

THE STATE IN A CHANGING WORLD
A CRITIQUE OF THE 1997 WORLD DEVELOPMENT REPORT

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Abstract

In recent years, the World Bank has been at the vanguard in pressing for a circumscribed role for the State in developing countries. It therefore comes as somewhat of a surprise that the 1997 World Development Report (WDR – the World Bank’s annual flagship publication), *The State in a Changing World*, underscores the continuing significance of the State in LDCs.

The WDR is generally successful as a didactic device, both in refocusing attention on roles and capabilities that enhance state effectiveness and as a guide to policy makers on the “what”: the State’s role must focus on social and economic fundamentals, but should always be tailored to capabilities. It is, however, much weaker when it comes to the “how”. Its recipe for reinvigorating institutional capabilities -- increased competition, decentralization and participation, and international collective action -- is neither controversial nor novel. Myriad exercises at quantification to “prove” its case, especially with regard to the importance of State “credibility”, are often misplaced and analytically flawed. And by avoiding contentious issues at the heart of the State, in particular those related to politics and power, and instead genuflecting to current intellectual fashions, the report says more about the World Bank than the role of the State in LDCs.

*Ideas efficacious at some times and in some human surroundings
are not so at other times and elsewhere.*

William James

"*Why and how* some states have been more effective than others at playing a catalytic and sustainable role in economic development and the eradication of poverty". This vexing question is at the heart of the World Bank's 1997 World Development Report, The State in a Changing World. The search for better government has been one of the central quests of the modern era - a quest that is both as necessary as it is difficult. The sheer range of tasks that states undertake means that any global analysis of the role of the state in today's world is likely to be either so general as to be uninteresting, or so specific as to carry few general implications. Given the potential pitfalls, the World Bank should be commended for at least making the attempt.

A half-century of continuous and sustained engagement with governments of all ideological hues, with widely varying capacities and commitment to economic development would seem to confer upon the Bank a strong comparative advantage to address this difficult issue. A considerable part of its analytical and operational work invariably addresses itself to some state institution or function. And in their role as the World Bank's annual intellectual flagship publication, the World Development Reports (WDRs) have in the 1990s examined the state's role more broadly (for instance, the 1991 WDR, *The Challenge of Development*) as well as particular aspects of the state's functions and effectiveness - in poverty alleviation, public finance and the provision of infrastructure, to name a few. Moreover, in recent years several

regional studies (such as the *Long-Term Perspective Study* on Africa and the *East Asia Miracle*) as well as functional analysis (in particular, *Bureaucrats in Business*) has also engaged various facets of this subject.

If the Bank seems perched at a particularly advantageous vantage point to address the issue of the changing role of the state, several other factors would appear to militate against it. At its core the "state" is fundamentally a political entity and its role is a political issue. And, largely because of its Articles (and over time its functional expertise), the Bank has been uncomfortable about engaging political issues explicitly, although of course much of its work has political determinants and consequences. Moreover, as a creature of states and having developed a bureaucratic personality as well, the Bank itself is a political animal. And political animals are likely to graze where the grass grows greener and thicker.

With the state much maligned of late, being held responsible at one end for egregious acts of commission and omission, and at the other derided for its irrelevance in the face of pressures from a variety of forces, both supra- and subnational, it is interesting to ask why the Bank chose this particular topic when it did. The report lists four factors that have given "the rethink [about the state's role] particular impetus":

- i) the collapse of the command and control economies of the FSU and Eastern Europe;
- ii) the important role of the state in "miracle" economies of East Asia;
- iii) the fiscal crisis of the welfare state in most OECD countries;
- iv) the collapse of states and the explosion of humanitarian crisis in several parts of the world.

To this list we may add two additional reasons. A closer scrutiny of the gamut of supranational and sub-national forces that have been both cause and consequence of the weakness of states and were deemed to hold unbounded promise for the human prospect -- for instance global capital markets and NGOs -- have led to some sobering reassessments (Edwards and Hulme, 1996; Soros, 1997).¹ Particularly troubling to some observers is a sense that the growing dominance of the market metaphor is resulting in a seemingly inexorable trend towards universal commodification. For these observers the underlying assumptions of human nature in the rhetoric of the market metaphor are exacerbating the difficulties in inspiring more humane visions of the “good society” (Radin, 1996; Kuttner, 1997). But for the Bank there is a second reason closer to home. As a creature of nation-states and enjoined to work with them, the Bank's own effectiveness mirrors that of the state. If the state faces a predicament today so does the Bank, which may explain the empathy the report shares with the state, more than anytime in recent years.

Organization and Structure:

Beginning with an emphatic statement that "Development -- economic, social, and sustainable -- without an effective state is impossible", (p. 18)² the report then lays out the

¹ This soul-searching is more noteworthy because of the authors' backgrounds - one a symbol of the power of global capital markets and the other a member of a prominent NGO.

