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REVITALISING THE POLICY FOR GLOBAL DEVELOPMENT

Per Molander

Revitalising the Policy for Global Development

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Preface

Sweden has a long history of international development cooperation and an ambitious agenda for its promotion of development at global level. The target of using one per cent of GNI for international development assistance each year is an example of the high level of ambition. Another example is the adoption of the 2003 *Policy for Global Development*, focusing on policy coherence and the impact of domestic policies on the developing world. In the OECD DAC peer review of Sweden (2013), it was recognised that “Sweden has put development at the heart of its foreign policy agenda, showing a strong willingness to take the lead in addressing global challenges”. More recently, the Swedish Government reiterated its ambitions by committing to lead by example in the implementation of the 2030 Agenda.

Over the years, there have been shifts in the relative focus of different thematic priorities, but the overall tendency has been to engage in an increasing number of thematic issues rather than to set priorities. In the OECD DAC review referred to above, Sweden was encouraged to concentrate its efforts, to aim for maximum impact instead of spreading “thinly across a wide range of countries, themes and programmes”. In sum, we find ourselves in a situation where we have a broad global development agenda as a framework for Swedish policies, at the same time as there is a recognised need for increased concentration.

In this EBA report, Per Molander asks what policies for global development and international development cooperation a small country like Sweden should focus on. The report and its policy conclusions are based on a systematic assessment of a broad range of social science literature. In brief, the report provides an overview and an analysis, based on what we know about important drivers of development. Hence, the report should be of great interest to readers who want an overview of what academic literature says about development, as well as for policy-makers and people engaged in policy implementation.

In the report, Molander singles out three central aspects for development: growth, state-building and inclusive social development. Based on academic literature, he argues for a revitalisation of the Policy for Global Development and a change in the overall allocation of the aid budget. According to Molander, more could be done within

the Policy for Global Development. Specifically, he emphasises the importance of adapting international trade agreements and policies to the needs of developing countries, and also strengthening international efforts to counter tax evasion. When it comes to spending on development cooperation, Molander argues that there should be increased focus on public administration and education, given their relative importance to societal development.

We hope that this report will provide interesting reading for a broad range of people interested in development issues, and that it will also stimulate a discussion on priorities in Swedish development policies and development cooperation. The work on the report was conducted in dialogue with a reference group that I had the pleasure of chairing. The analysis and the conclusions expressed in this report are solely those of the author.

A handwritten signature in blue ink, reading "Uwe Leiker". The signature is fluid and cursive, with the first name "Uwe" and last name "Leiker" clearly distinguishable.

Stockholm, December 2016

Sammanfattning

Föreliggande rapport diskuterar med utgångspunkt i aktuell samhällsvetenskaplig forskning politiken för global utveckling och utvecklingssamarbetet från en liten, neutral stats perspektiv. Anslaget är tämligen brett. Vissa inslag i handels- och skattepolitiken finns med, eftersom de är viktiga för den internationella utvecklingen och samtidigt kan ändras inom gruppen av utvecklade industriländer. Å andra sidan behandlas inte viktiga inslag i biståndspolitiken som enprocentsmålet, valet av partnerländer, budgetstöd, stöd via ideella organisationer och militära interventioner i konfliktzoner.

Ett osäkert kunskapsunderlag

Samhällsvetenskapernas utveckling och deras bidrag till förståelsen av sociala processer är viktig för policydiskussionen. Nya data, nya analysmetoder och datakraft har märkbart förbättrat kunskapsläget. Det vore fel att hävda att samhällsvetenskaperna har sett genombrott av det slag som har påverkat fysiken eller biologin; det rör sig snarare om en stadig kunskapstillväxt, både på mikronivå och på samhällsnivå. Utvecklingen av striktare metoder för att belägga orsakssamband har också ökat möjligheterna att utvärdera den förda politiken med faktiska eller naturliga experiment.

Analysen av sociala processer i utvecklingsländer försvåras av den låga datakvaliteten. Infrastrukturen för att få fram data om demografi, hälsa, utbildning och arbetsmarknad är allmänt svag. Felaktigheterna i statistiken är inte heller slumpmässiga utan systematiska. Fattigdom underrapporteras, därför att fattiga hushåll tenderar att falla utanför de undersökningar som görs. Siffror om läs- och skrivkunighet och andra grundläggande färdigheter är överdrivna, som framgår av kontroller utförda i fält. Medarbetare i hälso- och sjukvården eller utbildningssystemet är ofta inte närvarande på sina arbetsplatser, och de sysslar inte alltid med sina faktiska uppgifter när de är på plats.

Betydelsen av tillväxt

Det råder bred om än inte total konsensus om betydelsen av materiell tillväxt för utveckling. Den ekonomiska vetenskapen har spelat en central roll i diskussionen om tillväxtens förutsättningar, och

argument och politisk inriktning har förändrats allteftersom det ekonomiska tänkandet har utvecklats. Under de första decennierna efter det andra världskriget riktades intresset mot sparande och kapital, men de enkla teorierna bakom detta synsätt fick inget empiriskt stöd. Senare lade man till teknologi och humankapital, men fortfarande lyckades man inte reproducera den faktiska utvecklingen. Åren runt 1990 vändes intresset mot historien, naturliga förutsättningar och institutioner som bestämningsfaktorer, och åtskilliga debatter har förts om den relativa betydelsen hos dessa och andra faktorer.

Policybildningen inom viktiga institutioner som Internationella valutafonden (IMF) och Världsbanken kom under 1980-talet att domineras av vad som har kallats *The Washington Consensus*, ett paket baserat på frihandel, en liten stat, makroekonomisk stabilisering och privatiseringar. Erfarenheterna från dessa åtgärds paket visade sig negativa i många av de länder där de prövades.

Ett starkt argument mot Washington-paketet är att några av de mest framgångsrika länderna i Asien valde en helt annan politik för att ta steget från låg- till medelinkomstland. Starka stater, skydd för inhemska industrier under uppbyggnad och en aktiv forsknings- och utvecklingspolitik har också varit regel snarare än undantag i den tidigare historien för de länder som nu hör till höginkomst kategorin.

Sammanfattningsvis kan man dra slutsatsen att alla faktorer som nämnts ovan – välfungerande marknader för varor, tjänster och kapital, en rimlig sparkvot, effektiv infrastruktur, utbildad arbetskraft, makroekonomisk stabilitet, offentliga finanser i balans och gynnsamma historiska och naturliga förutsättningar – tycks ha betydelse för den ekonomiska tillväxten, mer eller mindre beroende på situationen. Det finns inga mirakelkurer i politiken dock; sammansättningen och ordningsföljden av åtgärderna måste bero på lokala förutsättningar och de politiska möjligheterna att reformera.

Det har gjorts ett antal försök att utvärdera effekterna av bistånd på tillväxten. Det finns tendens under senare år att se mer positivt på möjligheterna. Bistånd förefaller ha en viss positiv, om än svag, effekt på den ekonomiska tillväxttakten.

Institutionernas betydelse

Efter några decenniers intensiv forskning om institutionernas betydelse för politikens förande och för den faktiska utvecklingen har växande ansträngningar gjorts för att stärka institutionerna i låg- och medelinkomstländerna. Spektret av institutionella reformer är brett och sträcker sig från konstitutionella ingrepp och budgetprocedurer till antikorrupsionsåtgärder på mikronivå i förvaltningen. Att en åtgärd har varit framgångsrik i en grupp länder är emellertid ingen garanti för att den fungerar i andra länder. Institutioner verkar inte i ett politiskt eller historiskt vakuum, och erfarenheterna från reformförsök innehåller åtskilliga negativa överraskningar. Vad som förefaller fungera bäst inom förvaltningsbiståndet är förhållandevis tekniska komponenter i den politiska och administrativa infrastrukturen – folkbokföring, offentlig redovisning, skatteförvaltningslösningar och så vidare.

Det råder bred enighet om att utvecklingsländerna är underbeskattade, och det finns goda skäl att utveckla skattepolitiken och skatteförvaltningen för att stärka budgetens inkomstsida.

I nästan alla studier av institutionernas effekter på den samhällsliga utvecklingen framstår utbildningssystemet som en nyckelfunktion. Utbildning är viktig för individens utveckling, inte minst vad gäller den kvinnliga halvan av befolkningen. Utbildning höjer arbetskraften produktivitet och bidrar till den ekonomiska tillväxttakten. Den ökar också den politiska mobiliseringen och stärker civilsamhället. En hög allmän utbildningsnivå i ett samhälle minskar risken för korruption.

Inkluderande social utveckling

Det räcker inte att fokusera på institutioner och andra faktorer som skapar förutsättningar för en gynnsam social och ekonomisk utveckling; man måste också rikta uppmärksamhet mot politikens innehåll och den ekonomiska tillväxtens struktur. Det demokratiska systemets djup och jämlikhetsaspekters genomslag i den förda politiken är centrala för den väg som ett lands utveckling tar. Jordreformer i agrara ekonomier, lika tillträde till utbildning och andra offentliga tjänster, en rimligt jämn inkomstfördelning och jämställdhet mellan könen är inte bara en fråga om politiska preferenser utan har djupgående effekter på samhälle och ekonomi. En positiv utveckling i

dess dimensioner och ekonomisk tillväxt tenderar att stödja varandra ömsesidigt.

En komplicerande faktor är att utvecklingssamarbete med denna inriktning kan möta motstånd i samarbetsländerna. Grundläggande idéer om demokrati, jämlikhet och jämställdhet kan uppfattas som självklara i många industrialiserade länder men är föremål för politiska strider i andra delar av världen (inklusive delar av den industrialiserade världen). Länder som nu är utvecklade och tillhör höginkomstskiktet behöver inte gå långt tillbaka i historien för att finna starkt motstånd mot värden som nu är allmänt omfattade, så en ödmjuk attityd på det här området är väl motiverad.

Biståndets roll

Utvecklingssamarbetet har kritiserats alltsedan det började växa fram. Bistånd hävdas hindra utvecklingen av sunda institutionella och ekonomiska villkor, pervertera politiska och ekonomiska beslutsfattareshandlingar och öka korruptionen. Som konstaterades ovan finns det dock en viss effekt på tillväxten, om än svag. På program- eller projektnivå kan man räkna en lång rad framgångar, samtidigt som bakslag och misslyckanden också går att finna. En förklaring till de begränsade framgångarna är att biståndet har använts för många andra syften än utveckling – politiska eller militärstrategiska, handelsrelaterade eller humanitära.

Mot bakgrund av att utvecklingssamarbetet håller på att förlora i relativ betydelse bör en inriktning ske mot verksamheter och samhällsfunktioner som inte väl eller inte alls tas om hand av marknader, eller där offentliga ingrepp krävs för att stävja negativa externa effekter eller illegala aktiviteter inom den privata sfären.

Policyplattformar

Sveriges riksdag beslutade år 2003 om en Politik för Global Utveckling (PGU), som fortfarande är det grundläggande dokumentet på området. Denna politik bygger på en generell ansats, vilket innebär att ett antal politikområden är tänkta att bidra till det övergripande målet om en hållbar och rättvis global utveckling. Denna politik har inte förverkligats. Politiken inom områden som handel och skatter beslutas utan någon hänvisning till utvecklingsperspektivet.

De globala målen för hållbar utveckling (SDG) som beslutades av FN:s generalförsamling hösten 2015 har satt i gång diskussionen på nytt. I föreliggande rapport hävdas att det finns relativt få genuina nyheter i detta dokument och att den ökade detaljeringen riskerar att leda till fragmentering av den förda politiken.

PGU:n behöver förnyas; det finns tecken som tyder på att den har förlorat i styrka. Det finns en risk att PGU:n överges och att betydande administrativa resurser och intellektuell energi läggs på att omformulera politiken till att passa SDG-ramen. Denna frestelse bör motstås. Skälen för PGU är lika starka i dag som när denna politik ursprungligen antogs, och om något bör detta initiativ förstärkas.

För att ett politikområdesövergripande initiativ ska bli framgångsrikt måste politiken koordineras i Statsrådsberedningen. En förklaring till det relativt magra utfallet är att ansvars- och finansieringsfrågor inte klarades ut vid lanseringen 2003.

Policy slutsatser: Politiken för Global Utveckling

Två områden utanför biståndspolitikerna framstår som särskilt relevanta för en koherent politik för global utveckling: *handel* och *skatter*. På global nivå hanteras *handelspolitiken* inom världshandelsorganisationen WTO, men hur detta regelverk används i praktiken av viktiga aktörer som EU är minst lika viktigt som det multilaterala regelverket i sig. Ursprungsregler och fytosanitära regler formuleras inte alltid med utvecklingsländernas intressen i åtanke.

En viktig fråga är om de existerande undantagen för utvecklingsländerna i WTO-stadgan är tillräckliga i ett utvecklingsperspektiv. Med tanke på att nu utvecklade länder i ett tidigare skede använde metoder som i dag är svåra eller omöjliga att tillämpa verkar det rimligt att tillåta utvecklingsländerna större handelsfrihet än vad som för närvarande är möjligt. När Sverige är engagerat i förvaltningsutveckling i dessa länder, är det viktigt att frågorna ses ur deras perspektiv, som kan skilja sig från vårt eget.

På *skatteområdet* gäller att utvecklingen av finansiella flöden tenderar att underminera skattebaser som är viktiga för alla länder men särskilt viktiga för utvecklingsländerna. Här har regeringarna i de flesta länder (men inte alla) ett gemensamt intresse av att utveckla system för informationsutbyte mellan nationella skattemyndigheter

och att driva in beslutade skatter. Vissa steg har tagits har tagits inom OECD:s samarbetsnätverk (Base Erosion and Profit Shifting, BEPS) men i avsaknad av ytterligare initiativ kommer skatteflykten att förbli stort och växande problem.

Två problem måste lösas. Globala tillgångs- och ägarregister krävs för person- respektive företagsbeskattning. Byggstenar till sådana register finns redan i form av privat förvaldade register (tillgångar) eller är under utveckling (ägare). En operativ definition av skattebaser måste dessutom beslutas gemensamt på internationell nivå. Standarder som bygger på en kombination av kapital, arbete och försäljning tillämpas redan i USA eller har föreslagits (inom EU). Dessa lösningar behöver koordineras och utsträckas till övriga världen.

Policyslutsatser: utvecklingssamarbetet

Offentlig förvaltning är ett nyckelområde i statsbyggandet och bör vara prioriterat i biståndsbudgeten: statistisk infrastruktur (folkbokföring), fastighetsregister, offentligfinansiell styrning, socialförsäkringar, revision och – i synnerhet – skatteadministration. Mot denna bakgrund ter sig senare års reduktion av budgeten för förvaltningsbistånd svår att försvara. Denna form av bistånd är föga kostnadskrävande i relation till de mycket stora vinster som kan göras i form av bättre styrning, stärkta offentliga finanser och ökat förtroende för offentliga institutioner och det politiska systemet. Det är också ett område där det finns anledning för små länder som Sverige utan någon nämnvärd kolonial historia att vara närvarande och försvara en egen förvaltningstradition.

Politiken på det här området kan uppgraderas i ett antal avseenden. Man kan skapa en formell organisation ledd av Sida som integrerar expertis från olika delar av förvaltningen i syfte att utnyttja synergieffekter och öka effektiviteten, och man kan öronmärka en del av budgeten för att finansiera samarbetsprojekt med svenska myndigheter. Planering bör göras för insatser också på kort sikt för att utnyttja tillfälliga möjligheter som öppnas, samtidigt som det naturligtvis måste vara klart att detta rör sig om långsiktiga åtaganden. Budgeten bör expandera och inte krympa.

Utbildningens fundamentala betydelse återspeglas inte i den svenska biståndsbudgeten. Utbildning fick 3,5 procent av den bilaterala budgeten år 2015, vilket var en nedgång från 5,1 procent året

före. Med tanke på det starka forskningsstödet för att utbildning är den kanske viktigaste hävstången för utveckling skulle det vara naturligt att använda en större del av budgeten för utbildningsändamål. Kontroller som har gjorts i fält har visat på stora brister i de existerande skolsystemen, vilket innebär att de publicerade siffrorna om läs- och skrivkunnighet är starkt överdrivna. Det finns följaktligen ett stort utrymme för att stärka befintliga skolsystem utan att man behöver bygga upp nya strukturer.

Internationella kollektiva nyttigheter bör vara prioriterade på utvecklingsagendan. Ofta används denna term på miljöområdet för nyttigheter (biologisk mångfald) eller problem (klimatförändringar), men det finns andra kollektiva nyttigheter som är värda uppmärksamhet. Jordbruk och hälso- och sjukvård är områden där bidrag till forskning och utveckling kan försvaras.

Kunskap om effekterna av bistånd är en annan global kollektiv nyttighet. Det finns utrymme för att höja standarden på *utvärderingar* med sikte på striktare kausala analyser. En vanlig iakttagelse är att utvärderare kommer in för sent i projektens livscykel. Kvaliteten på en utvärdering kan ofta höjas genom smärre justeringar i projektplaneringen. Det finns å andra sidan anledning att varna för en övertro på utvärdering som ett sätt att höja effekten på biståndet.

Tekniken för att *hantera intressebaserade sättnings* mellan givare och mottagare behöver utvecklas. När parterna har olika prioriteringar, finns olika möjligheter beroende på hur stora skillnaderna är. I vissa situationer kan indirekta åtgärder vara effektiva utan att uppfattas som provocativa av samarbetspartnern. Ibland kan problemen lösas genom dialog. I andra ändan av spektret kan ett land helt motsätta sig vissa projekt. I sådana fall kan det enda alternativet vara att verka genom andra kanaler än de officiella, och även det är i vissa fall svårt. I mellanlägen – ointresse snarare än direkt motsättning – kan *cash-on-delivery* vara en metod att pröva. Resurser överförs då när vissa överenskomna mål har nåtts och verifierats av externa observatörer. Detta är inget universalmedel men kan vara användbart i situationer där prestationerna är någorlunda lätta att mäta, såsom i vaccinationsprogram, läskunnighetsinsatser och liknande.

Starka centrifugalkrafter leder till splittring av projektportföljerna både geografiskt och sektoriellt. Efter det att Parisagendan hade antagits gjordes en medveten ansträngning för att koncentrera insatserna, men på senare år har spridningstendenserna tilltagit igen.

De prioriteringar som föreslås i denna rapport kan vara en utgångspunkt för diskussioner om en koncentration av insatserna.

Summary

The present report discusses, on the basis of recent social-science literature, policies for global development and development cooperation from the perspective of a small, non-aligned country. The scope of the analysis is relatively wide. Certain elements of trade and tax policies are included, being arguably relevant to international development, while at the same time possible to change within the group of industrialised countries. Conversely, other important elements of development cooperation such as the one-per-cent target, the number and choice of partner countries, budget support, and cooperation via nongovernmental organisations are excluded, as is military intervention in conflict-ridden societies.

An uncertain knowledgebase

The development of the social sciences and their contribution to our understanding of social processes is important to our discussion. New data, new methods of analysis and the power of computers have contributed to our knowledge base in a way that should affect policy discussion. It would be wrong to claim that the social sciences have seen breakthroughs in the way that physics or biology have; the process is more of a steady accumulation of knowledge, both at the micro-level of social phenomena and at the aggregate level of policies. The development of stricter methods for establishing causal relationships in social systems has also benefited the evaluation of policies using experiments or quasi-experiments.

The analysis of social processes in developing countries involves difficulties with data quality. The infrastructure for providing basic data on, for instance, demography, health, education and labour markets, is generally weak. Further, misreporting is not neutral but biased. Poverty is under-reported because poor households or individuals tend to be omitted as a result of the sampling procedures used. Figures on literacy and other basic abilities are exaggerated, as shown by field studies of actual capabilities. Producers of services in health and education are often not present at their workplaces and when they are, they are often engaged in activities other than their defined tasks.

The importance of growth

There is wide, albeit not total, consensus on the necessity of material growth for societal development. Economics has played a central role in the discussion about determinants of growth, and arguments and policies have changed as economic thinking has developed over the decades. During the first post-WWII decades, interest was focused on savings and capital, but the simple theories behind these policies were not supported by actual growth rates across the world. Later, technology and human capital was added, but even so economic theories failed to reproduce the facts observed. Around 1990, interest turned towards history, natural conditions and institutions as the determinants of economic growth. There have been heated arguments over the relative importance of these and other factors.

Policy discussions and policy-making in important institutions such as the International Monetary Fund and the World Bank were dominated from the 1980s by what has been termed ‘the Washington Consensus’, based on a package of measures such as free trade, small states, macroeconomic stabilisation, and privatisation. As experience was gathered, it was concluded that the consequences of this policy package were negative in many countries.

A strong argument against the Washington package is that some of the most successful countries in Asia chose to follow very different policies when making the transition from low- to middle-income status. Strong states, protection of infant industries and active research and development policies have been the rule rather than the exception also in the earlier history of countries that are now in the high-income category.

In summary, it can be concluded that all the factors mentioned above – well-functioning markets for goods, services and capital, a reasonable savings ratio, efficient infrastructure, an educated labour force, macroeconomic stability, public finances in good shape, efficient public institutions, and historic and natural conditions – do seem to affect economic growth, to an extent depending on the situation. There is no panacea in the field of policies, however; the mix and sequencing of policy measures must depend on local conditions and windows of opportunity for reform.

There have been a number of evaluations of the effects of ODA on growth rates. There is a tendency towards somewhat more positive

conclusions in recent years. Aid does seem to have a generally positive, but rather weak, net effect on growth.

Institutions matter

Following intensive research over the last two or three decades on the effects that institutions have on policies and outcomes, an increasing amount of capacity-building has been devoted to improving the institutional framework of low- and middle-income countries. The spectrum of institutional reforms under discussion is broad, ranging from constitutional matters to budgeting procedures and anti-corruption measures at the micro-level of administration.

The fact that a particular solution has proved to be successful in one group of countries is no guarantee, however, that it will be conducive to good policy-making in other countries. Institutions do not function in a political or historical vacuum, and experience is full of negative surprises. What seems to work best in transfer operations are the fairly technical components of the political infrastructure – civil and vital registration systems, a system for public accounting, tax administration solutions, and so on.

There is general consensus that low-income countries are under-taxed, and that there are strong arguments for developing both tax policies and administrative solutions in order to strengthen the revenue side of the budget.

In virtually all studies of the effect of institutions on societal development, the educational system emerges as a key factor. Education is important for the development of the individual, in the female as well as the male half of the population. It increases the productivity of individuals in the labour market and contributes to economic growth. It also increases engagement in political activities and civil society. A high general level of education reduces corruption and increases the level of trust.

Towards inclusive development

Beyond good institutions and other factors that tend to benefit societal and economic development, it is necessary to take into account the substance of policy-making and the structure of economic

growth. The depth of the democratic system and the extent to which egalitarian aspects characterise public policies are fundamental to the path of development that a country will follow. Land reforms in agriculturally dominated economies, equal access to education and other public services, a reasonably even distribution of incomes and equal treatment of men and women are not simply matters of political taste but have profound effects on the workings of an economy and society at large. Positive trends in these respects, and economic growth, tend to be mutually supportive.

A complicating factor is that the development cooperation that falls under this category may be strongly contested in recipient countries. Basic values of democracy and equality in general, or between the sexes, may be more or less taken for granted in many industrialised countries, but are the subjects of political struggle in other parts of the world (including parts of the industrialised world). Countries that are now developed and belong to the global high-income stratum do not need to go back far in history to find strong opposition to values that are now generally accepted, so a humble attitude in this respect is justified.

The role of development cooperation

Development cooperation in various forms has been criticised from its inception. ODA is claimed to hinder the development of sound general institutional or economic conditions, to pervert the incentives of policy-makers in government and the private sector, and to increase corruption. As noted above, evaluations at the aggregate level indicate that there is a positive effect from aid on growth, albeit weak. At the level of programmes or projects, a very long list of successes can be drawn up, just as failures can be listed with equal precision. One explanation for the sometimes poor record of aid is that it has been used for many purposes other than development in the narrow sense – politically or militarily strategic, trade-related, or humanitarian.

Against the backdrop of the decreasing relative importance of ODA, the main focus of assistance henceforth should be on activities and functions that are not well, or not at all, taken care of by markets, or where government intervention is necessary to curb negative side-effects or illegal practices on the part of the private sector.

Policy platforms

Swedish parliament decided on a Policy for Global Development (PGD) in 2003, which is still the basic policy document in this field. This policy is based on a whole-government approach, implying that a number of relevant policy areas were intended to contribute to the overall goal of sustainable and equitable global development. This policy has not materialised. Policies in important areas such as trade and taxation are decided with little or no reference to development perspectives.

The Sustainable Development Goals that were decided by the United Nations General Assembly in the autumn of 2015 provides new input for policy discussion. It is argued in the present report that there are relatively few genuine novelties in this document and that the increased level of detail may actually contribute to the fragmentation of current policies.

The Policy for Global Development (PGD) needs to be revitalised; there are signs that it has lost some of its momentum. There is a risk that the PGD will be abandoned and that large amounts of administrative resources and intellectual energy will be used to adapt the policy to the SDG framework. This temptation should be resisted. The reasons for maintaining a PGD perspective are as strong today as they were when this policy was originally adopted, and, if anything, this initiative should be reinforced.

For a cross-ministerial initiative of this kind to be successful, it is necessary to coordinate policy-making in the Prime Minister's office. One reason for its relatively poor outcome is that issues of responsibility and financing were not clearly sorted out when this policy was launched in 2003.

Policy conclusions: the Policy for Global Development

Two areas outside development cooperation emerge as particularly relevant to the development of a coherent policy for global development: *trade policy* and *taxation*. On a global level, trade policy is managed within the World Trade Organization (WTO), but how this framework is used in practice by important agents such as the European Union may be equally or more important than the

multilateral framework. Rules of origin, or phytosanitary rules, are not always formulated with the interests of low-income countries in mind.

An important question is whether the existing concessions to developing countries in WTO framework are sufficient from the development perspective. Given that currently developed countries relied on policy instruments earlier in history that are now difficult or impossible to use, it seems reasonable to accord developing countries more freedom of action than is currently the case. When Sweden is involved in trade-policy capacity-building in developing countries, it is essential that policy issues are viewed from the perspective of these countries, which may differ from that of a high-income country.

As for *taxation*, current trends in financial flows tend to undermine tax bases that are important to all countries but particularly so for low-income countries. Here, the governments of most (although not all) countries have a common interest in developing systems for the exchange of information between national revenue authorities, and in enforcing taxation. Some steps have been taken within the OECD cooperative network (the Base Erosion and Profit Shifting Project, BEPS), but in the absence of further measures, tax evasion will remain an increasing problem.

Two problems must be solved in this context. Global registers of assets and beneficial owners are necessary for the taxation of physical persons and corporate taxation, respectively. The building-blocks for such registers already exist in the form of privately managed registers (assets), or are being developed (beneficial owners). Agreeing on a working definition of the tax bases is a second problem that needs to be tackled. Standards relying on a combination of capital, labour and sales are already in use (in the United States) or have been proposed (in the European Union). These solutions have to be coordinated and extended to the rest of the world.

Policy conclusions: development cooperation

Public administration is a key component of state-building and should be a high priority in the foreign aid budget: statistical infrastructure (civil and vital registrations systems), cadastral registries, public financial management, social security, audits, and – in particular – tax administration. Against this background, the decline of capacity-building in the Swedish ODA budget in recent years seems difficult to

defend. This form of assistance is relatively inexpensive, given the potentially high pay-off in the form of better governance, improved public finances, and confidence in public institutions and the political regime. It is also an area where there are reasons for small countries without a colonial history, like Sweden, to be present and to defend an administrative tradition of their own.

Policies in this field could be upgraded in a number of ways: a formal organisation led by the Swedish International Development Agency, integrating expertise from various parts of public administration with the aim of exploiting synergy effects and increasing efficiency, and a stable budget for financing cooperation projects by Swedish state agencies. Planning should include preparations for missions at short notice, in order to exploit windows of opportunity while bearing in mind that this form of commitment is necessarily long-term. The budget should be expanded, not shrunk.

The fundamental importance of *education* to development is not reflected in the Swedish ODA budget. Education received 3.5 per cent of the bilateral budget in 2015, down from 5.1 per cent in 2014. With the strong evidence for education as a lever of change presented in the literature, it would be natural to see a higher share of the budget devoted to systems of universal education. Field investigations have revealed large gaps in actual school systems, implying that the current figures on school enrolment and literacy are grossly exaggerated. There is consequently ample room to reinforce existing systems of education and no need to build new structures.

International public goods should be a priority in the development cooperation agenda. Normally, this concept is used in connection with environmental goods (biodiversity) and problems (climate change), but there are other public goods that merit attention. Agriculture and health care are fields where increased contributions to research and development can be defended.

Knowledge of the effects of development policies is another global public good. There is scope to raise the standards of *evaluation*, aiming at more causal analyses. A common experience is that evaluators are often engaged too late in the life cycle of a project. The quality of evaluation can often be improved by limited adjustments in the project planning phase. On the other hand, there is reason to warn against over-confidence in evaluation as a means of increasing the efficiency of aid.

Techniques for *managing divergence of opinion* between donor and partner country need to be developed. When donor and partner countries have different priorities, various options are available depending on how much opinions differ. In some situations, indirect action may be efficient without being perceived as provocative by the partner country. Sometimes dialogue may be sufficient to reach agreement. At the other end of the spectrum, a partner country may be entirely opposed to outside initiatives. In these cases, working through channels other than government is the only feasible alternative, and even that option may be difficult to implement in practice. In intermediate situations – disinterest rather than opposition on the part of the government in the partner country – the use of cash-on-delivery aid could be tested; resources are transferred when agreed targets have been met and verified by external observers. This is not a panacea but can be useful in areas where outputs are relatively simple to measure – vaccination programmes, literacy initiatives, and so on.

Strong centrifugal forces lead to portfolios that are scattered both geographically and sector-wise. After the adoption of the Paris agenda, there was a conscious effort towards *concentration*, but in recent years the general tendency towards diffusion has resumed. The priorities suggested in this report provide a starting point for a renewed effort and focus.

1 Introduction

International policies for global development and development cooperation are currently being reconsidered in many countries and organisations. A number of factors have contributed to this atmosphere of self-searching – geopolitical change, trends in the global economic system, climate change, and new threats to international security, among others. An unprejudiced discussion about the future role of policies for global development is therefore necessary.

1.1 Purpose and organisation of the report

The main purposes of this report are

- to survey and summarise recent findings from the social sciences on central aspects of social and economic development;
- to discuss, at an aggregate level, current and future priorities in the Swedish policy for global development, on the basis of this survey.

Questions about which factors are important for societal development are to some extent political and contentious. It should therefore come as no surprise that opinions on central matters diverge, among both scientists and policy-makers. This report aims not just to identify such differences of opinion but also to scrutinise the arguments put forward by participants in the debate. The survey chapters are therefore relatively rich in references, so that readers interested in digging deeper into the matters discussed can find paths into the relevant literature and form their own opinion.

