



## Democratizing Development: An Agenda for Middle Income Countries



*ISIS Focus reproduces the speech made by Ms Sri Mulyani Indrawati, Managing Director of the World Bank, at a Forum organized by ISIS Malaysia on 8 November 2010. [Read more.....](#)*





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# Democratizing Development: An Agenda for Middle Income Countries



*Sri Mulyani Indrawati*

## **Democratizing Development at the Global Level**

The global economy is struggling to regain its footing after the greatest global economic crisis since the Great Depression. And as it does so, it is hard not to notice that the world has changed. It is increasingly apparent that it is not the developed world – the world’s established economic powers – that will need to pull us out of this global crisis. Rather it is the emerging economies – such as Malaysia – indeed truly Asia – that are proving to be the engines of global growth.

Increasingly the US and Europe are looking to emerging markets in Asia and Latin America to lift global demand. Led by emerging markets, developing countries now account for half of global growth and are leading the recovery in global trade. In Asia, these shifts were taking place well before the crisis.

Asia’s share of the global economy in purchasing power parity terms has risen steadily

from seven per cent in 1980 to 21 per cent in 2008. Asia’s stock markets now account for 32 per cent of global market capitalization, ahead of the United States at 30 per cent and Europe at 25 per cent. Last year, China overtook Germany to become the world’s biggest exporter.

The world has changed and the World Bank is changing. Growth and development are now multi-polar, and the dichotomies of North and South are less important. At the World Bank, we see this as an opportunity for ‘democratizing development.’ As World Bank President Zoellick noted in a recent speech in Washington, ‘rising economies bring new approaches and new solutions.’ ‘A new multi-polar economy requires multi-polar knowledge,’ he said. Democratizing development in part is about having the important knowledge we have gained from our own development experience being shared and used among the development community to achieve development solutions.

*‘Open Data, Open Knowledge, and Open Solutions’* is the name of an initiative we are

undertaking at the Bank. It aims to learn from knowledge and use solutions from the laboratory and database that is our common experience. This is about learning from what works – whether it is coming from Mexico or Ghana, China or Malaysia. For example, many countries are increasingly looking at Malaysia's experience with Islamic Finance.

The World Bank has backed this up with action. We doubled the number of indicators released to the public to 4,000, providing them free of charge. We launched an 'Apps for Development Challenge' to challenge software developers to create applications, tools, data visualization and more, that would utilize this data to analyze and tackle the world's long-standing problems.

This increased openness and transparency is also reflected more broadly in the World Bank. Our new Access to Information policy makes the World Bank a world leader among multilateral institutions on disclosure. We know that being effective in today's evolving world with new growth patterns requires us to be a beacon of transparency and accountability. In the fight against poverty, we recognize the need for a steadfast focus on results without a 'one size fits all' approach.

'Democratizing development' is also about having the voices and experiences of developing countries heard. As economic tectonic plates shift, so do those of global governance. With increased globalization, emerging economies are gaining more voice, in fora such as the G-20, or the World Bank (which we like to refer to as the G-187!). Indeed the voting share of developing and

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*Many countries are increasingly looking at Malaysia's experience with Islamic Finance*

transition countries at the World Bank has been increased over the past year. As a development professional, and as the former Finance Minister of an emerging economy, I think it is important that emerging economy countries take their place at the table and have their voices heard.

And those voices are being heard. Just on Friday the IMF took action on increasing the voice of developing countries. Both the IMF and the World Bank are in the midst of a series of internal reforms. Remember that you and the rest of the G-187 own them. You have a role in making these institutions effective in being responsive to the range of issues our world faces.

But with increased voice in global governance for emerging economies, comes increased responsibility. This is also part of 'democratizing development.' Taking on more leadership through participation in global development fora is requiring governments in Middle Income Countries (MICs) to speak to global issues. Taking on the role of a 'global citizen' requires the challenge of stepping beyond domestic interests alone. This is an old and continuing challenge for G-7 governments; but it is a new challenge for most Middle Income Countries.

Moreover, beyond new global responsibilities, there is a critical domestic dimension to democratizing development. With

increased wealth, and the weaning from development assistance, emergent Middle Income Countries face an increased (global) responsibility to address domestic social issues – including the persisting challenges of poverty and inequality. As we may expect of higher income countries, they are increasingly expecting Middle Income Countries to sort out their own social and development problems.

