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New Ideas in Development after the Financial Crisis

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Dramatic events, particularly those that contradict expectations, elicit the demand for “lessons”—how could the conventional wisdom have gone so wrong? Certain events become associated with the apexes and nadirs of intellectual tides. The beginning of the end of the popularity of “import substitution” policies can be dated to August 1982 when Mexico was unable to service its debts, which occasioned a re-examination of debt-financed big push industrialization through import substitution. The dramatic collapse of Argentina’s hyper-orthodox approach to pegging their currency to the dollar in December 2000 dates the end of the popularity, at least in some circles, of policies that attempted to

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1 This is a much expanded version of remarks made at the conference “New Ideas in Development After the Financial Crisis” hosted by SAIS and Center Global Development April 22/23 2009. I would like to thank Michael Clemens, Nancy Birdsall, Frances Fukuyama and Seth Colby for helpful comments.
wring all government discretion out of macro-economic policy making. Therefore it seems natural that events as dramatic as the financial/economic crisis of 2008 must have “lessons” and mark the end of at least some of the ideas that created the conditions for such dramatic and negative events to occur.

I address the question not of lessons from the financial crisis generally, but rather, are there lessons for the financial crisis for development thinking? This is a more difficult question than the lessons about financial and asset markets in the advanced countries which were the epicenter of the crisis, as the developing countries generally played no essential role in causing the crisis. I argue that the main lesson from the financial crisis of 2008 for development thinking is an indirect, but important, three-fold lesson that (i) it is not policies that matter but policy implementation (ii) that the capability for policy implementation is a key determinant of success and (iii) that this capability is not a fixed fact but varies under pressure and with non-linear dynamics capacity can be hard to build but easy to destroy.

This essay follows that three-fold structure. The first section defines and empirically illustrates the difference between “policy” and “policy implementation.” The second section discusses what capability for policy implementation is and its centrality for success using the paradigm examples of the Spartans, Paper Tigers and the Keystone Cops. The last section introduces the notion of the risks for policy implementation capability of premature or excess load bearing, that is, that while the building of capability for policy implementation is usually a long drawn out process of incremental change, a lesson of this financial crisis is that excess pressure on policy

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2 This phenomena extends beyond economic policy of course as the US loss in the Vietnam war, the collapse of the Soviet Union, and the events of 9/11 are used to draw “lessons” and to date the shifts in intellectual tides.
implementation—financial, political, technical—can cause sudden collapses. I argue that, while this may be a small part of the lessons of the crisis it is a huge lesson for development as the practice of encouraging development has been riddled with examples of destroying capabilities through pre-mature load bearing on organizations and institutions being built that appear isomorphic to functional institutions but which in fact have weak capability, or, to risk yet another metaphor, building paper mache replicas of bridges then driving heavy trucks over them. Before I dive into a substantive discussion of organizational capability as it relates to development, we should first look at the paper tiger that prompted this whole discussion in the first place, the financial regulators of the United States.

Yes, Even Here

The conventional wisdom in pre-crisis development thinking was that prosperity came from good policies and “good institutions”: “good institutions” that created and facilitated markets (e.g. property rights), “good institutions” that prevented rapacity and arbitrary actions by the state (particularly the executive), “good institutions” that made governments capable of smoothing the rough edges of capitalism by providing a modest amount of regulation, some needed services that were state responsibilities (e.g. infrastructure), and some services (e.g. education, health, safety nets).

Simon Johnson, formerly a Chief Economist of the IMF, has popularized the view that the financial crisis in America is a simple case of elite capture of the institutions of governance (Johnson 2009). This elite capture both facilitated the emergence of the bubble directly and indirectly by allowing puzzlingly irresponsible regulation of financial
markets. The obvious solutions to the crisis—nationalizing the banks for instance—were also not pursued due to elite capture. As he put it in a widely read article in a popular magazine, if this were any other country coming to the IMF for assistance and proposing to do what they were doing they would be told to go home and come back when they were serious about tackling their underlying problems of elite capture.

While it is hard to gauge what the “general” opinion among economists is, I would guess that nearly all of my close colleagues believe the financial crisis reveals the deep susceptibility of the US organizations responsible for regulating key markets to political influence. Put another way, many believe that, in the face of the pressure the large scale financial institutions (commercial banks, Wall Street investment banks, and quasi-private organizations like Fannie Mae) were able to bring to bear, the organizations and institutions responsible for regulating financial markets proved to be Paper Tigers. Economists find it easy to point to a variety of decisions made about the way in which banking regulation was implemented, or the rating of commercial paper was handled that appear to be example of the organizations responsible caving into to political pressures.

