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POLICY RESEARCH WORKING PAPER 2448

On "Good" Politicians and "Bad" Policies

Social Cohesion, Institutions, and Growth

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One of the primary reasons that otherwise good politicians enact bad policies in countries all over the world, but especially in low-income countries, is that they face significant constraints in their efforts to bring about reform. These constraints— the "room for maneuver"— are shaped by the degree of social cohesion in a country and the quality of its institutions.

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Summary findings

Social cohesion—that is, the inclusiveness of a country's communities—is essential for generating the trust needed to implement reforms. Citizens have to trust that the short-term losses that inevitably arise from reform will be more than offset by long-term gains. However, in countries divided along class and ethnic lines and with weak institutions, even the boldest, most civic-minded and well-informed politician (or interest group) will face severe constraints in bringing about policy reform.

Ritzen, Easterly, and Woolcock hypothesize that key development outcomes (particularly economic growth) are more likely to be associated with countries that are both socially cohesive and governed by effective public institutions. They test this hypothesis for the sample of countries with available data.

The authors develop a conceptual framework based on the idea of social cohesion, then review the evidence on which it is based. While several earlier studies have shown that differences in growth rates among developing countries are a result of weak rule of law, lack of democracy, and other institutional deficiencies, Ritzen, Easterly, and Woolcock focus on the social conditions that give rise to these deficiencies. They also seek to establish empirically a causal sequence from social divisions to weak institutions to slow growth.

The essence of their argument, supported by new econometric evidence, is that pro-development policies are comparatively rare in the developing world less because of the moral fiber of politicians (though that surely matters) than because good politicians typically lack the room for maneuver needed to make desired reforms. This lack of maneuverability is a product of insufficient social cohesion and weak institutions.

The authors also explore the determinants of social cohesion, focusing on historical accidents, initial conditions, and natural resource endowments.

Social cohesion should not be seen as a concern primarily of developing and transition economies. Indeed, it is as important in the United Kingdom as in Ukraine, in Canada as in Colombia, in the Netherlands as in Nigeria.

This paper—a joint product of the Office of the Vice President, Development Policy and Macroeconomics and Growth, Development Research Group—is part of a larger effort in the Bank to understand the role of social cohesion and institutions in development. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Anne Joy Kibutu, room MC4-320, telephone 202-473-4047, fax 202-522-1158, email address akibutu@worldbank.org. Policy Research Working Papers are also posted on the Web at www.worldbank.org/research/workingpapers. The authors may be contacted at jritzen@worldbank.org, weasterly@worldbank.org, or mwoolcock@worldbank.org. September 2000. (35 pages)

On "Good" Politicians and "Bad" Policies:

Social Cohesion, Institutions, and Growth

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1. Introduction

Policy and institutional quality are to a large extent endogenous. This statement reflects the constraints to policy reform, constraints that can be a major impediment to changes that are dearly needed to bring about better living standards for all people, but especially the poor. To be sure, considerable debate remains regarding the details of which policies are most likely to achieve these ends, as the recent protests in Seattle and Washington attest. There is increasingly broad agreement, however, on good policies, e.g. that greater prosperity is achieved by ensuring a stable and open macroeconomic environment, by building accountable and inclusive public (legal, financial, political) institutions, and by investing in health, education, and social safety net programs.[1] These programs, coupled with rights to free speech and association, help to empower civil society organizations, thereby giving greater voice to the interests and aspirations of marginalized groups.

The majority of politicians understand both intuitively and substantively what these good policies (or "best practices") are, and most have the best of intentions with respect to trying to bring about a better life for all in their country. But if this is so, why do too many "good" politicians end up standing for, defending, or perpetuating policies that undermine rather than advance general prosperity? In short, why are good politicians so often associated with bad policies?

Before trying to provide a more formal explanation, let us begin with two examples of good politicians and bad policies. The first comes from a developing country (which shall remain anonymous, as it is a client of the World Bank) with a male illiteracy rate of about 40% and female illiteracy rate of 70%, placing it in the world's bottom 25% while the country's GDP per capita is in the upper 25% of developing countries. The education policy in this country is clearly "bad" despite a relatively high level of spending (6% of GDP). This can be illustrated with a number of points:

a) Teachers are not accountable and may show up or may not show up. In particular in the rural areas, teachers teach few hours.

[1] This is the essence of the Comprehensive Development Framework.

b) Many schools are closed between 12:00 p.m. and 3:00 p.m. making it nearly impossible for children who live often as far away as one hour walking distance to attend both morning and afternoon sessions.

c) The overhead is high; here may be at least one civil servant in the ministry of education for each two teachers.

The Minister of Education in this country is a "good" politician, with the best of intentions, a superior knowledge of what is wrong with the education system, and what good practice looks like. However, the Minister feels constrained in his/her efforts to bring about change because of pressures from particular constituencies, like the civil service and organized teachers.

The second example comes from higher education policies within the European Union. With the exception of the four countries (UK, the Netherlands, Norway and Sweden), the financing of higher education in the rest of Europe is clearly regressive, diverting resources away from the poor to the rich. These countries are clearly pursuing "bad" policies. Like their developing country counterparts, the European ministers of education are often fully aware of these flaws, and have the best intentions of changing it. But they don't, or more accurately, can't because they fear the wrath of students and upper income parents.

In this paper we seek to address the causes and consequences of constraints to policy reform in developing countries. We argue that one of the primary reasons why otherwise good politicians enact bad policies in countries all over the world, but especially in low-income countries, is that they experience significant social constraints in their efforts to bring about reform. These constraints—or what we here call "room for maneuver"—are shaped by the degree of social cohesion within a country. Social cohesion and room for maneuver determine the quality of institutions, which in turn have important impacts on whether pro-poor development policies are devised and implemented.

A country's social cohesion is essential for generating the trust needed to implement reforms. Inclusiveness of the country's communities can greatly help to build cohesion. Citizens have to trust the government that the short-term losses that inevitably arise from reform will be more than offset by long-term gains. On the other hand, countries divided along class and ethnic lines will place severe constraints on the attempts of even the boldest, civic-minded, and well-informed politician (or interest group) seeking to bring about policy reform. The strength of institutions itself may be, in part, determined by social cohesion. We therefore propose that key development outcomes (the most widely available being "economic growth") are more likely to be associated with countries that are socially cohesive and hence governed by effective public institutions. We test this hypothesis for a sample of countries. We are well aware of the limitations of a cross country regression. We will use the statistical tools as an instrument to find some degree of order in a complex world.

Social cohesion should not be seen as primarily a developing or transition country concern; indeed, too much is made of the distinction between "developed", "transitional" and "developing" countries. Social cohesion, like the problem of order it seeks to flesh out, is as important in the Ukraine as it is in the UK, in Canada as it is in Colombia, in the Netherlands as it is in Nigeria. The data set we use contains both developing and developed countries.

The paper proceeds as follows. In section two we develop a conceptual framework based on the idea of social cohesion. In section three we then review the data which is available to investigate this framework. Then we proceed in section four with our statistical analysis. While several earlier studies have shown that differences in growth rates among LDCs are the result of lack of democracy, weak rule of law, and the like, we are more interested here in the social conditions that give rise to these institutional deficiencies. Importantly, we are also concerned with establishing empirically a causal sequence that goes from social divisions to weak institutions to slow growth. The essence of our argument, supported by new econometric evidence presented here, is that pro-development policies are comparatively rare in the developing world less because of the moral fiber of politicians (though that surely matters) than that good politicians typically lack the room-for-maneuver needed to make desired reforms. This lack of maneuverability is a product of insufficient social cohesion and brings about weak institutions. In section five we explore the determinants of social cohesion, focusing on historical accidents, initial conditions, natural resource endowments, but also ways to foster social cohesion. Section six presents a summary and implications for policy.

