CHAPTER 10

THE AGENDA FOR CHANGE

This report has shown that the state has enormous sway over a country's economic and social development and whether that development is sustainable. The state's potential to leverage, promote, and mediate change in pursuit of collective ends is unmatched. Where this capacity has been used well, economies have flourished. But where it has not, development has hit a brick wall.

The process is not irrevocable: examples through history, and throughout the world, have shown that countries can change track, reforming policies and institutions to improve the state's effectiveness and forward development. But why do so many of these efforts fail to achieve their goals? Even more important, why is it that so many states, in desperate circumstances, do not even attempt them? Politics provides much of the answer. But it is not simply a matter of democracy versus authoritarianism. We need to go beyond those broad concepts of political organization to understand the incentives that inspire state organizations to work better. We need to understand better how and when the economic and political interests that favor development can be harnessed to bring about the institutional changes needed to make development happen.

> ***Efforts to restart development in countries with ineffective states must start with institutional arrangements that foster responsiveness, accountability, and the rule of law.***

Enabling the state to do more good for the economy and society means building confidence; people must have trust in the basic rules governing society and in the public authority that underpins them. The task is difficult for two reasons.

First, it requires patience. It takes time for judiciaries to convince firms and citizens that they are impartial in their decisions. It takes time for national and provincial legislatures, political appointees, judges, civil servants, public-private deliberation councils, independent watchdogs, and nongovernmental organizations—arrayed in unique relations to one another in different societies—to learn to respect the limits of one another's authority and to work together. It takes time to lay the foundations of a professional, rule-based bureaucracy. Still, it is possible to sequence reforms in a manner that yields some early payoffs. Such early measures can include strengthening the capacity of central government, raising upper-end salary scales to attract capable staff, inviting more inputs into policymaking and making deliberations more open, hiving off contestable and easily specified activities for private sector involvement, and seeking more feedback from clients. In general, however, there are few quick fixes.

Second, the task is difficult because the same institutions that can foster credibility and accountability can also be constraining. The same rules that prevent abuse of state authority can also lessen the ability to use that authority well. The challenge is to devise institutional arrangements that provide flexibility within appropriate restraints.

In the end each country must strike its own balance. Countries with strong track records of following through on commitments, and whose state institutions have deep roots in society, are likely to have room to experiment and to respond flexibly to unanticipated events, with little cost to credibility. But countries emerging from long periods of arbitrary and dysfunctional government might be better off forswearing the short-term benefits of flexibility in favor of the long-term goal of building credible and sustainable institutions.

Where prospects for reform are strong, this Report has suggested a two-part approach to improving the effectiveness of the state:

- Matching role with capability, and
- Reinvigorating state capability by subjecting the state to more rules and restraint and greater competitive pressure, and making it more transparent and open.

Focusing limited state capability on the basics is a badly needed first step in a wide range of countries—especially in Africa, the CIS countries, and parts of Latin America, the Middle East, and South Asia.

Matching role with capability must come first. In many parts of the world the state is not even performing its basic functions: safeguarding law and order, protecting property rights, managing the macroeconomy, providing basic social services, and protecting the destitute.

In some cases the state has been overregulating the economy, even though it lacks the capability to enforce regulations systematically. One consequence has been the spread of corruption, which corrodes capability even further—sometimes rendering the state incapable of delivering even basic services. Reasonably well functioning bureaucracies have been weakened over the years and will now need considerable overhaul. Deregulating these economies is vital.

Reforms supported by the World Bank and other international organizations have tried to help countries design reforms to match the state's role to its capability. Many reforms over the last decade or so have tried to trim back the state's role in some areas of the economy and refocus the released resources on core functions. These are a start, but more is needed.

However, as this Report has shown, matching role to capability is not simply a matter of reducing the state's role. It is not just a question of what to do, but also a question of how to do it: how to manage the financial sector, how to regulate economic activity, how to protect the environment—all these choices depend critically on the state's institutional capability.

Efforts to focus the state's existing capability more effectively must be complemented by reforms to improve capability by reinvigorating public institutions. In many areas the state will only be able to improve its effectiveness by forging new partnerships with other organizations of civil society. In other instances it will become more effective only if its decisions and actions can be contested—if people and business have choices and if the state's monopoly is broken.

Improving state capability is not simply a matter of more technical assistance. It takes the right incentives.

The precise recipe for improved state capability will vary from country to country, since so much of the reform involved is institutional, and institutional change is path-dependent. We examine below some of the key opportunities and challenges facing states in each developing region. But the advice is premised on the assumption that there is, at least, a state there to reform. Increasingly, even this basic precondition for improving development outcomes does not apply. We turn first to these most extreme cases of institutional failure, when, for a period, the state itself as a legitimate and functioning order is gone.

When states collapse

In recent years a growing number of countries have seen virtually all of the functions and institutions of government collapse, often in the context of civil war. When the state ceases to perform even its most basic functions, the associated crisis can be prolonged and severe. Structures that might normally mitigate the impact of the crisis and provide a vehicle for eventual recovery are frequently destroyed, making the more generic prescriptions for enhancing state capability somewhat inapplicable.