Let me say first, I am not entirely convinced by this view, second, I am no expert on the US financial industry or its regulation, but that said, this is a by no means implausible. If we assume that this account of events is true, then a major lesson of the financial crisis is that the organizations responsible for implementing financial regulation both in the US (and throughout large parts of the rich industrial world) were incapable of implementing technically sound policies because of the pressures that could be brought to
bear by the financial institutions. If this narrative of the financial crisis is true, what are
the implications for development thinking?

Development practice of the last decade has been built around the notion of
liberalized markets and strengthened institutions, both political (the expansion of
democracy) and administrative (establishing professionalized civil services with high
levels of individual capacity)\(^3\). But what if the right lesson from the financial crisis is
that US organizations were not robust to the degree of pressure liberalized capital
markets created? The US has had over 200 years to develop democratic institutions,
independent judiciary, and institutionalized checks and balances on executive function
with legislative oversight. The USA has a nearly 100 year old tradition of civil service.
The main organizations responsible for regulation of financial markets, the Federal
Reserve Bank system and the Securities and Exchange Commission were established in
1913 and 1933 respectively and hence have over 70 years of organizational history. The
US has a professionalized cadre of economists around which a professional identity is
formed among many who move in and out of positions of responsibility. The country has
a free press, laws promoting transparency in public policy making, campaign finance
reform and on and on. And I only use the US because I live here. The crisis was just as
deep and handled perhaps even more weakly in countries like the UK or in some
European countries (there is lively debate on this of course).

If, with these long and deep historical conditions and organizational capabilities and
individual capacities the USA is, as Johnson asserts, just another country suffering from
elite capture, then what does one make of advice to other countries to liberalize markets

\(^3\) One way of interpreting Fukuyama’s (1992) famous “end of history” argument is that “democracy” as a
mode of organizing polities was the final condition to which historical evolution had been (inevitably?)
headed and that “development” was merely an accelerator in this process.
and strengthen the institutions to regulate those markets⁴? If the lesson of the crisis for the US is that the size, sophistication, and complexity of financial markets exceeded the organizational capability of the US regulatory apparatus, then what is the lesson for say, Algeria or India or Indonesia or Mexico? That their problem is that they have “weak institutions”? These questions are not rhetorical but are pressing to pursue as the origins of the crisis becomes clearer.

I) Policy and policy implementation

A problem with discussing the lessons from the crisis is that words like “policies” and “institutions” have been used in so many ways by so many people, both across disciplines and even within disciplines. It is less than clear what people mean when they talk about “policy failures” or “weak institutions.” Before discussing lessons about capability for policy implementation I must introduce a few key definitions, with illustrations.

A policy is a mapping from states of the world to actions by an agent of an organization. This is an articulation of the common sense notion of policy but already clarifies that the difference between a “policy action” and a “policy” (which is roughly that between a real function and a real number). Some mistakes in “policy” are not that the mapping is incorrect but that the state of the world is not correctly identified so that the policy action is a mistake. When different people say “policy” it is not clear whether people are even talking about the same type of thing as people commonly conflate a specific policy action (raising the interest rate in a particular circumstance), with a

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⁴ The financial crisis is perhaps the power crisis in California writ large. As California’s system was apparently the “model” of separation of generation and delivery with regulated markets being promoted, it did raise some pretty fundamental questions about the needed capacity to implement. Whatever you think of California, if I were a Moroccan or Indonesian policy maker the fact that California could mess up so badly would give one pause.
notional policy (managing interest rates to stabilize economic activity), with a realized policy (the sequence of policy actions resulting from the implementation of a notional policy).

Since a policy is a mapping there are several elements to a completely specified policy beyond just the statement of the rule or notional policy. I wish to highlight two. A completely specified policy has to specify what organization or body or individual has the authority to declare the juridical and hence administratively relevant state of the world (and how, if at all, this declaration can be challenged and over-turned). So while a policy of a “ten percent flat rate income tax” may sound like a simple policy, as the mapping from the state of the world (taxable income) to the action of the agent of the state (collect ten percent of that amount) is simple, policy implementation is complex as there have to be a set of rules that define what “income” is for tax purposes (which may or may not agree with common sense notions of what income is) and who gets to declare what income is. This declaration of the state of the world may, or may not, be separated in policy implementation from the agents/organization responsible for other actions in policy implementation. This conceptual distinction of declaring the state of the world is important as it is immediately obvious there is no interesting policy without *de facto* discretion. Even if the mapping appears to have no discretion (e.g. if the state of the world is X you must always do Y) the declaration of whether the state of the world is X automatically creates discretion as what matters for policy is not the simple common sense notions of state of the world but the juridically declared state of the world and if the

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5 Other than the policy of doing the exact same thing in all states of the world, which is not a very useful policy in any domain.
appropriately specified body declares, for the purposes of policy implementation that
night is day then night is day.

**Figure 1:** Distinction between notional (*de jure*) and realized (*de facto*) policy
depends on organizational capability, influenced by background institutions.