2. Social Cohesion and Development: A Conceptual Framework

Social cohesion may provide one of the clues to development, though the expectation that it might be *the* clue does injustice to the complexity of development. Moreover, social cohesion may be no more than an analytical concept, helping us to organize our thinking on the complex processes which lead to social or political choices which may serve better short or long term development.

We prefer the term "social cohesion" above the widely used term "social capital" for a number of reasons. First, we find the term 'capital' to be confusing when applied to social issues because many of the characteristics of physical capital do not apply (e.g., divisibility, non-negative, and the possibility for establishing ownership). Second, we use the term social cohesion differently from social capital. There is a growing literature emphasizing the "dark-side" of social capital (a good example is the possibility that more local social capital leads to corruption or cronyism). Just as more physical capital is not necessarily good for everyone, there is an optimal level of social capital. In the way we define social cohesion, more is better. Third, the term social capital has no inherent ambition to be related to inclusion or responsive political institutions, while social cohesion does so (in my use of the word). Fourth, as a former politician myself (* this applies to first author), we want to use terms that policymakers and citizens alike intuitively understand and are comfortable with. We also want to refer to broader features of society, whereas social capital is primarily concerned with networks and communities. It is true that the term human capital does not satisfy the characteristics of physical capital either, but at least one of the common elements about human and physical capital—as Glaeser (2000) rightly points out—is that *individuals* decide on the investments. With social capital it takes always two to tango; indeed, given the number of people often involved in a network, social capital may be more of a square dance than a tango! In the end, however, the use of a particular term over another matters far less than that the issues they all encapsulate are brought to the table and seriously debated.

For this presentation, we define social cohesion in the following way:

> *Social cohesion is a state of affairs in which a group of people (delineated by a geographical region, like a country) demonstrate an aptitude for collaboration that produces a climate for change.*

Presumably what some people would define as social capital—i.e., the norms, networks and other related forms of social connection—will be an important basis for this aptitude.[2] At the same time it will matter how, with whom, and on what terms these norms, networks and other connections are made. Linking relations that connect people to representatives of public institutions (such as the police, banks, and agricultural extension agencies) are vitally important, as are bridging relations that connect individuals from different socio-economic and demographic groups. Overwhelmingly, however, the poor have few extensive linking or bridging ties, and are left instead to draw upon their intensive bonding relations (family, friends, neighbors) to manage high levels of risk and vulnerability (see Woolcock 2000; World Bank 2000).

In seeking to unpack this notion of social cohesion, let me stress from the outset that we am fully aware of the fact that some political partisans with a narrow – even sectarian – agenda have an unfortunate history of invoking social cohesion-type arguments as the basis for their actions. The desire to cultivate a sense of national unity and "purity" brought us the holocaust of ethnic cleansing, so we are most surely not arguing that social cohesion equals cultural homogeneity or intolerance of diversity; quite the opposite. Nor are we invoking some naïve suggestion that socially cohesive societies are always harmonious, or without political conflict. Rather, we use the concept of social cohesion to make the point that – whether the entity concerned is a community, a corporation, or a country – the extent to which those affected will work together when crisis strikes or

[2] Other contributions to this field have used the term social capital to denote what in this paper we call social cohesion. Social cohesion is a more appropriate term for analyses at the societal level, since social capital refers primarily to norms and networks residing at the community and household level.

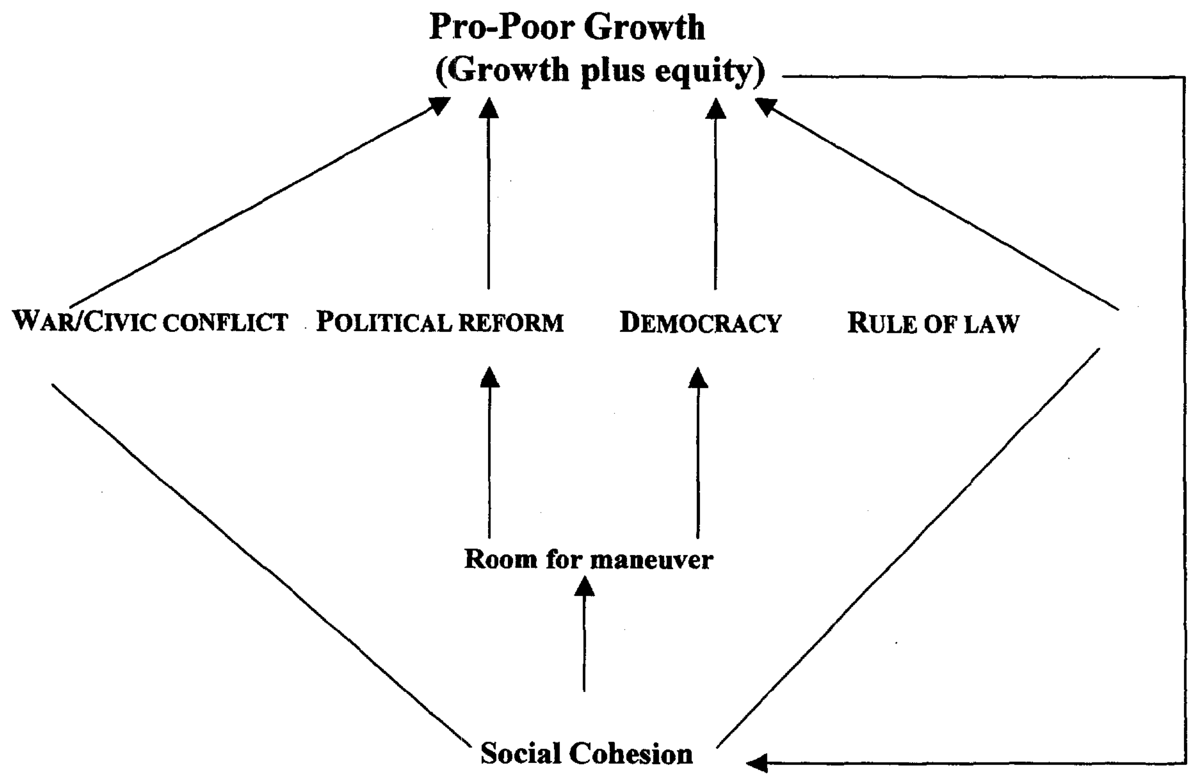
opportunity knocks is a key factor shaping performance. Graphic scenes on CNN during the 1997 financial crisis in South Korea provided a fascinating case of social cohesion in action, of people tearfully parting with family treasures in the belief that their humble contribution was making a difference. Where this cohesion is lacking – as it was in Indonesia – the response to crisis was far more sluggish, heightening a number of other political tensions. Dani Rodrik (1997) accurately notes that crises of this sort are "not a spectator sport – those on the sidelines also get splashed with mud from the field. Ultimately the deepening of social fissures can harm all".

