

# Politician-Proof Policy?\*

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## Abstract

In this paper I discuss the nature of the political constraints that the World Bank faces in delivering basic services to the poor. The main problem arises because the Bank has to work through domestic governments which have political aims different from helping the poor. The conceptual approach attractive to economists and central to the WDR2004 is the notion of *politician proofing*. Given that political incentives derail good policies, how can those policies be politician-proofed? I argue that evidence and theory suggests that such an approach is ultimately futile, basically because we simply do not understand the relevant political incentives. I discuss alternative policy strategies and conclude that what is required is a much more fundamental assessment of what type of political equilibria deliver services to the poor. As I illustrate with the case of Botswana, once the political equilibrium is right, everything goes right and politician proofing is redundant.

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# 1 Introduction

The aim of the World Bank is to reduce world poverty. With this aim it lends money to developing countries and supports redistribution towards and investment in the poor. To deliver these policies it relies on the sovereign governments in various countries. Unfortunately, these governments typically have different objectives than the World Bank. For example, governments wish to be re-elected and stay in power, but this is irrelevant for the World Bank. Much experience suggests that these differences in objective functions lead domestic governments to choose policies which are different from those designed by the World Bank.

What policies? The focus of the WDR 2004 is on services for the poor. These include investing in schools and education, building hospitals and clinics, engaging in public health programs such as immunization, providing crucial public goods such as sanitation, sewage and clean water, and doing other things like electrification. The government is involved in these activities for the classical reason that there are endemic market failures. Poor people underinvest in education because there are imperfect capital markets and they cannot borrow against the future (Banerjee and Newman, 1993, Baland and Robinson, 2000), because there are positive externalities from education, and because educational provision involves the provision of public goods, such as schools and books. Poor people underinvest in other types of public goods such as sewage and the provision of portable water. For reasons well articulated in welfare economics there is therefore an important role for the public sector in improving the welfare of the poor by attacking these market failures. The goal of the World Bank is to encourage and support such interventions.

Unfortunately, there is a large gap between welfare economics and reality. Governments do not just solve market failures, they have their own objectives and they reward their supporters and penalize their opponents. I call a deviation from the policies dictated by a social planning problem a *political pathology*. One way of saying it is that one has to consider the net effects of political failures and market failures. I agree however with the thrust of the WDR in the sense that even when one considers an environment with both market failures and political failures it is highly unlikely that the optimum will be a corner solution with zero government intervention (see Acemoglu and Verdier, 2000). Government intervention will be needed, the issue is how to make it more effective given the political constraints.

In this paper I therefore discuss the nature of the political incentives that leads to the divergence between World Bank intentions and actual policy outcomes. I then move to address what the World Bank can or should do about it.

The conceptual approach that I follow is that it is rational, calculating, Machiavellian political realities that are the main problem which stops pro-poor policy being implemented. Of course in the real world there is much uncertainty about the exact form that an optimal policy could take. An excellent discussion of this is in Chapter 9 of the WDR2004 in the context of educational policy. We do not know the answer to questions such as; what is the optimal teacher-pupil ration? Nevertheless, the actual situation in many developing countries is that teachers are absent, there are no books, or infrastructure is deteriorating. There is no debate on the implications of these conditions or on measures to improve them. In other contexts there may be a lot of uncertainty at the level of poor individuals about what their options are and what it is best for them to do. This may well be true in contexts such as sanitation and basic health care, or the implications of condom use for the transmission of HIV. Nevertheless, since there is no real scientific uncertainty about the benefits of these health interventions we'd like to understand why governments repeatedly fail to make them. My approach is well summed up by the following passage (WDR2004, 9-9) on educational policy,

“efforts to improve proximate determinants through internal management initiatives have usually failed not because of lack of knowledge of *what* to do, but because of lack of sustained bureaucratic, market, parental and political pressure to make it work.”

I try to understand why the political pressures net out in the way they do. There are many question related to the World Development Report that I do not tackle. I focus most on link between citizens and policymakers. Obviously, as the report details, there are many places at which services fail to get delivered to the poor. For instance, there must be important principle-agent problems which influence the relationship between politicians and the bureaucrats who actually provide public services. These fall outside the scope of my discussion.

There are several conclusions of my study.

- The main problem with pro-poor policies is that the political incentives of client governments to redistribute are not aligned with the aims of the World Bank.

- Redistribution is targeted at people and groups which have desirable political characteristics, and these may be unrelated to the economic characteristics (such as poverty) that motivate the World Bank.
- Worse, political incentives involve redistributing in *forms* that can be narrowly targeted, implying that the collateral benefits to the poor may be limited.
- Worse still, the nature of governance and more generally the political equilibrium in client countries is almost certainly endogenous to World Bank aid. Aid is intrinsically political.

What can be done about this? The World Bank has several meta alternatives. The first is to recognize that politicians are politicians and design policies accordingly. This suggests, for instance, that narrowly targeted policies, though attractive from a normative point of view, will not do the job. Policies must be designed to be *politician proof*. However, in politician proofing the intellectually most attractive solution is almost certainly useless. By which I mean:

- The first thing to recognize is that designing complete contingent contracts when giving aid is infeasible. Neither academics nor the Bank understands how politics ‘works’ in Zambia or Colombia, so designing aid subject to the constraints that politicians act rationally is impossible.
- Incentive contracts with imperfect understanding of the constraints probably do more harm than good.

Given this one strategy is to look for alternatives that are *robust* against classes of *political pathologies*. Hopefully one can improve things without a detailed understanding of the constraint set. Some major candidates for robust policies are.

- Universal, blunt policies that cannot be targeted.

If even this is infeasible then perhaps we have to face up to the fact that in reality policy just cannot be made politician-proof.

If politician-proof aid is a chimera, or maybe counterproductive (I discuss examples) one possibility is to do nothing to make aid contingent, simply hand it over. In this case the evidence suggests that aid improves development outcomes when there is a ‘good’ government and has no effect when there is a ‘bad’ government. However, even when

aid has no impact on developmental outcome it almost surely improves welfare in poor countries and in some sense this is the ultimate goal.

Another clear possibility is:

- Go round the roadblock of domestic politics and attempt to use NGO's or create parallel institutions to deliver services directly to the poor.

This approach has many problems, including further undermining indigenous state capacity.

Alternatively, the World Bank can consciously attempt to mould the political equilibrium in ways that allow pro-poor policies to naturally arise in equilibrium. This suggestion may sound outrageous, but actually there is much evidence that, like it or not, the World Bank does alter the political equilibrium of the countries that it deals with. In this case it is much better to face up to it and consciously evaluate the effects that one's policies have. An obvious strategy for this (much alluded to the WDR2004) is:

- Give the poor more political power.

Yet I worry that this may replace a pro-rich or pro-middle class political pathology with an ultimately equally pernicious pro-poor pathology (one thinks of the APRA government under Alan Garcia in Peru in the 1980's). A more attractive approach is:

- Change the incentives of politicians so as to change the whole qualitative nature of the political equilibrium.

How on earth can such a goal be achieved? I discuss some relevant and rather optimistic evidence. Though we are a long way from understanding exactly how this could be done I am not sure that we are further from this than understanding how to politician-proof specific policies. I argue more that this is the right perspective and I illustrate it with a discussion of the political equilibrium in Botswana. When you get the political equilibrium right, everything goes right and understanding the details is not crucial. Thus one should not aim to achieve politician-proof policy. Moreover, I'd say the WDR's distinction between pro-rich and pro-poor politics is misleading. In fact what we want is neither pro-rich nor pro-poor politics, we want non-clientelistic politics where people, irrespective of their political coalition or political characteristics have access to basic services and rights.

The paper proceeds as follows. In the next section I provide an overview of what the political science and political economy literature has to say about the political logic of redistribution. I provide a taxonomy of some of the mechanisms that lead to political pathologies, distinguishing between *ex ante* and *ex post* mechanisms. In the political science literature the most studied class of pathologies comes under the rubric of ‘clientelism’ and I discuss the implications of this literature for the World Bank. As it stands the WDR2004 focuses very heavily on issues of accountability, which I see as relating to *ex post* mechanisms. I stress that the *ex ante* perspective is equally if not more important.

In section 3 I discuss what evidence there is to help us decide when these different mechanisms come into play. What do we know about the factors that determine actual political strategies? This is crucial for the World Bank because if it wants to understand the implications of its actions for the political equilibrium, and how this might be changed, it needs to know what factors lead the political equilibrium to be what it is.

In section 4 I then ask what can the World Bank do. I discuss the ideal of *politician-proof policies* and the reasons I do not believe this is a useful way to think.

## 2 Political Pathologies

The central problem with targeting policies at the poor is that politicians may not have the correct incentives to implement the policies. There are two aspects to this, an *ex ante* one and an *ex post* one. In *ex ante* terms, equilibrium policies chosen by politicians favor individuals or groups with desirable political characteristics, not desirable economic characteristics. If the poor do not have the right political characteristics then, *ex ante*, politicians will not have the right incentives to design policies that benefit them. In *ex post* terms, politicians may not find it optimal to implement the policies they promised to introduce. This problem can only be solved by mechanisms of accountability. If the poor do not have access to such mechanisms then policy promises to them will not be honored.

Most of the academic literature is not specifically concerned with particular services such as health or sanitation. Rather, it tends to focus on more general ‘redistribution.’ Redistribution may be pure transfers with no efficiency implications or they may take the form of public goods, either ‘general’ ones such a defense, or perhaps a clean environment, or ‘local’ public goods. It is local public goods that the WDR2004 is really about. Nevertheless, since many of the conceptual issues are the same I survey the relevant literature on redistribution more generally.

## 2.1 *Ex Ante*

What political characteristics are seen to drive *ex ante* policy? There are three basic questions: how much redistribution goes on, to whom, and in what form?

### 2.1.1 How Much?

The question of how much is addressed in a large empirical literature and is probably the least relevant question for the WDR2004. The empirical evidence on this has been recently re-evaluated by Persson and Tabellini (2003). They show using cross-sectional data that the size of government in society (government spending as a % of GDP) is greater when old people are a greater proportion of the population, the more democratic a country is, and the more open the economy is (a result initially emphasized by Rodrik, 1998). They find that federal nations have lower spending other things equal. Many other candidate covariates, such as ethno-linguistic fragmentation, per-capita income, and inequality are not robustly significant though appear to be statistically significant in some specifications. They also consider a panel dataset thus exploiting time-series variation and here find that in addition to the above results that per-capita income (Wagner's Law) has a positive and significant coefficient.

### 2.1.2 To Whom?

More interesting for the present discussion is to *whom*. The formal political economy literature finds that redistribution in democracies is targeted at groups,

- Which are relatively numerous.
- Which are able to solve the collective action problem when others are not (Bates, 1981, Persson and Tabellini, 2000, Section 3.5, Grossman and Helpman, 2001).
- Who manage to form political parties while others are not (Wittman, 1983, Acemoglu and Robinson, 2003).
- Who are un-ideological 'swing' or 'floating' voters (Lindbeck and Weibull, 1987, Dixit and Londregan, 1996).
- Who are relatively well informed (Strömberg, 2001, Besley and Burgess, 2002).
- Who turn out to vote in high numbers.
- Who are relatively poor (Dixit and Londregan, 1996).

- Who are in the same social network as politicians (Dixit and Londregan, 1996, Robinson and Verdier, 2002).