The second key concept is that there may be little or no connection between the
*notional* policy as specified on paper in the laws and regulations and the *realized* policy.
The *realized* policy is not a choice of any given individual or agency but rather is the
*endogenous outcome* of the operation of a complex set of incentives and motivations that
face the individual agents responsible for implementation. These depend on the direction
organizations of implementation and on the *background conditions* in which the
organizations and front-line agents are embedded (e.g. existence of effective legislative
or judicial oversight, social norms of behavior, etc.).

In the context of the US these roles are usually quite clear. The tax code constitutes
the “notional policy”—the mapping between states of the world (income) and taxes
owed. The Internal Revenue Service (IRS) is the designated organization responsible for implementation, giving it the responsibility to both declare the juridical state of the world (what any taxpayer’s taxable income is) and to act to collect the corresponding tax through its front-line workers. The IRS is embedded in a complex set of “institutions” ranging from accountancy that influences bodies of professional practice and creates codes of conduct of those who interact with the IRS as well as legislative oversight of IRS functioning and possibilities of judicial review of IRS conduct or, in some cases, decisions. In the US one generally feels the gap between notional policy and realized policy is present, but manageable and not sufficient to thwart the actual intent of the notional policy. In some sense what one means by “strong institutions” is that the average policy implementation capability of the designated organizations is high. However, this is in stark contrast to developing countries where the gap between notional and realized policy is first order. An empirical example from India will illustrate this idea. A study examined a program to reduced absences among nurses in Rajasthan (Banerjee, Duflo, Glennerster 2007). The study examined the impact of introducing better tracking of nurse’s attendance with a potential to dock them pay if their attendance was not at least 50 percent (note already the low baseline and target). Since the program was implemented in cooperation with an NGO that had long experience in the state there was enormous attention to accuracy in assessing the seemingly very simple state of the world of whether the nurse showed up for work or not. They instituted an automated time recording system that was then independently “ground truthed” by the NGO doing spot checks on both the machines and the physical presence of the nurses. In the end after 18 months of implementation the program had no impact on presence—even of the
newly hired people even on the monitoring days—but recorded “absences” were no higher than they ever were. How? One exception to the attendance rule was if the nurse’s presence was required elsewhere for other duty so that as a juridical matter, even if the nurse was not there their absence was not an absence for administrative purposes. This then created a sufficient loophole. So the notional policy that “if you are absent more than 50 percent of the time (state of the world) your pay will be docked (action by the state)” which seems like a wholly non-discretionary policy conditioned only on hard facts was subverted to a realized policy of getting untruthful but nevertheless administratively compelling excuses for absences and non-attendance.

The first lesson of the crisis is that whether or not a “policy” will be effective depends not only on whether the notional policy would be effective if it were to be implemented (which is often a technical matter of the relevant causal model) but also whether the policy is capable of being implemented in the political and administrative environment. Why this is a lesson of the crisis we will come back to below, but across the developing world there is an increasing realization that in many domains the capacity for policy implementation is in fact the key constraint. Changing the policy may or may not have any impact on anyone’s behavior where the de jure and de facto policies have diverged. Conversely, one need not change the de facto policy to achieve substantial differences in policy implementation, either strengthening or weakening the impact of the same notional policy.

II) Organizational Capability: Spartans, Paper Tigers, and Keystone Cops
The battle of Thermopylae, at which a small force of Spartans (and others) held off a massive invading force from Persia, fighting to the last man, resonates through the ages. It is remarkable that a relatively obscure battle over 2000 years ago inspired (another) recent Hollywood movie (and a spoof). There are of course a variety of reasons why this battle is so famous, but the reason I want to focus on is that the Spartans illustrate the robustness of organizational capability for policy implementation to countervailing pressures.

Drawing on the definitions above of policy and policy implementation I can define organizational capability for policy implementation as some measure of the distance between outcomes from the *ideal* set of actions conditional on realized states of the world that would maximize the organization’s objectives and the *actual* set of actions undertaken by the agents of the organization, appropriately integrated over states of the world. Public sector organizations—Ministries of Education, Police forces, Militaries, Central Banks, Tax Collection agencies—have *stated* objectives. One can define their organizational capability as the extent to which the agents of the organization, both leadership and front-line agents, undertake the actions which would, contingent on the states of the world, pursue the organizations objectives.

The first important distinction to make is that the *individual capacity* of the agents is one, but only one, element of *organizational capability*. Figure 2 begins constructing the graphs that illustrate the points of this essay. On the vertical axis is the extent to which the agents of the organization *if they were to act at their maximum individual capacity* would fulfill the organization’s objectives.
While individual capacity plays a role in organizational capability, it is far from the only factor. As we all know there is many a slip twixt the cup and the lip, and the ideal of individual agents using their maximal individual capacity at all times to pursue their organization’s objectives is only a thought experiment. In fact agents have their own interests, goals, and objectives and agents choose their actions to pursue those objectives. This is not to say those objectives are pecuniary exclusively or even primarily as intrinsic motivation or commitments to professional identities or desires to help their comrades or not “lose face” certainly play important roles. But there are pressures on agents to pursue other objectives and these can be less or greater. Let us first illustrate these with a military analogy.