A policy-oriented perspective was chosen, that is, the questions asked primarily concern societal factors that can be influenced via policy choices. Nonetheless, given factors such as the geography or dominant religion of a country may be relevant. They affect the available spectrum of political choices in various respects, and they may also justify concentrated efforts in certain areas to compensate for less favourable conditions. The history of a country imposes restrictions, but may also be interesting as a source of experience for other countries.

The task defined above excludes a number of interesting policy issues from the discussion. Concentrating on the aggregate policy level means that only high-level policy characteristics, such as distribution between sectors and the priorities given to the main categories, are the focus of the discussion. Taking social science results as the point of departure also implies that policy issues that are not fit for scientific inquiry are excluded. For instance, the choice of total budget for development cooperation is purely political by nature and is not an issue where social science can contribute. A number of other important, qualitative policy issues such as geographical priorities, the choice between multilateral and bilateral cooperation, the role of budget support, and development cooperation via non-governmental organisations, are also omitted from the discussion.

The report focuses on Sweden's Policy for Global Development, and on bilateral development cooperation. Multilateral aid has increased rapidly over time and now accounts for approximately half of all aid (including multi-bilateral aid in the multilateral category).¹ This development is partly a result of membership of the European Union, but can also be seen as a response to criticism of the administrative burden inflicted on partner countries as a result of bilateral relationships. A general analysis of multilateral aid obviously falls outside the scope of the present study.

Organisation of the report

In Chapter 2, the knowledge base for policy-making in the area of development is discussed against the backdrop of data problems, theoretical shortcomings and less than complete policy evaluations. Some conclusions can already be drawn about the direction of development cooperation efforts.

The next three chapters analyse some of the main themes of development literature: growth, state-building, and inclusive social development. In fact, a substantial part of the development literature cited can be categorised under one of the headings, or possibly a combination. These headings have not been chosen at random; most of the intentions behind the Policy for Global Development are

¹ Andersson et al. (2013).

expressed in terms of these three targets.² The recently adopted Sustainable Development Goals (Agenda 2030) are also closely linked to the main themes in this report.³

It is unavoidable that there is considerable overlap between these chapters. Topics such as institutions and education cut across any categorisation, and the reader will therefore have to accept some repetition.

Current debates in relevant fields are summarised as far as possible in the form of stylised facts that can be used for policy guidance. It should be stressed at the outset that full consensus seldom prevails among social scientists or practitioners (nor between these two groups), and that any summary must therefore necessarily be presented with some qualifications and reservations.

In Chapter 6, a succinct overview of current Swedish policies for global development is presented, and some assessments are cited. Conclusions for the Policy for Global Development are summarised in the light of the previous findings.

² See further Chapter 6.

³ The 17 goals can be categorized in the same way as this report is structured. There is one group related to growth and economic security (Goals 1, 2, 8), a second group related to different state functions (Goals 3, 4, 6, 7, 9, 11, 12, 13, 14, 15), and a third group related to inclusive social development (Goals 5, 10, 16). Goal 17 is tied to implementation and falls outside the categorisation because of its technical nature.

2 An uncertain knowledge base

Public policy should preferably be based on the best knowledge and information available. Ideally, this knowledge base will consist of a reliable theoretical framework, clear definitions, accurate data with sufficient coverage, and empirically supported ideas regarding the consequences of the various policy alternatives available. This ideal rarely materialises in domestic policy-making in donor countries, and the situation is of course far less favourable in developing countries.

Decision support for policy purposes is, briefly, built on data, information, and knowledge. Data are collected on the basis of hypotheses, which are tested and refuted, confirmed or refined. As confirmed hypotheses accumulate, the body of (provisionally) reliable knowledge grows, and new hypotheses may be formulated. There is no difference in principle between evaluation in the causal sense of the word and scientific inquiry in general; in both cases, the purpose is to establish causal relationships. What differs is that scientific inquiry is also devoted to background factors that are not open to policy choice, such as religion and history. Such knowledge may nonetheless also be valuable to policy analysis by providing important information about the context in which policy choices are made.

2.1 Data problems

Basic data on fertility and mortality, access to schooling and educational results, the size of the labour force and employment situation is fundamental to governments in all countries. Efficient public policies are impossible unless such basic information is available. Reliable data are also essential for democratic accountability. These requirements are equally valid for donors, vis-à-vis both cooperation partners and donor country electorates.

Since comprehensive data based on economic development has become available, the econometric analysis of conditions for growth and development has grown into a minor industry. World Development Indicators (produced by the World Bank), The Penn World Tables (maintained by the University of Pennsylvania), and

Maddison's data⁴ are among the most commonly used. The reliability of the data is less than satisfactory, however. In an analysis of the African situation, Glassman et al. identify a range of problems concerning the production of, and access to, data, usability, comparability between countries and stability over time.⁵ Only 5.3 per cent of the countries had more than 90 per cent coverage of death registrations after 2005; the corresponding figure for births was 7.1 per cent. Reducing maternal mortality is one of the Millennium Development Goals, but most of the data for these countries involve estimates made by international organisations. According to one observer, trends in maternal mortality are "basically immeasurable".⁶

Collier has painted a sombre picture of Africa as a big problem as regards development, placing most of what he terms *the bottom billion* in this continent.⁷ This picture has been criticised by Jerven, who has scrutinised the production and dissemination of data on economic development with particular focus on Africa.⁸ There are large inconsistencies between data produced by national statistical offices and internationally available datasets such as the World Development Indicators or the Penn World Tables. For instance, the correlation between Tanzanian annual growth figures for the period 1961-2001 and those found in the Penn World Tables was as low as 0.23.⁹ A purely statistical artefact in 1988, following a structural reform programme, led to the elimination of this year in the Penn World Tables. As a result, the average growth rate for the period 1985-95 increased from 1.9 to 5.4 per cent; national data yield the more realistic figure of 2.9 per cent.¹⁰ Examples such as these cast doubt on much of the international debate about periods of African negative output shocks, growth miracles, etc. In Jerven's words, "when economic development experts are not country experts, the road from fact to fiction is short".

Deaton, who has made major contributions to the measurement of living standards and poverty around the world, is himself sceptical about the quality of data on both household consumption and

⁴ Continued in the Maddison Project; Bolt and van der Zanden (2014).

⁵ Glassman et al. (2014).

⁶ Jutting, quoted in Glassman et al. (2014).

⁷ Collier (2008).

⁸ Jerven (2013, 2015).

⁹ Jerven 2013, Table 3.7.

¹⁰ Idem, Table 3.9.

aggregate production and growth.¹¹ An indication of quality problems is that consumption measured from household surveys, which is used to measure poverty, grows less rapidly than consumption measured in national accounts. In consequence, there is a mismatch between measured poverty and measured growth in poor countries. A possible explanation is that richer households participate less in surveys, but growth in the national accounts can also be upwardly biased. Deaton's assessment is that current statistical procedures in poor countries simultaneously understate the rate of global poverty reduction and overstate growth in the world.

Sources of error also appear in basic statistics on fundamentals such as population and agricultural production. What makes the problem worse is that errors cannot be assumed to be neutral ("white noise"), but are biased in important respects. Carr-Hill has highlighted missing millions among the poorest.¹² In developing countries, assessments of progress toward development goals are based increasingly on household surveys. These are inappropriate for obtaining information about the poorest people. The homeless, those who are in institutions, and mobile, nomadic, or pastoral populations are typically neglected. Household surveys also underrepresent those in disjointed households, slum populations and areas subject to security risks. These groups constitute a large proportion of the poorest strata of the population. Carr-Hill estimates that 300-350 million people are omitted worldwide in the surveys, leading to substantial biases in reporting on the global state of affairs concerning poverty.

Only 7 African countries have data in cadastral registries related to the total number of landholders, and no data are available before 2004.¹³ Two-thirds of the countries conducted a household survey sometime between 2005 and 2014, including in most cases a health component, but an education component only in 29 per cent of the countries. Estimates of poverty levels vary with the sources of data that underlie the estimation – household surveys, consumer price indexes, censuses, national accounts, and the International Comparison Program (ICP) run by the World Bank. Adjusting the methods or data sources can change poverty figures by hundreds of

¹¹ Deaton (2005).

¹² Carr-Hill (2013).

¹³ Glassman et al. (2014).

millions of people. The problem of instability over time is illustrated in Nigeria, where a recent update of the base for GDP assessment led to an increase of the GDP by 89 per cent.

These problems have several roots. National statistical offices have limited budgets. Their autonomy is also called into question; only 12 out of 54 statistical offices were considered autonomous in an assessment made by the Regional Strategic Framework for Statistical Capacity Building in Africa.¹⁴ This is a universal problem; integrity in the production of statistical information can interfere with the interests of political power-wielders.

There is also an incentive problem at the local level where statistical data is produced. For instance, school administrators have an interest in exaggerating figures for both school enrolment and education results. This problem of perverse incentives is particularly pronounced where donor payments are conditional on results.¹⁵ This is not a specifically African problem; Drèze and Sen report similar distortions from India.¹⁶ Although, on average, only 10 per cent of pupils aged 6-14 were registered as non-enrolled in the year 2004-5, the proportions of children able to perform the elementary operations of reading, writing and subtraction in the same year were no higher than 50, 64 and 43 per cent, respectively.¹⁷ The gap is the combined result of misreporting and the low quality of education delivered.

The absence of the service provider is a common problem in both education and health care. Chaudhury et al. studied surveys in which investigators made unannounced visits to primary schools and health clinics in six countries in Africa, Asia and Latin America.¹⁸ On average, about 19 percent of teachers and 35 percent of health workers were absent. Many providers who were at their facilities were not working, so even these figures present too favourable a picture. In India for instance, one-quarter of government primary school teachers were absent from school, but only half the teachers present were actually teaching when investigators arrived at the schools.¹⁹ The problem is further aggravated by child labour, which persists in many

¹⁴ UNECA (2010).

¹⁵ Sandefur and Glassman (2014).

¹⁶ Drèze and Sen (2013).

¹⁷ Desai et al. (2010).

¹⁸ Bangladesh, Ecuador, India, Indonesia, Peru and Uganda.

¹⁹ Chaudhury et al. (2006).

parts of the world. According to estimates by the International Labour Office, 168 million children were subject to child labour in 2012.²⁰

The phenomenon of distortive incentives is universal, often referred to as Goodhart's law: "Any observed statistical regularity will tend to collapse once pressure is placed upon it for control purposes."²¹

A somewhat awkward complicating factor is that donor countries sometimes contribute to these problems by competing for the scarce resource of local statistical competence.²² Donor countries have their own reporting requirements, often at the micro level, coupled to field experiments that are to be evaluated. For this purpose they need locally available statisticians, who are often drawn from public statistical offices; donor countries have no problem in attracting them with higher levels of remuneration, often in connection with training and general capacity building.

The data problems raised here are not neutral. There is a bias against countries where the informal sector is important, in the sense that GDP in such countries will be underestimated. Similarly, a large formal sector presupposes a well-developed state, equipped with tax administration, a statistical office, etc. If state capacity is correlated with GDP, there is a risk of overestimating the role of the state, and more generally, "institutions," in economic and social development.²³ Against this background and the generally low reliability of data from developing countries, heated disputes about whether institutions matter more than geography or human capital appear somewhat shaky in their foundations.²⁴

2.2 Concepts, models and assumptions

The knowledge basis of public policy is social science, not physics, and an assessment of the quality of decision support must recognise this fact. The resulting theoretical uncertainty has implications for basic

²⁰ ILO (2013).

²¹ Goodhart (1975).

²² Knack and Rahman (2004).

²³ Jerven (2012).

²⁴ See further Section 4.3.

concepts, models and assumptions used in analysis. This is illustrated below in a number of examples.

Concepts

Concepts need to be defined; differences in definitions may lead to unnecessary misunderstandings. By way of example, consider the definition of *poverty*. Poverty alleviation has been at the top of the development agenda for a long time and will remain so. The definition of this term is therefore of central importance to both scientific inquiry and policy analysis.²⁵ A number of definitions have been presented. Amartya Sen has suggested a multi-dimensional concept of development in *Development as Freedom*.²⁶ Sen's concept of development has three components: political freedom, freedom of opportunity and economic protection from poverty. Poverty prevails when any of these three dimensions is missing. The World Bank lists economic opportunities, empowerment and security,²⁷ and the OECD reiterates the World Bank definition.²⁸ The Swedish government, while stressing the right of the poor to choose their own definition, has highlighted the three dimensions of security, capabilities and opportunity.²⁹

Although there seems to be consensus on the need for a multidimensional definition of poverty, this does not solve the problem of definition as such; a limit of some sort between the poor and the non-poor is necessary. Much of the international discussion about poverty alleviation is based on the poverty line and how many individuals live above or below this line. When comparing across countries, it is necessary to take into account the fact that living conditions differ between countries. It has been argued that one and the same poverty line should be used across the board, with adjustments for purchasing power parities (PPP), but this recommendation does not recognise that welfare is to some extent socially defined, as is clearly visible in the substantial variation in nationally defined poverty lines. This has been known for a long time

²⁵ Ravallion (2015); see also Ravallion (2016).

²⁶ Sen (2001).

²⁷ World Bank (2001).

²⁸ OECD (not dated).

²⁹ Swedish Government (1997). There is an obvious circularity in letting the poor choose their own definition of poverty.

according to studies in developed countries,³⁰ but as anthropologists testify, the effect is not limited to these countries. A relative measure of poverty is therefore called for. A purely relative measure yields too low a threshold in poor countries, however, so some hybrid construction is necessary.

The discussion does not stop there. The situation of the poorest – those who fall below the poverty line – must be taken into account one way or other. Where the lowest acceptable level of consumption should be defined, somewhere between biological necessity and the poverty line, remains an open question.

To these problems may be added the difficulty of comparing prices internationally; the outcome of analysis is highly sensitive to the choice of method. The ICP addresses this problem by collecting prices nationally (neglecting price variations at the subnational level, which may be substantial).

Models

A technical and rather difficult problem pertains to the structure of econometric models chosen. In the literature, *linear models* are dominant for reasons of simplicity and tradition. Such a choice imposes an implicit structure on the phenomena to be described – doubling the value of an independent variable will double the effect – an assumption that is far from always satisfied. For instance, in a survey of the literature on the relationship between inequality and growth, Banerjee and Duflo argue that inequality has important effects on growth that are nonlinear, and that linear models will necessarily lead to false conclusions.³¹

A different but related problem concerns the translation of real-world conditions into quantitative *indicators* that can be manipulated in econometric models. By way of example, Sachs and Warner use the percentage of land area in the geographical tropics and a malaria index in an analysis of the natural-resource curse, but there may be problems associated with a high-temperature climate that are not well captured by these indicators.³² Besley and Burgess use the number of land

³⁰ Duesenberry (1949), Runciman (1966).

³¹ Banerjee and Duflo (2003).

³² Sachs and Warner (2001); following Gallup et al. (1999).

reforms in India to analyse whether the distribution of land has affected growth and poverty,³³ but a better indicator would rather be the distribution of land holdings as measured by the Gini coefficient or some other indicator of distribution. In fact, it can be argued that repeated attempts at land reforms may sometimes indicate the failure rather than success of reform efforts.

Behavioural assumptions

A relatively new phenomenon is that the discipline of economics, originally developed for the analysis of market behaviour, is now increasingly applied to a range of different social phenomena outside the market – demographic choices, social conflict, corruption, political processes and others. The theoretical basis for these extensions can be questioned. Economic analysis revolves around the concept of optimality to a large extent; something – profit or consumer utility – is supposed to be maximised. When applied to decisions outside the market, it is not obvious what is being maximised, or even if it is possible to describe fundamental decision problems in terms of maximisation.

Such extensions become even more contentious when applied to countries outside the West, with different histories and cultural contexts. Although there are reasons for assuming some human universals at a very basic level,³⁴ things become more complicated when more detailed descriptions are required. By way of example, Mkandawire has criticised the development literature about the African continent in general for being eurocentric.³⁵

Given these general weaknesses, it should come as no surprise that forecasts are difficult to produce and highly uncertain as a basis for policy decisions. For instance, the effects of structural reform programmes have been severely misjudged.³⁶ There have also been systematic errors in the World Bank's forecasts of the prices of important raw materials such as copper and cotton prices, which have

³³ Besley and Burgess (2001).

³⁴ Brown (1991).

³⁵ Mkandawire (2001).

³⁶ Ocampo (2004).

been overly optimistic, and the IMF has identified similar systematic errors in its own forecasts.³⁷

2.3 Evaluation, experiments and quasi-experiments

Policies should be judged by what they accomplish, not by their resource input. The Swedish Budget Act requires the government to account for results achieved in relation to goals decided by the parliament,³⁸ and the annual report from Sida, together with other channels of communication, aims to satisfy this requirement in the area of development cooperation. There is a general tendency, however – not only in this area – to focus on output rather than outcomes or impact. In the quest for evidence-based policy, outcomes or impacts must be focal, and evaluation plays a central role.

An evaluation should ideally answer the question, “What is the causal link between a measure taken and an observed outcome?” Such questions arise at all levels of policy-making. At the macro-level, they may concern the choice of monetary policy or the use of protective tariffs. At the meso-level, typical questions ask what anti-corruption strategies are efficient or how decentralised health service management should be. Micro-level issues concern operational designs such as anti-malaria prevention or school attendance.

It is also necessary to emphasise that this definition of evaluation is more narrow than in the common use of the term, which often refers to simpler follow-up studies with no ambition to establish causal links but merely to investigate whether certain activities have taken place as planned and whether goals have been met.

It is essential to stress that this search for causal links is not limited to policy evaluation but coincides with normal scientific inquiry. What is specific to policy analysis is that the causal links that are normally in focus concern independent variables that can be influenced by human choice at the political or individual level, for instance via the design of benefits, taxes or infrastructure investments. General scientific inquiry would also include variables that are given, such as history or religious context, for instance shedding light on the causal links between the

³⁷ Deaton (1999), IMF (2014).

³⁸ Swedish Budget Act, Chapter 10, §3.

dominant religion and the level of corruption. Such knowledge may of course be valuable for policy-makers.

Although different methods are available for answering this type of question,³⁹ the alleged gold standard in the field of evaluation is often considered randomised control trials (RCTs), that is, an experiment where a group of subjects (treatment group) are exposed to the measure to be analysed, while a different group (control group) is left unexposed. The effect of the measure in question is taken to be the difference in average outcome between the treatment group and the control group.⁴⁰

It is obvious that RCTs are not possible at the macro-level and that even meso-level experiments may be difficult to carry out. At best, experiment-like situations can occur without conscious intervention, so that a treatment group and a control group are formed spontaneously – so-called ‘natural’ experiments. Such analysis design requires special care in order to avoid false conclusions, however.⁴¹ In the field of development cooperation, the situation is sometimes favourable. Somewhat paradoxically, the general state of penury that prevails may actually be a help rather than an obstacle. Given that resources are often insufficient to provide a certain service or supplementary measure for everyone, it may be politically and ethically acceptable to use a randomised distribution – more so than if the service in question is defined as a fundamental right to which everyone should have access.

RCTs have been applied to a broad range of sectors in the field of development cooperation: agriculture, health, education, finance, governance, and so on.⁴² The question of internal validity, that is, whether an analysis answers the question posed, is often the least difficult. If there is a reasonable hypothesis behind the experiment, there are statistical tests for determining that randomisation is successful and that conclusions can be drawn as desired. In some applications, the control group may have access to second-best alternatives, in which case the effect will be underestimated.

³⁹ Stern et al. (2012).

⁴⁰ For surveys of the field with further references to the literature, see Banerjee and Duflo (2011) and Olofsgård (2014).

⁴¹ Deaton (2010), Dunning (2012).

⁴² Olken and Pande (2013).

More cumbersome is the question of external validity. If a certain measure for increasing school attendance has worked in the region where the experiment has been carried, will it work in other regions? Can the results be generalised to other countries? In order for such generalisations to be possible, the original study should preferably be replicated, but replications receive poor academic credit and are often not accepted for publication. Even if experimental results can be reproduced in other regions or countries, it is not in general true that the same results will be obtained when the experiments are scaled up. Public servants may be less conscientious than academics involved in an experiment when applying the rules of a programme. A small-scale experiment may be uninteresting to corrupt decision-makers but becomes attractive when applied on a broader scale. The step from experiment to policy is far from straightforward.

There is also the problem of self-selection. If the experimenter is not in full control of an experiment, there is a risk that those who are selected for treatment will differ in important respects from the control group. In such cases, the effect will be over-estimated. Other requirements for RCTs are that the outcome should be measurable with reasonable accuracy and that the desired effect should not take too long to develop. In the latter case, there is a risk that the effect under study will spread spontaneously to the control group, and the result will be distorted.

Even when these technical requirements for RCTs are satisfied, there are risks associated with this approach. In a thorough critique of RCTs, Deaton scrutinised both true RCTs and quasi-randomization through so-called instrumental variable (IV) techniques or natural experiments.⁴³ Deaton's first point of criticism is that exogeneity is often misunderstood. Analysts often manage to show that certain background factors used as instruments are *external* in the sense that there is no causal link from the variables studied to these factors, for instance if the latter precede them in time, but this is not equivalent to being *exogenous* in the sense that there is no connection between them via other links. The study of macroeconomic volatility and growth across countries by Acemoglu et al. is an illustrative example.⁴⁴ The authors use settler mortality in former colonies as an instrument that affected the choice of institutions and then indirectly the output

⁴³ Deaton (2010).

⁴⁴ Acemoglu et al. (2003).

variables that are in focus, but the background factors can also affect the output via other channels in ways that are not captured by the model, even if attempts are made to correct for those effects by including other regression variables. Further, as Nunn points out, the colonies inherited not only the institutions but also the settlers themselves, which may cause the effect of institutions to be overestimated.⁴⁵

Another point of critique is that this approach only provides information about average effects, but other aspects of the distribution of effects may be very interesting to political decision-makers. Typically, median effects would be more relevant than average effects.

Several of the above reservations apply to actual randomisation and quasi-randomization alike; as Cartwright notes, “there is no gold standard”.⁴⁶

Beyond these technical difficulties, there may be an incentive problem involved, in the form of a temptation to look for alternatives that yield quick and observable results, so that more difficult but potentially more efficient alternatives are avoided.⁴⁷ This risk is present in both donor countries and developing countries.

There is also the question of resources for evaluation. As pointed out in the previous section, statistical competence is a scarce resource in most developing countries, and there is a risk that RCTs on a broad scale will encroach on basic statistical production.

2.4 Summary

Need for clear definitions and robust relationships

Some differences of opinion in the international debate on development policies stem from differences in definitions. For instance, the term *poverty* is used by most economists as referring to incomes and assets, whereas most international organisations have

⁴⁵ Nunn (2009).

⁴⁶ Cartwright (2007).

⁴⁷ Olofsgård (2012).

opted for a multidimensional concept of poverty. Clear definitions are a prerequisite for successful policy analysis.

Development cooperation, like any other public policy, should preferably be evidence-based. As the above discussion has shown, conditions in this field are not particularly favourable in general. The general theoretical basis is relatively weak, data supply is scarce and often marred by quality problems, and systematic evaluation is difficult. Sometimes, problems of communication arise because of differences in basic definitions.

Coordinated efforts are made at the international level in all these respects, and the situation is slowly improving. It is imperative, both in the context of general knowledge and pertaining more specifically to policy analysis, to strive for results that are *robust* with respect to variations in definitions, data sets and assumptions.

One of the basic instruments in this search for robust knowledge is strict hypothesis testing following established scientific standards. The term *evaluation* should be reserved for causal testing of this kind. Too often, simple follow-up reports with limited generalisability are presented under this heading.

A rosy picture

In the international debate on development, there is currently a line of argument that the world is moving in the right direction. Statements put forward to this effect are, for instance, that Africa is on the rise, that virtually all children now learn to read, write and calculate, that poverty is being eradicated by economic growth, and so on. To some extent, this attitude was supported by the follow-up to the Millennium Development Goals in 2015. As we have seen, many of these statements are misleading and sometimes false.

Data errors are large, and they are also biased. Up to 5 per cent of the world's population are missing from household economic surveys, leading to an underestimate of world poverty. School enrolment data are exaggerated, because far from all teachers are present in schools and a large proportion are not teaching even when they are present. This unsatisfactory state of affairs is confirmed by assessments of student capabilities in reading, writing and mathematics. The overall

impression is consequently that the depiction of the situation in developing countries as supplied by world media is too rosy.

Improving the knowledge base

Some preliminary conclusions may already be drawn regarding policies for global development. Reliable data are a scarce resource in low-income countries, and strengthening the infrastructure for statistical production is a high priority, more or less independently of which sector is in focus. Basic data on population and property holdings is always needed, but too often such data is collected ad hoc, at high cost, and in connection with specific projects or programmes instead of being retrieved from existing registers. As shown by examples given in the text, perverse incentives at the local level often distort the data produced, so there is also room for innovation when it comes to collecting and ensuring the quality of basic data.

Related more specifically to the needs of policy-making in the field of development cooperation, the accumulation of knowledge about the impact of ODA activities requires careful causal analyses of the kind described above. This form of knowledge can be seen as an international public good, and support for such activities is another legitimate use of the ODA budget.

3 Growth

Improving material wellbeing is a general primary goal for development policies. Among the Millennium Development Goals, the first (eradicating extreme poverty and hunger) directly addresses the basic standard of living, and several others are related to other aspects of material living conditions (primary education, child mortality, maternal health, infectious diseases, and aspects of environmental sustainability).⁴⁸ The eighth of the 2030 goals explicitly mentions growth, and several of the other sixteen are directly related to it (food security, health, education, water and sanitation, infrastructure, and human settlements).⁴⁹ What has been added in the 2030 agenda is a particular emphasis on sustainability in various respects; two-thirds of the goals are explicitly or implicitly related to sustainability.

This chapter surveys the literature on factors that affect growth, both natural conditions and factors that are subject to policy choice. It also examines the policy package called the *Washington Consensus*, which was developed during the 1980s and has dominated policy-making for decades. This policy package is evaluated against the background of historical experience from Western Europe and the United States, as well more recently industrialising countries in Asia. The difficulties that arise when attempts are made to translate this experience into policies for today's developing countries are also discussed.

3.1 Natural conditions for growth

The borderline between natural and political conditions for growth is somewhat fluid. For instance, demographic development has a strong momentum of its own but can be influenced in the long term by a number of policy instruments. Conflicts are anthropogenic but are affected at any given moment by factors beyond the reach of individual decision-makers.

⁴⁸ United Nations (2015).

⁴⁹ United Nations (2014).

The dominant paradigm in economics, the neoclassical theory, can be traced back to Adam Smith and even further.⁵⁰ This tradition was subsequently developed by Ricardo, Mill, Walras, Marshall, and in a somewhat different format, Keynes. Post-war economists such as Arrow, Debreu and Samuelson contributed to its current, highly mathematicised format. The core of this construction is the model of *general equilibrium*, based on rational consumers with access to full information, and profit-maximising producers. The main results of this theoretical effort is that the abstract economic system so defined – the market – has an equilibrium that is efficient in a sense that can be made precise (Pareto), and that any efficient equilibrium can be implemented as a market equilibrium combined with lump-sum transfers, thus decoupling efficiency questions from political issues pertaining to the distribution of incomes and assets. Free trade is *a fortiori* optimal, given that it opens possibilities for economic exchange which will be used if they are beneficial, but otherwise not. The role of the state is reduced to creating favourable market conditions, with priority given to establishing property rights, and solving a limited number of collective-action problems.

A number of objections have been raised to the unrealistic assumptions behind this theoretical construction – full information, perfect forecasting capacity, an infinite number of producers etc.⁵¹ These objections have generated a number of theoretical additions and developments – theories of asymmetric information, monopoly and oligopoly theory, and so on. Despite this there are still a number of points where the general equilibrium complex is at odds with both historical experience and the current state of affairs.

Geographic location and climate

A handicap of mainstream economic theory, originating in the desire to develop a manageable mathematical description, is its abstract nature, which does not differentiate between products and branches, and where geographic space normally plays a subordinate role. Given that rich and poor countries are not spread stochastically across the

⁵⁰ On possible inspiration for Smith in medieval sources, see Graeber (2011), p. 279, and note 85, p. 446.

⁵¹ For some entries to the literature, see Ackerman and Nadal (2004).

globe, there is reason to conclude that geography matters for development.

There is a different theoretical tradition in economics which has run parallel to the mainstream and has had its strongest representatives in Central Europe – List, von Thünen, Lösch, Christaller, Sombart, Schmoller – and partly or wholly in the United States, Thorstein Veblen and Joseph Schumpeter.⁵² In succinct terms, these economists focused specifically on what was downplayed by mainstream theory – concentration processes in geographical localisation theory (von Thünen, Lösch, Christaller), self-reinforcing mechanisms stemming from increased returns to scale (see below) and dominant positions in a sector favouring research and innovation (Schumpeter), the benefits from trade restrictions (List), and the general importance of institutions and institutional development (Veblen).

The relevance of this theoretical corpus to development issues has also gradually been recognised by mainstream economists, for instance in the form of modern economic geography.⁵³ Urbanisation is central to this line of development, associated with agglomeration and more efficient markets, increased possibilities for specialisation and skill-intensive industries, and increased knowledge transfer between industries. An important aspect of this process is that is self-reinforcing, that is, the increased concentration of population and economic activities at one geographic location will favour this location at the cost of alternatives, at least up to a certain point.⁵⁴

Geography is also involved in other, more direct ways. It does not come as a surprise that *being landlocked* may be problem for a country. Of the billion people in the world that have the lowest incomes, 38 per cent live in landlocked countries and 30 per cent of Africa's population live in landlocked countries that are also resource-scarce.⁵⁵ The cost associated with this precarious position depends greatly on the policies of neighbours in the area of infrastructure development, but a country can affect its own situation – by investing in air transport facilities, electronic communication, developing financial or

⁵² Baptised by Reinert *the Other Canon*; Reinert (2007).

⁵³ For a broad overview, see Krugman (1995).

⁵⁴ Arthur (1994).

⁵⁵ Collier (2008), Chapter 4.

other services that are less dependent on transport of physical goods, and so on.

Geography further affects climate and the ecological parameters related to this – precipitation patterns, disease panoramas etc. Sachs claims, partly in opposition to those who stress the dominant role of institutions and history, that geography affects growth prospects directly, not only via location as such, or isolation from the coast, but also via climate and ecologically determined factors such as the risk of malaria.⁵⁶ This is a good argument for government interventions in the field of disease prevention and health care, quite apart from the welfare arguments directly related to health.

Natural resources

It is commonly understood that *natural resources* are a mixed blessing.⁵⁷ They yield rents and thus represent a certain revenue potential for the country in question, but revenues tend to be volatile,⁵⁸ and there is the risk of negative spillovers on other export items (the so-called ‘Dutch disease’). Experience also suggests that they invite the politics of patronage and increase the risk of embezzlement and other diversions of public funds. By offering the incumbent easy revenue – compared to taxes on income or consumption – they also undermine the checks and balances of the political system. The effect on growth rate appears somewhat mixed. In the absence of natural resources, democracies tend to outgrow autocracies, but with increasing revenue from natural resource extraction, the relative advantage of autocracies increases. An explanation suggested by Collier is that revenues in democracies are used for less efficient investments.⁵⁹

Taken together, these problems are often described as the *curse of natural resources*, a term that may convey a somewhat deterministic impression of the problem. This is not a law of nature; for instance, a free press has a significant positive impact on growth, and the effect is

⁵⁶ Sachs (2004).