² The Overview (p.1) is similarly emphatic, "An effective state is vital for the provision of the goods and services -- and the rules and institutions -- that allow markets to flourish and people to lead healthier, happier lives." The basis of the leap from flourishing markets to “happier lives” is unclear.

principal questions that form its inquiry (p.29): "What institutional arrangements best allow markets to flourish? What is the role of the state both as a direct agent (mostly in the provisions of services) and as a shaper of the institutional context in which markets function? How do policies and institutions interact in development?" The questions posed have long been seen to be central to understanding the process of economic development -- but are also ones whose complexity is easy to underestimate.

The report is divided into four parts. The first part attempts to provide a conceptual framework in which to understand the state and the rationale for rethinking its role in today's world. In particular it calls for refocusing attention on state effectiveness - and the roles and capabilities that enhance state effectiveness.

This basic message is translated into a two-part scheme. The first, elaborated in the second part of the report, strongly cautions states against biting off more than they can chew. A state's role must match its capability -- and the less a state's capability the more limited the role envisaged by the report. The state must first focus on economic and social fundamentals, which the report defines as: a "foundation of law and property rights"; a "benign policy environment, including macroeconomic stability"; "investment in people and infrastructure"; "protection of the vulnerable". The more limited its capabilities the more it should lean towards liberalization and deregulation. While industrial policy is not ruled out, only states with strong capacity are advised to consider it.

The second element of improving state effectiveness is specified in the third part of the report, which examines options for "Reinvigorating Institutional Capability". The report puts the onus for building institutions for an effective public sector on rule-based public institutions and

policy making that curbs arbitrary state action and corruption. How is this to be achieved? First, by subjecting state institutions to greater competition and organizational reforms in the state apparatus, encompassing pecuniary and non-pecuniary incentives. Second, by making the state more responsive to people's needs by enhancing participation and decentralization. And third, through international collective action by the community of states, in providing global public goods that benefit all states, but especially weaker ones.

Finally, the fourth and concluding section revisits the agenda for change and examines options for removing obstacles that could derail the process.

Approach:

Unavoidably given the vastness of the subject, the 1997 WDR is more noteworthy for its breadth rather than its depth. To its credit it strives to be a consensus, balanced document. It is broadly successful in making the subject matter accessible and understandable to a broad audience, helped undoubtedly by a dazzling presentation of colorful graphics on glossy paper. In general WDRs have a reputation as carefully polished documents, a result of countless presentations and reviews, and the high level of generality is perhaps unavoidable in all documents of this nature.

On several issues where the Bank had adopted a strong position just a few years ago, the 1997 WDR takes a more nuanced approach. These include the analyses of decentralization (chapter 7), central bank independence and social insurance. On several other controversial issues as well, such as the presumed virtues of electoral democracy, its analysis is also

reasonably balanced. The report's principal recommendations on improving the efficiency and effectiveness of the public sector -- a greater decentralization of functions and responsibilities allowing for new ways for doing things, greater competition, more transparent procedures, as well as meritocratic recruitment processes -- are not notably dogmatic or novel. These ingredients of the "new" public management have been around for a while now (Foster and Plowden, 1996). On the whole the report at least attempts to eschew the blueprint approach and leaves room for diversity of state response.

Unfortunately, for the most part the report fails to examine contentious tradeoffs inherent in many of the choices that states make and the numerous value judgments inherent in these choices, analyses essential to understanding of the diversity of state response. Thus transparency and speed are stressed for successful privatization to be achieved -- but the extreme difficulties of achieving both simultaneously are glossed over. Decentralization and pluralism are put forth as important ingredients of improving the state's effectiveness, but there is no discussion of how this may be achieved without the excessive contractualization that seems to be an inevitable concomitant of this shift. The importance of local solutions and traditional institutions is recognized (chapter 7), but there is no analysis of how poor countries can deal with the threat posed to these very traditions and local approaches from the global market juggernaut. The transmission of global changes to fragile local cultures, made more rapid by the increased pace of technical change and "openness", necessarily forces socially and culturally vulnerable groups (especially tribal groups) to adapt willy-nilly at a rapid pace which almost inevitably appears to fracture their social institutions. The dilemma defies simple solutions, as evidenced by the social

conditions of tribal groups in North America and Australia, countries with vastly superior resources to come to grips with this conflict. It has to be faced, not avoided.

As a result of avoiding contentious issues, the report abounds in bromides and generalities (e.g. "reliable institutions make credible states"). Undoubtedly this is unavoidable in some cases. For instance the WDR takes the juridical status of the international system of states as a given. As a multilateral institution, the Bank cannot question the sanctity and viability of some states as independent political entities no matter how artificial and weak they may be and despite serious doubts whether some states can ever be "effective" in the sense defined by the WDR, in the absence of a shared sense of nationhood amongst its citizenry.

The remarks that follow have been grouped under three categories: the Bank's conception of the state; important issues that have been either underplayed or avoided in the report; and the quality of evidence the report provides to make its case.