On the vertical axis in this case is an army’s ability to inflict damage on an enemy. One can imagine how large this capability would be if the army itself were under no countervailing battlefield pressure themselves and every agent (from officers down) were operating at their maximum individual capacity. This might be larger or smaller

Figure 2: Individual capacity and organizational capability
depending on the size of the force, the equipment at their disposal, the level of training etc. But every military leader knows that this definition of organizational capability is irrelevant. The more important question is the robustness of that capability to pressure from the opponent. How quickly does the ability of a fighting force to act to inflict damage on the capability of the opponent degrade under actual battlefield conditions?

The US Marine Corps official doctrine *Warfighting* (1997) is publicly available and makes for interesting reading. For the US Marines “war is an interactive social process” in which one force attempts to impose its will on the other. Hence the overwhelming emphasis of their war fighting doctrine is not destroying the opposing force in material terms (casualties or equipment) but destroying the opposing force’s will to fight. Their goal is to sufficiently disrupt the opposing forces’ organizational coherence such that its individual agents cease to act as a coherent purposive body, pursue their own immediate interests, and the organizational capability of forces, even with huge numbers of personnel and massive equipment, disintegrates\(^7\). Roughly, turn the opposing army—an (social) organization capable of directed action—into a mob of individuals\(^8\).

One element of this process, and which makes military history fascinating, is that the process is sharply non-linear. That is, in battlefield situations the degradation of organizational capability often does not follow a linear process in which incremental units of battlefield pressure yield constant units of degradation of capability. At least at times a small action can cause a ripple effect in which soldiers believe their position is

\(^7\) None of this is particularly original as these are the ideas of B. Liddell Hart, transmuted into the German Army’s application of *blitzkrieg* in which the deep penetration of rapidly moving armored units sufficiently disrupts the ability of the opposing army to respond such that the capability of the opposing army disappears, often with small casualties or materiel loss. The German conquest of France in World War II is perhaps the paradigm example.

\(^8\) Using the example of an army is hardly original, Wilson’s classic *Bureaucracy* (1989) opens with a martial example.
untenable, lose the will to defend it, and a battle becomes a rout (or conversely, a single
action prevents the loss of a position that would cause a rout).

These considerations of the robustness of organizational capability with respect to
pressure and potentially non-linear dynamics lead to Figure 3 which contrasts three

The Keystone Cops were a staple of early silent film comedies and were a platoon of
policemen who, with great fanfare and flurry of activity would rush around completely
incompetently. This is an example of an organization (or disorganization) in which even
under ideal conditions is incapable of accomplishing anything and hence have low
organizational capability over all ranges of pressure.

A contrast to the Keystone Cops is a Paper Tiger. A Paper Tiger is an organization
that appears to have high capability—it has trained people with the individual capacity to,
in principle, to recognize states of the world and respond to them—and has the materials
with which to work and has, again at least in principle, modes of command and control of
the organization that allow it to operate. But, when put under battlefield stress the
capability collapses as the individuals cease to pursue the organization's interests, the
organizational integrity and coherence necessary for capability disappears—a large army
that looks fantastic in parades becomes a mob on the battlefield.
This brings us back to the Spartans. Part of the point of Spartan training (indeed Spartan society itself) was to create individuals with high capacity (e.g. knew how to execute the individual skills) but another part—a part of all militaries training--was devoted to maintaining that capability as an organization even under the greatest duress when the actions of the individual put their lives at risk in order to maintain the overall organizational integrity and coherence.

All of this discussion of militaries is in part relevant, because militaries are large public sector organizations given responsibility for aspects of policy implementation. But primarily they serve as a useful analogy of more general issues that affect all elements of policy implementation, from direct service provision (e.g. education, health, agricultural extension) to “obligation imposition” (e.g. policing, tax collection) to the implementation of economic policies from the macro (e.g. central banks) to the micro (e.g. prudential regulation).
Let me give another empirical example from detailed research that illustrates the gap between individual capacity and organizational capability and hence the potential for Paper Tiger organizations. Das and Hammer (2005) did a very detailed study of providers of medical care in New Delhi by starting not from a list of licensed providers but from a user survey. Hence the providers included both public sector doctors who had the standard Indian training (MBBS) and the variety of private providers from high quality doctors to “Bengali doctors” who were, euphemistically, “less than fully qualified” (some substantial fraction of private providers had less than a high school education). The study first assessed the individual capacity of providers by asking the providers to respond to a series of researcher-prepared vignettes in which study participants were trained to present with sets of diagnostic conditions and the providers (knowing these were hypothetical) attempted to diagnose and recommend therapeutics. Not surprisingly this aspect of the study revealed a substantial amount of “Keystone Cops” as the median provider was just below the standard of “do no harm” which is scary but not the most interesting part for present purposes.