⁵⁷ Sachs and Warner (2001), Collier (2010), Frankel (2010), Berman et al. (2014); for a somewhat different view, see Brunnenschweiler and Bulte (2008).

⁵⁸ Deaton (1999), Williamson (2011) with further references.

⁵⁹ Collier (2008).

stronger in countries that are rich in natural resources.⁶⁰ Botswana is an example of where revenues, in this case from diamonds, have been used for the benefit not only of the ruling elite.

Returns to scale

In certain sectors, production costs rise as the volume produced increases; agriculture and mining are typical examples. This is a simple consequence of the rational behaviour of producers – to start by exploiting the most fertile agricultural acreage or the mines with the highest content of the minerals sought. Given a certain level of technology, production is forced into areas where production costs are higher as demand increases. The economic term for this type of production is *diminishing returns to scale* (DRTS). – In other sectors, typically manufacturing industry and service production, the opposite holds; the average costs of production are reduced with increasing volumes. In this case, *increasing returns to scale* (IRTS) prevail.

A quick look at production patterns across the world reveals that countries whose economies are dominated by DRTS sectors are poor, whereas rich countries without exception rely on IRTS production. It seems that engagement in the latter type of activities – industrialisation – is a precondition for starting the transition towards becoming a developed, high-income country. What is somewhat awkward for the general equilibrium paradigm is that DRTS is a necessary assumption for the equilibrium of the market to exist.⁶¹ The theoretical core of economic theory thus collapses when confronted with what is indisputably the most important type of production in modern economic history. To some extent, this has been met by theoretical developments, such as human capital theory, that admit of IRTS and self-reinforcing processes.⁶²

Population

From a Malthusian perspective, population growth has a distinctly negative influence on the material wellbeing of that population.

⁶⁰ Ibid., Chapter 3.

⁶¹ This is somewhat reluctantly admitted *passim* in the recognised authoritative presentation of the theory, Arrow and Hahn (1971).

⁶² Romer (1986).

Nowadays, the social sciences have a more diverse view of the interactions between the population and the economy, and feedback mechanisms from standards of living to fertility decisions are considered equally or more important. Fertility decreases with economic development as a result of female emancipation and the increased use of birth control. In this sense, demographic development is not a purely natural factor but can be influenced by policy.

A higher birth rate requires that a larger fraction of society's resources will have to be devoted to child-rearing and related activities, which may affect the economic growth rate negatively. An interesting result from work by Przeworski et al. is that democracies and autocratic regimes had roughly the same rate of growth during the latter half of the 20th century, but that lower fertility in democracies resulted in higher per-capita growth rates.⁶³

Growth prospects depend not only on the size of the population but also on the demographic distribution. An individual's productivity, saving and spending vary systematically over their life cycle, which tends to create variations in the growth rate that are not dependent on economic policies.⁶⁴ Failure to recognise such variations is liable to generate mistakes in economic policy-making.

Peace

A basic condition for prosperity is that there is a functioning state administration in place, exercising a monopoly on legitimate violence. Failed states naturally have problems maintaining the conditions conducive to growth, and poor economic performance increases the risk of conflict. A typical low-income country faces a 14 per cent risk of war every five years; each percentage point of growth reduces this probability by one percentage point.⁶⁵

Blattman and Miguel confirmed that low per capita income and slow economic growth increase the risk of civil war, but other factors are also at work.⁶⁶ A weak state increases the risk, and foreign

⁶³ Przeworski et al. (2000).

⁶⁴ Lindh (1999), Lindh and Malmberg (2009).

⁶⁵ Collier (2008).

⁶⁶ Blattman and Miguel (2010).

companies involved in natural resource extraction may interfere and contribute to conflict.

Not only income and growth but also the distribution of income and assets matters to the risk of conflict. The effect of inequality on the level of conflict is now an established fact. Collier has claimed that inequality has no effect on the risk of civil war,⁶⁷ but Milanovic has shown that both the duration and the intensity of a conflict increase with the *inequality extraction ratio*, that is, with the extent to which the ruling elite pushes the actual level of inequality towards the maximum compatible with the current level of economic development.⁶⁸ This is a remarkable result, as it provides a predictor for conflict based only on economic data that is in principle accessible for measurement.

3.2 Policy and growth

Saving and investment

The starting point for modern theories of economic growth is the Harrod-Domar model, published just before and after the Second World War.⁶⁹ Domar never intended his work as a model of growth and later distanced himself from the model, to endorse Solow's growth theory.⁷⁰ Nonetheless, the Harrod-Domar model became (and to some extent remains) one of the most popular models of growth, because it delivered a very simple message – that the rate of growth is proportional to the share of investment spending in the GDP (adjusted for the replacement of worn-out capital). The policy conclusion was simple; if the rate of growth is deemed insufficient, an increase in investment spending will make it sufficient. If domestic saving is not enough, import the necessary capital to fill the financing gap. This also provided a natural role for development aid via grants or loans, and the financing-gap approach to ODA came to dominate the field for decades. With increased growth rates, income would soar and

⁶⁷ Collier, *ibid.*

⁶⁸ Milanovic (2013).

⁶⁹ Harrod (1939), Domar (1946). For a general survey of models of economic growth, see Gylfason (1999); in a more critical vein, Kenny and Williams (2001) and Easterly (2001).

⁷⁰ Domar (1957).

generate increased saving, and so it was believed that growth would soon become self-sustaining.

The popularity of this theory is matched only by its inability to meet reality. Although a correlation between investment and growth has often been observed,⁷¹ this says nothing about the direction of causality. When the aid hypothesis was tested by Easterly – aid increases investment and investment translates into a higher growth rate – he found no support for it.⁷² This general result can be supported by examples. Between 1980 and 1990, Guyana's GDP fell sharply, while investment rose from 30 per cent of GDP to an exceptional 42 per cent and ODA flows amounted to 8 per cent of GDP.⁷³ Among the rapidly growing East Asian economies, Taiwan had a high saving ratio during the 1970s (30.5 per cent on average), but South Korea did not (17.5 per cent).⁷⁴ More recent, careful analyses have identified some growth effects from aid,⁷⁵ but the simple view that there is a one-to-one correspondence between saving and investment on the one hand and economic growth on the other can be dismissed, together with the view that aid can fill the gap.

Infrastructure is a special case of (public) investment which is arguably beneficial to growth, but affluence will affect the level of investment in infrastructure, so there is an obvious risk of overestimating the effect of infrastructure investments in a straightforward statistical regression analysis. There is nonetheless consensus in recent literature that there are growth effects from public investments, although much lower than found in a classical study by Aschauer, the starting point for this line of research.⁷⁶ There is considerable heterogeneity in the effects across countries, regions, and sectors. The effects of new infrastructure investments will also depend on the quantity and quality of the existing capital stock, as well as on the general level of education.

⁷¹ See e.g. Barro (1991).

⁷² Easterly (1999).

⁷³ Ibid., p. 35–6.

⁷⁴ Wade (2003), p. 61.

⁷⁵ See Section 3.6.

⁷⁶ Aschauer (1989). For surveys, see Romp and de Haan (2007) and Calderón and Servén (2014).

Technology

In a paper published in 1957, Robert Solow showed that as much as seven-eighths of growth in labour productivity during the first half of the 20th century in the US was explained by technological change.⁷⁷ In other words, the change in quality of capital had been far more important than the change in quantity. As an explanation of productivity differences across countries, Solow's model works less well, however. If capital had a higher return when it is scarce, we would see large flows of capital towards poor countries, which we do not.

More generally, poor countries do not automatically grow faster than rich countries,⁷⁸ and variations in the growth of physical capital explain only a minor part of the difference in growth performance across countries. Again, some concrete figures may illustrate this. Klenow and Rodriguez-Clare estimated that between 1960 and 1985, 3 per cent of higher-than-average growth in a large sample of countries could be explained by growth in physical capital. To take an extreme example, both Nigeria and Hong Kong increased the amount of capital per worker by more than 250 per cent; Nigeria's output per worker increased by 12 per cent, whereas in Hong Kong it rose by 328 per cent.⁷⁹ Obviously, one or several important factors are missing from the equation. The ability to absorb investments in new and more productive technology depends, among other things, on the existing stock of human capital.⁸⁰

Education and human capital

Against the background of the problems in explaining growth differences across countries and across time, efforts have been made to include the level of education in the work force, referred to as *human capital*. Human capital should be related to the number of years of schooling, and this is also the most commonly used indicator. In this context, the previously noted unreliable statistics on education in developing countries must be kept in mind.

⁷⁷ Solow (1957).

⁷⁸ Pritchett (1997).

⁷⁹ Klenow and Rodriguez-Clare (1997).

⁸⁰ A good illustration of this is Lindqvist's study of the first attempt to introduce steam engines in Sweden (Lindqvist 1984).

Pritchett has tested the effect of growth in schooling on economic growth rates but found mainly negative results.⁸¹ Other specifications are possible, however. Benhabib and Spiegel⁸² have tested a specification based on a standard production function which includes human capital as a factor and found no significant effect on economic growth. In a different model, where human capital affects the growth of total factor productivity, more positive results were obtained. In this approach, human capital affects growth via two channels: the rate of domestic technological innovation and the speed of adoption of technology from abroad. The significance of this result is that it is the *level* of human capital rather than its *growth rate* that contributes to the growth of per capita income.⁸³

A case in point is the Indian state of Kerala, whose governments since autonomy have pursued very active policies of education, in spite of mediocre GDP-per-capita figures.⁸⁴ In recent years, Kerala has advanced to the highest performing group of Indian states, measured by growth rates. This is shown in the diagram below, where growth rates for the Indian states during the period 2001-10 are related to male literacy rates in 1991, the lag of ten years chosen because the effects of literacy on productivity can be expected to take time to diffuse.

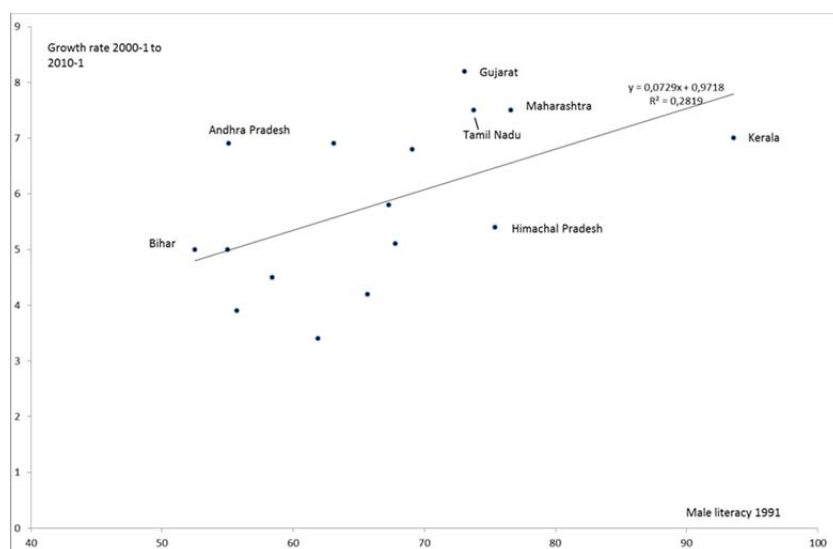
⁸¹ Pritchett (2000).

⁸² Benhabib and Spiegel (1994).

⁸³ This result was also obtained by Barro (1996).

⁸⁴ Ramachandran (1997).

Figure 1. Annual growth rates (per cent) among Indian states 2000/1-2010/11 related to male literacy in 1991. *Source:* own calculations based on data from Drèze and Sen (1995, 2013).



Education is generally speaking a difficult factor. It raises the productivity of the work force, and there is also an external effect – productive employees raise the productivity of their colleagues, but investments in education directly relevant to working life will only result in an immediate increase in the economic growth rate if there is a demand for education in the labour market. On the other hand, there are also indirect effects on society from an increased level of education – strengthened democracy,⁸⁵ lower corruption,⁸⁶ developed civil society,⁸⁷ increased trust in fellow citizens⁸⁸ – that may have a positive influence on the growth rate. Such indirect effects will take longer to spread through society, which may explain why they are difficult to detect and also why increases in educational level do not yield significant effects during the same period as they occur.

⁸⁵ Glaeser et al. (2007).

⁸⁶ Mungiu-Pippidi (2015).

⁸⁷ Putnam (1993).

⁸⁸ Helliwell and Putnam (1999).

Macroeconomic stability

The effects of macroeconomic policies on growth are, in very general terms, free from surprises. A government that is able to maintain a stable current account balance, stable public finances and a realistic exchange rate contributes positively to the growth climate. Beyond these generalities, the discussion becomes more convoluted, however. Causal analyses are difficult to carry out because of mutual effects between the main indicators. The public deficit and debt accumulation illustrates these difficulties. In recent years, there has been considerable debate concerning the effects of a high government debt on the rate of growth. Reinhart and Rogoff claimed to have found strong nonlinearities in the effects of high levels of debt,⁸⁹ which was contested by Herndon et al. as the result of coding errors, exclusion of data and unconventional weighting.⁹⁰ More recently, Pescatori et al., using a broader data base, found no indication of nonlinearities at high debt levels in the mean or long term.⁹¹ Quite to the contrary, the negative effect of a high debt flattens out at high level; the difference between growth rates in low-debt and high-debt countries is about 2 per cent. Further, it seems to be the trend rather than the level that is important to the growth rate; countries with a decreasing debt level outperform countries with increasing debt by about 1 percentage point at the same level of debt. This makes sense; a government that demonstrates its ability to master the public deficit shows that it has both the willingness and the ability to control public finances.

In summary, sound fiscal and monetary policies contribute to growth prospects by reducing uncertainty. The aim should be to avoid extremes rather than to search for an optimal debt level, exchange rate, or rate of inflation.

⁸⁹ Reinhart and Rogoff (2010), Reinhart et al. (2012).

⁹⁰ Herndon et al. (2013).

⁹¹ Pescatori et al. (2014).

Trade policy

The case for trade liberalisation as a means to stimulate economic growth was made forcefully in a long paper by Sachs and Warner published in 1995.⁹² The authors classified regimes as open or closed according to a list of criteria comprising non-tariff barriers to trade, tariff levels, black market exchange rates, a socialist economic system, or a state monopoly on major exports. The surprising result was that the group of open countries exhibited growth rates which were on average 2.45 percentage points higher than those of the closed group during the period studied, 1960-1995. What was further surprising was that the authors presented liberalisation as a powerful instrument for promoting growth no matter what problems might otherwise exist in a country – macroeconomic, administrative etc. An explanation for this surprising result was the unusual classification method, which included, for instance, South Korea and Taiwan in the open group, although these countries maintained high tariff barriers into the 1980s and liberalised only after their manufacturing industries had acquired sufficient strength to compete in international markets.

This paper and other similar papers produced at the World Bank were used as powerful arguments for free trade regimes around the world, arguments that transformed into policy changes with sometimes serious results for the countries affected. Although some countries did benefit from liberalising their trade policies, this is far from the panacea that it was pretended to be, and a number large of countries suffered severe setbacks from precipitate liberalisation.⁹³ The main reason, explained later in this chapter, is that trade liberalisation generates not only short-term benefits, in the form of an increased exchange of goods and services, but has secondary effects which are negative, and which may dwarf the short-term gains.

Financial liberalisation

The arguments for liberalising financial markets are analogous to the arguments for free trade. As in the case of free trade, empirical research has been unable to establish a clear general link between

⁹² Sachs and Warner (1995).

⁹³ Ocampo (2004), Reinert (2007), Shafaeddin (2005). For general critical discussions, see Rodriguez and Rodrik (2000) and Rodrik (2011), Chapter 7.

financial integration and economic growth. Most empirical studies find that financial integration has no effect, or at best a modest effect, on economic growth.⁹⁴ Following the most recent global financial crisis, analysts at the International Monetary Fund have also questioned whether free capital flows are a benign phenomenon.⁹⁵ Not all financial flows are the result of rational investing, borrowing or lending decisions. Foreign investors are sometimes subject to herd behaviour and suffer from excessive optimism. Even if foreign capital flows are on average based on real economic opportunities, it must be recognised that they may damage the economy by creating bubbles and asset booms and busts.

Volatility represents a threat to growth, whether it stems from terms-of-trade changes or has other origins.⁹⁶ In some circumstances the usual macro policy instruments are inadequate, so there may be circumstances in which capital controls are a legitimate policy response to variations in capital inflows. Capital controls also make a country less vulnerable to tax competition.⁹⁷

3.3 The Washington Consensus

Even if it were possible to explain in unequivocal terms what drives economic growth, there remains a complex policy issue concerning the appropriate role of the state. As long as the Keynesian paradigm dominated economic policy-making through most of the 1970s, there was general agreement that growth rates could be affected via a range of policy instruments – taxes, public investments in infrastructure and education, active trade policy and others. Following the right-wing turn in international politics in the early 1980s, an alternative paradigm developed and was formalised in what is normally referred to as *the Washington Consensus* (WC). The term is often associated with the name John Williamson, but has a wider background in Latin American politics.⁹⁸ The list of required policy measures drawn up by Williamson contains items such as strengthened fiscal discipline, tax reform, reduction of subsidies, liberal policies in the area of trade and

⁹⁴ See the survey by Prasad et al. (2003).

⁹⁵ Ostry et al. (2010).

⁹⁶ Kose et al. (2005).

⁹⁷ Devereux et al. (2008).

⁹⁸ Williamson (1990), Birdsall et al. (2010).

foreign direct investment, deregulation of financial and other markets, the privatisation of state property, and secure property rights. In succinct terms, this defines a narrowly circumscribed role for the state.

The main consequence for development cooperation was that conditionality became a common instrument in support agreements. Transfers and loans were made contingent on institutional reforms in the partner countries.

A priori, the likelihood that the private sector would solve the archetypal problems of markets with little or no state involvement is generally low; basic textbooks about economics explain why. As for conflicts and problems associated with natural-resource extraction, private capital is often part of the problem. The private interest in infrastructure has been overestimated historically; after all, this is a classical example of a public good (although not pure). Investments in infrastructure may alleviate the problems associated with being landlocked, but solutions often call for regionally organised initiatives that require high-level policy coordination and therefore are difficult to implement. Improving governance is by definition a political task. Paraphrasing Bauer's remark that development aid seems to work best where it is needed the least,⁹⁹ one might say that the same seems to hold for private capital.

In consequence, it should come as no surprise that the results of applying this policy package have not been convincing. Even a quick glance at the empirical evidence shows that many countries in Africa, Latin America and Asia have suffered severe setbacks when trying to follow the recommendations.¹⁰⁰ Even more question-marks arise if one turns to the economic history of countries that have made the transition from agricultural, low-income economies to fully developed, industrialised economies – Europe, the United States, and more recently, Japan, South Korea and other Asian countries. The policies pursued in these cases have been very different from what is now recommended as best practice in the difficult transition process. In an assessment of South Korea and Taiwan against the WC checklist, Rodrik verifies that these two countries did in fact opt for fiscal discipline, the redirection of public expenditure towards

⁹⁹ Bauer (1971).

¹⁰⁰ Ocampo (2004), Reinert (2004), Shafaeddin (2005).

education, health and infrastructure, tax reform, and competitive exchange rates.¹⁰¹ As for secure property rights, President Park started his rule by imprisoning leading businessmen and threatening to confiscate their assets, whereas the Taiwan government exercised more discipline. Deregulation and trade liberalisation were limited in both countries, and the same holds for the liberalisation of both foreign direct investment and internal financial markets. Both countries went against the programme regarding privatisation and established a number of public enterprises during the 1950s and 1960s. In summary, there is support in the experience of these two countries for fiscal and monetary discipline, and the government policies vis-à-vis markets were very different, and in one important respect ran directly counter to the WC programme. This is not to say that all components are ineffective or dysfunctional; as Birdsall et al. conclude, there are important lacunas in the agenda and fundamental flaws in the design or sequencing of measures taken, but part of the explanation for poor outcomes may also lie in shortfalls in implementation.¹⁰²

In order to obtain a more solid basis for policy discussion, it is necessary to look more deeply into both theoretical and empirical analyses of the growth phenomenon.

Empirical tests of the Washington Consensus

A natural way to resolve the conflict about which development policies to pursue is to look at the evidence from countries that made transition from low-income to middle- or high-income status. The paths of development are unique to each country, but it would be strange indeed to neglect the common experience of a large and highly varied group of countries that have made the transition. There is an almost universal sequence of phases in this transition, from agriculture via industry to services. There are exceptions, such as oil-producing countries of the Middle East that have enjoyed windfall profits from industrialisation elsewhere, but they remain the exceptions to a general rule.

¹⁰¹ Rodrik (1996); see also Rodrik (2010)..

¹⁰² Birdsall et al., *ibid.*

When modernisation in Europe started in the late Middle Ages, a number of very different factors contributed – intellectual, religious, and economic. If we restrict attention to the economic field, the following factors can be singled out. The starting point was an agricultural sector that rationalised and increased its productivity and the associated urbanisation, which are perhaps the most stable indicators of the process.¹⁰³ The need to rationalise agricultural production was realised early¹⁰⁴ and has been confirmed in recent studies¹⁰⁵. Matsuyama developed a formal model supporting this idea.¹⁰⁶

Land reforms have played an important role in many countries, because an ownership structure where large landowners dominate and a large part of agricultural land is cultivated by tenants is not conducive to growth. Tenants cannot safely reap the benefit of investments, and are in any case often too poor to make them, while landowners have little interest in productivity-enhancing measures if there is an abundance of cheap labour.

Eventually, increasing productivity in the agricultural sector leads to urbanisation and a steady inflow of labour into a hopefully growing manufacturing industry. The implication is that deliberate policy-induced diversification from primary agricultural production into manufacturing is justified. The state has a role here both in raising the educational level of the agricultural producers and in contributing to creating a demand for low-skilled labour that becomes superfluous when agricultural productivity is raised.

The second major point on the agenda is the development of competitive industries. It must be recognised that in many areas, both India and China were technologically ahead of Europe in industrialisation.¹⁰⁷ The processes of *imitation* and *catching-up* were therefore fundamental to European development.¹⁰⁸ Such processes may be stimulated by importing technology, often in combination with qualified labour.

¹⁰³ Timmer and Akkus (2008).

¹⁰⁴ Adelman (1986), Mellor (1986).

¹⁰⁵ Breisinger and Diao (2008).

¹⁰⁶ Matsuyama (1992).

¹⁰⁷ Pomeranz (2000), Hobson (2004).

¹⁰⁸ Abramowitz (1986).

Trade policy is central here. Far from adhering to a free-trade ideal, European powers originally *protected manufacturing industries* that were judged to be important by the government, using tariffs, export bans and other measures. Free trade is equivalent to opening up a wider spectrum of production and consumption possibilities and so by definition seems to be a preferable alternative to trade restrictions of any kind, but free trade has not been the main road to economic development in countries that have made the transition. During the period of modernisation in the 16th and 17th centuries, England, Holland and other burgeoning national states made extensive use of trade restrictions: export bans, tariffs, and aggressive attempts to monopolise trade. The North American Civil War was officially fought over slavery, but equally important were the divergences between the industrialising North and the agricultural South about what trade policy and industrial policy to pursue.

The European states took on the role as an *important customer* in the development of armed forces controlled by a central power, in certain sectors (e.g. arms, clothing and shipbuilding) by guaranteeing a steady demand. The development of an administration for levying taxes and tariffs was an important instrument to this end, but equally important was the state as the guarantor of a national currency and a *prime mover in the financial systems* that developed.

Government has a role also in generating the right conditions for the development of manufacturing industries, either producing for the domestic market or export-led branches of industry. This requires close cooperation with domestic capital owners, and it is essential that this cooperation is shaped in a way that whatever support is given to industry is both effective while in operation and can gradually be dismantled when it is no longer needed. There is empirical evidence that these measures also in part explain the success of the Western countries. Lehmann and O'Rourke have explored the relationship between tariff rates and economic growth in a group of industrialising countries during the period 1875-1913.¹⁰⁹ Unlike most of the studies made, they focus on the structure of protection rather than average tariff rates – the relative weight of agricultural tariffs, industrial tariffs, and tariffs on other goods. Industrial tariffs turn out to be positively correlated with growth, whereas agricultural tariffs are negatively correlated, although the relationship is often statistically insignificant

¹⁰⁹ Lehmann and O'Rourke (2008).

at conventional levels. There is no relationship between tariffs on other goods and growth.¹¹⁰

The third major phase of economic development is the transition to a service-dominated economy. The limits between goods and services have become fluid by the process of *servicification*. Both the production process and the products become increasingly knowledge-intensive. An increasing number of services are now delivered in electronic form, making it possible to separate the production of services from consumption.

Beyond the Western experience

In the 1950s, Raul Prebisch and Hans Singer advanced the thesis that the world production system has a centre – Western Europe and the United States – and a periphery, where the periphery produces primary goods for the centre, and the centre produces secondary goods for export to the periphery – essentially German localisation theory writ large.¹¹¹ As technology develops, there is a tendency for the centre to retain the gains, because the world trade system reflects the unequal power bases of centre and periphery. At the periphery, by contrast, gains from technical savings accrue to customers in the form of lower prices. Prebisch stressed the decline in terms of trade of non-industrialised countries.

The Prebisch-Singer hypothesis became the intellectual basis of infant-industry protection policies in many developing countries. When these were not successful, the idea of active industrial policies fell into disrepute, but as in the case of the Washington Consensus package, errors may have been made at the stage of implementation rather than in theory itself. Economic policy-making is a difficult task, the record of which is marred by repeated errors, including in developed countries. In recent years, a number of unprejudiced studies of the consequences of active and passive policies have been carried out, and there is growing evidence that there is a case for an active role to be played by the state.¹¹²

¹¹⁰ See also Nunn and Trefler (2010).

¹¹¹ Prebisch (1959), Singer (1964); see also Lewis (1954).

¹¹² For a survey of this literature, see Whitfield (2011).

Recent research on trade and development has put the Prebisch-Singer hypothesis to the test. In *Trade and Poverty*, Williamson summarises a broad research effort in a quasi-definitive analysis of the effects of the expanding trade and international division of labour on standards of living in the industrialising core – Europe and the United States – and the periphery during the 19th and 20th centuries.¹¹³ The process of globalisation contributed to the increasing gap via three important channels: de-industrialisation, inequality, and price volatility in primary products. First, trade contributed to industrialisation in the core and de-industrialisation in the periphery, as trade theory says it should. The changes were quite dramatic. The table below shows the relative shares of world manufacturing output from various parts of the periphery and the industrialising core.

Table 1. World manufacturing output, 1750 to 1938 (per cent). Source: Williamson (2011), based on Simmons (1985) and Bairoch (1982).

Year	India	China	Rest of the periphery	Core
1750	24.5	32.8	15.7	27.0
1800	19.7	33.3	14.7	32.2
1830	17.6	29.8	13.3	39.5
1880	2.8	12.5	5.6	79.1
1913	1.4	3.6	2.5	92.5
1938	2.4	3.1	1.7	92.8

The gains from specialisation accrued unevenly to the two parties, however; although they both gained in income in the short term, the industrialising countries gained much more in growth rates because of the effect of endogenous growth associated with industry.

Second, the gains from trade and specialisation were unevenly distributed within the poor countries, which led to stark increases in inequality. Land, mines and other resources central to primary product exports were owned by oligarchies that were able to appropriate a disproportionate part of the gains. As their political influence grew, they concentrated on protecting their rent-seeking activities rather than on fostering growth. In the land-scarce countries of Europe, and to some extent also in Asia, these tendencies were less pronounced.

¹¹³ Williamson (2011).

The third channel of impact was the terms of trade of primary products, not so much in the form of a continuous deterioration in the periphery as Prebisch and Singer suggested, but via much higher volatility of periphery commodities. Specialisation often meant concentrating on one or two primary products, which added to volatility. It has been confirmed in a number of studies that volatility is harmful for growth, and it is particularly harmful in poor countries.¹¹⁴ From the 1860s to the First World War, the terms-of-trade volatility in the periphery was about 2.7 times higher than in the core. Between the wars, this ratio decreased to 1.4. Interestingly, it was as high as 2.9 during the 1990s.¹¹⁵

It can be concluded from a detailed analysis of the period 1870-1939, that trends and volatility had significantly different effects on core and periphery. The general trend increased growth in the rich countries, whereas it had little effect on the periphery. Volatility damaged growth in the periphery but had little effect on the core. Data is lacking for earlier decades of the 19th century, but as Williamson argues, “it is likely that the test would have been even more supportive there.” Terms of trade explain approximately half the divergence in growth rates between core and periphery during the period 1870-1939, and are estimated to explain three-fourths of the divergence during the earlier part of the 19th century.

The so-called miracles of industrialisation in Asian experiences of the 20th century were also based on very active state involvement in the protection of industries and export promotion. Wade’s detailed study of the role of government in East Asian industrialisation shows that governments in these generally successful countries assumed a very active role in governing the process of industrialisation.¹¹⁶ From a somewhat different perspective, Khan et al. show in a number of detailed studies of Asian countries that the social structure of the economic elite in each country is unique, and that policies have to adapt to local conditions in order to be successful.¹¹⁷ Part of the secret

¹¹⁴ Ramey and Ramey (1983), Acemoglu et al. (2003), van der Ploeg and Poelhekke (2007).

¹¹⁵ Williamson (2012), table 10.2, for the earlier figures and Loayza et al. (2007) for the last figure.

¹¹⁶ Wade (2003). The introduction to this new edition of the original 1990 book by Wade provides an interesting picture of the various positions held at institutions such as the World Bank during the 1990s. See also Weiss and Hobson (1995).

¹¹⁷ Khan and Jomo (eds.) (2000).

lies in the design of conditionality; industry should be rewarded for success in the export market and only for that success.¹¹⁸

In summary, these experiences provide strong arguments for a far more active state than that suggested by the Washington Consensus.

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3.4 Building on experience

No country has grown rich while remaining an agricultural economy. The path that must be followed moves from agriculture via industrialisation to the production of qualified services. A basic question for governments in developing countries today is therefore how to use the experience of previous industrialisation processes.

Modernising the agricultural sector

An essential element of modernisation is an increase in the productivity of the agricultural sector. Land reforms played a central role in the modernisation of those East Asian countries that made a successful transition to industrialism. In Taiwan, land reform was inaugurated by Japan, who had taken control of this part of China in the late 19th century and made use of its own experience from the Meiji restoration. This policy was continued by the Nationalist government after the Second World War.¹²⁰ In South Korea, the United States exercised similar pressure for reform after the Korean War. In contrast, no serious land reform took place in the Philippines because of strong internal resistance from the large land proprietors. The Philippines illustrates the typical trap of stark inequality, high corruption and low growth.¹²¹

Land reforms have been far more difficult to bring about in Latin America and Africa.¹²² The same holds for programmes to increase

¹¹⁸ For discussions of the Indian experience and India's somewhat idiosyncratic path, see Aghion et al. (2005), Rodrik and Subramanian (2005) and Kochhar et al. (2006).

