



Market Engagement

The Market as an Institution and the Role of the State

Markets exist to facilitate the exchange, coordination and allocation of resources, goods and services between buyers and sellers, and between producers, intermediaries and consumers. **Markets are active institutions that form the “rules of the game” around competition and the exchange of information between these different actors.** The way these rules are formulated has significant implications on how society is organized — via the relationships between producers and consumers, firms and the labor market, and corporate entities and the environment.

The state supports the creation, expansion and organization of the market through three major measures: (1) setting and enforcing rules for commercial activity; (2) supporting the operation and continued development of private enterprise; and (3) intervening in times of market failure. The extent to which states have utilized these three measures to engage and build markets has varied around the world and throughout history. Differing approaches have often been driven by societal expectations around market efficiency and equality (and the costs imposed by state intervention) as well as the perceived extent of market failure.

Still, while the state can impose costs on the market, the market cannot operate without the state. **The state provides the environment for predictable and consistent market creation and expansion (through the provision of the rule of law, stable macroeconomics, etc.) and sets standards for the production and delivery of public value within both the public and private sectors.** Without the state’s support to the enabling environment and standard-setting, informal, illicit and criminal economies can arise — and market failures can permeate unchecked. Recent global crises — from the 2008-09 global financial crisis to the collapse of markets during the COVID-19 pandemic — reiterate the important role of the state in supporting an effective and equitable market.

For ISE, the question is not “state” or “market” but the allocation of functions and tasks between them. Engaging and building markets is a core function of any state, as the opportunities they create are central to improving citizens’ lives. A stable and equitable market is central to the legitimacy of the state and its internal stability, and the state’s strategic relationship with the development of the market is

key to building lasting regional and international relationships based on positive exchange. This sourcebook lays out several case studies of countries that have effectively pursued these objectives — such as Singapore’s emergence as a strategic market planner in the 1970s and 1980s and Mozambique’s export sector growth in the 1990s — and provides an overview of how to navigate the divergent views on the role of the state in the market when developing this crucial government function.

Sourcebook Objectives and Typologies

The objective of this sourcebook is to showcase the various approaches that states have taken to engage and build market institutions and to provide a set of institutional arrangements and operations that any state can use to engage the market without waiting for the development of the market’s enabling environment.

It provides a toolkit of practical steps the state can take to directly engage the market while simultaneously supporting the development of an equitable environment for domestic commerce and cross-border trade. Thus, the sourcebook does not seek to serve as the authority on the role of government in the market, nor does it provide a template for the state’s role in developing an enabling environment. These topics have been sufficiently discussed by donor governments and development agencies, notably through the World Bank’s annual Ease of Doing Business reports.

The sourcebook argues that, while the state can impose costs on the market, the market cannot operate without the state. To support the market environment and set standards for public value in the private sector, the state can affect market behavior both directly and indirectly.

- **Direct strategies**, which are linked to interventionist, structuralist and neo-structuralist theory, stress the need to upgrade and build knowledge-based competitive advantages and assume that market failures are pervasive in any economy.
- **Indirect strategies**, on the other hand, focus on the state’s role in the regulation and creation of an investment climate, as advanced by traditional neoliberal economic theory and the World Bank’s Ease of Doing Business rankings.

Around the world and throughout history, states have used different mixtures of direct and indirect strategies to engage, build and organize markets — ranging from *laissez-faire* neoliberal systems to socialist, market abolitionist systems (see Table 1).