The study then followed up with the same providers by observing their actual clinical practice, with the providers knowing they were being observed. This created a measure of the application of individual capacity in a variety of organizational settings. Figure 4 differentiates by three types of settings: private providers, government operated primary health clinics (PHCs), and government hospitals. There are three striking findings. First, there is almost perfect alignment in the private sector between what they know in theory and what they do in practice-if anything, the incentives are to over-treat (the study shows that they do substantial amounts of over-prescribing of needless therapy). Second,
in the government PHCs there is an enormous gap between what they know in theory and what they do in practice. There is a huge “effort deficit” as, even when these doctors are in the clinic (and other studies have shown that absenteeism among health providers in India is rampant) they simply do not perform. Third, interestingly, in public hospitals the “effort deficit” is not nearly so larger as in the clinics.

**Figure 4: The gap between individual capacity and organizational capability in public sector clinical care in Delhi, India.**

This empirical work illustrates the concepts. The stated objective of the “notional policy” of the government is to provide clinics to expand availability of health care services. The implementation of this policy requires that public sector agents (e.g. front-line health care providers) make the correct mapping between “states of the world” (e.g. disease conditions) and the appropriate action by the agent of the state (e.g. recommend therapy). Successful policy implementation requires both individual capacity—the ability of the agents to make the correct assessment of the state of the world and how to
respond as evidence by ability to correctly diagnose and treat—and that this individual
capacity be embedded in an organization with capability—the material conditions and
overall setting in which individuals exercise their capacities to further the (notional)
objectives of the organization. This evidence suggests that large parts of the government
run health care system in India is a Paper Tiger: on paper there are clinics, in the budget
there are medicines, on the payroll there are nurses and doctors but under the actual
everyday pressures in which individuals face incentives the organizational capability of
the system is a small fraction of its notional or apparent capability.

III) Lessons about institutions and organizational capability from the crisis

Prior to the financial crisis the conventional wisdom in development economics was
tending towards the view that “institutions rule” in explaining long-run growth and levels
of economic prosperity\(^9\). If one could crudely caricature the stages of general slogans of
development, there was an “accumulation” phase in which the key problem of
development was framed as the rapid accumulation of human and physical capital\(^10\). A

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\(^9\) Rodrik, Subramanian and Trebbi (2004) have the title “institutions rule” arguing for the primacy of institutional indicators over measures of “policy” and “geography” in explaining economic growth. Easterly and Levine (2003) argue that countries’ endowments affect income through institutions. Hall and Jones (1999) decompose levels of income into observed accumulated factors and what they call “social capability” finding that most of income differences are due to this “social capability.” The massively influential paper of Acemoglu, Johnson and Robinson (200) argued that institutions were important (and that they could empirically identify the causal impact of institutions using settler mortality, but that controversial claim was subsidiary to the real point that institutions cause prosperity). The economic historians Engerman and Sokoloff (2000) argued that factor endowments affected long-run productivity by influencing the development of the institutions necessary to support prosperous market economies (again, the view that institutions are essential to prosperity is essential, whether or not these are affected by factor endowments is a separate point).

\(^10\) As an aside, in spite of the myth to the contrary there never was a “physical capital” phase that was displaced by a “human capital” phase among development thinkers. All of the early writers on development (e.g. Arthur Lewis, Gunnar Myrdal, etc.) emphasized the importance of accumulating human capital. Myrdal’s book *Asian Drama* written in the late 1950s takes the point about the importance of schooling as the settled conventional wisdom. It perhaps received less attention because success on this
second phase was a “policies” phase in which economists confronted the puzzle of low growth in spite of accumulation of physical and human capital and in particular confronted the debt crisis of the early 1980s in which the Volker shock of sudden increase in rates and decrease in availability of capital flows revealed that the debt accumulation had not created sufficient capability for production, and in particular export capability to service those debts. The shorthand for the conventional wisdom of the macro-policies was the “Washington Consensus.”

This led to the third phase of either (a) “good institutions” were needed to implement the “good policies” (the World Bank conventional wisdom was to pair “good policies and institutions”) or (b) the more radical “institutions rule” view that if countries had sufficiently “good” institutions they would either muddle along even without particularly good policies or that these institutions themselves would eventually produce the equivalent of good policies in practice. In either case, prior to the crisis the view that long-run development required not just good policies but organizations capable of policy implementation and “building institutions” was the conventional wisdom.

