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If Politics Is the Problem, How Can External Actors Be Part of the Solution?

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Abstract

Despite a large body of research and evidence on the policies and institutions needed to generate growth and reduce poverty, many governments fail to adopt these policies or establish the institutions. Research advances since the 1990s have explained this syndrome, which this paper generically calls "government failure," in terms of the incentives facing politicians, and the underlying political institutions that lead to those incentives. Meanwhile, development assistance, which is intended to generate growth and reduce poverty, has hardly changed since the 1950s, when it was thought that the problem was one of market failure. Most assistance is still delivered to governments, in the form of finance and knowledge that are bundled together as a "project." Drawing on recent research on the politics of government failure, the paper shows how traditional development assistance can contribute to the persistence of government failures. It proposes a new model of development assistance that can help societies transition to better institutions. Specifically, the paper suggests that knowledge be provided to citizens to build their capacity to select and sanction leaders who have the political will and legitimacy to deliver the public goods needed for development. As for the financial transfer, which for various reasons has to be delivered to governments, the paper proposes that this be provided in a lump sum manner (that is, not linked to individual projects), conditional on the government following broadly favorable policies and making information available to citizens.

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If Politics Is the Problem, How Can External Actors Be Part of the Solution?

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Despite a large body of research and evidence on the policies and institutions needed to generate growth and reduce poverty (synthesized, for example, in Commission on Growth and Development [2008]), many governments fail to adopt these policies or establish the institutions. Research advances since the 1990s have explained this syndrome, which we generically call "government failure", in terms of the incentives facing politicians, and the underlying political institutions that lead to those incentives. Meanwhile, development assistance, which is intended to generate growth and reduce poverty, has hardly changed since the 1950s, when it was thought that the problem was one of market failure. Most assistance is still delivered to governments, in the form of finance and knowledge that are bundled together as a "project". The canonical example is a dam or bridge, which requires both money and technical assistance for its design and implementation. When the policies to make these projects productive were lacking, development assistance was extended to budget support, "conditional" on policy reforms. This paper asks whether these forms of development assistance can actually achieve what is needed to solve government failures. Drawing on recent research on the politics of government failure, we show how traditional development assistance can contribute to the persistence of perverse political incentives and behavioral norms.

We propose a new model of development assistance that can help societies transition to better institutions. Specifically, we suggest that knowledge be provided to citizens to nourish the transparency that is needed for citizens' engagement, to build their capacity to select better leaders who wield power in government, as well as sanction them if they fail to deliver. Transparency policies that are thus targeted at citizens' political engagement can contribute to building political will and the legitimacy of leaders to pursue policies on the basis of technical merit. As for the financial transfer, which for various reasons has to be delivered to governments, we propose that this be provided in a lump-sum manner (that is, not linked to individual projects), conditional on governments' following broadly favorable policies and making information available to citizens.

Section I of the paper provides a potted history of development economics, tracing the evolution of both thinking and assistance from an initial concern with market failures to the recognition that government failures were standing in the way of development. We examine various ways that development assistance has attempted to address government failure, and find them falling short in tackling the political incentives that lead to the government failure. In section II, drawing on recent research, we unpack the politics of government failure as the breakdown in a series of principal-agent relationships. In section III, we show how citizen engagement and transparency—two forces that are changing quite rapidly—can help to restore accountability in these relationships, and hence enable politics to play a positive role in overcoming government failure. We then derive, in section IV, the implications of these findings for development assistance. Given the recent and unmistakable increase in citizen engagement in selecting and sanctioning the leaders who wield power in government, this new approach may be the tide "which, taken at the flood, leads on to fortune."

I. From market failure to government failure: A potted history of development economics

The field of development economics, which sought to help poor countries grow and reduce poverty, was initially focused on correcting market failures. The analytical foundations were provided by early writers such as Rosenstein-Rodan (1943) and Chenery (1959), who pointed to coordination failures if investment decisions were left to the market. The profitability of a port, say, depends on whether there was a road leading to it. They advocated that governments undertake a “big push” to achieve development results. Others such as Nurkse [1966] noted that low savings could leave poor people (and hence poor countries) in a poverty trap. A transfer of capital from rich countries would enable poor countries to escape the trap and achieve sustained economic growth. This thinking won support from the general field of economics, which was emerging from the Keynesian revolution, which made a strong case for government intervention in the economy, albeit for short-run stabilization purposes. The apparent success of the Soviet Union in industrialization with a planned economy provided compelling empirical evidence.

With this backdrop, governments in developing countries intervened in almost all aspects of the economy. To solve the coordination problem, governments set up enterprises, producing everything from steel to shoes to baked goods (World Bank, 1995). To help nascent public and private enterprises grow, governments protected them from import competition with tariffs and quotas, invoking the “infant-industry” argument. As part of the big push, governments built and operated power plants, water systems, roads, and other infrastructure. Mimicking the current systems in their former colonial powers (France and Britain), governments provided health and education free of charge.

Development assistance complemented governments’ efforts to overcome market failures. Not only would the external resources help countries escape the low-savings poverty trap, but they could finance the building of infrastructure whose costs exceeded domestic resources. They could also finance the health and education systems. Furthermore, since many countries lacked the technical expertise to design and carry out these infrastructure and social-sector programs, donors would provide technical assistance as well. The idea of a development project—where financial and technical assistance was bundled in a package—was born. It soon became—and still is—the dominant mode of delivering development assistance.

In this setting, the interests of donors, governments and the general public were assumed to be aligned. Governments were correcting market failures, which is what governments are supposed to do, so they could take credit for improving social welfare. And donors, since they were supporting governments in this effort, could also be seen as contributing to the betterment of poor people’s lives.

Unfortunately, the actual performance of most developing countries that followed this approach was disappointing. India, which embraced central planning for the first three decades after independence, had achieved neither growth nor significant poverty reduction (Lewis, 1964). In Africa, South Asia and to some extent Latin America, import-substituting industrialization had promoted neither industrialization nor exports (Bhagwati, 1978). For example, the Morogoro shoe factory, financed by the World Bank in Tanzania, never exported a single pair of shoes. Meanwhile, East-Asian countries that had followed export-promoting policies were seeing rapid growth in GDP and employment. Significantly, these countries also adjusted more effectively to the oil price shocks of the 1970s. Despite billions of dollars in foreign aid to finance infrastructure, health and education, most of Sub-Saharan Africa through the mid-1990s was mired in poverty (African Strategic Review Group, 1981). Much of the public infrastructure was breaking down (Foster, 2008). Water was available for only a few hours a day; power cuts were commonplace; roads were impassable. While primary school enrollment rates were rising, student learning outcomes were extremely poor (van Fleet, Watkins and Greubel, 2012). Less than 40 percent of Ugandan children aged 10-16 have literacy and numeracy skills at the Grade 2 level (Uwezo, 2013).

Why, despite the logic of market failures and the clear role for government to correct them, were the outcomes so disappointing? The proximate reason is that the public interventions, such as import tariffs, state-owned enterprises, infrastructure investment and provision of health and education, created a set of government failures that overshadowed the intended benefits from correcting the original market failures.

The government failures fall into two categories. The first has to do with the incentives in the public sector, which are different from those in a competitive private market. For instance, state-owned enterprises operated under what Kornai [1986] called a "soft budget constraint": the government covered their losses. Unlike their private-sector counterparts, these enterprises had little incentive to minimize costs or maximize profits, much less innovate and upgrade their technology. Industrialization failed to materialize. Public electricity and water utilities, since these services were typically subsidized, were not accountable to the consumer. Utility managers let grid maintenance deteriorate to the point where power and water cutoffs were common, making industrialization even more difficult (Devarajan and Harris, 2007). Teachers in public schools and doctors in public clinics were paid whether they were present or not. As a result, they were absent 25-40 percent of the time (Chaudhury et al., 2006), contributing to poor learning outcomes; most people resorted to the private sector for health care (World Bank, 2003).