Table 1: Typology of Market Systems

Market System	Primary Characteristics
Predatory and auction-based	<ul style="list-style-type: none"> • Defined by corruption and a predatory relationship between the state, market and people • Elites control oligarchical monopolies, causing recurrent market failure • Public goods are accessed through corrupt auctioning procedures • Illicit economies overshadow the formal market
Market abolitionist	<ul style="list-style-type: none"> • Embodies the belief that the economic market should be eliminated from society and instead mandated by the state • In practice, applied through absolutist planning without significant participation by private actors
Neoliberal	<ul style="list-style-type: none"> • Assumes that most market factors work well without government intervention — if property rights and competition are guaranteed • Sets the most basic enabling environment for private action • May intervene in market failures that impact competition
Social market	<ul style="list-style-type: none"> • Operates as a combination of neoliberal market approaches and the establishment of a welfare state through social policy • Does not include direct state planning and guiding of production — but the state influences market activity through comprehensive economic and fiscal policy
Structuralist	<ul style="list-style-type: none"> • Focuses on the structural elements of moving from primary to industrial market development • Utilizes import substitution industrialization • Does not guide market production — but the state sets general industrial policy for the development of specific sectors
Developmental and evolutionary	<ul style="list-style-type: none"> • Often more interventionist than social market and structuralist systems • Relies on continuous experimentation and innovation in key sectors, guided by government intervention and support • Requires strong bureaucratic structures and interconnectedness between the public and private sectors
Hybrid and transitional	<p><i>Many countries (e.g., post-communist countries) have utilized systems that are hybrids of the above, especially as they transition from one system to another</i></p>

The Building Blocks of Effective Market Engagement

Regardless of a society’s chosen or inherited market system, effective market engagement starts with the development of a clear and equitable legal system as well as an arrangement of stakeholders and institutions that maximizes potential partnerships between public and private actors in the market. Legal frameworks define the rules of the game for the market. Directed by this legal framework, institutional bodies —from legislators, regulators and the executive to central banks, chambers of commerce and import-export banks — collaborate with private actors in the financial sector, business associations and individual firms and corporate entities to carry out the various components of the market engagement and building function.

The sourcebook outlines how these institutional bodies and legal frameworks operationalize the function, both directly and indirectly. While the role of the state in the market is highly context-specific, the mechanisms illustrated in the sourcebook and introduced below

are often used by states to support the market environment and set standards for the delivery of public value in the private sector.

- **National planning and competitiveness strategies.** The state plays a key role in uncovering the nation’s global competitive advantages and setting out priority areas for private sector and trade growth in national development strategies. These strategies can encompass whole-of-economy industrial policies, outline approaches to develop specific economic clusters, build domestic demand through poverty alleviation and protect nascent industries through effective trade policies.
- **Acting as a market leader and investor for innovation.** The state can lead or enable innovation in the market through the delivery of public services and state-generated, state-driven or state-funded research & development (R&D).
- **Public procurement and government contracting.** The state directly engages the market — and sets standards for the delivery of public value — as a consumer through the procurement of goods and services from private firms. Crucially, procurement by public bodies is estimated to

average between 15 and 30 percent of most countries' GDP, and in some cases may be even higher.

- **Licensing and public-private partnerships.** In order to maximize public resources and develop domestic firms, states can license the development, operations and maintenance of key public goods and services to private sector actors.
- **Correcting market failures.** When market failures occur, the state can step in to promote both improved efficiency and equity in the market. Some common public interventions to correct market failures have included anti-trust regulations and the promotion of competition, public ownership in monopolistic sectors and consumer protection measures.
- **Regulating business and the labor market.** The state regulates the market to promote competition, efficiency and equity in society. This regulatory role affects many areas of the economy, from productivity and employment trends to anti-trust issues and the size of the informal economy. Furthermore, the state invests in human capital that drives the labor market, preparing citizens for the future of work through effective education systems and training.
- **Assuring access to and protection for property, infrastructure and the equitable availability of credit and insurance.** The state provides the requisite security, regulatory environment and public spending to promote access to land, the protection of property rights (and intellectual property), property registration, land development and construction permits, electricity and transport infrastructure. This also includes a robust and stable financial infrastructure for equitable access to credit and insurance.
- **Supporting cross-border trade.** Aside from its direct role in setting national strategies for trade and market growth (including trade agreements), the state improves access to two kinds of infrastructure for cross-border trade: hard infrastructure (physical infrastructure and information and communications technology) and soft infrastructure (border and transport efficiency and business and regulatory environment and standards).