My reflections take as their point of departure missing clues in the mystery of development. Consider the case of Ireland, for example, which emerged from being a relatively poor OECD country to recently overtake the UK in GDP per capita. The explanations for this rise are quite solid: the Irish combined sound fiscal policy and a strong human development policy, with a commitment to the rule of law and peaceful labor relations in an open country environment (Barry, 1999). We need to look behind these explanations, however, since they tell us nothing about *how* the Irish were able to organize these good policies. Conversely, consider Argentina, which fell from being one of the world's richest countries in GDP per capita in 1920 to developing countries status now, doing so largely because of its poor choice of economic policies. We know in general that good policies matter for development, but we are still looking for clues as to why good policies come about in one country but not in another.

Social cohesion may differ in conception in various countries and regions, but it is equally important for every society. Conceptions of social cohesion differ among the OECD countries, and between OECD and less developed countries, in terms of the themes and approaches given priority. In OECD countries, discussions about social cohesion are driven by a concern to maintain an inclusive society able to withstand external shocks and the harsh effects of a global economy. In the developing world, social cohesion is discussed more in terms of reconstructing and developing a sense of shared identity. Encouraging effective rule-of-law (especially in post-conflict societies), and developing a new set of formal institutions for managing exchange that complement existing informal institutions, is a high priority.

The framework we use to understand social cohesion is depicted in Figure 1. In this framework social cohesion is the driving force for"room for maneuver" which is in turn needed for political reform, but also to further the democratic content of the institutions of the society. Social cohesion also contributes to an effective rule of law and diminishes the chance for war or civil conflicts. And naturally, there is the feedback loop. Social cohesion will be strengthened if, indeed, the trust given to empower parties to bring about change, does result in growth with a "reasonable" distribution over the different groups in the population. This feedback loop could be one of the determining forces in development as a vicious, or a virtuous spiral.

Figure 1: A Conceptual Framework for Understanding Social Cohesion



3. Data on Social Cohesion, Institutions, and Growth

Emile Durkheim, one of the founders of modern sociology, believed that if all members of a society were anchored in a common set of symbolic representations – i.e. to common values and assumptions about the world they live in – moral unity could be restored. Without these moorings, he argued, any society, primitive or modern, was bound to degenerate and decay, to be left unprotected against existential crises. One can ask of policymakers, political leaders and others who "celebrate diversity", whether there needs to be "a common set of symbolic representations " or "common assumptions" (a set of values and objectives that a society or community coalesces around) in order to bring about the desired change. If indeed there is a set of values, or assumptions, what ought they be? Whose ought they be? The questions become critical for development and for uprooting poverty during times of great social change (of the type commonly associated with developing and transitional countries) and when broader, systemic transformation undermines or challenges existing (familiar or traditional) systems of economic, social, and political organization. These are among the questions that arise from the literature on social cohesion and are implicit, too, in the World Bank's policy debate on development.

To grasp social cohesion one ought perhaps take a step back and look at social exclusion and its four main causes. In its economic dimension, exclusion is first and foremost linked to poverty. Although in some instances it may be the cause, in general it is understood to be largely the result of poverty. The unemployed are typically excluded from mainstream economic activity and are, therefore, denied access to property and credit. In most of the developing world, especially Africa, long-term unemployment has rendered many people unemployable. The second dimension is social: unemployment does more than deprive one of an income, in most societies unemployment greatly reduces one's status in society. This has been a particular concern in transitional economies, where memories are still fresh regarding times of full employment, and where exposure to global markets has exposed many painful differences in productivity and living standards. Exclusion takes on a political (third) character when certain categories of the population (women, ethnic, racial and religious groups, especially minorities) are deprived of access to their rights, and/or when they can be blamed as the source of problems being endured by the majority. A fourth dimension is identified as "non-sustainable modes of development". This is explained as development that compromises the survival of future generations (and which) excludes them from the benefits of feasible, durable development.

There is a very short leap, conceptually, between social exclusion and social cohesion; indeed they can be understood as two sides of a coin. However, addressing exclusion and developing more cohesive societies is a task complicated by lack of coherence in the understanding of what makes a country or a community cohesive, and when the prevailing orthodoxy equates society with economy. The notion of exclusion raises the point that there are often pockets of disaffected and/or marginalized groups within society—which can cause rupture and stand in the way of development or integration.

For instance, whereas cohesive communities are able to identify problems, prepare objectives, develop strategies to meet those objectives, and put them into action, distinct pockets of cohesion may fracture and divide the community or broader society and undermine the trust that is essential to collective action. Listening to the concerns of isolated groups, and incorporating them into the broader vision of society, is an important task for politicians.

The late Mancur Olson (2000) discusses how governments that have an "all-encompassing" interest in society's prosperity and welfare will promote growth more than governments that have a more narrow interest. He argues that a stable autocrat will outperform an unstable autocrat, while a stable democratic government that will outperform either form of autocracy. Best of all will be a democracy with checks and balances, enforcement of the rule of law, and with clear rules of the game that prevent the majority from excluding or expropriating a minority. Virtually all of the nations that are rich today fall into this latter category. It's not too much of a stretch to see that social cohesive societies will more likely generate governments that have an "all-encompassing interest" in promoting growth.

Note that neither "stability" nor "democracy" alone is sufficient. An unstable democracy poses the risk to investors and contractors that a short-sighted populist government will come along, expropriating investments and breaking contracts. Stability with autocracy is not enough, as Olson argues, because even the strongest dictators die and throw their autocracies into succession crises sooner or later.

In the context of globalization, social cohesion enables us to recognize the continuous process whereby individuals and groups are included or excluded from participation within wider society. It can also refer to the measure of shared values, or to a willingness, refusal or indifference to face common challenges in a society. These are influenced, in turn, by any combination of a variety of factors such as, for example, ethnicity, culture, religion, gender, education, class, physical disability and associations of choice.

Along these lines we approach our definition of social cohesion as an aptitude. One encounters in the literature a great number of different measures, both direct and indirect. Among the direct measures are:

- Measures on memberships rates of organizations and participation in organizations: Social relations have been measured in developing countries by Deepa Narayan and her collaborators (e.g., Narayan and Pritchett, 1999), but mostly on a micro (community) scale. At that level they are shown to be significant predictors of an aptitude for cooperation. Robert Putnam's (1993) important work uses membership of organizations as a measure of social cohesion (or more accurately, what he calls "social capital.") There are sharp differences, however, between his assessment of the US and that of many European countries, where indeed social cohesion went up as measured in this way. Is this variance in "social cohesion"—as measured by a richness of participatory processes in organizations—related to strong variance in social and economic policy reform? I do not think so. Hence I question whether Putnam's measure is that relevant for social cohesion as I have defined it. The results presented by Steve Knack (2000) seem to support this. He finds that the trust variable does contribute to the explanation of economic growth, but the membership of organization variable is not influencing growth in a statistical significant way. For reasons and because of the relative small available sample, we will not use the membership variable.

- Measures on trust

A typical measure on trust (from the World Value Survey) is the aggregate of the answers to the question "do you think people can be trusted?" for a random sample of respondents.

There are cross-country measures of "trust" (see Knack and Keefer 1997). The new surveys being conducted around the world, including OECD countries such as Australia and members of the European Union, promise to yield significant new insights, and will allow us to address these issues with much greater confidence. Work in the transition economies is in its infancy, though some early promising work is starting to appear (e.g. Rose, 1998).