The second type of government failure was that these interventions were captured by politically powerful groups who then resisted their reform. Import protection resulted in a coalition between the owners and workers of the protected industries, and government bureaucrats who, when the protection was in the form of import quotas, wielded enormous power in being able to hand out scarce import licenses. These groups, who stood to lose enormous "rents" if the protection were removed in favor of greater export promotion, were able to keep the system in place even though it was not delivering (Krueger, 1974). Similarly, the subsidized public utilities were an instrument of political patronage: politicians could control who got access to electricity and water and also use them for giving jobs to their constituents—the practice of "featherbedding". Furthermore, defending the status quo was politically easy, since the alternative—removing the subsidy and raising the price—would be seen as discriminating against poor people (even if the reality was the opposite). Finally, in many countries, teachers managed the political campaigns of local politicians (Béteille, 2004). If the politician won, he gave the teacher a job from which he could be absent.

Starting in the late 1970s, the donor community realized that development assistance, which was largely delivered as investment projects, was not being productive in the wake of these policy distortions and institutional weaknesses (many of which were created by previous donor-funded projects and advice to correct market failures). The structural adjustment era was born. The World Bank and IMF in particular set out to help countries reform their policies and institutions, so that development projects could generate higher returns (Isham and Kaufmann, 1999). Since many countries were also experiencing balance of payments or budgetary difficulties (due to terms of trade shocks such as the oil price spikes), the Bank and the Fund provided financing—budget or balance of payments support—in return for removing some of the major distortions in the economy, such as overvalued exchange rates, prohibitive tariffs, and insolvent public enterprises.

While a few of the egregious distortions were removed, the general consensus was that this form of "conditionality" did not work as intended, especially in Africa. By the mid-1990s, after two decades of structural adjustment, Africa was saddled with low growth, high poverty, undiversified economies, and a crushing debt burden (that was subsequently alleviated with debt-relief). Moreover, many of the distortions that prevented projects from generating returns and the economy from growing were still in place. For instance, Kenya had implemented no agricultural price reforms—despite three World Bank structural adjustment loans with such reform as conditions (Devarajan et al., 2001).

That conditionality did not lead to significant reforms is not surprising if the reason for the original distortions was politics. A coalition of bureaucrats and owners of protected industries could block import tariff reforms, say, even if much-needed budget support were at stake. In some cases, governments would agree to the reforms, get the money, and then reverse the policies. In others, different parts of government were responsible for negotiating the loans and implementing the policies. For instance, the Zambian government signed a structural adjustment loan with maize price reform as a condition—without consulting the Minister of Agriculture. When it came time to implement the reform, the Minister refused (Devarajan et al., 2001). Finally, incentives within donor organizations, such as the desire to show substantial transfers of aid (Svensson, 2008) or defensive lending (Basu, 1991) played a role. And coordination failures among donors played into the hands of rent-seeking local leaders.

The fundamental problem is that the alignment of interests among donors, government and the general public, which is assumed when everyone is trying to solve market failures, does not hold up when the problem is government failure.[2] As pointed out above, a government failure persists because politically powerful people are earning rents from the distortion. External actors who are trying to remove the distortion to benefit the general public bump up against the same political force that is benefiting from the distortion. Often this force is within government, the same government to whom the aid is given.

The international community has sought to address this problem in at least three ways. The first and most common is to recognize that there are limits to how much the government will reform, but continue to provide the aid on grounds that there are poor people in the country who would benefit from the money. Typical examples include infrastructure projects, where the project document identifies all the price and regulatory distortions in the sector, but concludes that the country nevertheless has a huge infrastructure "deficit" that needs to be filled, and thereby justifies the project. But if the distortions are not removed, the additional aid could be making the problem worse. The welfare loss from the existing distortions is amplified. Furthermore, the financial assistance may give the government breathing room to postpone or even avoid reforms altogether—a syndrome observed in many reviews of aid to Africa (Devarajan et al., 2001). The three structural adjustment loans to Kenya mentioned earlier likely enabled the government to postpone agricultural price reforms. In fact, most of the reforms in Kenya took place in 1992, when the donors cut off aid. In the words of Michael Bruno, the then chief economist of the World Bank, "We did more for Kenya by cutting off aid for one year, than by giving them aid for the previous three decades."

The second approach is to provide knowledge assistance to government officials and leaders on the benefits of policy and institutional reforms, to increase the chances that such reforms will take place.

[2] There is also the possibility of government failure in donor countries, which leads to aid not in fact being targeted at fixing market failures in recipient countries (World Bank, 2003).

Examples include reports on the benefits of trade reform in India, or fertilizer subsidy reform in Tanzania. While they are of high technical quality and may ultimately be useful, these reports do not necessarily help shift the political equilibrium in favor of reform. Those in favor of the reforms already know this information; those opposed—because they are earning rents from the status quo—are unlikely to change their mind based on technical analysis.[3]

Levy [2015] has proposed a third approach, "Working with the Grain." At the risk of caricature, the approach can be described as follows: Assume we already know what the "right" policies are. We then use the available political analysis, such as North, Wallis and Weingast (2012), to identify entry points where it will be politically feasible to adopt the right policies or to move in the appropriate direction in incremental or "second-best" ways that satisfy political constraints. However, second-best policies that are feasible in a dysfunctional political setting may not be solutions at all, having little impact on economic outcomes. For instance, politicians who are reluctant to reform the public educational system (because they rely on absentee teachers for their electoral campaigns) may be willing to experiment with an NGO-run school in a particular district. While the students attending this school may benefit, the overall education system will likely remain dysfunctional.

Furthermore, there is an inherent hubris in assuming that external actors will have the capacity to identify the appropriate entry points and engineer reforms in the right direction, simultaneously solving both the technical policy problem and that of adapting it to political constraints. Ex ante, there is little reason to believe that the selected entry points are the right ones; they may make the situation worse. The incentives of donor organizations to show results and count reforms as success are further reasons to search for other approaches that do not depend entirely upon external agencies' getting both the economics and the politics right.

More recently, another instrument has come to the fore as a means of improving development outcomes despite government failures: providing financing directly to citizens and non-state actors, who would then demand and deliver public services. Initiatives such as GiveDirectly have emerged on the basis of research evidence of the impact of direct cash assistance in reducing poverty. Grants to local communities, civil society and non-governmental organizations for "community-driven development" have increased. Yet, even if such initiatives result in improved outcomes by making citizens provide public goods for themselves, bypassing the problem of government failure means, logically, that it remains a constraint on development. Unless direct transfers combined with citizen engagement eventually lead to pressure on governments to improve performance in providing public goods, the original market-failure rationale for development assistance—not to mention for government in general--will remain unaddressed.

In sum, the development community still has to confront the problem of delivering aid in the presence of government failure. These failures cannot be side-stepped. Recent research has reinforced the point that prosperity cannot be sustained without sufficient state capacity to maintain law and order and provide the institutions that support competitive markets (Besley and Persson, 2009, 2011; Acemoglu, García-Jimeno, and Robinson, 2015). For development to be sustained, government failure to build state capacity has to be solved.

[3] As we will discuss in the following sections, providing the knowledge to citizens more broadly, going beyond government officials and leaders, is a strategy that may help shift the political equilibrium.

Fortunately, some recent research has increased our understanding of the politics underlying government failure, which in turn points to potentially transformative ways in which external assistance can help developing countries overcome these failures. The research identifies two current forces of change—greater citizen engagement and increased transparency in the political process—and shows how they affect how leaders who wield power within government are selected and sanctioned. In the next section, we describe these findings. In section IV, we draw on these findings to propose a different way of providing development assistance, one that harnesses the power of citizens and transparency to help countries overcome government failures.

