

EMBARGO Not for publication or broadcast until 3 p.m. EDT (1900 GMT) Wednesday, June 25, 1997

WORLD DEVELOPMENT REPORT 1997

17300



STATE



SELECTED WORLD DEVELOPMENT INDICATORS

WORLD DEVELOPMENT REPORT
1997

THE
STATE
IN A
CHANGING
WORLD

PUBLISHED FOR THE WORLD BANK

OXFORD UNIVERSITY PRESS

Oxford University Press

OXFORD NEW YORK TORONTO DELHI BOMBAY CALCUTTA
MADRAS KARACHI KUALA LUMPUR SINGAPORE HONG KONG
TOKYO NAIROBI DAR ES SALAAM CAPE TOWN MELBOURNE
AUCKLAND

and associated companies in

BERLIN IBADAN

© 1997 The International Bank for Reconstruction and
Development / The World Bank
1818 H Street, N.W., Washington, D.C. 20433, U.S.A.

Published by Oxford University Press, Inc.
200 Madison Avenue, New York, N.Y. 10016

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Interior design and typesetting by
Barton Matheson Willse & Worthington.

Manufactured in the United States of America
First printing June 1997

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ISBN 0-19-521115-4 clothbound
ISBN 0-19-521114-6 paperback
ISSN 0163-5085



Text printed on recycled paper that conforms to the American Standard
for Permanence of Paper for Printed Library Material Z39.48-1984

FOREWORD

WORLD DEVELOPMENT REPORT 1997, THE TWENTIETH in this annual series, is devoted to the role and effectiveness of the state: what the state should do, how it should do it, and how it can do it better in a rapidly changing world.

These issues are high on the agenda in developing and industrial countries alike. For many, the lesson of recent years has been that the state could not deliver on its promises: transition economies have had to make a wrenching shift toward the market economy, and much of the developing world has had to face up to the failure of state-dominated development strategies. Even the mixed economies of the industrialized world, in response to the failures of government intervention, have opted for a decided shift in the mix in favor of market mechanisms. Many have felt that the logical end point of all these reforms was a minimalist state. Such a state would do no harm, but neither could it do much good.

The Report explains why this extreme view is at odds with the evidence of the world's development success stories, be it the development of today's industrial economies in the nineteenth century or the postwar growth "miracles" of East Asia. Far from supporting a minimalist approach to the state, these examples have shown that development requires an effective state, one that plays a catalytic, facilitating role, encouraging and complementing the activities of private businesses and individuals. Certainly, state-dominated development has failed. But so has stateless development—a message that comes through all too clearly in the agonies of people in collapsed states such as Liberia and Somalia. History has repeatedly shown that good government is not a luxury but a vital necessity. Without an effective state, sustainable development, both economic and social, is impossible.

History and recent experience have also taught us that development is not just about getting the right economic

and technical inputs. It is also about the underlying, institutional environment: the rules and customs that determine how those inputs are used. As this Report shows, understanding the role the state plays in this environment—for example, its ability to enforce the rule of law to underpin market transactions—will be essential to making the state contribute more effectively to development.

The pathways to an effective state are many and varied. The Report makes no attempt to offer a single recipe for state reforms worldwide. It does, however, provide a framework for guiding these efforts, in the form of a two-part strategy:

- First, focus the state's activities to match its capability. Many states try to do too much with few resources and little capability. Getting governments better focused on the core public activities that are crucial to development will enhance their effectiveness.
- Second, over time, look for ways to improve the state's capability by reinvigorating public institutions. The Report puts particular emphasis on mechanisms that give public officials the incentive to do their jobs better and to be more flexible, but that also provide restraints to check arbitrary and corrupt behavior.

Drawing from examples of successful and unsuccessful states, and of state reform around the world, the Report elaborates this two-part strategy and shows how it can be implemented from a number of starting positions. Significantly, although there is an enormous diversity of settings and contexts, effective states clearly do have some common features. One is in the way government has set rules underpinning private transactions, and civil society more broadly. Another is in the way government has played by the rules itself, acting reliably and predictably and controlling corruption.

Building a more effective state to support sustainable development and the reduction of poverty will not be easy. In any situation many people will have a vested interest in keeping the state as it is, however costly the results for the well-being of the country as a whole. Overcoming their opposition will take time and political effort. But the Report shows how opportunities for reform can open, and widen, with the help of careful sequencing of reforms and mechanisms to compensate losers. Even in the worst of situations, very small steps toward a more effective state can have a large impact on economic and social welfare. As we approach the twenty-first century,

the challenge for states is neither to shrink into insignificance, nor to dominate markets, but to start taking those small steps.



James D. Wolfensohn
President
The World Bank

May 30, 1997

This Report has been prepared by a team led by Ajay Chhibber and comprising Simon Commander, Alison Evans, Harald Fuhr, Cheikh Kane, Chad Leechor, Brian Levy, Sanjay Pradhan, and Beatrice Weder. Valuable contributions were made by Jean-Paul Azam, Ed Campos, Hamid Davoodi, Kathleen Newland, Kenichi Ohno, Dani Rodrik, Susan Rose-Ackerman, Astri Suhrke, and Douglas Webb. The team was assisted by Ritu Basu, Gregory Kisunko, Une Lee, Claudia Sepulveda, and Adam Michael Smith. Stephanie Flanders was the principal editor. The work was carried out under the general direction of the late Michael Bruno, Lyn Squire, and Joseph Stiglitz.

The team received useful advice from a distinguished panel of external experts comprising Masahiko Aoki, Ela Bhatt, Kwest Botchwey, Peter Evans, Atul Kohli, Klaus König, Seymour Martin Lipset, Douglass North, Emma Rothschild, Graham Scott, and Vito Tanzi.

Many others inside and outside the World Bank provided helpful comments, wrote background papers and other contributions, and participated in consultation meetings. These contributors and participants are listed in the Bibliographical Note. The International Economics Department contributed to the data appendix and was responsible for the Selected World Development Indicators.

The production staff of the Report included Amy Brooks, Valerie Chisholm, Kathryn Kline Dahl, Joyce Gates, Stephanie Gerard, Jeffrey N. Lecksell, and Michael Treadway. Rebecca Sugui served as executive assistant to the team, and Daniel Archison, Elizabete de Lima, Michael Geller, and Thomas Zorab as staff assistants. Maria Ameal served as administrative officer.

This Report is dedicated to the memory of Michael Bruno, Senior Vice President and Chief Economist of the World Bank from 1993 to 1996, whose life's work, including his contributions to this and past editions of *World Development Report* immeasurably advanced our understanding of development.

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Definitions and data notes

The countries included in regional and income groupings used in this Report (except those for the private sector survey) are listed in the Classification of Economies tables at the end of the Selected World Development Indicators. Income classifications are based on GNP per capita; thresholds for income classifications in this edition may be found in the Introduction to Selected World Development Indicators. Group averages reported in the figures and tables are unweighted averages of the countries in the group except where noted to the contrary.

The use of the term "countries" to refer to economies implies no judgment by the World Bank about the legal or other status of a territory. Statistics reported for "developing countries" include economies in transition from central planning except where noted to the contrary.

Dollar figures are current U.S. dollars except where otherwise specified.

Billion means 1,000 million; *million* means 1,000 billion.

The following abbreviations are used:

CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
GDP	Gross domestic product
GNP	Gross national product
IMF	International Monetary Fund
NGO	Nongovernmental organization
OECD	Organization for Economic Cooperation and Development
PPP	Purchasing power parity