What has the crisis taught us about those ideas? Two things, it has highlighted the dangers of putting institutions under stress, particularly in the development context of pre-mature load bearing and it has challenged the notion of “good institutions.”
III.A) Organizations, institutions, and pre-mature load bearing

One of the pressing difficulties of development is that we know very little about building organizational capability but we increasingly realize we know a lot about destroying it.

Given the definitions above of organizational capability, it is clear that “building organizational capability” can mean one of two things. The predominant way in which the development literature, and even more especially development assistance organization’s practice, has conceived of building organizational capability is pushing up the vertical axis of individual capacity and/or organizational design. The robustness to stress was often not a key consideration. Take an example of an agency responsible for collecting taxes—a custom’s agency for instance. Their organizational job is to map from a juridical state of the world—the dutiable value of an import—to an action—collecting the appropriate tax. This requires the agents of the customs agency to carry out these actions. One can think of building capacity of the organization by “training” the agents so that they know the legal tariff code and how to apply it in specific circumstances. One can also think of strengthening the organization’s apparent stress-free, capability through material support—e.g. computerization, making the code updates available, etc.
Alternatively, one can conceive of the expansion of organizational capability as
the increase in the willingness of the organization’s agents to perform under pressure.
That is, it may well be that the agent’s of the organization already know what it is they
ought to be doing, but are simply failing to do it. One reason the studies of absenteeism
cited above are so telling is that it is very difficult to attribute absenteeism to a lack of
individual capacity: everybody knows that day it is. If the problem is that an
organization is Paper Tiger that has collapsed under stress and is already performing far
below its existing apparent capability it is doubtful that expanding individual capacity is a
fruitful strategy.\textsuperscript{11}

\textsuperscript{11} For instance, in the example above with medical care providers, one can estimate the connection between
existing years of formal training and actual performance and ask the hypothetical: “how many years of
additional training of public sector doctors would it take before their performance in practice (at the
existing patterns of behavior) matched that of the private sector?” The connection between capacity and
performance is so weak the answer is roughly that doctors would have to spend their entire careers in
training—clearly “individual capacity building” and “organizational capability building” are not synonyms.
The links between organizational capability and “institutions” comes to the fore in plans to expand organizational capability, in three ways: overall accountability through the background institutions in which organizations are embedded, intrinsic motivation through professional identities, and available organizational strategies.

Accountability is an omnibus term for mechanisms that induce agents to pursue the interests of principals—in this case public sector organizations tasked with policy implementation. The World Bank’s *World Development Report 2004* (I was part of the team that produced that report) emphasized that accountability is a system and that there are multiple channels through which agents have to be held accountable. One can imagine various ways in which the management of public sector organizations can expand capability. But, as the old saying goes, “just because the tire is flat does not mean the hole is on the bottom.” Just because tax collectors are wildly corrupt does not mean the problem is with the management of the tax agency. It could well be that the relationship between the citizens and the state (taken as the executive control of the administrative apparatus of the state) the relationship of accountability we called “politics” is so weak that the state is predatory and benefits from corrupt and/or rapacious tax collectors. Alternatively, it could be the control of the executive and/or legislative apparatus of the state over its implementing organizations is so weak the leadership of public sector organizations themselves feel no responsibility for performance.

Organizational capability is not formed in a vacuum but is, at least in part, dependent on the country and societies background institutions: How well does the polity work to

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12 I learned this aphorism from Robert Solow in connection with labor markets and unemployment, but cannot find any source so perhaps he made it up.
represent the interests of citizens? Is there an independent judiciary? Is there a tradition of civil service? Is there legislative oversight?

Figure 6: The accountability triangle and the four relationships of accountability

Source: Adapted from World Development Report 2004

A second element is that in many functional organizations it is not extrinsic accountability through the threat of punishment or the promise of reward but intrinsic motivation that accounts for at least some measure of performance. This is far too complex a topic to address, but professional identity almost certainly plays a role in framing many people’s behavior. Even in organizations that are otherwise dysfunctional
and in which there are no high powered (or even low powered) incentives one often finds people toiling away at their jobs because this is just what people like them (e.g. teachers, doctors, military officers) do.

There is also a rich literature on “social capital” in which individuals’ behavior is shaped by their embeddedness in a rich set of relationships which an intrinsic element of development (Fukuyama 2001, 2004) and continues to play a role in the performance of public sector organizations even in developed economies who are notionally completely “modern” states (Putnam, Leonardo and Nanetti, 1993). Often organizations function because of the organization’s social capital, in that individuals in organizations perform not because of outside threats but rather that, because of their relationships within the organization, individuals are more satisfied when performing well (and trust that others will do their part). Again, the analogy to the military literature is strong, as it has long placed enormous stress on “unit cohesion.” Tendler (1998) shows how important the construction of the social conditions conducive to governance reforms is to the ability of reforms to actually change behavior.