II. A framework for government failure

The forthcoming report, *Making Politics Work for Development* (World Bank, 2016), untangles a vast and complex literature on the political economy of development to pull out a common thread—political engagement--which both explains government failures and holds the key to solving or averting these failures (World Bank, 2016).[4] Political engagement is the participation of citizens in selecting and sanctioning the leaders who wield power in government, including by entering themselves as contenders for leadership. Government failures have been examined in economic theory as a series of principal-agent problems: between citizens and political leaders; between political leaders and public officials to whom responsibility is delegated to manage a myriad agencies within government; and between public officials who lead government agencies and the frontline providers they manage (Figure 1). Political engagement influences each of these principal-agent relationships.

Political engagement happens in every institutional context, from democracies to autocracies, albeit in different ways. The main contrast examined in the literature is between when there is scope for greater political engagement by a large number of individual citizens, acting as voters or as contenders for leadership; and when there is not--that is, when power over leaders is instead concentrated among elites or organized groups of citizens such as political parties (Keefer, 2011). It may seem that the difference has to do with electoral institutions. But diffused participation by non-elite citizens can happen in informal ways that constrain leaders even in authoritarian contexts, such as through protests, revolutions, and the threat thereof (Acemoglu and Robinson, 2000). Research examining differences in outcomes across countries with different national political institutions concludes that the key question that applies to both autocracies and democracies is whether leaders are selected and sanctioned on the basis of performance in delivering public goods (Besley and Kudamtasu 2008).

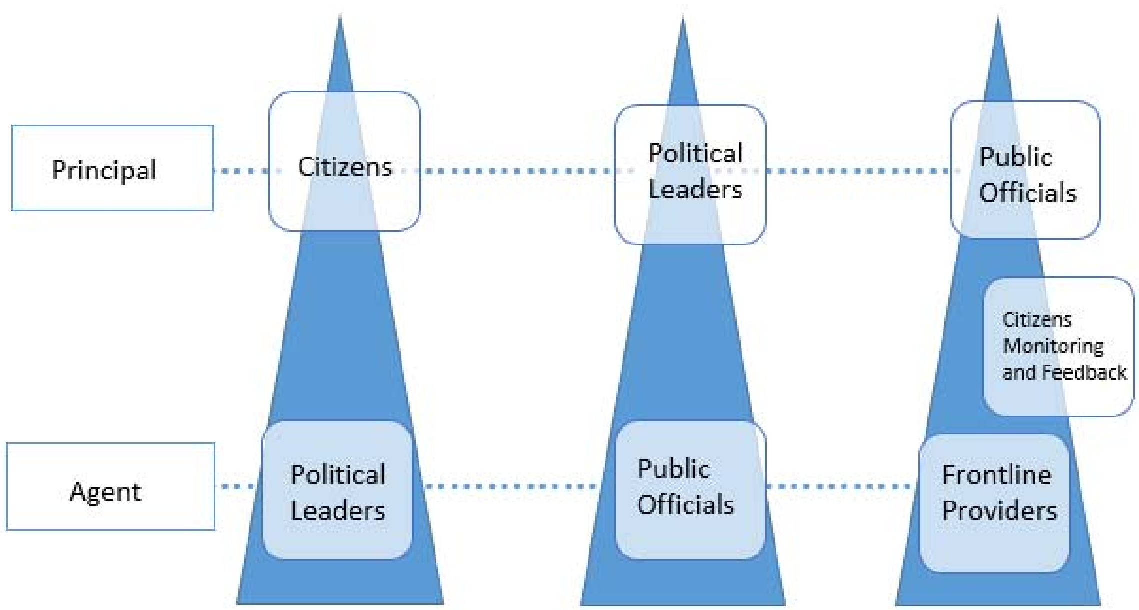
Citizens' political behavior—what issues they consider when selecting and disciplining leaders, and their attitudes towards the public sector—underpins the functioning of all three principal-agent relationships. Political engagement shapes the incentives and characteristics of leaders who in turn select within-government management policies to address the principal-agent problem vis-à-vis public officials and providers. Leaders and public officials also determine whether to provide citizens with powers of monitoring and feedback on frontline providers. Non-political citizen engagement has become a prominent feature of efforts to improve government performance and fits into this framework as how leaders choose to engage citizens to solve their within-government management problems. For

[4] This section draws upon World Bank (2016), *Making Politics Work for Development: Harnessing transparency and citizen engagement*, Policy Research Report, Washington DC: World Bank

example, a middle-tier bureaucrat like a district executive officer who has formal powers over teachers, health workers, agricultural extension workers, road work contractors and so on, can engage civil society organizations and request feedback from beneficiaries as an input into internal management practices.

Unhealthy political engagement, when leaders are selected and sanctioned on the basis of their provision of private benefits rather than public goods, casts a long shadow. It can diminish accountability not only of elected leaders but also within the principal-agent relationships between leaders, public officials and frontline providers. Leaders directly influence incentives and norms within public bureaucracies through the management policies they select. When political leaders provide jobs in the government as political patronage, they prevent the professionalization of bureaucracies. A growing body of research provides evidence on the behavior of officials in the public sector that is consistent with the implications of such patronage politics. For example, doctors with connections to political leaders are more likely to be absent from public health clinics, and the public officials who manage these doctors are more likely to report political interference when trying to apply sanctions (Callen et al, 2014).

Figure 1: The Principal-Agent Relationships of Government



Source: World Bank (2016)

Unhealthy political engagement undermines the legitimacy of leaders, weakening their ability to manage complex organizations and effectively implement policies (Akerlof, 2015). For example, leaders can use new technologies to monitor frontline providers, reducing opportunities for graft (Banerjee, Duflo and Glennerster, 2008; Muralidharan, Niehaus, and Sukhtankar 2014; World Bank, 2016). But when leaders lack legitimacy, they may face resistance from frontline public providers to take up these technologies. Time-stamp machines that were installed to monitor attendance of staff in public health clinics in India were sabotaged by the staff (Banerjee, Duflo and Glennerster, 2008). Widespread electricity theft and non-payment of dues to public electric utilities in the developing world are further examples of the lack of legitimacy of the state in environments of unhealthy political engagement (Min and Golden, 2014; Min, 2015).

If political norms allowed vote-buying and patronage to flourish in elections, those same norms would influence how leaders manage public officials, how public officials manage frontline providers, and how citizens engage with the public sector. Leaders who can get away with poor service delivery during their term in office by purchasing votes at election time also tend to provide jobs to public officials and to frontline providers as political patronage and *not* hold them accountable for service delivery. When frontline providers are patronage appointees, citizens do not expect that monitoring them or providing feedback on their performance will have any effect and therefore do not engage to improve the third principal-agent problem. Citizens' expectations of how political power is exercised within government can maintain this vicious cycle, leading to citizens' demanding private benefits only and unhealthy political engagement persisting.

Citizens' roles as monitors in the third type of principal-agent problem is also subject to free-riding problems. Monitoring is a public good and so any individual citizen lacks the incentive to provide it. An influential strand of the literature has focused on the free-rider problems that plague collective action and how group organization and cohesion play a role in outcomes (Olson, 1965; Lowi 1972; Wilson 1973). Powerful local elites can capture civil society and invert the role of citizens in the third principal-agent problem, again, through their control over local institutions of coercion or economic resources (Acemoglu, Reed, and Robinson, 2014; Andersen, Francois, and Kotwal, 2015). Rather than being engaged to hold public officials accountable, citizens can be engaged to deliver public services for themselves, letting leaders and public officials off the hook in fulfilling their responsibilities.

Unhealthy political engagement arises out of conflict of interest among citizens. It exacerbates the accountability problem and can lead to "inversions" in each of the principal-agent relationships of government. Powerful elites with control over the coercive institutions of the state can subvert formal democratic and governance institutions. For example, the first principal-agent problem can become one in which leaders hold citizens accountable for providing political support by using violence and clientelist strategies such as vote buying (Stokes, 2005; Acemoglu and Robinson, 2006).