To the extent that the poor do not have these characteristics we would expect them to lose out in the determination of policy. There are some obvious relevant facts, in particular some of these factors cut in opposite directions for the poor. For example, we know that individual turnout in elections is positively related to education and income. The higher is the relative turnout of a group, the more attractive politically is it for politicians and the more likely it is that they will design policies to favor such a group. This hurts the poor. Moreover, the poor are likely to be less well informed than the non-poor. Strömberg (2001) and Besley and Burgess (2002) have shown how important the media is in redistributive politics. If the poor are relatively uninformed, they tend to get less. On the other hand the poor are relatively numerous and this cuts in the opposite direction.

Two other factors from the above list are almost certainly highly relevant - the ability of groups to solve the collective action problem, and the formation of political parties. Poor people are often relatively isolated and are less organized collectively. Moreover, in a society such as Colombia where the same two political parties have been sharing power for 150 years, it is hard for the voices of the poor to be heard.

The above list of factors are derived from formal models which place voting and elections at the heart of policy determination. What about non-democracies? There are few attempts to construct a theory of dictatorships at the same level of the theory of democracy so it is quite hard to draw out as many implications. Most (see Acemoglu and Robinson, 2003, Chapter 5) start from the idea that in a dictatorship some group chooses policy to maximize its own welfare subject to the constraint that it stays in power. To stay in power a dictatorship needs support and this support must be bought with policies, transfers, favors etc. Though dictatorships clearly use repression much more than democracies to stay in power the analytics of support may be related to the analytics of democratic support. If this is right then there are some important lessons from the above results. For instance, groups that solve the collective action problem may be more of a threat to a dictator and therefore have to be bought off. They therefore benefit from redistribution. Similarly, better informed groups may be more discontented with the dictator's policy and again may need to be bought off.

In contrast to the mechanisms outlined above, the political science literature has focused on simple dichotomies to answer the 'to whom' question. Scholars make a distinction

between policy which is 'clientelistic' and that which is 'programmatic' and these are conceived of as two polar political strategies that parties or groups contesting power might adopt. On the one hand, political parties can compete for support by offering different types of public goods which affect the entire population. These policies might concern ideological issues, such as human rights, or they may be more economic, such as law and order, trade and macroeconomic policy, or regulatory regimes. On the other hand, instead of focusing on such collective or public goods, parties can concentrate on offering particularistic benefits or private goods to groups of supporters. Shefter (1977, p. 403) provides a classic statement of this dichotomy;

“A Political party may employ two basic strategies in its efforts to induce voters to support its candidates..It may distribute divisible benefits-patronage of various sorts-to the individuals who support the party. Alternatively, it may distribute collective benefits or appeal to a collective interest in an effort to elicit...votes.”

A more recent statement, Kitschelt (2000, p.845-846) distinguishes between

“pursuit of policy programs that distribute benefits and costs to all citizens regardless of whether they voted for the government of the day or not (programmatic linkages). Alternatively, does accountability and responsiveness have to do with delivering specific material advantages to a politicians' electoral supporters (clientelistic linkage)?”

The problems that the World Bank faces stem from precisely the fact that clientelism is seen to plague developing countries. This is most evident from the academic literature in African politics in which there is a huge consensus that African politics can be described as clientelistic or 'neo-patrimonial' and subject to 'personal rule.' Leonard and Strauss (2003, p. 2) characterize this as the 'personal-rule paradigm' (stemming from Rosberg and Jackman, 1982) noting,

“In the African context, personal rule is often shorthand for describing the prevalence of patronage politics: the distribution of public goods - offices, public works projects, permits, tax breaks, and so on - in return for loyalty. Used in this way the state operates less according to procedural rules and more by personal relationships. Clientelism is another term for this dynamic. Personal, informal dynamics here are of foremost importance, not abstract bureaucratic laws.”

The main implication is that (p. 4),

“personal rule contributes to weak states. Procedures based on loyalty, informal agreements, and personal relationships tend to undermine a government’s ability to function effectively...public resources tend to be used for patronage or private purposes, resulting in a lack of public investment...The state is not a tool for public development but for private ‘eating’ and for rewarding support networks.”

From the point of view of the WDR2004 the key issue here is that since developing countries are seen to be clientelistic, under what circumstances might we expect the poor to be the clients of politicians? Clientelistic politics is worse than programmatic politics, but conditional on being in a clientelistic regime it is better to be a client than to be completely excluded from patronage.

Unfortunately, there are few generalizations in the political science literature on who clients are and it is difficult to draw any conclusions about the circumstances under which such people are poor. The general idea is that there is some extra-political relationship, possibly economic, possibly social that leads patrons to be matched with clients. One interesting way to link this literature to the political economy literature discussed above is to see the formal model as generating mechanisms that might help in identifying what sort of people or groups are likely to be clients, the recipients of personalized redistribution.

### **2.1.3 In What Form?**

A key issue is not simply how much redistribution and who gets it but the *form* that this redistribution takes. One of the key problems for the delivery of services to the poor is that even in circumstances where the poor have the right characteristics, political incentives may dictate that they get redistribution in something other than the socially optimal form.

The study of the form of redistribution dates to the work of Stigler (1971) and Becker (1976) in the 1970’s. They asked why there are inefficiencies in the form of redistribution. For example, why redistribute to farmers by subsidizing the price of agricultural output. This is socially inefficient since it keeps resources in agriculture that could be better used elsewhere. From a social point of view, if farmers have sufficient political power to get redistribution at all, the best thing to do would be to transfer income to them. Recent research on the form of redistribution has tried to elucidate political mechanisms which

might lead inefficient forms of redistribution to be politically attractive. In the recent literature inefficiencies in the form of redistribution may be motivated by a desire

- By politicians to conceal that they are really redistributing (Coate and Morris, 1995).
- By interest groups benefitting from redistribution to maintain their political power (Acemoglu and Robinson, 2001).
- By politicians hoping to reduce the total amount of redistribution that they have to undertake (Rodrik, 1986, Wilson, 1990, Becker and Mulligan, 1998).
- By politicians because it helps them to create incentives for voters to support them (Bates, 1981, Persson and Tabellini, 1999, Lizzeri and Persico, 2000a, Robinson and Verdier, 2002, Robinson and Torvik, 2002).
- By interest groups because it can help them solve the collective action problem.

A key finding in this literature is that even when poor get stuff, the form of that stuff is biased against public good provision or the things that the World Bank might want to provide. This is again because of political incentives. The idea here is old but was brilliantly illustrated by Robert Bates in his study of agricultural policy in Africa. In his analysis of why governments persistently and inefficiently underprice agricultural goods, but instead choose to subsidize fertilizer and state farms he notes (Bates 1981, p. 114),

“Were the governments of Africa to confer a price rise on all rural producers, the political benefits would be low; for both supporters and dissidents would secure the benefits of such a measure, with the result that it would generate no incentives to support the government in power. The conferral of benefits in the form of public works projects, such as state farms, on the other hand, has the political advantage of allowing the benefits to be selectively apportioned. The schemes can be given to supporters and withheld from opponents.”

His analysis isolates a key force influencing the form of redistribution. When redistribution is clientelistic it is important to target it to specific people or groups. This idea has been elegantly formalized by Persson and Tabellini (1999) and Lizzeri and Persico (2000a). It leads to a generic underprovision of public goods because, by their definition, these are blunt and benefit all people.

Robinson and Verdier (2002) extend these ideas emphasizing that not only are public goods non-targetable, they are provide non-excludable benefits. This is not politically attractive when politicians want to reward their clients only and exclude others from the benefits. Moreover, if politicians are attempting to punish citizens who did not support them, then they will tend to underprovide such goods.

Apart from these issues the other one which is central for the WDR2004 is the connection between the form of redistribution and state capacity. Though this issue is imperfectly understood (see Robinson and Verdier, 2002, for a stab at this), one of the most common inefficient instruments is employment in the public sector or bureaucracy. There is overwhelming evidence that this is an endemic source of lack of state capacity (see Alesina, Baqir and Easterly, 1998, and Alesina, Danninger and Rostagno, 1999, for empirical evidence on this issue). The reason for this is obvious, if employment is governed by political criteria then employees cannot be given incentives to work hard because they cannot be credibly threatened or sanctioned. Thus typical incentive contracts won't work. The political science literature on clientelism and neo-patrimonialism takes it as axiomatic that clientelism involves employment and that this destroys state capacity.

It is political incentives that influence the form of redistribution that answer the questions posed in the WDR2004 Chapter 5, page 1 such as “why are large public expenditures systematically misallocated- for example to large infrastructure projects and the wage bills of bulky state administrations, often at the expense of social services.” This arises because, for example, a job can be targeted to a person in exchange for support but social services cannot. Moreover, is it easier for a politician to get credit for a job.

## **2.2 *Ex Post***

There are endemic problems of moral hazard in politics. Whatever politicians may actually promise before an election (or perhaps a ‘contest for power’ in a non-democratic context) ex post they may have incentives to renege. Given the nature of politics it is not possible to enforce promises using third parties, such as judges, since it is the government itself which is supposed to enforce contracts and which controls the judiciary. Politicians may deviate from promises because they themselves prefer other policies, or simply because they want to steal for themselves money that they promised to spend on providing public goods for citizens. The main issue here is what mechanisms of accountability do citizens have to make sure that politicians carry through with their promises and do not engage in venal activities.

Work on accountability in a democratic context stems from papers by Barro (1973), Ferejohn (1986) and Persson, Tabellini and Roland (1997). They examined the conditions under which voters could use punishment strategies to discipline politicians who renege on commitments or engage in corruption.

Though this literature is much less developed than the *ex ante* literature there are some implications which are interesting for the WDR2004. To be effective in disciplining politicians citizens have to coordinate their voting strategies, so that again the ability of groups to solve the collective action problem is crucial for accountability. Groups who cannot do this will not be able to effectively sanction politicians.

Who controls the agendas of political parties is also likely to be important. Sanctions are only going to be effective in situations where there are real alternatives for voters. If one considers a case like Colombia then there are few options for voters who wish to discipline one of the main parties. This clearly happens, President Samper was widely believed to have taken bribes from drug mafias to help his election campaign and as a result the Liberal party was punished in the next election. Yet the only alternative is to punish by replacing the Liberals with the Conservatives who are probably equally corrupt. Note also that if the poor controlled the agenda of a political party directly there would be no commitment problem here (barring massive agency problems) because the party itself would wish *ex post* to honor any promises it made to the poor.

Many of the mechanisms I isolated in the *ex ante* section also apply in this context. If people are poorly informed they may not understand that policies they had been promised have not been implemented properly, or at all, and again there will be a failure of accountability. Similarly, un-ideological ‘swing voters’ will be effective at punishing miscreant incumbents because such voters are relatively willing to switch and support an alternative political party.

### **2.3 Neglect - Benign or Strategic?**

So far I have considered situations where the poor do not benefit from redistribution because *ex ante* they do not have the correct political attributes to extract promises, or *ex post* because they are not able to effectively impose accountability on politicians. In some sense the neglect that the poor experience in these situations is relatively benign. They lose out because others are more desirable to court politically. Nevertheless, there are other situations where groups are discriminated against strategically because of the anticipation that policy that favors them will influence the future balance of power. This

idea was first discussed by Robinson (1998) and developed by Acemoglu and Robinson (2000, 2002b) and Bourguignon and Verdier (2000). I illustrate it with an example from Ghana.