A third point about the “background institutions” is that they constrain the possibilities available to various organizational types. That is, publicly traded private sector firms can offer high powered incentives to employees based on stock market valuation—as these sets of institutions exist and function. Ministries of Education cannot offer teachers explicit high powered incentives.

Building organizational capability is therefore an extremely complex and problematic task. The naïve view that organizational capability is the sum of individual capacities and that “training” and material support through assets and budgets are the key to
organizational capability is untenable. Building the robustness of organizations so that they can withstand pressure and induce their agents to utilize their capacity involves both a wide variety of determinants, many of which are not under the control of organizational leadership. So while organizational capability for policy implementation is central to successful development, there are few generalized lessons about how to build capacity.

On the other hand, it is increasingly obvious how to destroy organizational capability: premature load bearing. While I know nothing about how to build the capability of an army I know exactly how to destroy that capability—put it into battle against a force capable of generating pressure and it will disintegrate.

This leads to a central emerging issue in development thinking: the dangers of isomorphic mimicry, which repeats for the third time the key mistake of development. The first time was to say, “rich countries have more stuff (e.g. bridges, factories) than poor countries, hence accumulating stuff is the key to development.” The second time was to say “rich countries have good policies (e.g. open to trade), hence adopting good policies is key to development.” The charming third time is to say “Rich countries have good institutions, hence promoting good institutions is the key to development.”

The problem is defining “good institutions.” If these are defined in form then it is relatively easy to transplant organizations and institutions. Countries can easily adopt the legislation that establishes the forms: independent central banks, outcome based budgeting, procurement practices, electricity regulation. However, having the forms does not automatically create the organizational capability to carry out the functions. Isomorphism (Dimaggio and Powell 1991) is the securing of organizational legitimacy, not by actual functionality but by imitating the forms other organizations that are
successful. The evolutionary analogy is to nature’s mimics, such as insects that adopt the coloration of other insects that are poisonous even though they themselves are not poisonous.

The problem comes in allocating to the isomorphic organizational forms the high pressure functions these organizations perform in rich countries after they have developed high and robust organizational capability. For instance, Dubash (2008) describes the adoption of an “independent regulator” to set electricity tariffs in India. The transplantation of the exact legislation and organizations of the “independent” regulation of electricity from other countries did not lead at all to the expected results when of course none of the background institutions, conditions, and history that made this successful in its original environment were not present in the Indian states adopting the form. Figure 7 illustrates a hypothetical case in which the existing tax code—because of its complexity, level of rates, or definition of base—creates pressured for individual agents to deviate from compliance that exceed, not only what the organization is capable of, but the maximum organizational capability even if those elements under control of leadership (the “management” elements of accountability) were optimally designed.\footnote{The example of customs is not random. In earlier work, with Geeta Sethi (Pritchett and Sethi 1993) we demonstrated that as the official \textit{ad valorem} tariff rate on items went up the actual ratio of officially reported revenue collected to officially reported import value both (a) stagnated and (b) the variance across items with the same ad valorem rate increase. This strongly suggested that, beyond a certain ad valorem rate (around 30-40 percent) the demands for undermining collections over whelmed organizational capability.}
An empirical example perhaps helps illustrate the point of premature load bearing.

There have been two major approaches to measuring the “investment climate” and how government regulations do or do not inhibit business growth. One is the “Doing Business” surveys which record the \textit{de jure} regulations. The other sources are the Enterprise Surveys that ask firms. In some cases these overlap so that the Doing Business survey records what compliance with regulations would entail while businesses tell of actual practice. Figure 8 (Hallward-Driemeier and Pritchett 2009) shows one such example in which we compare the Doing Business estimates of the days it would take to import with the distribution across all firms of the actual days the firms report their last import took them. Each box-whisker is the distribution of the firm’s Enterprise Survey responses which provides an estimate of the typical but also the time taken in the worst cases. The striking thing about this figure is that \textit{all} of the increase in the Doing Business reported number of days to import is associated with the \textit{gap} between \textit{de jure} and \textit{de facto}—actual days taken, even among the firms reporting the worst delays—do not
appear to increase days reported taken for import at all. For instance, compare the
country with the *de jure* regulations that take 32 days to comply. The median is less than
10 days but the 90th percentile is actually roughly full compliance (30 days). In contrast,
the country where the *de jure* regulations imply it would take 95 days to import, the
median is still less than 10 and the 90th percentile firm by reported delay takes only 21
days. While there are obviously a number of interpretations of this figure, one
interpretation is that when *de jure* regulations exceed the organization capability
maximum compliance simply breaks down and outcomes are deal by deal. Once a
policy implementing organization has passed the threshold into collapsed Paper Tiger all
else is irrelevant.