"Trust" is typically high in the richer countries (rates are around 50%) and low in developing countries. Central and Eastern European (CEE) countries generally have higher trust rates (between 15 and 35%) than Latin American (LA) countries (with rates as low as 5% in Peru). Also Turkey is remarkable with a trust rate of only 10% in 1990 and 6.5% in 1995. African countries are in between CEE and LA countries in trust levels, while Asian countries are in between developed world and CEE countries. In other words:

trust higher

- Rich countries
- Asia
- CEE
- Africa
- LA and Turkey

Indirect measures are related to structural factors such as class and ethnicity inequalities, which may undermine the capacity of different groups to work together, like:

- Income distribution measures (Gini coefficients and share of income to middle 60%):

The Gini coefficients has been used by Dani Rodrik (1999) to address issues pertaining to economic divisions in society. William Easterly (1999) seems to find that what he calls the "middle class consensus" (i.e. a social inequality index that includes of the share of income going to the middle 60% of the population) is a better measure. It is suggestive (we don't establish causality here but Easterly 1999 addresses causality) that countries with a middle class share above 50 percent are rich economies (see Figure 2). While it would be difficult to show that differences in middle class share are direct predictors of enormous differences in aptitudes for change, a plausible case can be made that social cohesive countries will ensure that rich and poor alike share in both the costs and benefits of change, and thus enjoy greater prosperity than those more divided countries where the benefits primarily go to the rich and the costs are borne by the poor.

Note that the simple correlation between the Gini coefficient and the "middle class consensus" is high (0.88). But, still we have countries with a large middle class, but (for rich countries) a large "Gini" inequality (e.g. U.S.), with the reverse of low "Gini"-

inequality and a small middle class (e.g. Hungary) and of a large middle class and low "Gini"-inequality (also for rich countries) (e.g. the Netherlands).

- Ethnic heterogeneity ('ethnolinguistic fractionalization') measures. The most widely used measure establishes the probability that two randomly selected individuals will not belong to the same ethnilinguistic group. India scores high on this measure (89), but so do, for example, Cote d'Ivoire (83) and Bolivia (63). Examples of countries with low scores are Korea (0) and Japan or the Netherlands (1).

Table 1a gives an overview of the indicators used for social cohesion (Table 1a about here). For 57 developing countries and 25 high-income countries we have data available on the middle class share and on ethnic fractionalization. Data on trust is only available for 34 countries (11 high income and 23 developing countries) for which also all the other data is available.

The table also includes our measures on institutions and their summary statistics. Institutions have been assessed by experts from very different organizations..

Table 1a

Social Indicators and growth	Mean	Standard Deviation	Number of Observations	Range
Ethnic fractionalization	39.63	29.29	82	0 - 93
Middle class share	45.95	6.85	34	30 - 58
Gini	40.16	9.95	132	20.5 - 63.7
Trust	32.07	16.28	82	5 - 64
GDP per capita, PPP	6112.90	5556.69	82	404 - 20004
GDP per capita growth	2.07	1.67	82	-10 - 10

Ethnic fractionalization	Ethnolinguistic fractionalization index (measures the probability that two randomly selected persons from a given country will not belong to the same ethnolinguistic group). Source: Mauro, initially from the Atlas Narodov Mira (Department of Geodesy and Cartography of the State Geological committee of the USSR, Moscow, 1964) and Taylor and Hudson (World Handbook of Political and Social Indicators, 1972).
Middle class share	Share of quintiles 2-4, average 1960-1996.
Gini	Average of the period 1900-1996
Trust	Percentage of respondents in each nation replying "most people can be trusted". Source: World Values Survey.
GDP per capita, PPP	World Development Indicators.
GDP per capita growth	World Development Indicators.

Table 1b

Institutional Indicators

	Mean	Standard Deviation	Number of Observaions	Range
Voice and Accountability	0.352	0.92	82	-2.5 – 2.5*
Quality of the Bureaucracy	3.678	1.46	72	0 - 6**
Civil Liberties	3.397	1.62	81	1 – 7***
Property rights & rule-based governance	3.232	0.82	56	1- 6****
Government Effectiveness	0.284	0.94	78	-2.5 – 2.5*
Graft	0.278	1.00	78	-2.5 – 2.5*
Law and Order Tradition	3.743	1.40	78	0 – 6**
Political Instability and Violence	0.116	0.94	78	-2.6 – 2.5
Political rights	3.305	1.83	81	1 7***
Regulatory Burden	0.386	0.60	82	-2.5 – 2.5
Rule of Law	0.263	0.97	82	-2.5 – 2.5*

* 2.5 represents best outcomes
** 6 represents lowest risk
*** 1 represents most free
**** 6 represents best policy

	Source
Voice and Accountability	
Quality of the Bureaucracy	Kaufmann, Kraay and Zoido-Lobaton (1999a).
	International Country Risk Guide (ICRG), average
Civil Liberties	1984-1998.
Property rights and rule-based	Freedom House, average 1972-1998.
governance	Country Policy and Institution Assessment (CPIA), the
Government Effectiveness	World Bank 1998.
Graft	Kaufmann, Kraay and Zoido-Lobaton (1999a).
Law and Order Tradition	Kaufmann, Kraay and Zoido-Lobaton (1999a).
	International Country Risk Guide (ICRG), average
Political Instability and	1984-1998.
Violence	Kaufmann, Kraay and Zoido-Lobaton (1999a).
Political rights	
Regulatory Burden	Freedom House, average 1972-1998.
Rule of Law	Kaufmann, Kraay and Zoido-Lobaton (1999a.
	Kaufmann, Kraay and Zoido-Lobaton (1999a).

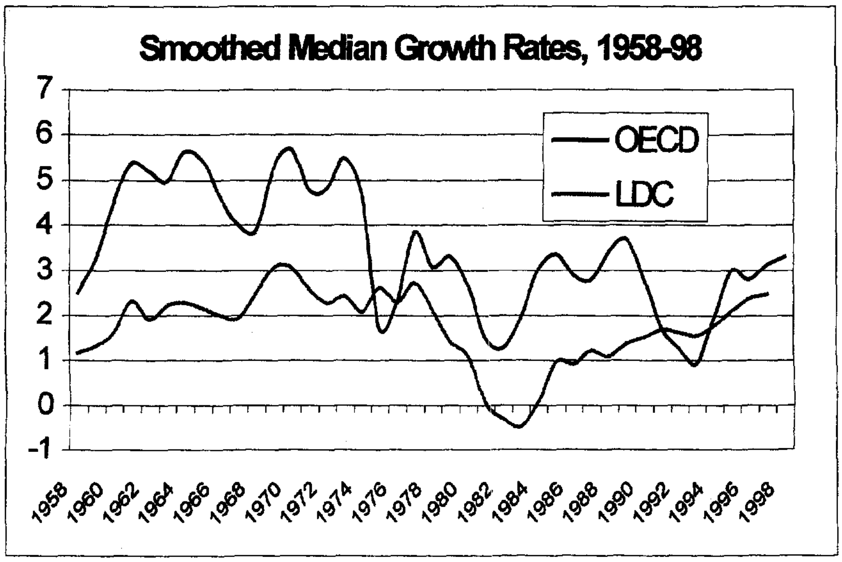
The quality of political institutions will clearly also be an important factor for growth. As the recent literature on corruption (e.g. La Porta et al, 1997) has shown, arguments that corruption "greases the wheels" of growth simply do not stand up to empirical scrutiny (Tanzi and Davoodi, 1997). A central hypothesis emerging from our social cohesion framework is that strong social cohesion makes it easier to improve the quality of institutions..

