

**World Development Report 1997**  
**The State in a Changing World\***  
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\* This paper was presented in a brain storming workshop organized by the Egyptian Centre for Economic Studies (ECES) Cairo - August 25th, 1996 . The Paper Provides a brief outline of the proposed WDR 1997 . The report's outline is followed by the distinguished comment made by Dr.I.S.Abdalla .

### **Overview :**

The state can do enormous good - and hard . Good policies, effectively implemented, can help lift millions of people out of centuries of poverty - as in much of East Asia. Effective preventive health services can wipe out crippling diseases - like polio , bilharzia, and malaria - and active state actions can save precious forests. Even modest improvements in public action in the 1960 's were sufficient to wipe out famine in China and India, But poor policies can drive millions into despair - as in much of Africa . Too big a state can cripple an economy - as in the former Soviet Union . But too weak a state can lead to anarchy - as in Liberia and Somalia. The state's ability to facilitate and leverage change is enormous .

This WDR will try to show that an effective capable state is vital for the provision of the goods and services rules, and institutions that allow markets to flourish and people to lead healthier, happier lives. It recognizes that the state's role differs enormously across countries at different stages of development - as in new Guinea compared with New Zealand - or even at the same level of income - as in the United States, Europe , and japan. Many differences also arise from size, geography, ethnic diversity, culture, and political systems. Our goal in this WDR is not to try to delineate some ideal role of the state. Instead, keeping all these cross-country differences in mind, we ask why and how some states are more capable than others at playing a catalytic and facilitating role in sustainable development and poverty eradication and how changes the world over - rapid globalization and technological change, the collapse of socialism, the re-awakening of citizen action - are re-shaping our thinking about the state.

The Report starts with a simple conceptual perspective. The state is fundamentally a mechanism to facilitate the provision of public and collective actions ranging from breathable air, safe water, an ozone layer, sound cur-

rency, law and order, defense and (in an increasingly information - based world) public information. History and recent experience tell us that capable state institutions are needed to provide these and other collective actions but also to provide a check and balance to the arbitrary and capricious use of sovereign state power . Yet in many countries state capability has eroded because of excessive checks and balances that lead to paralysis or grid lock. In some others insufficient checks and balances have led to abuse of state power for personal or misguided objectives. And in some cases short-term expediency has led to populist policies with severe long-run costs. The challenge is to create a balanced state structure that mediates interests, protects the underprivileged and weak, delivers services, and focuses collective action toward sustainable economic and social development and the eradication of poverty.

People identify and associate states very closely with nations - in fact nation and state are often interchangeable. This was not always so , and we are seeing a reemergence of pressures from above or beyond the state - from globalization and from within or below the state - for greater participation and decentralization that challenges its sovereign power, and for reforms . This Report takes as its principal focus a country's sovereign authority - the state , including the judiciary , the legislature , and central , provincial , and local government. But it also examines these pressures from above and below that now exert pressure for reform of the state to make it a more effective facilitator of economic and social change.

**The Report will be in five Parts :**

- How are states changing and how well have they helped deliver on sustainable economic and social development especially over the past 50 years (Part One) ?

- What are the primary sources of pressure on states to change - markets, citizens, global forces - and how are they manifesting themselves in different parts of the world (Part Two) ?
- What does country experience tell us about how the interplay between check and balances and flexibility can lead to new and better ways of thinking about key functions of the state - as economic manager , rulemaker, protector of the vulnerable , and service provider ( Part Three)?
- Are the pressures for change leading to greater contestability between different constituents of the state , and will they eventually improve its functioning ( Part Four) ?
- Despite strong pressures , why is reform of the state so difficult, and what can be done to sustain it (Part Five) ?