The Bank's Conception of the State:

A most curious aspect of the WDR's conception of the state is the virtual absence of politics in an analysis of an entity whose very essence is political. Any analysis of the state may have been expected to squarely confront issues of power, since the state is an inherently political creature. In examining issues such as corruption, participation, transparency, and agencies of restraint, the WDR indirectly touches upon one or other aspect of power. But the absence of a more forthright examination of "power" is puzzling. Explicit political analysis has not been the Bank's strength, stemming no doubt from its Articles' proscription against political

considerations in lending decisions (even though this fig leaf has been wearing thin in recent years). Consequently, it is not surprising that the WDR's implicit model of the ideal state is a modified Weberian state: a happy marriage of Singapore with a New England small town - a technocratic ruling class wedded to a communitarian ideal. The result: swift, well informed decision making that does not pander to populism or get driven by personal enrichment but is marked by transparency and participation.

As an expression of governance of, by and for human beings, the state embodies all the frailties and contradictions of its progenitors. Conflicts between human interests are inevitable even in a world of perfect information. In the real world, plagued as it is with chronic difficulties in understanding what human beings are doing, the problem is worse. Consequently the state is inherently a somewhat chaotic institution, no matter how orderly the analysis thereof, a feature well recognized by James Wilson, in his sweeping study of bureaucracies: "All complex organizations display bureaucratic problems of confusion, red tape, and the avoidance of responsibility. These problems are much greater in government bureaucracies, because government itself is the institutionalizing of confusion (arising from the need to moderate competing demands); of red tape (arising out of the need to satisfy demands that cannot be moderated); and of avoided responsibility (arising out of the desire to retain power by minimizing criticism)." (Wilson, 1989). To expect otherwise (the example of Singapore notwithstanding), is a will o'the wisp.

An understanding of organizational behavior and dynamics has not been a strong suit of the Bank, with its own poorly conceived reorganizations providing ample testimony in this regard. One reason is that the public administration literature, the traditional bastion of analysis

of the functionings of state bureaucracies, has occupied a low position in the intellectual pecking order of the social sciences and this is true within the Bank as well (admittedly its rigor and insights have been often limited). Consequently, the organizational aspects of state behavior are poorly understood. Compounding the problem are the extreme difficulties (if not impossibility) of designing systems of public choice that simultaneously combine fairness and basic standards of justice in economic distribution with simplicity of design that preserves efficiency in economic processes. Freedom of political choice is certainly compatible with a wide variety of social and political orders, but it also necessarily carries with it the power to disrupt. Perfectly informed (and even perfectly rational) human agents can choose to impair the economic prosperity of future generations; and indeed even to diminish their own future prospects of consumption. As the political philosopher John Dunn has argued, “Political freedom in fact entails the opportunity to impair the future real wealth of a community.” (Dunn, 1990). All this is to emphasize that the reality that states may engage in such behavior is not simply a pathological condition intrinsic to them. Rather, it reflects the frailties of its creators and constituents.

In focusing on state capacity and how to augment it, the WDR is preoccupied with the technocratic ingredients of state capability. It does not dwell on the more intangible (and analytically difficult) social foundations that determine state legitimacy and authority, without which the best of designs for improving state capability are bound to flounder. Nor does it dwell on that other intangible, but crucial, variable: political judgment on part of a country’s leadership (Berlin, 1996) without which any project to improve the effectiveness of the state is perhaps predestined to flounder. Machiavelli’s dictum that “a ruler who is not himself wise cannot be given good advice” points to a chronic dilemma that has confronted all states: how does one get

people of good political judgment to positions of political power? A reader of this WDR will not be enlightened on this score.

States today are suffering from an authority crisis stemming from a multitude of factors: a reduced capacity to provide satisfactory solutions to the major issues on their political agendas, partly because the new issues are not wholly within their jurisdiction, partly because older issues have significantly greater international components (from labor rights to land resettlement, from taxation to trade) and partly because the compliance of their citizens can be taken even less for granted. The range of issues within which the authority and legitimacy of states is operative has narrowed, and although the composition of demands has changed they have scarcely diminished in the aggregate. One consequence of ignoring issues of state legitimacy is that the state's symbolic role in redistribution is downplayed. Although state interventions in pursuit of redistribution have only too often reduced efficiency while doing little for equity either, the need to be seen to be doing something in this sphere is typically essential to its retention of a modicum of political legitimacy - a powerful driving force behind seemingly irrational state actions. There is a widespread sense (although hard data are difficult to come by), that the recent liberalization efforts have exacerbated inequities. The political implications and constraints this reality imposes on states would have been worth examining.

There are many other issues that are fundamental to understanding the effective functioning of states which the report skirts, either by the manner in which it defines the issues in some cases or by simply avoiding them in others. Space constraints in the report do not explain these lacunae since the report dwells at length on several issues that do little to deepen our understanding of the state.