The causes of state collapse

State collapse is not a new phenomenon. It does, however, seem to have become more common in the 1980s and 1990s than in the earlier postwar years, and it is a matter of grave concern for other states, individually and collectively. Collapsed states such as Afghanistan, Cambodia, Liberia, Rwanda, and Somalia have been the settings for some of the worst humanitarian disasters of recent years. These often spill over into neighboring countries in the form of violence, banditry, and refugee flows. They also send countries into arrears, destroy economic assets and infrastructure, claim huge amounts of international assistance—and, of course, waste countless lives. Three broad and overlapping pathologies of state collapse can be identified:

- States that have lost (or failed to establish) legitimacy in the eyes of most of the population notionally under their authority, and are therefore unable to exercise that authority
- States that have been run into the ground by leaders and officials who are corrupt, negligent, incompetent, or all three
- States that have fragmented in civil war, and in which no party is capable of reestablishing central authority.

What all these states have in common is a fundamental loss of institutional capability. As outlined in Chapter 1 (see Table 1.1), at a minimum the state must perform the most basic functions of maintaining law and order, providing national defense, and establishing a framework for managing economic transactions. A collapsed state, then, is not one that fails to do the right things, but one that fails to do much of anything effectively—even maintain repressive order. A collapsed state is not the same as a state defeated in war, or a state split apart into two or more states, where, despite some incapacity, systems continue to function more or less effectively. Nor is a collapsed state the same thing as a "predatory" or repressive state. Successful repression of a whole population can require considerable organizational capacity. Such acts may provoke the replacement of one state structure or regime with another, as in Cambodia or Rwanda, but do not necessarily—or even probably—bring about its collapse.

Factors perpetuating the conflict

In most countries where the state has collapsed, there are forces that have an interest in perpetuating a state of anarchy, and whose unbridled pursuit of riches or power would be constrained by a state with the capability to make rules, collect revenue, and enforce the law. The most troubling and intractable of collapsed states are those in which these forces predominate. In Angola, Liberia, and Somalia, for example, a self-sustaining economy of armed violence has emerged, based on looting, protection rackets, drug trafficking, money laundering, and the extraction of crude resources such as gems, minerals, and tropical timber (Box 10.1). Civil warfare in these countries has its roots in political or ethnic rivalries, but it has gradually shifted character and is now centered around the control of economic assets, which provide the source of financing for the war and for private enrichment.

In such countries factional warfare is the main system of resource allocation, and violence the source of power. These economies operate independently of any state institutions, and indeed would likely be hindered by them. Thus, strong economic forces are at work perpetuating the fighting. The role of economic factors as a driving cause of the war has been especially pronounced in the case of Liberia (Box 10.2), but it can also explain the prolongation of wars in Angola and Sierra Leone. Ordinary people pay a high price for their helpless proximity to these systems. Normal international economic transactions are disrupted and, often, corrupted by them.

Box 10.1 State collapse and beyond in Somalia

Somalia is one of the most ethnically homogeneous countries in Africa; one of the most common factors in state collapse—interethnic conflict—played no part in its collapse. Rather, the dynamic of Somalia's collapse was set in motion during a long period (1969–91) of dictatorial rule and egregious economic mismanagement by Mohamed Siad Barre, followed by a fierce contest for power after he was violently deposed. Siad Barre played off the Cold War superpowers against each other. His external support, first from the Soviet Union and then from the United States, unbalanced the fragile social ecology of Somalia's clan politics and introduced high levels of lethal weaponry. A north-south conflict inherited from the preindependence era, an irredentist war to seize Ethiopia's Somali-populated Ogaden region, and the suspension of economic and military aid in 1989 all further contributed to the erosion of state capability.

Since 1991, continuous civil war between rival clans and factions has completed the destruction of the formal economy and left Somalia with no state institutional or public administration. Physical infrastructure and economic assets have been destroyed, private businesses looted, and agricultural and pastoral production drastically reduced. Professionals, technocrats, and civil servants have fled. International intervention to halt a major war-induced famine brought a respite and some reconstruction from late 1992 to early 1995, but these gains were reversed after U.N. forces withdrew, and anarchy returned.

Some elements of the private, informal market have shown an extraordinary, if somewhat perverse, resilience to the chaos and violence that surrounds them. Merchants and entrepreneurs can operate only with clan protection; those who benefit from this protection, and from their clan's control of economic assets such as ports, mineral deposits, and agricultural lands, finance clan militias. With no government regulations or controls, the prices of goods and foreign currencies float freely. Transactions costs are high, but markets operate efficiently. The Somali shilling has value despite the absence of a central bank, but banknotes are physically wearing out. Remittances from abroad are handled quickly and reliably through clan networks.

Today, Somalia exemplifies a post-state economy. Productive capacity, private investment, and employment are extremely low; risks are high, and violence is the normal means of competition and resolution of economic disputes. If a functioning state with legitimate institutions were able to restore law and order without reverting to the heavy-handed economic mismanagement of the Siad Barre regime, the private sector has shown that it could weather the high risk and respond to the challenges of the market.

Box 10.2 The economic underpinnings of conflict: The case of Liberia

Initially, the war in Liberia was fought largely for social and political motives, with control over the central government as the central objective. Foreign support helped finance the launching of the war. Gradually control over Liberia's rich natural resources and other assets, in addition to being a means of ensuring funding for the war, has become an end in itself for the fighting factions.