Even in contexts where power is more dispersed among citizens, rather than controlled by a few elites, there can nevertheless be conflict of interest among citizens with pernicious consequences for accountability for public goods. Citizens are heterogeneous in their beliefs about the role of government and what they demand from public policies and government leaders. Subsets of citizens organized as "special interests" can capture leaders and extract private rents from public policies (Grossman and Helpman 2001). Groups can form to engage in collective action with the objective of obtaining group-specific benefits that may come at the expense of public benefits that are shared with other citizens who are not organized (this is clearly conveyed, for instance, in Grossman and Helpman [1996]). Public officials and frontline providers can each organize as special interests (for example, teacher unions) that wield political power over leaders, thus inverting the second two principal-agent relationships within government. Social conflict leads to inefficient outcomes because those in power can choose policies to serve their interest and there is no outside agency with the capacity to control them (Acemoglu, 2003).

Alongside explaining how political engagement underpins government failures, this framework lends itself to distilling policy lessons for how transparency can contribute to changes in the nature of political engagement to improve outcomes. The very experience of political engagement, and the outcomes it produces for quality of government and service delivery, can lead to evolution in political behavior to solve government failures. Growing experience with political engagement and the learning that comes from it, sometimes through frustration and indignation with bad outcomes, can contribute to endogenous changes in political behavior, over time (Bidner and Francois, 2013).[5]

For example, a rise in demand by the elite for public goods has been linked to historical episodes of institutional reform. Lizzeri and Persico (2004) explain the extension of suffrage by English elites in the mid- to late-1800s as arising from an increase in the value of urban public goods following the industrial revolution (public health infrastructure such as sewerage, waterworks, and paved roads). A majority of the franchised elite pushed for reforms to extend the suffrage so that political parties would have stronger incentives to deliver these public goods. Consistent with their explanation, the authors document that following suffrage reforms, spending by municipal corporations on public health infrastructure increased substantially. Demand for common-interest public goods and inclusive political institutions are highlighted by Besley and Persson (2009) as part of the explanation for the origins of state capacity. The building of legal and fiscal institutions of the state, which are needed to support markets, protect property rights, and provide public goods, are linked in their model to conditions that enable citizens to come together for a common purpose.

If citizen beliefs and demands are important because they shape political engagement, one avenue to improving outcomes would be to foster interventions that affect those beliefs and demands for common-interest public goods. The literature on transparency offers guidance on how it can interact with institutions for political engagement to bring about the changes in political behavior that are needed to build state capacity and overcome government failures. Empirical evidence on the impact of transparency suggests that citizens, even in the poorest countries, are ready to use information to hold leaders accountable (World Bank, 2016). Transparency's impact in one area—voting behavior—is significant across all regions and in a variety of institutional contexts. Whether the responsiveness of voting behavior to transparency will bring about sustained changes in the institutions of governance in poor countries, where these institutions are weak to begin with, is an open question. The historical experience of rich and middle-income countries suggests that transparency works hand in hand with political engagement to enable societies to gradually build better institutions that serve the goals of economic development (Lizzeri and Persico 2004; Glaeser and Goldin 2006; Camp, Dixit, and Stokes 2014).

Working together, transparency and political engagement could not only hold elected leaders more accountable, but they could improve the incentives, political beliefs, and behavioral norms of appointed officials and of citizens. These forces together influence institutional change not only by affecting the "political will" or incentives of leaders to take up formal reforms, but also by changing informal behavioral norms in the public sector to act upon them.

[5] A body of research examining regional differences in governance within Italy has attributed the presence of greater social capital and of public interest or "civic" voting to earlier experience with participatory democracy (Putnam, Leonardi, and Nanetti 1993; Guiso, Sapienza, and Zingales 2006; Nannicini et al. 2013; Alesina and Giuliano 2015).

Political engagement is a blunt instrument for accountability. Other strong institutions beyond the ballot box, such as supreme audit institutions and independent judiciaries, are needed. The problem is how to build such institutions from a weak base. Change in formal institutions alone is not sufficient to change actual behavior. Research has found that healthy and unhealthy political behaviors can coexist and vary within the same formal institutional context (Acemoglu, Reed, and Robinson 2014; Andersen, Francois, and Kotwal 2015; Banerjee, Iyer, and Somanathan 2005). The importance of informal behavior is further highlighted in research that examines persistent effects of historical institutions, even when those institutions (such as slavery) have long disappeared and been formally replaced by others (Nunn, 2014, provides a review). A wealth of experience with efforts to strengthen institutions has shown that programs that replicate successful rich-country institutions in developing countries (often by providing equipment and training to bureaucrats) often fail (Pritchett, Woolcock, and Andrews 2013; Andrews, Pritchett, and Woolcock 2013; IDS 2010). Effective institutions are more likely to be homegrown, using local knowledge and tailored to local contexts (Dal Bó, Foster, and Putterman 2010; Rodrik 2000).

Political engagement and transparency, and the leaders selected through it, can foster these homegrown institutions by shifting political beliefs and promoting cooperative behavioral norms among citizens. Leaders can play this role as "prominent agents" who signal a shift in beliefs among society at large (Acemoglu and Jackson, 2015).[6] Multiple levels for political engagement, such as through local electoral institutions within countries, can enable transitions to healthy political behavior by increasing the supply of leaders who have built a reputation for responsible management of public resources (Myerson, 2006, 2012). Both the spread of local political competition and instruments for transparency, such as new communication technologies, can lower barriers to entry for new political contenders (Campante, Durante and Sobbrio, 2013). Changes in political engagement at the local level could potentially translate into larger changes at the national level, with local levels serving as the training ground for citizens to develop their political beliefs and behavioral norms (Giuliano and Nunn 2013).

III. How can political engagement and transparency be harnessed to overcome government failures?

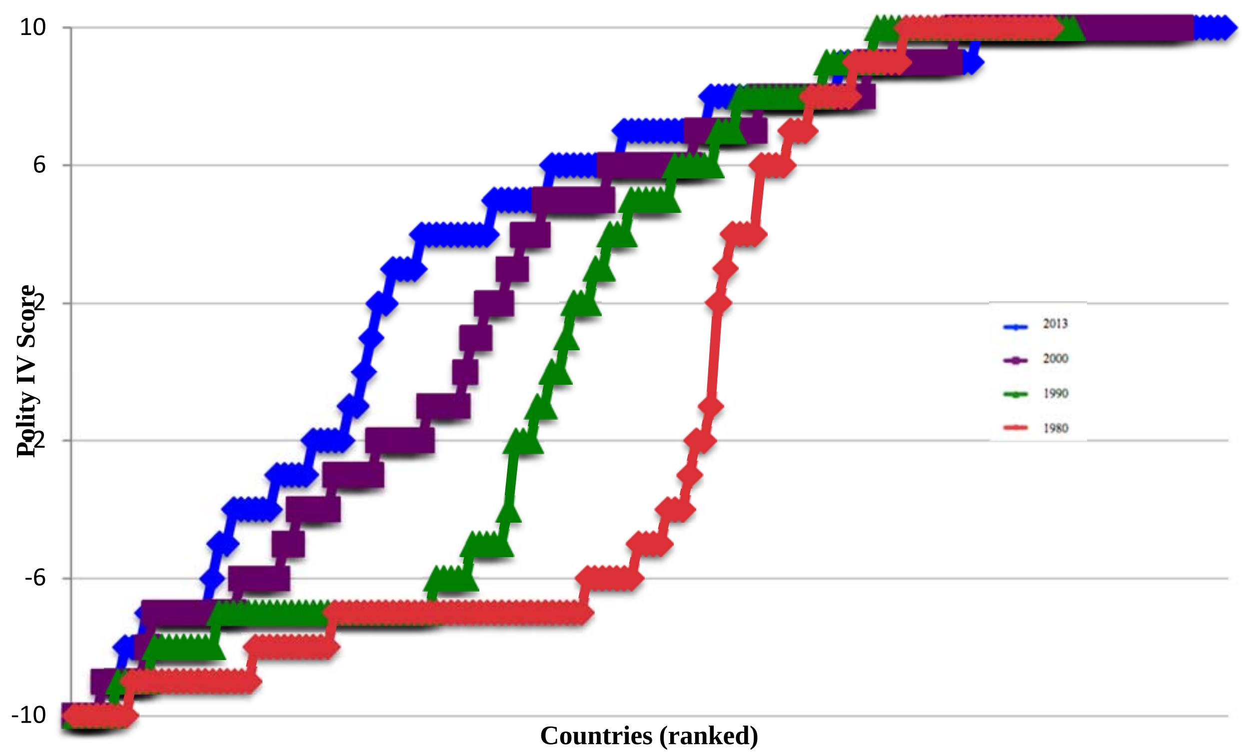
Conditions in today's poor countries resemble those described in historical accounts of institutional transition in rich countries. These conditions include: widespread political engagement by citizens, even the poor and less educated; broad-based demands for improvements in public services; dissatisfaction with the politics of patronage and vote-buying; and availability of cheap and accessible mass media such as television and radio. But good outcomes are far from guaranteed, with many risks of unhealthy political engagement by citizens and perverse responses by leaders. This section draws lessons on ways to manage the risks and channel these forces toward the goals of economic development.