Underexplored Issues:

1. State Capability: The report repeatedly emphasizes the importance of state capability defining it as "the ability to undertake and promote collective actions efficiently" (p.3). The definition is simple and seemingly elegant. But does efficient collective action imply greater good for the greater number? What does efficiency for society mean? Is it defined in terms of costs and, if so, how are financial, human and environmental costs to be reconciled, and over what time horizon? How are these to be distributed amongst the citizenry? How are individual rights to be balanced against group rights? Are the answers to these questions *sui generis* to individual countries? Disputes on "sustainable development", attempting to reconcile the views of those who place emphasis on the "sustainable" end of the spectrum with those who emphasize the "development" aspect, illustrate the difficulties. Reconciling means and ends has always posed thorny dilemmas with which all societies and states have to struggle. They cannot be wished away by definitional simplicity. This does not mean that the definition is incorrect. Any alternative definition of state capability would face its own problems. Rather, the seemingly straightforward, technocratic and almost axiomatic character of the definition fails to alert the reader as to its normative implications.

2. Property Rights: The report strongly emphasizes the benefits of a sound property rights regime (chapter 3), especially for private property rights. That poorly defined property rights can (and do) hurt the poor is now well recognized. At the same time, property rights have acquired

an almost hallowed status in the Bank's thinking in recent years. The report does recognize that in certain settings strengthening communally based property rights may be the better option (p. 45). Others have stressed that in rural settings in particular, non-market institutions rooted in traditional social norms may be a more suitable response to the problem of scarce resource allocation (Sjaastad and Bromley, 1997). When property rights are established rapidly -- for instance during periods of transition -- conflicts are not removed but settled in a particular way. If the prior absence of property rights reflects prevailing power relationships, when established their particular legal configuration and modes of enforcement are not devoid of problems either.

The last is as true in the international sphere as in domestic contexts. For LDCs this is most apparent in the domain of intellectual property rights (IPRs). If, as the 1998 WDR is attempting to argue, knowledge is so important for development, what are the consequences of an aggressive IPR regime, with its exclusionary and monopolistic characteristics? Although specific examples may be cited -- for instance more expensive medical products for the poor; or rents accruing to private (largely rich country) firms arising from their patenting of plant genetic material sourced from LDCs because of the inability of poor nations to organize and protect their common resource -- the aggregate welfare consequences are poorly understood. If, as at least one careful study has demonstrated, a policy of tighter intellectual property rights does *not* benefit poorer countries (Helpman, 1993), should LDCs indeed support a more aggressive IPR regime?

3. Industrial policy: The discussion of "industrial policy" (in chapter 4) is somewhat elusive since the term is not explained. Is "industry" in "industrial policy" narrowly defined or does it

refer to a more "strategic" element in economic statecraft? The discussion in this section seems to indicate the former. That being so, given that services are a dynamic part of many developing economies (as well as the increasing blurring of boundaries between services and "industry", especially in the informatics sector), and with agriculture continuing to play a major role in poorer countries, the treatment is especially disappointing. In services, for instance, a government could champion the higher education sector not simply to improve domestic human capital, but also as an export activity in a sector that is labor intensive. Is that "industrial" policy?

Elsewhere the report emphasizes that effective public sectors have been characterized by a strong central capacity for "strategic policy formulation" (p. 81). But is that not at the heart of "industrial policy" broadly defined? In fact the report is replete with references to the word "strategy", whether its call for a more strategic selection of collective goods and services by states or, as in its laying out "strategic options" at the end of various chapters. But it is never made clear what "strategic" means, and one wonders if it is an elliptical way to signal industrial policy without explicitly acknowledging that term.

4. Corruption: The report takes the position that all corruption has negative effects, but it is most concerned with "unpredictable" corruption, the effects of which it finds to be most pernicious (chapter 6). Unfortunately it straitjackets itself by viewing corruption entirely through the lens of property rights. More curious is the report's definition of corruption as "the abuse of *public power* for private gain" (p. 102, my emphasis). It is clear that, for the Bank, "public power" means public *office* rather than the arbitrary exercise of power by any actor, public or private, but

in the public *domain*.³ By definition, the role of markets and the private sector in corruption is wished away. At one point the report states that "the briber has as much responsibility as the bribed; effective penalties on domestic and international business must be part of the solution" (p. 9, "Overview"). However, it does not elaborate what this might entail.

Having locked itself into a property rights perspective, the report does not examine other aspects of corruption. The abuse of power may not necessarily be driven by considerations of personal gain. By the definition of the WDR, public officials engaging in torture or ethnic cleansing would not be corrupt if they were not doing it for personal gain. Moreover, often it is not abuse of power per se, but a more human "keep the head down" behavioral pattern stemming from a desire to minimize the downside (for instance a transfer to a less desirable location) that leaches away a bureaucracy and whose cumulative effects can be as negative as those resulting from the aforementioned definition of "corruption". Is unethical behavior that has public consequences a phenomenon that is distinct from corruption?