¹¹⁹ Reinert (1999), (2007).

¹²⁰ Wade (2003), pp. 73, 76, 243.

¹²¹ You (2014).

¹²² For a broad overview of the problems connected with land reform, see Lipton (2009); for Latin America specifically, Kay (2002), and for Africa, Lumumba-Kasongo (ed.) (2016).

agricultural productivity; the Green Revolution has not taken place in large parts of Africa in the way it transformed Asian agriculture.¹²³

More generally, research and development in the agricultural sector has shifted focus in recent decades in a way that threatens the development of productivity in poor countries. The second wave of potential production increases after the Green Revolution, propelled by genetic modification, has not targeted higher yields.¹²⁴ In rich countries, where most agricultural R&D is located, research agendas are dictated more by changing dietary patterns, precision farming technology and other capital-intensive production modes. Strengthened intellectual property-rights regimes also imply that technologies that were once freely accessible will be more difficult and expensive to acquire in the future. In summary, research interests are diverging between rich and poor countries.¹²⁵

Industry

As we have seen, there are strong arguments for careful design of the transition processes connected with industrialisation. The structure of tariffs is important, and optimal levels depend strongly on the level of development of the existing manufacturing industry. Industries that are closest to the technological frontier are those that benefit most from trade liberalisation. Countries that have not developed competitive industries should exercise great care in the transition process.

There are signs of an increasing role for manufacturing industries in the economies of developing countries.¹²⁶ There have been substantial reductions in trade barriers inhibiting the participation of these countries in world trade. Lower barriers have shifted the pattern of developing country trade away from commodity exports towards manufacturing and services. Trade between developing countries has also become more important. Nonetheless, volatility remains high in Africa and parts of Asia.¹²⁷

¹²³ For contrasts between Asian and African reform attempts, see van Donge et al. (2012).

¹²⁴ Lipton (2007). See also World Bank (2007) for a general discussion of the agricultural sector.

¹²⁵ Pardey et al. (eds.) (2006).

¹²⁶ Martin (2003); Williamson (2011), Chapter 10.

¹²⁷ Williamson (2011), Table 10.1.

A number of writers have pointed to the potentially problematic process of *premature de-industrialisation* in developing countries.¹²⁸ Traditionally, the manufacturing industry grows at the cost of the agricultural sector, whereupon the service sector starts growing and the employees in this sector eventually outnumber those in the manufacturing sector. It appears that the peak in manufacturing occurs earlier now than was previously the case, and there is a risk that the manufacturing industry will be insufficient to play the same role as it did in countries that industrialised earlier in history.

Botswana represents a more classical variant of the problem. The diamond industry thrives and the quality of government is high, in spite of otherwise unfavourable conditions, but the manufacturing industry contributes only 4 per cent to the GDP, which raises doubts about the sustainability of economic development.¹²⁹

In several respects, developing countries in Africa now face a more difficult challenge than the developing countries of yesterday. Wage increases in manufacturing that were associated with early industrialisation processes in the West have also been seen in China and India, but there are sizeable reservoirs of inexpensive labour in these countries and their immediate neighbours. In China, there have been substantial wage increases in the large industrial centres in recent years, matching productivity increases, and the response of industry has been to move towards the inner parts of the country and other countries in South East Asia.¹³⁰ Because capital is now more mobile than it was half a century ago, the downward pressure on wages is stronger.

Traps

So far, some of the main factors that affect growth have been discussed separately. It is a common observation that problems in one dimension are seldom isolated. A poorly developed infrastructure leads to high production costs in agriculture and the manufacturing sector. Weak tax bases create problems on the revenue side of the budget, which leads to negative effects elsewhere in the public sector

¹²⁸ Dasgupta and Singh (2006), Rodrik (2015), Amirapu and Subramanian (2015).

¹²⁹ Hillbom (2008).

¹³⁰ *The Economist*, March 14th, 2015.

and eventually also in the economy at large. As a result, developing countries can get stuck in equilibria characterised by malfunctioning in a number of dimensions – *traps* – where problems in different sectors go together and the countries suffering from similar deficiencies tend to form clusters.

A large part of the literature about development traps refers to basic economic conditions as well as to institutions and to inequality;¹³¹ this will be discussed further in Chapters 4 and 5. Suffice to mention in this context that development traps can also be deduced within a traditional (neoclassical) analytic framework, where one or several of the basic assumptions break down. Murphy et al. developed a model in which a simultaneous and coordinated investment effort may be necessary to lift a country out of a development trap.¹³² A condition for this to happen is that there are positive spillovers from each of the investments on other activities and that each investment in isolation is non-profitable. This model provides formal support for the old idea of *the big push* as a mechanism to put a country in a virtuous circle of development.¹³³

Another type of trap, related to education and human capital accumulation, was identified by Galor and Zeira.¹³⁴ In this case the dysfunctional equilibrium is connected to inequality and the impossibility, above a certain threshold, of starting a process of human capital formation. There may also be a role for active government policies in this situation.

3.5 Developing countries in the international trade regime

Among the policy issues that directly concern the relationship between developing and industrialised countries, one item appears to be particularly important: the trade regime chosen by the developing country – the degree of openness, conditions for foreign investment, restrictions on support to domestic industries under the WTO framework etc. Both rules and practice in this field are in many respects better adapted to the needs of countries that are already

¹³¹ Azariadis and Stachurski (2005).

¹³² Murphy et al. (1989).

¹³³ Rosenstein-Rodan (1943).

¹³⁴ Galor and Zeira (1993).

industrialised than to the needs of low-income countries. As we have seen above, the division of labour resulting from trade development has historically led countries in the latter group into a raw-materials trap that blocked the way to industrialisation, further aggravated by large inequalities and high price volatility. Even as some of these countries are now entering the road to industrialisation, price volatility remains a problem.¹³⁵

There are also new formal obstacles on the way to development. Imitation, one of the important strategies of yesterday, is severely circumscribed by patents and copyright legislation following the agreement on trade in intellectual property rights (TRIPS). The WTO framework has reduced the room for manoeuvre in the area of tariff protection and export promotion. It appears that low-income countries subject to structural adjustment programmes have also been forced to apply even lower tariffs than those prescribed.¹³⁶ There is also evidence that whatever room for there is for manoeuvre is not used optimally but is to a considerable extent governed by rent-seeking activities.¹³⁷ Some observers have claimed that these are deliberate policies designed to keep low-income countries in their present state of being the suppliers of raw materials and inexpensive labour – “kicking away the ladder” as it were, to higher levels of income.¹³⁸

The WTO is not an organ of development cooperation. On the contrary, it was designed for interaction between countries that are relatively equal partners in a negotiation. The restrictions built into the framework – quite legitimately protecting the idea of free trade between equals – also pose problems for countries that are at an earlier stage of economic development and want to mimic some of the policies applied by countries that are now developed. Admittedly, the WTO agreements include provisions giving developing and least-developed countries special rights or extra leniency, so-called *special and differential treatment*. Among these are provisions that allow developed countries to treat developing countries more favourably than other WTO members. The General Agreement on Tariffs and Trade (GATT, which deals with trade in goods) permits a certain level of non-reciprocity in trade negotiations between developed and

¹³⁵ Williamson (2011).

¹³⁶ Khan (2007).

¹³⁷ Nunn and Trefler (2010).

¹³⁸ Chang (2003).

developing countries. These non-reciprocity schemes are designed unilaterally in developed countries such as the United States and in the European Union, and so it should come as no surprise that they have not been particularly beneficial to developing countries.¹³⁹ Exceptions are made for so-called *sensitive products*, and these often happen to be the products where developing countries have their most pronounced comparative advantages. Rules of origin apply and are often so constraining that countries have to pay standard tariffs. Even where preferences do have a value, this is often captured by the importers and distributors in high-income countries.

Other measures concerning developing countries include extra time to fulfil their commitments, provisions designed to increase market access, special provisions concerning the interests of developing countries when adopting measures such as anti-dumping, and provisions for helping developing countries to deal with, for instance, animal and plant health standards. Nonetheless, there is room for further improvement of the framework. Measures to address the general heterogeneity of the group of WTO members include:¹⁴⁰

- greater policy flexibility for developing countries, as long as spillovers to other members are limited
- adapting the implementation of new rules to national priorities
- the possibility of opting out of a certain regime for a limited time period, depending on level of development, administrative capacity etc.

Trade does not materialise automatically, as soon as the possibility arises; limitations in infrastructure, administration etc. may represent important obstacles. The international initiative *Aid for Trade* seeks to address issues of importance to the ability of developing countries to export and import, thereby providing a link between trade policy and development cooperation. In addition to capacity-building in trade policy and regulations, it includes trade-related infrastructure and the building of productive capacity (business and financial services, agriculture, manufacturing, mining etc.). Sweden participates in this international initiative and has registered some success, for instance in East Africa. At the international level, *Aid for Trade* has been

¹³⁹ For a detailed treatment, see François et al. (2006).

¹⁴⁰ Hoekman (2005).

examined by the OECD and the WTO.¹⁴¹ A number of favourable results and valuable experiences are reported. The initiative is particularly valuable for the least-developed countries and for small and medium-sized enterprises. Success depends on a policy environment that is conducive to economic development, however, and many of these policy elements lie outside the trade policy agenda. Assistance with policy coordination from the donor community can therefore be a suitable complement.

3.6 Development cooperation and growth

If economic growth in some form is vital to societal development, it is natural to ask what contributions from overseas development aid economic growth. There is a large body of literature on this subject, which will be briefly reviewed here.

Critical literature

Overseas development aid (ODA) was criticised at an early stage of its development. Bauer's *Dissent on Development*, published in 1971, became particularly appreciated among right-wing politicians in the West. Bauer stressed the importance of private property and individual effort in moving from a subsistence economy to a higher standard of living, a position for which he had argued in a previous work with Yamey¹⁴². He also argued that dynamic gains from international trade were fundamental to economic development. In his view, ODA is neither necessary nor sufficient for development, and might actually be an obstacle. It tends to work best where it is least needed.

These arguments have been repeated and developed since they were first presented. A number of critical analyses of ODA have been published: Karlström's *Aid – An Impossibility*¹⁴³, Easterly's *The White Man's Burden*¹⁴⁴, Moyo's *Dead Aid*¹⁴⁵, and Deaton's *The Great*

¹⁴¹ OECD/WTO (2015).

¹⁴² Bauer and Yamey (1957). An illustrative example is that low production is considered unimportant if it is the result of a decision of a private landowner, for instance fallow (p. 56), but transformation of communal land into private property should be encouraged by government in order to ensure that production is sufficient (p. 174).

¹⁴³ Karlström (1996; in Swedish: *Det omöjliga biståndet*). The first edition of this book was published in 1991.

¹⁴⁴ Easterly (2006).

*Escape*¹⁴⁶. There is a common theme in these works – that aid as an institution is more or less bound to fail and that low-income countries must adapt themselves to more normal conditions of economic and social development: opening up their economies for trade, investment financing via normal financial markets, and so on. Aid in its current form perverts the incentives of governments and administrations in partner countries, contributes to corruption, and is, generally speaking, not efficient.

There is also a body of literature that focuses on the incentives of the ODA system in order to provide a diagnosis for its shortcomings. *The Institutional Economics of Foreign Aid* by Martens et al.¹⁴⁷ and *The Samaritan's Dilemma* by Gibson et al.¹⁴⁸ are representative of this approach. These analyses are more sympathetic to aid as such, and attempt to find remedies in changing the general modalities of aid or the design of projects.

The critique presented is rather sweeping, and other observers have come to different conclusions. Riddell stresses the generally poor information underlying much of the follow-up and evaluation literature: “While the quality of the information and data contained in these studies [donor studies of country impact] has certainly improved over time, with some notable exceptions... the overwhelming majority of these studies provide insufficient information from which to draw firm conclusions about aid impact at the country level – as most authors readily and explicitly acknowledge.”¹⁴⁹

When considering these differences of opinion, it must be borne in mind that a very large number of different activities have been presented under the umbrella of foreign aid. Motives differ – strategic, geopolitical, traditional, and genuinely development-related – and there may also be differences between officially declared motives and real motives.¹⁵⁰ Against this backdrop, it should be no cause for surprise that ODA often comes out poorly in evaluations; only the part of ODA that is actually used for development purposes should

¹⁴⁵ Moyo (2009).

¹⁴⁶ Deaton (2013), Chapter 7.

¹⁴⁷ Martens et al. (2002).

¹⁴⁸ Gibson et al. (2005).

¹⁴⁹ Riddell (2007, p. 214); summarised in Riddell (2014).

¹⁵⁰ Alesina and Dollar (2000).

count in evaluation, and even that is multifarious (debt relief, cash transfers, food programmes, etc.). Two questions must consequently be kept separate – the efficiency of aid delivered so far, and the potential efficiency of aid. In Radelet's words, aid can contribute to genuine development goals under certain circumstances, conditions that connect either to the country context or to characteristics of aid management.¹⁵¹ Pertinent country-related factors are, for instance, level of education, financial development level, and the governance context (political stability, quality of democracy and administration, macroeconomic policies pursued). Aid-related factors of importance are the total volume of aid, the type of aid (modality or sector), and aid governance, such as donor and recipient policies and approaches (ownership, fragmentation, stability, as exemplified in the Paris agenda).

Another recurrent and rather natural observation is that outcomes are easier to identify at the project and programme level than at higher levels. In its annual report for 2014, Sida reports that, thanks to Sida projects, more than 2 million people have gained access to clean water, more than half a million children have been vaccinated against measles, and close to 100 000 people have gained access to electricity.¹⁵² On the other hand, 144 cases of corruption in Swedish development cooperation were reported during the same year, an increase from the previous year.¹⁵³ Both supporters and critics of foreign aid can easily find such concrete examples to strengthen their case, but it is difficult to draw any general conclusions from such examples. Even impeccable randomised control trials suffer from a problem of generalisability. Failures are not unique to the foreign aid sector; most private sector activities suffer from repeated mistakes. If organisations do not learn from mistakes, *that* is cause for concern – not the mistakes in themselves.

It is also worth noting that critics of foreign aid present few promising alternatives. Apart from general references to the benefits of markets, Moyo argues in favour of trade, microfinance, remittances, and the marketisation of dormant assets along the lines suggested by de Soto.¹⁵⁴ We have seen that trade is ambiguous in its effects, because short-term gains from increased exchange may be more than offset by

¹⁵¹ Radelet (2006).

¹⁵² Sida (2015).

¹⁵³ OmVärlden 24 februari 2015.

¹⁵⁴ de Soto (2000), summarised in de Soto (2001).

lost opportunities in industrialisation, by increased inequality, and by price volatility that hampers growth.¹⁵⁵ Microfinance has been tried in a number of countries with some success, but it is certainly not the panacea that it is often presented to be.¹⁵⁶

Remittances are now significant, amounting to at least twice the total ODA flow, and they have the advantage of strengthening the purchasing power of less well-off households while still keeping under the radar of predatory corruption. Estimated remittance flows have soared in recent years, but the effect on growth in single countries has been difficult to detect. Clemens and McKenzie claim that a large part of the recent rise in measured remittances may be illusory rather than real.¹⁵⁷ Even if these increases were correctly measured, they would still be too small to be detected in the growth rate. Further, the most important factor behind rising remittances is migration, which of course has an opportunity cost in the form of production lost at the origin. Migration and remittances can be expected to affect global GDP positively, but attempts to detect their effects on the growth of the origin economy will most likely be in vain.

There is scattered support for de Soto's suggestion that the poor in low-income countries possess significant assets which are not marketable in the absence of formal entitlements from India, where gold assets – not all belonging to poor people – were attracted into the formal banking system following a government initiative. There is also an analysis of an entitlement experiment in Peru by Field.¹⁵⁸ Between 1996 and 2003, the Peruvian government issued property titles to more than 1.2 million urban households. Because there were differences across regions caused by the timing of the programme and across target populations in levels of pre-programme ownership rights, it was possible to identify the causal effect of ownership rights. According to the estimates, the programme led to a substantial increase in hours worked, a shift towards the formal labour market, and the substitution of adult for child labour.

A similar natural experiment in the suburbs of Buenos Aires has been analysed by Galiani and Schargrodsky.¹⁵⁹ In 1981, squatters

¹⁵⁵ Section 3.3.

¹⁵⁶ Bjorvatn (2015).

¹⁵⁷ Clemens and McKenzie (2014).

¹⁵⁸ Field (2007).

¹⁵⁹ Galiani and Schargrodsky (2010).

occupied a piece of land in a poor suburban area of Buenos Aires. In 1984, a law was passed expropriating the land from the former owners to entitle the occupants. Data from two surveys performed in 2003 and 2007, reveals that entitled families increased housing investment, reduced household size, and enhanced the education of their children relative to a control group. These effects, consequently, did not take place through improvements in access to credit, but through the slower channel of physical and human capital accumulation. Like microfinance, such examples illustrate the potentially limited benefit of entitlements rather than a universal solution to the problem of poverty alleviation.

In summary, nobody in the foreign aid debate can claim to have a solution. All the measures that have been proposed are partial; at best they can contribute to triggering a virtuous circle of change given the right conditions and a judicious combination of instruments. It is in the conviction that there is, in the words of Chauvet and Collier, “an alternative to Godot” that a niche for foreign aid should be carved out.¹⁶⁰

Empirical studies¹⁶¹

The first generation of empirical studies of aid and growth, produced in the 1970s, focused on the extent to which aid increases savings and investment in recipient countries. A second generation, dating from the 1980s and early 1990s, went one step further and tried to measure the impact of aid on growth via investment. These two generations reflect the influence of the Harrod-Domar model of economic growth. Hansen and Tarp summarise the first-generation studies as generally concluding that aid does increase total savings, while the second-generation studies consistently indicate a positive link between aid and investment.¹⁶² In all 131 studies reviewed by Hansen and Tarp, aid led to an increase in investment, and in all but two effects on growth were positive.

A third-generation from mid-1990s, reflecting the rise of the Washington Consensus, has been christened “the conditionality

¹⁶⁰ Chauvet and Collier (2005).

¹⁶¹ For a recent general survey, see Glennie and Sumner (2014).

¹⁶² Hansen and Tarp (2000).

literature” by Stockemer et al.¹⁶³ Conditionalities come in different forms: as a requirement of *policies* – aid works if the recipient government has ‘good’ policies;¹⁶⁴ as a requirement of *dosage* – aid works in correct amounts but is ineffective if too scarce or too abundant;¹⁶⁵ or as a requirement of *institutions* – aid works if the right institutions are in place.¹⁶⁶

Many studies in this generation suffer from fragility in their findings. Roodman tested seven well-cited aid-and-growth studies and found that none of the results were robust with respect to sample expansion, changes in definitions of aid, changes in time periods and other factors.¹⁶⁷

A fourth generation of analysis was provoked by Rajan and Subramanian, who claimed to find no effects from aid on growth.¹⁶⁸ A good representative of this generation is the careful study by Clemens et al., which is critical to many of the previous studies in the field.¹⁶⁹ First, the most cited research has focused on measuring the effect of aggregate aid on contemporaneous growth, while many aid-funded projects can take a long time to influence growth. Investing in a new road may affect economic activity more or less immediately, whereas contributions to the areas of health or education may take a decade or more to yield visible effects. Second, because current growth is likely to affect current aid, it is necessary to separate correlation from causation. A common approach is to rely on instrumental variables, but the instruments used are of questionable validity and strength.

The authors allow aid to affect growth with a time lag, use first-differencing to remove the effects of time-invariant omitted variables, and consider only those parts of aid that can be expected to produce growth within a few years. With these modifications, the data reveals that over the last three decades, substantial increases in aid receipts were followed on average by small increases in both investment and growth. The magnitudes found are reasonable and consistent across different specifications. A one percentage-point increase in aid/gross domestic product (GDP) typically results in a 0.3–0.5 percentage-

¹⁶³ Stockemer et al. (2011).

¹⁶⁴ E.g. Burnside and Dollar (2000, 2004), Collier and Dollar (2002).

¹⁶⁵ E.g. Collier and Hoeffler (2004), Dalggaard et al. (2004).

¹⁶⁶ E.g. Doucouliagos and Paldam (2006).

¹⁶⁷ Roodman (2007).

¹⁶⁸ Rajan and Subramanian (2005).

¹⁶⁹ Clemens et al. (2012).

point increase in investment/GDP and a 0.1–0.2 percentage-point increase in growth of real GDP per capita.

These results do not imply that aid works everywhere, or even in the typical recipient country. A universal result in analyses of the relationship between aid and growth is that a large number of countries lie far from the regression line, that is, they deviate from the expected effect. In a number of countries, even large aid inflows have been insufficient to trigger growth even when the time horizon is extended. A second observation of some importance is that the relationship between aid and growth appears to be nonlinear, demonstrating decreasing returns to scale at high levels of aid flows.¹⁷⁰

A UNU-Wider survey¹⁷¹ of the effects of aid on growth and employment similarly finds that it is positive in all but two of the sixteen studies in the survey and that there is a statistically significant positive average effect across the set of studies.

Recently, Galiani et al. improved on the identification of older papers using a strategy similar to regression discontinuity.¹⁷² The focus is on 35 poor countries, some of which have crossed an arbitrary per capita income threshold that made these countries ineligible for aid from the World Bank's International Development Association (IDA). The effect of aid can be estimated under the assumption that countries just above or below the threshold are identical except that the former receive less aid. The main finding is that aid does indeed increase growth. A one percentage point increase in the aid-to-GNI ratio from the sample mean raises annual real per-capita growth in gross domestic product by approximately 0.35 percentage points.

In summary, a stable result from these fourth-generation analyses appears to be that aid does on average contribute to economic growth and increased per capita income, but the effects may take time to materialise and they are, on average, modest.

¹⁷⁰ Roodman (2015) has criticised the conclusions as not being robust, but the critique appears unwarranted; see the response by Bazzi and Bhavnani (2015).

¹⁷¹ UNU-Wider (2014).

¹⁷² Galiani et al. (2014).

3.7 Summary

General conditions for growth

In very general terms, there is consensus about the conditions that are conducive to steady economic growth. Some of these factors – geography, history, religion – are given, and are difficult or impossible to affect through policy choices, whereas other are possible to change in a political process. Most accounts of the growth phenomenon mention well-functioning markets for goods, services and capital, efficient infrastructure, an educated labour force, macroeconomic stability, a sufficient saving ratio, public finances in good shape, and efficient public administration.

Above all, education stands out as a key lever for lifting a country out of a dysfunctional but stable decreasing-returns-to-scale equilibrium, although it must be recognised that efforts to improve the education system will yield visible effects only in the medium to long term. Classical factors such as infrastructure investment and maintenance and technological transfer are also confirmed as important, but not quite at the level suggested by early literature in this field.

The Washington Consensus versus the Other Canon

For decades, the policy corpus summarised in the Washington Consensus (WC) package dominated thinking and policy-making in the area of development. This is somewhat surprising, given that both theoretical and empirical support are weak. Detailed studies of the effects of trade liberalisation are ambiguous, and the links between saving, investment and growth are far from clear. Looking at the history of industrialisation both in the West and more recently in Asia, one finds that the policies pursued were very different from the Washington recommendations and in several respects ran counter to them. These experiences – amounting in summary to the alternative of the Other Canon – provide arguments for a more important role for the government than the Washington policy package suggests.

This is not to say that all WC recommendations are all irrelevant or dysfunctional. Sustainable monetary and fiscal policies supported by a

reasonably efficient administration remain an important building-block, no matter what policies are developed in other areas. At best one can hope for a synthesis of the two traditions, maintaining respect for the complexity of the decision problems confronting politicians in developing countries while imposing some of the rigour of the neoclassical tradition.

Trade policy

Building on the experiences of now industrialised countries, it can be concluded that trade policy is an area where an active state is justified. Tariffs are not the only instrument for fostering industrialisation and are most often not optimal; a variety of measures other than tariffs should be considered. The WTO framework, although allowing for special and differential treatment of developing countries, is skewed against the interest of these countries, and the use of trade policy instruments made by the US and the EU is far from always conducive to economic development in low-income countries.

Consequently, trade policy is a key area where policy adjustments should be considered, possibly both at the EU level and at the WTO level, with the aim of providing developing countries with more room for manoeuvre in designing their industrial policies.

Aid and growth

The literature on the effects of aid on growth indicates that there is a significant, although rather weak effect. This general conclusion goes against claims in the critical literature that aid at best has no effects on growth and may even be counterproductive. This does not imply that aid has a visible effect in the median country, let alone everywhere. The effects observed vary significantly across countries, and aid seems to result in decreasing returns to scale when aid flows become large.

Growth is necessary for development, but the kind of growth that is generated is not immaterial. This will be discussed further in Chapter 5. First we will turn to the important intermediate factor in the growth panorama – institutions.

4 State-building

During the 1990s, the importance of well-functioning institutions was gradually more strongly stressed in the development literature, partly as a result of numerous studies that aimed to prove a causal relationship between public institutions and economic growth rates or other outcomes relevant to development policy-making. To some degree, this research effort was triggered by increasing problems with deficits and debt accumulation in the industrialised countries during the 1980s. It was realised that different countries were more or less successful in meeting these challenges, and that part of the explanation could be found in the institutional framework of public decision-making. In short, institutions are not neutral – they make certain policy choices more likely and others less likely.

The present chapter starts with a survey of this literature, aimed at answering the question, “Do institutions matter?” The answer is in the affirmative, which naturally leads to questions about the scope and focus of public interventions. The framework used here is abstract and general and will be used a second time when addressing the issue of development policies in Chapter 6. The following section is devoted to the problem of raising the revenues needed to finance the expenditure thus defined. Experiences from development cooperation in the field of state-building are summarised in the concluding section.

4.1 The importance of history and institutions

When looking at a global map of gross national income per capita, it is striking to see how much the topography of wealth can tell us about the colonial history of a country. Western Europe, where the once dominant colonial powers are found, belongs to the top stratum, together with the United States, which liberated itself in the 1770s and joined the group of colonisers. Asian states that managed to move up the income ladder and join the high-income group – Japan, South Korea, and Taiwan – are countries where Western colonialism never fully penetrated, like China, which is now swiftly moving forward.¹⁷³ Most countries in Africa gained independence only after the Second World War, and as consistent with the overall pattern, are low-income

¹⁷³ Hong Kong and Singapore are special cases, being cities rather than countries.

countries. Latin America has fared somewhat better, but then it gained independence a few decades into the 19th century. The colonial powers here left a problematic institutional heritage and a social structure characterised by stark inequality, with lasting effects on growth and development.

If there are strong arguments for an active state relying on solid institutions, it is nonetheless reasonable to ask just how important these institutions are to societal development when compared to history or geography. Numerous studies have shown that social and economic development have gone hand in hand with the establishment, and enhanced quality, of public institutions, but the question of causality remains open in most cases. Nunn summarises his review of the literature on the importance of history and institutions in the following way: “Although the literature has made considerable progress in showing that history matters, the exact channels of causality through which history matters are less well understood. For most of the studies undertaken to date, the greatest shortcomings lie in their inability to identify the exact mechanism or channel of causality.”¹⁷⁴

Human capital versus property rights

In the academic debate over the determinants of social and economic development, there are two main camps: those who stress the importance of natural conditions or the long history (or both), and those who highlight factors that are shaped by more recent political choices – policies. The former camp is represented, for instance, by Sachs, who argues that geography provides the main determinants, but also by Rodrik et al., who by contrast claim that institutions are fundamental and drown the effects of geography.¹⁷⁵ In the second camp, one finds Glaeser et al., who raise a number of objections to the institutional version and claim that the causal link goes from growth to good institutions rather than in the opposite direction.¹⁷⁶ These authors claim that a number of indicators used to measure institutional quality are unsuitable for that purpose, mainly because they are volatile and thus do not reflect deep and stable characteristics.

¹⁷⁴ Nunn (2009).

¹⁷⁵ Sachs (2004), Rodrik et al. (2004). See also Djankov et al. (2003).

¹⁷⁶ Glaeser et al. (2004).

The key factor is claimed to be education, which we have already met as affecting growth and development via a number of different channels. In the context of political institutions, this argument goes back at least to Lipset.¹⁷⁷

Acemoglu et al. take issue with this explanation, arguing that the key factor is the protection of property rights, using the risk of expropriation as the indicator.¹⁷⁸ But the risk of expropriation is a questionable indicator in this context. In certain situations one would argue to the contrary, that protection of property rights stands in the way of development, for instance by protecting large land-owners from land reforms, thereby hindering the emergence and growth of a class of freeholders. Further, as we have argued earlier, the protection of property rights is an ambiguous concept, given that political conflict often stems from a clash between different sets of property rights; the question pertaining to economic development is which set of property rights is most conducive to growth. An interesting example from Swedish history is the expansion of hydropower around the turn of the century, in 1900.¹⁷⁹ In order to make the expansion of hydropower generation possible, it was considered necessary to encroach on age-old water rights belonging to land-owners along the major Swedish rivers, because they had the potential to veto any use of the water that threatened the natural course of the rivers. In other parts of the world, similar clashes have occurred between corporations and aboriginal populations, where the latter almost always find themselves in weaker positions because their rights are not codified. In countries with a history of colonisation, the legitimacy of formalised property rights is often highly dubious, being the result of land-grabbing operations generations in the past.¹⁸⁰

In summary, some types of property rights are conducive to growth and development, whereas others rather represent obstacles. Further, a given property right may be growth-enhancing in one situation and represent an obstacle in another.

An interesting contribution by Acemoglu et al. concerns literacy and the accumulation of human capital. They use the density of Protestant missionaries as an instrument to study regional variation

¹⁷⁷ Lipset (1959, 1960).

¹⁷⁸ Acemoglu et al. (2014).

¹⁷⁹ Lundgren (1978), Chapter 2.

¹⁸⁰ For examples, see Kieh (2016) and Chikulo (2016).

within countries, which consequently have the same institutional framework but generate different levels of human capital, but this example illustrates precisely what can be achieved via different policies within a given institutional framework, and so indicates that there is substantial freedom of action even when history and institutions are considered as given.

Budgetary institutions

In the industrialised world, the importance of budgetary institutions to fiscal policy and outcomes is an established fact, and similar conclusions have been drawn for middle-income countries. Dabla-Norris et al. have carried out a similar analysis of low-income countries, based on multi-dimensional indices of the quality of budget institutions.¹⁸¹ The study provides empirical support for the hypotheses that strong budget institutions help improve fiscal balances and public external debt outcomes, as measured by higher primary balances and lower debt. Countries with stronger fiscal institutions also have more scope to conduct countercyclical policies. The analysis suggests that the (statistically) most significant institutions are those related to planning and implementing the budget, and to the sustainability, comprehensiveness, and transparency of the budget process. The results do not suggest that other factors, such as rules concerning the legislature and the external audit agency, or top-down budgeting, are unimportant for the future development of budget institutions.

