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Governance and the Law

Green Cover Draft

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Overview

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Overview

0.1 In the last 20 years, enormous progress has been made around the world in terms of socioeconomic indicators. The rapid diffusion of technology and greater access to capital and world markets have enabled economic growth rates that were previously unfathomable and have helped lift over one billion people out of poverty. Yet at the same time, increased flows have also led to rising inequality, both within and across borders, and to greater vulnerability to global economic trends and cycles. Although the global spread of capital, technology, ideas, and people has helped many countries and people progress, other places and populations have been seemingly left behind and are still confronted by violence, slow growth, and limited opportunities for advancement.

0.2 As ideas and resources spread increasingly rapidly across countries, policy solutions to promote further progress abound. However, policies that should be effective in generating positive development outcomes are often not adopted or are poorly implemented or end up backfiring over time. While the development community has focused a great deal of attention on learning *what* policies and interventions are needed to generate better outcomes, it has spent much less attention on learning *why* those approaches succeed so well in some contexts, but fail to generate the same results in others.

Improving governance to meet today's development challenges

0.3 Ultimately, confronting the challenges faced by today's developing countries—poor service delivery, violence, slowing growth, corruption, and the natural resource curse, to name a few—requires a rethinking of the process by which state and nonstate actors interact to design and implement policies, what this Report calls governance (box 0.1). Consider some recent cases that have attracted global attention.

Box 0.1 What is governance?

For the purpose of this Report, *Governance* is the process through which state and nonstate actors interact to design and implement policies, within a given set of formal and informal rules that shape and are shaped by power.^a This Report defines *power* as the ability of groups and individuals to make others act in their interest and to bring about specific outcomes.^b

Depending on the context, actors may establish a *government*, as a set of formal state *institutions* (as used in the literature to denote organizations and rules) that enforce and implement policies. Also depending on context, state actors will play a more or less important role with respect to nonstate actors, such as civil society organizations or business lobbies. In addition, governance takes place at different levels, from international bodies, to national state institutions, to local government agencies, to community or business associations. These dimensions often overlap, creating a complex network of actors and interests.

a. Dahl 1957; Lukes 2004.

b. The general definition of governance used in the Report is consistent with the World Bank's corporate definition, which emphasizes formal institutions and the role of state actors.

0.4 *State building in Somalia and Somaliland.* Somalia is one of the world's most fragile countries. It has been racked by violence for more than two decades. Insurgent attacks and regional conflicts have prevented the emergence of a centralized state with monopoly over the legitimate use of force. Warring factions, many with their own regional sources of power, have been unable to reach a credible deal that determines the make-up and responsibilities of the central state. In contrast, in Somalia's autonomous region of Somaliland, an area with similar tribal and clan tensions, 20 years of stability and economic development have followed a 1993 clan conference that brought together leaders from both modern and traditional sectors, successfully institutionalizing these clans and elders into formal governing bodies.

0.5 *Confronting corruption and the resource curse in Nigeria.* Just a year after a decade-long bounty of windfall revenues from high oil prices, Nigeria was requesting budget support from its development partners. Instead of saving to invest in the future, Nigeria's government has squandered its oil wealth. According to a former president of the central bank, billions of dollars have been lost to corruption by the National Petroleum Company. Nigeria's institutional context did not provide the capacity to safeguard natural resource revenues to reduce fiscal volatility and promote a macroeconomic environment conducive to long term investment. Corruption has become a built-in feature of government interactions, rather than a discrete problem to be eradicated. Several countries have demonstrated that the "resource curse"—the paradox that countries with abundant natural resources have slower growth and worse development outcomes than countries without resources—can be avoided through effective economic and fiscal policies. These policies, however, were not credibly adopted in Nigeria.

0.6 *China's growth performance and growth challenges.* For four decades, as China has increasingly integrated with the global economy, it has grown at double-digit rates and lifted more than 700 million people out of poverty. This successful track record of economic growth is well known. Yet, according to frequently used indicators, China's institutional environment during this period remained static. Does this imply that institutions do not matter for growth? No. Rather, a deeper understanding of China's development shows that the adaptive policy decisions and state capacity that enabled economic success were facilitated by deep changes to mechanisms of accountability and collective leadership. China's experience highlights the need to pay more attention to how institutions function and less to the specific form they take. Meanwhile, China today faces a growth slowdown. Maintaining rapid growth requires the political incentives to switch to a growth model based on firm entry, competition, and innovation. In many middle-income countries, this transformation has been blocked by actors that benefited from early growth and have little incentives to join coalitions for further reforms. Going forward will involve addressing these governance challenges.

0.7 *Slums and exclusion in India's cities.* Urban development that stems from coordinated planning and investment by coalitions of developers, bureaucrats, citizens, and politicians can lead to cities that are centers of growth, innovation, and productivity. Planners can help ensure that infrastructure meets the demands of investors who seek to maximize land rents; businesses that need connectivity to consumers, employees, and other firms; and citizens who want access to services and jobs. But many cities fail to deliver on these promises. In India, massive urban slums—about 49,000 at the latest count, with tens of millions of inhabitants—represent failures to align public investments and zoning with the needs of a diverse set of urban constituents. Poorly designed cities with misallocated investments have limited connectivity between housing,

affordable transportation, and utilities, driving workers into informal settlements, often in peripheral areas. While many developers and politicians have exploited the system to generate rents for themselves, this uncoordinated urban development has prevented cities from achieving their growth potential, and has resulted in large slums where most citizens are deprived of basic services.

0.8 *Demanding better services in Brazil.* In 2013, the world watched when protests erupted in Brazil's streets, with citizens complaining about the quality of public services—transport, education, and health—as the FIFA World Cup soccer tournament approached. Brazil had gone through twelve years of inclusive and sustained growth, which had lifted more than 30 million people out of poverty and strengthened the middle class. But these same middle classes that contributed with their taxes to the provision of public services were now demanding better quality and coverage, including “FIFA-standards for our schools.” Why did this change come about? Brazil's social contract has historically been weak and fragmented. Low-quality public services were provided to the poor, while the upper-middle classes relied upon private services and were thus unwilling to contribute to the fiscal system. The creation of an expanded middle class and the reduction of poverty paradoxically heightened the perceptions of unfairness as the new middle class expected more than low-quality public services for its contributions.

0.9 *“Brexit” and the rise of populist parties.* In June 2016, voters in the United Kingdom elected to leave the European Union (EU). The British pound immediately fell in value, and fear set in over the potential medium- and long-term economic consequences and costs of this decision. Across the European continent, far-right populist parties campaigning against further European integration have enjoyed unprecedented electoral success, and in 2016, hold power in Finland, Hungary, Latvia, Lithuania, Norway, and Switzerland. In these countries, despite high incomes (Western Europe) and rapid economic growth over the past two decades (Eastern Europe), populist “anti-Europe” messages have resonated as citizens have felt increasingly disenfranchised and excluded from European decision making, while a perception of free-riding by specific groups was growing without much objective assessment. With the perceived ineffectiveness of “voice” in European decision-making bodies, they have opted for “exit,” most clearly in the case of Britain's vote to leave the EU.

0.10 What do these examples have in common? This Report assumes that all countries share a set of developmental objectives: minimizing the threat of violence (*security*), promoting prosperity (*growth*), and ensuring that prosperity is shared (*equity*), while also protecting the sustainability of the development process for future generations (box 0.2). But policies do not always translate into these development outcomes in expected ways. As the previous examples illustrate, contradictions occur in the real world. Somalia is as close as it gets to a failed state, while Somaliland seems to be doing well. China grew rapidly, even though its institutions apparently did not (and may need to do so now). India grew, but cannot control the propagation of slums. Nigeria has an abundance of resources, but is persistently poor. Brazil experienced inclusive growth, but is now facing widespread protests from the middle class. Britain had low unemployment, but voted to quit the EU. The common thread across these contradictions appear to be governance malfunctions: ineffective policies persist, effective policies are not chosen, and unorthodox institutional arrangements generate positive outcomes. So, what drives policy effectiveness?

Box 0.2 Governance for what? Achieving the goals of security, growth, and equity

Many aspects of governance are valuable in and of themselves (that is, that they have intrinsic value)—in particular, the notion of freedom. In economic terms, freedom can be seen as an opportunity set, and development can be seen as “the removal of various types of unfreedoms” (exclusion from opportunities), where these unfreedoms reduce people’s capacity of “exercising their reasoned agency”.^a As essential as such an intrinsic value of freedom is, its instrumental value also matters because of the “effectiveness of freedoms of particular kinds to promote freedoms of other kinds”.^b These positive relationships are what economists call complementarities. This Report acknowledges the intrinsic value of various dimensions of governance, and the notion of development as positive freedom, while also recognizing their instrumental value to achieve equitable development.

The analysis of this Report starts from the normative standpoint that every society cares about freeing its members from the constant threat of violence (*security*), about promoting prosperity (*growth*), and about how such prosperity is shared (*equity*). It also assumes that societies aspire to achieving these goals in environmentally sustainable ways. The Report assesses governance in terms of its capacity to deliver on these outcomes.

This approach is consistent with the transition from a dialogue based on ideology to a dialogue based on ideals, which has transpired in the global development community over the past few decades. The establishment of the Millennium Development Goals (MDGs) in 2000 and the recent ratification of the Sustainable Development Goals (SDGs) by member countries of the United Nations are examples of these efforts to set common goals for social and economic advancement. SDG 16 calls for promoting “peace, justice, and strong institutions,” and is explicitly related to governance. Nevertheless, as this Report will argue, beyond the intrinsic value of SDG 16, it also holds important instrumental value because the attainment of SDG 16 will aid in the attainment of all the other SDGs. Indeed, the achievement of all the development goals will require a solid understanding of governance in order to enable more effective policies.

a. Sen 1999.

b Sen 1999.

Drivers of effectiveness: Commitment, coordination and cooperation

0.11 Often, when policies and technical solutions fail to achieve intended outcomes, blame falls on institutional failure, and the solution usually proposed is to “improve” institutions. But many types of institutional arrangements and trajectories can enable development, as examples around the world demonstrate—while many other supposed “best practices” fail. In some cases, rapid progress comes about suddenly, seemingly unexpected. Given this diversity of paths and perils, it becomes essential to uncover the underlying drivers of policy effectiveness. How can policies increase the likelihood of this kind of switch? This Report draws attention to *commitment*, *coordination*, and *cooperation* as the three core functions of institutions that are needed to ensure that rules and resources yield desired outcomes.¹

Form versus function: Underlying determinants of policy effectiveness

0.12 *Commitment.* Commitment enables actors to rely on the credibility of policies so as to calibrate their behavior accordingly. Consistency over time in terms of policies is not easy to achieve. Circumstances change, policy objectives may extend beyond the political cycle, and resources may fail to match, changing the incentives to implement previously chosen policies. In line with the economic theory of incomplete contracts, policies require commitment devices in order to ensure their credibility.

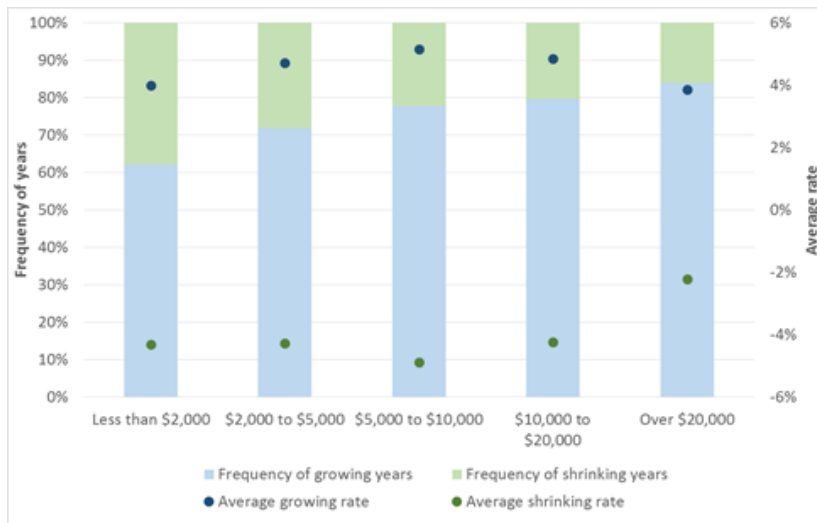
¹ The chapters of this Report will focus on the specific question of policy effectiveness. The framework, however, can be used to address broader questions about social dynamics.