The anti-colonial movement was organized in Ghana by Kwame Nkrumah and his Convention People's Party (CPP). However, as soon as the promise of independence had been secured from the British the anti-colonial coalition in Ghana crumbled. Chazan and Pellow note (1986, p. 30)

“by 1951, with the British agreement in principle to grant independence to the colony, this stage of decolonization gave way to a period of domestic struggles for power on the eve of independence. At this junction, the internal tensions that had been somewhat in check erupted into an open clash over the control of the colonial state.”

This left Nkrumah (who was from a minor Akan ethnic group - the Nzima) with a very precarious political base. To compensate for this Nkrumah engaged in a “divide and rule” strategy with respect to the Ashanti (whose chiefs were one of his strongest opponents) by attempting to set different factions of commoners against the chiefs. Austin (1964, p. 250) notes that the chiefs and their National Liberation Movement (NLM),

“met the nationalist appeal of the CPP with a rival nationalism of its own, through an impassioned demand for recognition of the traditional unity of the Ashanti nation,”

This political strategy ensured Nkrumah's power at independence in 1957. After the departure of the British, he moved to suppress the opposition and altered the Constitution (in a fraudulent plebiscite) to strengthen his powers. Pellow and Chazan (1986, p. 41) argue that

“The 1960 constitutional referendum...augmented the powers of the executive..Nkrumah was elected president of the First Republic, and thus, for all intents and purposes, by 1960 Ghana had become a one-party state with Nkrumah as its leader. The authoritarian tendencies apparent during decolonization were officially entrenched in the centralized and personalized pattern of government that emerged at this juncture.”

Despite the announced objectives of modernization, the need to stabilize political power seems to be the key determinant of economic policies. Pellow and Chazan (1986, p.45) argue that by 1964 the CPP had

“reduced the role of the state to that of a dispenser of patronage. By advocating the construction of a ramified bureaucracy, Nkrumah established a new social stratum directly dependent on the state. By curtailing the freedom of movement of these state functionaries through the diversion of administrative tasks to political ends, the regime contributed directly to undermining their effective performance.”

The disastrous economic impact of the CPP’s policies have been well analyzed by Bates (1981), some of whose results I discussed above. In addition to the agricultural policies Nkrumah also embarked on an ambitious industry policy. However, the contradictions of Nkrumah’s heavily subsidized government led industrialization program immediately became apparent, as Killick (1978, p. 37) notes,

“Even had there been the possibility [of creating an indigenous entrepreneurial class] it is doubtful that Nkrumah would have wanted to create such a class, for reasons of ideology and political power. He was very explicit about this saying ‘we would be hampering our advance to socialism if we were to encourage the growth of Ghanaian private capitalism in our midst.’ There is evidence that he also feared the threat that a wealthy class of Ghanaian businessmen might pose to his own political power.”

Further evidence on this comes from E. Ayeh-Kumi one of Nkrumah’s main economic advisers who noted after the coup that Nkrumah (Killick, 1978, p. 60)

“informed me that if he permitted African business to grow, it will grow to becoming a rival power to his and the party’s prestige, and he would do everything to stop it, which he actually did.”

Nkrumah’s solution was to limit the size of businesses that Ghanaian could own. This caused problems for his industrialization policy which he got round by allowing foreign businessmen to enter Ghana. Though this was inconsistent with his aggressively nationalistic and anti-imperialistic rhetoric these businessmen did not pose a domestic political threat. Killick (p. 37) notes “Given Nkrumah’s desire to keep Ghanaian private

businesses small, his argument that ‘Capital investment must be sought from abroad since there is no bourgeois class amongst us to carry on the necessary investment’ was disingenuous. He goes on to add that, (p. 40) Nkrumah “had no love of foreign capitalists but he preferred to encourage them rather than local entrepreneurs, whom he wished to restrict”.

In this example it was not simply that Ghanaian businessmen did not have the correct positive political characteristics to induce the CPP to offer them favorable policies. They actually had negative political characteristics which made the CPP want to bias policy against them. There are many examples of this sort of thing in the historical and political science literatures (see Robinson, 1997 and Acemoglu and Robinson, 2002b for other examples and Dalton, 1965, on Liberia).

Another particularly interesting related issue is whether or not the decision to adopt clientelism is influenced by the desire to control collective action. In many informal studies it is argued that clientelism is a type of ‘divide and rule’ political strategy and is attractive precisely because it destroys the ability of groups to engage in collective action by selectively undermining their solidarity. For example, Waterbury (1977, p. 340) notes

“In the poorer societies patronage helps obscure and disorient class alignments and to perpetuate the power advantage of the dominant groups by the conscious cultivation of vulnerability and dependency.”

If these types of forces operate against the poor then things may be even worse than had been imagined. There may be a bright side however. Under the CPP, Lebanese businessmen were allowed to function because they were not politically threatening to the regime. Similarly, it could well be the case that NGO’s and the Bank can function in providing services in a non-politically threatening way which might not be open to domestic organizations or groups.

### **3 Determinants of Political Strategies**

I discussed above some of the empirical findings about why the level of public expenditure varies across countries. In this section I concentrate on the more relevant issues of what we know about what determines the extent of clientelism in a society, or the factors that lead politics to be clientelistic rather than programmatic? What factors might influence the intensity of clientelism? Why do some societies suffer more from political pathologies than others? What do we know about the conditions under which some political characteristics

dominate others? What determines the form of income redistribution or government policies?

Evidence on any of these questions is highly tentative. There are quite a few ideas in both the formal and informal literature, but as yet few conclusive tests. For example, though the theoretical models which follow Lindbeck and Weibull (1987) emphasize the idea that swing voters are important, there is not much evidence that swing voters are important in determining actual redistributive outcomes. Recent work by Ansolabehere and Snyder (2002) using a panel of U.S. states finds no evidence that swing voters are important and rather government spending is concentrated on the districts that tend to support the incumbent party. Their empirical work is interesting because it tends to support a view of the world related to the ‘citizen-candidate’ model of Besley and Coate (1997) and Osborne and Slivinski (1996). In this, politicians have preferences over the policies they adopt and are unable to commit to any other type of policy. Anticipating this, voters vote for politicians whose preferences are relatively like their own. This echoes a theme which I have already introduced, the importance of political party objectives, and suggests that the poor will only benefit from policies when they can organize their own political party and poor people themselves manage to run for office (such as the Worker’s Party in Brazil).

What about empirical evidence on the composition of expenditure? Persson and Tabellini (2003) examine the cross-country determinants of welfare spending as a % of GDP. Welfare spending includes things like spending on pensions and unemployment insurance. They find that only the age structure of the population has any robust explanatory power, though there is some evidence that welfare spending is higher in democracies.

I now discuss some of the factors which models suggest are important and what evidence can be brought to bear to assess their importance.

### **3.1 Modernization**

Consider first the conditions under which a society tends to have clientelistic politics. The basic idea in political science is that clientelism characterizes ‘unmodernized’ polities (e.g. Lemarchand and Legg, 1972). Indeed, clientelism is seen as an extension of pre-modern politics. In some models the attractiveness of clientelism may depend on the level of per-capita income. For example, in Robinson and Verdier (2002) the higher is per-capita income, other things equal, the greater the opportunity cost of inefficient clientelistic redistribution and the less attractive it is. In their model, income growth can lead to the

abandonment of clientelism, and this certainly formalizes some of the ideas in the political science literature.

What cross-country evidence there is, is roughly consistent with this. Apart from the evidence cited above on the cross-country determinants of transfer income, there is very little work on how to measure or account for clientelism. I know of no good work trying to explain the composition of government expenditures across countries in order to test some of the ideas I have discussed. One idea is to look at corruption. Empirical studies find that the level of per-capita income has a robust negative effect, other things equal, on corruption (e.g. Treisman, 2000, Persson, Tabellini, and Trebbi 2003, Persson and Tabellini, 2003). Nevertheless, examples such as the persistence of endemic clientelism in Italy at least into the 1990's and the widespread clientelism currently argued to exist in middle income countries such as Argentina and Colombia does not suggest that simply waiting for growth to end clientelism is a very attractive option.

## **3.2 History**

A potent source of institutional variation between countries is different historical experiences. In the context of currently developing countries colonialism had radically different impacts creating very different societies in different places (Engerman and Sokoloff, 1997, Acemoglu, Johnson and Robinson, 2001). This is obviously important in explaining why the United States is more democratic and has more pro-poor politics than Bolivia. These historical legacies certainly have important implications today. For example, Bratton and van de Walle (1997) argue that the semi-settler colonies such as South Africa and Zimbabwe have more chance of ultimately consolidating democracy than other African nations because of their different institutional endowments.

## **3.3 Factor Endowments**

One set of factors, heavily emphasized in the informal political science literature, concern natural resource endowments. Countries with economies centered on the extraction of natural resources such as oil or precious minerals like gold or diamonds are seen to be particularly prone to clientelism. This is because such endowments give the government a solid resource base which they can use for patronage. Even if the rest of the economy collapses due to state incapacity or failure to provide necessary public goods the income from the resources keeps flowing. In addition, since natural resource rents can so easily be taxed in poor countries with inadequate fiscal systems, the greater the share of such

resources in income, the greater the benefits from holding power. Since clientelism is a strategy aimed at staying in power, the greater the benefits of being in power the more endemic will be clientelism (see Robinson, Torvik and Verdier, 2002).

Nations that depend on the extraction of natural resource ‘enclaves’ are thus thought to be highly prone to clientelistic strategies. To quote Leonard and Strauss (2003, p. 13)

“Enclave economies, we argue, are a foundation for personal rule. In such regimes, rather than developing infrastructure or institutional capacities for broad-based markets, states collect and distribute ‘rents’ (taxes and bribes) as patronage. An enclave economic base allows personal rule to sustain itself over the long run both because enclaves themselves are susceptible to state predation and because enclaves do not depend on widespread productivity for their sustenance. Thus the state’s primary function can be private patronage distribution because wealth generation does not depend on development.”

The relevant empirical evidence on this, due to Treisman (2000), looks at the connection between natural resource exports and corruption. His findings suggest some evidence that countries where natural resources are a high fraction of income tend to be more corrupt, other things equal. Ades and di Tella (1999) present similar evidence. Persson and Tabellini (2003) also show that the size of government is larger in such economies.

### **3.4 Geo-Political Environment**

Possibly the most important source of comparative statics for the WDR2004 is the relationships between the international geo-political environment and domestic political strategies. Unfortunately, the resounding conclusion is that the international system has created highly perverse incentives for politicians in developing countries. The most recent sweeping version of this thesis is in the literature on state formation in Africa due to Herbst (2000) and Bates (2001) (though see Robinson, 2002, for some caveats about the empirical applicability of this thesis).

Herbst and Bates attempt to explain why African states have so little ‘capacity’ and why the continent is plagued by ‘state failure.’ A state is meant to provide certain public goods in society, such as law and order, defense, contract enforcement, and infrastructure. Yet in Africa most states provide very few of these. They are unable to exercise control over much of their territory, they do not provide order or public goods. What then is different about African states that leads them to diverge so radically from our ideal?