From the development of a coherent strategy that focuses on delivering value to citizens to the adoption of experimental cluster-based approaches, the sourcebook provides strategies for how stakeholders can be aligned around these various actions to develop an effective and equitable market. Experiences of successful market engagement strategies around the world inform how the state can use national planning, efficient revenue collection and budgeting, investment pipelines, public communication and citizen participation to improve market performance and form the foundation for stability and legitimacy.

Modern Challenges and Opportunities for Better Markets

As outlined in the sourcebook, the state can shape private incentives in the market through vision-setting, regulation, taxation, public spending and direct intervention to support an enabling environment and set

standards for public value in the private sector. With these mechanisms in mind, the sourcebook also explores some of the key modern challenges and opportunities for states to consider when developing market functions. It explores the extent to which foreign assistance and dependence on natural resources disrupt and overburden local markets as well as the existential threat posed by climate change and its implications for sustainable economic and market development. At the same time, the sourcebook examines some of the opportunities afforded by modern technologies, the regionalization of value chains and markets, massive capital flows in a globalized market and the potential for low-income countries to “leapfrog” traditional Western strategies for building markets.

Aided by a growing diversity of actors and financing streams in the private sector, governments can explore and take advantage of new thinking and technological solutions to tackle modern challenges. The sourcebook provides a number of examples, some of which are outlined below:

- As norms around competition and its centrality to market efficiency and equity have been challenged by large technology firms and multinational corporations, states have begun to wield antitrust and anti-competition legislation and regulation to improve competition in local markets.
- In the wake of the COVID-19 pandemic and related economic crises, international organizations and firms are considering how to intensify their focus on insurance and risk reduction.
- Against the recurring threats of global financial crises, low investment and a changing climate, there is growing momentum and support for public sector innovation agencies to support research and development in the private sector.
- In the constantly modernizing and fast-paced global market, technological advances (e.g., automation, robotics, blockchain and end-to-end visibility, on-demand delivery and “Big Data”) are shifting how states and markets approach the future of supply and value chains.

Benchmarking and Measuring State Strategies for Market Engagement

In addition to an exploration of strategies for the development of the function, the sourcebook explores mechanisms and benchmarks that states can use to measure the performance of their engagement with the market. While the sourcebook explores the wealth of international indices (from the World Bank's Ease of Doing Business rankings to the IMF's Financial Development Index) that measure elements of the state's market engagement, ISE argues that the context-specific nature of the market requires localized data to effectively benchmark state performance. Macroeconomic and national-level data on growth rates, export performance, carbon emission and labor growth as well as customer satisfaction surveys for businesses and consumers allow governments to pinpoint bottlenecks and underinvestment in

key enabling areas while assessing the overall health of the market. A balanced approach to national data, key indicators from evaluation of national strategies and international indices provides a robust set of benchmarks to assess the performance and development of state approaches to market engagement.

Conclusion

The state can impose costs on the market, but the market cannot operate without the state. **The performance and growth of the market are underpinned by the performance of other core state functions** — from the creation of an enabling environment with the security of property, effective rule of law and physical and financial infrastructure to the development of human capital for an effective labor force. Regardless of the market system, the state provides the environment for predictable and consistent market creation and expansion and sets standards for the production and delivery of public value within both the public and private sectors.

In the digital age, the state should focus on being a locus of innovation and strategy-making for private actors without imposing additional costs on their operations. This sourcebook outlines key steps to take (and serious missteps to avoid) when considering how to build and support markets, pulling from a diverse set of case studies around the world. ISE hopes that this sourcebook can spur communities of practice around the state's role in engaging, building and organizing the market — a key function for ensuring sustainable growth, equity and opportunity for each nation's citizens.