Corruption and rent-seeking

Corruption, although certainly not a new phenomenon, has only relatively recently been placed on the development agenda.¹⁸² There is a general consensus that corruption is a problem, although estimates are by definition uncertain and opinions about the consequences of corruption differ.¹⁸³ A common definition is that corruption is the

¹⁸¹ See Dabla-Norris et al. (2010), which also contains references to the previous literature on middle- and high-income countries.

¹⁸² An ambitious tutorial such as Ray's *Development Economics* does not even mention the problem (Ray 1998).

¹⁸³ For general references to the relevant literature, see Rose-Ackerman (ed.) (2006).

misuse of public office for private gain, but this can be challenged for several reasons. It excludes corruption within the private sector, which exists, for instance, in the form of breach of trust vis-à-vis shareholders. Rothstein and Tannenbergs criticise the definition for being vague in the sense that the term *abuse* is context-dependent. Their alternative definition is that quality of government (in this case, absence of corruption) should be understood as respect for the principle of impartiality in the implementation of public policies.¹⁸⁴ This definition is open to the same form of criticism, however; *impartial* is understood to mean that decisions should not be affected by irrelevant factors, and relevance is again a culture - or context - dependent concept.

Corruption levels are normally reported on the basis of interviews, that is, they are *perceived* levels rather than actual. The Corruption Perception Index produced by Transparency International is one of the most often used. In some situations, such as public procurement or following extraordinary audit input, it may be possible to come closer to actual levels.¹⁸⁵ Perceived levels can be assumed to underestimate the problem, given that most interviewees are reluctant to give correct answers. Kraay and Murrell applied a technique (originally developed by Warner¹⁸⁶) to reveal the true levels using a randomisation mechanism when answering sensitive questions.¹⁸⁷ In the original design, the interviewer does not know whether the respondent answers the actual question or follows the randomisation mechanism, which should make interviewees more inclined to answer truthfully.

When applied to a business enterprise survey in Peru, the reticence-adjusted rate of corruption turn out to be about twice as high as that previously reported. Reticence-adjusted estimates of corruption are also substantially higher in some Asian countries, but vary. A general and important conclusion from this exercise is that corruption estimates that are based on interviews – which are the overwhelming majority used in analysis and research – are highly uncertain. This casts a shadow of doubt over analyses of both the determinants and the effects of corruption.

¹⁸⁴ Rothstein and Tannenbergs (2015).

¹⁸⁵ For a survey of such techniques, see Olken and Pande (2012).

¹⁸⁶ Warner (1965).

¹⁸⁷ Kraay and Murrell (2013). For a similar message, see Olken (2006).

A number of different possible determinants of corruption have been investigated – the level of economic development, human capital, trade openness, religion, institutional heritage, freedom of media, and political factors such as the voting system rules concerning public office. There is a stable observation that rich countries have lower corruption levels than poor countries, but the spread around the regression curve is large, indicating that the level of economic development is but a partial explanation of corruption. Human capital, measured for instance by years of schooling, yields stable results; higher education levels lead to less corruption. Countries with a Protestant tradition appear to have a lower level – possibly mediated by education – but religious influence is generally fragile.¹⁸⁸ There also seems to be some effect from colonial heritage via institutions.¹⁸⁹ A liberal trade regime appears to have some positive effect, but it is weak when controlling for other factors of importance. Similarly, the effect of democracy is weak and only clearly visible after many decades of democratic rule.¹⁹⁰

The next important question concerns the *effects of corruption*. Svensson mentions a cost of 3 per cent of the global GDP, as regards the size of the problem in economic terms, but this should be considered a very rough estimate giving an idea of the order of magnitude.¹⁹¹ Whereas relatively precise estimates of costs are possible at the micro-level – single projects or activities – it has turned out to be difficult to produce significant figures at the aggregate level, because the socioeconomic costs are different from the sums of bribes or kickbacks that have been transferred in the individual case. In a follow-up to a previous study, Reinikka and Svensson show that increased transparency about transfers to schools in Uganda led to increased school enrolment with potentially strong effects on the creation of human capital.¹⁹²

The effects of estimated levels of corruption on growth rates are in general not significant.¹⁹³ This echoes the previously cited observation by Khan that the positive correlation between good governance (in the present sense) and growth is driven mainly by the prevalence of good

¹⁸⁸ Treisman (2000).

¹⁸⁹ LaPorta et al. (2007).

¹⁹⁰ Treisman (2000).

¹⁹¹ Svensson (2005).

¹⁹² Reinikka and Svensson, (2004, 2005).

¹⁹³ Mauro (1995), Svensson (2005).

governance in rich countries, and that corruption is not a critical factor from the perspective of economic growth.¹⁹⁴ Although corruption is certainly a problem to be taken seriously, it is perhaps not the “lethal” disease that it is sometimes claimed to be.¹⁹⁵ After all, China and a number of other East and South Asian countries have achieved high growth rates over long periods in spite of very high reported levels of corruption.

Khan and Jomo et al. have addressed this issue by widening the perspective from corruption in the narrow sense to *rent-seeking*.¹⁹⁶ *Rent* is understood as remuneration at a level above that which an ideal market would yield. In simple economic reasoning, rents always imply costs to society and conditions or institutions that protect rents should always be removed. In real economies, the situation is very different and rents may be essential to growth and development.

Khan distinguishes a number of different sources of rents.¹⁹⁷ *Monopoly rents*, when analysed in a classical framework, imply higher prices – a transfer from consumers to producers – but also pure efficiency costs. Apart from the direct cost stemming from high prices, monopoly producers may be inefficient because they are not subject to competition, but also – and perhaps more importantly in the long run – because they neglect investment in new technologies. *Natural resource rents* accrue to owners of land, fishing waters, mines etc. In the absence of property rights, profit-maximising producers have an incentive to over-exploit their resources, because the costs that they face are lower than the actual costs.¹⁹⁸ The design of property rights to cope with this problem may of course vary – private, collective etc. A number of different rents originate from information deficits and asymmetries: *Schumpeterian rents* to innovators who acquire an advantage over competitors, *rents for learning* (acquiring modern technology and adapting it to local circumstances), and *rents for monitoring* management efficiency and exploiting efficiency gaps, often exercised by financial institutions. Rents may also be created as *politically decided transfers* to new groups of producers, as compensation to losers in transformations processes etc.

¹⁹⁴ Khan (2006).

¹⁹⁵ World Bank (2010).

¹⁹⁶ Khan and Jomo (eds.) (2000).

¹⁹⁷ Khan (2000).

¹⁹⁸ This is referred to as *the tragedy of the commons* (Hardin 1968).

These different types of rents have varied effects on efficiency in the short term and growth prospects in the longer term. They also depend critically on local conditions – the state of development of various sectors in the economy, the relative power of interest groups connected with various resources, and other parameters. These effects are summarised in the table below, together with succinct comments.

Table 2. Implications for efficiency and growth of various types of rents.
Source: Khan (2000).

Type of rent	Effects on efficiency and growth
Monopoly rents	Inefficient and most likely retarding growth
Natural resource rent	Efficient and normally growth-enhancing
Schumpeterian rent	May be efficient and normally growth-enhancing
Learning rent	Inefficient but may be growth-enhancing
Monitoring rent	May be efficient and growth-enhancing
Transfers	Possibly neutral but may have negative effects on short-term incentives. Long-term effects are indeterminate.

In a number of detailed analyses from Asian countries Khan and Jomo et al. show that the consequences of the policies chosen depend critically on the economic and social conditions prevailing in each country, and that the degree of success depends on the ability of governments to adapt their policy design to these conditions. Needless to say, the task of adapting policies to local conditions requires detailed knowledge of these conditions; we are very far from one-size-fits-all recommendations for free trade, privatisation and minimal state involvement in industrial-policy matters.

Synthesis attempts

Besley and Persson's *Pillars of Prosperity*¹⁹⁹ is an ambitious attempt to synthesise theory and data on state-building and economic development in both developing and industrialised countries. The analysis revolves around the complexes of fiscal and legal capacity, conflict, and economic development. It is well-known that there are clusters of countries with respect to these dimensions. Fiscal and legal capacities go together; they correlate positively with economic development, and negatively with conflict.

The core model describes the incumbents and the opposition as making decisions over two periods, assuming rationality among the players. The extensive data used in the analysis is condensed into parameters and outcomes in order to become mathematically tractable. For instance, conflict level is summarised in three alternatives: common interest, repression or civil war. Such simplifications of course imply that many of the complexities in institutions and political landscapes have to be sacrificed. *Legal capacity* refers to the Western definition of contract enforcement and property rights, but in many countries the problem is a dual jurisdiction – one traditional, often religiously influenced, and one imposed by a former colonial power. When conflicts between these legal corpuses arise, it is an open question as to what takes precedence. In Mauretania, for example, the eradication of slavery has extended into the 21st century because Sharia courts have upheld owner's claims in trials on related matters.²⁰⁰ The requirement of *property rights* may also be ambiguous, given that land reforms of some kind – which, per definition, imply a partial repeal of established property rights – have proved to be a necessary ingredient in the transition to a high-growth trajectory. Another type of ambiguity appears in conflicts between corporations and aborigines defending traditional, but not always documented, rights to natural resources.

With such reservations in mind, the authors are nonetheless successful in bringing together a large body of empirical material and reproducing aggregate stylised facts from their theoretical analysis. Much of the analysis output conforms to common sense and contains no surprises. Fiscal and legal capacities go together, partly because

¹⁹⁹ Besley and Persson (2011).

²⁰⁰ Miers (2003), Chapter 24.

they are favoured by much the same background factors, partly because they are mutually supportive. The risk of violence is high if the power-wielders do not see any strong arguments for developing the state – because their time horizon is short, because of high natural resource rents, or for other reasons. There is a negative causal relationship between violence and income which goes both ways. Predatory regimes that exploit state property for the benefit of a small elite group represent a stable behavioural equilibrium.

The conclusions that can be drawn with respect to development cooperation are fairly limited and conform to common sense. Formal conditions under which budget support can be defended are presented. The analysis also lends some support to military intervention in conflict situations and more generally to capacity-building, without reservations.

A problem with Besley and Persson's approach, which it shares with many others stressing the long-term effects of institutions and historical antecedents, is the absence of a theory of change. Pritchett and Werker have attacked this problematic from a different angle by focusing directly on transitions from one growth regime to another.²⁰¹ They start from the observation that there are basically four distinct growth regimes: i) steady, moderate and constant growth (typically old industrial states), ii) poverty traps, iii) acceleration to states of persistent high growth, and iv) non-persistent growth (boom, stagnation, and bust). The hypothesis that the authors present is that the possibility of transition from one regime to another depends on the relative strength of the different economic and political elites in a society. Some are high-rent seekers in export markets and require good infrastructure, but otherwise a non-interventionist state. High-rent seekers oriented towards domestic markets, by contrast, favour tariff barriers and low transparency. Competitive entrepreneurs are interested in good infrastructure but also favour other types of market-friendly government interventions such as R&D support and export subsidies. A fourth category of competitive producers oriented towards domestic markets, comes close to the traditional liberal ideal of low taxes, reasonably good infrastructure, and easy administration. The relative power positions of these four groups determine the room for manoeuvre of the political leadership and will also affect the fate of reform attempts, whether initiated internally or from outside. Some

²⁰¹ Pritchett and Werker (2012).

feedback effects from outcomes to the power balance are positive in the sense that changes are reinforced; this is the origin of virtuous (and vicious) circles. Although the main value of Pritchett and Werker's report is that it poses relevant questions, there is an interesting potential to link the model to qualitative empirical work, such as the study of Asian growth paths by Khan and Jomo et al. mentioned above.

In summary, institutions do matter, but their effect is highly context-dependent, and great care must be exercised when trying to transfer experiences and solutions from one country to another. Current institutional solutions in developed countries are very different from those that prevailed in earlier phases of development.

4.2 Defining the scope of the state

The role of the state is a politically contentious issue, but approaching it from a qualitative viewpoint at least permits structure in the discussion. The approach from the first principles used below serves a double purpose. It provides a basis for discussing the role of the state in any society (this chapter), but also offers a method for structuring discussion of the natural niche for states within the field of policies for global development (Section 6.1).

Abstract definition

The point of departure for the liberal theory of the state is a society in which rational and well-informed individuals make their own, decentralised decisions by default. The niche for public initiatives is consequently situations where markets fail in one way or other. In a modern classical analysis based on this approach, Musgrave established allocation, distribution and stabilisation as the three tasks of government.²⁰² Referring to the general equilibrium framework, these three categories can be defined as follows:

- *Allocation*: Market equilibrium does not exist or is not efficient because the conditions for existence or efficiency are not satisfied.

²⁰² Musgrave and Musgrave (1989).

- *Distribution*: Market equilibrium exists and is efficient but the resulting distribution of incomes and assets is not considered acceptable.
- *Stabilisation*: Market equilibrium exists and is acceptable from the distribution point of view, but it is dynamically unstable.

In order to make the list more useful, it is necessary to use a more fine-grained characterisation of the allocation category. The following list is one possibility:²⁰³

1. *Positive external effects and public goods*: If there are positive external effects associated with the consumption of a certain good or service, this good or service will be under-supplied. Public goods are extreme cases, where demand is spread over a large number of individuals and the investments necessary are far too large for each individual – typically infrastructure, defence and the judicial system.
2. *Negative external effects* can be seen as the mirror image of the previous category – negative effects associated with either production or consumption. In the absence of public action, these goods will be over-supplied, leading to environmental degradation.
3. *Long-term decisions* are decisions whose time horizons are such that the individual decision-maker cannot in general be expected to take all relevant consequences into account. Deforestation is an example, and a forest management act is the corresponding countermeasure.
4. *Information deficits*: Information is an unusual good in the sense that one cannot judge its value until one is in possession of it. An individual can be stuck in an inefficient equilibrium characterised by low information.
5. *Autonomy problems*: Children are not autonomous decision-makers, and their parents cannot in general be assumed to internalise all of their children's current and future needs and expectations. Adults may also suffer from a loss of autonomy, for instance due to drug addiction.

²⁰³ Molander (1999).

6. *Non-competitive markets*: Unless full competition prevails, markets will not be efficient, and consumers will face higher prices. Competition and anti-trust policies are therefore necessary.
7. *Distribution of incomes and assets*: It is possible to consider income distribution as an abstract collective good, which falls under category i) above,²⁰⁴ but it is more natural to analyse inequality, for instance inequality in opportunities for education, as a potential threat to efficiency and thereby a market failure. This will be discussed in more detail in Chapter 5.
8. *Stabilisation*: The standard example here is business cycles, but external disturbances stemming from volatility of raw materials prices or crises in the financial markets may represent a more significant threat to developing countries.

The above list provides a platform for potentially widespread state involvement in social affairs. In reality, priorities need to be made, and the risk of government failure must be set against the market failures identified.

There is considerable overlap between the categories, whether one uses Musgrave's original tripartite categorisation or the developed list above. For instance, although low-information traps can be defined at the individual level, a different way of looking at the problem – and one which is probably more common in practice – is to consider information as a public good for which there are arguments for public intervention. Another example is that policies of redistribution and stabilisation have allocative effects, implying that such policies can be justified by reference to efficiency arguments.²⁰⁵

Core tasks: security, legal and administrative systems

Military defence, judiciary, police and parts of public administration are traditionally considered the main building-blocks of the night-watch state. In the language used above, they are all examples of public goods. There is broad consensus that the quality of these services is important to the welfare of citizens.

²⁰⁴ Thurow (1971).

²⁰⁵ Atkinson (1991), Barr (2001), Sinn (1995).

The main problem of military defence in developing countries is normally not shortage of resources. On the contrary, reducing military expenditure would be an efficient means of raising growth rates.²⁰⁶ Armed forces often intervene in the political process, and domestic conflict represents a dysfunctional equilibrium from which it can be difficult to exit.

The judiciary, police and parts of public administration – what can be summarised as the legal capacity of the country – by contrast often suffer from a shortage of resources, insufficient competence and threats to integrity. In a survey of fragile states, the OECD identifies inability to contain violence, weak legal systems and other public institutions as the main threats to public welfare and societal development.²⁰⁷ More than three-quarters of the poorest billion of the world's population live in what are referred to as failed states, according to the Country Policy and Institutional Assessments produced by the World Bank. The probability of exit from this status is low; the average duration is 59 years. Factors affecting the probability of state failure in the positive direction are income level, size of population and education. There are sizeable negative external effects from state failure; the average cost to neighbouring countries is in the order of USD 100 billion.²⁰⁸

Monetary and fiscal policy-making is another core function of a well-functioning administration. Although these areas are of course highly political, policy-making can be supported by strong budgetary rules and institutions and macroeconomic expertise that reduce the likelihood of poor outcomes.

How active a state?

Beyond basic requirements for law and order – a state monopoly on violence, maintaining and developing the legal corpus, an autonomous judicial system with the capacity to take measures against crime and resolve conflicts – there is the contentious issue of the scope for state intervention in public life. According to adherents of the neo-institutional line of thinking, the state should limit itself to good

²⁰⁶ Knight et al. (1996), Collier (2006).

²⁰⁷ OECD (2015).

²⁰⁸ Collier (2008).

governance, that is, defining and protecting property rights and maintaining an efficient public administration; private investors will then drive economic development.²⁰⁹ A different approach to governance argues that markets are inefficient in developing countries and will remain so until the country has reached a higher level of development. Given the limitations of markets in many developing countries, development requires active governance in order to accelerate productivity growth in both the private and public sectors.²¹⁰ Khan highlights the differences between these two approaches to governance by calling them *market-enhancing* and *growth-enhancing* governance, respectively.²¹¹

Cross-country regressions across the whole world and using standard measures of good governance (in the above sense) indicate a correlation between those variables and economic outcomes, with more or less support for causal relationships, but if the same regression is restricted to low- and middle-income countries, the result is more ambiguous. The importance of markets to economic development is not questioned. Economic development is likely to be more rapid if markets become more efficient, independent of the general level of development. The question has rather been whether markets can be made efficient in developing countries, and whether maximizing the efficiency of markets is sufficient. Adherents of the second approach point to the evidence of the successful East Asian developers of the last five decades, where the state took a much wider responsibility than merely ensuring the conditions for efficient markets. In terms of the market-enhancing conditions that are advocated in the institutional approach, East Asian states have often performed rather poorly. They had institutions that could accelerate growth in conditions of technological backwardness and high transaction costs. This approach shows the importance of a different set of governance capabilities, which can be described as growth-enhancing governance. Which alternative is chosen in this debate also has consequences for the design of aid policies.

The academic literature has produced both theoretical and empirical arguments against state-based solutions. Axelrod's *The Evolution of Cooperation* belongs to the former category, Ostrom's

²⁰⁹ Typical examples are by North and Thomas (1973), North (1990) and Alston et al. (eds.) (1996). See also Greif (2006) for a somewhat different approach.

²¹⁰ What was termed "the Other Canon" in Chapter 3.

²¹¹ Khan (2006).

Governing the Commons to the latter.²¹² A critique of Axelrod's and related work is that it is based on the analysis of games with only two parties, whereas most collective-action problems in real life involve thousands or even millions of interacting players. In such situations, the prospects for spontaneous cooperation are substantially bleaker.²¹³ Ostrom's studies of local solutions for collective-action problems are interesting, but the fact that such solutions exist in relatively small groups characterised by strong social interaction does not imply that they work for large-scale problems with sometimes millions of anonymous agents involved.

Fostering social and economic development

Although opinions about which public services to prioritise on the development agenda may differ, a number of items are common to all proposals: education, health, infrastructure and environmental protection. *Education* is, in a sense, the most basic component.²¹⁴ Education enhances quality of life by developing the capacity for thought and for communicating with others. It determines the spectrum of economic opportunities open to an individual, and is important for self-confidence and for political voice, particularly among women.²¹⁵ Literacy strengthens democracy and reduces corruption.²¹⁶ It increases the productivity of the labour force and, as we have seen in the previous chapter, contributes significantly to growth. It is also important for health; higher literacy makes it easier to understand medical advice, as demonstrated in studies from Bolivia, Mexico and Nicaragua.²¹⁷

The level of literacy significantly affects verbal working memory when measured with indicators such as digit span, verbal abstraction, long-term semantic memory, and calculation.²¹⁸ Literacy can even be traced at the neurophysiological level.²¹⁹

²¹² Axelrod (1984), Ostrom (1990).

²¹³ Molander (1992).

²¹⁴ Drèze and Sen (2013), Chapter 5.

²¹⁵ Unesco (2005).

²¹⁶ Glaeser et al. (2007), Uslaner and Rothstein (2016).

²¹⁷ Regarding Bolivia: Burchfield et al. (2002), Mexico: Dexter et al. (1998) and Nicaragua: Sandiford et al. (1995).

²¹⁸ Reis et al. (2003).

²¹⁹ Petersson et al. (2007).

Some of these effects are clearly collective by nature, which justifies public involvement. The fact that children are not autonomous decision-makers is sufficient as an argument even for the non-collective aspects of education. Parents cannot be assumed to internalise the needs of their children fully; to some extent, there is even a conflict of interest, such as when parents prefer to use their children as labour in the household rather than send them to school.

Free universal education was historically often the first public policy provided in an impartial and equal manner.²²⁰ Such an education system indicates that the state is not primarily an instrument for the domination of the masses by a power elite. Universalism is considered an important characteristic of institutions in societies with low corruption.²²¹

Health, like education, is essential to personal well-being and family life, but also to employability and productivity.²²² There is a sizeable effect on the economic growth rate from improving health and increasing life expectancy.²²³ Measures to improve public health can therefore be seen as a public investment, quite apart from other arguments for state involvement such as containing the negative external effect of contagious diseases, or taking responsibility for child health independent of family background. Private insurance is not an efficient alternative, because public-goods aspects of health care operations tend to be underfinanced.²²⁴

Infrastructure is a classical niche for public involvement, and has historically also been a common target for development cooperation projects. There have been great expectations of large projects such as dams, highways and airports, but infrastructure projects, like other public initiatives, require a combination of measures in order to bear fruit. There is nonetheless consensus in the recent literature that there are growth effects from public investments, although much lower than those found in a classical study by Aschauer²²⁵, the starting point for this line of research.²²⁶ There is considerable heterogeneity in the

²²⁰ Ansell and Lindvall (2013).

²²¹ Mungiu-Pippidi (2006), North et al. (2009).

²²² Deaton (2013).

²²³ Bloom et al. (2004).

²²⁴ See Drèze and Sen (2013), Chapter 6, and Ravi and Ahluwalia (2015) for a discussion of the Indian case.

²²⁵ Aschauer (1989).

²²⁶ For surveys, see Romp and de Haan (2007) and Calderón and Servén (2014).

effects across countries, regions, and sectors. The effects of new investments will depend on the quantity and quality of the existing capital stock.

A complicating factor is that effects are often regional rather than restricted to one single country – growth effects spread to neighbouring countries – which makes these initiatives collective by nature. Another common problem is the traditional tendency to underestimate running costs; inaugurating new projects is politically more attractive than maintaining existing ones.²²⁷

As regards *protection of the environment*, climate change currently overshadows other problems in the international debate. Climate change may lead to serious problems for many developing countries in the long term, but in most developing countries, local or regional contamination is a more acute problem. Environmental factors cause a significant burden of death, disease and disability – about one-quarter globally and about one-third in Sub-Saharan Africa.²²⁸ This includes environmental hazards in the work, home and broader living environment. Major risks include availability of water and poor water quality, sanitation, poor ambient and indoor air quality, road traffic injuries and toxic substances (e.g. lead, chromium, pesticides).

Redistribution policies will be discussed in more detail in Chapter 5; suffice it to note in the present context that the public supply of some of the above-mentioned services has a significant redistributive effect.

The main concerns in industrialised countries concerning state responsibility for *stabilising the economy* have been a stable currency, countermeasures to business cycles and, in recent decades, the stabilisation of financial markets. In developing countries, other types of disturbances may be more important – spill-overs from international crises in the financial markets (as in the late 1990s), and the volatility of raw materials prices (agriculture, minerals, oil). A low income level implies greater sensitivity to variations. State-managed buffer funds such as the Norwegian oil fund provide an interesting example.

²²⁷ Rioja (2003).

²²⁸ WHO (2006).

4.3 Financing the state

The state is on average considerably smaller in developing countries than in industrialised ones, not only in absolute terms but also relative to the GDP. Mobilising resources and putting them to efficient use in the public sector is therefore one of the central issues of development. The explanation for the small state normally put forward is a shortage of resources and weak state-building capacity. The root causes of these difficulties are most often sought in developing countries, but there is also reason to discuss the responsibility of the industrialised world.

Revenue problems in developing countries

A striking feature of state revenues in developing countries is the generally low tax rate.²²⁹ In low-income countries, tax ratios are typically between 10 and 20 per cent of the GDP, whereas in industrialised countries they are typically 40 per cent or higher. Other typical patterns are that the role of income tax increases with the level of development (which is reflected in the history of the currently industrialised countries), and that the role of trade taxes correspondingly diminishes. There are natural explanations for these facts. The share of the informal economy, which is difficult to tax, is higher in developing countries. Taxes on trade are easier to collect than income taxes, not requiring national population registers. The formal economy is relatively more important in urbanised regions, and urban elites tend to have a more-than-proportional influence on government policies, but corruption also plays a role, giving rise to leakages in various forms.

The general trends in tax reforms carried out in developing countries follow roughly the same lines as in industrialised countries – the introduction of value-added tax, lower personal and corporate income tax rates, reduction of import duties and simplification of the rate structure, and abolition of export taxes.²³⁰ In spite of these reforms, tax systems remain complex and difficult to understand. Many administrative procedures, including the procedures for reporting tax revenues, are lacking transparency. Tax officials may have discretionary power over important decisions, such as those

²²⁹ Besley and Persson (2014).

²³⁰ Fjeldstad and Rakner (2003).

related to the provision of tax exemptions, determination of tax liabilities, selection of audits, litigation, etc.

Attempts have been made to increase the autonomy of tax administration, but this autonomy tends to be fragile, and agencies remain vulnerable to political interference. Corruption remains a problem with respect to both hiring and firing decisions and discretionary decision-making in daily operations.

Increasing revenues from distributed tax bases will require an increased level of trust between the government and the population at large, which in turn requires higher accountability. There are positive examples of such processes, for instance from Somaliland and other countries in Sub-Saharan Africa.²³¹

Baunsgaard and Keen highlight a problem connected to the process of liberalisation of trade.²³² With decreasing levels of border protection, revenues from this source will fall and there is a need for compensation from other sources. Historically, high-income countries have been able to find this compensation, and for middle-income countries, there is also evidence of significant recovery. Low-income countries, by contrast, have been less successful and recovery has been far from complete – on average no more than 30 per cent of revenues lost from lowered tariffs have been recuperated from other sources. At the same time, there is evidence that corporate tax revenues in many low-income countries are under pressure from intensified international tax competition.²³³

The responsibility of the industrialised world

The awkward resource situation in developing countries is not solely caused by unfavourable conditions and ill-designed policies in these countries. It is also to a considerable, and increasing extent, the responsibility of developed countries. The current globalisation of the world production system is the result of both technological change and policy-making in the industrialised world. The rapid development of information and communication technology has led to a fragmentation of the production process, to the point where it is often

²³¹ Eubank (2012), Bräutigam et al. (eds.) (2008), OECD (2010).

²³² Baunsgaard and Keen (2005).

²³³ Keen and Simone (2004).

difficult or impossible to tell where a given product was actually produced. This ambiguity is a problem for the multilateral trade policy framework, creating lacunas that can be exploited by stronger parties in negotiations or in day-to-day decision-making in trade matters.

A direct consequence of this process of fragmentation is that transnational corporations are able to exploit differences in tax legislation in order to minimise their tax load. A number of countries, in colloquial language referred to as *tax havens*, offer their services and invite corporations at low or zero tax rates in exchange for administrative fees that generate substantial revenues. The problem of *double non-taxation* has arisen.²³⁴ Countries have historically organised their own tax systems, and in isolation. Hybrid mismatch arrangements exploit differences in the tax treatment of instruments, entities and transfers between two or more countries. Typical devices include hybrid entities, dual residence companies, hybrid instruments and transfers. Hybrids aim to achieve double deductions (claimed for income tax purposes in two or more different countries), deductions coupled to no-inclusion (where a deduction in one country does not correspond to inclusion in taxable income in another country), and foreign tax credit generators (which generate foreign tax credits that would otherwise not be available).

Tax havens are also exploited by households. In this context, the legal issue is simpler; tax havens simply offer the secrecy that makes it possible to hide fortunes from taxation in the country of domicile.

The International Monetary Fund has expressed serious concern about the situation.²³⁵ Spillovers from corporate taxation, that is, negative external effects from legislation in one country on the revenues of other countries, have a number of adverse effects. They matter for macroeconomic performance; taxation powerfully affects the behaviour of multinational enterprises. The effects on corporate tax bases and rates are significant and sizable. They are not just tax impacts on real decisions but also tax avoidance. Further, spillovers are especially marked and important for developing countries. These countries typically derive a greater proportion of their revenue from corporate tax.

²³⁴ OECD (2012).

²³⁵ IMF (2014b). The World Bank has also recognised the problem; see van der Does et al. (2012).

A Norwegian public commission that looked into the issue of tax havens identified a number of problems, quite apart from tax base erosion in developing countries.²³⁶ There is an efficiency problem involved, because the measures taken by corporations are based on artificial differences in tax legislation that do not in general reflect economic realities. The high level of secrecy involved makes accurate estimates of risk impossible, thus debilitating one of the central mechanisms of financial markets. Other deleterious spillover effects include the facilitation of money laundering, corruption, trafficking, drug trade, and the financing of terrorism.

Taken together, these modes of behaviour have affected international resource flows on a large scale, affecting tax bases negatively in both developing and industrialised countries. It is difficult to estimate the size of flows with precision, given the level of secrecy offered by a number of countries involved. Griffiths summarised his findings about flows into and out of developing countries as, “for every dollar that goes in, two dollars flow out”.²³⁷ Forstater warns against over-estimating the flows and the gains that could be reaped from sharpening procedures or policies.²³⁸ The term *illicit* is contentious, because it evades the problem of legal deliberation whose outcome is uncertain. Griffiths’ report relies on this term, but even using a conservative interpretation, the net flow would be negative for the developing countries.

The best current estimate of global tax evasion to date is by Zucman.²³⁹ His approach is based on the simple fact that for every liability, there is a corresponding asset. The difference between global liabilities and global assets is a measure of what is hidden from taxation in tax havens. Zucman estimates that 8 per cent of global household financial assets, that is, 7.6 trillion out of 95.5 trillion dollars, are hidden in this way. About one third is kept in Swiss banks, which are by far the most important tax haven; the remaining two-thirds are kept in other countries (Singapore, Cayman Islands, etc.). The above figure represents in fact a lower boundary. Other assets should be added – bank notes, life-insurance contracts, and physical assets such as gold, art etc. – yielding a total of perhaps 10 or 11 per cent, or about 10 trillion dollars. The tax amount lost to governments

²³⁶ NOU (2009).

²³⁷ Griffiths (2014).