The factions depend on a steady supply of income from the export of rubber, timber, iron ore, gold, and diamonds. During periods of intense conflict, much of the income is used to purchase arms and ammunition. When no fighting is taking place, a revenue "surplus" is created, which provides for the personal enrichment of the leaders and for the payoffs that keep faction members loyal. This, together with the uncertainty that faction members face regarding their economic prospects after the war, creates strong pressures down the ranks to share in the surplus. However, lower-rank fighters rarely receive direct payments, instead relying on looting and pillaging for their livelihood.

Because fighting actually runs down the "surplus," as long as the prospects for private enrichment remain high the incentives are strong for factions to maintain a "no war, no peace" equilibrium. This helps explain the difficulties in reaching a lasting peace agreement in Liberia.

Thus, to restore peace, any intervention will have to include actions that make the "surplus" accruing to the fighting organizations zero or negative, while simultaneously eliminating individual fighters' income from looting, or raising the associated risk. Such actions range from economic sanctions on the export of timber and rubber exports to international agreements that increase the cost of arms. In addition, combatants' incentives to continue the war must be removed through a combination of carefully planned demobilization and enforcement of criminal laws.

Although the diminishing returns of conflict and resource extraction imply that wars will eventually fade away without international intervention, this point is reached only after nearly all the assets of a country have been destroyed. This leaves other states, and intergovernmental organizations, facing two urgent questions: How can state collapse be prevented? And how can a functioning state be rescued from the ashes of a collapsed one?

Preventing state collapse

The enormous toll of collapsed states has naturally turned attention to prevention as a preferable and potentially less costly course of action. But there are no easy shortcuts. Preventing state collapse ultimately involves the whole gamut of institutions and policies that affect social, political, and economic relations within a society. Nevertheless, two interrelated approaches have emerged as ways of reducing the likelihood that political conflict will spiral down into a comprehensive collapse of the state.

The first strategy emphasizes the reinforcement of civil society as a way of increasing the resilience of social institutions that may be able to fend off anarchy even if the state is very weak. A rich associational life may enable communities to maintain local law and order, support a safety net, and resist official corruption or exploitation. The second approach, drawn from the East Asian experience, points to the need to build bureaucratic structures that are insulated from political interference, and to embed bureaucratic decisionmaking within appropriate restraints. The integrity and professionalism of the civil service are an important element in this.

An active civil society and a competent and professional bureaucracy are twin pillars of a constructive relationship between state and society. When comprehensive collapse of the state is a danger, these twin pillars may reduce the risk.

The challenge of reconstruction

Rapid retrieval of a lost state is even more difficult—if not impossible. Most collapsed states are immersed in, or just emerging from, bitter internecine conflict. Politics is often highly charged with suspicion of complicity; mistrust is widespread. Cooperation among former rivals is difficult to achieve, and the desire for justice on the part of some may look like vengeance seeking to others. There may be little confidence that peace will be sustained, or policies maintained, and social and human capital has often been severely damaged.

External actors face unusual difficulties when they decide to become engaged in a country without a functioning state. A basic question arises: how and with whom should one work? One strategy involves choosing among local factions or leaders and attempting to reinforce the position of the chosen partner. This is risky. The chosen partner may be unreliable or may abuse the position of leadership. There is also the risk that another external force will pick an alternative winner, prolonging the conflict, as occurred in Mozambique and Angola. Alternatively, outsiders can choose to work with those local authorities and institutions that often retain legitimacy and capability long after central institutions collapse. Such a strategy can help rebuild local confidence and strengthen local decisionmaking capacity. But it can also prolong the period of state fragmentation if it is not combined with a strategy for rebuilding the authority of a central government. Somalia is a case in point.

In many instances external actors focus on mitigating the human cost of state collapse through relief and rehabilitation programs, rather than intervening directly in civil or political reconstruction. Recent experience suggests, however, that after some time these programs can lead to dependency among the population, and even undermine the rebuilding of state capability by drawing attention away from minimal state functions. By contrast, more-comprehensive peace approaches, such as adopted in Angola, Cambodia, and Mozambique, place far-reaching formal authority in the hands of international organizations to oversee peace agreements, deliver public services, and facilitate the repatriation of refugees. All this is with a view to handing over power to an indigenous authority after elections have been held. The international operations in Cambodia and Mozambique are generally considered to have been successful in this regard. But both were enormously costly, and external actors cannot and should not be expected to replace absent state capability indefinitely.

The choice of strategy for external actors will differ according to the particular pathology of state collapse involved. As the discussion in Chapter 8 suggests, there is an increasing awareness of the role that external donors and agencies may need to play in the future to allow for the long process of reconstruction and rehabilitation. Some of the challenges facing external actors are mentioned below.

REESTABLISHING SECURITY. The end of civil war does not lead automatically to the end of insecurity. Fear of personal violence or theft may actually increase after the war, and without measures to increase the opportunity cost of warfare for individual combatants, the end of the war may signal increased opportunities for criminal activity. Well-designed demobilization programs, like that in Uganda, that assure combatants of their reintegration into civil society after the war, and so give them a legitimate exit strategy, are therefore a priority. Also essential will be efforts to strengthen local police forces and tighten enforcement of criminal laws and other measures, to reduce the risks of banditry and criminal enterprise. The long-term response, however, must be to address the socioeconomic root causes of the conflict.