Transparency can be targeted to nourish the growing political engagement and thereby complement other capacity building efforts to establish effective public sector institutions. Research on the attributes of transparency that bring about positive change suggests that external actors may have two advantages: the technical capacity for generating new data and credibility of information through politically independent expert analysis.

[6]. Beamen, Duflo, et al. (2009) and Beaman, Chattopadhyay, et al. (2012) provide evidence on how female leaders shift social norms related to gender.

A global shift in political institutions is providing space for greater political engagement. The dramatic spread of elections at national and at local levels, even within countries with authoritarian national political institutions, has created unprecedented opportunities for citizens to influence governance. Citizens are engaging as never before in the political process, as individual voters and as contenders for political office. Figure 2 plots the distribution of countries ranked by the Polity IV measure of democracy, with higher values corresponding to greater space for political engagement by citizens. During the past three and a half decades, the distribution of political institutions across countries has steadily shifted towards greater political engagement. Although some individual countries have experienced reversals to more autocratic institutions or seen little change, the overall trend has been toward greater opportunities for political engagement.

Figure 2. Global Shift toward Democratic Institutions for Political Engagement, 1980–2013



Source: World Bank (2016) using data from the Polity IV project. *Notes:* The Polity IV Score is a measure of state authority that is widely used in research, varying on a 21-point scale ranging from −10 (which corresponds to hereditary monarchy) to +10 (which corresponds to the Polity IV view of consolidated democracy). Higher values are associated with more democratic institutions.

Political engagement within countries is also growing through elections at the local level, even under different national political institutions. National leaders across the political spectrum are concerned about monitoring and managing public officials at the local level, who are often on the front lines of service delivery. National leaders even in authoritarian regimes are considering how best to use citizen engagement and transparency to solve this "last-mile" problem, including through local elections. For example, local elections at the village level in China have been found to support local accountability and to improve local government performance in delivering public goods, compared with bureaucratic monitoring through upper-level governments (Martínez-Bravo et al. 2011; Martínez-Bravo et al. 2014). Three country cases—India, Indonesia and Uganda—offer a picture of how political engagement is growing at the local level across very different national institutional contexts (World Bank, 2016). In Indonesia and Uganda, space for political engagement has grown as the result of proliferation of new subnational political units. India has seen a marked increase in contending political parties in state elections.

At the same time, the conduct of elections in many poor countries is marred by violence, fraud, vote buying and ethnic favoritism, leading researchers and observers to discount the role of elections in bringing about accountability (Collier, 2009; Kaplan, 2000; Chua, 2002; Zakaria, 2003). Furthermore, some observers doubt the capacity of poor and less educated citizens to exercise their vote responsibly. Robert D. Kaplan (2000 p. 62) states that 'If a society is not in reasonable health, democracy can be not only risky but disastrous." In the regions where most of the poorest people live, Africa and South Asia, more than 70 percent of respondents report voting. Citizens with less than a primary education, and therefore likely to be relatively poor, are *more* likely to report voting. Citizens in Africa with less than a primary education report voting 7 percentage points more than others; in South Asia the gap is 10 percentage points (World Bank, 2016). Pande (2011) finds that in many developing countries less educated and income-poor citizens tend to be more politically active than those with greater education and income.

Electoral malpractice does *not* imply that authoritarian institutions that bypass or suppress political engagement would necessarily improve outcomes. One study finds that ethnic favoritism led to distortions in public resource allocation even under authoritarian regimes in Kenya, but that periods of transition to multiparty electoral competition were in fact associated with *reductions* in these ethnicity-based policy distortions (Burgess et al. 2015). The same factors that explain unhealthy political engagement, such as the ability of political elites to punish voters through economic sanctions, violence, and coercion, can also prevent autocratic arrangements from being successful (Acemoglu and Robinson 2006; Besley and Kudamatsu 2008).

The diversity of successful institutions around the globe might tempt reform leaders to find ways of bypassing the messiness of electoral politics rather than improving it. It may even be interpreted as evidence in favor of restricting political engagement and establishing institutions run by benevolent dictators and organized elites. For example, some have attributed the East Asian growth "miracle" to institutions that restricted citizen engagement, allowing leaders to select and implement policies on technical merit.[7] This view, however, begs the question of where benevolent dictators come from, and whether the "miracle" can be replicated in other countries. Societies in which elites do not sanction poor leaders, or where elites benefit from poorly-performing leaders' remaining in office, are unlikely to be successful autocracies (Besley and Kudamatsu 2008). Why are some autocratic settings successful in selecting and sanctioning leaders on the basis of competence and performance, and others disastrous at

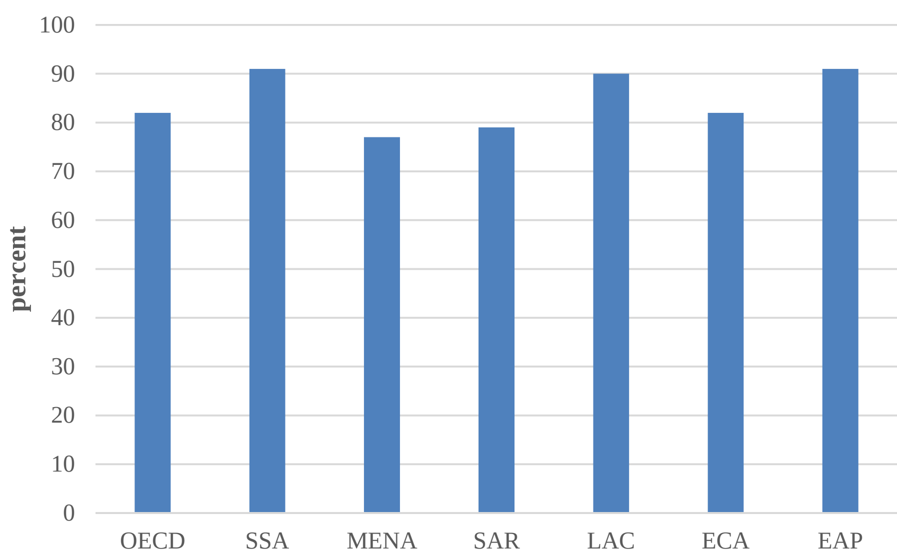
[7]. Isham, Kaufmann, and Pritchett (1997) suggest that this is the argument in a World Bank report on the growth performance of East Asian countries.

it? There is little research available to guide us on this question, and even less on whether messy democracies can eschew elections, however flawed they may be, and become well-functioning autocracies.