The analysis is also wanting in explaining why it has been so difficult to stem corruption not only in the privatization process, but even after it. In several countries (both developing and industrial) that have been at the vanguard of privatization, the "sleaze" factor continues to haunt the political landscape, while in others privatization has indeed contributed to reducing corruption. What explains these differences? In more traditional societies, is the rapid monetization of the human experience in the absence of the evolution of a parallel set of norms, creating the climate for corruption? It would seem reasonable to believe that if corrupt LDC

³ Indeed, a later issues paper on combatting corruption, prepared for the September 1997 meetings of the Development Committee by the staffs of the Bank and IMF, defined corruption as "the abuse of public *office* for private gain" (emphasis added).

officials could not hide their money they might well plunder less. What is the role of the lack of transparency in overseas accounts, many of them held in OECD countries, in nurturing money laundering and tax evasion? The absence of potent anticorruption laws in OECD countries (until very recently) regulating their companies doing business abroad is surely important in this regard. This is in contrast to OECD pressures put on LDCs with respect to the control of money laundering arising from drug related activities.

5. Civil Society and Participation: The term "civil society" having moved from its cottage industry status a few years ago to a robust growth industry finds an important place in this WDR (chapter 7).⁴ It is worth noting that, other than the business group constituent of civil society, the Bank did not regard it as a significant variable in its analysis of the East Asian "miracle", just a few years ago. The report documents well the positive contributions of this "third sector" and the importance of partnerships between the state, the private sector and the constituents of civil society to a country's development efforts.

However, and perhaps an indication of the pressures the Bank faces, the WDR for the most part equates civil society with NGOs. There is little discussion of the accountability and legitimacy of NGOs - the fact that the state in many cases lacks one or the other attribute does not *ipso facto* imply that NGOs necessarily possess them. There is also no acknowledgment that, philosophically, "civil society" also embodies the politics of "difference". Many formations that constitute civil society -- religious, ethnic or caste groups, unions, business associations -- can be

⁴ The term "civil society" has its roots in the Scottish enlightenment. Its current rediscovery owes much to East European dissident movements in the 1970s and 1980s.

quite parochial and exclusionary in character. Like "common sense", which is often less than common, civil society can be less than civil. The report does not address this issue -- or whether these formations are good in and of themselves, or rather for their instrumentality. The lacuna in the analysis reflects the Bank's preoccupation with the relationship between civil society and the state, with little understanding of the relationship of civil society with the "nation" or with religion, which can unleash forces that can derail the state (Hann and Dunn, 1996). The last is a particularly salient omission, since dominant Western views of civil society have historically had strong religious roots - whether the Anglo-Saxon tradition of civil society as the vision of the ethical life within a Protestant congregation or the French tradition based on the Catholic vision of the role of religious community within a strong secular state (Seligman, 1992).

"Participation", like "civil society", is now broadly acknowledged to be an essential ingredient of sustainable development. But as with the treatment of "civil society", the WDR does not seriously examine the limits of participation as a constraint on state actions. This is all the more curious since barely a stone's throw away from where the report was drafted, a casual observer can find very visible manifestations of the often limited political fruits that participation can provide, even in societies that have a hospitable climate for participatory action.

6. International Collective Action: The analysis makes a sound case for increasing the supply of global public goods, from research to the global environment, from making international development assistance more effective to protecting global economic stability (chapter 8). There is little to dispute in this, but what is missing is equally interesting. Thus while the welfare improving effects of a greater openness to the movement of trade and capital is stressed, nothing

is said about the movement of people (except in the case of refugees). Similarly while much is made of the importance of the rule of law within countries, little is said regarding its importance in the international context, as for instance the implications of extraterritorial application of a country's laws when they run contrary to international mechanisms to promote global economic stability, or geopolitical and commercial interests that frequently override the high-sounding rhetoric on the rule of law (p. 107-8). Relatedly, the report (as indeed a large part of the development community) sidesteps a dilemma: the bottom line is supposedly "people", but the numeraire for allocations and analysis is done in terms of states.

7. Anglo-Saxon legal norms: The report's emphasis on formal institutions for reinvigorating state effectiveness -- well functioning legal institutions that enforce the "rules of the game" and property rights -- did not get much play in the East Asian Miracle study. In the East Asian case, formal legal systems have been (till very recently) quite limited. To a considerable extent, commercial arrangements in East Asia have not been based on formal, explicit, contractual relationships. The emphasis on formal mechanisms neglects an important point. The development of a complete set of formal institutions is costly. Historically, social norms have served as a surrogate mechanism to lower transaction costs. The process of economic development is accompanied by a breakdown of informal institutions or social norms and a corresponding rise of formal institutions. But the latter seldom rise concurrently to take their place. How societies manage this transitional lag is crucial. Consequently, the importance of formal legal institutions is perhaps more in their *ex ante* effects on behavior by their mere existence, than in their use. In the latter mode, they serve principally in a fire-fighting capacity,

a use that itself frequently signifies a failure of informal institutions developed by societies to resolve disputes.