0.13 For instance, security—a foundation for sustained development—is premised most basically on commitment. Are conflicting parties able to reach credible agreements to renounce violence and endow the state with the monopoly on the legitimate use of violence? In Somaliland, for example, commitment has been achieved by establishing institutional arrangements that provide sufficient incentives for all key groups to work within the rules. The commitment is credible because all parties stand to lose if any party reneges on the institutional arrangements. In Somalia, by contrast, despite several internationally sponsored efforts at state-building, polarized groups continue to believe that they are better off retaining their own power or forming shifting alliances with others than conferring the monopoly of violence on a central state. This is mainly because the nature of the agreements and proposed institutional arrangements have failed to serve as effective commitment devices. When commitment to deals is not credible, contending sides walk away from the bargaining table and violence prevails: warring factions may renege on peace agreements, policy makers may default on promises to transfer resources to discontented groups or regions, disputants may fail to abide by court judgments, or policemen may abuse citizens instead of protecting them.

0.14 Credible commitment to pro-growth policies and property rights is also essential to ensure macroeconomic stability and to enable growth. Recent evidence shows that most long-term growth comes not from episodes of rapid growth—as commonly believed—but from countries not shrinking as a result of economic crisis or violent conflict (figure 0.1). Growth requires an environment in which firms and individuals feel secure in investing their resources in productive activities. This commitment may be provided in diverse ways. China’s growth success depended on a credible pledge to local governments, private enterprises, and rural farmers that they would be able to keep their profits—credible commitment was thus provided, even if it did not enshrine formal private property rights. In contrast, in Nigeria, the institutional context did not provide the commitment capacity to safeguard revenues from natural resource extraction to support long-term development. In the Nigerian context of rent-distribution, implementing “best practice” fiscal rules that worked in other country contexts did not constitute a credible commitment because government officials were overcome by short-term interests. State governors, for instance, uncertain about whether resources would still be there in the future, had incentives to spend them straight away.

Figure 0.1 Long-term growth is less about how fast you grow than about not tripping along the way

High-income countries are better off not because they grow faster when they grow, but because they shrink less frequently and at a slower rate than low-income countries.



Sources: WDR 2017 team based on Wallis 2016, with data from the Penn World Tables 2015.

Note: Real GDP per capita (constant prices: chain series). Countries first sorted into income categories based on their income in 2000, measured in 2005 dollars. Average annual growth rates are the simple arithmetic average for all the years and all the countries in the income category, without weighting. The sample underlying the figure includes 141 countries, which have data available from at least 1970 onward.

0.15 *Coordination.* Credible commitment alone, however, is not sufficient. Coordination is also needed. Investment and innovation require that firms and individuals believe that others will also invest. Institutions can help solve market failures by coordinating investment decisions and coordinating the expectations of market participants. The insight that a failure to coordinate investment activity can lead to underdevelopment is decades old.² Consider the case where large-scale factories are more efficient, but investing in them is not profitable for individual firms unless investment is made simultaneously in a group. This could be because the market size is too small to justify large-scale investments, unless all the industries expand together, providing markets for one another. There are two possible outcomes, or “equilibriums,” in such a situation. The first is one in which no firms invest in large-scale factories, and efficiency levels stay low. The second, better outcome, is one in which firms are able to coordinate a simultaneous move to large-scale, efficient production. Such problems of coordination can occur in many contexts, ranging from finance and adoption of technology to innovation and industrial clusters to urban planning.³ In India, the lack of coordination between urban planners, real estate developers, and local politicians has prevented an efficient design of urban areas, hindering many cities from performing their roles in enhancing growth.

² See Rosenstein-Rodan (1943). Murphy, Shleifer, and Vishny (1989) model a more recent version of this idea.

³ Hoff (2000) reviews models of coordination failures in a wide range of contexts, including social norms and corruption. Cooper (1999) reviews macroeconomic models of coordination failures, while Rodríguez-Clare (2005) reviews microeconomic models of coordination failures.

0.16 *Cooperation.* Finally, policy effectiveness to achieve equitable development requires cooperation, particularly citizens’ willingness to contribute to public goods and not free-ride on others. The extent to which societies can ensure opportunities for all individuals relies on their ability to provide high-quality services, such as health, education, or connectivity, and to ensure access to economic opportunities, especially access to markets that allow individuals to use the assets acquired. Collecting the taxes needed to fund investments in public goods requires individuals’ willingness to comply and cooperate. Credible and consistent enforcement of laws are also needed to expand opportunities and level the playing field.

0.17 Sometimes, societies face a breakdown of cooperation. For example, Brazil, where citizens organized to demand higher quality of public services, faced a problem common to many countries: namely, the fragmentation of a social contract. In these cases, the low quality of service provision leads the upper middle classes to demand private services, which in turn weakens their willingness to cooperate fiscally and contribute to the provision of public goods, in a perverse cycle. At other times, actors potentially affected by policies may be excluded from their design, undermining their incentive to cooperate, and weakening compliance. An induced perception that the European Union engaged in technocratic and exclusionary decision making, and that there was free-riding by some countries, which were benefiting disproportionately from the agreement, led to the United Kingdom vote for “Brexit”—and to the rise of populist parties in Europe that challenged further integration.

0.18 *Commitment, coordination, and cooperation* are therefore essential institutional functions for making policies effective and thereby achieving development outcomes (table 0.1).⁴ Yet, they are only effectively fulfilled under certain conditions. This Report proposes an analytical framework to advance our understanding of how governance can help achieve these functions to promote development outcomes.

Table 0.1 Three institutional functions—commitment, coordination, and cooperation—are essential to the effectiveness of policies

Function	Some examples of why these functions matter
Commitment	<ul style="list-style-type: none"> • Decision makers may want to spend windfall revenues now instead of saving them for others to spend in the future. • Politicians may resist continuing policies that have worked in the past and prefer to propose others that are associated with their political group. • Public service providers may push to renegotiate the terms of their contracts in their benefit, when they know the political cost of suspending service is high.
Coordination	<ul style="list-style-type: none"> • Investment and innovation are induced when individuals believe the others will also invest. • Financial stability relies on beliefs about credibility of policies; failures involve, for example, bank runs, where everyone believes the rest will rush to withdraw deposits.

⁴ Including at the subnational level. Preventing crime, for instance, can be explained from the functional perspective as part of what local governments provide for the public, as shown in Part 2 of this Report.

	<ul style="list-style-type: none"> • Laws serve as a focal point for individuals to behave in certain ways, such as the convention to drive on the right side of the road.
Cooperation	<ul style="list-style-type: none"> • People have incentives to free-ride or behave opportunistically, for example, not paying taxes while enjoying the public services other (tax-paying) individuals are contributing to fund. • Some actors potentially affected by policies may be excluded from their design, which weakens compliance and leads to fragmentation.

Source: WDR 2017 team.

When political will is not enough: Power, bargaining, and the policy arena

0.19 This Report argues that institutions perform three key functions to enhance policy effectiveness for development: enabling credible *commitment*, enhancing *cooperation*, and inducing *coordination*. But why are policies so often ineffective in doing so? A typical response among policy practitioners is that the right policies exist, ready to be implemented, and that what is missing is the existence of political will in the national arena. This Report argues that decision makers—the elites⁵—may have the right objectives and yet may still be unable to implement the right policies because doing so would challenge the existing equilibrium—and the current balance of power. Thus, the balance of power in society may condition what kind of commitment, coordination, and cooperation results come about.

0.20 Ultimately, policy effectiveness depends not only on what policies are chosen, but also on *how* they are chosen and implemented. Policy making and policy implementation both involve bargaining between different actors. The setting where (policy) decisions are made can be termed the *policy arena*: the space where different groups and actors interact and bargain over aspects concerning the public space, and where resulting agreements eventually also lead to changes in the formal rules (law). It is the setting where governance manifests itself. Policy arenas exist at the local, national, international, and supranational levels. They can be formal (parliaments, courts, intergovernmental organizations, government agencies); traditional, and informal (backroom deals, Old Boys networks).

0.21 Who bargains in this policy arena, and how successfully they bargain, is determined by the relative *power* of actors, by their ability to influence others through control over resources, threat of violence, ideational persuasion (de facto power), as well as by and through existing rules themselves (de jure power). Power is expressed in the policy arena by the ability of groups and individuals to make others act in their interest and to bring about specific outcomes. It is a fundamental enabler—or constraint—to policy effectiveness (see box 0.3).

0.22 The distribution of power is a key element in the way in which the policy arena functions. During policy bargaining processes, the unequal distribution of power—*power asymmetry*—can influence policy effectiveness. Power asymmetry is not necessarily harmful, and can actually be a means to achieve effectiveness—for example, through delegated authority. In contrast, the negative manifestations of power asymmetries are reflected in capture, clientelism, and exclusion.

⁵ What distinguishes elites from citizens in this Report is their ability to directly influence the design and implementation of a certain policy. Elites, in this way, are defined in a positive (as opposed to a normative) sense. See box 0.6 for further detail.

How power asymmetries matter for security, growth and equity

Box 0.3 The idea of power and the power of ideas

“The ideas of economists and political philosophers,” John M. Keynes noted in *The General Theory of Employment, Interest and Money*, “both when they are right and when they are wrong, are more powerful than they are commonly understood. Indeed, the world is ruled by little else.” The notion of how ideas can influence historical paths in fundamental ways has long been studied by social scientists, not only from the perspective of ideology and culture but also from the view of “cultural entrepreneurship.”^a It is important, however, to distinguish two specific ways—not exhaustive but fundamental—in which ideas influence policy making and effectiveness: ideas as knowledge, and ideas as a means to shape preferences and beliefs.

From the perspective of ideas as knowledge, the policy discussion has been influenced in the past few decades by the principles of “capacity building” in the form of knowledge sharing and dissemination of “best practices.” Ideas as knowledge undoubtedly play a role in strengthening the effectiveness of policies and enhancing the capacity to deliver on specific policy commitments.

But ideas also shape preferences and beliefs. Keynes ended his discussion on ideas by saying that “practical men, who believe themselves to be quite exempt from any intellectual influences, are usually slaves of some defunct economist. . . soon or late, it is ideas, not vested interests, which are dangerous for good or evil.” Since the eighteenth century, Hume’s law established that no normative statement (such as a policy prescription) can be derived from a positive one (observation of facts) without a normative idea as an assumption. Policy prescriptions based on facts still require some normative notion: an idea, in the background. Acknowledging the importance of ideas, this Report discusses the relevance of shaping preferences as a means to understand the policy bargaining process

It was Eric Wolf who, in 1999, called attention to the importance of understanding power and ideas as complementary to understanding social dynamics.^b Indeed, following Michel Foucault, Wolf argues that the ability to shape other people’s beliefs is a means to elicit an action from another person—an action the other person would not otherwise take. The ability to make others act in one actor’s interest or to bring about a specific outcome—the definition of power in this Report—is thus closely related to the notion of ideas as beliefs.

The dichotomy between ideas (ideology and culture) and power as a primary determinant of social dynamics is thus a false one. The idea of power cannot be understood without taking seriously the power of ideas.

a. See, for example, Mokyr (2005) for a discussion on the “intellectual origins of modern economic growth.”

b. Wolf (1999). See also Barret and others (2001).

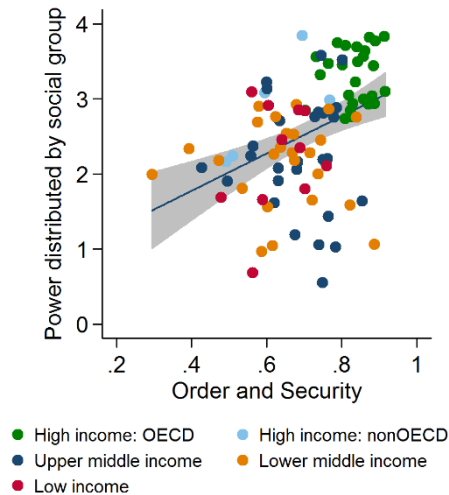
0.23 *Exclusion*. One manifestation of power asymmetries, the *exclusion* of individuals and groups from the bargaining arena, can be particularly important for security (figure O.3). When powerful actors are excluded from the policy arena, violence may become the preferred—and rational—way for certain individuals and groups to pursue their interests, such as in Somalia. It can lead to failed bargains between participants in the bargaining arena (such as when peace talks between rival factions break down, or when disputants fail to reach an agreement over a dispute).