ECONOMIC RECOVERY. Although the elements of a postconflict stabilization and recovery program may differ little from programs applied elsewhere, there are grounds for caution and for examining the components of the standard policy package in light of the conditions and distortions peculiar to the postconflict environment. Civil conflict erodes the social capital that inspires trust and facilitates investment. Consequently, fear may be a bigger obstacle to the revival of investment than damaged infrastructure. Policies to spur the private sector's recovery should therefore avoid overly aggressive increases in taxation and should stress the early sequencing of investment-sensitive reforms, including the preservation of low inflation, the sale or restitution of expropriated housing stock, and restraint in revenue collection. Avoiding aggressive revenue collection does not, however, mean offering overly generous tax incentives for private foreign investment. As Cambodia's experience now shows, these may be counterproductive, depriving the government of substantial revenue for many years and taking government further from the all-important task of reviving domestic investment.

PROMOTING FUNDAMENTAL SOCIOPOLITICAL RECONCILIATION. Economic policy and sectoral projects need to be tailored to take account of the special problems of traumatized populations and societies with heavily damaged social capital. The sequencing of standard economic policy reform and of governance measures also needs to be tailored to avoid threatening the sustainability of peace agreements and to take account of the typically severe distortions in economic conditions.

BUILDING CAPABILITY. The problem at the heart of attempts to sustain recovery and reconstruction in postconflict situations is lack of capability. Yet even where effective macroeconomic and political reforms have been undertaken, improvements in bureaucratic capability have often lagged well behind (as in Uganda, for example). Various options have been tried to jump-start the capacity-building process, including drawing on a diaspora of professionals to occupy positions within the new government (as in Cambodia, Lebanon, and Haiti) and providing foreign experts to work as advisers to their local counterparts. As the strategy for enhancing state capability implies, conventional technical assistance is rarely effective in settings where even minimal rules and restraints on arbitrary action are lacking. The absence of such rules is a defining feature of a failed state. Thus, it is vital that imported technical assistance come with efforts to implement and enforce the most basic rules of accountability and restraint within government and so begin to rebuild its lost credibility.

The collapse of a state is an extreme phenomenon, and each case is unique. Hence there are no simple generalizations about their causes or effects. Each produces its own challenges for the afflicted nation and for the international system. The consequences are, however, almost uniformly borne by ordinary people, illustrating once again the critical importance of an effective, responsive state to the long-term health and wealth of society.

Some regional steps—and missteps

Inevitably, the elements of any strategy for improving the state's effectiveness will differ hugely from country to country, according to the institutional and political setting. The key features and challenges facing states in various regions are summarized below. These are necessarily broad generalizations: each region includes several countries whose experiences are entirely different.

It is in *Sub-Saharan Africa* that the deterioration in the state's effectiveness has been most severe—the result of eroding civil service wages, heavy dependence on aid, and patronage politics. There are a few exceptions, such as Botswana. But a recent report commissioned by a group of African finance ministers, echoing themes raised in the preceding chapters of this Report, concluded that the majority of countries in Sub-Saharan Africa now have lower capability (including state capability) than they did at independence. As a consequence, many are trapped in a vicious circle of declining state capability and, thus, declining credibility in the eyes of their citizens.

There is a crisis of statehood in much of Africa—a crisis of capability and of legitimacy.

The first part of the two-part strategy recommended by this Report is perhaps the more urgently needed in Sub-Saharan Africa. A sharp refocus of the state's priorities is badly needed. In a few cases this refocus has taken place, although only after protracted crisis. Typically, the reach and effectiveness of the state have withered away, and perforce the state has in effect withdrawn. Unfortunately, since the refocus has not been carefully managed, the state has also weakened or withdrawn from areas that are its legitimate function. An institutional vacuum of significant proportions has emerged in many parts of Sub-Saharan Africa, leading to increased crime and an absence of security, affecting investment and growth.

Achieving a turnaround in the effectiveness of the state will not be easy, since the roots of state failure are many and complex. Chief among them has been a continuing struggle between traditional forms of governance and social organization (often based on tribes, lineages, and language and kinship groups) and modern forms of government. High military expenditure and dysfunctional behavior of military personnel (in the absence of other checks and balances) have been other important impediments. These have often reduced the transparency and accountability of public institutions to the extent that governments have felt a decreasing need to explain and justify their actions to the domestic population.

The urgent priority in Africa is to rebuild state capability through an overhaul of public institutions and credible checks on the abuse of state power.

The clear need in most African countries is for a thorough reform of the machinery of the state, so that it can deliver quality public services and facilitate private activity rather than impede both. As this Report has emphasized, the second part of the strategy—rebuilding capability—must also start on an urgent footing. In this it is essential to start in some areas of priority. Strengthening the rule of law must be a vital first step. Another is to strengthen the capability for legislative oversight of the executive. But strengthening the executive—particularly the central government's capacity to formulate macroeconomic and strategic policy, and its incentives to deliver core public goods efficiently—is also a key priority. Disappointingly, with some promising exceptions (Botswana and more recently Uganda), improving the effectiveness of the state in Africa has generally been limited to tinkering around the edges and to promulgating reforms on paper. But there are signs that these issues are now being taken seriously. Recent reform programs pay much greater attention to institutional strengthening, and macroeconomic management is improving across a broad swath of African economies.