4. New Evidence on Social Cohesion, Institutions and Economic Performance

The central story of economic growth over the last 50 years has been the contrast between the years 1950-74 and 1975-2000. The former was a time of general prosperity, in which all strategies yielded positive outcomes; rich and poor countries, open and closed economies, temperate and tropical countries—everyone did well. The twenty-year period between 1974 and 1994, however, was disastrous for virtually everyone except the

East Asian Tigers and India; the developing world suffered a twenty-year growth collapse, from which it has only recently emerged (Figure 3).

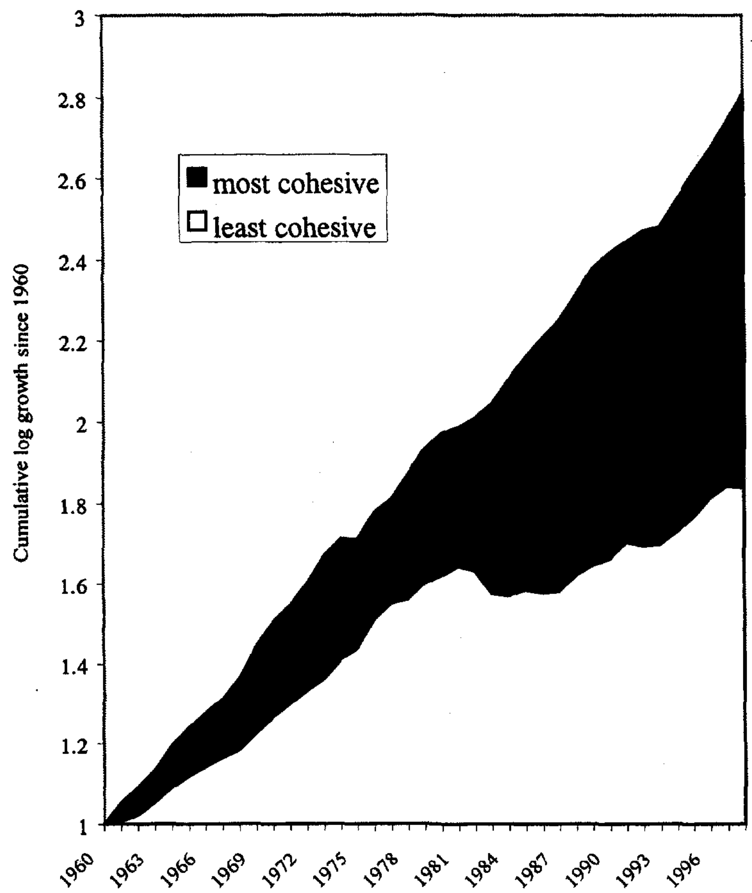
Figure 3



While the causes of the global recession in the 1974-1994 are fairly well-known, it is instructive to examine some of the differences between those countries that weathered the storm, and those that did not. In his study of a large sample of developing countries, Rodrik (1999) finds compelling evidence that weak public institutions and (ethnically) divided societies responded worse to the shock than did those with high quality institutions and united societies.

We find something similar here. We define as most cohesive those societies in the lower half of ethnolinguistic fractionalization and in the upper half of share of the middle class, and as least cohesive the reverse. We see that more cohesive societies have always grown faster than less cohesive societies, but the difference only became pronounced with the recession in the latter in the 1980s, with a tepid recovery that failed to close the gap in the 1990s (figure 4).

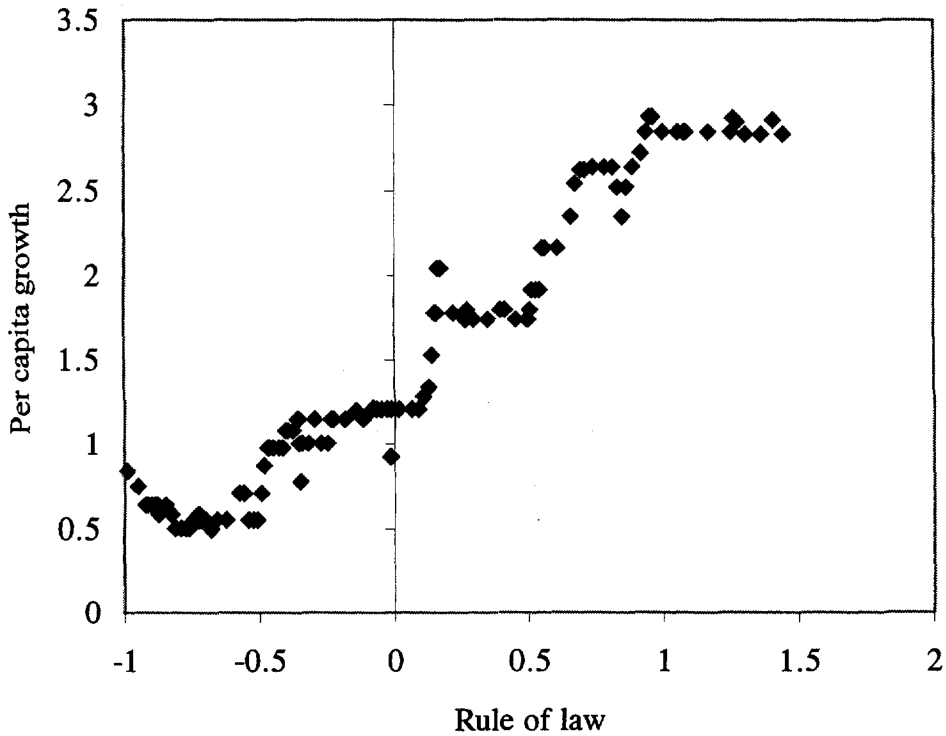
Figure 4: Index of per capita income in least cohesive and most cohesive societies (1960=1)



(sample of 82 developing and developed countries)

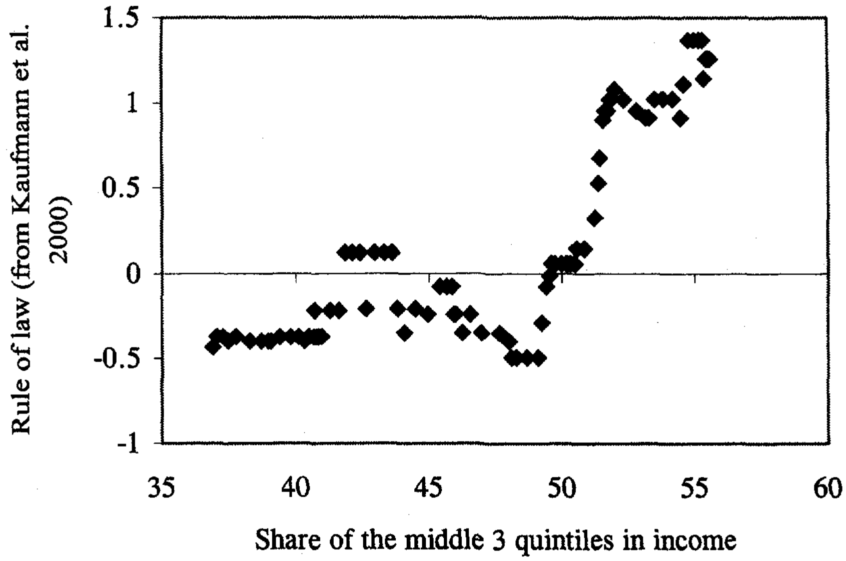
By what mechanisms does social cohesion affect growth? Consider first the role of institutions. Using a dataset compiled by Kaufmann, Kraay, and Zoido-Labatan 2000 it is possible to assess whether high-quality institutions have been important for the LDC's. Figure 5 suggests they have been, i.e. that higher quality institutions (measured here by rule of law -- we will try many different measures in the next section) are positively associated with higher average growth rates over the post-reform period.