#### **Part One : Re-thinking the State - the World Over**

The twentieth century, especially its second half , has seen a massive and widespread expansion in the size of the state. The Report will begin by presenting an empirical and historical overview of how the public and collective domain has grown and how that growth has affected ordinary citizens. From the basics of, national security, law and order, to education, health, economic management, and redistribution, the Report will lay out how the contours of the state - and , by implication , the objectives of public policy - have changed over time. Fiscal pressures are forcing countries to re-think its scope . The size of government spending, the sources of revenue, and the incidence of public outlays will therefore form a key part of this analysis. Similarly, the levels at which government operates - the national, state , local , and institutional differences in the ways states are organized will be profiled . Although size is clearly a critical measure, the Report will also concentrate on the scope of government actions, a key issue given the widespread prevalence of government interventions through indirect or non-fiscal channels. The impact of these interventions over time - on such basic

economic variables as investment and savings, on the overall quality of life and sustainability - will be presented.

Today, the world over - from Ougadougou to Ottawa, from Warsaw to Wellington - we see attempts to reform the state and we will try to document and evaluate them . The reforms involve two inter-related questions- what is the appropriate role of the state and how to get the state to play its assigned role better ? In some cases there are efforts to retract and refocus an over-stretched and ineffective state ( the former Soviet Union) . In others it involves removing a maze of checks and balances that have paralyzed the levers and agencies of the state (Bangladesh , India, Mexico) . In others still it means decentralizing and bringing the state closer to the people and building better partnerships between the state and civil society.

The changes can involve broad political reforms, as in Eastern Europe, Russia, Latin America , and parts of Sub-Saharan Africa , where more democratic forms of government have emerged over the past decade. Or they can result from political upheaval or ethnic and other social tensions that break down the basic functions of the state to law, order, and stability. In such dysfunctional states ( Bosnia, Somalia) , building state authority will be a vital first step .

But , barring a few exceptions, Part One will attempt to show that reforms have been difficult to sustain. Moreover, globalization is bringing benefits but also considerable challenges, and is showing that collective action is even more difficult to organize internationally than nationally . There is no perfect Model . But there are answers as to the direction of reforms , and the world over there is considerable rethinking on the role and capability of the state .

### **Part Two : What are the pressures for change ?**

Pressures for change come from three sources - markets demanding more credible states, citizens desiring more responsive and accountable states, and the forces of globalization requiring more agile responses from the state .

The impact of these pressures varies across countries.

### **2.1 States and Markets : An Evolving Balance**

- The Report will try to show how the balance between state and market has changed over time, from a relationship of control and antagonism to one of partnerships and complementarity . While markets are the bedrock of a flourishing economic system a capable state is vital for sustained, market-led development. How do effective states provide greater predictability, and the institutional infrastructure which underpin property rights and helps markets grow ? Why and how are some states more credible?

- In solving the problems of market failure and helping markets to grow. some analysts argue that government intervention (if done the right way) can be market-enhancing. This is particularly so where mechanisms to help coordination of private entrepreneurs were introduced (especially in East Asia) . We will examine in WDR 1997 how such interventions worked, how rent-seeking and agency problems were avoided, and whether these experiences can be replicated. This is important as the recent history of economic development is replete with instances of government failure in attempting to correct market failure (the former Soviet Union, South Asia, parts of Latin America, Africa) but only scattered instances of government success.

- The Report will also examine concerns about the ability of markets to take appropriate consideration of inequality and of future generations . Too much inequality destroys the shared goals of society and threatens a market-based development strategy. How can state action address these inadequacies of the market - recognizing that not all states have the same capacity to intervene?

### **2.2 Citizens ; The Desire for a more Responsive and Accountable State**

Constitutions and state charters in most countries are increasingly similar in the promises - universal education , safe water, basic health, protection from exploitation, law and order - they make to their citizens . But there are

huge differences in their ability to deliver them. As a result citizens around the globe are becoming more active and vocal about state failures and inefficiencies. The gap between performance and promise is under greater scrutiny . In many countries citizens are taking a more active role in deciding their political leadership ( Bangladesh, Benin, West Bank and Gaza) , challenging and sometimes changing government policy . They are also doing more to provide services to their communities. But just how widespread are these phenomena ? What explains the rise of citizen participation? And what are the implications for the scope and legitimacy of the state?