### **Democratizing Development at the National Level: MICs and the Social Agenda of Inequality**

Middle Income Countries are among the most dynamic economies in the world. By the World Bank's classification, some 100 countries fall in this category. Their GNI per capita falls between \$996 and \$12,195 per year, in purchasing power parity terms. Together, these countries account for 69 per cent of the world's population, and 41 per cent of its economic output. Despite their diversity, however, most of these 'MICs' are facing three common challenges:

- i. How to get more sustained growth?
- ii. How to make this growth more inclusive?
- iii. How to achieve green and clean growth?

First, policy makers in almost every MIC, including China, want to figure out how to avoid the dreaded 'middle-income trap.' Many countries in Asia and Latin America have surpassed the low income threshold, but are unable to generate the sustained growth needed to achieve the high-income status of the OECD countries. Precisely for these reasons, Malaysia has just launched an Economic Transformation Programme, with the

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aim of joining the league of high-income economies by 2020.

Second, MIC leaders are struggling with how to make growth more inclusive in their countries. How do we avoid the risk of 'unshared growth' which can often threaten the very social cohesion and stability needed to sustain growth? Indeed with middle income status, often inequality has increased. And while poverty may have declined, poverty persists. Incredibly, three-quarters of the world's poor live in Middle Income Countries. The rapid rise of countries like China and India in this region has often gone hand-in-hand with an increase in inequality, rather than a reduction in inequity. This is also true in Malaysia, where despite the impressive record in reducing poverty, inequality remains an issue: the bottom 40 per cent of households account for only 12.6 per cent of total income, while the top 20 per cent account for nearly 50 per cent of total income.

Third, leaders and citizens are talking about and searching for solutions to the challenges presented by green and clean growth. I just came from the Apec Finance Ministers' meeting where this issue was highlighted. The threat of global change is real. The transition to low carbon emission intensive societies hinges on investment in green technologies, the use of market mechanisms in pricing greenhouse gas emissions, and complementary policy and regulatory measures. The recent increase in the solar energy industry here in Malaysia is just one example of a response to the complex climate issues, although few of the solar panels are used in the local market, which still needs to be developed.



*A car that showcases the latest low-carbon technology*

Almost everywhere across the middle-income landscape, disparities in living standards are enormous. Let me give you an example from Turkey. A recent World Bank study found that a 15-year-old boy, born to an educated mother, in a small family in an urban area in Central Turkey, had a 95 per cent chance of being enrolled in school. At precisely the same time, a 15-year-old girl, born to a mother with no education, in a household with six or more children, in a rural area of Eastern Turkey, had an enrollment probability of approximately only 10 per cent.<sup>1</sup> Naturally, these boys and girls cannot be held responsible for the families to which they were born, and yet so much of their lives will be pre-determined by the very unequal opportunities they get at the start.

The development solution we are looking for in MICs is more growth; and growth that is more inclusive. We need to address both issues at once. I would like to highlight three broad areas that will be critical – both for sustained and more inclusive growth.

<sup>1</sup> Source: Ferreira and Gignoux (2010): 'Inequality of Opportunity for Education: Turkey,' Ch. 6 in Kanbur and Spence (eds), *Equity and Growth in a Globalizing World* (Washington, DC: Commission on Growth and Development).

### Creating Economic Opportunities and Jobs

First, inclusive growth is aided by policies that generate economic activity and provide broad-based access to them. And here, actions in six areas are proving to be critical to avoid the "MIC trap."

1. Rapid and sustainable growth requires high levels of investment. History suggests that sustained high levels of investment are critical to moving up the value chain, yet among the middle-income countries of Asia, hardly any are back at levels reached before the 1997-98 Asian financial crisis. Investment rates in Thailand, Malaysia, and the Philippines have yet to recover, and are well below the 30 per cent averaged by Korea and Japan during their economic take-offs. Investment — both among bigger firms and small enterprises — is critical to generating jobs and enhancing opportunities for all. Another critical factor is macro stability — as the foundation that is necessary, but not sufficient, for sustained growth.
2. Becoming a high-income economy requires innovation. Companies will need to become more innovative at introducing new or

improved goods and services, and developing or adopting innovative production processes and better modes of business operation. How can East Asian countries create a business enabling environment for innovation? One that creates incentives for entrepreneurs, both big and small, to experiment, to take risks, and then — should these risks fail to bear fruit — to take new risks without stigma?