An important constraint on systemic institutional reform of the state in Africa is its cost, but resources can be found if the priorities are clear. Most countries will need to redirect existing, misallocated resources to raise real public wages (more than proportionately to any savings from further retrenchment), increase spending on social services, and undertake vast investments in personnel management, retraining, and accountability. This major rebuilding of state capability cannot happen without international assistance. But an exceptional degree of cooperation between governments and external agencies has culminated in a pattern of external dependency. The types of assistance and the incentives it generates also need to be reexamined, to ensure that assistance supports coherent and well-contested policies and strengthens the overall framework of incentives within and outside the state. Prioritizing and even strategic enclaving are necessary, to start the reform process, but must be part of a well-thought-out plan to broaden and deepen the reforms.

Improving the delivery of public and collective services will require closer partnerships with the private sector and civil society. Such partnerships should be encouraged, especially when the links between the state and civil society are underdeveloped.

A hopeful recent development is a growing array of self-help community initiatives, particularly in elementary education, basic health care, and local services such as waste disposal. These initiatives have often sprung from the state's own failure to provide such services effectively. Although they can seldom fully substitute for a well-functioning government administration, they offer a partial escape from the current morass. That said, it is difficult to imagine how reform of the role of the state and improvement in its capability can be realized in most African countries without the stronger incentives that this Report also recommends: more competitive pressure, greater voice and transparency, and rules and restraints including the rule of law.

The situation in Asia is different. In the newly industrializing countries of *East Asia,* the state is generally viewed as effective, engaged in a productive partnership with the private sector. With few exceptions, it has matched its role to its capability very well and thereby enhanced its effectiveness. Whereas ineffective authoritarian states have been directly responsible for economic decline in Africa, many East Asian countries have experienced remarkable growth (with some improvement in equity) under authoritarian regimes. As the previous chapter implied, the link between authoritarianism and economic decline, so evident in Africa, has been inoperative in Asian countries, largely because of their powerful commitment to rapid economic development, strong administrative capability, and institutionalized links with stakeholders such as private firms, as well as their ability to deliver on the economic and social fundamentals: sound economic management, basic education and health care, and infrastructure.

In East Asia the state's ability to change in response to important new challenges will be critical to the region's continued economic success. At the same time, steps to modernize public administration and achieve effective decentralization will be critical.

Yet throughout East Asia there are major new challenges to the role and functioning of the state. China and Vietnam, the region's transition economies, are struggling with the need to redefine the state's role in the enterprise and financial sectors. Both countries have combined rapid growth with the maintenance of large public enterprise sectors, but these sectors appear increasingly fragile financially. There is also a continuing debate in these economies about the potential role for an activist industrial policy in guiding investment. However, the conditions facing these two economies appear to be very different from those prevailing in Japan and the Republic of Korea in their early stages of industrialization (Chapter 4).

Throughout the region substantial economic rents (flowing from legal monopolies or restrictions, or from influence and corruption) continue to coexist with great private sector dynamism and international engagement. Tolerance of these rents is probably declining—witness the recent anticorruption offensives in China, Korea, and Vietnam. And heightened international competition may mean that inefficient, protected sectors can no longer be carried on the shoulders of dynamic and efficient ones, either in Japan and Korea or in the newly emerging economies.

This suggests that deeper, modernizing reforms will be needed in much of East Asia to develop robust regulatory structures to support competition and, in areas of continued government action, mechanisms to ensure greater transparency and accountability. Particularly vital for these countries' long-term development prospects will be more efficient financing and delivery of infrastructure in partnership with the private sector. Although many high-profile projects are under way, East Asia needs to move faster in developing regulatory frameworks for creating competition, managing the contracting process, and regulating monopolies.

At the same time, many East Asian societies are likely to face new areas where enhanced state action is called for. These are likely to include formal mechanisms such as social and health insurance schemes, to help manage the new risks facing individuals and households in increasingly urbanized and aging societies, and more vigorous efforts to protect the environment. Public action will also be needed to reach those left behind by rapid development, for example the rural populations in some inland provinces of China, the relatively poorer populations of eastern Indonesia, and, in some countries, ethnic minorities. New mechanisms to respond to rising inequality may also be needed, for example in China, Malaysia, and Thailand.

Finally, many countries in the region face a need to build more-effective core government institutions (following the agenda laid out in Chapter 5) and address the problem of corruption (Chapter 6). Institution building is a high priority for those countries where the civil service is relatively weak (Indonesia, for example) and where traditional state capabilities have eroded somewhat (such as the Philippines and Thailand). Efforts to build bureaucratic capability at lower levels of government are also urgently needed in countries such as China, Indonesia, the Philippines, and Vietnam, where the decentralization of some government functions puts power in the hands of lower-quality staff and raises risks of local government capture (see Chapter 7).

The situation is different in South Asia, where in many countries state inefficiency and corruption have coexisted with a relatively competent and

efficient civil service, albeit one whose quality has suffered a noticeable decline.