Figure 5: Rule of law and per capita growth 1960-98
(moving median of 30 observations ordered by rule of law)



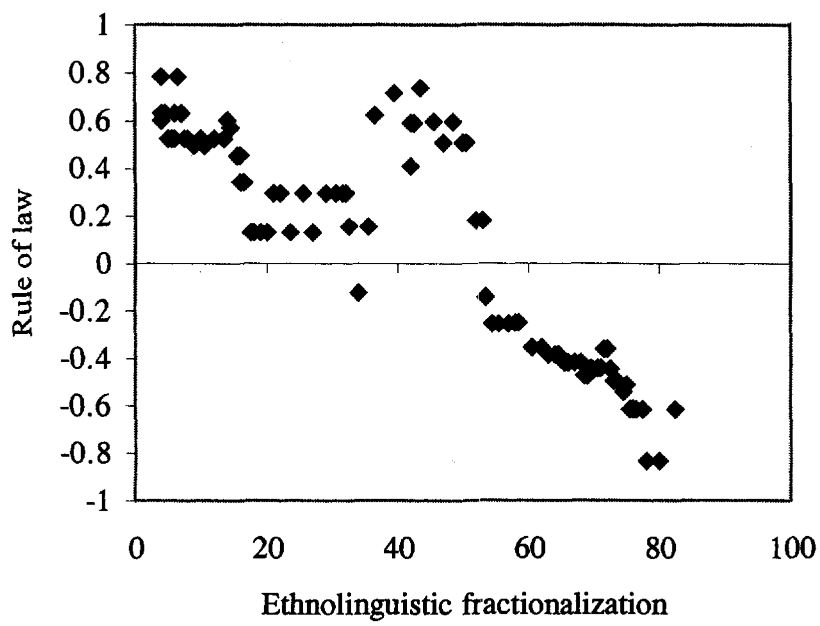
Quality institutions themselves reflect the nature and extent of social divisions, as we will develop more formally in the next section. Figure 6 shows that, indeed, high quality institutions are associated with lower levels of inequality in developing countries. Here inequality as a proxy for social divisions is measured by the share of the middle class. If we would have chosen instead of the middle class, the Gini coefficient, a similar result would have emerged.

Figure 6: Share of the middle class and rule of law
(moving median of 20 observations ordered by middle class share)



Together, these suggestive empirical results show that building social cohesion – through the construction and maintenance of high-quality institutions pursuing the common good, and through the lowering of economic (and other) divisions – has been, and remains, a vital task for countries wrestling with development.

Figure 7: Ethnolinguistic fractionalization and rule of law
(moving median of 20 observations ordered by ethnic fractionalization



Ethnic divisions make it difficult—although not impossible, as we will see below—to develop the social cohesion necessary to build good institutions. Figure 7 confirms that more fractionalized societies have worse rule of law.[3]

We are left then with two determinants of social cohesion and thus good institutions – initial inequality and ethnolinguistic fractionalization. We predict that societies with a lower initial inequality as proxied by a larger share for the middle class larger share for the middle class and more linguistic homogeneity have more social cohesion and thus better institutions, and that these better institutions lead in turn to higher growth. In a sensitivity analysis we also include the Gini coefficient and the trust variable.

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[3] Alesina and La Ferrara 2000 found that one measure of instititutions "trust" was negatively related to ethnic diversity.

These predictions are confirmed in the Appendix, where we use the different proxies for "good institutions" of Table 1b. Table 2 gives an example of four measures of institutions which show a highly significant pattern of voice and accountability, civil liberties, government effectiveness and graft, with signs indicating more social cohesion leading to better institutions. Table 3 gives an overview of the more and the less significant relations. All of our measures of institutional quality are positively associated with growth (as was shown by Kaufmann, Kassy and Zoido-Loboton (KKZ) 1999 for their measures of institutions). Here, we have used three stage least squares to take into account the possible endogeneity of institutions – our two indicators of social cohesion make natural instruments that allow us to identify a causal link from good institutions to growth. Interestingly the two measures of the International Country Risk Guide seem to be less reliable, within this framework, than the other measures. Also, the CPIA index of the World Bank is less reliable, which should not surprise as the standard deviation is small (see Table 1b).

Thus our findings support the two-stage hypothesis we outlined at the beginning -- that more social cohesion leads to better institutions and that better institutions lead to higher growth. This is true regardless of how we measure institutions.

In Table 4 a typical example is given of the sensitivity analysis for trust, group membership and the Gini coefficients for the institutional variable "voice and accountability". {Table 4 about here}. This example is part of the pattern: all sensitivity analyses show the following:

- The Gini coefficient and the middle class share are separate dimensions of social cohesion. Including the Gini coefficient hardly reduces the significance of the effect of the middle class share on institutions, while the effect of the Gini coefficient itself is highly significant.

- Trust (strongly) interacts with ethnic fractionalization and the middle class share. In countries with high levels of trust ethnic fractionalization is less important for the quality of institutions. Also the size of the middle class becomes less important.

Table 4

Statistics of Regressions on Voice and Accountability with trust, participation and the Gini-coefficient

N	C(1) constant	C(3) ethnic	C(3) middle class	C(3") trust	C(3") Gini
81	-3.24	-3.54	4.83	-	
34	-2.27	-1.47	2.23	1.93	-
82	-3.60	-2.72	4.76	-	-2.60

When comparing the predictions for growth rates using the "Voice and accountability" variable for institutions, a distinct regional pattern is visible. Almost all East Asian countries in the sample (Hong Kong, Indonesia, Japan, Korea, Malaysia, Singapore, Sri Lanka and Thailand) have growth rates between 1.3% (Sri Lanka) and 4.5% (Singapore) larger than predicted. Only the Philippines remains below the predictions (with –1.1%).

Many Latin American countries in the sample on the other hand remain substantially below the predictions (Bolivia, Costa Rica, Jamaica, Nicaragua and Venezuela with between 1.3% and 2.4%).

The same is true with many of the African countries (Benin, Chad, Ghana, Niger, Senegal, Sierra Leone, Tanzania, Zambia, South Africa, with a distance of between –1.2 and –2.7%). Botswana (4.2%), Gabon (1.7%), Lesotho (2%) and Uganda (1.4%) have substantial positive differences.

Also, for many European countries, the predictions exceed actuals, notably for Switzerland (-1.3%) and the UK (-1.1%). This is also the case for the US (-1.2% and New Zealand (-1.8%).

In contrast, some North African countries (Tunisia (2.0%) and Egypt (2.1%) as well as Turkey (1.5%) do better than predicted.

Table 5 gives the general picture for all 11 measures of institutions. This is a remarkable finding: in some areas of the world growth rates are decidedly higher or lower than in other areas with the same institutions and cohesive forces. The general picture is that:

- In Asia predicted growth falls short of actual growth;
- In rich countries and LA predicted growth exceeds actual growth;
- In Africa the pattern is mixed.

How to interpret this "regional" component? Non linearities or other intervening variables may be the reason.