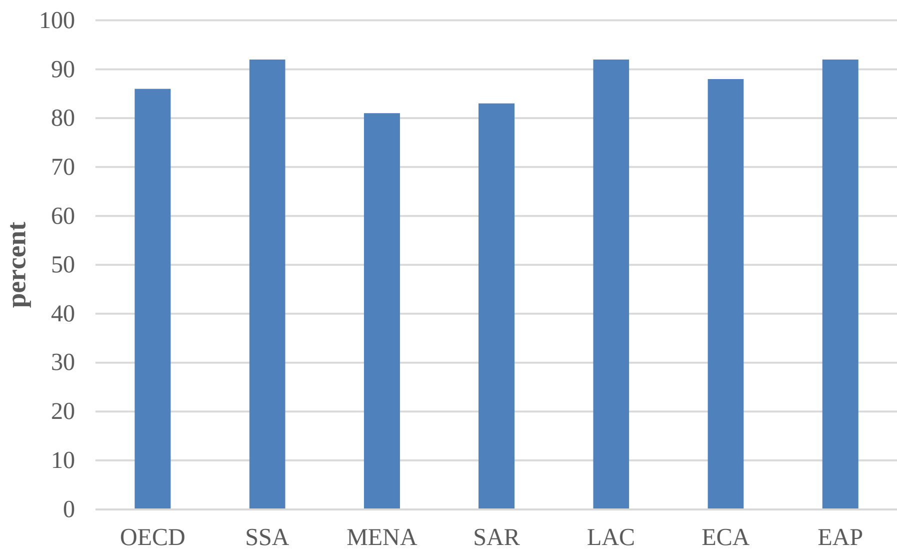
In contrast to researchers and external observers, citizens who experience electoral malpractice tend to believe that elections do matter, that through their votes they can improve their lives. The two panels of Figure 3 show the share of individuals by region who described elections as being very or rather important on a personal and national level, respectively.

Figure 3 Citizens' Views of the Importance of Elections

a. **Does Having Honest Elections Make a Lot of Difference in Your and Your Family's Lives? Percentage of respondents answering "Very" or "Rather" Important**



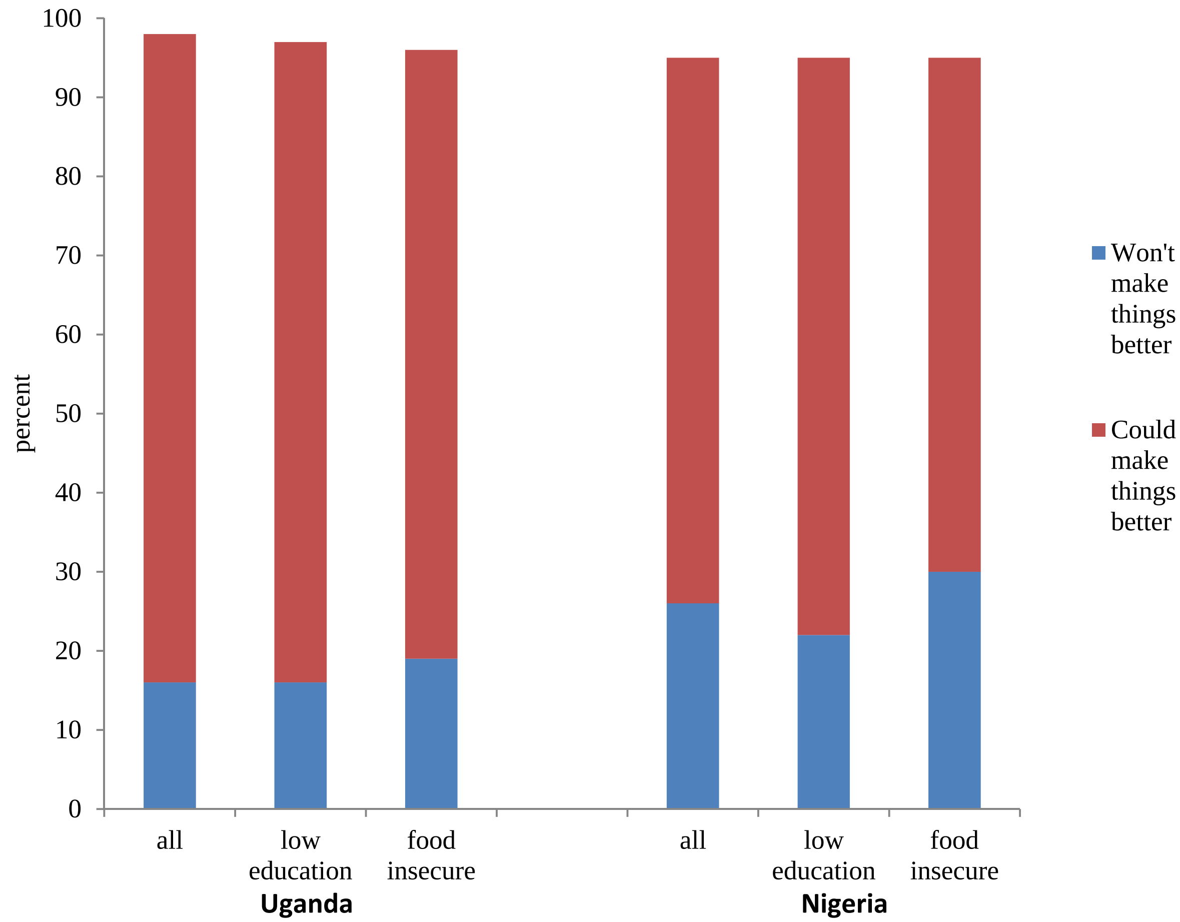
b. **How Important Is Having Honest Elections for Whether the Country Develops Economically?**



Source: World Bank (2016) using World Values Survey (Wave 6 undertaken over 2010-2014).

Similar patterns were obtained from two Afrobarometer surveys undertaken in Uganda and Nigeria on the eve of their elections in 2011 and 2007, respectively. In these surveys, about 80 percent of respondents in Uganda and 70 percent in Nigeria said that they believed the way they voted could make things better (Figure 4). Those respondents, many of whom are likely to be poor, with low education and reporting food insecurity, are just as likely as others to express the belief that the way they vote could make things better.

Figure 4. Citizens' Beliefs about Whether the Way they Vote Could Make Things Better, Uganda and Nigeria