The Herbst-Bates thesis builds on a rich tradition of work on the origins of European Nation States initiated by Max Weber. This literature attempted to explain the origins of modern institutions such as nation states with well-defined territories. Nation states are characterized not just by borders and citizens with national identities, but also by bureaucracies, fiscal systems, and representative institutions such as parliaments. Especially influential has been the work of Charles Tilly (1990). The central idea of this literature is that the high population density of Europe made land relatively scarce and valuable to control, particularly from the late middle-ages onwards. This and technological change in the methods of warfare (e.g. more sophisticated battle tactics and firearms) drew states into continual conflict. But warfare is costly and early modern states required resources to attack and defend. Kings were therefore in a continual battle with Lords and Commoners over taxes. To get money for wars, Kings had to build bureaucracies, they had to gather information and map their territory and people. They also had to make concessions - such as creating regular parliaments where citizens could have a voice. An alternative to concessions was to crush domestic opponents who resisted the demands of Kings. All these things were necessary to survive. If a state did not become “stronger” then typically it became extinct, as was the case with Poland.

This process created the modern system of nation states with their familiar institutional infrastructures that consolidated in Europe in the nineteenth century. The Herbst-Bates thesis is that this process has not taken place in Africa. It did not take place historically in the pre-colonial era, it did not take place during the colonial epoch, and it is not taking place since or now. Why?

Africa is different because the structural conditions that led to the path of state formation and institution building in Europe were absent in Africa. Firstly, unlike in Europe, land was and is not scarce in Africa. Rather labor was scarce. Thus in the pre-colonial period states did not fight over land, but rather people. This explains why property rights in people (slavery) are well defined, but those in land were not (to this day most land in Africa is held communally). This meant that pre-colonial states had vague borders and were often very “weak”. Without the constant necessity of defending a well defined territory states did not need to invest in bureaucracies, censuses of their population, tax collectors, permanent militaries. Herbst also argues that this explains the absence of pre-colonial mapping in Africa.

This absence of external threats coupled with low population densities persisted. During the colonial period there was little fighting over borders between the colonial powers. The conference of Berlin in 1885 largely determined which European power would have

which bit of Africa. This meant that like the pre-colonial polities, European colonial powers had little incentive to develop state institutions. Instead they focused on commercial exploitation and outright plunder of the mineral and natural wealth. The exceptions to this are the settler-colonies of South Africa, Rhodesia, and to a lesser extent Kenya. Following independence, the situation could have changed but it did not because the International state system and United Nations decided to enforce the colonial boundaries that had largely determined the form that the new nations took. This trend was reinforced by Cold-War politics. Thus African states were still able to survive without having to engage in the type of institution building that occurred historically in Europe. When the borders were threatened, such as when Libya invaded Chad, they could reply on the United Nations or European powers sending troops to the rescue.

Herbst and Bates argue that the lack of development of African state institutions helps explain many aspects of modern Africa. Since states never had to fight to survive they never had to build effective fiscal institutions. Therefore they have no tax bases and instead have to engage in highly distortionary methods of raising taxes (such as taxing trade) or redistributing income (for example via employment in parastatals). Since states never had to fight to survive, rulers never had to consolidate their rule and crush domestic opposition. Hence the incidence of warlordism so evident in countries such as Angola, Liberia, and Sierra Leone. Since states never had to fight to survive, they never had to make political concessions to their citizens. Hence the lack of functioning domestic political institutions such as parliaments and the completely unconsolidated nature of democracy in Africa. Moreover, the lack of these institutions can help explain the extent of venality and state corruption in Africa since these institutions provide key checks on abuses like this. Finally, this set of institutions has been further encouraged in the last fifty years by foreign aid and development assistance. These transfers give states valuable resources that allows them to stay in power without having to develop indigenous state institutions to raise taxes. Thus the incapacity of African states has been reinforced not just by Cold-War politics but also by less cynical attempts to help.

The connection between the Herbst-Bates thesis and the WDR2004 is that it provides a structural explanation for why there are weak states in Africa and weak states are prone to clientelism. Indeed, both authors subscribe to the 'personal rule paradigm' the idea being that weak state institutions make personal rule and attractive, maybe necessary political strategy. The key idea here is that both authors argue that it is the international system, of which the World Bank is a key player, that has helped to sustain weak clientelistic states.

Another perspective on the same issue come from the work of van de Walle (2001). He examines the failure of African countries to perform well economically since independence and why policy reform since 1979 has been so unsuccessful in changing anything. His analysis suggests that good economic policies and performance are inconsistent with clientelism (or neo-patrimonialism in his terms) and that policy reform does not take place because it would undermine the ability of rulers to use patronage to maintain their power. Depressingly, he concludes that the role of International Financial Institutions such as the World Bank has been to entrench such practices since they provide the resources that allows clientelism to persist as a viable political strategy even in the midst of economic collapse.

Even the World Bank itself recognized this potential. For example, Devarajan, Dollar and Holmgren (2001, p. 6) in their summing up of ten African case studies make one of their conclusions,

“Large amounts of aid to countries with bad policy sustained those poor policies. The funding allowed the delay of reform. Attaching conditions to the aid in these cases has not successfully led to policy change, nor has it delayed the disbursement of funds.”

There is even some tentative cross-national empirical work on this topic by Knack (2000).

### **3.5 Other Socio-Economic Variables**

The academic literature also contains other comparative static results which may help to understand when clientelism or political pathologies occur in equilibrium.

One interesting factor here is globalization. Many empirical studies have found that greater trade openness or globalization reduces corruption (e.g. Treisman, 2000). This finding is also consistent with more detailed country work such as that of Diaz-Cayeros, Magaloni and Weingast (2000) on the collapse of PRI hegemony in Mexico, and that by Golden (2001) on the collapse of Christina Democratic hegemony in Italy. In both cases political parties which had sustained their power for decades using highly clientelistic strategies collapsed in the face of changed international environments. The most likely explanation of this seems to be that globalization changes the socio-economic structure and undermines the political base of clientelism. For example in Mexico, globalization led to a large expansion of maquiladores in the northern states. These firms had non-unionized

workforces whose political activities were not controlled by the unions associated with the PRI. This provided a political base for other parties such as the PRD.

What about inequality? The notion that relative poverty may be an attractive political characteristic (first discussed by Dixit and Londregan, 1996) seems overly optimistic. When voters have strictly diminishing marginal utility of income, poor people have higher marginal utility. This means that they are willing to change their voting behavior for smaller amounts of money than richer people and hence are cheaper for politicians to ‘buy’. The problem with this story can be illustrated with the following idea from Robinson and Verdier (2002). Imagine that incumbents governments have to choose some action before an election, such as how much public good to provide and this public good increases individual incomes. When poor individuals are cheaper to buy, this gives politicians an incentive to under-provide public goods in order to keep them poor and make them cheaper to buy.

### 3.6 Political Regimes and Institutions

An obvious source of variation in equilibrium political strategies stems from differences in political institutions. Might some types of political institutions lead to clientelistic redistribution? This idea has been answered positively by recent work.

One cut at this might be to distinguish between regime types. Are democracies more or less clientelistic than dictatorships? Unfortunately, as I noted above, most of the formal and empirical literature has focused on democracies so it is hard to say on the basis of this research how much clientelism one would expect in a dictatorship. Nevertheless, as I argued there, even dictators have to generate support, even if they lean less on soliciting votes in elections. To get support they face similar trade-offs between clientelistic and programmatic strategies. A natural conjecture is that the base of support of a dictatorship (at least a non-totalitarian one) is narrower than one for a democratic politician. One might expect this to be true because of there is a trade-off between repression and policy. Consider the probability of a dictator remaining in power as a function of repression and amount of support, call this  $P(R, S)$ . Fixing an iso-probability function (level set),  $P(R, S) = \bar{P}$  it is natural to imagine that as  $R$  increases  $S$  decreases. Hence, since dictators find it easier to use force to stay in power than democrats, we expect the dictatorial optimum to involve more  $R$  and a smaller base of support than in a democracy.

A natural idea is that clientelism is more attractive as a strategy the narrower is the support base a politician aims for. For instance Cox (1987) argued that democratization

in Britain in the 19th century led to a switch from clientelism to programmatic appeals because clientelism is simply infeasible in large electorates (see Lizzeri and Persico, 2003, for an interesting formal approach to this idea). In this case we might expect, other things equal, less clientelism in democracy since there is a shift away from repressing to attracting support. There is not much relevant evidence on this question. Treisman (2000) for example finds no evidence that, other things equal, democracies tend to be more corrupt than non-democracies, although he does find that a sufficiently long history of democracy reduces corruption. On the other hand, and relevant for this study, Dollar and Svensson (2000) do find that democracies implement structural adjustment programs more and Svensson (1999) finds that international aid has a positive effect on growth only in countries that are relatively democratic. If the presence of successfully implemented reforms and good effects of aid on economic performance are indicative of a lack of clientelism, then this is interesting evidence about the implications of democracy.

Also relevant for the WDR2004 is the literature on the connection between democracy and educational expenditures. Interestingly, this connection is played down in Chapter 9 of the report and India is mentioned as a case where there is democracy but lamentably poor educational outcomes. I think that the treatment of democracy here is too perfunctory. Yes India does not fit well, which means that the  $R^2$  is not one, something I am happy to admit. If one tries to investigate the connection across countries between democracy and education there is not much if a relationship, mostly because of the former (or currently) communist countries. I think this shows that after a revolution educational expansion is very important in stabilizing a regime, particularly one based on a new ideology. However, in non-revolutionary societies there is a rather strong relationship between democracy and education. Acemoglu and Robinson (2000b) first pointed out that historically within Western Europe educational expansion followed democratization and this point has been firmly supported by Lindert (2001, 2003). Engerman, Mariscal and Sokoloff (2000) and Engerman and Sokoloff (2001) show that a similar relationship holds within the Americas. Though this is only correlation, not causation, case studies suggest that the relationship is indeed causal with greater democracy leading to public demands for education to actually become policy. There is also quite a bit of other evidence suggesting that democracy is more pro-poor than the alternatives (e.g. Rodrik, 1999, Foster and Rosenzweig, 2002).

Most of the empirical work on this topic restricts attention to institutional variation within democracies. This work looks at how things like the electoral system and whether or not a democracy is presidential or parliamentary influences clientelism. In an important

paper, Carey and Shugart (1995) provided an analysis of the types of features of electoral systems which lent themselves to ‘personalism’. They argue that clientelism tends to arise when political parties are weak, exert little influence over candidate selection and where votes are cast for individuals, rather than parties. Also important is whether or not votes pool across lists and whether lists are open or closed. Also important is the size of electoral districts and the number of votes a politician needs to win. This literature qualifies the claims of Cox (1987) about Britain. It stresses that the infeasibility of clientelism in Britain after the 1870’s may have been due to the form of electoral institutions. In other countries, such as Italy or Colombia, clientelism seems to be consistent with large electorates.

The more recent empirical work of Persson and Tabellini (2003), Milesi-Ferretti, Perotti and Rostagno (2002) has examined the effect of institutional variation on the level of spending, which is less interesting for our present purposes. However, Persson, Tabellini and Trebbi (2002) do examine the implications of institutional variation for corruption. They find that larger voting districts – and thus lower barriers to entry – are associated with less corruption, whereas larger shares of candidates elected from party lists – and thus less individual accountability – are associated with more corruption. Individual accountability appears to be most strongly tied to personal ballots in plurality-rule elections, even though open party lists also seem to have some effect. Because different aspects roughly offset each other, a switch from strictly proportional to strictly majoritarian elections only has a small negative effect on corruption. These authors derive a number of testable implications from political economy models where aspects of the incentives created by electoral institutions are formalized.