Public debate about the quality of government is not new , especially in industrial countries. What is new is the increasing number of open elections taking place in Africa, Eastern Europe, and latin America. Also new is the recent growth of organized civil society in any parts of the world (Eastern Europe and Central Asia). New as well are the different types and levels of interaction with the state - from service delivery to special interest causes, more scrutiny of corruption, to broader policymaking and democratization. Are these interactions leading to improvements in the ability of these states to respond to the needs and demands of citizens, especially less privileged ones ?

This chapter will examine ways of checking potential abuses and violations of state power and subjecting state officials to public scrutiny . How can traditionally excluded groups (women, minorities, the poor) be given a voice in public debate and decisionmaking,mitigating polarities within society and developing the responsibilities and capacities to improve their welfare ? The chapter will also examine the challenges and risks of voice - what happens when the voices of certain groups dominate? How should governments respond when greater pluralim brings the potential for conflict as well as consensus, instability as well as participation?

### **2.3 Globalization : The Need for a More Agile State**

The pressure to change comes from outside the nation state as well. Large private capital flows and lower transport and communication costs have made it tougher for individual states to act alone and independently - some call it "the end of geography". Governments that challenge financial markets do so at tremendous cost to their credibility - as Mexico's recent experience has highlighted. Rapid communications have altered people's access to knowledge and are changing their expectations of government. Global and cross - border environmental problems, movements of labor, and spread of narcotics - are showing that the world is becoming more interconnected in good and harmful ways . This chapter will ask whether global integration is leading to more disciplined government and to greater convergence in tax regimes, regulations, investment codes, and accounting and environmental standards?

The chapter will explore globalization's links with the structure of the state - especially decentralization . Subnational governments in Brazil, China, India , the United States , and Europe have become major interlocutors and competitors for foreign investment . Is this competition for investment and jobs leading to better government , discipline , and business orientation . Will it also lead to greater regional inequalities and create tensions ?

The chapter will also ask who governs the global markets. Foreign investors do not always want governments to pursue sensible policies. Market-led globalization could worsen inequality (though evidence suggests the opposite), and a global market may not produce the best outcomes for emerging environmental problems. How are countries that once provided elaborate social safety nets to contain the risks and uncertainties generated by volatile international markets are now forced to cut back due to fiscal pressures handling these trade-offs? Could it lead to a reversal to inward-looking policies? Can more imaginative national and international solutions be found ? And unless cooperation across state boundaries is more effective, such problems



as global warming, ozone depletion, and narcotics may continue to escalate? The Report will show that much more needs to be done to strengthen state institution and international coordination to address these cross-national issues .

### **Part Three : How Change Is Affecting Key State Functions**

Part Three of the Report moves from the why to the how. It does not attempt to address the appropriate role of the state in different sectors - environment, health, education, infrastructure. Instead, it asks how country experience is reshaping our assessment of what works - and why - under four key functions of the state: managing the economy, regulation, protecting the vulnerable, and delivering services.

#### **3.1 Managing the Economy**

There is considerable agreement today on the fundamentals of sound economic management. But how and why some countries appear to be more successful than others in setting good policies is still not fully understood. This section will examine how countries have used different mechanisms to avoid economic instability - budget rules, currency boards, open capital accounts, strict rules for monitoring and controlling borrowing from the domestic economy and abroad, and independent central banks to constrain the normal tendency for treasuries to overspend. But can rules alone work without a clear commitment from the highest levels of government - and society at large? Why do countries continue to resort to short-term populist measures when their long-run costs are well known?

Flexible and swift responses in economic management have also been hallmarks of governments that manage their economies well (Chile, Malaysia, Thailand) . This chapter will review the vast literature on the credibility of economic policy, drawing common lessons on what has worked and why. It will also examine patterns in institutional arrangements that encourage or discourage good economic management and consistency in economic policymaking.

Greater efficiency and equity in the allocation of public expenditures and tax policy are essential elements of state reform. But many countries still spend too much on inequitable programs and on the military sector. The chapter will examine how budgetary institutions can be used to achieve better outcomes from public spending. It will also summarize the major lessons from trade and tax reforms and the growing convergence in trade and tax regimes in industrial and developing countries.