South Asia, too, suffers from a mismatch between the state's role and its capability. Here it is not that the state's capability was historically weak, as in Africa. In fact it was not, but the state pursued an overly activist agenda that went well beyond its capability. As a result, development suffered, and over time the state's capability declined as well. The agenda now is to refocus the state's role to match its current capability, stem its further decline, and improve that capability.

The main issue in South Asia is overregulation and an overextended state—both cause and effect of bloated public employment, and the surest route to corruption. As stressed in Chapter 4, regulatory simplification and public enterprise reform, and the resulting contraction of the role of the state, will be complex and politically difficult. But such measures stand to boost economic efficiency, increase competitive pressure, reduce corruption, and produce substantial fiscal savings. Another imperative is to build stronger partnerships with, and listen more effectively to, business and civil society, to improve feedback and supplement the state's capability.

Pervasive political interference is a second major barrier to state effectiveness in many countries of the region. As discussed in Chapter 5, India's bureaucratic capability suffers not merely from legendary amounts of administrative red tape, but from the fact that the autonomy of its highly qualified civil servants is severely circumscribed in practice (despite statutory protection from interference in their individual actions) by frequent, often politically motivated transfers of personnel and other arrangements.

In Pakistan the machinery of the state has come increasingly under pressure from powerful business and feudal interest groups. More recently the resulting erosion of state authority and effectiveness has spurred an attempt to reform the very machinery of the state. Here, too, a competent civil service, allied with an activist judiciary, offers grounds for optimism that reform is not only possible, but will occur. In Bangladesh, recent political developments have also created conditions for beginning to address the decline of the state's authority and effectiveness, using the pillars of strong top-level political commitment, popular participation, and decentralization, buttressed by competent and professional elements of the civil service. Similar possibilities for improving government and streamlining public administration are emerging elsewhere in the region.

As noted earlier, substantial differences exist among countries in all regions, and regional generalizations are useful only as a first approximation. This is particularly true of the countries of *Central and Eastern Europe* (CEE) and the *Commonwealth of Independent States* (CIS), now undergoing the transition from central planning. There are also broad differences between the CEE countries as a group and the CIS countries. Although both face a common challenge of economic and political transformation—and hence of a fundamental refocusing of state activities—the CIS countries (except Russia) face the gigantic, and historically unique, double challenge of economic transformation *and* state building: they have had no central government within living memory, nor have they constituted for centuries (most never) independent political entities within their present boundaries.

The challenge of bringing more effective government to these transition economies is in some ways easier and in other ways more difficult than—but certainly quite different from—that faced in most developing economies. The first part of the two-part strategy, that of matching role to capability, is critical, but especially difficult in a situation where both role and capability are changing rapidly. The extent of deterioration in capability varies enormously, with islands of excellence in a sea of declining effectiveness and huge problems of basic governance. In this context matching role to capability is not a simple matter of focusing on the fundamentals. It is not that the fundamentals are not critical—without them progress toward a market-based economic system will be rocky. But the challenge in these countries is providing these fundamentals while at the same time maintaining existing centers of excellence that have been developed over time, and providing the population with the mechanisms of social protection to which they are accustomed. Given the inherent capabilities of a highly educated, socially conscious population, the task of rebuilding state capability—the second part of the strategy—is here more than elsewhere one of changing incentives and the culture of bureaucracy. How quickly this reorientation is managed will determine how quickly the transition is completed.

The job of reorienting the state toward the task of "steering, not rowing" is far from complete in Central and Eastern Europe. But most countries have made progress in refocusing the state's role and are on the way to improving capability and accountability.

It is no surprise, then, that improvements in the effectiveness of the state have been more noticeable in CEE, especially in countries such as the Czech Republic, Hungary, and Poland. Much of this has come from a very swift refocusing of the state's role—part one of the two-part strategy. However, progress in southeastern Europe has generally been much less significant, both in terms of policy reform and on the public administration front.

In particular, several CEE countries have made advances toward setting up competitive systems for service delivery and toward relying much more on the private sector (including, in part, for education and health care). Autonomous professional associations are also beginning to take root in these countries, with healthy potential implications for institutional capability outside the government (capability that is needed to help implement the reforms) and for the rebuilding of social capital. And substantial regulatory reform and simplification have occurred, aided by support from the European Union. Again, in southeastern Europe progress in all these areas tends to have been much slower. The difficulty is not so much a lack of consensus on the desirability of these reforms, but a severe lack of capability at the core of government to formulate and guide them—compounded, in some countries, by a fluid political situation.

Low state capability in the former Soviet republics is a serious and mounting obstacle to further progress in most areas of economic and social policy.

In the CIS the process of reorienting the state is still at an early stage, and a host of severe problems have emerged. Unlike in CEE, in the CIS there is often no clear definition of the state's new role. And even where it is clear in principle, in practice weak central capacity has made it extremely difficult to translate those principles into reality. In most cases the basic institutional structures for an effective state are weak. The first and fundamental problem is the weak accountability of the executive to the legislature in most CIS countries. In the very early 1990s, parliaments in most of the new countries were the only repository of whatever political legitimacy existed after the collapse of the Soviet Union. There were even instances of excessive interference by the legislature in routine executive functions (which remains a problem in Ukraine). But the situation in most countries today is one of a dominant executive and weak legislative oversight.