The usual interpretation of the Doing Business results is that the regulations that
create such long delays for importing, are overly restrictive of economic activity. In this
interpretation it may well be that the non-compliance is in fact a positive thing as if the
firms actually had to comply with the *de jure* regulation it would freeze up economic
activity entirely. There is certainly a sense which, if one has bad policies weaker
implementation can be a blessing. However, once organizational capability has
collapsed, one has to consider what impact regulatory reform would have. Even if the
new regulations are substantial reductions over the existing regulations they may still
require greater implementation capability than the organization’s possess and hence result
in the similar gaps between *de jure* and *de facto*. Once you are in a submarine whether
the water is 10 or 100 feet deep is not a huge issue.
So, a first lesson is that putting organizations (whose capability depends at least in part on the background institutions on which it can draw to create accountability on the one hand and intrinsic motivation on the other) under duress before they have developed sufficient not just apparent capability but also robustness to pressure is a recipe for disaster. This is like building a paper 

\textit{mache} model of a bridge a then driving a truck over it or, to return to military analogies, throwing green troops into a rout. The developing world is in fact now riddled with agencies delegated responsibilities for implementation of policy regulations in which the \textit{de jure} policy and the stated organizational objectives have no normative or positive traction on the behavior of the agents of the organization. While this is perhaps a good thing if the policies themselves...
are overly restrictive, organizational disability spills over into capability to enforce even desirable regulation.

III.C) Specific lessons for development

There are a variety of reactions to the problems with the strains placed on organizational capability for policy implementation by the pressures of overly complex, detailed, and “high stakes” policies which the de jure and de facto realities to diverge.

One is to adopt the view that we should all become “libertarians of necessity.” Many argue that development policy advisers and supporters should admit that, while it would be nice if it were the case that optimal policies could be implemented, it cannot. The question is then whether it is better to just admit the incapability and not pretend to regulate as that regulation itself can create negative pressures. That certainly was an argument made to support liberalization of import policies in the 1980s and 1990s: it didn’t matter whether or not there was, in principle, an empirical case for “infant industry” protection; in practice one would get rent seeking. The fact that the US regulatory apparatus was not Spartan but, at least at the pressures applied, a Paper Tiger suggests that no country will be able to regulate financial transactions to guarantee the absence of crisis. The “libertarian of necessity” argument would suggest that being guarded by a Paper Tiger is worse than no protection at all (as Paper Tigers do eat).

While this argument that “none is better than weak” might have been an attractive argument about trade policy, one can hardly take the same view with respect to say the responsibilities of the state for security, or law enforcement, or contract enforcement—all

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16 As much as I wish this were my phrase, it is the working title of a paper by Melissa Thomas now entitled “Great Expectations: Rich Donors and Poor Country Governments” (2009).
of which require large degrees of organizational capability. Not to mention other key developmental functions of the state—infrastructure, public health (*not* curative services), basic education.

The alternative to “standing back and letting it all be” will be a rather thorough-going re-thinking of how development is to be achieved. From a variety of different angles (including both “left” and “right” politics) people are pointing out that the expectations placed on the contemporary developing country states and their organizations of implementation far exceed those placed on the now developed countries when they had similar levels of income (Chang 2003, Hall and Leeson 2007). This is perhaps most obvious in the “state building” exercises the US and its allies are promoting in Afghanistan in which gains in democratic practice and administrative capability acquired over centuries in the historical experience of the US are expected to be “short-run” goals. Fukuyama (2004) has begun the exploration of what state building looks like in the post “end of history” world, but this is a daunting task. Most development efforts are grounded in a practice of development as “accelerated modernization through transplanted best practice” (Andrews, Pritchett, Woolcock forthcoming) which emphasizes form over function. Placing more emphasis on allowing the robust capability of policy implementation to emerge gradually contextually under performance pressure (which will be against all instincts of most “big development” practice) is one way of avoiding the problems of pre-mature load bearing.

**Conclusion**
I propose three lessons highlighted by, and some directly stemming from, the “Great Recession”.

First, policies are only as good as the organizational capability for policy implementation as the outcomes are produced by realized policy not what is on the books.

Second, organizational capability is not a constant but itself depends on the countervailing pressure under which policy is implemented. Some organizations are like Spartans and can withstand enormous amounts of pressure without buckling. Some organizations are Keystone Cops and have no capability even under ideal conditions. In between are the Paper Tigers that appear on paper to have all of the right designs and resources and perhaps even individual capacities but the organizational capability is not robust to pressure and so Spartan on paper becomes Keystone Cop in practice.

Third, pre-mature load bearing is asking organizations to take on tasks of greater complexity and/or countervailing pressure than the organization can withstand. Years, or even decades, of “capacity building” or “institution building” can disappear if a non-linear dynamic of organizational demoralization is set in motion. On this score the lesson of the financial crisis for the USA is that “it can happen here” and the lesson for the rest of world of that “it can happen there” should be sobering indeed.
References