0.24 *Exclusion*, which can take the shape of lack of access to state institutions, resources, and services, often takes place along identity fault lines. The distribution of power among ethnic groups, measured by their access to central state power, is a strong predictor of violent conflict at the national level (whether in the form of repression by the state or rebellion against the state).⁶ Cross-country statistical analyses using the Ethnic Power Relations dataset from 1945 to 2005

⁶ However, lack of access to state power is not the only determinant of violence; the capacity to mobilize against governments also matters (Cederman, Wimmer, and Min 2010), as does the opportunity to mobilize. On the former, see Fearon and Laitin (2003).

indicate that states that exclude large portions of the population based on ethnic background are more likely to face armed rebellions.⁷ The existence of norms that exclude certain groups, like women and minorities, from the bargaining arena where disputes are settled tend to reinforce power asymmetries and perpetuate inequitable and insecure outcomes.⁸

Figure 0.2 A more even balance of power is associated with positive security outcomes



Source: World Justice Project, Rule of Law Index 2015 Factor 5, “Order and Security” (consisting of “Crime is effectively controlled”; “Civil conflict is effectively limited”; “People do not resort to violence to redress personal grievances”) and V-Dem v.6 (consisting of “Power distributed by social group”) (where a score of 0 means political power is monopolized by one social group and a score of 4 means that social groups have equal political power).

Note: OECD = Organisation for Economic Co-operation and Development.

0.25 *Capture.* A second manifestation of power asymmetries, the ability of influential groups to “capture” policies and make them serve their narrow interest, is helpful to understand the effectiveness (or lack thereof) of policies in promoting long-term growth. In the 1990s, for example, some of Indonesia’s largest industrial groups had strong connections to then-President Suharto.⁹ Between 1995 and 1997, rumors about President Suharto's health circulated on several occasions. In every episode, the closer that industrial groups were to the president, the more their stock market returns fell (figure 0.3). The effects of capture can be quite costly for the economy. Politically connected firms are able to obtain preferential treatment in business regulation for themselves as well as to raise regulatory barriers to entry for newcomers—such as through access to loans, ease of licensing requirements, energy subsidies, or import barriers. This can stifle competition and lead to resource misallocation, with a toll on innovation and productivity. Between 1996 and 2002, politically connected firms in Pakistan received 45 percent more government credit than other firms, even though they were less productive and had default rates

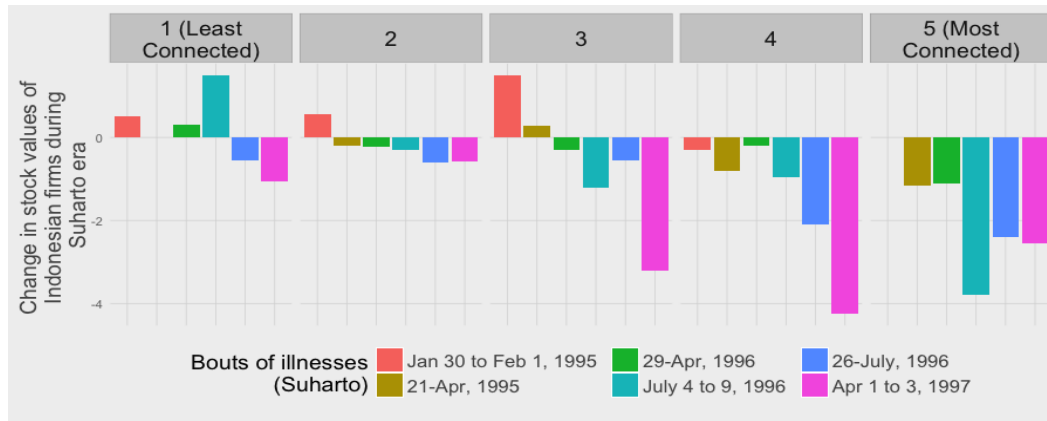
⁷ Wimmer and others 2009.

⁸ Platteau 2000.

⁹ Suharto was the second President of Indonesia; he held the office for 31 years from the ousting of the first President Sukarno in 1967 until his resignation in 1998.

that were 50 percent higher. Based on the productivity gap between firms, the annual cost of this credit misallocation could have been as high as 1.6 percent of GDP.¹⁰

Figure 0.3 The value of political connections: Indonesia during President Suharto’s era



Source: Fisman (2001, figure 1).

0.26 While it is possible for economies to grow without substantive changes in the nature of governance, it is not clear how long such growth can be sustained. Consider the case of countries stuck in “development traps.” Contrary to what many growth theories predict, there is no tendency for low- and middle-income countries to converge toward high-income countries. The evidence suggests that both low-income and middle-income countries are at risk of growth stagnation. What is it that keeps some countries from transitioning to a better growth strategy, when their existing growth strategy has run out of steam? With a few exceptions, policy advice for these countries has focused on the proximate causes of transition, such as the efficiency of resource allocation or industrial upgrading. The real problem, however, may have political roots: powerful actors who gained during an earlier or current growth phase (such as the factor-intensive growth phase) may resist the switch to another growth model (such as one based on firm entry, competition, and innovation, in the process of “creative destruction”). These actors may exert influence to capture policies to serve their own interests. Box 0.4 presents an example of the political challenges in transitioning toward a different growth strategy, related to investments in environmental sustainability.

¹⁰ Khwaja and Mian 2005.

Box 0.4 Why some people see red when they hear “green growth”

“Green growth is about making growth processes resource-efficient, cleaner and more resilient without necessarily slowing them” .^a There are many reasons why environmental conservation is also good for long-term economic growth and development. Economic production depends on the stock of natural resources and on environmental quality (“natural capital”). By preventing environmental degradation, green growth strategies can increase natural capital. Environmental protection can also contribute to growth indirectly by correcting market failures. For example, a policy that addresses market failures leading to urban congestion can improve air quality and increase urban productivity. Greener growth can also improve well-being directly by improving air and water quality.

However, switching to greener growth strategies could impose short-term costs on some groups in society. Take the case of agricultural policy and fertilizers. In 2005, faced with food insecurity, Malawi introduced a fertilizer subsidy for smallholder maize farmers, which led to a sizeable effect on maize production. However, the intensive use of fertilizers—such as that promoted by this subsidy—can have substantial long-term costs on the environment and the economy. While more environmentally friendly alternatives exist, their adoption tends to be unfeasible in the short run. It would not be easy for small farmers to adopt greener approaches, such as microdosing—which consists of smaller but more targeted doses of fertilizer—which would also require a shift in the behavior of farmers on a relatively broad scale. Getting rid of the subsidy could therefore hurt maize farmers for some years .^b

It could be that the groups that stand to lose from green growth policies in the short term have oversized influence over the policy arena, and are able to block reforms and undermine commitment. Since many of the benefits from cleaner technologies are intangible and dispersed, and the costs are concentrated, the potential losers from such reforms are likely to be better able to organize. They can also constitute a strong electoral constituency. Malawi’s fertilizer program has been popular among small farmers. When the subsidy was introduced, the incumbent party needed their support because it had a relatively weak rural vote base. Indeed, the government greatly increased the subsidy funding as the 2009 elections approached.

In other cases, switching to greener growth strategies could entail losses for influential groups of consumers and firms. For example, South Africa announced an ambitious climate change plan in 2010—one that would greatly reduce the share of electricity generated by coal-fired plants, in a country where coal is relatively abundant and electricity is in short supply. The plan, despite being watered down, has been opposed by consumers, labor unions, and business interests, particularly those in the mining sector and heavy industry .^c These examples illustrate how taking into account the potential resistance from short-term losers into the design of policies can improve effectiveness.

a. Hallegate and others 2012

b. Resnick, Tarp, and Thurlow 2012.

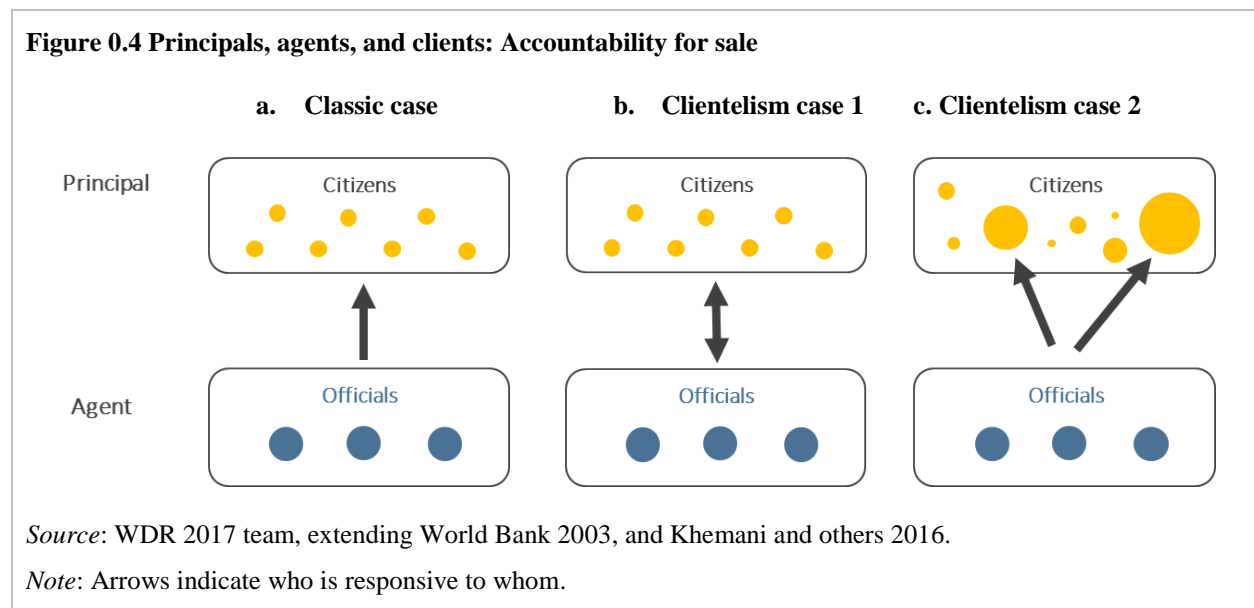
c. Resnick, Tarp, and Thurlow 2012.

0.27 *Clientelism*. A third manifestation of power asymmetries, *clientelism*—the exchange of political support for short-term benefits—is helpful to understand why policies that look to promote equity are often ineffective. Expanding opportunities and leveling the playing field may boost growth in the medium and long run, but in the short run may threaten the interests of specific groups. When such groups have direct influence on policy design or implementation—including because of existing patterns of inequality—they may attempt to undermine the adoption or implementation of redistributive policies, weakening the commitment to such policies. Clientelism can shape the adoption and implementation of policies in two main ways. First, in clientelistic settings, the relationship between public officials and voters becomes distorted. Instead of a dynamic where the official is the agent of the voter (who monitors and sanctions the agent) (figure 0.4, panel a), the interaction becomes a bargain, where the politician “buys” the vote in exchange for (usually) short-term benefits—such as transfers or subsidies .¹¹ This leads to a breakdown of

¹¹ Khemani and others 2016.

commitment to long-term programmatic objectives and becomes an obstacle in the achievement of a sustained path to equitable outcomes (figure 0.4, panel b).

0.28 Moreover, incumbent public officers often become dependent on the support of certain groups for their political survival, including the providers of public services. In this clientelistic equilibrium, politicians become responsive to those groups that wield greater influence—for instance, favoring the interests of teacher unions (over those of students) (figure 0.4, panel c). The costs of this malfunction can be high. In exchange for their political support, service providers may extract rents through the diversion of public resources, or withhold their effort in the form of absenteeism or low-quality provision, or engage in corrupt practices, hampering the delivery of services such as education, health, or infrastructure. For example, 40 percent of doctors in public health facilities were absent at any given time in a representative sample of rural areas of Madhya Pradesh in India. Doctors in public facilities in the sample spent on average 2.4 minutes with a patient and completed only 16 percent of a checklist of examination items and questions on medical history—while the same doctors performed better when they were in the private sector.¹² This form of clientelism also leads to a breakdown in commitment, where accountability becomes up for sale.