Beyond the issue of increasing executive accountability, three further sets of problems face most CIS countries. Between them these problems not only produce enormous economic costs, but also give rise to pervasive corruption. This last is rightly decried almost everywhere in the region, and confirmed in the results of the survey of private business commissioned for this Report. First, weak and slow judicial systems severely handicap both reform and economic activity. As is well known, weak enforcement of the law and weak judicial procedures have permitted the unprecedented rise of organized crime. Second, fuzzy boundaries between private and public property rights have generated massive rent seeking, with officials often exploiting public assets, including those of state enterprises, for private profit. Third, opaque and still hugely complex regulatory frameworks have fueled corruption across the spectrum of interactions between the public and the private sectors.

Outside assistance and encouragement—to tighten the accountability of executives to legislatures, to strengthen legislative oversight capacity, to streamline and reinforce judicial systems, to clarify property rights and provide for accountable management and oversight of public assets, to radically simplify the regulatory framework and move rapidly toward rules and away from discretion, and, not least, to bring criminal activities under control and sever their links to the public sector—are clearly essential to improve the functioning of the state and promote economic recovery throughout the region.

Genuine administrative reform to improve bureaucratic capability has been conspicuous by its absence in most CIS countries. Staffing of central government tends to be low, and although government workers are often highly educated and technically knowledgeable, they lack the skills needed for administration in a noncommand economy. They are, moreover, deprived of basic supplies and resources and very badly paid. Unsurprisingly, during the first stage of the economic transformation, attention and financial resources were devoted to the urgent tasks of privatization, to reforming the price and foreign exchange system, and to establishing some measure of fiscal and monetary control. But it is equally unsurprising that the next stage of the transformation, that dealing with reforms that require decisive and clear administrative action, is now severely hampered by the absence of the mechanisms and of the government personnel and resources necessary to implement those reforms.

The role of the state in *Latin America and the Caribbean* has been undergoing profound change over the past decade, fueled by fiscal crisis and rising expectations born of the return of democracy and the emergence of civil society. Competitive pressures from globalization have made it increasingly urgent for government to privatize or to contract out activities in which it lacks comparative advantage, and to improve its efficiency and effectiveness in producing public goods.

But while the first-stage reforms have been implemented successfully in a number of countries in the region, progress has lagged in the second-generation reforms, where institutional change is vital. For example, civil service reform and reforms in the social services are being held back by political constraints and vested interests. Such reforms (recently begun in Argentina and a few other countries) cannot be undertaken in isolation, but must be part of a broader decentralization of political administration and financial management, already under way in many countries.

Governments in Latin America are rethinking their approach to the alleviation of poverty, particularly important in a region with highly skewed income distributions.

A number of Latin American countries, having launched major economic and structural reforms, have now created social investment funds for the poorer segments of society. At a broader level, governments in the region have been faced with the bankruptcy of highly inequitable, state-run, pay-as-you-go pension systems. Chile privatized its system in 1981, reducing the role of government to that of regulator; other countries (Argentina and Colombia, for example) have pursued dual systems. A third group of countries are just now starting to contemplate how pension reform should proceed. But more aggressive action will be needed on the social fundamentals, to complement reform on the economic fundamentals, if Latin America is to compete with East Asia.

The priority in Latin America is to reinvigorate the institutional capability of the state, and here some major initiatives are under way. Both unitary and federal states have turned to decentralization, particularly to improve service delivery. Authority and responsibility for both revenue and spending have been transferred, although often these have been mismatched at first. Strengthening institutional capability at the provincial and the local level is a major challenge in countries with federal systems, such as Argentina and Brazil, which have a legacy of overly indebted local governments and weak state or provincial banks. Nevertheless, examples abound of successful local government reforms (for example, through public-private partnerships) emerging in time of crisis, where dynamic local leaders have been able to foster reforms on a manageable scale.

Decentralization of power and of spending, coupled with democratization, has dramatically transformed the local political landscape in Latin America, in what some have called a "quiet revolution." A new model of governing is emerging in the region.

The first stages of local reform in Latin America, covering roughly the period 1983–90, created an institutional environment that nurtured a fresh generation of office seekers, more professional and more reformist than their predecessors. Leaders in scores of cities were drawn by the ineluctable logic of popular participation as a natural means of sounding out the wishes of voters. This same logic led to a strengthening of the fiscal link between government and the governed, making more obvious the connection between the public works and service improvements that neighborhood residents say they want, and the payment burdens that authorities say residents must bear to achieve cost recovery. For instance, many local governments tie improvements to user fees or betterment levies, or rely on referendums. Traditional models of government take this exchange—payment for goods and services rendered—as axiomatic. But four decades of centralized systems in Latin America and the Caribbean have broken this unspoken bargain of trust, and poor cost recovery and low tax revenues are just two of the consequences. The outstanding feature of the new style of governing, and one bright prospect for the future, is the restoration of this critical fiscal link at the local level.

Governments are also moving to create more open administrations, reflecting the emergence of a more forceful civil society (media, private think tanks, nongovernmental organizations) demanding greater access to decisionmaking, particularly in the Commonwealth Caribbean through citizens' charters (in Jamaica, for example). Efforts are under way in countries such as Colombia to develop performance indicators (of economy, efficiency, effectiveness, service quality, and financial performance) that will provide accountability for public sector managers and politicians.