5. Social Cohesion: Origins and Development:

If social cohesion is so important, how can it be nurtured? While social cohesion is partly shaped by national leaders, social cohesion also depends n some exogenous historical accidents. A nation-state that has developed a common language among its citizens is more cohesive than one that is linguistically fragmented. This is not to say that linguistic homogeneity is bad or good – all nations started out as very diverse linguistically. Linguistic homogeneity may simply be an indicator of how much a group of nationals have developed a common identity over the decades or centuries that national identity forms. Where such a common identity is lacking, opportunistic politicians can and do exploit ethnic differences to build up a power base. It only takes one such opportunistic politician to exacerbate division, because once one ethnic group is politically mobilized along ethnic lines, other groups will.

This should not be interpreted in a pessimistic light – that nations where there are large cleavages of class and language are condemned to poor institutions and low growth. Of course, nations should not embark on forcible redistribution and mandatory linguistic assimilation. These results only say that on average lack of "exogenous" social cohesion has been exploited by politicians to undermine institutions, which in turn has resulted in low growth. But politicians can choose to build good institutions, unify fractionalized peoples, and defeat the average tendency to divide and rule. In fact where institutions are sufficiently well developed, there is no adverse effect of ethnolinguistic diversity on growth. The corollary is that good institutions are most necessary and beneficial where there are ethnolinguistic divisions. Formal institutions substitute for the "social glue" that is in shorter supply when there are ethnolinguistic divisions (Easterly 2000).[4]

The other determinant of social cohesion is whether the historical legacy is one of relative equality or of a vast chasm between elites and masses. Engerman and Sokoloff (1997) describe how inequality in Latin America arose out of factor endowments and historical accidents. The tropical land in Latin America was well-suited for large scale enterprises like silver mines and sugar plantations, worked by slaves or peons. The benefits of these operations largely accrued to the small criollo class. The elite was kept small by restrictions on immigration from Iberia or elsewhere to the Iberian colonies. The labor force had to be forcibly recruited through the import of African-American slaves and the encomienda system that tied the indigenous people to the elite's land.

In Canada and in the North of the US, by contrast, the factor endowments were conducive to small-scale production of food grains. A middle class of family farmers developed. Practically unrestricted immigration and abundant available land (once the tragic process of despoiling the native inhabitants was completed) swelled the size of the middle class. Immigrants voluntarily assimilated to (and contributed to) the dominant middle class culture. The American South was a kind of intermediate case between North and South America, with a mixture of free family farmers, elite slaveowners, and African-American slaves.[5]

[4] The notion of (ethno)linguistic fractionalization definitely begs operations on social cohesion within the European Union. Extra institutional efforts are required to ovecome this disadvante of different languages.

[5] For an application of this general argument to understanding growth collapses in LDCs, see Woolcock, Pritchett, and Isham (1999).

Heyneman (1998) identifies three ways in which education contributes to social cohesion. First, it helps provide public knowledge about social contracts among individuals and between individuals and the state. Second, education helps provide the behavior expected under social contracts, “in part through the socially heterogeneous experiences students have in the schools themselves”. Third, education helps provide an understanding of the expected consequences for breaking social contracts. As he puts it, social cohesion “constitutes a new challenge for the economics of education”.

The basic purpose of public schooling from the beginning has been to establish a cohesive, peaceful and, hence, profitable society”. An important implication of this is that measuring human capital simply in terms of “years of schooling” may be missing a vitally important component, namely, that the quality of education matters as much – if not more – than quantity. If social cohesion matters for the well-being of all societies, it becomes necessary to ask, who, or what is the vehicle for creating, or engendering it? The literature places the burden before governments and most arguments converge on education as the key.

Given the vital role the state has in shaping the context and climate within which civil society is organized, it can, in some cases, also actively help to create social cohesion—this is one of the conclusions of the forthcoming World Development Report (World Bank 2000).

Table 2

Examples of Regressions for Social Cohesion, Institutions, and Growth

Equation 1: Institutions=C(1)+C(2)*Ethnolinguistic Fractionalization+C(3)*Middle Class Share
Equation 2: GDPPCGR= C(4)+C(5)*Institutions

Institutions measure	C(1) Constant in first equation	C(2) Coefficient of institutions on on ethnic	C(3) Coefficient of institutions on middle class	C(4) Constant in second equation	C(5) Coefficient of growth on institutions	Number of observations
Voice and Accountability (KKZ)						
Coefficient	-1.963	-0.010	0.059	1.654	1.171	81
t-Statistic	-3.242	-3.537	4.827	8.192	4.668	
Civil Liberties (Freedom House) 1 most free, 7 most unfree						
Coefficient	7.388	0.019	-0.103	4.117	-0.615	80
t-Statistic	7.076	3.944	-4.936	8.477	-4.600	
Government Effectiveness (KKZ)						
Coefficient	-2.576	-0.009	0.070	1.848	0.896	77
t-Statistic	-4.244	-3.183	5.756	9.770	4.002	
Graft (KKZ)						
Coefficient	-3.205	-0.009	0.084	1.901	0.763	77
t-Statistic	-5.155	-3.119	6.690	10.296	3.791	

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Table 3

Highly significant
impact of social cohesion variables on institutions for:

- Voice and accountability
- Civil liberties
- Political rights
- Government effectiveness
- Graft
- Political instability and violence
- Regulatory burden
- Rule of law

Less significant

- Quality of bureaucracy (ICRG)
- Property rights and rule-based government (WB)
- Law and order tradition (ICRG)

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Table 5

Region		*Distance between Actual and Predicted GDP per capita Growth (Prediction based on Institutions Measures)*											
		Voice and Accounta-bility	Quality of the Bureaucracy	Civil Liberties	Property rights & rule-based governance	Government Effective-ness	Graft	Law & Order Tradition	Political Instability & Violence	Political rights	Regulatory Burden	Rule of Law	Confidence in Parliament
East Asia	Mean	3.21	2.68	3.28	3.15	2.60	2.75	2.60	2.64	3.18	2.64	2.51	3.04
	Std. Dev.	0.96	0.94	1.45	0.82	0.90	0.93	1.07	1.01	1.34	1.10	0.84	.
	Obs	7	7	6	4	7	7	7	7	6	7	7	1
South Asia	Mean	0.61	0.86	0.65	0.63	1.40	1.20	1.47	1.53	0.33	1.10	0.80	
	Std. Dev.	1.02	0.54	0.90	0.74	0.38	0.35	0.53	0.92	0.89	0.82	0.86	
	Obs	4	3	4	4	3	3	3	3	4	4	4	0
Pacific	Mean	-1.37	-1.15	-1.22	-1.53	-1.26	-1.27	-1.17	-1.39	-1.16	-1.67	-1.23	0.53
	Std. Dev.	0.40	1.11	0.75	.	0.65	0.93	1.02	0.61	0.64	0.78	0.77	.
	Obs	3	3	3	1	3	3	3	3	3	3	3	1
North Africa and Middle East	Mean	1.01	0.85	1.08	-0.17	0.67	0.68	0.82	0.94	1.01	0.89	0.56	-0.59
	Std. Dev.	0.68	0.78	0.54	0.69	0.56	0.56	0.56	0.58	0.74	0.83	0.61	.
	Obs	9	9	9	6	9	9	9	9	9	9	9	1
Subsahara Africa	Mean	-0.32	-0.78	-0.18	-0.33	-0.31	-0.46	-0.74	-0.39	-0.09	0.30	-0.43	-2.20
	Std. Dev.	1.77	1.94	1.71	1.72	1.98	1.83	1.86	1.83	1.67	1.69	1.70	1.07
	Obs	22	16	22	22	20	20	16	20	22	22	22	2
Europe	Mean	-0.53	-0.51	-0.46		-0.60	-0.55	-0.49	-0.57	-0.46	-0.64	-0.45	0.08
	Std. Dev.	0.80	0.91	0.80		0.91	0.94	0.85	0.87	0.81	0.81	0.89	0.95
	Obs	15	14	15	0	15	15	14	15	15	15	15	11
North America	Mean	1.01	0.85	1.08	-0.17	0.67	0.68	0.82	0.94	1.01	0.89	0.56	-0.59
	Std. Dev.	0.68	0.78	0.54	0.69	0.56	0.56	0.56	0.58	0.74	0.83	0.61	.
	Obs	9	9	9	6	9	9	9	9	9	9	9	1
Middle and South America	Mean	-0.61	-0.13	-0.71	-0.27	-0.34	-0.24	-0.24	-0.44	-0.72	-0.97	-0.17	0.05
	Std. Dev.	1.05	0.84	1.04	1.28	0.97	0.96	0.93	1.06	1.11	1.18	0.89	1.28
	Obs	20	18	20	19	19	19	18	19	20	20	20	15