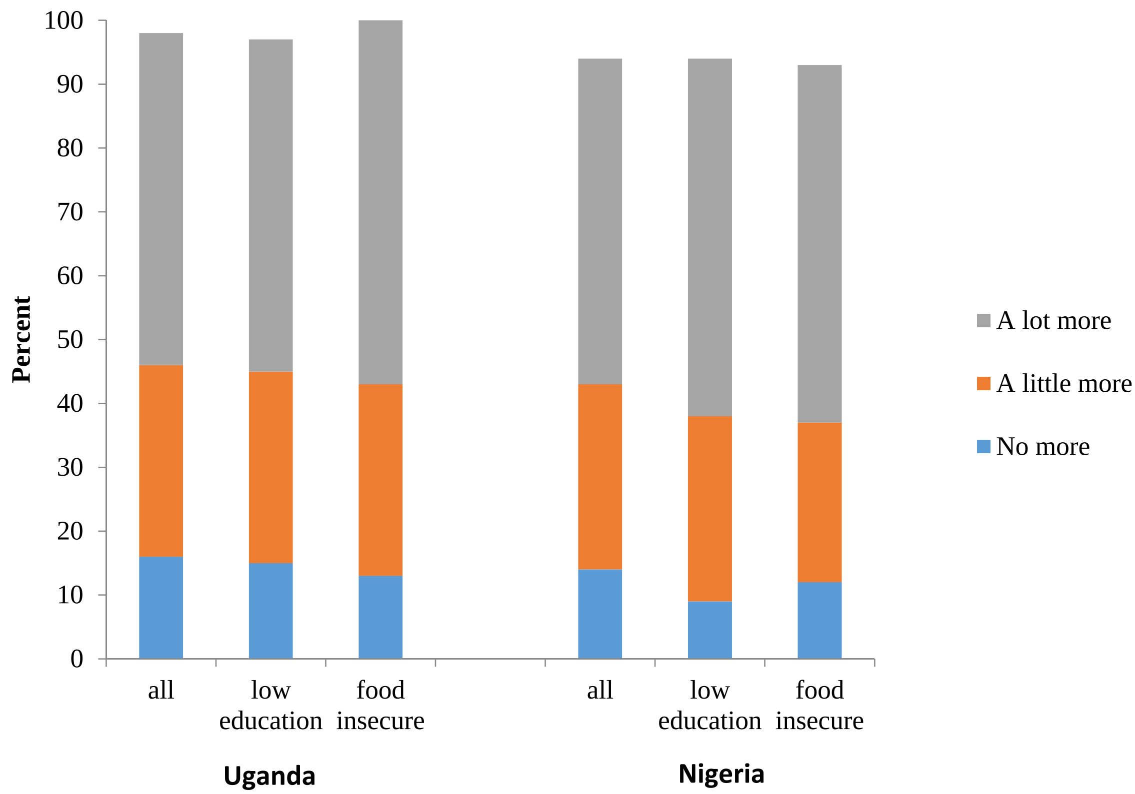


Source: World Bank (2016) using data from Afrobarometer Round 4.5.2 (Uganda 2011), Round 3.5 (Nigeria 2007).

Notes: The survey question is the following: "Which of the following statements is closest to your view? Choose Statement 1 or Statement 2.Statement 1: No matter how you vote, it won't make things any better in the future. Statement 2: The way you vote could make things better in the future."

Not only do Ugandan and Nigerian citizens believe in the importance of voting, and vote at high rates, but they also express interest in receiving information about elections. More than 80 percent of respondents said they wanted a little more or a lot more information ahead of the 2007 elections in Nigeria and the 2011 elections in Uganda (Figure 5). Again, those with less education and food security are just as interested in receiving more information as others.

Figure 5. How Much More Information Do Citizens Want in Order to Decide How to Vote, Uganda and Nigeria



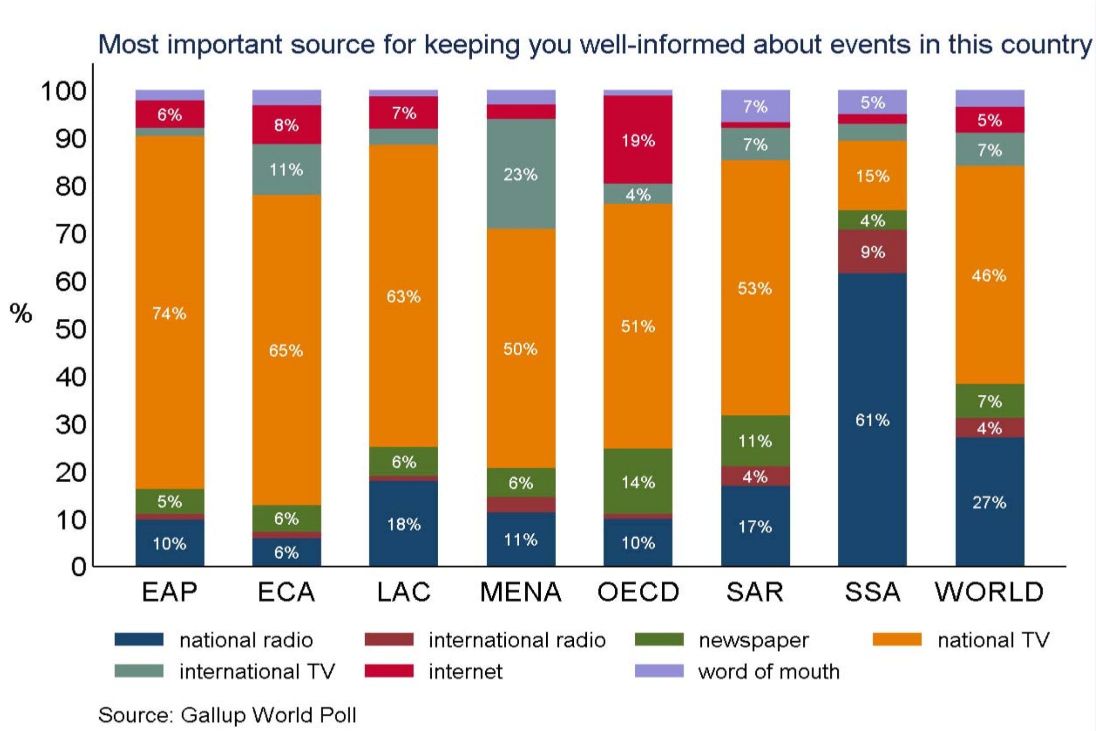
Source: Afrobarometer Round 4.5.1 (Uganda 2011), Round 3.5 (Nigeria 2007).

Notes: The survey question is the following: "In order to decide how to vote in the upcoming elections, how much more information would you like to have?"

There is substantial evidence that political engagement responds to transparency within and across a variety of institutional contexts. Transparency can increase voter turnout or shift the distribution of vote shares in countries as diverse as India, China, Malaysia, Mozambique, and Pakistan (Giné and Mansuri 2013; Banerjee et al. 2011; Guan and Green 2006; Aker et al. 2013; Miner, 2015). Even where corruption is rampant, concrete information on the extent of corruption, as revealed by public audits of government spending, can increase the likelihood that corrupt leaders are removed from office (Ferraz and Finan 2008). Where ethnic favoritism and vote-buying are widespread, the use of these clientelist practices to win office can be reduced by providing greater information about the quality of leaders and their performance in delivering public services (Casey 2015; Fujiwara and Wantchekon 2013; Keefer and Khemani 2014, Banerjee et al 2011).

Mass media, such as radio, television, newspapers, and the Internet, are important in bringing about changes in voting behavior. Leaders respond to mass media because it amplifies the role of political engagement to hold them accountable (Besley and Burgess, 2002; Snyder and Stromberg, 2010). Figure 6 shows that citizens around the world can obtain news from plural sources. A Gallup World poll question about the source people deem most important for becoming well-informed about events in their countries shows that in Sub-Saharan Africa citizens rely on radio. Research on the impact of radio in Africa has found that it provides information which helps relax ethnic and partisan loyalties, and promotes demand for broad public services in health and education (Casey, 2015; Keefer and Khemani, 2015).

Figure 6. Most Important Media that Citizens Report Using for News, by Region



Yet, the type of information, its source, and its “fit” with the institutional context are important. Information has sometimes had the opposite effect of discouraging voter turnout or increasing vote buying. The direction of impact depends upon the timing of information provision, the nature of the media market and the extent to which the information is credible or reflects political biases and polarization. The same type of information can have different effects depending on the credibility of the source. The pattern of evidence does not suggest that lack of impact or detrimental impact of transparency is limited to weak institutional settings or that successful impacts occur only in strong institutional settings. Yet, despite overwhelming evidence of the responsiveness of political engagement to transparency, there is no clear evidence on whether transparency’s impact is sufficient to get leaders to respond with sustainable or long-term improvements in outcomes, using the powers of their office to strengthen institutions. The extent to which incumbent politicians and party elites can undo any positive effects of information on voting behavior is not clear.

IV. Implications for development assistance

To summarize the argument so far: Government failures are constraining development. These failures, defined here as a series of principal-agent relationships between citizens, politicians, policy makers and service providers, are the result of politics. The political failures in turn can be understood as unhealthy citizen engagement to select and sanction leaders on the basis of receiving private benefits, which comes at the expense of broad public goods. Transparency can help strengthen and improve political engagement so that citizens can hold leaders accountable for public goods.