²³⁸ Forstater (2015).

²³⁹ Zucman (2015).

around the world is estimated as about 200 billion dollars, corresponding to one and a half times all overseas development aid (ODA).

Multinational corporations move profits to countries where tax on profits is low or non-existent, using one of two techniques, intragroup loans or transfer pricing. Firms have an incentive to move costs to high-tax countries and revenues to low-tax countries, and there is also clear evidence that such strategies are used in practice.²⁴⁰ This form of tax avoidance by US firms alone was estimated at 130 billion dollars in 2013, or the equivalent of total ODA.²⁴¹ The share of corporate profits kept in tax havens is steadily rising.

Limiting adverse spillover on developing countries requires not just capacity building but also addressing weaknesses in domestic law and international agreements. The institutional framework for coping with international tax spillovers is judged by the IMF to be weak. A less piecemeal approach to international tax cooperation is necessary. Wider reforms to the international tax system in order to address these spillovers have been suggested. Coordinated work is being done at the OECD within the Base Erosion and Profit Shifting project (BEPS),²⁴² but the proposals that have been put forward so far will not eliminate the problem. When the Swedish government recently imposed restrictions on intragroup loan rates, corporations responded by switching to external loans, that is, continuing previous practices but using banks as intermediaries.²⁴³

A somewhat awkward finding has been that a number of state-controlled companies engaged in development finance have used tax havens for transferring capital. The Swedish National Audit Agency has criticised Swedfund International over this matter in a report.²⁴⁴ The owner's instruction has now been changed in order to eliminate such abuse. Other donor investment organisations seem to have continued the practice, however.²⁴⁵

²⁴⁰ Clausing (2003), Cristea and Nguyen (2015), Davies et al. (2015).

²⁴¹ Zucman (2015), p. 107.

²⁴² OECD (2014).

²⁴³ Swedish Tax Agency (2015).

²⁴⁴ Riksrevisionen (2009).

²⁴⁵ Vervynckt (2014).

4.4 Development policies and institutions

Policy for global development: issues of taxation

Just as there are direct points of contact between rich and poor countries in the trade policy arena, it seems important to integrate the field of international taxation agreements into discussion about a policy for global development. In contrast to the situation in trade policy, there is close to full agreement about interests between rich and poor countries in the field of taxation. The losers in stricter enforcement of prevailing legislation and tightening existing loopholes would be wealthy households, transnational corporations and a handful of tax havens. It must be emphasised that beyond the purely revenue-related motives for stricter enforcement there are also the international efforts against money-laundering, transnational organised crime and the struggle against terrorism.

Although important steps have been taken towards a solution to these problems in recent years, they are far from sufficient and in the absence of further measures, tax evasion will continue to increase. Concrete proposals on how to solve the problems have been put forward, of which a succinct sketch will be given here.

There are two different problems involved – the taxation of physical persons or households, and the taxation of transnational corporations. Taxation of physical persons is the easier of the two; revenue losses occur because a number of well-off individuals hide part of their fortune from taxation in their country of domicile. The only sustainable solution to this problem is a global financial register – essentially a register of who owns what in marketable financial assets in the form of stocks, bonds etc. The building-blocks of such a register already exist in the form of privately managed registers in the United States (the Depository Trust Company) and Europe (Euroclear, Clearstream). In order to reveal the true owners of assets, it is necessary to go beyond the (possibly multiple) layers of companies that hide the identity of their true owners. Work on an infrastructure for such identification is currently being done within the framework of *The Legal Entity Identifier Regulatory Oversight Committee* (LEI ROC), which is a group of over 70 public authorities from more than 40 countries, established in January 2013, to coordinate and oversee a worldwide framework of legal entity

identification, the Global LEI System.²⁴⁶ The responsibility for the steady-state management of such a register must lie with an international organisation, which could be the International Monetary Fund or the Bank of International Settlements (where the LEI ROC is currently housed).

The taxation of transnational corporations also represents an intellectual problem, namely deciding how the different parts of the production process, from the extraction of raw materials through sales in the final markets, should be taxed. In principle, transfer prices within the corporation should be based on market prices, but there is no ability for tax authorities to check that this rule is followed in practice for the billions of operations involved. Among US international firms for instance, 55 per cent of profits are made in six low- or zero income tax countries, while very little production and few sales take place there. It is particularly easy to shift profits using intra-group loans, and although this measure is relatively easy to detect and restrict, corporations can circumvent such restrictions using banks as intermediates.

A working solution to this problem must depart from the consolidated profit of transnational firms, a sum that is difficult to manipulate. The question is then how to divide this profit across the production system of the firm without getting lost in the details of the specific company; a simple standard procedure is necessary. The European Commission has put forward a proposal to solve the problem within the EU, which is based on a simple apportionment formula assigning equal shares to labour, capital and sales.²⁴⁷ It avoids immaterial capital, which eliminates the potential for virtual transfers of profits to low-tax countries based on patents and logos. A similar formula is applied in the US, and these two schemes could be fused and extended to the global level.

Development cooperation and state-building

The OECD asserts that “governance and peaceful, inclusive societies are important priorities for development assistance providers”.²⁴⁸ As a

²⁴⁶ For more information, see www.leiroc.org.

²⁴⁷ EU (2015).

²⁴⁸ OECD (2014b).

consequence, support in this field is also an essential component of development cooperation. In 2012, development assistance totalling more than 17 billion USD was disbursed to support governance and peace in developing countries. This represents 15.7 per cent of total sector-allocable ODA. Four subsectors dominate the picture: public sector policy and administration management, legal and judiciary development, strengthening civil society and public financial management.²⁴⁹

Significant efforts have been made in fragile states, where public institutions, by definition, are particularly weak. The so-called *New Deal for Engagement in Fragile States* is an agreement concluded in 2011 between fragile and conflict-affected states, international development partners and civil society, to improve current development policy and practice in fragile states. Against the backdrop of these and other efforts, it is natural to ask about the prospects for contributing to societal development via capacity-building in the area of public institutions. It must be recognised that evaluating this is even more difficult than the problem of estimating growth effects from development cooperations. Outcomes depend on a number of different factors – institutions, policies, and purely exogenous factors.

There are different arguments for these efforts, whether in fragile states or in developing states in general. One source of arguments is the evaluation literature that links aid performance to policy-related or institutional conditions. In their previously cited survey, Glennie and Sumner refer to a number of these studies.²⁵⁰ Collier and Dollar, building on Burnside and Dollar, claim that orthodox economic policies improve aid effectiveness.²⁵¹ According to Alvi et al., there is a macroeconomic policy threshold (based on a policy index consisting of budget surplus, trade openness and inflation) above which aid is effective for GDP per capita growth.²⁵² Islam finds that aid is only effective in a politically stable environment, irrespective of the quality of economic policies, and is ineffective in an unstable environment even in the presence of “good” economic policies.²⁵³ This has been contested, however. Dalgaard et al. find that the effectiveness of aid is not conditional on “good” economic policy as defined by Burnside,

²⁴⁹ Ibid.

²⁵⁰ Glennie and Sumner (2014).

²⁵¹ Collier & Dollar (2004), Burnside & Dollar (2000).

²⁵² Alvi et al. (2008).

²⁵³ Islam (2005).

Dollar and Collier.²⁵⁴ Easterly et al. report that the Burnside-Dollar aid-policy result is fragile when the dataset is expanded (by years and countries), and Chatelain and Ralf find that it is fragile if a handful of observations are removed.²⁵⁵ According to Tan, “good policy” (budget surplus, inflation and trade openness) in fact reduces aid effectiveness in terms of the long-run growth rate.²⁵⁶ Even if the evidence is somewhat mixed, there is at bottom an argument that support to institutional capacity-building may increase the efficiency of other development efforts, that is, there is some form of synergy effect at work.

Booth notes, in a survey of the literature, that there is a strong case for *distinguishing between the long- and the medium-term needs* of poor developing countries.²⁵⁷ As confirmed by the successes in East and South-East Asia referred to in the previous section, the institutions that are conducive to growth and reducing poverty in the poorest countries may be quite different from the best-practice arrangements that have proven their worth in moving forward from middle- or high-income starting points. This is highly relevant to the current debate on development policies. Even if there is general agreement that a certain institutional framework may support development in various ways, it comes at a price, and it is necessary to determine priorities. For instance, patent laws and the workforce needed to make them work – administrators, lawyers – must be traded against basic education and maternal health. There is also a problem of implementation; translating, for instance, central bank legislation from an industrialised country to a developing or a transitional economy will not necessarily lead to success, quite apart from the questions surrounding the legislative design as such.

There is a second general argument for including institutional reform in the development agenda: *traps*. Many low-income countries are stuck in dysfunctional political and social equilibria, and the change required is not self-generating. External assistance may help push society towards socially preferred equilibria. On the other hand, institutional improvement, new social norms, and new patterns of behaviour will not emerge without political conflict. Institutional

²⁵⁴ Dalgaard et al. (2004).

²⁵⁵ Easterly et al. (2004), Chatelain and Ralf (2014).

²⁵⁶ Tan (2009).

²⁵⁷ Booth (2011).

change is a function of politics, a fact which must be recognised by the development assistance donor community.

Institutional reform is also not a shortcut to development, as stressed by van Donge et al. in a comparative study.²⁵⁸ The project behind the report has been devoted to development processes and outcomes in matched pairs of African and South-East Asian countries between 1960 and 2010 with very different growth and poverty-reduction performances. The main finding is that all of the Asian countries, but none of the African countries, adopted policies that combined macroeconomic balance, public investment with a view to increasing agricultural productivity, and land reform giving economic freedom to smallholders. The conclusion drawn by the authors is that the differences in performance are explained by the differences in the policies pursued, not in institutions, which were no more conducive to development in the Asian countries at the outset.

Capacity-building: failure diagnosis

Andrews has analysed the reasons for the often poor outcomes of attempts to reform institutions, and identified errors with respect to context, content, agents of reform, and definition of results.²⁵⁹ A common – perhaps the most common – error is that the *context* is ignored, or that its complexity is underestimated. Errors of *content* amount to mimicking best-practice templates without reference to existing institutional heritage and without feedback from those who are entrusted with maintaining it. A broad set of *agents* must be involved in the process; if this group is too narrow and the reform is attempted as a package to be introduced by edict, it will most likely fail. As for *results*, the best-practice approach often includes a number of visible results to be ticked off a checklist, but the actual result may be quite different from what is achieved on the surface, and the behavioural change that is the ultimate aim of the operation may never materialise.

What reformers sometimes seem to have in mind are analogies with technical jumps, in which a country may use the experience of other countries to take shortcuts in the construction of a new infrastructure.

²⁵⁸ van Donge et al. (2012).

²⁵⁹ Andrews (2013).

There are such examples, for instance in the area of telecommunications, where latecomers could go directly for radio relay links and satellite-based communication links without burying large amounts of expensive copper cable. There may be similar solutions available in the institutional field as long as they are “technical” in nature; as soon as important changes in behavioural patterns are necessary, adaptation to the political landscape and existing institutions are necessary.

Reforms that aim to curb corruption are good illustrations of these dilemmas. There are few documented examples of successful anti-corruption programmes. At the aggregate level, Hong Kong and Singapore are often mentioned, but they are exceptions to the general rule.²⁶⁰ In these cases, there was strong commitment at the highest political level, a condition that is often not satisfied. At the micro-level, there are more reports of successful operations – for instance, regarding schools in Uganda and customs operations in a number of African and Asian countries.²⁶¹ Gains are often temporary, however, as civil servants learn how to circumvent the checks introduced.²⁶²

Capacity-building: What works?

If the reasons for failure are reasonably well understood, it is natural to ask what does work. According to the previously cited survey by Glennie and Sumner²⁶³, there is a greater convergence of results in the areas of education and monetary poverty than in health. Given the limited number of cross-country studies, it is nonetheless more difficult to establish significant positive results here than in the area of economic growth. Six studies have reported on the effect of aid on education outcomes, which are largely positive, but results are modest.

Given the importance of education to societal development, more precise conditions for success in this field are particularly interesting to establish. A broad survey by Damon et al., based on 114 studies, aimed to determine the types of intervention that can improve

²⁶⁰ Quah (1994). For a wider set of examples, see Meagher (2002) and Mungiu-Pippidi (2015).

²⁶¹ Reinikka and Svensson (2005) and Yang (2008), respectively.

²⁶² Olken and Pande (2012).

²⁶³ Glennie and Sumner (2014).

educational results in developing countries.²⁶⁴ The underlying studies satisfy the criterion that a causal link between intervention and effect be proved.²⁶⁵ The general question is divided into two separate ones: firstly, how can student presence in schools be improved where absence is a problem (enrolment, attendance, dropout), and secondly, how can education be improved once the pupils are present? The two most efficient countermeasures to the first problem are conditional cash transfers and the construction of new schools where access is a problem. Other measures that have produced positive, although weaker, results include school meals, extra teachers and teaching materials, deworming operations, and single-sex schools. Measures to improve learning outcomes when pupils are present include merit-based scholarships, providing supplemental or remedial instruction, decreasing pupil-teacher ratios, and building new schools. Conditional cash transfers and schools have also proven effective in this respect.

In a parallel study, Samoff et al. analysed interventions in the field of education using a more qualitative approach.²⁶⁶ These authors stress the importance of context and argue that local ownership, the right form of decentralisation, and sustainability must be recognised as factors that are vital to success.

Comparative studies of aid in the health sector are more mixed. According to Glennie and Sumner, seven of the available eleven health-related studies suggest that aid has positive outcomes, whereas four are mixed or even negative.

An ambitious study on a Nordic basis of capacity-building has been devoted to a diverse portfolio of projects: a municipal programme on solid waste management, a partnership in statistics, and a municipal training system project, all in Bosnia and Herzegovina, a national agriculture and livestock extension programme, a water and sanitation programme, and support to police reforms, all in Kenya, and finally two projects in Cambodia: an education capacity development partnership fund and a programme for development of quality assurance.²⁶⁷ The overall assessment is generally favourable, with overall effectiveness deemed to be in the range of medium to high for all projects in the study. Without going into details, a fair

²⁶⁴ Damon et al. (2016).

²⁶⁵ As established by methods such as regression discontinuities or difference-in-difference.

²⁶⁶ Samoff et al. (2016).

²⁶⁷ Carneiro et al. (2015).

conclusion is that the main reason for success is that these projects belong precisely to that technical category where interference with extant power relationships is less likely and where political conflicts can consequently be avoided.

Doing no harm

A minimum requirement for development cooperation is, of course, that it does not leave the recipient partner worse off after a reform project than it was before. Operations in fragile states are particularly sensitive in this respect. In the report, *Do No Harm*, the OECD analyses state-building development projects from this particular angle in different dimensions: the political processes that drive state-building, the relations between state and society, and the capacities of the state to perform its basic functions (security, rule of law, taxation etc.).²⁶⁸ Firstly, electoral competition does not necessarily lead to a more inclusive political settlement. Donors risk doing harm if pushing for elections where major political agents are excluded from the process, or where political organisations and powerful elites can choose to exit and engage in organised violence. Secondly, where an ethnic conflict has excluded minorities from gaining voice through electoral exercises, elections may also lead to further violence and less inclusive political settlements.

Civil society – the sphere lying between the state, family and private sector – emerges in parallel with state-building development, and its consolidation needs to be considered as an aspect of state-building. There is a general tendency to equate civil society with non-governmental organisations (NGOs), through which most donor support to non-state actors is channelled. This support, largely devoted to service-delivery programmes, has generally been positive, but donors have contributed far less, or not at all, to assisting states to develop the regulatory frameworks in which NGOs work. It is essential not to create a “dual” public sector. It must also be recognised that higher administrative costs must be expected when working in fragile states, due to the need for specialist knowledge and detailed understanding of political settlements.

²⁶⁸ OECD (2010b). The rest of this section follows this report.

4.5 Summary

Institutions matter

There is support in the social-science literature for the idea that institutions are important to societal development, and that properly designed and deployed reform projects can contribute to such development. State-building is vital to the project of improving living conditions globally. There is less unanimity about which institutions are the most important and how they should be designed. For several decades, policy-making was dominated by a minimalist conception of the state, reducing it to the production of some very basic services – police, judicial system, defence and a few others – and the maintenance of property rights. This set of recommendations can be refuted on the basis of both the early experience of now-developed countries and the experience of Asian countries that recently went through the process of industrialisation. A more active state, assuming responsibility for industrialisation, is called for.

The standard set of functions associated with the state are all possible candidates for development cooperation – judiciary, police and other core components of public administration. If any two functions should be highlighted, it is an infrastructure for statistical services and a tax administration. A well-functioning statistical office and cadastral registries are general-purpose assets that are vital to the functioning of a range of public services and for that reason should be a priority.

The list of essential basic services includes education and health care. Education is a service with positive external effects in a number of dimensions that are vital to the state-building project – political engagement, conflict management, building trust and human capital accumulation more generally in the perspective of economic growth.

Institutions are no shortcut to development

Good institutions are conducive to good policy-making but cannot replace good policies. Respecting the complexities of the existing institutional and political landscape is fundamental to the success of development cooperation in this field. Blue-print approaches relying

on some generic best-practice construct will most likely not be crowned with success. Persons with expertise in local idiosyncrasies and historical traditions must be involved in the capacity-building process.

Raising revenues is a common interest for developing and developed countries

There is broad consensus that developing countries are undertaxed. Assistance in the development of adequate tax policies and a functioning tax administration must be highly prioritised in the development cooperation agenda, but the management of tax bases is an international issue where the interests of developing and developed countries often coincide. Steps have been taken towards the improved exchange of information and coping with strategic profit shifting in transnational corporations, but much remains to be done. Outlines for solutions exist, so further progress is mainly a question of political will.

Capacity building can work

The collected experience from common capacity-building efforts indicates that projects that are technical by character and do not interfere with existing power balances are easier to manage. In the important field of education, there is solid evidence that increased resources via, for instance, conditional cash transfers, new schools, more teachers and teaching materials, are efficient both for increasing school attendance and for improving results once the pupils are present – all with due respect to the local context.

5 Inclusive social development

The previous chapters illustrated the importance of both economic growth and well-functioning public institutions. The discussion cannot be limited to clinical measures of economic growth and the quality of institutions, however. Progress has been made with respect to poverty reduction in recent decades and appears to support the idea that economic growth is the main route to eliminating poverty. There are question marks, however, concerning the efficiency of growth as a vehicle for eradicating poverty among the population strata that live in the neighbourhood of, or below, the extreme poverty line. In 1990, the global \$2-a-day poverty gap – that is, the transfer necessary to lift everyone living below the poverty line to this level – was \$493 billion (at 2011 PPP rates). By 2012, after global consumption had risen by more than \$15 trillion, that poverty gap was still \$205 billion.²⁶⁹ Another illustrative example: there is, as shown by Deaton, no correlation between growth and infant mortality.²⁷⁰

The reason for this weak coupling between growth and poverty reduction is that not only the rate but also the structure of growth is important – how the fruits of growth are distributed across the population, what life chances are offered to young people from various socioeconomic strata, and so on. It is necessary to ask more precisely which institutions are important, and whether processes or outcomes should be in focus.

This chapter is devoted to three important aspects of growth and institution-building – the quality of government, inequality and gender. It summarises evidence that these dimensions of development are not merely questions of political taste but have far-reaching real economic and social effects – which is also of importance to development cooperation.

²⁶⁹ Edwards and Sumner (2015).

²⁷⁰ Deaton (2013), p. 116 f.

5.1 Good governance, quality of government

The state is a powerful, but blunt, instrument. As history shows, it can be used for many purposes. While it has been instrumental in bringing about freedom and civil liberties, it has also been abused by autocratic regimes to pursue policies of oppression and even genocide, but even within the category of democratic states, there are problematic experiences. In Bastian and Luckham's words: "Democracy, it would appear, is Janus-faced. As well as empowering citizens, overcoming exclusion and contributing to good governance, it can also become the tool of powerful economic interests, reinforce social inequalities, penalise minorities, awaken dormant conflicts, and fail in practice to broaden popular participation in government [...]." ²⁷¹

Defining good governance

The dilemma formulated by Bastian and Luckham raises the following important question: Should a discussion about institutional design be limited to the general design of the constitutional framework, or should it also include the substance of policies generated?

Legislation is one thing; implementation is another matter. Sound policies produced within the framework of democratic institutions are of little effect in the absence of a reasonably effective public administration. This has led some researchers to focus on the governance segment of the public sphere rather than on fundamentals related to the voting system, parliamentary arrangements, etc. A choice between process and outcomes is also necessary in this case. If the choice is for outcomes, one must specify who defines a good outcome. Should objective output measures, such as infant mortality and literacy be used, or should we rely on surveys containing questions about trust in the government and legitimacy?

There are four possible combinations, based on the two dimensions of democracy/government and process/outcomes. All four approaches are represented both in the academic literature and in the practice of institutions involved in development cooperation. The World Bank perspective is comprehensive, encompassing all the above possibilities. The concept of *good governance* is defined as "the traditions and

²⁷¹ Bastian and Luckham (2003, p. 1).

institutions by which authority in a country is exercised. This includes (1) the process by which governments are selected, monitored and replaced, (2) the capacity of the government to effectively formulate and implement sound policies, and (3) the respect of citizens and the state for the institutions that govern economic and social interactions among them.”²⁷² This definition is operationalised in the form of the Worldwide Governance Indicators based on six dimensions: voice and accountability, political instability and violence, government effectiveness, regulatory quality, rule of law, and control of corruption.²⁷³

This definition has been criticised for being too wide, and most analysts have chosen more narrow alternatives. The indicator systems commonly used in the analyses of the consequences of institutional choice – such as the methodology of Freedom House or the State Fragility Index developed within the Polity IV project – aim to capture not only formal aspects of democracy but also deeper aspects such as civil liberties, legitimacy and so on.²⁷⁴ Nonetheless, preconditions for democracy are more in focus than the difficult aspects of actual accountability and responsibility.

If material wellbeing is considered the dominant target, this focus on democracy is open to debate. A large economic literature is primarily preoccupied with the question, “Does democracy contribute to economic growth?” Efficiency in this case is equivalent to efficiency in delivering prosperity. Przeworski et al. come close to a general answer when establishing that on average, there is no significant difference in aggregate economic growth rates between democracies and autocratic regimes.²⁷⁵ Because fertility rates have been lower in democracies, however, per-capita growth rates have been higher in these countries.

This general answer must be qualified in more specific situations. Brett argues that in troubled situations when power is strongly contested, autocratic regimes may be more efficient in accomplishing transitions to democracy and prosperity.²⁷⁶ Collier supports this view

²⁷² Kaufmann et al. (1999, p. 1). A non-technical summary can be found in Kaufmann et al. (2000).

²⁷³ Kaufmann et al. (2010).

²⁷⁴ Freedom House (2015), Marshall and Cole (2014).

²⁷⁵ Przeworski et al. (2000).

²⁷⁶ Brett (2012).

when claiming that there is no significant effect from democratic rule on the probability of exit from a dysfunctional social equilibrium.²⁷⁷

Rothstein and Tannenbergs²⁷⁸ also criticise the idea of democracy as a primary lever of social development and argue that the efficiency of government is more important. They stress the link between the quality of government institutions that implement policies on the one hand and economic performance, economic equality and subjective wellbeing on the other. Gilley's finding that legitimacy of government is strongly correlated to quality of government – more strongly than democratic rights – lends further support to this approach.²⁷⁹

The definition, according to this group of researchers, is process-oriented: quality of government equals *impartiality* of government institutions.²⁸⁰ In finding the corresponding principle to Robert Dahl's *political equality* as the basic norm of the input side of the political system, Rothstein and Teorell refer to Dahl's concept of political equality and present impartiality in the exercise of public power as the corresponding concept on the output side of the system: "When implementing laws and policies, government officials shall not take anything about the citizen or case into consideration that is not beforehand stipulated in the policy or law".²⁸¹

Legislation can be considered the output of the legislative branch of government, so an output-oriented analysis of this part of the public sphere typically deals with protection of property rights, the quality of regulation, and tax policy. The neo-institutional school of North and others represents this line of thinking.²⁸² Knack and Keefer followed this path in an early analysis.²⁸³ A similar line of thinking is taken by Acemoglu and Robinson, who in their book, *Why Nations Fail*, argue that the road to prosperity travels via a block of institutional factors that they term *inclusive development*.²⁸⁴ This package of political measures has three main components: property rights, a level playing field, and policies for encouraging investments in

²⁷⁷ Collier (2008), p. 71.

²⁷⁸ Rothstein and Tannenberg (2015).

²⁷⁹ Gilley (2006).

²⁸⁰ See Rothstein and Teorell (2012), which also contains a discussion of other alternatives. Holmberg and Rothstein (eds.) (2012) provides an overview of contributions based on this approach.

²⁸¹ *Ibid.*, p. 24.

²⁸² North and Weingast (1996).

²⁸³ Knack and Keefer (1995).

²⁸⁴ Acemoglu and Robinson (2012).

new skills and technologies. According to the authors, the opposite of inclusive policies, *extractive* (or more bluntly, predatory) regimes can possibly sustain growth for a limited time period but will eventually run into stagnation. Acemoglu and Robinson's message calls for some qualifications. 'Property rights', as history shows, is an ambiguous term, given that political conflict often stems from a clash between different sets of property rights or between different interpretations of one and the same property right. One and the same property right may also be conducive to growth and development in one situation and represent an obstacle in another.

Other authors have focused on the output of the public administration, measuring quality of government via indicators such as infant mortality, literacy and infrastructure quality. "The quality of government" study by La Porta et al. is an early representative of this tradition, and the same basic approach is used in the Human Development Indicators.²⁸⁵

All these approaches have their strengths and weaknesses. Focusing on process characteristics alone poses the risk of neglecting the negative outcomes that are produced by an impeccably effective parliamentary procedure or public administration. This risk is common to democracy-based and government-based approaches, and it is not a purely hypothetical problem; when measurements are based on surveys (as is often the case), minority views may not receive the attention that they deserve.

Neglecting procedures and concentrating on outcomes may appear safer as a research strategy, but experience shows that procedures are important to legitimacy. There are also technical problems connected with the aggregate indexes used. They are often defined as the direct sums of sub-indexes pertaining to different dimensions of the aggregates that are in focus. The underlying assumption – that the overall quality of the democratic infrastructure is the sum of the quality of its constituent parts – can be questioned. In some respects, one would rather argue that the overall quality depends on a number of separate and logically independent conditions, in which case a product is more appropriate than a sum.²⁸⁶

²⁸⁵ La Porta et al. (1999), UNDP (2015).

²⁸⁶ This is the technique used for the Human Development Index (UNDP 2015).

These different approaches are summarised in the table below, together with some representative examples.

Table 3. Different approaches to the problem of good governance or quality of government: fundamentals of the political system versus administration, process versus outcomes (selected examples).

<i>Quality criteria</i> <i>Focus</i>	<i>Process characteristics</i>	<i>Outcomes</i>
<i>Political fundamentals</i>	Freedom House (2015)	North and Weingast (1996), Knack and Keefer (1995), Acemoglu and Robinson (2012)
<i>Administration</i>	Holmberg and Rothstein (eds.) (2012)	La Porta et al. (1999), Human Development Indicators (UNDP 2015)

When an index is based on a survey, the problem of credibility arises as soon as sensitive questions pertaining to politics or religion are asked. In a number of countries, it is illegal to question the wisdom of the ruling elite or to answer a question about the existence of divine authorities in the negative, and such restrictions are liable to affect the results of the survey.

There is also a language problem involved when comparing results from different countries. Even if the word *happy* is considered to be the correct translation of the French word *heureux*, it is far from certain that two persons that are in some objective sense equally happy will answer in the same way if they have different mother tongues.

In the choice between good democracy and good government as ultimate targets, the arguments presented by Rothstein and Tannenberg have some strength. The main risk seems to be connected with development in the long term. Most observers see democracy as an intrinsic value, and a well-functioning democratic system to be the ultimate goal, even admitting that autocratic regimes may be more effective in the short to medium term (assuming that they have the right agenda). History plays an important role for societal

development in general, and this is also true in the present context. As shown by Persson and Tabellini, it is possible to define *democratic capital* as an entity that summarises a country's historical experience with democracy, and the incidence of democracy in its neighbourhood.²⁸⁷ A large democratic capital appears to reduce exit rates from democracy and raises exit rates from autocracy. Higher democratic capital also stimulates growth by increasing the stability of democracies, suggesting a virtuous circle where accumulation of physical and accumulation of democratic capital reinforce each other.

A different counterargument concerns the risk of extreme outcomes. Drèze and Sen's book, *Hunger and Public Action*, makes a strong case for democracy as a means to reduce the risk of starvation for the poorest strata of the population.²⁸⁸ This thesis has been thoroughly discussed since it was first advanced and seems to have survived empirical tests in different parts of the world.²⁸⁹

It is also worth noting that while there is indeed a strong correlation between good governance (following the Quality of Governance index, QoG) and *level* of GDP per capita, the relationship between economic *growth* (the change in the level over twenty years) and the QoG is much weaker.²⁹⁰ Part of this is due to catching-up effects, but among countries with the same quality of governance there are massive differences in growth (e.g. China versus Cote d'Ivoire) and among countries with rapid growth, the QoG ranking ranges from 0.15 (Indonesia) to 0.9 (Singapore).

In summary, there seem to be valid arguments for democracy even within the limited perspective of material well-being. At the aggregate level, democracy doubtless poses risks in the short term but appears positive in the long term, whereas for the poorest and most vulnerable strata, democracy appears to be an insurance mechanism against extreme deprivation. If democracy is perceived as an end in itself, this of course adds further strength to the previous argument.²⁹¹

²⁸⁷ Persson and Tabellini (2009).

²⁸⁸ Drèze and Sen (1989).

²⁸⁹ Drèze and Sen (2013, p. 260 note).

²⁹⁰ Pritchett and Werker (2012), Figure 7b.

²⁹¹ Schumpeter's *Capitalism, Socialism and Democracy* (1943) defines democracy as a method for delivering collective decisions which is based on political competition, thereby legitimising rulers and ensuring some degree of accountability. From this perspective, democracy is essentially an instrument that can be judged according to standard norms of efficiency.

Education and democracy

If economists tend to ask whether democracy is conducive to growth, many observers will find it equally or more relevant to ask whether economic growth leads to democracy. The general answer seems to be in the negative; there is no automatic mechanism by which increases in material well-being will strengthen democracy. As Sokoloff and Engerman explain in their analysis of the economic history of the Americas: “Neither the timing of the general movements across the nations of the Americas toward universal white male suffrage, nor the record of adoption across states within the United States, seem to fit well with the idea that higher per capita income can provide a full accounting of the patterns through its effect of increasing a population’s demand for democracy.”²⁹²

Instead, general education seems to be the key variable. The importance of education is found in many different contexts, and also in connection with democracy. The hypothesis that higher education leads to more democratic politics was originally put forward by Lipset and has received a good deal of empirical support.²⁹³ Across countries, education and democracy are indeed closely correlated. The causal link is no doubt many-faceted. A higher average educational level should increase the general propensity of the population to solve conflicts verbally rather than by violent means. It also makes citizens more self-confident and capable of defending their rights, and it will strengthen civil society and political participation. Glaeser et al. have presented a theoretical model that substantiates this line of reasoning.²⁹⁴

The connection between education and democracy is further confirmed in a study involving 78 countries by Uslaner and Rothstein, who show that there is a link between levels of education in 1870 and corruption levels in 2010.²⁹⁵ The connection remains strong when controlling for changes in the level of education, GDP per capita, and democratic governance. These education efforts were made from the perspective of increased state capacity, but societies with more equal education also gave citizens more political resources and power to oppose corruption. Strong states provided more education to their

²⁹² Sokoloff and Engerman (2000).