0.29 When commitment breaks down systematically, it can affect legitimacy, eroding people’s incentives to cooperate and some groups may “opt out” by demanding private services and avoiding to contribute to the provision of public goods.¹³ In clientelistic settings, states tend to have low tax revenues and provide few public goods, undermining economic activity and future taxation.

¹² Das and others, 2015

¹³ Ferreira and others 2013.

0.30 In contrast, repeated commitment builds legitimacy in terms of outcomes¹⁴. When a government repeatedly delivers on its commitments, it legitimizes itself—for instance, by reliably providing public services. Legitimacy also comes from other sources, namely a perception of fairness in the way that policies and rules are designed and implemented, i.e., *process* legitimacy. Finally, legitimacy is also relational, where sharing a set of values and norms encourages individuals to recognize authority. Outcome, process and relational legitimacy form the three types of legitimacy identified in this Report. Legitimacy matters for cooperation and coordination, as it implies voluntary compliance with an act of authority. Even if a government delivers on its commitments and is able to coerce people into complying, there might be “legitimacy deficits” if the process is perceived as unfair and people might not be willing to cooperate.

Best practice or best fit? Revisiting the notion of “first best”

0.31 The development community has largely focused its reform attempts on designing best practice solutions and building the capacity needed to implement them. Capacity is often considered a prerequisite for policy effectiveness. Capacity is certainly important, and in many cases constitutes an overriding constraint. At a given point in time, capacity can be thought of as a stock. How and where to use such capacity, however, is also the outgrowth of a bargaining process. Even if physical and administrative capacity exists, policies may still be ineffective if groups with enough bargaining power have no incentives to pursue implementation. An example is the low investments in statistical capacity in Africa that limit the ability to monitor policy effectiveness (box 0.5). In addition, existing power structures may be reinforced by prevailing norms, as socially accepted, persistent shapers of behavior.¹⁵ Such norms may reinforce or undermine policy effectiveness.

Box 0.5 The need to strengthen incentives to gather development data

For years, the development community has invested heavily in developing statistical capacity in Africa. It has done this through economic resources as well as technical expertise. However, the results have been disappointing.^a Many countries in the region still lack the data to monitor socioeconomic conditions such as poverty, inequality, and service delivery. Many voices are now demanding more money and more capacity building to solve this problem. However, this view neglects the fact that in order for countries to develop statistical capacity, there is a need for political incentives to do so.

In many countries, political incentives lead those in power to avoid investing in capacity or to actively undermine capacity. Some elites in African countries consider high-quality data systems a tool the opposition could use to audit their performance. They thus have incentives to establish either weak statistical offices or partisan ones, staffed with political supporters rather than with technical experts.^b Of course, this practice is not unique to Africa.

The argument is as valid for the use of existing capacity as it is for building such capacity. In Latin America, a region well-known for its capacity for data collection, there are examples where the political dynamics led to a weakening of the credibility of official statistics. For example, in Argentina, after building a reputation for high-quality data collection and independence from the political sphere, the Kirchner administration decided to replace the technical experts with political appointees who first manipulated the data to reduce the poverty estimates and then stopped measuring poverty altogether.^c

a. Devarajan 2013.

b. Beegle and others 2016

c. Noriega 2012; Roitberg and Nagasawa 2016.

¹⁴ Outcome legitimacy is related to the notion of *trust*, which is defined in this WDR as the probability that an actor assigns to other actors delivering on their commitment, conditional on their past behavior.

¹⁵ World Bank 2015.

0.32 Thus, investing in capacity may not be enough. Designing policies to improve security, growth, and equity requires understanding the balance of power among different actors. In the presence of powerful actors who can block or undermine policies, optimal policies from a strict economic standpoint (first-best policies) may not be the optimal implementable policies (second-best, but feasible). Even when feasible, implementing what seem like first-best economic policies, from a static perspective, can lead to worse outcomes for society when they negatively affect the power equilibrium. For example, in cases where governments are captured by firms and there is high inequality, unions may be the only way for workers to solve their collective action problem,¹⁶ even if representation is not perfect. In such cases, passing a law to make labor contracts more flexible may undermine union membership and lead to more inequality, which, in turn, can perpetuate the power of the wealthy.¹⁷

Levers for change: Incentives, preferences, contestability

0.33 From the perspective of power asymmetries, efforts to strengthen the ability of institutions to effectively enable commitment, coordination, and cooperation call into question many traditional practices of the development community. In order to design more effective policies, it is necessary to recognize how the distribution of power in the policy arena may affect policy design and implementation and to consider how the policy arena can be reshaped to expand the set of policies that can be implemented.

Reshaping the policy arena occurs when changes take place in who can participate in decision-making processes (the contestability of the policy arena), when *incentives* to pursue certain goals are transformed, and when there are shifts in actors' *preferences and beliefs*. For example, the enfranchisement of previously disengaged illiterate voters in Brazil (through the introduction of electronic ballots) shifted the balance of power in their favor by reducing the entry barriers for their participation, increasing contestability, ultimately leading to increased spending in healthcare. In Kenya, elections helped transform the incentives of ruling elites, reducing the scope of ethnic favoritism. Moreover, political parties, as a form of political organization, can help aggregate citizens' preferences, integrating different groups in the political process, encouraging a culture of compromise. In Tanzania, the power-sharing agreements within the Chama Cha Mapinduzi party has been instrumental in accommodating the demands of various leaders.¹⁸ Depending on the primary functional challenge (that is, whether the policy needs to enable commitment, coordination, and/or cooperation), the entry point may be different. As these functional challenges are interdependent, the entry points act as complements to one another.

0.34 As an illustration, consider how countries are more or less effective at redistributing income through the fiscal system. The average measure of inequality (as captured by the Gini coefficient) based on individuals' market income is 0.47 for developed countries and 0.52 for developing countries. After considering the effect of taxes and transfers, the corresponding

¹⁶ Collective action problems include those solved through *coordination* (the coordinated actions among actors based on a shared expectation about what others will do) and *cooperation* (the cooperative behavior among actors, whereby opportunistic behavior—free riding—is limited). Throughout the Report the term refers to these two different manifestations of collective action problems.

¹⁷ Acemoglu and Robinson 2013.

¹⁸ Ezrow and Frantz 2011.

coefficients drop to 0.31 and 0.50, respectively. If the effect of publicly provided services (in particular, education and health) is also included, inequality falls further: to 0.22 in developed countries and to 0.42 in developing countries.¹⁹ The quantifiable redistributive capacity of these countries can be interpreted in different ways. It can be interpreted as the relative ability of different actors to influence and contest decisions over the distribution of resources in a given country. It can be interpreted as the incentives of governments to commit to the collection of taxes and allocation of spending; more checks and balances on power are associated with more redistribution.²⁰ Or it can be interpreted as the preferences for redistribution in a given country. WDR 2017 explores in depth how changes to contestability, incentives, and preferences can enhance policy effectiveness for security, growth, and equity.

The role of law: Closing the gap between laws on paper and laws in practice

0.35 Law is a powerful instrument to reshape the policy arena. While laws generally reflect the interests of those actors with greater bargaining power, law has also proven to be an important instrument for change. By its nature, law is a device that provides a particular language, structure, and formality for ordering things, and this characteristic gives it the potential to become a force independent of the initial powers and intentions behind it. Law, often in combination with other social and political strategies, can be used as a commitment and coordination device to promote accountability, and also to change the rules of the game to foster more equitable bargaining spaces. Effective laws are those that are able to shape bargaining spaces that increase contestability by under-represented actors; change incentives by changing payoffs to lower the cost of compliance (or increase the cost of noncompliance); and change preferences by enhancing substantive focal points around which coordination can occur.

0.36 *Contestability.* Who is included and who is excluded from the policy arena is determined by the relative power of the competing actors, as well as by the barriers of entry to participate (that is, the *contestability* of the process). A more contestable policy arena is one in which actors or groups who have reason to participate in the decision-making process have ways to express their interests and exert influence. As contestability determines who is included and who is excluded from the bargain, it is closely linked to the notion of inclusion but it also emphasizes the barriers to participation. While the inclusion of more actors in the decision-making process is not necessarily a guarantee of better decisions, a more contestable policy arena tends to be associated with higher levels of legitimacy and cooperation. When procedures for selecting and implementing policies are more contestable, those policies tend to be perceived as “fair” and to induce cooperation more effectively.

0.37 Law can play a role in making the policy arena more contestable. Enhancing the contestability of the arena encompasses both *ex ante* procedures (which relate to the means by which law is made, and the extent to which it is participatory and transparent) and *ex post* ones (the extent to which it is applied consistently and fairly). If various actors believe that the process is exclusionary, or reflects only the interests of some groups, they may not comply, or they may outright oppose it. Public hearings, stakeholder consultations, social audits, and participatory

¹⁹ See Aaberge and others (2010); Lustig (2015).

²⁰ See Besley and Persson (2014).

processes are some examples of instruments that can make the arena more contestable.²¹ In this case, law serves as a tool to promote accountability, change the rules of the game, or both. This is embodied, for example, in the advocacy to adopt right to information laws.

0.38 *Incentives.* The *incentives* that actors have to comply with agreements are fundamental to enable commitment in the policy arena. Credible commitment requires consistency in the face of changing circumstances; incentives for actors to commit to agreements is thus crucial for the effectiveness of policy design and implementation. Stronger incentives to hold policy makers accountable can also strengthen voluntary compliance, as repeatedly delivering on commitment helps build trust in institutions. Law can play a role in shaping the incentives of actors to comply with agreements, for instance, by providing a credible threat of punishment or a credible commitment to obtaining the reward for compliance. Law orders behavior through rules ranging from prohibiting bribery, to establishing licensing fees and business registration, to banning child marriage, as well as by the means to enforce them. Laws induce particular behaviors of individuals and firms through coercive power, coordination power, and legitimating power.

0.39 *Preferences and interests.* The *preferences and interests* of decision-making actors matter for shaping whether or not the outcome of the bargain will enhance welfare, and whether or not the system is responsive to the interests of those who have less influence. Law can effectively reshape preferences and coordinate expectations about how others will behave, serving as a focal point. As the different preferences and beliefs of actors shape their policy goals, an important condition for policy effectiveness relates to the coordination of actors' expectations. In this way, law can serve the role of a sign post—an expression—to guide people as to how to act when they have several options, or, in economic terms, in the presence of multiple equilibria.²² The law provides a clear reference in the midst of diverging views. People comply with the law because doing so facilitates social and economic activities.

0.40 Ultimately the *rule of law*—the impersonal and systematic application of known rules to government actors and citizens alike—is needed for a country to realize its full social and economic potential. But as Gordon Brown, the former prime minister of the United Kingdom, noted, “When it comes to rule of law, the first five centuries are the hardest.” The ideal of the rule of law comes about as a result of a home-grown (endogenous) process of contestation that shapes societies' adherence to principles of rule of law over time—sometimes a very long time. Box 0.6 discusses the challenging process of transitioning to the rule of law. Pragmatic policy design that takes into account how these different roles of law can bolster the effectiveness of development policies can ultimately move countries on a trajectory toward a stronger rule of law.

²¹ The evidence for how some of these mechanisms lead to better outcomes however, is mixed, as further discussed in chapter 8.

²² Basu 2015; McAdams 2015.

Box 0.6 Transitions to the rule of law

Compared to the extensive literature on transitions to democracy, a surprisingly small amount of systematic work has been done on transitions to a modern rule of law. There are actually three separate transitions to consider: first, the shift from a customary, informal, and often highly pluralistic system of law to a unified modern one; second, how powerful elites come to accept legal constraints on their power; and third, how countries successfully adapt foreign legal systems to their own purposes.

The shift from a customary and/or pluralistic system to a codified modern one is usually motivated, at base, by actors who see a single formal system as better serving their interests, particularly economic interests in expanded trade and investment. Scale matters: at a certain point, the personal connections that characterize customary systems become inadequate to support transactions between strangers at great remove. However, transition costs are high, and customary rules are often preferred by existing stakeholders. This means that political power is critical in bringing the transition about.