In this setting, how can development assistance help promote growth and poverty alleviation? As we mentioned earlier, the traditional mode of development assistance—the investment project—was based on overcoming market failures. That mode has not proved to be effective when the problem was government failure. Investment projects do not by themselves reform policies or institutions. Budget support based on conditions for policy reform has its limitations when the distortions that the reforms are meant to correct is the result of a political equilibrium. Knowledge assistance, provided only to the government, is unlikely to dislodge the political equilibrium. And looking for politically-feasible entry points or giving cash directly to citizens do not directly address the flawed principal-agent relationships that created the government failure in the first place.

For development assistance to be effective, the tradition of "bundling" knowledge and financial assistance—in a project, for instance—has to be abandoned. Knowledge assistance should be provided to citizens to help them in holding the government accountable. External actors should target transparency to nourish the growing forces of political engagement. External agents have technical capacity for generating new data and credible information through politically independent expert analysis. This technical advantage stands in sharp contrast to their lack of such advantage when it comes to building capacity and organizations for collective action from the outside (Mansuri and Rao, 2013; Pritchett, Woolcock, and Andrews 2013; Andrews, Pritchett, and Woolcock 2013; IDS 2010). Even though there is less established evidence from the poorest countries (in contrast to rich and middle-income countries) about the eventual impact of transparency on governance and institutions, what is available shows that political engagement is highly responsive to transparency. The theory on how changes in political engagement bring about larger institutional changes, going beyond the ballot box, and the supporting evidence on specific channels of the selection and sanctioning of leaders, are consistent with the potential of targeted transparency to work together with political engagement to gradually build better institutions in developing countries.

Research also indicates which attributes of transparency are important to cultivate healthy political engagement to overcome government failures. These attributes, discussed below, also imply that the aid architecture should be transformed to de-link financing from the knowledge transfer, to enable the latter to be more effective in helping countries build homegrown institutions and deliver results using the aid they receive.

Transparency is most effective when it supports specific, reliable, and impartial evidence on the performance of leaders. The information provided through transparency must be specific about both policy actions and the resulting outcomes, so that citizens can use this information to select and sanction leaders. Information that is not specific in this way will erode the benefits of transparency. For example, information only on budget allocations is of limited use without information on how these allocations were spent and what the spending accomplished. Naturally, the information provided must also be reliable, and must be accepted as impartial and untainted by partisan political considerations.

Media markets are crucial to foster healthy political engagement. Policies can promote healthy competition in media markets, and can be complemented by interventions to support public-interest programming that provides impartial information to cultivate citizens' political engagement. Even when media are independent from state control and markets are competitive, citizens can choose to access primarily entertaining programs that do not sufficiently inform them about public-interest issues. Sponsorship of appealing programs, or "infotainment", to communicate evidence on the actions of leaders and the effects of public policies, has the potential to persuade citizens to shift political beliefs in favor of good leaders and good policies.

The information and access to media has to be relevant and timely to the political process. A key dimension of relevance is jurisdictional: information on the performance of public policies needs to be targeted to the jurisdictions in which citizens select leaders. Information on public goods provision at the local level is more relevant to voters' decisions in local elections than is information at the national level. Timeliness matters as well: performance assessments of both current incumbents and of challengers, delivered regularly during a term in office but also at the time of elections, can make it easier for citizens to use information to decide on how to vote. Information that enables citizens to assess the potential of political contenders, not just incumbents, can be useful to avoid incumbency bias. Relevant information broadcast through media that citizens actually access and pay attention to can make it easier for candidates to compete on platforms of improving public policies and government performance.

Transparency can improve the functioning of local electoral institutions. Not only are local governments at the last mile of service delivery, but they are also at the "first mile" at which citizens determine the platforms on which leaders are selected and sanctioned. These platforms, whether they are the healthy ones of good public performance or the unhealthy ones of vote buying and ethnic favoritism, not only determine the incentives and quality of selected local leaders but can also shape the behavioral norms in the public sector as a whole. This first mile can matter for building legitimacy and capacity of state institutions in fragile contexts; for building capable and accountable local governments in rapidly urbanizing environments; that plan well for urban development and mobilize the domestic resources needed for sustainable development. The local level can matter for improving political attitudes and behavior of citizens in rich-country contexts as well, where the national stage appears to be hopelessly mired by political polarization among citizens. Targeting transparency to improve the functioning of local institutions of political engagement along the lines described above can therefore address some of the growing areas of economic concern throughout the world.

What is different about the recommendation here is the importance of communicating to citizens, in ways that effectively shift citizens' political beliefs and behavior on the basis of technical evidence. The traditional policy approach has treated leaders as the sole audience of expert analysis, and has treated communication to citizens as a matter not requiring scientific investigation. Communicating information to influence beliefs and political behavioral norms requires an understanding of the institutions within which and through which citizens form these beliefs. Research has offered a better understanding of how political engagement, and the leaders selected through it, shape beliefs and behavior in the public sector. Transparency can be targeted at these political institutions to try to improve beliefs and behavior towards solving shared problems of public goods for economic development.

Applying these policy lessons for transparency depends upon the characteristics of existing government jurisdictions: which tasks are assigned to which leaders, and who are the citizens who select and sanction them? If government jurisdictions have clearly assigned responsibilities for public goods, then it is easier to generate data on performance that can be attributed to the leaders of those jurisdictions, and to communicate that information to enable citizens to hold those leaders accountable for public goods. Most places will have a complex set of political and bureaucratic institutions that share responsibilities for the provision of public goods. In these cases, higher-order transparency, such as civic education about the roles of different government jurisdictions and officials, can play a role in strengthening political engagement.

What about the financial transfer? If it is in the form of a sovereign loan, the transfer has to go to the government. But it should be transferred in such a way that maximizes citizens' ability to hold the state to account, to complement the efforts by the knowledge transfer of improving the quality of political engagement through transparency. This can be achieved if the financing is transferred in a lump-sum fashion to the government budget. Note that this is the polar opposite of a traditional project, where the money is transferred only if it will be spent on a particular project (and disbursed only when expenses against that project are incurred). But aid where the donor specifies how the money should be spent weakens citizens' ability to verify—not to mention have a say in—whether the government is spending according to their preferences. The proposed method of transfer is also different from policy-based lending, which is usually conditioned on certain policies being enacted. This type of conditionality, imposed by the donor, again goes against citizens' efforts at demanding policy changes from their governments.

While this proposal may at first glance appear radical, it is in fact not very different from how aid is transferred now. For example, the World Bank (and other multilateral development banks) allocate aid to low-income countries according to a formula, based on the Country Policy and Institutional Assessment and other factors. The formula indicates the total amount of aid to a particular country that will be productive. Typically, the actual aid provided to a country is equal to this formula-based amount. The only difference is that the total is usually broken up into specific projects on health, transport, water and the like. But as pointed out above, these projects do not address the government failures plaguing low-income countries. Since the Bank has already determined that the formula-based total amount of aid will be productive, they should transfer that amount directly. If the country wants to build a road or school or hospital, it is welcome to use the aid resources to finance these investments. However, the decision should be the government's—so that the government can be held accountable—rather than the donor's. We should add that there is considerable evidence that project-specific aid is fungible (Feyzioglu, Swaroop and Zhu, 1998). That is, when the donor is financing a project that the government would have undertaken anyway, then the aid is replacing government resources, which are now spent on other items in the budget. In other words, even project-specific aid is effectively budget support. Finally, this lump-sum aid could still be conditional, but it should be conditional on those measures that promote citizen engagement and transparency, so that the financial transfers contributes to overcoming the government failure.

To be sure, this transition in the aid architecture will not take place overnight. The development community is accustomed to a traditional way of doing business, where knowledge and finance are bundled, and the two are primarily delivered to the government. However, the same development community has for a long time recognized that government failures are the main obstacle to faster growth and poverty reduction and, more recently, that these failures are political. Now that we have a better understanding of how politics contributes to government failures, and the role of citizen engagement and transparency in turning a vicious cycle to a virtuous one, the development community must re-think its mode of delivering aid, so that external actors can contribute to, rather than detract from, citizens' ability to select leaders who have the political will and the legitimacy to deliver the public goods needed for development.

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