Unfortunately, it is quite hard to draw strong conclusions from this literature as it stands. Firstly, many of the empirical implications seem quite unrobust to small changes in the model. Secondly, this work undoubtedly places too much emphasis on formal political institutions. As is well known, actual political outcomes represent an interaction between formal and informal institutions and the whole point of the ‘personal rule paradigm’ is that the political reality in Africa is very uninstitutionalized in a formal sense. Personalism is the antithesis of a world governed by formal institutions. Thus the applicability of any of these results in developing countries must be in severe doubt.

Finally, it is not clear what causes what. For example, following Carey and Shugart (1995), do describe situations where political parties are weak, exert little influence over candidate selection and where votes are cast for individuals, rather than parties, as an institutional environment which leads to clientelism seems to confuse a description of a

phenomena with its explanation.

Moreover, the notion that electoral institutions have large independent effects on the level and composition of government expenditure takes as axiomatic the exogeneity of the electoral institutions, something which is clearly problematic. Consider the contribution of Milesi-Ferretti, Perotti and Rostagno (2002). They argue that Scandinavian countries redistribute more because they have proportional representation (PR) electoral systems. Where did these systems come from? Rokkan (1970) showed that in the nineteenth century nearly all European countries had majoritarian electoral institutions. Some switched to PR as mass democracy arrived in the early twentieth century. Why did some (Sweden) but not others (Britain) do so? Rokkan argued that this depended on how strong the socialist party was. When the socialist party was strong (Sweden) incumbent conservative parties feared being eliminated in majoritarian competition and thus switched to PR to preserve some portion of their power. When socialist parties were less powerful (Britain) conservatives felt able to compete under the old institutions and there was no change. Imagine then that the socialist parties favored more redistribution. In this case what Rokkan argued was that the move to PR in Scandinavia was motivated by a desire to *reduce* redistribution. Why do Milesi-Ferretti, Perotti and Rostagno (2002) find that PR increases redistribution? This is because there is an omitted variable, the strength of socialism which presumably rests on other uncontrolled for socio-economic variables. Interestingly then, thinking through some of the implications of endogenizing institutions, suggests that the actual impact of PR may be the opposite of the existing conventional wisdom.

Further reason to be sceptical about the causal claims made by scholars about electoral institutions comes from the work of Mazzuca and Robinson (2002) on Latin America. They show that in the case of Colombia and Uruguay, the phenomena which the electoral institutions are supposed to have caused (in Carey and Shugart, 1995) actually *preceded* the introduction of the electoral institutions. In Colombia, parties were weak and politics clientelistic throughout the nineteenth century and endemically so in the period prior to 1929 when PR was introduced. They study why electoral institutions took the form that they did in this period and show that they were designed basically as a barrier to entry. The traditional Liberal and Conservative parties were very fragmented and worried about factions breaking away to form new parties. This became a huge problem in the 1920's because of rapid modernization and socio-economic change. In response, the parties introduced electoral rules which guaranteed to factions that they would be represented in congress and the senate and the only way this could be credibly assured was by building

the weakness of the central party into the institutions. Thus the institutions did not cause weak parties and personalism. If anything it was the other way round.

Another type of political institutions which has been linked to political corruption is federalism. Contrary to his working hypothesis Treisman (2000) found that federalism increased corruption.

### **3.7 Political Competition**

The extent to which any of these mechanisms come into play plausibly depends on the amount of political competition. For example, even if a group cannot solve the collective action problem this may not matter if they are numerous enough that politicians need their support. An interesting example of this comes from the work of Bates (1997). In his work on Ghana, Bates (1981) showed that because cocoa farmers were smallholders they had been unable to solve the collective action problem. Cocoa farmers were also politically disadvantaged because they were primarily Ashanti, and the early post-independence governments in Ghana, particularly under Nkrumah, were based on a non-Ashanti coalition of ethnic groups as I noted above. As a result, cocoa farmers were heavily penalized. Compare this to Colombia where the majority of coffee growers are also smallholders. Bates (1997) showed that coffee growers had been favored by policy because of the intense political competition between the Liberal and Conservative parties. Thus Bates provided a very interesting example of a situation where political entrepreneurs had solved the collective action problem for producers because they had seen it was in their direct electoral interests.

The question of the impact of political competition on pro-poor policy is particularly interesting because despite the Chicago-style intuition that political competition, just like market competition, must be good, many of the recent theoretical models suggest that in fact it is bad. Highly relevant for this paper, this is true in Persico and Lizzeri's model (2002b). These authors allow the number of political parties to vary exogenously in a model where parties can compete by offering broad public goods which benefit all citizens or transfers that can be individually targeted. They show that when there are more parties, a situation they call more competitive, the smaller the expected vote share of any particular political party. The smaller is this vote share the less attractive is the provision of the public good (since this benefits all agents even those not expect to support you) and the less efficient in expectation in the equilibrium.

One might complain about the definition of political competition here. Moreover, it

seems somewhat unrealistic to imagine that political competition is always and everywhere bad. In the Appendix to this paper I present a simple example from Acemoglu and Robinson (2003a) where we try to reconcile these apparently unreconcilable positions. We use a more standard definition of political competition which is incumbency advantage. In our model there is a socially efficient policy which the incumbent can take but which erodes his advantage. We think of this as a reduced form for a number of ideas in the literature. We then show that there is a non-monotonic relationship between the extent of incumbency (political competition) and efficiency. On the one hand when incumbency is very high (political competition very low) the incumbent is very entrenched and there is little chance of losing power. In this case he is relatively indifferent to losing some of this advantage and implements the efficient policy. On the other hand, when incumbency advantage is very low (political competition is very high) the incumbent has little to lose and again adopts the efficient policy. It is therefore somewhere in-between, where there is incumbency advantage but the incumbent fears losing it, that we expect inefficient policies to be chosen.

### **3.8 Political Identity**

One of the factors listed in section 2.1.2 was the ability of the poor to form a political party or perhaps equivalently to capture the agenda of an existing party. The case study literature from political science, following the seminal work of Shefter (1977), suggests the overwhelming importance of this factor. Shefter (see also his 1994 paper) made a distinction between political parties that were ‘externally mobilized’ and those that were ‘internally mobilized.’ Parties that were internally mobilized formed within the current political system and were able to have access to government employment, contracts and all the other usual levers of patronage. Parties that were externally mobilized however did not have these advantages. They could not compete for power by offering clientelism and instead had to adopt programmatic, non-clientelistic methods of competing. Shefter initially used this model to explain the collapse of clientelism in Britain, Germany and Italy.

Shefter’s model certainly has theoretical problems, for example if patronage is so useful why can’t externally organized parties use it when they attain power? Nevertheless, it appears to have very widespread political applicability. Indeed, most of the case studies of the collapse of clientelism fit very well into his simple dichotomy. One example of this include Chubb’s (1982) superb study of the Christian Democratic machine in Palermo

and Naples. Chubb describes in great detail how the control of patronage, particularly public sector employment, allowed the Christian Democratic party to be continually re-elected despite completely failing to deliver socially beneficial policies. In 1975 the Christian Democrats lost control of Naples to the Communists and clientelism ended because the Communists were committed to a non-clientelistic public sector employment policy. Chubb also explains why the Communists won in Naples but not in Palermo. This was because the central government in Rome followed a regional development policy which entailed building large industrial plants in Naples, but not Palermo. The employment practices of these plants were constrained by the fact that the workers were organized by labor unions who were closely connected to the Communists and who opposed the clientelistic practices of the Christian Democrats. This provided an electoral base for the Communists and broke the electoral dominance previously provided by the control of public sector appointments.

This analysis is consistent with that of Tarrow (1967, p. 44) who suggests that,

“faced by the well organized interest groups of Milan, Turin and Genoa, southern clienteles are unable to bargain effectively since they can only trade in personal favors. The lack of political integration between the regions...is a structural factor; the clientelistic system is actually congruent with the south’s fragmented social structure and resists or modifies the forms and techniques of a modern party system.”

Another important example just as well documented is the fall of clientelism in Porto Alegre in Brazil (Abers, 2000). Other examples of the collapse of clientelism fit into Shefter’s scheme. An interesting example comes from the evidence on the effects of political and fiscal decentralization in Colombia. Angell, Lowden and Thorp (2001) studied the impact of political decentralization in four Colombian cities, Pasto, Manizales, Ibagué and Valledupar. An important force breaking clientelism in Pasto was the election of Antonio Navarro Wolf in 1994, one of the leaders of the M-19 party. M-19 was originally a guerilla movement which laid down it’s arms in the 1980’s and became a political party, another example of an externally mobilized party. A final example from India is the effects of the rise of the Communist party in West Bengal in the 1970’s (see Banerjee, Gertker and Ghatak, 2000, for some interesting implications of this).

In all these cases it was the rise of an externally mobilized party which was committed to non-clientelistic strategies which marked a dramatic change in the political equilibrium. In all cases this led to much more pro-poor policy and a greater provision of public goods.

Note however that what is important about this evidence is that a clientelism of the rich was not simply replaced by a clientelism of the poor, there was a qualitative change in the nature of politics and a switch away from clientelism to a socially much more efficient form of political competition.

## 4 When Things go Right

The above sections suggest that there are many features of a society's institutions and endowments that influence the nature of the political equilibrium. It appears that all of these may vary independently. Other evidence however suggests that many of these things may be correlated so that often good things go together as do bad. This would be consistent with the empirical findings of Levine and Renelt (1992) who show that the estimated effects of policy on growth tend to be highly non-robust probably due to multicollinearity. The obvious interpretation of this is that countries with high budget deficits and parastatals with negative value added do not at the same time do a good job providing public goods like health services or education. When one thing is screwed up, everything tends to be screwed up. This is also consistent with the evidence of Acemoglu, Johnson and Robinson (2003b) who shows that the negative growth effects of many policy variables disappears. Their evidence suggests a more parsimonious account of poor development.

To illustrate how things may go right together let me consider the case of Botswana (I follow Acemoglu, Johnson and Robinson, 2003a). As is well known, Botswana a small, tropical, landlocked country in sub-Saharan Africa has had the fastest average rate of economic growth in the world in the last 35 years. So what explains Botswana's success? One can list several factors,

1. Botswana is very rich in diamonds.
2. It appears to have had a relatively unique set of indigenous socio-political institutions.
3. Colonization had a very limited impact on these indigenous institutions.
4. The post-independence political elite inherited the legitimacy of these institutions.
5. It was also rurally based and heavily invested in the main non-mining productive sector (cattle ranching).

The argument of Acemoglu, Johnson and Robinson (2003a) is that it is not any of these key factors by itself, but a combination of them— i.e., the interaction between them— that has been important in Botswana. They argued that Botswana was able to

adopt good policies and institutions because they were in the interests of the political elites, which included the cattle owners and powerful tribal actors. But it wasn't simply that cattle owners were politically powerful. Instead, they inherited a set of institutional prerequisites that ensured that they would keep their political power by pursuing good policies and placed restrictions on infighting among themselves over political rents.

Crucial in this was the fact that, contrary to many other nations in Africa, South America or the Caribbean, Botswana avoided the adverse effects of colonial rule. This is particularly important in the Botswana case because, as noted above, its pre-colonial socio-political institutions were relatively good. These institutions lowered the stakes from politics and the vested interests in bad policies, and increased the legitimacy and breadth of the coalition that sustained the post-independence political elite. These institutional features also helped to make good economics also good politics in Botswana, while restricting the range of distortionary economic policies that the leaders could pursue.

