

# PART TWO

## MATCHING ROLE TO CAPABILITY

AS PART ONE HIGHLIGHTED, AN EFFECTIVE STATE PROVIDES VITAL INGREDIENTS for development. This part of the Report argues that governments will achieve better results by being realistic in what they set out to accomplish. They must strive to match what they do—and how they do it—to their institutional capabilities, not to some idealized model.

Where government has a long record of failure, seeking a better match between the state's role and its capability can sound like a recipe for dismantling the state altogether. But market development without a functioning state is not an option. Rather, as Chapter 3 explains, the point is to prioritize. In many countries the state is still not securing the economic and social fundamentals: a foundation of lawfulness, a benign (and stable) policy environment, basic social services, and some protection of the vulnerable. At the same time, it is overproviding many goods and services that private markets and voluntary initiative could deliver instead. For development to proceed, such governments need to go back to the basics.

Chapter 4 explores how governments can find the right match between role and capability in a second area of policy where the state's behavior will inevitably make a large difference to development outcomes: regulation, liberalization, and

industrial policies designed to foster markets. Markets and society need and benefit from effective regulation of certain activities. But many states are stifling private sector development by overregulating or, often, monopolizing large chunks of the economy by attempting complex strategic interventions in industry that are beyond their institutional capabilities. Deregulation, privatization, and less demanding approaches to regulation and industrial support in these circumstances will deliver large and immediate payoffs.

These chapters carry four basic messages for policymakers:

- States at all levels of institutional capability should respect, nurture, and take advantage of private and voluntary initiative and competitive markets.
- States with weak institutional capabilities should focus on providing the pure public goods and services that markets cannot provide (and that voluntary collective initiatives underprovide), as well as goods and services with large positive externalities, such as property rights, safe water, roads, and basic education.
- Credibility is vital for success. States with weak institutional capabilities should also focus on the tools for policymaking and implementation that give firms and citizens confidence that state officials and organizations will not act arbitrarily and will live within their fiscal means.
- Matching role to capability is a dynamic process. As institutional capability develops, states can take on more difficult collective initiatives (initiatives to foster markets, for example), and use efficient but difficult-to-manage tools for collective action, such as sophisticated regulatory instruments.