Although the report does acknowledge informal institutions, its heart is understandably in formal institutions. Management theorists wax eloquent on the effects of "corporate culture" on corporate performance. Similarly there is now a vigorous debate on the social conditions upon which the viability and efficiency of the market system rests (Platteau, 1994; Moore, 1994; Murshid 1997). Does national culture have similar implications for the nation? Are some configurations of society more conducive to effective states? Again, the document tiptoes around this analytical quagmire, choosing implicitly to attribute cultural "flaws" with *sui generis* origins to common attitudes and behavioral patterns, a consequence of systems where power has been concentrated and used arbitrarily. Such an approach, while undoubtedly often valid, is not without limitations. East Asia has not been characterized by any less concentration of power than less "successful" countries. Culture encompasses understandings of obligations and rights among various actors in a given cultural system, as well as self enforcing norms for a broad range of transactions, including those in markets. Moreover, variables rooted in culture, such as patterns of ethnic ties, trust and cooperation both within and between societal groups, may affect transaction costs, and mitigate free rider problems.⁵

Finally, it is interesting to note that the recent stress on enforcing property rights, whether through law and order or contract enforcement, places almost the entire analytical emphasis on

⁵ For long the attitude amongst development analysts to the role of informal institutions, was perhaps best illustrated by Arthur Lewis's comments, when it was suggested to him that a set of Indian institutional norms, the caste system, constituted a powerful barrier to economic development: "The love of money is a powerful institutional solvent". (Lewis, 1962).

the judiciary with scarcely any mention of the role of executive investigative agencies and the police - a case of putting the cart before the horse.

8. Credibility versus Flexibility: The dilemma of rules versus discretion is inherent to all decision-making bodies. In a more volatile world what are the tradeoffs between credibility and flexibility? Amidst increasing demands for a more agile state, that dilemma -- checking arbitrary decision making without building rigidities (p. 108) -- is a tricky one. The WDR recommends "lock in" rules using mechanisms that make it costly to reverse course (privatization or signing on to international agreements being good examples). However, there are also cases where the credibility arising from "lock-in" rules is outweighed by the lack of flexibility in a volatile world, as recent problems with fixed exchange rate regimes indicate. But flexibility creates its own problems. The dilemma is especially pronounced in cases where long-term contracts may be required, as in infrastructure. Thus, recent exchange rate depreciations in South-East Asia, while emphasizing the importance of flexible exchange rate regimes, also shows how these might exacerbate problems in infrastructure financing. Rapid changes in policies, by pointing to a government's commitment to reform, may signal credibility. However, what can be done quickly can often be undone quickly. On the other hand, gradualism may simply be a cover for foot-dragging, whose costs can be highly detrimental as well. Unfortunately, there is little by way of a framework in the WDR that may help elucidate these choices.

9. While providing new rationales for regulation in finance, utilities and the environment, the analysis is weak with regard to countries with weak institutions (see Table 4.2). Even in the

better endowed countries, bank supervisors have to run ever faster merely to keep abreast of rapidly changing instruments and risks in financial markets. The mushrooming of non-banking financial institutions and the growth of electronic money, all add to the already difficult task facing many poor countries in the financial sector. The WDR's homilies ("given an appropriate - and enforceable -- legal framework" for financial sector development) appear more like linguistic sophistry than practical advice given the sharp asymmetries in the time periods required to institute policy changes on the one hand and to develop corresponding institutional structures on the other. The virtues of economic openness are now taken as axiomatic by the Bretton Woods institutions. It would be worthwhile to more closely scrutinize whether in countries where institutions are particularly weak there are perhaps some sectors, such as the financial sector or the capital account, where the degree and form of economic openness, and not just the state's role, may need to be matched to capability.

Misplaced quantification:

Some of the weakest parts of the report are to be found in its misplaced emphasis on quantification. In some cases problems arise from comparing apples and oranges. Thus in documenting the growth of the state as measured by government expenditure as a fraction of GDP (figure 1), data for OECD countries include all government expenditure, central as well as local. Data for LDCs, however, only include central government expenditure. Consequently the decline of government expenditure to GDP may be simply a result of fiscal decentralization which has been occurring in the same period (indeed table 7.1 on subnational finance appears to

indicate so). All that can be said is that one measure of the size of the state -- central government expenditure -- appears to have stopped growing in the mid-1980s.

More troubling are the myriad of regressions, many based on an ambitious private sector survey that tries to buttress support for the importance of "credibility" - a difficult measure as well as a subjective one. For instance, how sensitive are responses by the domestic private sector to expectations or the degree of political openness in their countries? It is another matter whether an elaborate survey was required to "prove" the point that "credibility" matters, since no one had argued otherwise. While the survey's results will be widely quoted, it may have been expected that like Caesar's wife, a survey on credibility should itself be credible. Unfortunately the strong conclusions drawn from the survey themselves lack credibility, plagued as they are with technical problems of sample bias, endogeneity, simultaneity and collinearity.