These structural factors created a political equilibrium in which the diamond wealth that came on stream in the 1970's could be efficiently exploited. The diamond reserves, in turn, created enough rents that the critical actors were relatively satisfied with the status quo, and did not want to fight to increase their share at the expense of destabilizing the whole system. Acemoglu, Johnson and Robinson (2003a) conjectured that, although it was not simply the diamonds that made Botswana grow, the diamonds played a very important role, not only by providing a resource base that could be exploited effectively with the correct set of institutions, but also by creating sufficient rents in the system, so as to increase the opportunity cost of further-rent seeking by the key actors.

Although this explanation is in terms of structural features, it also appears that Botswana benefited from outstanding political leadership that made several critical decisions that clearly influenced the development path. These leaders operated in a relatively helpful environment, but they probably also made a big difference. Seretse Khama's handling of the independence negotiations and constitutional convention, minerals policy, and generally political issues ensured that political stakes remained low, contributing to political stability and an environment with secure property rights. For example, it appears plausible that had Seretse Khama not transferred the property rights over sub-soil diamonds away from his own tribe, the Bangwato, to the government, there could have been much greater conflict among tribes over the control of the wealth from diamonds. Or had he not reduced the real political powers of tribal chiefs shortly after independence, tribal cleavages may have been more important.

Interestingly Acemoglu, Johnson and Robinson's (2003a) account de-emphasizes the

fact that Botswana is homogeneous from an ethno-linguistic point of view. As we show below, to the extent that this is true, it appears to be more of an outcome of Botswana's political institutions than an independent cause. Moreover, it is clear that political elites have studiously avoided exacerbating any underlying ethnic tensions in Botswana. Both Somalia and Lesotho are undoubtedly more homogeneous than Botswana and neither has succeeded economically like Botswana. Moreover, Lesotho has a linguistic, cultural and institutional inheritance that is identical to Botswana, ruling out simple cultural explanations of the exceptionality of Botswana.

One can therefore see Botswana's exceptionality as a hopeful example of what can be done, even with relatively unfavorable initial conditions— though perhaps the juxtaposition of a number of favorable characteristics was also necessary in enabling relatively good leadership. Despite many apparent disadvantages, a good political equilibrium emerged in Botswana and from this many good things flowed - political stability, astonishingly prudent macroeconomic policy, hard budget constraints everywhere in the public sector, a socially rational minerals policy. Botswana has also been able to respond to droughts and threats of famine with very effective famine relief policies so that actual famines have never arisen. Finally, in the 1970's when the political hegemony of Khama's Botswana Democratic Party first began to be challenged it responded to the rise in political competition by expanding education, not by engaging in clientelism.

Other success stories, such as Mauritius also seem to have this property that when one thing goes right, everything does. In Mauritius one sees the same types of things as in Botswana. For example, in the 1970's when the Labour Party under Seewoosagur Ramgoolam started to be challenged in elections by the Movement Militant Mauricien they introduced free universal secondary education.

## **5 What can the World Bank Do?**

Though there are many ideas and some interesting case studies which certainly reveal a lot about why pro-poor policies are not adopted, the lessons for the World Bank are not obvious. First of all there is a lot of uncertainty about which of the theoretical mechanisms are actually important in practice and no doubt this varies a lot from country to country. Empirical work of the most rudimentary kind (cross-national regressions) has only just begun on this issue. Moreover, there is nothing that the Bank can do about many of the determinants of equilibrium political strategies even if it wanted to. For instance, it is hard to change the colonial inheritance of a country.

What then can the World Bank do? One clear message, I believe, is that the activities of the World Bank are intrinsically political. The Bank provides resources which may help to sustain or destabilize particular regimes. Sustain, if a regime gets to allocate the resources to supporters, destabilizing if the resources end up in the hands of opponents. This may sound overly dramatic, but the fact is that international aid represents very large proportions of government expenditure and even GDP in many developing countries. The Bank ought to recognize this much more explicitly than it does.

There appear to be several potential approaches to taking on board the political realities.

## 5.1 Mechanism Design

A natural approach to economists when faced with an incentive problem is to design an incentive compatible mechanism to deliver services to the poor, taking into account the incentives of politicians. Much of the implicit discussion of policy conditionality is in these terms and there is a small literature which takes this perspective (e.g. Drazen, 2002). A possible way for the Bank to solve political problems is to design an incentive compatible way of helping the poor.

I doubt that this is a feasible way of making policy pro-poor. The main problem is that neither the Bank nor academics understand politics well enough to actually be able to design such a mechanism. Without a full understanding one risks making things much worse. To see this consider the following example from Coate and Morris (1999). They argue that if politicians in developing countries are self-interested and maximizing subject to the relevant set of political constraints, then any observed redistribution must be cost minimizing. If the World Bank or another IFI comes along and attempts to change the pattern of redistribution by imposing conditionality this does not alter the fundamental structure of political power. Therefore rulers still have to redistribute as before. If they cannot do this using the instruments that they were initially using then they will have to do this in another way, which may be socially more costly if the initial situation was constrained efficient (van de Walle, 1993, for an interesting example and many insights).

An important example of this type of phenomena comes from the recent political science literature on the politics of policy reform in Latin America. The consensus amongst scholars here (Gibson, 1997, Roberts, 1995, Roberts and Arce, 1998, Weyland, 2002) is that in practice the application of the ‘Washington Consensus’ was politics as usual. In the hands of Menem or Fujimori, privatization, deregulation and market reforms could all be

structured in a way as to reward supporters and punish opponents. Of course the change in policy necessitated some re-orientation. For example, the Peronist party in Argentina had to abandon their long-running commitment to promote the interests of trade unions, but the shift in political coalitions did nothing to alter the fundamental political attractiveness of clientelism. This literature again suggests how extraordinarily difficult it is to design politician-proof policy. The designers of the Washington consensus certainly saw these policies as reducing the scope for inefficiencies and patronage. Unfortunately this is difficult to achieve when the underlying political equilibrium is unaltered.

Even worse implications than this come from the work of Reno (1998) and Herbst (1990b) who suggest that structural adjustment, by destroying the ability of African elites to use patronage to stay in power, led to a switch to repression and violence.

## 5.2 Universalistic, Blunt Policy

In a first-best world the best thing would be to target resources to the poor to improve their welfare. If the Bank does not have a detailed understanding of the relevant political constraints then one idea is to design policies which are robust to broad types of political pathologies and which do not rest on the details of specific cases. I think there is much to be said for this idea and in many ways the current draft of the WDR2004 takes this approach.

The key thing is to design policies that are attractive to broad coalitions of citizens not just the poor. There is interesting evidence on this issue from the literature on the European welfare state, at least on the question of sustainability. This shows that policies which benefit the middle classes are much harder politically to re-trench than those that simply benefit the poor. One imagines that the same is true about the introduction of the policies in the first place.

What are these policies? I'm a bit unsure in this context. Reinikka and Svensson (2002) show that in Uganda only 13% of central educational spending gets through to the schools, the rest is 'political leakage.' Could this have been solved by designing the policy more broadly? I am not sure that this can be done in ways that stop politicians targeting.

Nevertheless, I doubt that ultimately it is very effective. Consider Tables 5.2 and 5.3 where conclusions are drawn about how pro-poor policies should be designed when politics is pro-poor and when it is anti-poor. The main example of blunt policy here is "rule based allocation" this needs much more justification and discussion.

### **5.3 Unconditional Aid**

If it is impossible to design any incentive compatible policy, if the political constraints are just too difficult to circumvent than an option is just to forget about conditionality. As I argued in the introduction, ultimately we care about welfare. The research of Burnside and Dollar (2001a,b) basically shows that good governments use aid to further development goals, while bad governments do not. However, there is no evidence that development goals are reduced by aid even when there is a bad government.

Of course one could conclude from this that aid should just be given to good governments. However, I'm not sure if this is the correct normative conclusion to draw and it is probably irrelevant as a positive conclusion since we know that political criteria gets used to allocate aid (gulp..!) (e.g. Alesina and Weder, 1999). My guess is that even giving aid to bad governments promotes welfare and is probably better than nothing. Though of course one could argue that inducing a 'crisis' by cutting off aid might induce policy reform the recent experiences of aid embargoes to Kenya and Zimbabwe suggest that the more likely outcome is that things will get worse for the poor.

Moreover, as I noted above, the evidence of Reno (1998) and Herbst (1990b) suggests that the Bank really has to think about the counterfactual here. If cutting off aid leads to civil war or 'warlordism' then things are definitely going to get worse for the poor.

### **5.4 Bypass the Roadblock**

Another tack, discussed often in the WDR2004 is to bypass politics and go straight to the poor. This, presumably is what NGO's do. The WDR2004 rightly is sceptical about this. There are nice examples about in any case how this doesn't work and it seems clear that this destroys state capacity, just the thing you need to build. This does not seem like a long term or desirable solution.

### **5.5 Promoting Good Governments (not Good Governance)**

If politician-proof policies don't exist, inaction is not enough, and circumventing the government infeasible or undesirable, then the Bank can try to change the political equilibrium. Actually, since anything the Bank does will change the political equilibrium I don't think there is any escape from this. I believe then that it is better to think about this clearly and try to articulate the ways in which this may happen.

As I hoped to demonstrate with the discussion of Botswana, if you get the political equilibrium right then you solve many problems which seem distinct. I illustrate this with

a discussion of the ‘soft budget constraint.’ This is discussed in some detail in Chapter 8 of the WDR2004 but is not properly connected to the politics. The soft-budget constraint is simply another facet of clientelism. Ask yourself why it is that the government has a commitment problem? Why can the government not commit to bail out parastatals that make losses? This is precisely because of the political rationale for the existence of the parastatals. Though it is true that clients are dependent on patrons, patrons are also dependent on clients and it is this mutual dependence which significantly reflects the incentives that one can give to the other. Thus solving the soft budget constraint, as is discussed on page 8-231 is not simply a technical matter of “creating fiscal incentives and establishing hierarchical controls...to disperse power and reduce the commitment burden on the center.”

But how to move the political equilibrium is a desirable direction? The most obvious thing is to increase the political power of the poor. The WDR2004 Chapter 5 discussed two approaches, both of which are very sensible. First, help the poor solve the collective action problem. Second, give the poor access to more information. I don’t think that either of these are necessary or sufficient to improve policy for the poor but they almost certainly help. In my estimation this is a probably more reliable way of improving policy than trying to politician proof.

Why is it legitimate to discuss increasing the political influence of the poor but not discuss the political equilibrium more generally? On the margin, giving the poor more information may help them make politicians accountable but it is probably hard to sustain without formal political representation, parties, changes in political institutions. As I noted above, the big stylized fact in the political science literature about the collapse of clientelism involves particular types of political parties. We need to investigate this more and the types of social conditions that allow these parties to come into existence.

There are no simple answers about how to design institutions which create a good political equilibrium, but it is clear that what is required are interventions which alter the whole political equilibrium in a desirable direction. We need to think about what these are and find a better way of characterizing the institutions, interests and forces that lead to good political equilibria. This is a highly dissatisfying place to end this paper but in lieu of hard results, I am advocating a conceptual approach that I find altogether more useful than politician-proofing.

## 6 Conclusion

In the introduction to this paper I noted that the World Bank has different objectives from the governments with which it has to deal. For example, the World Bank does not care about the re-election probabilities of governments. Actually, we now see that this is probably not true. If there are two political parties in a country, one pro-poor and one pro-rich, effective poverty reduction almost surely necessitates the pro-poor party being in power. This is the political reality.