### **3.2 Better Regulation**

This chapter will synthesize the growing body of evidence on the impact of regulation in specific country settings. It will try to show that the track record of government efforts to influence market outcomes for public purposes is very mixed. Sometimes economic and social regulation has been beneficial for societies. But all too often regulatory initiatives have been undermined by powerful vested interests and self-interested officials. Moreover, regulation sometimes has raised transactions costs, undermined property rights, and thereby inhibited private sector development.

The challenge is to identify a menu of regulatory tools from which countries can select those most likely to yield benefits in their specific country settings. Across a wide variety of markets, the scope for competition is greater than was initially thought. Yet the challenge of regulating imperfect markets remains. Using the examples of utility, financial sector, and environmental regulation, the chapter will explore empirically the ways in which a country's institutions and politics constrain the range of workable options. Evidence reveals that approaches highly successful in some countries - such as decision - making by independent utility commissions, with input from open public hearings - may be less successful in countries where there are fewer checks and balances to restrain arbitrary decision-making.

Some countries with weak institutions may be able only to make binding commitments to private investors at the cost of radically constraining their

room to modify market outcomes and respond flexibly to change. They may have no alternative but to use external commitment mechanisms - guarantees, conditionality, international arbitration, and the like - as substitutes for national judicial and regulatory institutions in advanced states of disintegration.

### 3.3 Protecting the Vulnerable

In addition to sound economic management and appropriate regulation, the state is also expected - across the political spectrum - to protect the most vulnerable segments of society. Designing effective programs to meet this end without falling into the trap of an expensive and ineffective welfare state remains a nettlesome challenge.

In the context of this Report three issues are of particular interest. First, what are structural changes needed in traditional transfer mechanisms, which are typically associated with the welfare state. These programs include, inter- alia pensions, unemployment compensation, severance pay, family benefits, and child benefits.

Second, how to design compensatory schemes in order to, simultaneously, cushion vulnerable groups from short term adverse effects. This is particularly important for many countries in the former Soviet Union and Eastern Europe, where poverty doubled between 1987 and 1993. Third, what has been the experience with a range of anti-poverty programs such as employment-guarantee schemes, food subsidies, special incentives for credit.

Due to growing fiscal pressure, developing countries - and many developed countries - are reexamining the costs and benefits of these interventions. Experience strongly suggests that there are powerful efficiency and equity gains to targeting. But critics argue that finely targeted programs usually fail - either in fully covering the poor or in avoiding leakages to the nonpoor - and usually cannot be sustained because they lack political support.

Better partnerships between the state, business, and labor provide another

avenue to share benefits and costs of welfare is another avenue to help build a shared vision of responsibility. How are countries coping in these difficult choices and the broader social concerns that reduced benefits may exacerbate crime, inner - city violence, and social disintegration more generally with costs down the line for businesses and taxpayers? What options are emerging and what choices should developing countries consider ?

### **3.4 Improving and Unbundling Public Services**

Changes in technology and better appreciation of the capacity of markets and NGOs have created new opportunities for more competitive and efficient provision of public services. This section will show that broader experience and better analysis is improving our understanding of the rationale for state provision of services - on a spectrum from such purely public goods as defense, police and the law (non-excludable and non-subtractable) to such collective goods as common pastures and groundwater (subtractable but non - excludable) to such toll goods as ports and highways (excludable but non - subtractable) to purely private ones. There is greater experimentation and partnerships emerging between the state, market, and community on financing and delivery mechanisms in providing a variety of services.

The private sector and NGOs already do much in the financing and delivery of many services that have long been considered the domain of public activity in developing countries. While some governments have provided services as efficiently as the private sector and NGOs (health services in Malaysia, state- provided education in Kerala, India), private sector and NGO provision have often been associated with better outcomes than the public sector (secondary education in Dominican Republic, Colombia, Thailand, the Philippines and Tanzania). And where the state has collapsed because of civil war or internal turmoil (Uganda), NGOs have been the major player in the provision of basic services.

The chapter will use sectoral and country examples to illustrate how the state can use alternative interventions (subsidies, regulation, contracting) to

improve service provision , taking into account the market structure for publicly provided services. In addition, the chapter will highlight how changes in technology have created new scope for competition and private financing (telecommunications in Mexico, power generation in China, and road maintenance through contracting. While more multi-faceted options on service delivery are emerging, the state will need to provide a core set of services. How to get states to improve these will be taken up in Chapter 4.3.