²⁹³ Lipset (1959, 1960); empirical support Barro (1999), Glaeser et al. (2004).

²⁹⁴ Glaeser et al. (2007).

²⁹⁵ Uslaner and Rothstein (2016). Cf. Section 3.3 and the Indian example.

citizens, and such provision was also more common where economic disparities were initially smaller.

5.2 Equality

In analyses of development processes it is not uncommon to meet a somewhat negligent attitude vis-à-vis problems related to income distribution and gender relationships, which are classified as “soft” or second-order issues. Aggregate growth, by contrast, is a “hard” or “bottom-line” issue. This attitude has a long tradition in economics, going back at least to the Kaldor-Hicks criterion formulated in the late 1930s, often used in socioeconomic cost-benefit-analyses.²⁹⁶ In practice, this leads to an implicit division of labour, in which the task of the analyst is to advise on the policy that maximises aggregate welfare, whereupon it is up to political decision-makers to take care of matters related to distribution.²⁹⁷

Most of the political process revolves around the distribution of income and assets. The state influences this distribution not only via the obvious levers of taxation and transfers but also via interventions in the labour market, corporate legislation, the educational system, inheritance laws and so on. Traditionally, the political left has sought to use the state as an instrument of equalisation, whereas the right has resisted such attempts by arguing that differences are necessary as incentives, and that efforts to equalise incomes or assets will be harmful for economic growth. Maximising the growth rate of the economy will also benefit the weaker groups in society as wealth trickles down the income ladder, according to the latter view.

Empirical research in recent decades has shown that the relationship between inequality and growth is complex, and there is in general no necessary conflict between equality and growth. In fact, they may be mutually supportive.

The *World Development Report 2006* from the World Bank provides some interesting examples.²⁹⁸ In one of the background

²⁹⁶ Kaldor (1939), Hicks (1939).

²⁹⁷ That this attitude is still alive at the highest levels is indicated by the following quotation from Lucas (2004): “Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution.”

²⁹⁸ World Bank (2005).

studies, the Bank analysed a group of countries (20 to 25) that had made the journey from the low-income to the middle-income category during the period 1960-2000. The central question was how the initial distribution affected growth rates during the four decades that followed. Because these countries were all agricultural economies at the beginning of the period, the fundamental asset was agricultural land. The results of the analysis were very clear; the countries that had the most equal distribution of land in 1960 were also those that had the highest growth rates.²⁹⁹ There was no conflict between equality and growth in this case – quite the opposite.

Another result from the same report sheds light on the trickle-down hypothesis. On average, growth does not affect distribution very strongly.³⁰⁰ There is, however, a large variation between countries around this close-to-zero average influence, and this variation is systematic. The fraction of the population that is lifted above the poverty line by a given increase in GDP is greater the more equal the distribution at the outset.³⁰¹ In other words, greater initial equality increases the power of growth to reduce poverty. There are even examples of high-inequality countries in the sample where poverty in relation to a fixed poverty line has increased at the same time as the economy has grown in aggregate.

An often-used distinction in discussions about equalisation separates equality of opportunity from equality of outcomes. In general terms, there is wider consensus on the need for equality of opportunity, which basically means that all individuals should enter a level playing-field for fairness to prevail. The land distribution example above illustrates the effect of equality of opportunity. The following example illustrates that the distinction between the two types of equality may be difficult to maintain in practice, however.

Corak has analysed the relationships between income inequality, equality of opportunity and intergenerational mobility.³⁰² This study is devoted to high-income countries, but there is little reason to assume that the mechanisms that are at work here are not also active in low- or middle-income countries.³⁰³ Corak shows that high inequality of

²⁹⁹ Ibid. Figure 8.1, p. 163.

³⁰⁰ Ibid. Figure 4.4, p. 85.

³⁰¹ Ibid. Figure 4.6, p. 87.

³⁰² Corak (2013).

³⁰³ In background material for the 2013 paper, Corak has studied also middle-income countries, with identical results.

income leads to lower intergenerational mobility, that is, high inequality implies that their parent's socioeconomic status will be more important to the life chances of their children. Further, and importantly, quite apart from the obvious financial inheritance link there is an important transmission mechanism via education: wealthy parents spend more on their children's education. Less expected perhaps is the observation that public spending in a high-inequality country also benefits high-income earners disproportionately. These results confirm Sokoloff and Engerman's conclusion that the educational system is an institution that is important for the long-term development of socioeconomic stratification. This also shows that the distinction between equality of opportunity and equality of outcomes will in practice be blurred; equality of opportunity is not possible in the long term where a high inequality in outcomes prevails.

The drift towards increased inequality

A somewhat different line of argument concerns the legitimacy of existing differences in outcome. The right-wing view is that markets reward productivity and effort, and that existing differences are therefore legitimate. A theoretical analysis of the ideal market mechanism by Fernholz and Fernholz casts doubt on this argument; there is an inherent drift in the market towards increased inequality.³⁰⁴

The model used by Fernholz and Fernholz assumes a growing market economy in a country inhabited by individuals who have the same abilities and make the same efforts. They consume part of their production and invest the remainder in financial markets. Because they are assumed to have identical preferences, differences in investment payoff arise only if assets differ, and such differences will emerge only as a result of chance. Individuals are assumed to be risk averse (more precisely, to have constant relative risk aversion), which is in line with experience. Now, if there is a small variation in chance, so that one individual receives a better payoff than the average, that individual can also permit themselves to take a somewhat higher risk than the average and will consequently be rewarded with a higher payoff. In this way, the original disturbance will be reinforced, and differences will grow with time – what is referred to as positive

³⁰⁴ Fernholz and Fernholz (2014).

feedback. In fact, the Gini coefficient of the distribution of assets (a standard measure of inequality) will grow steadily as time increases and will approach 1 as time approaches infinity, implying that one single individual or household will be the owner of all assets.

The model is of course highly idealised. In real life, individuals will differ with respect to both abilities and efforts. What the model nevertheless illustrates is that when there are such differences, the effects will be magnified over time – depending on inheritance rules – and eventually there is little or no connection between differences in abilities and efforts on the one hand and differences in outcomes on the other. The observed differences in outcomes have nothing to do with efficiency, and state interventions to reduce that part of the differences due to the positive-feedback mechanism will not induce any socioeconomic costs. On the contrary, such interventions are necessary to create the level playing-field where only abilities and efforts determine outcomes.

Consequences of inequality

As we have seen, stark inequalities in life chances may deprive talented individuals of their potential to develop, and may therefore be harmful for growth. Whether there are direct links between inequality and wellbeing is another matter. There is strong evidence for a link between inequality and trust in a society,³⁰⁵ and low trust may also be harmful for growth.³⁰⁶ There is also a debate on a possible link between inequality and low health, which if true may have both direct and indirect aspects of wellbeing.³⁰⁷ The evidence is not conclusive even in high-income countries, and as Deaton explains, in low-income countries poverty is certainly a more important determinant of health than inequality as such. Redistribution may be an efficient means to improve the general health status of a population, but more because it lifts the poorest strata out of extreme poverty than by reducing the Gini coefficient.^{308, 309}

³⁰⁵ Jordahl (2009).

³⁰⁶ Bjørnskov (2009).

³⁰⁷ Wilkinson (1996). See Deaton (2003) for a survey of the debate and an assessment of the evidence.

³⁰⁸ Deaton (2003), p. 152.

³⁰⁹ The general relationship between poverty reduction and inequality reduction is analysed in Rist et al. (2016).

Following the trajectories of today's industrialised countries, there is now a growing interest in developing social security in countries where income levels are lower.³¹⁰ Many transfer systems rely on in-kind transfers, but cash transfers, conditional as well as unconditional, are becoming more common. The poorest strata of the population often fall outside the safety net, in spite of urbanisation, because of difficulties in identifying and targeting these groups.

There are interesting parallels between some of the social traps that have been analysed in the literature on development – natural resource dependence, narrow elite control of basic institutions, or simply a generally high level of inequality. In situations like these, the ruling elite often stands more to gain from maintaining control over existing resources than by embarking on an uncertain journey of societal and economic development that may very well end in a regime where other elites or the population at large are in control. From the perspective of the younger generation of the ruling elite, inherited property is very like a natural resource. It may be quite logical for that category to invest more political energy in defending their inherited property and rights than in developing new skills and opportunities.

In summary, there are strong arguments for redistributive policies aiming at the equalisation of both opportunities (without restriction) and outcomes (up to a certain limit). This is not to say that all programmes of redistribution are justified; there are limits beyond which there will be costs of redistribution that are difficult to defend.

5.3 Gender equality

Discrimination against women is a special case of inequality but merits a discussion of its own. There is probably no other categorisation of human beings that is so widely used as a basis for discrimination as is gender, and with such far-reaching consequences.

A dramatic example of this is the biased sex ratios that are seen in a large number of countries. Sen highlighted this in a widely quoted article, pointing out that conservatively, more than 100 million women are “missing” in the world – missing with respect to the natural sex-ratio condition.³¹¹ In fact, the problem of the biased sex ratio is

³¹⁰ World Bank (2015).

³¹¹ Sen (1990).

increasing as technologies for prenatal sex determination diffuse across the world. In a study of India, Jha et al. find that the conditional sex ratio for second-order births when the firstborn was a girl fell by 0.52 per cent per year from 1990 to 2005.³¹² Declines were much greater in mothers with 10 or more years of education than in mothers with no education, and greater in wealthier households than in poorer households. The estimated number of selective abortions of girls rose from 0-2.0 million in the 1980s to 3.1-6.0 million in the 2000s.

Discrimination, having thus started in the prenatal stage, continues by limiting girls' access to schooling. Although most countries now in theory give equal access to boys and girls, differences remain in practice and become differences in de facto literacy. The picture is mixed, however; in some parts of the world – Latin America, the Caribbean, East Asia – the bias is now in favour of girls. In 60 developing countries, more than half the university students are girls rather than boys.³¹³

Many countries still maintain legal restrictions on the spectrum of economic opportunities open to women in adult life.³¹⁴ Women are overrepresented in the informal sector. Inheritance legislation is often biased against women. Religious norms contribute, in a more or less formalised way, to the burden. Female genital mutilation is widespread, mostly but not exclusively in Africa. Some 125 million women are estimated to be victims.³¹⁵ Social acceptance of female genital mutilation is decreasing in many countries, but not everywhere.

The bargaining power of women within households has wide-ranging consequences. It affects use of prenatal and delivery care, nutrition, child health and wealth accumulation. Beegle et al. investigated the relative power of Indonesian women in deciding on the use of prenatal and delivery care.³¹⁶ As possibly expected, a woman's control over economic resources affects the family's decision-making. Evidence suggests that her influence on service use also increases if she is better educated than her husband, if she comes

³¹² Jha et al. (2011).

³¹³ World Bank (2011).

³¹⁴ Ibid.

³¹⁵ Unicef (2013).

³¹⁶ Beegle et al. (2001).

from a background of higher social status than her husband's, or if her father is better educated than her father-in-law.

Men's power over fertility choice is clearly seen in a study by Ashraf et al. from Zambia.³¹⁷ In an experiment, married women were provided with a voucher guaranteeing free and immediate access to a range of modern contraceptives through a private appointment with a family-planning nurse. Some women received the voucher in private, while others received the voucher in the presence of their husbands. The difference was significant: compared to cases where husbands were involved, women who were seen alone were 23 per cent more likely to visit a nurse, 38 per cent more likely to ask for a relatively concealable form of contraception, and 57 per cent less likely to report an unwanted birth.

Djebbari has analysed women's influence on household decisions about nutrition in Mexico and finds that a change in the number of income earners is associated with a change in food calorie consumption, controlling for the change in household size and household income.³¹⁸ Both the number and the identities of income earners matter. When a female household member starts earning income, food consumption increases significantly; when a male household member starts earning income, it decreases.

Economic growth is not enough to reduce or eliminate discrimination against women. As the *World Development Report 2012* concludes, income growth by itself does not ensure female emancipation.³¹⁹ Where gender gaps have closed quickly, it is because of the combined effect of public initiatives, markets and household decisions.

Education also turns out to be a key factor in this context. It is an established fact that female education leads to lower fertility,³²⁰ with a number of different consequences in other areas. It is also possible to target girls in order to increase the efficiency of educational initiatives. A background study for the World Bank by Hong and Sarr evaluates the impacts of a stipend programme in Bangladesh (FSSAP) on education attainment, age of marriage and the labour force

³¹⁷ Ashraf et al. (2014).

³¹⁸ Djebbari (2005).

³¹⁹ World Bank (2011).

³²⁰ Ibid.

participation of married women.³²¹ The FSSAP has raised women's education average by 1.6 to 2 years. The programme also led to an increase in the age of marriage of women by 1.4 to 2.3 years. It is estimated that one additional year of education leads to an increase in the labour force participation of married women of between 2.4 and 5.3 per cent. Education initiatives targeted to women can thus raise female education attainment, with positive external effects on child and household welfare, but can also improve the economic prospects of low income families through increased female labour force participation.

A key factor is also women's access to the political system and decision-making power in public institutions. In a review of the literature on female empowerment, Duflo starts by noting that economic development and female empowerment are mutually sustaining.³²² Economic development can play a role in closing the gap between men and women; on the other hand, empowering women may benefit development.

Chattopadhyay and Duflo studied the reservation policy for women in India regarding the specific question of the effects of increased female influence on political decision-making.³²³ A constitutional amendment required states to both devolve power over expenditure for local public goods to rural village councils, and to reserve a third of all council seats and council presidencies for women. As a result, the political representation and participation of women has increased. A comparison of the type of public goods provided in reserved and unreserved village councils shows that the gender of the council president has an impact on investments. Women invest more in infrastructure that is directly relevant to the expressed development priorities of women. In West Bengal, where women complained more often than men about water and roads, reserved councils invested more in water and roads. In Rajasthan, where women complained more often about drinking water but less about roads, reserved councils invested more in water and less in roads.

More generally, Duflo concludes that increased female influence over political decisions does have external effects that are positive for children in most cases, typically concerning nutrition. A few studies

³²¹ Hong and Sarr (2012).

³²² Duflo (2012).

³²³ Chattopadhyay and Duflo (2004).

register negative effects on educational choice. Duflo's conclusion about the interplay between development and female empowerment is that these interrelationships are probably too weak to be self-sustaining, and that continuous policy commitment to equality between the men and women for its own sake is necessary to bring about change.

5.4 Development policies and inclusiveness

Much of what was said in the previous chapter on policies for global development and institutions carries over to the present context. Democracy, quality of government and equality are not produced as automatic results of social or economic development but require sustained political efforts. The aim of creating conditions for inclusive development therefore in many respects coincides with aim of state-building. This area is difficult – it touches the core of politics and central value systems – and general results are rather weak and fragile. The processes involved are slow, and proofs of success at the aggregate national level are consequently difficult to find.

Indicators of success

In spite of the difficulties, there are countries for which the Worldwide Governance Indicators report significant improvements during its two decades of operation: Ghana (voice and accountability, rule of law), Indonesia (voice and accountability, political stability, government effectiveness) and Serbia (all indicators). This shows that change is possible also over limited time periods. Some of the improvements have been achieved with assistance from outside, but it is difficult to give an estimate of the contribution from such external efforts. It must also be acknowledged that there has not been a worldwide improvement in overall governance during this period; a number of countries have seen a sharp deterioration.

Programmes or projects that aim to influence the conditions for democracy or equality indirectly, for instance via education or health improvements, are less problematic from the political point of view and may still be effective. According to the previously cited survey by

Glennie and Sumner³²⁴, there is evidence for success in the areas of education and poverty alleviation, and also significant, albeit somewhat weaker, evidence in the health sector. More detailed information on conditions for success can be obtained from the studies by Damon et al. and Samoff et al.³²⁵

Dialogue versus conditionality

At least since the Paris agenda was adopted, there has been unanimous support for dialogue between the partners of cooperation and genuine ownership of the activities involved in the recipient countries. “Working with the grain” has become a catchphrase for this approach, based on respect for existing institutions and norms and the complexity of societal change.³²⁶ Notwithstanding the good reasons for such an attitude, there is an ambiguity involved when donor and recipient countries have different opinions about basic values. How far should foreign nations be involved in the fate of another nation? Critique of development cooperation often carries an undertone of irony against the moral drive behind the whole enterprise, but at the bottom there *is* a moral question.

Dialogue is often combined with a form of soft conditionality; support is given provided that certain efforts are made in the partner country. The development literature abounds with examples where soft conditionality fails. Donors, often in coordination, meet with the recipient country, register the failure to meet obligations, and confront the recipient with this failure. The recipient renews the promises made, and the story is repeated in the following year.

If a donor country is determined to go through with an initiative in the inclusiveness category in spite of the difficulties envisaged, conditionality may be an instrument to consider. The problem stems from a potential divergence of preferences between donor and partner country. The donor may, for instance, be more interested in poverty alleviation than the government of the partner country, in which case there is a problem of compliance (sometimes referred to as the *Samaritan’s dilemma*). Svensson has analysed this interaction in an

³²⁴ Glennie and Sumner (2014).

³²⁵ Damon et al. (2016), Samoff et al. (2016).

³²⁶ Booth et al. (2011), Levy (2014).

abstract model, which yields some insights into how to deal with the problem.³²⁷ Conditionality – making transfers contingent on pre-determined outcomes – could theoretically solve the problem, but this requires strong commitment from the altruistic donor. In the absence of such commitment, delegation of part of the aid budget to an international agency with less aversion to poverty, as well as tied project aid, may be a superior alternative.

In spite of the difficulties analysed in Svensson's work, this "cash-on-delivery" approach has been developed by Birdsall and Savedoff and has also been tested in practice.³²⁸ The key features of this form of cooperation are to define an outcome indicator, an amount of the payment, the means of verification, and requirements for transparency. By channelling the flow through the recipient's budget system, capacity-building is enhanced while conditions are still less strict than would be required for budget support. The delegation of implementation to the partner country significantly reduces the administrative burden on both parties. By setting a norm for transparency, this approach also strengthens the position of citizens vis-à-vis the government.

Cash-on-delivery is not a universally applicable approach. It is restricted to services where outputs can be measured relatively easily, pertaining, for instance, to educational results or vaccination programmes. It is essential that the verification of outcomes is left to a third party (neither donor nor recipient) with full integrity.

5.5 Summary

The structure of growth is important

In the public discourse on development, contributors writing from a primarily economic perspective often tend to reduce values such as democracy, equality, and female empowerment to matters of political taste. What really matters is economic growth, and institutions that contribute to economic growth; democracy and equality are at best neutral with respect to economic development, at worst costly. As the

³²⁷ Svensson (2000).

³²⁸ Birdsall and Savedoff (2011).

literature survey in the present chapter has shown, this view is not supported by facts. Factors related to democracy and equality have real economic impact. The state of opposition traditionally claimed to prevail between equality and growth does not exist in general. The relationship between inequality and growth is complex, and as long as discussion is about equality of opportunity, equality and growth are mutually supportive. Experience also seems to indicate that in the absence of measures to maintain some equality of outcome, equality of opportunity will not survive.³²⁹

Economic growth alone is not a particularly efficient instrument for reducing poverty, nor does it automatically strengthen the position of women. Democratic institutions and economic development reinforce one another to the extent that growth is channelled for the benefit of the population at large – for men and women alike, across ethnic boundaries and socioeconomic strata.

Both quality of government and democratic institutions are important

For sustainable inclusive development, the quality of public administration is vital. Opinions vary more concerning the importance of democratic institutions. The main argument for democracy, apart from its intrinsic value, is that it acts as a guarantee against extreme deprivation for the poorest strata of the population, and that democratic capital – essentially the length of democratic tradition – reduces the risk of later relapse into autocratic regimes.

Education is basic

Creating a level playing field is tantamount to establishing equality of opportunity irrespective of socioeconomic background, ethnic origin or gender. Education is the fundamental factor demonstrated to have a decisive influence on a broad range of dimensions – the socioeconomic status of the individual in the household and in society at large, the productivity of the labour force, the strength of civil society, political engagement, absence of corruption, and democratic stability.

³²⁹ For further perspectives on this debate, see Kanbur (2001).

The role of aid

In their previously cited meta-study, Glennie and Sumner summarised their findings on the potential of aid in the following way: “Broadly speaking, we have found that the most recent studies, over the last decade, have been more positive on the role aid can play in these areas than previous generations of studies. Despite all the caveats on which we insist, this is an important finding which needs to better percolate into the public debates on aid.”³³⁰

This general conclusion is also valid as support for capacity-building in administration and support for sectors that are important to equality in general and between the sexes. Progress has been made in the area of institutions, as the statistics from the Worldwide Governance Indicators testify, and at least some of this progress can be ascribed to capacity-building assistance from outside. There are also significant positive results in the fields of basic education and health services.

³³⁰ Glennie and Sumner (2014).

6 Implications for Swedish development policies

In the present chapter, current policies are compared with some of the main results from previous chapters. Sections 1 and 2 provide a succinct description of current Swedish policies and an assessment of these policies, respectively. The concluding section summarises the conclusions from the analysis and identifies areas where current policies should be reconsidered.

6.1 Current Swedish policies for global development

International background

At the beginning of the new millennium, the Millennium Development Goals (MDGs) were formulated by the United Nations as an overarching framework for alleviating poverty globally, with 2015 as their target year for achievement. In September that year, having checked the outcomes against the goals, the United Nations member states decided on a new set of goals, the Sustainable Development Goals (SDGs).³³¹

The list of SDGs comprises 17 goals set for 2030. As indicated by the name, sustainability dominates the perspective; two-thirds of the goals explicitly or implicitly refer to sustainability. The goals of the SDG list are the following:

1. End poverty in all its forms everywhere
2. End hunger, achieve food security and improved nutrition, and promote sustainable agriculture
3. Ensure healthy lives and promote well-being for all, at all ages
4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
5. Achieve gender equality and empower all women and girls

³³¹ United Nations (2015b).

6. Ensure availability and sustainable management of water and sanitation for all
7. Ensure access to affordable, reliable, sustainable and modern energy for all
8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
9. Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation
10. Reduce inequality within and among countries
11. Make cities and human settlements inclusive, safe, resilient and sustainable
12. Ensure sustainable consumption and production patterns
13. Take urgent action to combat climate change and its impacts
14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development
15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
17. Strengthen the means of implementation and revitalise the Global Partnership for Sustainable Development.

Swedish policies

The Policy for Global Development (PGD), which was adopted by the Swedish parliament adopted in 2003, is still the basic platform for the Swedish development policy.³³² The overarching goal of the PGD is to contribute to equitable and sustainable global development. The idea behind this policy is that the development goal should apply to all policy areas – trade, agriculture, environment, security, migration, economic policy and others, thereby laying a foundation for a

³³² Swedish Government (2003).

consistent and coherent policy in order to contribute to equitable and sustainable development in the world. The focus is to be on poor people and poor countries.

More specifically, the PGD is defined by the following components:

1. respect for human rights
2. democracy and good governance
3. gender equality
4. sustainable use of natural resources and protection of the environment
5. economic growth
6. social development and social security
7. conflict prevention and management and human security
8. collaboration on global public goods.

Coherence is stressed: “Coordination and coherence between different policy areas should be improved in order to make policies better able to promote development. Conflicting objectives should be identified, and should be the focus of well-informed and well-considered strategic choices.”

Development cooperation was presented in the PGD document as an important component of the general policy. Its primary goal is to eradicate poverty, or more precisely, “to contribute to an environment supportive of poor people's own efforts to improve their quality of life”. The intermediate goals are the same as those given for the general PGD in the list above.

An update of the PGD was presented in 2008. This communication started by defining a number of global challenges in which Sweden can contribute to the solution – oppression, economic exclusion, climate change and environmental impact, migration flows, communicable diseases and other health threats, and conflicts and fragile situations. The main policy components were left unaltered.

The most recent high-level policy document in this area is a government communication to parliament, which is a comment on Agenda 2030 and a description of how the Swedish government works

and intends to work towards the implementation of this agenda.³³³ This document consists mainly of a translation of the Agenda and a list of examples of policy applications of the Agenda perspective to different policy areas.

A new general policy framework for development cooperation is under preparation and is in a preliminary version.³³⁴ The priorities and plans put forward in this document, if adopted, would not alter the conclusions of the present chapter.

6.2 Assessment

Sustainable development goals – a new starting point?

The Sustainable Development Goals (SDG) adopted by the UN General Assembly in the autumn of 2015 have been seen as the natural starting point for an overhaul of the Swedish Policy of Global Development. The SDG resolution is not radically new, however. Compared to earlier similar documents, it is more detailed, and there is a stronger emphasis on sustainability. There are separate goals for different ecosystems, natural as well as managed – terrestrial, marine, agriculture etc. – but in this field the concept of sustainability is well established and in itself nothing new. Goal 8 mentions sustainable economic growth, where there is more uncertainty about the interpretation of the term. Sustainable fiscal policy is well-defined, more or less equivalent to control of the public-debt development, but from a wider economic perspective the term is not well defined. Similar question-marks are necessary in the fields of energy supply (Goal 7), industrialisation (Goal 9) and consumption and production patterns (Goal 12).

The concept of *sustainability* suffers from a lack of clarity. The time horizon relative to which sustainability should be judged is obviously a critical parameter. In the energy sector for instance, coal is not a renewable source and consequently not sustainable in the long run, but coal assets across the world represent a very large reservoir of energy raw material, so the judgement about coal ought to be based

³³³ Swedish Government (2016b).

³³⁴ Swedish Government (2016c).

more on its effect on greenhouse gas emissions than on the sustainability of coal as such. At the other end of the spectrum, solar energy is normally classified as the perfect renewable energy source, but in the very long term, even solar energy is, of course, not sustainable.

An important consequence of this simple observation is that the meaning of sustainability depends on the sector or aspect of social life that is being discussed. Time horizons in urban settlements are very different from time horizons in fiscal policy-making, so there is an obvious risk that this term, by becoming a catchword for everything that is positive, will be deprived of its intellectual content.

At a deeper level, replacing more specific terms with a universally current concept implies changes that are not at all intended. In Goal 16, sustainable social development seems to be more or less equated with inclusive development, which is simply not correct. Authoritarian regimes may be extremely long-lived, so replacing *inclusive* by *sustainable* implies a – probably unintended – lowering of the level of ambition.

Another risk associated with the new and longer list of goals is *fragmentation*. When national ODA agencies and other organisations active in the field set out to translate the SDGs into agendas of their own, there is a risk that the SDG agenda will be perceived as a checklist where different items are ticked off and that everyone feels the need to be present in all the dimensions mentioned. If that were to happen, the SDG agenda would contribute to both sector and organisational fragmentation, whereas there is general consensus that concentration, if anything, is needed.

In summary, great caution must be exercised when the new agenda is processed in development agencies and organisations around the world. In some respects, it contributes nothing that is new, and in other respects, unintended changes of goals or ambitions may result. Improving on existing development policies – while keeping sustainability at the back of the mind – is a more appropriate response to the SDG agenda.

The Policy for Global Development

The US-based autonomous *Center for Global Development* regularly makes a general assessment of development-related policies, called the *Commitment to Development Index*.³³⁵ This index ranks 27 of the world's richest countries on their policies that affect more than five billion people living in poorer countries, more specifically:

- quantity and quality of foreign aid
- openness to trade
- policies that encourage investment and financial transparency
- openness to migration
- environmental policies
- promoting international security
- support for technology creation and transfer.

The index gives credit for generous and high-quality aid, incentives for foreign direct investment and financial transparency, open immigration policies, robust support for technological research and development, and contributions to global security and the environment. Scores are reduced for barriers to imports from developing countries, selling arms to poor and undemocratic nations, barriers to sharing technology, and policies that harm shared environmental resources.

According to this ranking, Sweden is in the second position after Denmark. Sweden scores highly on migration, low on arms export but also, perhaps more notably, low on technology transfer.

Even if Sweden's PGD thus receives fairly good marks according to an outside observer, there are some questions when the policy is evaluated against the criteria developed in Chapters 3 through 5. We have identified trade policy and international tax regulations as two key areas in this field. The PGD document makes the following claims concerning trade:

Free and open trade based on agreed rules is a powerful instrument for achieving development and distributing the

³³⁵ Krylová and Barder (2015).

fruits of economic progress. Freer trade is supportive of greater purchasing power among the broad masses of the people. Simplified import procedures promote new ideas and investment, and also make available cheaper consumption and input goods in production. Increased competition is central for the promotion of effectiveness of the economy. Exports generate foreign currency, stimulate industry and create new jobs. Open trade can mean a great deal to poor people, especially women, who often work in export-oriented sectors. [...] Trade can help to improve the efficiency of the economy and finance other important activities.

Many developing countries have not been able to benefit from global trade. One of the main reasons for this is the persistence of the view that extensive trade restrictions are the best way of promoting development. It has gradually been recognized in the last few decades that tariffs, subsidies and other trade barriers impede rather than promote development. Developing countries that have pursued more open economic policies have often achieved higher economic growth. Apart from this, barriers to trade, whether imports or exports, encourage corruption. Trade barriers often benefit groups that are already well-off while depriving poor people of the possibility of raising their income by means of trade. Governance has improved in countries where trade is freer and income and productive employment opportunities are more fairly distributed. All remaining border barriers and other unnecessary trade barriers should be abolished in order to promote sustainable growth in the developing countries.³³⁶

This unrestrained eulogy to free trade bears visible traces of the Washington Consensus package. As we have seen in previous chapters, free trade cannot be claimed to be a panacea for low growth, poverty, inequality, gender discrimination and corruption. A more balanced view is necessary, and this will affect both policy-making at the PGD level and capacity-building in the trade administration in developing countries.

Only domestic problems in the developing countries are mentioned in the policy document regarding taxation issues.

³³⁶ Swedish Government (2003), p. 37.

Regulating taxes on assets and financial flows is a truly collective challenge that calls for international cooperation.

Results

The government has reported on the PGD more or less regularly since the original launch in 2003. Needless to say, results in this field are difficult to identify and tie to the policies pursued. At this level of generality, it is normal that policies are judged by their design rather than by identified output.

The Swedish Agency for Public Management assessed the results of the PGD in 2014 and concluded that the policy lacks clarity and visibility and needs a more precise division of responsibility within the Government Offices.³³⁷

More recently, Felleson and Roman have analysed this policy and tried to identify the reasons for its relatively limited results, summarised as problems of lacking ownership, inadequate steering, and limited impact.³³⁸ The authors find a number of reasons in various dimensions: inadequate cognition (how the policy is understood by different actors), lack of motivation, and weak coordination (organisation and formal steering). Responsibility for financing has been perceived as lying within classical development cooperation.