Even if there is a pro-rich party it is possible that the World Bank could work with it, in some sense designing politician-proof policies that, despite the proclivities of the government in power, still got through to the poor. Such an exercise is however fraught with difficulties, second-best problems and complicated general equilibrium effects and our general ignorance of how politics works in most developing countries. My conclusion is that ultimately politician-proofing policies won't work. Promoting the political success of the pro-poor party is almost certainly the more effective route to poverty reduction.

Nevertheless there are clear dangers in this since one may simply replace a pro-rich clientelism with a pro-poor one. History certainly suggests this is possible, even though typically it is the rich who dominate. One interesting example is the Peruvian junta of General Velasco after 1968 which instigated a slew of radical pro-poor policies. Another is the pro-poor clientelistic regime of Hugo Chavez in Venezuela. These examples suggest however that in the end apparently pro-poor clientelism may not be that much better for the poor than pro-rich or pro-middle class clientelism.

At the end of the day clientelism is clientelism and what is really needed is a switch to a completely different style of political competition and public policy making. I surveyed the academic literature on this which is lamentably incomplete. Although there are many fragmented ideas about the structural conditions that lead to clientelism there is one big stylized fact that desperately needs to be understood - clientelism collapsed when new political parties mobilize outside the existing political system. Whether this is the Labour party in nineteenth century Britain, the Communist party in post World War II Italy, or the Workers Party in Brazil, these parties, cut off from the spigots of patronage, either commit themselves to, or learn to, compete in different, and socially preferable ways. Their triumph leads to large changes in the nature of political competition.

More generally, the Bank needs to allocate resources to trying to understand the types of forces and lead to the emergence of a good political equilibrium. This is a research agenda with a vast intellectual and practical payoff.

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## 8 Appendix: The Costs and Benefits of Political Competition

Is political competition good or bad? The conventional wisdom in much of political science and economics has assumed that it is good. Following Becker (1958), Stigler (1972) and Wittman (1989), it is plausible to reason by analogy that since competition promotes social efficiency in economic markets it also does so in political markets. The logic is powerful, competition between politicians and political parties implies that favors cannot be given to special interests, that redistribution to the extent it takes place must take an efficient form, and that politicians who try to keep rents from themselves will not be able to keep power. This follows because if a politician was ever tempted to offer a socially inefficient policy (perhaps in order to keep some rents himself), a competing politician would be able to offer a policy that a majority of voters preferred, thus denying power to the first politician.

Though the logic of this view is powerful, empirical evidence does not seem entirely consistent with it. Perhaps the most dramatic example of an increase in political competition is a democratization. Yet we know from cross-country data that democratization does not promote better economic policies or economic prosperity on average. Possibly in the light of this a new generation of models have appeared which show that political competition, rather than promoting efficiency, actually promotes inefficiency. Though there are many versions of this idea the kernel is that incumbent politicians can take an inefficient action which biases the outcome of an election in their favor. These actions may be issue too much debt (Persson and Svensson, 1989, Aghion and Bolton, 1990, Alesina and Tabellini, 1990), undersupply public goods (Persson and Tabellini, 1999, Lizzeri and Persico, 2001a,b, Robinson and Verdier, 2002), underinvest in infrastructure (Besley and Coate, 1998, Robinson and Verdier, 2002), block innovation and technical change (Acemoglu and Robinson, 2002b). With little political competition there is no incentive to sacrifice social efficiency, but as competition increases the inefficient action becomes more attractive.

How does one reconcile these positions? In reality it seems unlikely that political competition always promotes efficiency. On the other hand it seems equally as unlikely that it always promotes inefficiency. In this appendix I propose a simple reconciliation

of these apparently opposite views based on Acemoglu and Robinson (2002a). In section 2 I develop a model of electoral competition where an incumbent politician can take an action which is socially efficient but reduces their incumbency advantage in an election. Others things equal, politicians would like to take the efficient action since this increases their rents if they are in power, the problem is that this action simultaneously reduces the probability that they will win power. The key trade-off therefore is between the rents in power and the probability of being in power. I show that the efficient action will be taken either when the incumbent faces little competition, so that incumbency advantage is large, or when there is very intense competition, so that there is no incumbency advantage.

Intuitively, on the one hand, when there is little political competition there is no incentive for an incumbent to reduce his rents in order to bias the election probability. On the other hand, when there is no incumbency advantage it is worthless to forgo efficient actions that preserve this advantage and so again the politician concentrates on maximizing his rents. However, in intermediate positions where there is limited incumbency advantage then it can be optimal to take the inefficient action. Thus I show that there is a non-monotonic relationship between political competition and social efficiency. When competition is low or high we get the efficient outcome, but for intermediate values competition does not necessarily promote efficiency.

The model has many implications which seem consistent with the evidence. For example, it implies that whether or not *increases* in political competition improve efficiency depends on what part of the parameter space one is in. For example, consider a situation of a collapsing one party state which faces new entrants and competition in a previously uncompetitive environment. In such a circumstance we may see the efficiency of government policy deteriorate. An interesting example of this would be ZANU-PF in Zimbabwe. As Herbst (1990a) shows, during the 1980's when Mugabe's regime was popular and faced no political challenges no attempt was made to raise the issue of land redistribution. It was only when political competition increased that the issue was raised. This example fits our model nicely. The model also suggests that whether or not democratization induces more efficient policy depends on how competitive the new political environment is.

## 8.1 A Simple Model

I show the main result in a standard probabilistic voting model (Lindeck and Weibull, 1987, Persson and Tabellini, 2000). There are two political parties, an incumbent, party 1 and an opponent, party 2, who face an election. Before the election the incumbent has

to take a decision, which I refer to as an ‘investment.’ If the incumbent invests then I assume there is no cost and he increases the income of the economy but he also influences the probability of re-election. I use the notation  $\rho$  for the investment decision with  $\rho = 1$  meaning that the incumbent invests and  $\rho = 0$  no investment.

Let the utility of a citizen, indexed by  $i$ , if party 2 wins power be  $W(t_2)$  where  $t_2$  is the (tax) policy offered by party 2. I assume that there is a continuum of citizens with total measure normalized to one. Now let the utility experienced by a citizen  $i$  if party 1 wins power be  $W(t_1) + \sigma^i + \delta$  where  $t_1$  is the policy offered by party 2. I shall be more explicit about the exact forms of these indirect utilities after I have calculated the probability of different electoral outcomes. Here  $\sigma^i$  and  $\delta$  capture the ideological bias of the citizens for the incumbent.  $\sigma^i$  captures individual level heterogeneity and  $\delta$  an aggregate shock experienced by all citizens. The distribution of this random variable depends on whether or not the incumbent invests or not. If he does invest I assume that it is uniformly distributed on the interval  $[-\frac{1}{2\phi} + \bar{\sigma}, \frac{1}{2\phi} + \bar{\sigma}]$  where  $\bar{\sigma}$  is the mean of the distribution. If he does not invest then it is uniformly distributed on the interval  $[-\frac{1}{2\phi} + \gamma\bar{\sigma}, \frac{1}{2\phi} + \gamma\bar{\sigma}]$  where  $\gamma > 1$ . Here  $\bar{\sigma}$  is a measure of incumbency advantage. When  $\bar{\sigma}$  is large, there is a very strong bias in favor of the incumbent.  $\gamma$  captures the extent to which investment (the socially efficient decision) reduces the probability that the incumbent wins. The larger is  $\gamma$  the greater the effect of investment. I think of  $\bar{\sigma}$  as a measure of the extent of political competition. When  $\bar{\sigma}$  is large, incumbency advantage is large, and political competition is low. I finally assume that  $\delta$  is uniformly distributed on the interval  $[-\frac{1}{2\psi}, \frac{1}{2\psi}]$  and therefore has zero mean.

With these assumptions, citizen  $i$  votes for party 1 if,

$$W(t_1) + \sigma^i + \delta > W(t_2).$$

Thus to attract the vote of individual  $i$  the policy offered by 1,  $t_1$ , plus the ideological utility for 1, must be more attractive than the utility offered by the policy of the challenger.

For given policy platforms  $t_1$  and  $t_2$ , and given  $\delta$ , we can define a critical value of  $\sigma^i$ ,

$$\sigma^i = W(t_2) - W(t_1) - \delta,$$

such that any agent with a value of  $\sigma$  greater than this votes for party 1. The proportion of citizens who vote for 1, denoted  $\pi_1$  depends on the investment decision. When there is no investment I use the notation  $\pi_1(t_1, t_2; \rho = 0)$  while when there is investment I use the notation,  $\pi_1(t_1, t_2; \rho = 1)$ . We now have,

$$\pi_1(t_1, t_2; \rho = 0) = \int_{W(t_2) - W(t_1) - \delta}^{\frac{1}{2\phi} + \gamma\bar{\sigma}} \phi di = \frac{1}{2} + \phi [W(t_1) - W(t_2) + \delta + \gamma\bar{\sigma}].$$

Similarly,

$$\pi_1(t_1, t_2; \rho = 1) = \int_{W(t_2) - W(t_1) - \delta}^{\frac{1}{2\phi} + \bar{\sigma}} \phi di = \frac{1}{2} + \phi [W(t_1) - W(t_2) + \delta + \bar{\sigma}].$$

From this one can calculate the probability that party 1 wins the election, which I denote  $P_1(t_1, t_2; \rho)$  where the notation is meant to emphasize that the probability that 1 wins the election depends on the platform it adopts,  $t_1$ , the platform that 2 adopts,  $t_2$ , and the investment decision  $\rho$ .  $P_1(t_1, t_2; \rho)$  is the probability that

$$\Pr \left\{ \pi_1(t_1, t_2; \rho) \geq \frac{1}{2} \right\},$$

or noting that it is  $\delta$  that is a random variable and using the formula for  $\pi_1$ ,

$$\begin{aligned} P_1(t_1, t_2; \rho = 0) &= \Pr \{ \delta > W(t_2) - W(t_1) - \gamma \bar{\sigma} \} \\ &= \int_{W(t_2) - W(t_1) - \gamma \bar{\sigma}}^{\frac{1}{2\psi}} \psi di = \frac{1}{2} + \psi [W(t_1) - W(t_2) + \gamma \bar{\sigma}]. \end{aligned}$$

It is easy to see that,

$$P_1(t_1, t_2; \rho = 1) = \frac{1}{2} + \psi [W(t_1) - W(t_2) + \bar{\sigma}].$$

To determine the impact of political competition on investment I now have to calculate the Nash equilibrium in the electoral competition game. To do this I need to be more specific about the indirect utility functions of the voters and the utility functions of the parties. For simplicity I assume the following. All individuals have exogenous income of  $Ay$  if the incumbent invests and  $y$  otherwise. The only policy instrument is a tax rate on this income of  $t$ . I assume that income can be moved into the informal sector but this destroys a fraction  $1 - \tau$  of the income. Thus, if  $1 - t > \tau$  income is kept in the formal sector, while if this inequality is reversed it is moved to the informal sector. Hence, in the case where the incumbent invests,  $W(t_1) = (1 - t_1)Ay$  and  $W(t_2) = (1 - t_2)Ay$ . I assume that there is no commitment to policy platforms and political parties wish to maximize expected utility, namely, for party 1,  $P_1(t_1, t_2; \rho)t_1y$ . This implies that if elected, either party will choose a tax rate of  $1 - \tau$  and get expected utility of  $P_1(t_1, t_2; \rho)(1 - \tau)y$  and  $P_2(t_1, t_2; \rho)(1 - \tau)y$ . In this case where parties cannot commit to platforms there is no effective competition and the only decision is the investment decision of the incumbent. Note that this implies that  $W(t_1) = W(t_2)$ .