Formal law is usually applied first to non-elites (“rule *by* law”); the shift to “rule *of* law” occurs when the elites themselves accept the law’s limitations. Some have argued that constitutional constraints become self-reinforcing when power in the system is distributed evenly and elites realize that they have more to gain in the long term through constitutional rules.^a What this theory does not explain, however, is why these same elites stick to these constraints when the power balance subsequently changes and one group is able to triumph over the others. Similarly, independent courts are always a threat to elite power; why do rulers come to tolerate them when they have the power to manipulate or eliminate them? This suggests that constitutionalism needs to be underpinned by a powerful normative framework that makes elites respect the law as such. Subsequent respect for law depends heavily on the degree of independence maintained by legal institutions—the judiciaries, bars, law schools, and other structures that persist even after their normative foundations have disappeared.

Finally, with regard to the import of foreign legal systems, perhaps the most important variable determining success is the degree to which indigenous elites remained in control of the process, and can tailor it to their society’s own traditions. Thus Japan experimented with a variety of European systems before settling on the German civil code and Bismarck constitution at the end of the nineteenth century. Later in the twentieth century, China, the Republic of Korea, and other Asian countries similarly adapted Western legal systems to their own purposes. In other cases, such as Hong Kong, India, and Singapore, the colonial power (Britain) stayed for a long time and was able to shape the local legal norms in its own image. Even so, India today practices a far higher degree of legal pluralism than Britain itself, as part of the process of local adaptation. Less successful were cases in Sub-Saharan Africa, where customary systems were undermined by colonial authorities, but not replaced by well-institutionalized modern systems.

Much more research is needed into the question of legal transitions. It is clear that a fully modern legal system is *not* a precondition for rapid economic growth; legal systems themselves develop in tandem with modern economies. It may be that the necessary point of transition from a customary to a formal legal system occurs later in this process than many Western observers have thought. But relatively little is known about the historical dynamics of that transition, and thus there is too little by way of theory to guide contemporary developing countries as they seek to implement a rule of law.

Source: Prepared by Francis Fukuyama for the WDR 2017.

a. See North, Wallis, and Weingast (2009).

Reshaping the policy arena: Entry points for reform

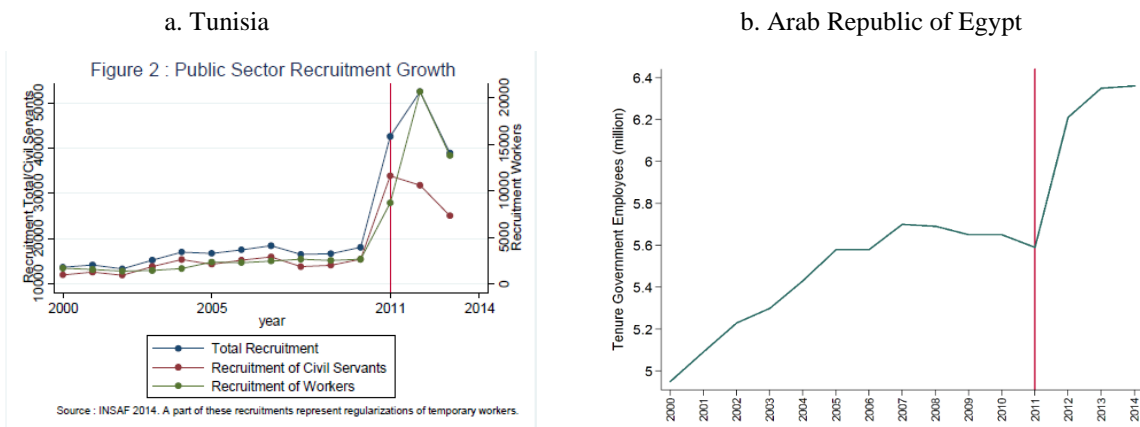
0.41 How can strengthening the role of law to change contestability, incentives, and preferences enhance policy effectiveness for security, growth, and equity? Take the case of security. Whether formally or informally, institutions of governance can solve commitment and cooperation problems in ways that create incentives not to use violence. Four main governance mechanisms matter for improving security outcomes: power sharing, resource redistribution, dispute

settlement, and sanctions. Power sharing and resource redistribution are highlighted in the illustrations below.

0.42 *Power sharing and resource redistribution can reduce exclusion and the incentives to engage in violence.* Just as exclusion may lead to violence, mechanisms that encourage power sharing—such as legislatures that guarantee the representation of all factions—can reduce the incentives to engage in violence by raising the benefits of security. Power-sharing arrangements are especially relevant for societies divided along ethnic and religious identity lines, such as in Bosnia and Herzegovina, Northern Ireland, Kenya, Lebanon, and South Africa, but also in countries where the conflict is a legacy of opposing ideologies. Power-sharing bargains that lead to peace and security typically take place between elites. They encourage cooperative behavior by providing elite groups with the incentives to compromise with one another and to inspire inclusion among their followers; and by offering alternative avenues for contesting power.

0.43 Mechanisms that redistribute resources can also reduce violence by reordering power and changing incentives. Redistributive arrangements include budget allocation, social transfers, and victim compensation schemes. Some government interventions to reduce urban crime in Latin America follow a common pattern of increasing security by reducing poverty and inequality. Employment in the public sector is also a potential instrument that can bring about stability by ensuring the loyalty of key constituencies. Witness the dramatic increase in the numbers and salaries of public employees following the Arab uprisings in 2011 (figure 0.5). While this kind of political patronage can solve the first-order problem of violence, it can also lead to corruption and can have ruinous effects on budgetary sustainability and administrative efficiency.

Figure 0.5 Recruitments of civil servants increased exponentially in Tunisia and Egypt in the aftermath of the Arab Spring



Source: Brockmeyer, Khatrouch, and Raballand 2015 for Tunisia; Darwish 2015 for Egypt, based on figures from the Egyptian Central Agency for Organization and Administration (CAOA).

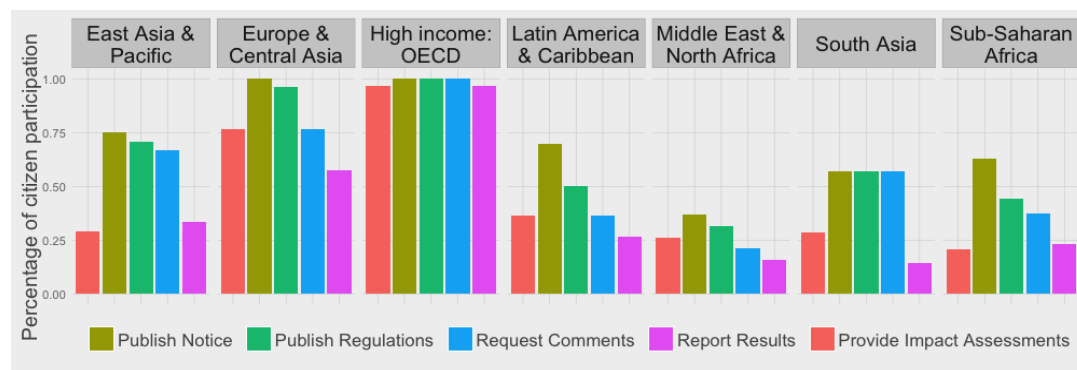
0.44 *Implementable policies can help reduce capture, enhancing growth.* Security is a precondition for prosperity but it is not enough, economic growth must follow. When it comes to growth, if the possibility of capture looms large, policies that are first-best on the basis of economic efficiency may be less implementable than second-best ones. Adopting an implementable second-

best design could therefore be more effective than choosing the seemingly first-best policy prone to capture. Moreover, the possibility of future capture can be reduced by anticipating the possible effects on the balance of decision-making ability among the actors involved, when considering alternative policy designs.

0.45 The experience of the Russian Federation and Eastern European countries in their transition toward market economies is illustrative.²³ Compelled by the then-dominant economic argument that the privatization of state-owned enterprises (SOEs) was of first-order importance in enhancing economic efficiency, Russia and many Eastern European countries focused on a rapid, large-scale privatization of SOEs. While this may have made sense on purely economic grounds, the way in which the privatization wave was implemented created a new class of oligarchs that resisted the next generation of procompetition reforms. Many of these economies are still struggling with inefficient, oligopolistic industries. In contrast, Poland chose to focus first on reforms that made it easy for new firms to enter, and privatized existing firms more gradually. This sequencing created a class of young firms that were collectively interested in further reforms, while preventing the sudden emergence of an influential group of large firms that could block reforms.²⁴

0.46 Better design of public agencies can help expand the set of implementable policies. First, how public officials are selected into service and the incentive structure that they face within their organizations matter. Recruitment and compensation schemes should take not just economic motivation into account, but also intrinsic motivation for public service and existing norms of behavior. For policies where there is a significant role for discretion during implementation, credible monitoring mechanisms can further discipline implementation. Establishing and maintaining greater accountability in public agencies can also help in balancing influence in the policy arena. For instance, general-purpose oversight agencies can act as a check on the capture of agencies in charge of specific policy areas. Mechanisms that help give a bigger say in the policy arena to less powerful, diffuse interest groups could help balance the influence of more powerful, narrow interest groups. Participatory mechanisms in regulatory institutions are still relatively uncommon in low- and middle-income countries (figure 0.6).

Figure 0.6 Formal avenues for broad-based participation in regulatory decision making are limited in low- and middle-income countries



Source: WDR 2017 team, using the World Bank’s citizen engagement in rule making data.

²³ Roland and Verdier 1999.

²⁴ Jackson, Klich, and Poznanka 2005.

0.47 Capture is not an inevitable outcome of close business-state ties. As long as influence and incentives are balanced through robust public agency design and accountability mechanisms, firms and business groups can have a positive influence on policies for growth. Contemporary case studies suggest that business associations have helped governments improve various dimensions of the business environment, such as secure property rights, fair enforcement of rules, and the provision of public infrastructure, through lobbying efforts or better monitoring of public officials.

0.48 *Controlling clientelism can help solve commitment problems to deliver on redistributive policies.* Mechanisms that control clientelism can enhance equity by making commitment to long-term objectives credible in the political arena. Providing information, enhancing transparency and involving communities in policy design and monitoring can work to strengthen the quality of service delivery, provided the rules establish clear mandates and tools to monitor providers. An intervention designed to strengthen local accountability and community-based monitoring in the primary health care sector in Uganda, for example, was remarkably successful in improving both health services and outcomes in the participating communities.²⁵ In this respect, information can be a critical tool; however, results on its impact are limited and contrasted. A promising result on the impact of information comes from Pakistan, where a randomized experiment that provided information to parents on the performance of private and public schools increased test scores, decreased private school fees, and increased primary enrollment.²⁶ Enhancing the bargaining power of users by involving them in management can also help improve services and reduce clientelism. For example, when school councils of parents are well trained and have credible sanctions, they can improve school results.²⁷ In a reform experiment in Kenya to hire contract teachers, capture by civil service teachers was lower by one-third in a subgroup of schools that received training in school-based management. In this subgroup, the school committee was better able to monitor the hiring of contract teachers, and capture—in the form of absenteeism and hiring of relatives—was reduced.²⁸

0.49 Over time, policies that effectively improve equity also reduce power asymmetries, making the policy arena more contestable. After a period of inclusive growth with greater income mobility, when the middle class grew in Latin America, people started demanding better quality services and demonstrating in the streets for better governance.²⁹ Conversely, inequitable growth, and the concentration of wealth in the hands of a few leads to dynamics of consolidation of power, can lead to perceptions of unfairness, and thus to weaker incentives for cooperation and coordination by those excluded from the benefits of development.

The drivers of change: Elite bargains, citizen engagement, and international influence

0.50 If changes in incentives, contestability, and preferences are the key levers of change for correcting power asymmetries in the policy arena to more effectively enable commitment, coordination, and cooperation, how can these be brought about? The Report identifies three encouraging drivers for bringing about significant change that is conducive to development: elite bargains (which take the distribution of power in the policy arena as given); citizen engagement

²⁵ Björkman and Svensson 2009.

²⁶ Andrabi, Das, and Khwaja 2015.

²⁷ Bruns and others 2011.

²⁸ Duflo, Dupas, and Kremer 2015.

²⁹ Ferreira and others 2013.

(which tries to change the distribution of power in the policy arena); and international interventions (which indirectly affects the distribution of power in the policy arena) (box 0.7)

Box 0.7 Elites and citizens: Who is who in the policy arena?