6. Conclusion

Let us conclude by pulling together some of the strands of this paper. On the preceding pages we have drawn attention to several points. The first of these is the need for a deeper consideration of, and a more focused research agenda into, the cohesiveness of societies and the quality of public institutions, and their relationship to sustained growth. We need to know a lot more about how equitable and fairly to manage the costs and benefits associated with the transformation of society, especially how to foster a greater sense of cooperation and inclusion in environments where there is division and hatred. This is an issue for all countries -- developing, transition, and developed. Building social cohesion matters as much in Uganda and Ukraine as it does in Sweden or Slovenia.

While these problems are enormously challenging, I think we can be greatly encouraged by the recognition that our definitions and conceptions of development have evolved quite dramatically in recent years. The accomplishments and recent traumas in East and South East Asia, the difficulties of building market institutions in former planned economies, and major conferences such as the UN Summit on Social Development, have shown us just how important it is to invest in the human and social dimensions of development. Healthy, educated people are not only more productive workers, they are also better parents, better neighbors, and better citizens. It is our hope that recent events have also taught us the importance of being more humble—though no less committed—in our approach to poverty reduction, of listening more and talking less.

Taking stock of the historical record also reveals that even when it is done well, development is inherently fraught with controversy, that rising prosperity necessarily alters the balance of power in society. As the social historian Theda Skocpol notes, revolutions are more likely to occur when conditions are *improving*, not deteriorating. This means that we must pay special attention to designing policies and projects that protect the most vulnerable members of society. Joe Stiglitz (1998) observes that development "represents a transformation of society, a movement from traditional relations, traditional ways of thinking, traditional ways of dealing with health and education, traditional methods of production, to more modern ways." Adopting and adapting these "more modern ways" is no easy task. Among other things, it requires credible local leaders who are able to articulate the interests and aspirations of the people, to identify a set of objectives and ideals around which those can coalesce. It requires a genuine sense of ownership and responsibility on the part of all stakeholders, and a commitment to work together.

There is the paradox of the increasing scale and scope of our global economic affairs in simultaneity with the reawakening of our sensitivities towards local issues and identities. An important feature of this paradox is that its resolution depends on overcoming two corresponding trends militating against it, namely increasing inequality (Pritchett, 1997) and increasing volatility. The technology that makes life more stimulating, cosmopolitan, and prosperous for some is making it more precarious and uncertain for many others. Managing the risks and rewards of globalization is thus the key policy challenge of our time. Doing so effectively and responsibly will entail giving renewed attention to social safety nets protecting the most vulnerable members of society. It will entail building more responsive and accountable public institutions that can anticipate problems, and make swift adjustments. It will entail encouraging leadership across all levels of society—from soccer coaches and classroom teachers to business executives and heads of state—to build bridges across the widening social and economic divides.

An inclusive economy and society requires a serious commitment to building and maintaining social cohesion. It matters in all countries and for all members of society, especially the poor, and their prospects of living with a sense of empowerment, security, and opportunity. We hope you will join us at the World Bank in helping to make that dream a reality.

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3SLS regressions for social cohesion, institutions, and growth, using different measures of institutions

Equation 1: Institutions=C(1)+C(2)*Ethnolinguistic Fractionalization+C(3)*Middle Class Share

Equation 2: GDPPCGR= C(4)+C(5)*Institutions

		C(1)	C(2)	C(3)	C(4)	C(5)			
Institutions measure		Con-stant in first equation	Coef-ficient of insti-tutions on ethnic fraction-alization	Coef-ficient of insti-tutions on middle class share	Con-stant in second equation	Coef-ficient of growth on insti-tutions	Number of observations		
Voice and Accountability (KKZ)	Coefficient	-1.963	-0.010	0.059	1.654	1.171	81		
	t-Statistic	-3.242	-3.537	4.827	8.192	4.668			
Quality of the Bureaucracy (ICRG)	Coefficient	-1.795	-0.008	0.126	0.027	0.574	71		
	t-Statistic	-1.819	-1.720	6.368	0.047	3.956			
Civil Liberties (Freedom House) 1 most free, 7 most unfree	Coefficient	7.388	0.019	-0.103	4.117	-0.615	80		
	t-Statistic	7.076	3.944	-4.936	8.477	-4.600			
Property rights and rule-based governance (CPIA)	Coefficient	3.264	-0.005	0.004	-8.394	3.121	55		
	t-Statistic	4.328	-1.406	0.243	-4.286	5.185			
Government Effectiveness (KKZ)	Coefficient	-2.576	-0.009	0.070	1.848	0.896	77		
	t-Statistic	-4.244	-3.183	5.756	9.770	4.002			

Graft (KKZ)	Coefficient	-3.205	-0.009	0.084	1.901	0.763	77
	t-Statistic	-5.155	-3.119	6.690	10.296	3.791	

Table 2: **3SLS regressions for social cohesion, institutions, and growth, using different measures of institutions**

Equation 1: Institutions=C(1)+C(2)*Ethnolinguistic Fractionalization+C(3)*Middle Class Share

Equation 2: GDPPCGR= C(4)+C(5)*Institutions

		C(1)	C(2)	C(3)	C(4)	C(5)	
Institutions measure		Constant in first equation	Coefficient of institutions on ethnic fractionalization	Coefficient of institutions on middle class share	Constant in second equation	Coefficient of growth on institutions	Number of observations
Law and Order Tradition (ICRG)	Coefficient	-1.462	-0.009	0.121	-0.110	0.598	71
	t-Statistic	-1.606	-2.166	6.659	-0.186	3.993	
Political Instability and Violence (KKZ)	Coefficient	-2.537	-0.009	0.066	1.994	1.004	77
	t-Statistic	-4.051	-3.165	5.217	11.074	4.118	
Political rights (Freedom House) 1 most free, 7 most unfree	Coefficient	7.384	0.022	-0.108	3.825	-0.544	80
	t-Statistic	6.046	3.905	-4.411	8.827	-4.505	
Regulatory Burden (KKZ)	Coefficient	-0.258	-0.007	0.020	1.286	2.012	81
	t-Statistic	-0.576	-3.229	2.207	5.491	4.933	
Rule of Law (KKZ)	Coefficient	-3.106	-0.007	0.080	1.892	0.704	81
	t-Statistic	-4.971	-2.594	6.340	11.391	3.639	

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