On a positive note, as our recently released Doing Business 2011 report states, the economies of East Asia were among the most active in improving the regulatory environment — and indeed Malaysia was among those rising in the rankings. Overall, an environment conducive to innovation is similar to the environment that is conducive to tapping into local savings to drive investment — clearly defined property rights, well-articulated and not too onerous policies for competition, and business entry and exit.

3. We need to ensure that investment and innovation translates into jobs. Malaysia's steady growth, as in many MICs, has yet to translate into steady employment, and it has not turned self-employment into an opportunity for its people to be independent and creative entrepreneurs. This points to policies that reduce costs and barriers in labour mobility and that increase competitiveness in the labour market to improve wages. It also points to the need to reduce the costs of doing business, and to create employment.
4. Access to adequate financing is essential for innovative entrepreneurs. But getting these investments is difficult because these (businesses) are typically risky and, at least initially, unprofitable. For grassroots innovation, improving access of small and medium enterprises (SMEs) to financing is

essential to ensure that small but powerful ideas can also be commercialised. SMEs account for more than one-half of formal employment in the region, and in some countries, they are collectively the largest employer.

Capitalising on growth in SMEs is critical for inclusive growth and the World Bank is an active partner in this endeavour, as we are assisting in the development of the SME Master plan for Malaysia. The establishment of an SME credit bureau in Malaysia is a recent example of a successful public-private partnership to improve access to finance. Thanks to the SME credit scores that the bureau now calculates, banks have reduced processing times for loan applications, in some cases by half.

5. Improved logistics and connectivity are also vital for innovation, sustained rapid growth and job creation. Innovative companies need tighter connectivity at home and abroad, knowledge-related infrastructure, and well-defined policies to encourage the formation of technological clusters in urban centres. Information and communications technology has been the main driver of transmission of innovative information, particularly in East Asia. The other important dimension of logistics and connectivity in the inclusive growth agenda is that in many MICs, including Malaysia and Indonesia, poverty and inequality also have a strong geographic dimension. Some of our more remote areas are also some of our poorest. For example, in Malaysia, 80 per cent of

*Improved logistics and connectivity are also vital for innovation, sustained rapid growth and job creation*

poor households are located in five provinces.<sup>2</sup> In addition to the policy implications for developing this human capital, these communities need to be connected to markets – whether they are markets in goods, services or labour – in order to participate in the growth that is benefiting the rest of the country.

6. Green growth and addressing climate change are essential elements of sustained inclusive growth. The poorest are often those most impacted by climate change and the environment. Policy-makers have the opportunity to encourage clean, green and sustainable growth to promote a more inclusive growth. For example, improved access to modern electricity services that are reliable, affordable, and clean is critical to economic growth and the achievement of the Millennium Development Goals. Access in rural areas, in particular, brings large benefits, in terms of better delivery of health, education, and communications services. The World Bank Group invested nearly US\$7 billion in low carbon energy options between 2005 and 2009 and we continue to place climate change and sustainable development at the core of what we do.

### Improving Human Capital and Skills

A second broad area for action, and one related to promoting opportunities, is that of further building the human capital base in Middle Income Countries

Inclusion requires more and better human capital. Some excluded people lack the skills to take advantage of income-earning opportunities. While some never had any skills in the first place, (for example, about 60 per cent of poor

households in Malaysia are headed by a person with primary education or less), for others, it is simply a skills gap between what they have to offer and what the market demands. In an MIC like Malaysia, educational and training opportunities may not have kept pace. Policies to reduce disparities can help address this skills gap. Disparities can exist in the quality of basic education across states, and between rural and urban areas. Currently, when a household head in Malaysia attains secondary education, the probability of that household being poor declines by 54 per cent in urban areas and by 28 per cent in rural areas. Action is also needed to strengthen links between industry and education to ensure a match between skills and market demands.