Participants in the policy arena can be grouped into elites and citizens according to their relative degree of influence in the policy-making process. What distinguishes elites from citizens is their ability to *directly* influence the design and implementation of a certain policy. Elites can vary from one policy to another. For example, a group that is an elite in the area of health may not be an elite in the area of crime control. The source of their ability to influence policy comes not only from formal rules such as delegated authority (de jure power), but also from other means such as the control over resources (de facto power). Thus, even if the government changes, those who are able to influence decisions may stay the same: they keep their seat at the table. A few years ago, an entertainment magazine in a Latin American country captured this dynamic in an interview with an unlikely political observer: the chef of the presidential residence. After a tight election, the new president and his family had just moved into the residence. The interviewer asked the chef whether it was difficult for him to adjust the menu to the new presidential family's tastes. "It is really not that problematic," he reflected, "because even though the presidents change, the guests are always the same."

Certainly, the dichotomy between elites and citizens is imperfect because it does not account for different degrees of relative power among individuals within those groups (elites or citizens), nor does it capture how their relative power differs from one policy to another. As Stephen J. Gould notes in his classic text, *Myth and Metaphor in the Discovery of Geological Time*, "Dichotomies are useful or misleading, not true or false. They are simplifying models for organizing thought, not ways of the world."^a The reality is much more complex and nuanced.

This Report views individuals as being on a continuum with respect to their position of power in the policy arena, and thus its definition of elites and citizens is a positive (rather than normative) one. Elites are not necessarily bad or self-interested, and citizens are not necessarily good and public spirited. Both groups exercise their influence as people do in other spheres of life: understanding their motivations matters to anticipate their conduct.

a. Gould (1987, 8–9).

0.51 All countries, regardless of their level of economic and institutional development, are subject to elite bargains. Change is unlikely to occur unless powerful actors—elites—in the country agree to that change. When influential actors resist change, suboptimal policies and governance institutions that are detrimental to development tend to persist. Under certain circumstances, however, elites may voluntarily agree to limit their influence in their own self-interest. Citizens can also organize to bring about change, playing an important role in applying pressure to influence the outcome of favorable bargains in the policy bargaining process. Moreover, governance does not occur solely within the boundaries of nation-states. While international actors cannot engineer development from the outside, these transnational actors play an important role in influencing the domestic bargaining dynamics by strengthening (or weakening) local coalitions for reform.

0.52 Change occurs over time as coalitions are formed among different actors, but this is often a long and self-determining "endogenous" process. For instance, success at achieving security in Somaliland arose from the collective action of a wide range of tribal and clan leaders. Sharing power among these actors helped reduce the incentives for violence by raising the benefits of security. In Nigeria, Muhammadu Buhari won the 2015 election by creating a broad coalition through a campaign platform focused on tackling corruption, potentially indicating an enhanced ability to overcome corrupt vested interests that benefit from oil rents. And in India, the Right to Information and Right to Education Acts, pushed through by grassroots coalition movements over

many years, have helped poor citizens demand better services and education for their children, improving living conditions within slums

Elites may adopt rules that constrain their own power

0.53 In December 1976, after the demise of General Francisco Franco—who had been in power since the late 1930s—a referendum was held in Spain to introduce a political reform that would allow previously banned political parties to participate openly in Spain’s political life. To the surprise of many, the Spanish *cortes generales* (Spain’s parliament, which was led by members appointed by Franco) allowed this referendum, even though it would constrain their power and likely imply the end of the existing regime. Analysts have argued that members of the *cortes* accepted the referendum because it was within the existing legal setting, which they had to protect. The conservative General Pita Da Veiga, Minister of the Navy and personal friend of Franco, publicly declared: “My peace of conscience is rooted in the fact that the democratic reform is being made within the *Franquista* legality”.³⁰ The *Franquista* legality he was praising was coming to an end precisely because of that reform, which received overwhelming public support: 97.4 percent of Spaniards voted in favor, with a turnout of 77 percent of the registered voters.

0.54 Just as in the case of the Spanish transition, there are many cases in which elites choose to constrain their own power. While changes to the “rules of the game” reflect bargaining outcomes that result from elites acting in their own interests (box 0.8), reforms that limit the arbitrary exercise of power today may be necessary for elites to maintain or enhance their power or provide insurance against a future loss of power tomorrow. Formal institutions—moving from deals to rules—can enhance the credibility of commitments, overcoming coordination challenges between elite actors, and strengthening the stability of elite bargains. In cases of long-term successful transformation, elite actors have adapted to changing circumstances by generating more capable, contestable, and accountable institutions; these institutions themselves helped enable further development.

Box 0.8 Who are elites and what do they do? Results from a survey of elites in 12 countries

All social science disciplines and development practitioners recognize the importance of elite actors in determining development outcomes: from Aristotle’s “oligarchy,” to early twentieth century “elite theorists,”^a to recent grand theories of economic and institutional co-evolution.^b The international community increasingly looks at the consequences of different “political settlements,” which can be understood as elite bargaining equilibria that emerge at critical junctures in a country’s development.^c Yet the set of conceptual research tools available to scholars of elite bargaining and to development practitioners remains limited, as does agreement on who exactly are elites.

To help fill this gap, as part of *World Development Report 2017*, the World Bank, in collaboration with the V-Dem Institute, has conducted expert surveys to generate cross-national indicators that enable comparison of who holds bargaining power and how they wield this influence. The surveys cover more than 100 years of data in 12 countries across 6 regions. Resulting data help identify how the distribution of elites maps onto the national structure of bargaining power and the formulation and implementation of laws governing the exercise of power.

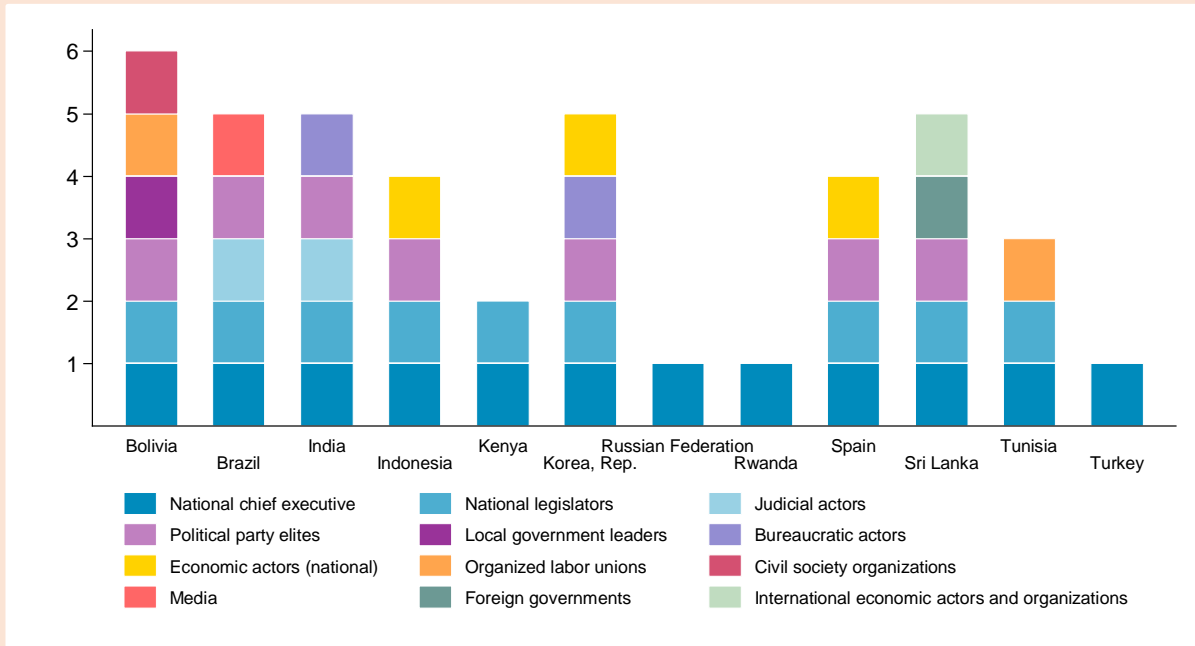
The survey reveals that the identity of the influential elite actors within a ruling elite coalition that decides policy at the national level differs greatly over space, time, and issue area. For instance, although national chief executives are part of the elite ruling coalition in all 12 countries surveyed as of 2015, the other actors vary greatly, both in number and representativeness (figure BO8.1, panel a). Although in Russian Federation, Rwanda, and Turkey, the national chief executive monopolizes decision making, in Bolivia, the ruling coalition is much more varied, consisting of legislators, party elites, local governments, labor unions, and civil society organizations.

³⁰ Preston 2003.

Ruling elites also differ within countries over time. In the Republic of Korea, during the Park regime, the bargaining strength of military actors, bureaucratic actors, and economic actors increased steadily (panel b). The transition to democracy after 1987 resulted in greater strength for new actors, particularly political parties, legislators, and the judiciary, but economic and bureaucratic actors remained highly empowered. In contrast, Brazil has experienced much more volatility in empowered elites, particularly before the 1990s (panel c).

Figure B0.8.1 Elite actors within national ruling coalitions vary greatly across countries and over time

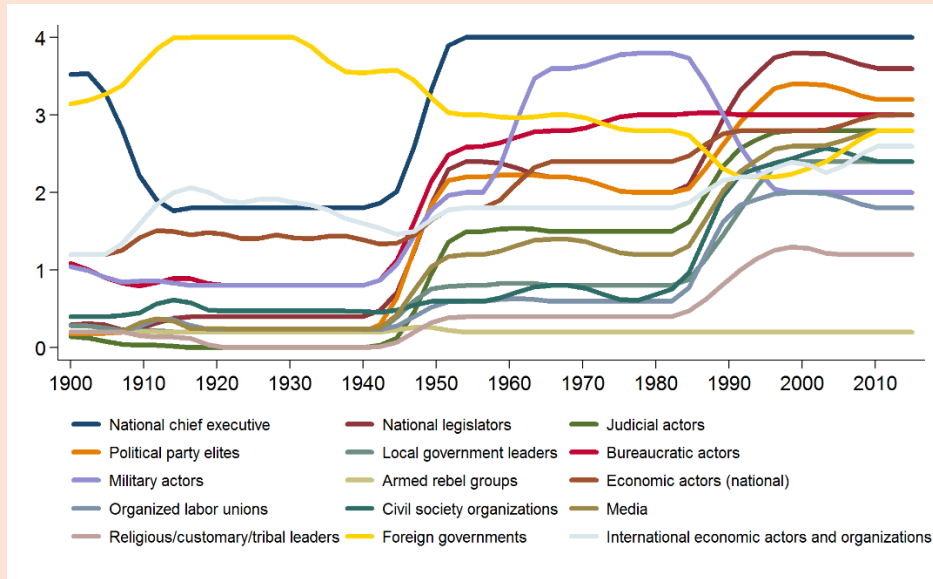
a. Twelve-nation comparison of number of groups in ruling coalition in 2015



Source: WDR 2017 team.

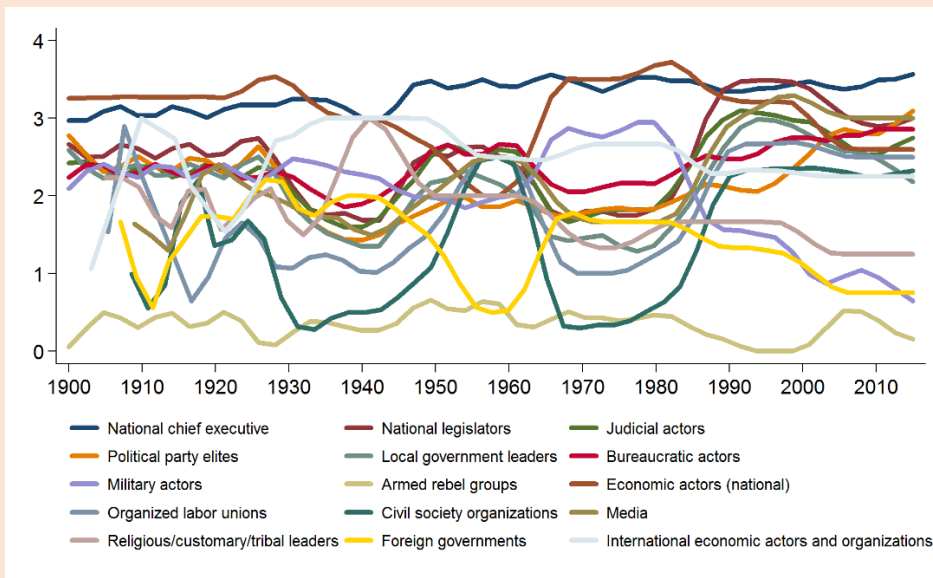
Note: Panel a shows the number of elite groups that have relative strength greater than 3 (on a 0–4 scale), but does not show the relative strength of these groups.

b. Relative strength of elite actors in the Republic of Korea, 1900–2015



Source: WDR 2017 team.

c. Relative strength of elite actors in Brazil, 1900–2015



Source: WDR 2017 team.