The survey covered domestic private sector firms in 69 countries -- an ambitious undertaking. One -- West Bank and Gaza -- is not a country (at least not yet) and does not have the presumed autonomy of an independent nation-state. Firms in only three countries in Asia responded (Fiji, India and Malaysia). Only 4% of all the firms surveyed in developing countries were from Asia (Table TN7 in the Technical Note). In other cases either the country did not allow the survey (China) or firms did not respond (Singapore), because they were uninterested or simply unwilling to put down on paper anything that could be construed as critical of their government. This is not a minor sampling bias. Excluding Malaysia, not one country representing the most economically dynamic region of the world is included in the survey results. Rather than use that reality to inquire as to what the lack of response may mean, the three countries that did respond have been included to comprise the "South-South East Asia" group of

countries. The report could have, in the interests of transparency (a much valued virtue in the report), simply stated which countries did not participate. In fact, while maintaining confidentiality of the precise nature of individual country responses, the Bank could (and should) have listed the percentage of firms responding by country as well as those countries that declined to participate in the survey (indeed the late Michael Bruno had stated that that would be done).

The use of indexes to rank countries on a variety of criteria has been in vogue in recent years as country “beauty contests” have soared in popularity. These criteria, whether the UNDP’s Human Development Index, Transparency International’s Corruption Index, the competitiveness indexes from the World Economic Forum or the International Institute for Management Development, all suffer from a variety of conceptual and statistical problems, a reflection of the difficulties of constructing indexes with unambiguous rankings.⁶ The WDR’s extensive use of indexes (social capital, corruption, school quality, budget institution quality, credibility, institutional capability, and policy distortions) conveys a pseudo-scientific basis to the conclusions drawn. All these factors, as the report points out, affect the effectiveness of governments. Since in many cases these are subjective indicators, qualitative judgments have to be arrived at. But the manner of presentation appears to give a sense of “hard” reality without any caution or discussion as to the limitations of these indexes and hence the robustness of results. For instance the index for political liberties is one formulated by Freedom House. There is no discussion of why this is the appropriate indicator rather than one, if it were asked for, developed in say Accra or Singapore. The choice of index is a revealed preference for certain

⁶ Transparency International’s “Corruption Index”, has been critiqued as “subjective” and “misleading” because it fails to distinguish between the type and scale of corruption (Financial

political values and one should not be coy about it. A separate point is whether these indicators accurately reflect reality. Recent detailed analysis of a somewhat similar indicator -- quantitative measures of democracy -- suggest that these measures contain substantial inaccuracies (McHenry, 1997). Similarly the “Quality of Bureaucracy” is derived as a composite index from sources whose principal evaluation criteria are variables that are of importance to foreign investors.⁷ There may well be quite practical reasons why these second best indexes have been used. But there are no caveats as to what biases may thereby have been introduced. Under the circumstances the report should have restricted itself to ordinal rankings as much as possible (as in Box 3.1).

Even then there are analytical problems and varying interpretations can be drawn from the results. For instance the rankings of the fifteen obstacles for doing business (in declining order of importance) are tax regulations/and or higher taxes; corruption; financing; crime and theft; and infrastructure. In fact, it is clear from the background paper (Brunetti, Kisunko and Weder, 1997, Appendix Table 8) though less evident from the final report (Box 3.1), that domestic firms ranked policy variables frequently cited by the Bank as major obstacles to business quite low: these include regulations on foreign trade, labor regulations, foreign currency regulations and price controls (ranked nine, ten, eleven and fourteen respectively). For domestic private business, regulation is much less important than issues related to law and order. Foreign businesses, because they are usually larger, have the muscle to deal with law and order

Times, August 13, 1997). Similarly even the revised the Human Development Index continues to be plagued by statistical artifacts (Luchters and Menkhoff, 1996).

⁷ The BERI (Business Environmental Risk Intelligence) index of Bureaucratic Delays; the International Country Risk Guide (ICRG) index of Quality of Bureaucracy; and the Business International/Economist Intelligence Unit’s index of Bureaucracy and Red Tape.

problems more easily. But trade and foreign exchange issues are clearly of much greater importance to foreign business - a message which the Bank invariably supports.

In reality the indexes used are, at best, only indicative results given that the methodological terrain is a veritable minefield. For instance, figure 5 (in the “Overview” chapter) examines the relative effects of policies and capabilities, each measured by an index, on economic growth. For any country, policies and capabilities change with time. Are these being measured at the beginning of the period, at the end or somewhere in between? The index of policy distortions is a composite of inflation, black market premium and openness (as measured by trade to GDP ratio). Even if we leave aside the well recognized problems in the measurement of these variables⁸, why these three variables? A vast literature has examined the effects of a myriad of country policies on growth, including policies affecting investment in physical capital, human capital, equipment investment, and R&D; government spending, tax policy, and financial policies; trade policies defined in different ways; policies affecting income distribution; and macroeconomic policies. Policy “distortions” can (and surely do) occur in most of them and the policy variables constituting “distortions” can be measured and weighted in different ways. Furthermore, just a few years ago a Bank research publication concluded that luck, especially in the forms of shocks to the terms of trade, plays as much of a role in explaining the variance of

⁸ For instance the black market premium and openness are correlated. Indeed the black market premium may simply be picking up the thinness of the foreign exchange market, and is affected both by interest rates and penalties for dealing in the black market. Trade openness, as measured by the trade to GDP ratio is sensitive to country size and is particularly dubious if openness is broadly conceived to apply to more than merchandise trade.

growth rates as policies.⁹ But here no such qualifications seem warranted and only policies and bureaucratic capabilities seem to matter.