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Education systems need to gradually shift from equipping workers with basic skills to providing them with abilities to create new products. My earlier example from Turkey clearly demonstrated the variability in educational opportunities as just one of many disparities within MICs. Education is important throughout the entire process of innovation, from the emergence of ideas to their implementation and commercialisation. And MICs in East Asia are falling below international averages on education outcomes, affecting the scope for equipping the labour force with the skills needed for them to be innovators rather than simply users of new technology. This is having a palpable impact on the ability of firms to move up the value chain. Although there have been declines in spending on education, more money is not the only answer – the content and design of the education are critical. Countries such as Malaysia and Thailand are appropriately reviewing education policies

<sup>2</sup> World Bank, *Malaysia Economic Monitor November 2010*. The five provinces with 80 per cent of poor households in 2009 are Kedah, Kelantan, Terengganu, Sabah, and Sarawak.

because of private sector concerns about lack of adequate skills and an innovative workforce. Skills mismatch is a common issue that needs to be addressed for countries to escape the MIC trap.

### Ensuring Social Protection

The third broad area I would like to highlight is social protection. The need to protect the vulnerable from risks is becoming all the more evident with recent crises, whether they are generated by economic or natural disasters. Going forward, Middle Income Country governments are increasingly stepping up to ensure that social safety net programmes have a clear and consistent poverty focus, that the targeting mechanism gets benefits to the right people, and that efforts to move from fragmented programmes to a coordinated social protection system are sustained.

Even if income-earning opportunities exist, and access to them is broadly adequate, some people will inevitably remain excluded or require temporary support. In Malaysia, a 10 per cent decline in incomes of households near the poverty line would increase the poverty headcount from 3.9 to 5 per cent.<sup>3</sup> Important elements of a social protection system are in place, but significant gaps remain. Social safety net programmes could have a stronger poverty focus, targeting mechanisms could be improved and fragmented programmes could be replaced by a well-coordinated social protection system.

Inclusion requires an effective and efficient safety net to protect the poor and help them to manage risks. Whatever the reason for exclusion — disability, natural disaster, financial crisis — some people have fallen behind and find it impossible to catch up. I have just been to Latin America where MICs have set the pace. Now, in Asia, countries like the Philippines are also taking on this critical agenda. From my own experience in Indonesia, there is often scope for better

<sup>3</sup> *Ibid*

targeted programmes for the poor that can be financed by reallocating funds from poorly targeted or regressive price and commodity subsidies.

### And the World Bank is Changing...

Now let me turn briefly to the World Bank. We also need to be inclusive. We also need to be results-oriented and strategic. And most important, we truly need to be the World Bank, not just a 'Some Countries of the World' Bank. So what are we doing? Following the food, fuel and financial crises, we have identified our priorities for the post-crisis direction:

- Targeting the poor and vulnerable;
- Creating opportunities for growth;
- Promoting global collective action;
- Strengthening governance; and
- Managing risk and preparing for crisis.

The consequence of this will be that the World Bank Group remains strategically focused where it could add the most value, has a governance framework appropriate for the 21st century, is financially strong, and continues to be responsive, innovative, flexible and accountable to its clients and shareholders. I hope that you hold us to these high expectations.

The World Bank is now a global transparency leader. It scored the highest rating on aid transparency among 30 leading multi-lateral and bilateral aid agencies.

For our internal reforms, the vision is a World Bank dedicated to results, transparency,

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## Democratizing Development

accountability, and working with others to find development solutions – and a Bank that excels at delivering customised, quality global knowledge and financial services in real time to the full range of client segments: poor countries, fragile and small states, middle income and emerging countries, the private sector and other stakeholders.

All of this requires a Bank Group that is locally responsive and globally connected, equally effective in serving country clients, delivering global public goods, and partnering with external stakeholders.

And this is the main reason why I am at the World Bank – development is my passion and what I just described is what I know we can achieve.

### Conclusion

I would like to conclude by reiterating that ‘democratising development’ has to do with emerging economies being more linked to the global economy and having more of a say in

global economic governance. It also means that the people in these countries need to be more linked to global and national growth, and that emerging economic powers can and should take steps to ensure that growth is more inclusive by addressing domestic inequalities. Moreover, democratizing development has a lot to do with good governance – both at the international and national levels.

Developing countries and their people cannot be ‘objects’ of development efforts but should increasingly be the ‘drivers’ of development. Indeed, the agenda of ‘democratizing development’ would also imply that people in these countries need to be increasingly recognised as the source of solutions to development.

And institutions like the World Bank, as an institution of which your country and people are members, must increasingly not only help share with you the development experience of others, but, also importantly, tap on your knowledge and experience and share it with others.

Thank you.



*A section of the audience*





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