- a. See Michels (1911), Pareto (1927), and Mosca (1939).
- b. See North, Wallis, and Weingast (2009) and Acemoglu and Robinson (2012).
- c. Di John and Putzel 2009; Khan 2010; Parks and Cole 2010.

0.55 To maintain their own power and influence, coalitions of decision-makers may have incentives to broaden the policy arena, including adding new actors in formal decision-making bodies of the state and increasing accountability to other elites (*horizontal accountability*). Despite a preference for keeping coalitions small, elites may choose to broaden them to improve stability

when the potential for conflict rises. Bringing new actors into credible institutions for contestation may be less costly than repressing them, and expanding the formal accountability space may help provide internal commitments that facilitate agreement.

0.56 Institutionalizing accountability to citizens (*vertical accountability*)—for instance through the introduction of elections or electoral reforms—may also be a rational elite strategy to maintain privilege, particularly in the face of rising demands from the opposition elite. When there are splits among elite actors, the introduction of vertical accountability mechanisms may enhance the bargaining power of one faction. Moreover, when bottom-up citizen movements threaten elite interests, elites may choose to introduce preemptive vertical accountability mechanisms to respond to societal demands before such pressure reaches a tipping point. In the case of Europe in the nineteenth century, the extension of suffrage was heralded by the threat of revolution and social upheaval, in the form of revolutionary activity in neighboring countries³¹ and strikes in the home country.³²

0.57 Although in many cases elites introduce rules to maintain their position of power, sometimes, acknowledging threats to their continued dominance, they may adopt rules to constrain their own influence as a type of political insurance. The hope is that those rules will bind not only themselves, but also their successors. The adoption of cohesive and constraining institutions increases with the likelihood that the incumbent will be replaced. This is an institutional variation on John Rawls’s veil of ignorance: design institutions without knowing whether you will be subject to them or be able to master the institution in the subsequent period.³³ Fiscal transparency, for example, ties not only the hands of current elites, but also those of successors. This is consistent with the actions of certain states in Mexico: freedom of information laws are much more likely to be passed when opposition parties are stronger and when there is greater executive office turnover.³⁴

0.58 Leaders can also spur elite-driven change by solving coordination challenges or by transforming the preferences of followers. *Transactional leaders* use an array of bargaining tactics and strategies to coordinate among elite actors to overcome common agency problems and reach positive-sum outcomes (win-win solutions). These leaders change the incentives of other elites by taking into consideration who wins and who loses over time. By overcoming information and coordination challenges through “good politics,” they can help find areas of agreement among conflicting elites, without shifting norms or preferences. U.S. President Lyndon Johnson’s deals, trades, threats, and ego stroking—“good politics”—helped the U.S. congress overcome a natural risk aversion and pass civil rights legislation, a clear example of transactional leadership. *Transformational leaders*, in contrast, can actually change elite preferences or gain followings by shaping beliefs and preferences. They are entrepreneurial in coordinating norms and can effect large changes in society by changing the environment in which politics play out, often by reducing the polarization of elites. Nelson Mandela provided a vision for South Africa, using charisma,

³¹ Aidt and Jensen 2014.

³² Kim 2007.

³³ Rawls (1971) proposes that citizens in an original position behind a Kantian “veil of ignorance”, ignorant of their lot in life—such as class, race, social status, distribution of assets, gender—would opt for a society that maximizes the level of welfare achieved by the worst-off person in society (Maximin principle), as the accepted social contract.

³⁴ Berliner and Erlich 2015.

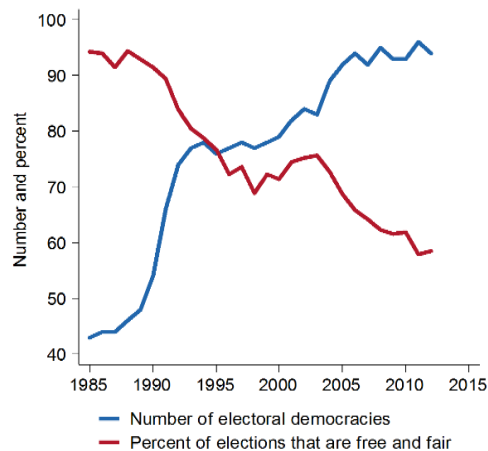
moral persuasion, and powerful symbols to motivate and inspire his fellow citizens during the transition away from apartheid.

Agency and collective action: Citizens influence change by voting, organizing, and deliberating

0.59 While individual citizens may not have the power to influence the policy arena on their own, different mechanisms of collective engagement—such as elections, political parties, social organizations, or public deliberation—can help overcome collective action problems and amplify citizens’ bargaining power. These mechanisms can enhance contestability—such as when civic associations or spaces of public deliberation open up more inclusive bargaining spaces. They can bring about changes in the incentives of actors—such as when coordinated voters are able to shape the incentives of local politicians to deliver on electoral promises. They can also reshape the preferences of actors—such as when political parties help to frame collective claims and interests in the policy arena. However, these mechanisms are imperfect, and may end up reinforcing rather than rebalancing existing power relations.

0.60 Elections are one of the most well-established mechanisms available to citizens to strengthen accountability and responsiveness to their demands. By doing so, they can help improve the level and quality of public goods and services provided by the state. This effect can be particularly strong at the local level, where voters might be better able to coordinate and shape the incentives of local politicians to deliver—including by curbing corrupt behavior. Evidence from Kenya, for example, suggests that multiparty elections successfully constrained the ability of leaders to divert public resources for partisan goals.³⁵ However, elections alone are an insufficient mechanism to produce responsive and accountable governments. Although they have become the most common mechanism to elect authorities around the world, they are increasingly perceived as unfair (figure 0.7).

Figure 0.7 Electoral democracies are spreading, but the integrity of elections is declining



Source: WDR 2017 team based on Polity IV (for number of electoral democracies) and Bishop and Hoeffler 2014 (for free and fair elections).

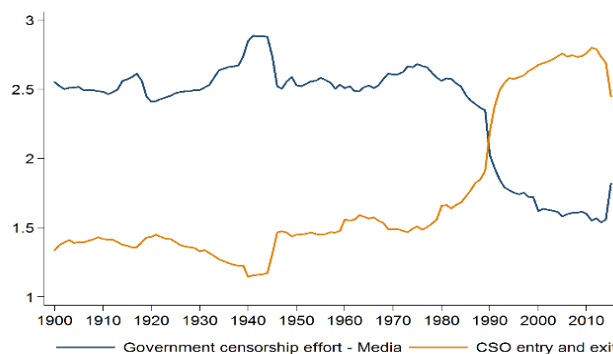
³⁵ Burgess and others 2015.

0.61 Political organization can serve as a complementary mechanism to represent and articulate citizens' collective interests, aggregate their preferences, and channel their demands in the policy-making process. Political organization, for example through political parties, can help solve citizens' coordination problems, and integrate different groups into the political process, encouraging a culture of compromise and reduced societal tensions. The evidence shows that *programmatically parties*—those organized around a well-defined agenda of policy priorities—are associated with better development outcomes. Ordinary citizens and marginalized groups sometimes find political parties unwilling to reflect their preferences, acting instead as “gatekeepers” to protect vested interests and existing power structure. This may help explain the disenchantment of citizens with political parties, which rank globally as the least trusted political institution.

0.62 Social organization can also help to solve collective action problems by mobilizing citizens around specific issues. This can bring new demands and interests into the bargaining space, reshaping the preferences of actors, and expanding the boundaries of the policy arena around previously neglected issues. Box 0.9 explains how pressure from social organization by international and domestic women's groups eventually achieved female suffrage in Switzerland, leading to other important policy changes for gender equality. However, after a continuous expansion over the last decades, civic space has shrunk in the past few years (figure 0.8). Many governments are changing the institutional environment in which citizens engage, setting up multiple legal barriers to restrict the functioning of media and civic society organizations, and reducing their autonomy from the state.

0.63 While social organization might be successful in giving voice to less powerful groups and putting pressure on public authorities, they often fail to consider the trade-offs associated with the proliferation of competing interests in the policy arena. Public institutions might be quickly overloaded with multiple pressures, undermining the coherence and effectiveness of public policies. Moreover, social organization is not necessarily motivated by a vision of more equal and just society. On the contrary, social organization can be used by narrow interest groups for exclusionary or violent purposes.

Figure 0.8 After decades of progress, civic space is shrinking globally



Source: WDR 2017 team based on V-Dem 2016.

Note: The scale was reversed for the media censorship variable (low score indicates less censorship). The average is based on a sample of 167 countries, with smaller coverage in 2013–15. CSO = civil society organization.

Box 0.9 Direct democracy delayed women’s voting rights in Switzerland

While most European countries enfranchised women during the first decades of the twentieth century, Swiss women were first allowed to vote in federal elections only in 1971, 65 years after the first country in Europe—Finland—did so. Yet Switzerland has had a tradition of direct democracy for centuries. What explains the late enfranchisement of Swiss women?

To change the constitution, the political system required a national referendum, in which only men were allowed to vote. Several petitions and motions initiated by women’s groups in the first half of the 1900s were unsuccessful in achieving women’s suffrage. Who participated in that process to change the rules was thus an important determinant of which rules persisted. But so were the existing social norms and the lack of incentives for change. Reflecting those deeply held norms, Switzerland also lagged behind most Western countries in removing other legal gender inequalities, notably those preserving the legal authority of the husband.

Under heightened international pressure, Switzerland was close to a turn in guaranteeing women’s rights in 1957, when, for the first time, the Swiss Federal Council called for a national referendum on women’s suffrage. “If Switzerland had not been a direct democracy, women’s right to vote would have taken effect immediately,” one study notes.^a The mandatory national referendum took place in 1959 when 69 percent of the entirely male electorate voted against the constitutional amendment. Still, women gained the right to vote on cantonal affairs in three Swiss cantons (Geneva, Vaud, and Neuenburg) in 1959–60. It wasn’t until 1971 that the majority of Swiss men voted in favor of women’s suffrage. Reform coalitions among many actors played a significant role in bringing about this change, including international influence and domestic action by women’s groups, such as the Swiss Association for Women’s Suffrage.

The change in female suffrage in Switzerland made it possible for new actors—women, in this case—to participate in the process of policy design and implementation, changing the incentives of politicians to be responsive to their preferences and interests. It also reflected a change in societies’ norms with respect to women’s rights. This led to further important policy changes in the 1980s. An amendment to the constitution to guarantee equal rights of all Swiss, men and women, was approved in a referendum in 1981. A few years later, in 1985, women were granted equal rights in marriage to men, eliminating legal requirements such as the wives’ need to have their husbands’ permission to work outside the home, or to initiate legal proceedings, or to open a bank account.^b

Sources: Stämpfli (1994); World Bank Women Business and the Law 2015 dataset.

a. Stämpfli (1994, 696).

b. World Bank 2016b.

0.64 Public deliberation—spaces and processes that allow group-based discussion and weighting of alternative preferences—can also help level the playing field in the policy arena. Citizens’ participation in local governance can be instrumental in improving the quality of deliberation and the legitimacy of decisions made, by clarifying needs and demands of local constituencies. However, participatory approaches to development sometimes fail to consider the possibility of *civil society failures*, where, in weakly institutionalized environments, the poor are less likely to participate, and participatory mechanisms can be captured by local elites.³⁶ Such failures are not necessarily ameliorated by the availability of new technologies. On the contrary, as discussed in WDR 2016 on the digital divide, information and communication technologies might actually reinforce socioeconomic inequalities in citizens’ engagement. In Brazil, for example, the use of internet voting on municipal budget proposals revealed stark demographic differences between online and offline voters; online voters were more likely to be male, university educated, and wealthier.³⁷

³⁶ Mansuri and Rao 2013; Devarajan and Kanbur 2012.