Court systems in most Latin American countries have suffered from major inefficiencies, widespread corruption, and political interference. For the new legislative and institutional structures to work effectively, the judicial system must work well and fairly. Needed reforms, already under way in a number of countries (including Bolivia, Ecuador, Trinidad and Tobago, and Venezuela) include legal education, better court administration and case flow management, and procedural reform, including the development of alternative dispute resolution systems outside the courts. Efforts are also needed to strengthen the criminal justice system, to address the growing problem of crime and violence, which is partly related to drug trafficking in the region.

In the Middle East and North Africa, unemployment is by far the single greatest economic and social problem and makes government downsizing especially difficult.

Countries in the *Middle East and North Africa* assigned vast economic responsibilities to the state in the 1960s and 1970s. More recently, governments have trimmed back their roles to some extent, but much remains to be done, within government and in the state enterprise sector. There has also been no proportionate slimming of the large civil services built up in those earlier years. With a few exceptions (Tunisia is one), regulation is excessive, as is state involvement in economic activity, and delivery of public services is inefficient.

Skilled civil servants are often in short supply, and the delivery of public services is often inadequate. Overregulation has produced a bloated work force, pervasive interference in private economic activity, and widespread corruption. Little effort has been devoted to streamlining agencies and improving state efficiency. And the system's capacity to change has slowly atrophied over time. Regional conflict has also distracted attention from state reform, but the end of the Cold War, the conclusion of the Gulf War, and the change in attitudes brought about by the peace process have led governments in the region to begin to give the issue more attention.

The first steps in most countries in this region must be to prevent any further growth in central government employment, and to liberalize the economy. These steps have begun in a few cases. Because the political and social difficulties of reform are considerable, although not insurmountable, one approach might be to decentralize selected services to improve responsiveness and accountability, and focus on selective state enterprise reforms while preparing the ground for more comprehensive state reform.

In the countries of the *Organization for Economic Cooperation and Development (OECD),* where the overall capability of the state is high, efforts are ongoing to improve its effectiveness. Driven in part by globalization and technology, changes are under way that will open greater opportunities in many OECD countries for government to enter into partnerships with the private sector and civil society, especially in the area of social insurance and assistance.

Some of the most comprehensive reforms of the state worldwide have occurred in OECD countries, driven primarily by the rising cost of government and citizens' demands for more value for money. It is too soon to render a definitive judgment on most of these efforts. But the depth of dissatisfaction with the effectiveness of the state in these countries suggests that the search for more effective government, for better public services at lower overall cost to society, will and must continue.

Even small steps can make a big difference to the state's effectiveness, leading to better standards of living and opening opportunities for more reforms. The challenge is to take those small steps that can open the way to virtuous cycles.

The two-part strategy laid out in this Report is only a broad guide for the many different agendas of reform being pursued throughout the world. Likewise, international assistance for state reform must go beyond a one-size-fits-all approach, or one based on donors' preferences rather than recipients' needs. It must be based on a clearer diagnosis of the case at hand and of how reforms would fit into broader political and social changes going on in each country.

An important component of the reforms discussed in this Report is institutional, and so will take time. Quick-fix capacity-building solutions have been attempted over the past twenty years, with limited impact. These efforts have focused largely on training, on building skills, and on importing technical systems. They have not focused on incentives, which come from competitive pressures, partnership, and transparency, and from rule-based systems. Reforms pushed forward too rapidly can produce new risks as well: they may be blocked by those likely to lose from change, and the danger is always present that the reforms will lead to fragmentation and the creation of an institutional vacuum.

International cooperation and decentralization are a potentially positive trend, since they create the opportunity to improve international collective action and the delivery of local public goods. The two trends, in fact, reinforce each other. But the gains will be realized only if the pitfalls are avoided. International cooperation will yield gains only if countries believe that they will benefit from international integration. This can happen only if the risks and uncertainties of globalization—for households, workers, the poor, and the vulnerable—are skillfully handled. Decentralization will also need careful management to ensure that the costs, such as loss of macroeconomic control and rising regional inequalities, do not overwhelm the benefits.

In the past, it seemed clear that reform delayed was growth merely deferred, that the cost of missing an opportunity to reform would be, at worst, continued stagnation. But a deeper understanding of the way in which declines in state effectiveness and credibility—and resistance to reform—can magnify over time, coupled with examples of collapsed states at the end of these downward spirals, suggests the costs are far greater. If governments cannot grasp the nettle of improving their effectiveness and reinvigorating public institutions, the prospects for significant improvement in economic and social welfare, in some countries, may be bleak indeed.

The approach of the twenty-first century brings enormous promise of change and reason for hope. In a world of dizzying changes in markets, civil societies, and global forces, the state is under pressure to become more effective. But it is not yet changing rapidly enough to keep pace. There is no unique model for change, and reforms will often come slowly, because they involve fundamental alterations in the roles of institutions and in interactions between citizens and government. This Report has shown that reform of state institutions is a long, difficult, and politically sensitive task. But if we now have a better sense of the dimensions of the challenge, we are also now much more aware of the costs of leaving things as they are.