Policy distortions themselves undermine capability - some more than others. Poor capabilities may themselves result in policy distortions. There are serious questions of endogeneity and simultaneity in the analysis of these relationships, and it is unclear how -- or whether -- these have been addressed. Consequently, peculiar conclusions can be drawn if the numbers (which are never ranges) are taken literally. Based on figure 5, the report argues that "good policies by themselves can improve overall results. But the benefits are magnified where institutional capability is also higher" (p. 33). In fact, as Appendix I shows, the results when initially computed indicated that capabilities mattered more than policies. When "capability" changed from "low" to "high", growth increased by 1.7 percent a year for a given degree of policy distortion. However, when policy distortions improved from "high" to "low", growth increased by just 1 percent for a given level of "capability".¹⁰ Since that would seem to indicate that, at the margin, states should focus on improving capability rather than policies, quite a change in the Bank's message, the offending column was simply dropped from the published version.

The message is similarly driving the analysis in figure 5.6 which attempts to show that a better bureaucracy requires relatively better paid public servants (Appendix II). The published version compares Philippines with "other East Asia" and shows that indeed bureaucratic capability and the ratio of public to private wages are correlated. Originally the comparison was

⁹ William Easterly, Michael Kremer, Lant Pritchett, and Lawrence Summers. (1993), "Good Policy or Good Luck? Country Growth Performance and Temporary Shocks", *Journal of Monetary Economics*, V. 3, No. 32, 459-484.

between the Philippines and Korea. There, although relative salaries of Korean public officials (compared to their private sector counterparts) were two-and-half times their Philippines counterparts, their "capability index" was only one-and-half times as good. One could therefore draw the (contrary) conclusion that the Korean system was more inefficient - it got much less bang for the buck than the Philippines! Using different comparators -- a particular group of East Asian countries and wages and salaries only of senior civil servants -- embarrassment is avoided: the "other East Asia capability index" is three times that of the Philippines, while the corresponding wage ratio is only two-and-half. Honor and results have been saved!

These comments do not imply that the WDR's conclusions are invalid or wrong. In fact, many make common sense. But the attempt to show that rigorous analysis underpins these conclusions is not infrequently unwarranted. Moreover, many of the issues identified in the report as important are precisely the ones that critics contend have not been important in East Asia. One has to reluctantly conclude that it is not the credibility of the analysis, so much as the credulity of the readers, that is at issue here.

CONCLUSION

Academia and policy circles have demonstrated remarkable fecundity in their analysis of the state. Given this analytical overabundance, what value added does the 1997 WDR, *The State in a Changing World* provide? Any judgment should be tempered by the reality that the difficulty of writing a WDR on the State cannot be underestimated. And, there is little doubt that,

¹⁰ World Bank, Report No. 16376, March 1997, Figure 2.2.

at least as a consciousness raising device, the WDR succeeds in sensitizing opinion regarding the state's significance on the global stage. Consequently, a plausible argument can be made that to the extent the WDRs' role is principally didactic, the various results should be seen as merely illustrative, and consequently that to subject them to more rigorous standards of proof is to miss the point. The World Bank is not a university and the WDR should not be seen as a research document per se. Indeed, the report is most convincing when it sticks to sound common sense advice. And, in common with most analysis on the state, it is stronger in its diagnosis of what does not work rather than what works, and in recommendations on the "what" rather than the "how".

Nonetheless, the WDR's nouvelle *cuisine* like character makes for a rather unsatisfying intellectual meal, with its high cost and low nutritional value. In part this reflects the reality that WDRs are an excellent public relations instrument for the Bank itself. But it also reflects an insecure and besieged institution, which has led the Bank to become increasingly intellectually risk-averse. One consequence is a tendency to downplay the dilemmas and complexities that are inherent in the changing role of the state and the institution's analysis, borne on a strong updraft of "win-win" and "feel-good" argot, glides over hard and unpleasant realities.

Multilateral institutions are circumscribed in the degree to which they can be candid on issues that are inherently political such as the "role of the state". Such efforts are apt to slip into the realm of subtle institutional public relations, especially when support for these institutions is lukewarm. It is therefore worthwhile to ponder for a moment the composition of resources spent by multilateral institutions on research and whether these resources could be better deployed elsewhere? The opportunity costs of the approximately \$4 million spent on a WDR are not

insignificant. If, for instance, instead of an annual WDR, the World Bank would deploy this sum to support research on malaria instead, would global human welfare be any worse? It is not just multilateral development bank projects to LDCs that require sound cost-benefit analysis. The internal deployment of resources by these institutions could benefit with such scrutiny as well.

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