Part Four: Reinvigorating the institutional underpinnings of the State

Part Four will try to show that introducing greater contestability is a key to making state institutions work better. It will attempt to understand how changes in the structure of the state toward greater decentralization, delegation, and participation - a state much closer to people, better checks and balances between the executive, legislature and judiciary and internal improvements - are helping to increase contestability. But it will emphasize that institutional reform is path - dependent - and that solutions must take into careful account country circumstances and local conditions.

#### **4.1 Restraining Arbitrary Government Action**

Countries have at their disposal a wide variety of checks and balances to restrain arbitrary action while maintaining the flexibility to pursue desirable public initiatives. When states turn dysfunctional - through bad policies, corruption, or even , at the limit, a breakdown in social order - development is undermined. All societies face the problem of corruption, but the scale, level of social condemnation , and efforts of state bodies to eliminate it vary considerably across countries and over time. The costs of corruption can be both direct and indirect. It raises transaction costs, undermines public confidence in government, engenders bad economic choices, and constrains government's ability to implement policy.

This chapter will examine the diverse array of checks and balances which countries have used to restrain arbitrary government actions and corruption.

Some fundamental checks and balances are embedded in the foundations of a nation's social and political system. Informal social norms can be powerful restraints. Some countries have built checks and balances into their formal political systems - diffusing power horizontally (between legislatures and executives) , vertically (between national, regional and local authorities) , or among competing political parties .

A strong , independent judiciary can be a powerful tool for restraining arbitrary action . Some countries have developed impartial and uncorrupted judiciaries ; others have not . The chapter will explore the key ingredients of success. It will also examine the track record of independent , statutorily constituted oversight agencies - for example, Australia's Independent Commission Against Corruption, and South Africa's newly created Office of the Public Protector - in reigning in arbitrary government actions. Also useful are statutory authorities that offer independent assessments of policies - for example, the Congressional Budget Office, which assesses budget and economic policy issues for the US Congress, and the Korea Development Institute, which for over two decades has performed a similar function for the Korean authorities.

Along with statutory tools, countries can enhance transparency, accountability, legitimacy, and often effectiveness by embedding government action more thoroughly into civil society. At the micro level diverse forms of voice have been used to elicit feedback from citizens to improve service delivery, At the macro level countries in East Asia (Japan, Malaysia, Singapore, Thailand) Europe (the Scandinavian countries, Germany) Africa (Ghana, Senegal, South Africa) and elsewhere have used high-level deliberative forums to communicate with civil society on new policy initiatives. The chapter will examine the effectiveness of these initiatives in different policy and country contexts .

#### 4.2 Decentralizing the State - Bringing It Closer to the People

Greater decentralization of decision-making to lower levels of government can make the state more responsive and accountable in service provision. But there are many pitfalls to avoid. The chapter will lay out the diversity in the levels and types of decentralization across countries. It will examine the cross-country and country-specific evidence on the efficiency and equity outcomes of decentralization, with an emphasis on identifying the political, institutional, and financial preconditions for successful decentralization. Using examples from large countries like Brazil, China, India, and Indonesia to smaller countries such as El Salvador and Uganda the chapter will analyze what has worked in decentralization and why - and the reasons decentralization has led to perverse outcomes in some circumstances.

The chapter will examine country experiences in assigning expenditures and revenues to different levels of government and designing intergovernmental transfers and revenue-sharing arrangements. The principle of subsidiarity, for instance, suggests that taxing, spending, and regulatory functions should be exercised by lower levels of government unless a convincing case can be made for assigning them to higher levels of government. For some services community operations and use may be the appropriate institutional arrangement for managing local collective action problems (water associations). Recent evidence suggests that local governments and communities may be better equipped at identifying and targeting the poor. And decentralization can increase efficiency when local governments compete for domestic and foreign capital.