Development cooperation

Sweden defends its position fairly well also in international comparisons of development cooperation policies. The regular evaluation by the *Center for Global Development* measures donor performance using 31 indicators of aid quality.³³⁹ The indicators are grouped into four dimensions associated with effective aid: maximising efficiency, fostering institutions, reducing the burden on partner countries, and transparency and learning.

Sweden's rank among 30 plus countries and institutions is 22 for maximising efficiency, 5 for fostering institutions, 12 for reducing the

³³⁷ Statskontoret (2014).

³³⁸ Felleson and Roman (2016).

³³⁹ Hashmi et al. (2014). Full report: Birdsall and Kharas (2014).

burden of partner countries, and 8 for transparency and learning – that is, satisfactory or good in the three last indicators, less well in efficiency. The composition of the indicators is of course open to discussion. Efficiency contains a sub-indicator measuring the degree to which aid is directed towards well-governed countries. This reflects the results of Burnside and Dollar and others who have claimed that aid works best in countries with good governance performance, but as we have seen, these results have been questioned.³⁴⁰ Even if they are correct, there may be political reasons for allocating funds on the basis of other criteria. On the other hand, there is reason to take seriously the implicit criticism of Sweden's inability to concentrate its efforts country-wise or sector-wise, which has also been noted by other observers.³⁴¹

The *OECD mid-term review* of Sweden's development cooperation also expressed satisfaction regarding Sweden's achievements in general, and progress since the preceding evaluation.³⁴²

In summary, there are no indications that Swedish development cooperation is less efficient than that of other countries with respect to administrative costs or leakage, but the highest costs do not typically stem from these two sources but from the inefficiency of *allocation* – calculated as the difference between socio-economic optimum and actual use – which is not among the efficiency factors evaluated in the above-mentioned assessments. The appropriate focus of the efficiency debate is therefore how aid flows are allocated at the aggregate level – between infrastructure, education, health, and other uses. This leads us to the issue of sector priorities.

Sector priorities

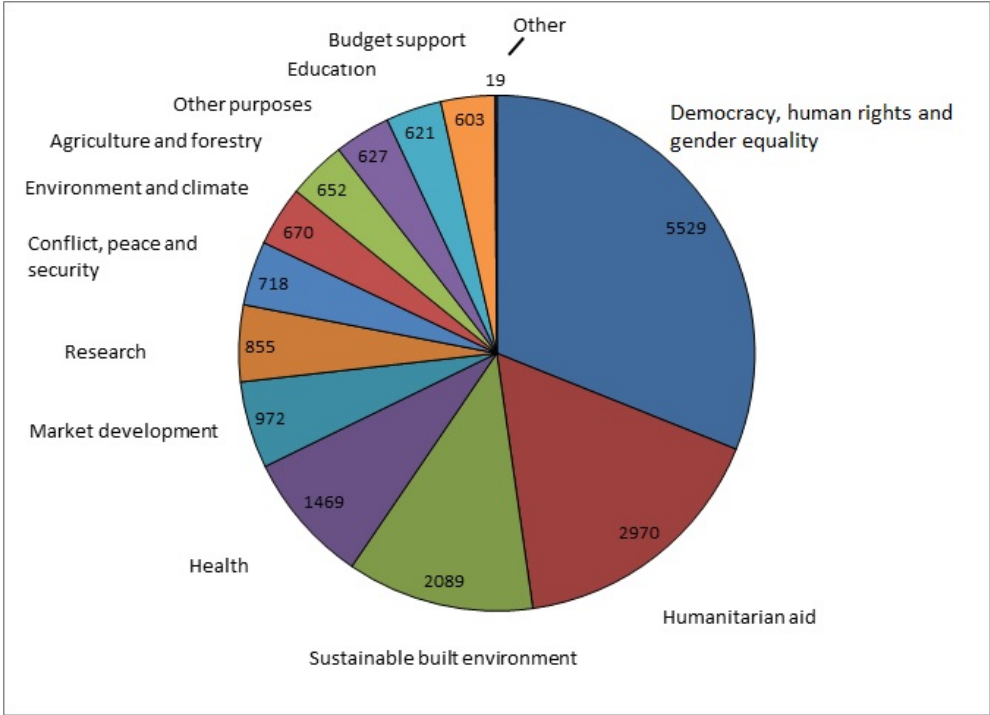
Within the bilateral ODA category, Sweden's priorities are reflected in the sector distribution of the budget presented in the diagram below.

³⁴⁰ Section 3.6.

³⁴¹ Hagen (2015).

³⁴² OECD (2015b).

Figure 2. Sweden’s bilateral development assistance broken down into main sectors (M SEK). *Source:* Summary of Sida Annual Report 2015.



It can be seen from the diagram that there is strong emphasis on *democracy, human rights and gender quality, humanitarian aid and sustainable built environment*. Beyond these three areas, resources are spread rather evenly across sectors.³⁴³ This diffusion across so many sectors raises questions about efficiency both at the donor and at the recipient sides of cooperation.

When compared to the abstract list of government responsibilities, the budget for *education* seems inadequate, corresponding to less than 3.5 per cent of total bilateral assistance, down from 5.1 per cent in the preceding year. As we have seen in previous chapters, education appears as a decisive factor in virtually all analyses, whether one is looking at economic growth, inequality, gender issues, political mobilisation, corruption or other important dimensions of societal development. If the government intends to come to grips with a portfolio of activities that is perceived as too scattered, both

³⁴³ For a more detailed analysis and a historical perspective, see Bigsten et al. (2016).

geographically and sector-wise, then education is a natural candidate for concentrated efforts.

To some extent, this inadequacy is compensated by Sweden's traditionally strong support for research, which of course contributes to the creation of human capital on a different level. This support is divided into three main areas: bilateral university cooperation, support for international and regional organisations and networks, and – less central to capital formation in developing countries – support for Swedish research into developing countries.³⁴⁴ Support for innovation may also be included here.³⁴⁵ Although assistance of this kind may be of strategic importance in some fields and or regions, it is of course not a remedy for a malfunctioning system of basic education.

Capacity-building in the area of governance and public administration is a decreasing part of Swedish ODA. In a detailed study of Sida's support for public administration and institutional capacity development, Hydén et al. show that there was a decrease in the support for policy development and public administration as part of Sida's total aid portfolio during the period 2003–2015, combined with a decrease in the share of this type of support both within the Democracy and Human Rights (DHR) portfolio and in the support for policy development and public administration in other sectors. It also appears that this decline has not been countered by increases to similar target activities under other budget headings.³⁴⁶

A number of Swedish central government agencies have been involved in capacity-building both in Europe and in more distant countries – the Swedish Tax Agency, Statistics Sweden, the Swedish National Financial Management Authority, the National Board of Trade, and the National Audit Agency, to name a few. There is an informal network comprising these agencies but no formal organisation of the various activities that guarantees the overall coherence of support given to a country. Most of the projects have been financed by Sida.³⁴⁷ There are some complaints that the administrative routines are burdensome; Sida makes no distinction

³⁴⁴ See Eduards (2006) for a somewhat dated overview.

³⁴⁵ Sida (2015b).

³⁴⁶ Hydén et al. (2016). This report was presented to the author only in late March 2016, so both this observation and the policy conclusions drawn in the present chapter are yet another example of identical discoveries made by independent observers.

³⁴⁷ The National Audit Agency has a budget of its own. The EU is an important source of financing for twinning projects.

between state agencies and commercial service producers in its routines.

Insufficient adaptation to local conditions is a recurrent theme in evaluations of development cooperation. In Chapter 4, we cited Andrews' diagnosis of failures in the field of public financial management, which is also valid for many other areas. There are of course examples of successful projects, and also complex areas involving institutional change, but on average the record is not satisfactory. In succinct terms, the main explanation is that institutions are context-dependent. There is of course a possibility that institutional innovation should be taken into account, just as there are technical innovations available today that offer shortcuts in the development of technical infrastructure, but the difficulty of transplanting institutions from one environment to another is well-known.

Scattered efforts

A common point of criticism of ODA is a lack of coordination between donors, fragmentation, and associated high administrative burdens on recipient countries. Birdsall and Savedoff described the situation in Vietnam in 2002, when it received about USD 1.3 billion from more than 40 official donors. An additional 350 international nongovernmental organisations contributed funds and operated in the country that year. Overall, foreign funding supported more than 8,000 development projects. Although these projects addressed critical needs of the Vietnamese people, they also imposed a great burden on Vietnamese officials, who were required to submit thousands of quarterly reports and host hundreds of donor visits that year.³⁴⁸

Development cooperation is constantly subject to centrifugal forces. Ministers from donor countries travel abroad and want to bring gifts to the countries that they visit. Experts or commercial agents see economic possibilities in the ODA budget and develop project proposals. Such pressures are liable to expand the portfolio both geographically and sector-wise. These forces are strong; Hagen's report to the Expert Group indicates that there was some tendency to concentrate Swedish ODA activities following the adoption of the

³⁴⁸ Birdsall and Savedoff (2011), p. 5.

Paris meeting in 2005, but also that there was again a tendency toward diffusion after 2009.³⁴⁹

Transparency, evaluation and learning

Sweden has a relatively strong tradition of openness in public affairs. According to the Aid Transparency Index 2014 published by the organisation Publish What You Fund, Sweden ranked sixth among donor organisations and third among national agencies in transparency, in the category “Very good”.³⁵⁰ There is also a wealth of publications on evaluation and follow-up.³⁵¹ Not all of these are evaluations in the strict sense of the word; a large proportion of the reports are more correctly follow-ups, verifying that certain activities have taken place according to plans and checking for a number of output targets. As Olofsgård argues in the previously cited report, there is room for more causal evaluation of Swedish ODA activities.³⁵²

Beyond the task of recording and evaluating, there is the problem of organisational learning. Evaluation reports are of little value unless they are used. The capacity for learning in an organisation is determined by the quality of the institutional infrastructure for receiving and processing reports as they are published. When Krohwinkel-Karlsson updated a previous assessment of Sida’s learning capacity in a report, her finding was that progress had been made during the two decades between the reports but that there was room for further improvement.³⁵³ There is no obviously optimal solution to the problem of organisational learning; within any given time budget, there will always be the problem of trading time for learning with time for everyday activities.

³⁴⁹ Hagen (2015).

³⁵⁰ Publish What You Fund (2014).

³⁵¹ A search on “evaluation” on Sida’s website yields 12 700 hits.

³⁵² Olofsgård (2014).

³⁵³ Krohwinkel-Karlsson (2008).

6.3 Policy conclusions

Policies for global development

The Policy for Global Development needs to be revitalised

There are signals that the Policy for Global Development (PGD) has lost some of its momentum, partly as a result of the meagre results of the whole-of-government approach. At the same time, the recent international mobilisation around the Sustainable Development Goals has created a sense of fresh start. There is a risk that the PGD will be abandoned and that administrative resources and much intellectual energy will be devoted to a new policy regime guided by the catchword *sustainability*. This temptation should be resisted. The reasons for maintaining a PGD perspective are as strong today as they were when this policy was originally adopted and if anything, this initiative should be reinforced.

The PGD has not been efficiently managed. In the previously cited communication to parliament on the implementation of Agenda 2030,³⁵⁴ the government addresses the problem of coordination raised in the report from the Swedish Agency for Public Management, but the overall impression from the text is that the government cares at least as much for implementation in Sweden as in the international arena. Three ministers were designated with specific areas of responsibility – the Minister for International Development Cooperation, the Minister for Public Administration, and the Minister for Strategic Development. The latter left office soon after the publication of the communication and the attention of the Minister for Public Administration is naturally directed towards domestic issues. This leaves us with essentially the same situation as before. For a cross-ministerial initiative of this kind to be successful, it is necessary to coordinate policy-making in the Prime Minister's office and invest more political capital.

³⁵⁴ Swedish Government (2016b).

Trade policies need to be better adapted to the needs of developing countries

The power asymmetries between developed and developing countries in the areas of trade, investment and taxation generate flows that outweigh ODA flows in the other direction. Redressing the balance in favour of developing countries would seem to be a priority if the commitment to global development is taken seriously. At the global level, trade policy is managed within the World Trade Organization (WTO). The WTO is not an aid organisation; it maintains a set of rules and restrictions on exchange that has been designed for basically equal trade partners. The threat of sanctions from a low-income country in Sub-Saharan Africa is negligible to a high-income country.

There are a number of preferential-treatment agreements between high-income and low-income countries, offering lower-than-average tariffs to the latter. As general tariff levels have been reduced, the value of these agreements has gradually eroded. This effect may be limited, and the problem appears to be bilateral (EU/low-income countries) rather than WTO-related. The main problem is often not tariffs but other barriers to trade such as rules of origin, and sanitary and phytosanitary rules. The EU level is also more critical in this respect than the multilateral playing-field.³⁵⁵

Special arrangements for developing countries in the WTO framework include extra time to fulfil their commitments, provisions designed to facilitate market access, special provisions concerning developing countries when adopting anti-dumping measures, and provisions for helping them to deal with, for instance, animal and plant health standards. There is still room for improvement. Measures to strengthen the position of developing countries include:³⁵⁶

- greater policy flexibility for developing countries as long as spillovers on other members are limited
- adapting the implementation of new rules to national priorities

³⁵⁵ A full-scale discussion falls outside the scope of this report. For some entries to the debate, see Hoekman and Mavroidis (2015), Chapter 6, and Narlikar et al. (eds.) (2014), Parts VIII and IX.

³⁵⁶ Section 3.5.

- the possibility of opting out of a certain regime for a limited time period, depending on level of development, administrative capacity, etc.

Again, many of the problems that face developing countries are EU-related rather than multilateral. Given the difficulties of influencing the EU in trade-related matters, it should nonetheless be decided whether action should be taken at the WTO level, aiming for more generous concessions for developing countries.

International efforts to counter tax evasion are still insufficient

Low-income countries are generally undertaxed. This is usually due to a generally weak administrative capacity, which is a problem for capacity-building efforts in development cooperation, but protecting tax bases is to a considerable extent also an international problem. The increased mobility of financial capital has created problems for policy-makers and tax administrations in both rich and poor countries, but poor countries are more damaged. A coordinated effort to come to grips with these problems is justified. The governments of most (although not all) countries have a common interest in developing systems for the exchange of information between national revenue authorities. Some steps have been taken, but they will not solve the problem, and in the absence of further measures, tax evasion will remain a problem, and in fact increase.³⁵⁷

There is also an asymmetry of resources and power in the area of tax treaties, that, unless controlled, will lead to consequences that run counter to the goals of the policy for global development. An illustrative case is when developing countries interested in new OECD-type double-tax agreements with Switzerland risk being forced into tax concessions in exchange for information.³⁵⁸ Sweden and like-minded countries could establish a different standard in this area.³⁵⁹

³⁵⁷ For more concrete details in this area pertaining to both corporate taxation and households, we refer to Zucman (2015).

³⁵⁸ Herkenrath (2010).

³⁵⁹ Following the publication of the so-called 'Panama documents', in April 2016 the Swedish government presented a summary of measures taken or envisaged against tax evasion (Swedish Government 2016).

As noted, this problem consists of two elements – the taxation of physical persons and corporate taxation. In the former case, the problem is essentially a problem of information; a global register of assets is needed. The building-blocks of such a register already exist in the form of privately managed registers, but a global regime needs to be established and a management authority identified.

There is also a need for a global register of beneficial owners in corporate taxation, but apart from that, a global standard for the taxation of transnational corporations must be established. A prototype for such a standard exists in the United States (for domestic purposes), and a solution has also been proposed by the European Commission to be applied in the European Union. These models need to be coordinated and extended to the global arena.

Development cooperation

Overall priorities in Swedish development cooperation do not reflect the relative importance of the sectors involved

Allocation at the aggregate level is where politics become most visible, and this is also where the potential for efficiency improvements is the greatest. Allocation within the budget for development cooperation can on the whole be defended, but things look different if it is required that the overall allocation of the budget should reflect the relative importance of the various sectors involved. As clear from the exposition in Chapters 3 to 5, two sectors stand out as particularly important to societal development: public administration and education.³⁶⁰ This is not reflected in the budget; education is treated as a sector like any other, with small and dwindling resources, and resources for capacity-building in public administration have decreased over a number of years.³⁶¹ There are strong reasons for reconsidering the overall allocation.

³⁶⁰ See Sections 3.2, 3.3, 3.6, 4.1, 4.4, 5.1 and 5.4 on public administration, Sections 3.2, 3.6, 4.4 and the whole of Chapter 5 on education.

³⁶¹ Hydén et al. (2016).

Capacity-building in public administration should be expanded

Public administration is a key component of state-building. Support for capacity-building in public administration has a more technical character than attempts to instil certain political values on the normative basis of a foreign country and is therefore politically less problematic. Establishing a climate of transparency in public administration also raises the quality of the public debate in a country and strengthens democracy. Against this backdrop, it is somewhat strange that the budget for capacity-building in this area has been shrinking.

Potential fields of cooperation cut across the entire public administration – basic statistical services, civil and vital registration services, cadastral registries, tax administration, other sector services, and supreme audit institutions. Tax administration is an area that is particularly interesting from the development point of view, both because of the general need for increased revenue and as a central component of public administration.

Sweden has an international position in the area of public administration, characterised for more than a century and a half by low corruption, and an efficient tax administration. A merit-based system of recruitment and the promotion of civil servants has played an important role in this development. Sweden leads the OECD in terms of public sector gender equality, and – restricting the perspective to financial management – Sweden has been one of the best fiscal performers since the institutional reforms in the mid-1990s.³⁶² The Nordic countries have achieved levels of equality and female emancipation that are unprecedented in modern human history.

A public-financial management system and an autonomous public audit institution are important instruments for increased transparency in public affairs and can thus contribute to the legitimacy of government. Macroeconomic policy-making is a national responsibility, and to the extent that international agencies should provide advice or conditional transfers, this is largely a responsibility for the International Monetary Fund. Public-financial institutional design, by contrast, is an area where other donors may assist in

³⁶² See Andrews (2015) for an analysis of Sweden's activities in this field.

capacity-building and may actually be perceived as less problematic partners than the IMF. The main reason for failures in this area is the wide gap between the point of departure and the best-practice ideal that has governed technical assistance in the field; a truly adaptive approach is necessary.³⁶³

Capacity-building in trade policy is another relevant area, given the importance of trade to development. A minor complication is that the Swedish National Board of Trade, according to its instructions, is a pro-free-trade agency.³⁶⁴ It is essential that in its advisory role the National Board of Trade is sensitive to the needs of low-income, primary-product-oriented countries, which normally differ from those of an industrialised country.

Support for developing countries in international negotiations with other countries or with multinational enterprises is another area where small countries with expertise can provide valuable assistance within fairly limited budgets.

A holistic approach to public administration is required, based on an analysis of the status of the administration as a whole in the partner country. Sida's own capacity for institution-building may need to be strengthened. Country expertise from Sida needs to be combined with sector-specific knowledge from Swedish agencies and possibly supplementary expertise drawn from the private sector, relevant non-governmental organisations, or retired staff from the public sector. A holistic approach is required. There is room for a strong formal organisation, integrating expertise from various areas of public administration with the aim of exploiting synergistic effects and increasing efficiency. Preparations should be made for missions on short notice, in order to exploit windows of opportunity, recognising of course that these commitments are long-term.

Support for education should be expanded

Among the many different tasks that can justly be assigned to the state, education stands out as exceptionally important. The general level of education affects society through a number of different channels. Education and the strength of democratic institutions are

³⁶³ Section 4.4.

³⁶⁴ Government Ordinance 2012:990, §1.

closely correlated. It makes citizens more capable of defending their rights, and it strengthens civil society and political participation. There is also a long-term link between the level of education and the absence of corruption level in a society. Strong states have provided more education to their citizens, and such provision has also been more common where economic disparities were initially smaller. The importance of education to the productivity of the work force is well established, and the level education is important for long-term growth.

The fundamental importance of education for development is not reflected in the budget for development cooperation. Against the massive evidence for education as a lever of change described in previous chapters, it would be natural to see a higher share of the budget devoted to systems of universal education.

The current state of affairs in education is worse than the picture conveyed in official statistics. A sizeable fraction of children officially enrolled do not receive the education that they are entitled to, either because teachers are absent or because they do not teach when they are present. Data on enrolment and literacy is exaggerated, and the quality of teaching is less than satisfactory, as confirmed by ability tests. Child labour remains a problem in many parts of the world.³⁶⁵

It is somewhat surprising that the importance of this all-purpose instrument of development is not more visible in the budget for development cooperation. It is also a sector where additional resources from outside would seem relatively easy to channel through the existing system. If one-third or one-half of teachers are either absent or present but engaged in activities other than teaching, as testified in field research,³⁶⁶ there is ample room for improvement within existent institutions.³⁶⁷

International public goods could receive further support

International public goods are a natural priority on the development cooperation agenda. Normally this concept is used in connection with environmental public goods (biodiversity) and problems (climate

³⁶⁵ Section 2.1.

³⁶⁶ Chaudhury et al. (2006).

³⁶⁷ The reports of Damon et al. and Samoff et al. provide more detailed information on the practicalities of cooperation in this sector (Damon et al. 2016, Samoff et al. 2016).

change), but there are other public goods that merit attention. Knowledge is a public good, and *research and development* and *qualified evaluation* are examples of activities that figure naturally on the development agenda.

As described earlier, *agricultural* R&D is a sector where the interests of rich and poor countries are diverging, and there is a risk of stagnation in yields of tropical crops.³⁶⁸ It also appears that in *medical research* private sector R&D investments are inadequate to meet future needs. The aggregate ability-to-pay in poor countries is often judged insufficient to justify investments even where basic research results are available. Antimicrobial resistance is a critical area of this kind, where the World Health Organization has taken the initiative and where the Swedish government is already involved.

Research into the *efficiency of aid* is another relevant collective asset. There is scope for raising the standards of evaluation, aiming for more causal analyses.³⁶⁹ On the other hand, there is reason to warn against over-confidence in evaluation as a means for increasing the efficiency of aid. Given the problems associated with both randomised control trials (RCTs) and their proxies relying on quasi-experiments and instrumental-variable techniques, the applicability of such techniques must be carefully checked in the individual situation.

Sweden has a fairly strong academic tradition in evaluations according to areas such as labour market policy, educational policy, and social security, so there is a wealth of analytic experience that can be put to use. It is not a question of imposing RCT on every project programme – certain perfectly legitimate activities are hard to evaluate using such an approach – but the matter should be given consideration at the outset of new activities. A common experience is that evaluators are often engaged far too late in the life cycle of a project. The quality of evaluation can often be improved through limited adjustments in the project planning phase, for instance, considering whether there is room for randomisation.

³⁶⁸ Section 3.4.

³⁶⁹ Section 2.3.

Methods for managing divergence of opinion between donor and recipient country need to be further developed

“Working with the grain” has become a catch-phrase for adaptation to local conditions.³⁷⁰ It implies that development plans and activities that run counter to established norms and rules in the recipient country are likely to fail. This is an important general fact to be kept in mind, but it does not solve the general problem of development policy. It is conceivable that the donor community does not accept established norms and rules and that one of the aims is specifically to change them. If priorities between the two parties to the dialogue have different opinions, the situation will be difficult, but no government is a monolith and there may be possibilities to ally with parts of the administration in order to enact projects that the centre of power is less interested in. Apartheid in South Africa is a pertinent historical example, and other, more recent examples may be cited. This creates the problem of interacting with a country where harmony between power-wielders and donors cannot be established.

In a country with a strong central government, there is little room for donors to act outside the scope defined by the government; some governments refuse to cooperate with donors that do not accept the government’s priorities. In such cases, the solution has often been to cooperate with civil society organisations when agreement with the government cannot be reached. Even this form of cooperation has become more difficult as some partner countries have reduced the scope for opposition parties and civil society organisations to act. Further, as the OECD warns, civil society is not to be equated with non-governmental organisations.³⁷¹

In countries where the central administration is weaker, there is more freedom of action. In such cases, there may be intermediate situations where it is possible to find allies within the government. What is often lacking in these situations is an analysis of power relations in the country under discussion. Who is in favour of societal change, and who are the enemies? It may be possible to find allies in a sector that the donor community wants to prioritise even if the centre of power, normally represented by the Prime Minister’s Office and the Ministry of Finance, is less interested. The Ministry of Education

³⁷⁰ Booth et al. (2011), Levy (2014).

³⁷¹ OECD (2010b).

would normally be interested in support for the educational sector, and similarly for other spending ministries.

In these situations, the method of *cash-on-delivery* could be considered. The idea here is to finance a project or a programme in exchange for demonstrated results to be verified by an external party without vested interests in the activity. The responsibility for implementation rests with the partner country, which may help strengthen the capacity of the ministry in charge. Interestingly enough, some recipient countries have proposed this form of support, so there is not necessarily any form of coercion involved. Experience from this type of arrangement is now accumulating and can be used to develop the methodology further.³⁷²

Development cooperation needs to be further concentrated

Development cooperation is subject to strong centrifugal forces. Political contacts with distant countries are facilitated by contributions from the development cooperation budget, which contributes to the geographical scattering of efforts. On the supply side, different stakeholders continuously push for new activities to be included on the agenda, leading to sector-wise scattering. After the adoption of the Paris agenda, an effort was made to concentrate resources, but in recent years, there have been new tendencies to spread the efforts more widely. There is no general antidote to these tendencies; the only solution is subjecting the portfolio to continuous scrutiny in order to maintain focus.

The refugee situation in Europe has led to a major reallocation of resources within budgets. This would seem to be an appropriate moment for renewed efforts to concentrate the portfolio in both of the above dimensions.

There are basically three different ways to tackle the problem of scattering. One alternative is to redirect flows via *multilateral channels*. In this way, the number of agents is reduced, in agreement with the Paris agenda. A prerequisite for this to be a superior alternative is that the multilateral organisation is at least as efficient in its allocation and implementation of projects as the original donor country. In the case

³⁷² Birdsall and Savedoff (2011). See the website, www.cgdev.org, for more recent examples.

of aid managed by the European Union for instance, there is a risk that local representatives –who are relatively autonomous – will use their discretionary power for purposes other than maximising overall efficiency.

A different problem, highlighted by the Swedish National Audit Agency, is that responsibilities and reporting requirements tend to become confused when aid flows are channelled through multilateral organs.³⁷³

A second way to tackle the scattering problem is to rely on *local coordination*. The increase in multi-bilateral cooperation, where Sweden uses multilateral channels for defined projects, is justified primarily as a means for reducing the burden on partner countries. Multilateral organs are also considered to have a comparative advantage in fragile states.

Another alternative for local coordination is that Sweden and like-minded countries agree on a division of labour, where one country assumes responsibility for administering the flows from several donors. This division of labour may apply to the entire flow or to particular sector, depending on the situation. Such a solution is easy to implement and also flexible. The cost is lower than for the full multilateral solution, but then the coordination gain is also more limited.

The third solution is that the Sweden manages to *reduce the diversity of its bilateral portfolio on its own* by reducing the number of partner countries, or sectors, or both. This requires a strong political commitment but it is the best alternative if maintaining authority over spending is considered important. If this alternative is chosen, it is necessary to decide on the criteria to be used for the selection of countries and sectors. Criteria can be applicable on the partner-country side or at the donor side, or be based on more general considerations. Basing selection on demand suffers from the problem that demand is more or less infinite. It is always possible to find a potential cooperation partner no matter which country or sector one selects. Further, as noted above, we do not always accept weak or absent demand as an argument for not taking the initiative.

³⁷³ Riksrevisionen (2014).

Hagen suggests that selection be based on an efficiency criterion; only partner countries with a favourable policy environment should be considered. This is questionable for two reasons. Firstly, this criterion is highly political, given that it amounts to abandoning countries that are difficult to work in. Secondly, it can be questioned on a factual basis; the correlation between favourable environments and good outcomes is fragile, as we have seen in Section 4.4.

General criteria related to the partner country can be based on the type of knowledge that has been summarised in previous chapters – the importance of infrastructure, good governance or education for economic growth, the importance of transparency and free mass media for democratic development, and so on.

Supply-side criteria involve Sweden's comparative advantage in implementation. This question is to some extent independent of the general issue of allocation. The primary question is what the overall allocation should be across countries and sectors; a secondary issue is whether Sweden should be more deeply involved also in the implementation phase.

The choice of partner countries – the geographical dimension – is mainly a political parameter. Countries with fragile states are more difficult to work in, which implies higher administrative costs, greater risks and more uncertain outcomes, but less efficiency in these respects can be justified by greater needs.

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Definitions

Developing country: According to the OECD, there is no established definition of developing or developed countries. In the United Nations terminology, a developing country is a low- or middle-income country that has left the category of Least Developed Countries (see definition below) and is now above the threshold. In the present report, developing will be equated with low- or middle-income. In the context of international trade, as regulated by the World Trade Organization, there is no formal definition of a developing country, a fact that has occasionally caused conflict in the organisation.

Development Assistance Committee (DAC): Forum for consultations among donor countries established within the OECD in 1961.

Evaluation, follow-up: *Evaluation* is understood in the present report as *causal evaluation*, that is, an analysis of the causal link between a measure taken (“treatment”) and an effect. Evaluation should not be confused with *follow-up*, which consists simply of verifying that a certain activity has been performed and that targets have been met. In the absence of a true causal analysis, the decision-maker is liable to make serious mistakes concerning the adequacy of measures under study.

Gini coefficient: The Gini coefficient (or Gini index) is a measure of inequality pertaining to the distribution of incomes, assets, land holdings etc. It varies between 0 (full equality) and 1 (maximum inequality, implying that one unit possesses all assets under study).

Income classification: According to the World Bank’s classification (July 2015), which refers to 2014:

- *low-income* economies are defined as those that had a GNI per capita of \$1,045 or less;
- *lower middle-income* economies are those that had a GNI per capita of more than \$1,045 but less than \$4,125;
- *upper middle-income* economies are those that had a GNI per capita of more than \$4,125 but less than \$12,736;
- *high-income* economies are those that had a GNI per capita of \$12,736 or more.

International Development Association (IDA): Part of the World Bank designed to support the poorest nations via concessional loans (low or zero rates, long repayment horizons).

Least developed countries (LDCs): In the United Nations classification, a least developed country is a country that exhibits low indicators of socioeconomic development according to their Human Development Index rating (poverty, human resources, economic vulnerability). A country that improves its rating above the threshold becomes a *developing country*. The list of LDCs currently comprises about 50 countries. Only a handful of countries have graduated since the original list was made by the UN in 1971.

Official development assistance (ODA): According to the OECD definition, official development assistance consists of “flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element of at least 25 percent (using a fixed 10 percent rate of discount).”

Output, outcome, impact: The term *output* refers to what is produced in an activity, such as teaching hours or vaccinations. By contrast, *outcome* is the effect of these products on what is the actual target, such as increased literacy or resistance to infectious diseases. *Impact* is normally reserved for outcomes in a wider context or over a longer time horizon.

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