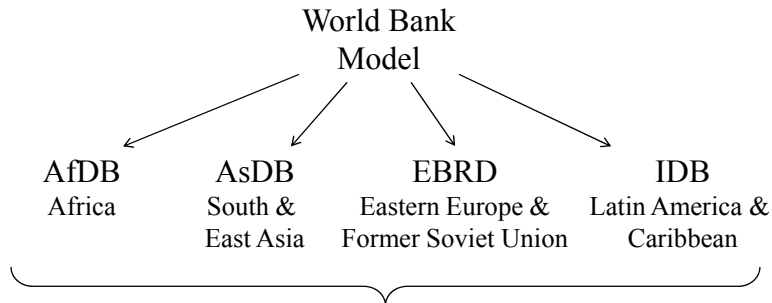
MIGA: Insuring Non-Market Risk

- MIGA provides insurance to private projects
- MIGA insures against
 - currency transfer restrictions
 - expropriation
 - war and civil unrest
 - breach of contract
- Insures ~ 30 new projects per year, covering ~ \$1 billion
(~ \$35 million coverage on average)
- Example: Coca-Cola buys bottling facility in Bosnia in 2000.
MIGA provides \$23 million guarantee against expropriation,
disruption due to war, etc

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Other Multilateral Development Agencies



These banks have sub-agencies that perform roles similar to the IBRD, IDA, IFC, and MIGA

- Also, United Nations agencies can provide contracts to firms
 - UNDP, UNICEF, UNAIDS, WFP, et cetera

Bilateral Development Agencies

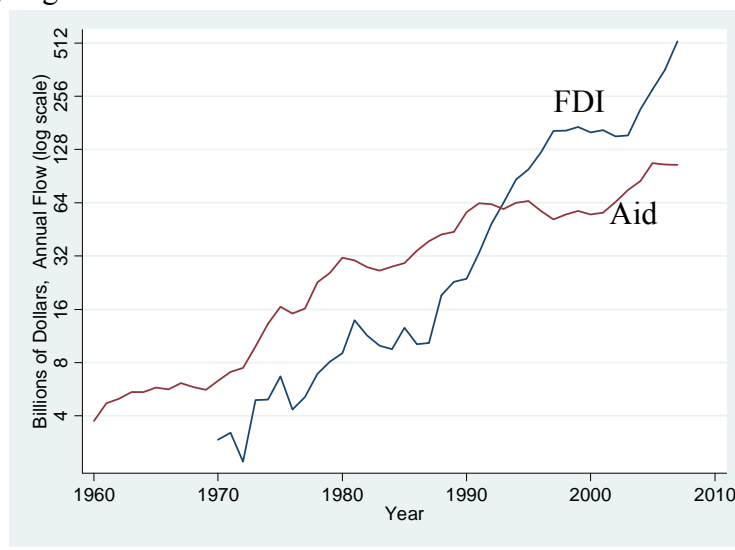
- Individual governments have additional agencies. Three types.
 1. Development aid agencies (~ IBRD/IDA like)
 - Focus on poverty reduction, with added direction of donor country's foreign policy
 - e.g. USAID from United States
 2. "Export Credit Agencies" (~ MIGA/IFC like)
 - Offer *insurance* and *financing* to help exporters from country
 - e.g. The Export-Import Bank of the United States
 3. Overseas investment agencies (~ MIGA/IFC like)
 - Offer *insurance* and *financing* for overseas investments
 - e.g. Overseas Private Investment Corporation (OPIC) in U.S.

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The Role of Private Enterprise

- Since 1993, private investment (FDI) has outpaced aid dollars going to low and middle income countries



Firms as Development Institutions

- Private enterprise is essential to development
 - Much more FDI than aid today
 - Brings capital, technology, market channels
 - Raises workers incomes, which may bring many additional benefits for health, individual rights, peace, etc
- The profit motive
 - Efficient employment of resources when firms compete and market institutions are functioning
 - The profit motive will drive convergence
- Social ethics
 - Must avoid reinforcing bad norms/equilibria
 - Possible to have extremely positive non-market impacts

Strategy: Private Enterprise & International Development Agencies

- Contracts to win
 - Enormous contracts are written with relatively safe sponsors = big opportunities for firms
 - IBRD/IDA, USAID activities
- Financing & insurance to attain
 - Risky projects can be financed more cheaply and perhaps only with IFC, MIGA, OPIC, Ex-Im type support
 - Formal and informal insurance against non-market risks
- Expertise to tap
 - World Bank Group agencies and similar organizations provide unusual local expertise in risky environments