Despite these potential benefits, the experience with decentralization has been mixed. The chapter will explore the conditions that have been associated with success and failure. It will explore, for instance, whether local political contestability is a necessary precondition, or whether other forms of accountability - revenue-raising by local governments, economic contestability

across local levels of government, administrative accountability - can also yield successful outcomes. Country experiences with decentralization will also be used to explore other issues such as the risk of rent capture by local elites in particular institutional contexts, the capacity of local governments to formulate and implement policies and programs, the magnitude of the revenue-expenditure mismatch and the design of intergovernmental grants to achieve efficiency and equity objectives, and the rules for local government borrowing.

#### **4.3 Improving the Core Public Sector**

Accountability and transparency can be vital in binding governments to improved performance, and imposing checks and balances to make it costly for politicians and bureaucrats to violate rules and norms. This chapter will review how reforms in core public sector institutions can improve performance along two interrelated dimensions ; better decision - making and improved strategic priorities ; and efficient and effective implementation of policies and programs .

The budget is a principal mechanism to discipline and legitimize decision - making in government. The chapter will review how the reform of budgetary institutions can improve outcomes. A central challenge is how to set strategic priorities within a hard budget constraint. In some countries ( e.g., Georgia, Moldova ) , we will examine how policy making mechanisms can be built up where none existed. In several low-income countries, a principal challenge is to discipline policy making to stay within affordable medium-term limits to achieve strategic outcomes. The dual budget structure in aid-dependent countries contributes significantly to an inherently expansionary bias and creates incentives for governments to continue to live beyond their means. Reforms where medium-term expenditure frameworks with costing systems to force a reconciliation between competing needs (Australia in OECD, ongoing reforms in Malawi and Uganda) might offer useful pointers. Elaborate ex-post evaluation systems to assess whether programs are



meeting their intended goals ( Colombia) is another avenue which will be looked at.

Improving the civil service must be a central element of reforms . The chapter will review alternative paradigms for the reform of pay and employment policies. It will argue that earlier attempts at reducing numbers and raising average pay were important but insufficient. But we may need to look beyond pecuniary incentives. How to provide a good balance between managerial flexibility to set clear goals and appropriate accountability is a central issue? But going beyond that to see how to motivate a public bureaucracy (to establish a spirit-de-corps, pride, respectability) for public service will also be looked into .

Long standing bureaucratic systems in Germany, Japan, and Singapore provide useful pointers to the direction reforms must take. The chapter will also ask : How recent reforms in New Zealand, United Kingdom and others offer examples on improving technical efficiency by instituting private sector incentive-mechanisms? How greater contestability in service delivery - Where feasible - holds an important promise for improving performance ? How client surveys to benchmark and publicly disseminate the satisfaction of beneficiaries (Uganda) and better financial management ( Argentina) can help?

#### **Part Five ; How Can Reforms of the State be Sustained ?**

Borders are becoming more porous. The false dichotomy between state and market is giving way to their complementarity. Citizen action is increasing. Yet most states remain resistant to change. Beneficiaries of the status quo - including politicians, bureaucrats, and corporate or farming interests - will try to slow or derail changes that threaten their position, regardless of the broader social benefits. The Report will not expect to provide definite answers on the political economy of state reform, but will instead take stock of and contribute to our knowledge about ; (1) the role of political contestability, (2) the need for reform strategies to internalize specific obstacles, and (3) the role of international cooperation and assistance.

### 5.1 How to Help Remove the Obstacles to Change ?

Casual observation of wealth and political systems in the world shows that richer countries tend to rely more on democratic institutions. It can therefore be expected that economic progress will lead toward more democratic forms of government. And shift towards greater political contestability in Africa, Latin America, and Eastern Europe is likely to lead to more open and transparent states. Broad contestability, however, is neither necessary nor sufficient for sound economic and social policies, and many countries - Korea ( in the 1970s) , Chile (in the 1980s) and China - have recorded remarkable economic and social progress within what appeared to be non-contestable political systems. In several East Asian countries, emphasis on meritocratic bureaucracy , fiscal discipline, and state institutions to help information and coordination problems in the market have been identified as factors skillfully applied to ensure growth and improve public services - even without overall political contestability.