We assume the following timing for the game. First, the incumbent decides whether or not to invest. Second, the two parties non-cooperatively adopt policy platforms to maximize their expected utility. Second, citizens decide who to vote for. Finally, whichever party wins the election the policy which maximizes its payoff.

Since tax policies can be solved for by backward induction the only decision to compute is the investment decision by the incumbent. This solves,

$$\max_{\rho} \rho P_1(t_1, t_2; \rho = 1)t_1Ay + (1 - \rho)P_1(t_1, t_2; \rho = 0)t_1y$$

Clearly,  $\rho = 1$  is optimal if,

$$P_1(t_1, t_2; \rho = 1)t_1Ay \geq P_1(t_1, t_2; \rho = 0)t_1y$$

or,

$$\mathcal{P}\left(\frac{1}{2} + \psi\bar{\sigma}\right)A \geq \mathcal{P}\left(\frac{1}{2} + \psi\gamma\bar{\sigma}\right) \quad (1)$$

where I have used the fact that  $W(t_1) = W(t_2)$  and cancelled  $y$  and  $1 - \tau$  (recall that since there is no commitment to tax rates backward induction implies  $t_1 = t_2 = 1 - \tau$ ). Here we define the function  $\mathcal{P} : \mathfrak{R} \rightarrow [0, 1]$  such that  $\mathcal{P}(x) = x$  if  $x \in [0, 1]$  while  $\mathcal{P}(x) = 0$  for  $x < 0$  and  $\mathcal{P}(x) = 1$  for  $x > 1$ .

I now think about what (1) implies. Notice that when  $\bar{\sigma} = 0$  so that there is no incumbency advantage, then  $P_1(t_1, t_2; \rho = 1) = P_1(t_1, t_2; \rho = 0)$  and we must have  $\rho = 1$  since  $A > 1$ . In this case, when incumbency advantage vanishes, there is no penalty from an investment which erodes incumbency advantage. Thus the probability that party 1 wins becomes independent of its investment decision and therefore  $\rho = 1$  becomes optimal since it means that revenues and utility are higher when the incumbent retains power. Now think about the case where  $\bar{\sigma} = 1/2\psi$ . Now we have  $\mathcal{P}\left(\frac{1}{2} + \psi\bar{\sigma}\right) = \mathcal{P}\left(\frac{1}{2} + \psi\gamma\bar{\sigma}\right) = 1$  and again  $\rho = 1$  becomes optimal. In this case the incumbency bias is so high that the incumbent is very solidly entrenched and does not fear losing power. In this case there is no incentive not to invest. It is therefore in the intermediate cases where  $\bar{\sigma} \in (0, \frac{1}{2\psi})$  that we may find  $\rho = 0$  to be optimal. Indeed, this is the case when,

$$\gamma > 1 + \frac{A - 1}{2\psi\bar{\sigma}} \quad (2)$$

We can see from (2) that the larger is  $A$ , the greater the opportunity cost of not investing, and the larger the value  $\gamma$  must be for  $\rho = 0$  to be optimal. I can sum up the message of this section with a simple result.

**Proposition 1** When  $\bar{\sigma}$  is sufficiently small or large (political competition very high or very low), the incumbent politician takes the socially efficient action. For intermediate values of  $\bar{\sigma}$ , however, the incumbent may fail to take the socially efficient action.

## 8.2 Other Instruments

In order to focus on our main result, the model in the previous section abstracted from the use of other policy instruments by assuming that parties could not commit to platforms when competing in the election. I now show that even if parties are able to commit to policies, the main intuition of the result stands only slightly amended. Intuitively, being able to commit to a tax rate gives the incumbent another instrument to increase the probability of winning. One might conjecture, therefore, that the incumbent would be tempted to invest and compensate for the reduced probability of winning by offering voters a lower tax rate. I show that although the basic intuition that the incumbent lowers his tax rate when he invests is correct, this does not reverse or remove the incentives which led to Proposition 1.

To model credibility I must alter the assumptions about the game. Now assume the following timing. First, the incumbent decides whether or not to invest. Second, the two parties non-cooperatively adopt policy platforms to maximize their expected utility. Second, citizens decide who to vote for. Finally, whichever party wins the election implements the policy which it announced before the election.

The analysis of this model is more involved because at the first stage the incumbent has to take into account the way in which his investment decision influences the subsequent game with the challenger. One therefore must calculate the Nash equilibrium between the parties for both  $\rho = 1$  and  $\rho = 0$  and compare the indirect utility of the incumbent across these two equilibria. I now solve for the Nash equilibrium in tax rates in the above model. Denote these  $(t_1^N(\rho), t_2^N(\rho))$  where,

$$t_1 = \arg \max P_1(t_1, t_2; \rho = 1)t_1y$$

and,

$$t_2 = \arg \max P_2(t_1, t_2; \rho = 1)t_2y.$$

The Nash equilibrium tax rates must satisfy the two first-order conditions (using the above definitions of  $P_1(t_1, t_2; \rho = 1) = \frac{1}{2} + \psi [(1 - t_1)Ay - (1 - t_2)Ay + \bar{\sigma}]$  and  $P_2(t_1, t_2; \rho) = \frac{1}{2} - \psi [(1 - t_1)Ay - (1 - t_2)Ay + \bar{\sigma}]$ ),

$$\frac{\partial P_1(t_1, t_2; \rho = 1)}{\partial t_1}t_1y + P_1(t_1, t_2; \rho = 1)y = 0 \Rightarrow \quad (3)$$

$$t_1 = \frac{1}{2\psi Ay} \left( \frac{1}{2} + \psi [Ayt_2 + \bar{\sigma}] \right)$$

and for 2 we find a similar reaction function,

$$t_2 = \frac{1}{2\psi Ay} \left( \frac{1}{2} + \psi [Ayt_1 - \bar{\sigma}] \right). \quad (4)$$

Notice that it is the probabilistic voting that stops this being a Bertrand game. Note from (3) and (4) that  $t_1$  and  $t_2$  are strategic complements. For example, if  $t_2$  increases then this increases the optimal tax rate for party 1. Intuitively, when  $t_2$  goes up, other things equal,  $P_1(t_1, t_2; \rho = 1)$  increases. In response to this party 1 by raising the tax rate it offers to increase the rents it gets from office. I can now easily solve (3) and (4) for the Nash equilibrium taxes. These are,

$$\begin{aligned} t_1^N(\rho = 1) &= \frac{\frac{3}{2} + \psi\bar{\sigma}}{3\psi Ay}, & t_2^N(\rho = 1) &= \frac{\frac{3}{2} - \psi\bar{\sigma}}{3\psi Ay}, \\ t_1^N(\rho = 0) &= \frac{\frac{3}{2} + \psi\gamma\bar{\sigma}}{3\psi Ay}, & t_2^N(\rho = 0) &= \frac{\frac{3}{2} - \psi\gamma\bar{\sigma}}{3\psi Ay}. \end{aligned} \quad (5)$$

Here one should strictly have  $\max\{\cdot\}$  operators to take into account the fact that the informal sector is potentially important. I abstract from this here and assume that the Nash equilibrium tax rates are always sufficiently low that the informal sector is irrelevant.

Interestingly, in this Nash equilibrium we have  $t_1^N(\rho) > t_2^N(\rho)$  for  $\rho = 1$  and  $\rho = 0$  since  $\bar{\sigma} > 0$ . Intuitively, because party 1 has an incumbency bias, it raises its tax rate above that of party 2 and uses part of this bias to generate greater rents in the event that it wins the election. Also interesting is the result that  $t_1^N(\rho = 0) > t_1^N(\rho = 1)$ . When the incumbent decides not to invest in order to bias the outcome of the election, the total tax base in power is smaller and the incumbent partially offsets this by offering a higher tax rate to the electorate.

We can now investigate the equilibrium investment decision by the incumbent. This is,

$$\max_{\rho} \rho P_1(t_1^N(\rho = 1), t_2^N(\rho = 1)) t_1^N(\rho = 1) Ay + (1 - \rho) P_1(t_1^N(\rho = 0), t_2^N(\rho = 0)) t_1^N(\rho = 0) y$$

so  $\rho = 1$  if,

$$\mathcal{P} \left( \frac{1}{2} + \frac{\psi\bar{\sigma}}{2} \right) \left( \frac{3}{2} + \psi\bar{\sigma} \right) A > \mathcal{P} \left( \frac{1}{2} + \frac{\psi\gamma\bar{\sigma}}{2} \right) \left( \frac{3}{2} + \psi\gamma\bar{\sigma} \right) \quad (6)$$

noting that  $P_1(t_1^N(\rho = 1), t_2^N(\rho = 1)) = \frac{1}{2} + \psi \left[ (t_2^N(\rho = 1) - t_1^N(\rho = 1)) Ay + \bar{\sigma} \right] = \frac{1}{2} + \frac{\psi\bar{\sigma}}{2}$  where we see  $(t_2^N(\rho = 1) - t_1^N(\rho = 1)) = -\frac{\bar{\sigma}}{2Ay} < 0$  from (5). Moreover, it is easy to check that  $P_1(t_1^N(\rho = 0), t_2^N(\rho = 0)) = \frac{1}{2} + \frac{\psi\gamma\bar{\sigma}}{2}$ .

Now looking at (6) we again see that if  $\bar{\sigma} = 0$  so that incumbency advantage vanishes  $\rho = 1$  is optimal. Moreover, as  $\bar{\sigma} = 1/2\psi$  then  $\mathcal{P} \left( \frac{1}{2} + \frac{\psi\bar{\sigma}}{2} \right) = 1$  and investment is optimal if

$$\left( \frac{3}{2} + \psi\bar{\sigma} \right) A > \left( \frac{3}{2} + \psi\gamma\bar{\sigma} \right), \quad (7)$$

i.e. tax revenues are higher after investment. There is an interesting trade-off here since with investment total income rises, but the tax rate is lower in order to compensate somewhat for the lower incumbency bias in the election. Nevertheless, it must be true that  $\left(\frac{3}{2} + \psi\bar{\sigma}\right) A > \left(\frac{3}{2} + \psi\gamma\bar{\sigma}\right)$  is the interesting case. This follows because if tax revenues fell when the incumbent invested even though output was higher, it could never be optimal to invest since without investment both tax revenues when in power and the probability of winning are higher. Intuitively why might tax revenues fall when the incumbent invests? This would be true if the game between the parties dissipated the majority of the benefits of investment and higher income to voters. This will not happen if there is enough uncertainty in the model. One way to capture this is through  $\psi$ , since (7) clearly holds when  $\psi$  is small which is the case where there is a lot of uncertainty in the outcome of the election.

The results in this extended model are therefore essentially the same as in the basic model where there were no other policy instruments. Despite the fact that party 2 now has something to offer voters to compete with the incumbent this does not alter the fundamental trade-off the incumbent faces - between rents from office and biasing the election. Nor does it alter the basic intuition about the non-monotonic relationship between political competition and efficiency.

**Proposition 2** *Even when political parties are able to commit to the use of other policy instruments, if  $\psi$  is sufficiently small so that the outcome of the election is sufficiently uncertain, then the results of Proposition 1 hold.*