This chapter will examine how contestability within the public sector - such as improved competition among public entities, among units within government, and among different levels of governments - may help accelerate positive changes and reduce common agency problems. To solidify reform programs , some countries have developed mechanisms and institutions for shared growth (East Asia) or targeted vulnerable groups who may not benefit immediately from the reform- say, by creating social funds (Bolivia, Mexico, Peru) . The benefits of these compensatory schemes must be weighted against the costs of potential political manipulation and institutional fragmentation.

This chapter will also examine countries that dramatically improved their public institutions - often after a fiscal crisis - on how coalitions were formed and sustained. In a growing number of cases in which voters rewarded a political candidate or party for a significant turnaround in economic performance, particularly for the eradication of hyperinflation (Brazil, Peru). Where institutional structures are weak, the quality of political leadership

could be important and the chapter will examine the role, and importance of leadership under different institutional structures and stages of development. Ethnicity is increasingly cited as a major cause of state dysfunction. Successful multiethnic countries Malaysia, - Mauritius - will be analyzed to see how carefully crafted state policies and growth were used to ease ethnic tensions.

## **5.2 Strengthening International Cooperation**

More effective international cooperation will be needed to help nations manage global challenges and take advantage of opportunities. As the relationship between international markets and institutions and nation - states changes, some observers are asking whether the nation - state can survive. Setting that issue aside, this Report will try to show that cross - border problems need cross - border solutions and will require more international cooperations. Some progress is being made as with the establishment of WTO for trade issues and the Montreal Protocol for the environment. But more - much more - needs to be done.

The breakdown of basic functions of the state - as in the Horn of Africa, Rwanda , Somalia, and Liberia have raised issues about reconstruction of state authority. And pressure is increasing for a different type of international assistance for peace-keeping , relief, rehabilitation, and refugees. The Report will address some of the issues relating to the reconstruction of state authority in these dysfunctional states.

The changing state raises serious questions about the role and relevance of foreign aid and external assistance. Foreign aid, under attack from those who claim that it goes to support a moribund and wasteful public sector, is now linked more to issues of governance and human right. And a bigger share of a shrinking aid budget now goes to fund NGO activity or to support the private sector more directly. To the extent that foreign aid has helped preserve large government, its decline can accelerate reforms.

Smaller government, yes. But what about improving the quality of gov-

ernment, and strengthening the state in its performance of key functions? The needed institutional strengthening of the state will require new forms of institutional and technical assistance. A detailed analysis of aid effectiveness is not intended. Instead, some important issues will be raised to help set the agenda for further work.

### **Part Six : Conclusion**

The conclusion will draw together the main policy messages of the Report. Even though countries differ a great deal and have very different state structures, institutional arrangements and organizations, there are strong pressures over the world to make the state a more effective facilitator of economic and social change - a more capable state. In different parts of the world as set out in the Overview the agenda for reform will vary. The following are illustrative examples of possible lessons :-

- The state and its policies explain many differences in people's lives around the globe. It is not the size of the state alone that matters - it is the capability.
- The great (and false) debate between state and market for now seems to be over. There is growing realization that a more credible - not larger - state is needed to create the institutional infrastructure necessary for markets to flourish.
- All over the globe citizens are demanding greater transparency and openness in the conduct of government - cleaner government that delivers services, but also one that effectively mediates competing interests.
- Globalization is making governments generally more responsive and less capricious in their economic actions. Handling 21<sup>st</sup> century problems will require a more agile, information - intensive state working in concert with the international community - not a weak state subordinated to international interests.

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- Reforms are under way - beginning with reducing the size of the state and moving toward strengthening vital state functions and in some cases requiring reconstruction of the state. Introducing greater economic contestability is a key to making state institutions work better.
  - Changes in technology, better appreciation of the capacity of markets and NGOs, greater decentralization to local government and communities, reforms in public sector management - all these have created new opportunities for more competitive and efficient provision of public services.
  - More effective international cooperation will be needed to help nations manage global challenges and take advantage of the emerging opportunities in the 21<sup>st</sup> century as the demand for international collective action grows.