³⁷ WDR 2017 team, based on Spada and others 2015.

0.65 Ultimately, in order to strengthen their influence in the policy arena, citizens need to engage through multiple mechanisms designed to solve collective action problems. Since all these mechanisms are imperfect, it is their strategic combination that maximizes the chances to effectively bring about changes in contestability, incentives, and preferences. Policy actions targeted toward strengthening transparency by increasing the availability and relevance of reliable information—such as generating evidence on the performance of public officials, strengthening the independence of media outlets, and aligning the targeting and timing of information with the political process—can be a fundamental first step toward promoting an enabling environment for strengthening citizen engagement.³⁸

0.66 By amplifying citizens' influence in the policy arena to make leaders more accountable and responsive to their demands, healthy citizen engagement—that is, *when leaders are selected and sanctioned on the basis of performance in providing public goods*—is a key for driving governance change in a positive direction for development.³⁹ As evidence from a range of institutional settings suggests, “fostering healthy political engagement rather than suppressing it is more likely to result in better development outcomes”.⁴⁰

Change with outside support: International actors in the domestic policy arena

0.67 The domestic policy arena, where elites and citizens bargain, does not exist in a vacuum. Increasing transnational flows of capital, trade, ideas, and people have had profound effects on domestic growth, equity, and security outcomes—both directly and indirectly through their effects on governance. The world today is very different from the one in which today's developed countries emerged: cross-border flows were low; they received no aid; and they were not subject to a proliferation of transnational treaties, norms, and regulatory mechanisms. For developing countries, the era of globalization and “global governance” presents both opportunities and challenges.

0.68 As the velocity of flows across borders increases, so too do the instruments and mechanisms that are used to manage these flows. To influence domestic politics and governance, international actors can introduce transnational rules, standards, and regulations (hereafter referred to as *transnational rules*). These rules can help induce domestic reform through incentives to generate credible commitment of domestic actors—such as through trade and regional integration. They can serve as focal points for domestic actors to improve coordination by changing ideas and diffusing norms. They can seek to achieve a global good through enhanced cooperation—such as preventing *races to the bottom* when countries compete to attract investment and gain access to markets, leading to reductions in corporate tax or environmental and labor standards.

0.69 For example, international agreements on economic integration can provide credible commitments that domestic actors will follow through on economic reforms. The success of the European Union (EU) integration process demonstrates the power of these types of inducements. Prospective member-countries must change domestic rules to abide by 80,000 pages of regulations in the *acquis communautaire*. For the countries that decided to undergo these changes, the potential economic benefits of joining the EU outweighed any loss of domestic autonomy in specific areas,

³⁸ Khemani and others 2016.

³⁹ Khemani and others 2016.

⁴⁰ Khemani and others 2016.

and the benefits of accession were used by elites to overcome domestic resistance to the required reforms. Moreover, for member-countries, accession helped change elite incentives by changing the relative power of domestic actors, as some parties benefited much more than others. EU membership contributed to the institutional consolidation of former dictatorships in the European periphery, such as Greece, Portugal, and Spain in the 1980s. It also played a role in the transition in Central and Eastern Europe after the elimination of the communist regimes in the 1990s and 2000s.

0.70 Since the end of the Second World War, official development assistance (ODA) or “foreign aid” has been one of the most prominent policy tools used by rich countries to induce security, growth, and equity outcomes in poor countries.⁴¹ While the literature on aid effectiveness is voluminous, it tends to be inconclusive. Ultimately, the literature suggests that aid is neither inherently good nor inherently bad for development. What matters is how aid interacts with prevailing power relations and affects governance.

0.71 In some cases, donor engagement supports the emergence of more accountable and equitable governing arrangements that become embedded in the domestic context. Evidence from a community-driven reconstruction program in Liberia, for instance, suggests that introducing new institutions at the local level can have an effect on social cooperation that can persist beyond the completion of the program.⁴² In other cases, aid can undermine the relationship between the state and its citizens by making the state less responsive to their demands. For example, the more that states rely on revenues from the international community, the fewer incentives that they have to build the public institutions necessary to mobilize domestic revenues through taxation. And the less that states rely on their domestic tax base, the more state-citizen accountability erodes.⁴³

0.72 Currently, aid represents more than 10 percent of GDP for half of all low-income countries, and over 30 percent of total revenues for approximately 40 countries (figure 0.9). The empirical evidence linking aid flows to decreased taxation is mixed (box 0.10). Aid has thus been likened to a natural resource curse: a windfall of unearned income that may enable inefficient government spending, unconstrained by the kind of state-citizen social contract that engages citizens in policy discussions and makes the policy arena more contestable.⁴⁴

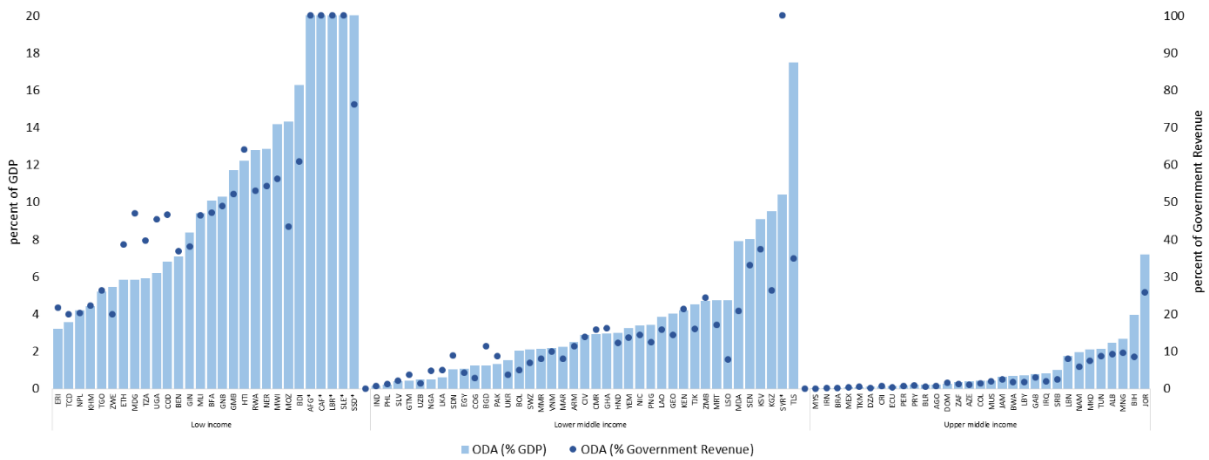
⁴¹ Foreign aid refers to official development assistance as defined by the Organisation for Economic Co-operation and Development (OECD).

⁴² Fearon and others 2009.

⁴³ Moore 2004.

⁴⁴ The “aid curse” argument is made by Collier (2003); Moss and others (2006); and Djankov, Montalvo, and Reynal-Querol (2008).

Figure 0.9 Aid is a large share of GDP and revenue in many developing countries



Source: WDR2017 Team on OECD data (ODA) and IMF, Economic Outlook, for General Government Revenue

Note: ODA from all donors, to all recipients in low and middle income countries with a population of at least 1 million individuals. Figures for ODA (% GDP) are capped at 20 percent of GDP for sake of visualization. The underlying uncapped data are AFG (24.1), CAF (35.4), LBR (37.0), MWI (21.8). Figures for ODA (% Government Revenue) are capped at 100 percent for sake of visualization. The underlying uncapped data are AFG (105.2), CAF (260.6), LBR (126.0), SLE (143.2).

Box 0.10 Domestic resource mobilization, foreign aid and accountability

There is a growing consensus that increasing domestic resource mobilization can enhance accountability, particularly if such efforts are explicitly linked to the provision of public goods. If ruling elites need to depend on broad-based taxation, they are more likely to include citizens and others elites in policy bargains. But does foreign aid undermine domestic resource mobilization—and hence accountability to citizens?

Studies testing that hypothesis initially showed a negative correlation between the two.^a More recently, these studies have been refuted by the adoption of different datasets^b or different econometric techniques.^c Although the behavioral effect of aid flows undermining accountability has been tested and isolated in experimental settings,^d in reality the relationship is more complex and seems to depend on three factors: the type of aid (for instance, whether it is grant or debt, budget support, or project specific); the contemporaneous effects of conditional policies associated with the aid; and, more importantly, the governance setting specific to each country. Moreover, even if aid were to reduce incentives to mobilize domestic resources, the removal of aid may result in societally sub-optimal taxation policies to raise revenues, leaving the poor worse off.

The effects of domestic resource mobilization on accountability depend on how domestic funds are mobilized. Many available taxes may not have the capacity to enhance accountability, such as resource taxation, or may have strong distortionary effects, such as trade taxes. International corporate tax competition and trade liberalization have also diminished states’ capacity for domestic resource mobilization (a race to the bottom). In settings with low savings rates or the potential for capital flight and tax evasion, consumption taxes are most likely to be effective, but also the most likely to be regressive. Frequently in these cases, domestic resources are mobilized in ways that may increase poverty—for example, by increasing consumption taxes—without enacting specific offsetting mechanisms of compensation for the poor. Indeed, fiscal policy itself increased the \$2.50 per day poverty headcount ratio in 9 out of 25 countries, with available household survey data for 2010.^e That is, more poor people were made poorer through the taxing and spending activities of governments than those who benefited from those activities.

Notwithstanding the importance of mobilizing domestic resources to expand responsiveness and accountability to citizens, many countries may be too poor to have the capacity to collect enough revenues to address important

development goals; they may harm the poor in the process of collecting domestic resources; or they may be politically unable to pass reforms to increase revenues. In countries where poverty rates are higher than 65 percent (mainly in Sub-Saharan Africa), for example, there is no feasible redistribution scheme that allows eradicating poverty only by transferring resources domestically from the rich to the poor.^f Moreover, in many developing countries, poor individuals are often impoverished by the fiscal system, when both government taxation and spending are taken into account.^g Finally, political power might be concentrated in the hands of a few rich individuals whose interests collide with those of the poor. In such instances, where there is need to mobilize a larger set of individuals to counterweigh the political influence in the hands of the few, domestic resource mobilization might be very difficult to achieve.^h

a. Most notably, Gupta and others (2004).

b. Morrissey and Torrance 2015.

c. For instance, Clist and Morrissey (2011) invalidate the contemporaneous negative correlation found in Gupta and others (2004) by introducing a lagged effect of aid and taxation, and conclude that the relationship is negligible.

d. Martin 2014; Paler 2013.

e. Lustig 2016.

f. Ravallion 2010; Ceriani and others 2016.

g. Lustig 2016.

h. Ceriani and others 2016.

0.73 For a long time, the need for intervention has been justified on the basis of classic market failures, where governments intervene to lead to socially desirable outcomes that cannot be achieved by relying on solely markets. Later, the literature showed the existence of government failures, where government interventions also failed due to lack of capacity, informational asymmetries, or distorted incentives.⁴⁵ One of the issues that this Report analyzes is the difficulties faced by the international community when trying to influence change in the presence of government failures. Indeed, many times, well-intentioned interventions become ineffective because they reinforce an equilibrium that sustains the outcome the intervention attempted to change. These situations can arise from interventions that do not take into account the existing power balance.

0.74 These development assistance challenges are *not* unavoidable or intractable. Like market failures and government failures, they can be addressed. Development assistance can be more effective when donor engagement supports the emergence of more accountable and equitable governing arrangements that become embedded in the domestic context—for example, by making relevant information available to citizens to strengthen their capacity to hold political leaders accountable.⁴⁶ When and how these positive effects take place, however, is difficult to predict in advance, given the web of intersecting and evolving factors that determine how donor initiatives engage with local political dynamics.

0.75 The development community has recently been engaging in efforts to “think politically” about aid; however, many of the operational imperatives that arise from greater attention to these challenges—such as the need to increase flexibility of implementation, tolerate greater risk and ambiguity, devolve power from aid providers to aid partners, and avoid simplistic linear schemes for measuring results—run up against long-established bureaucratic structures, practices, and habits. The way forward may require a more adaptive or agile approach, in which strategies are tried out locally, and then adjusted upon based on early evidence. Moving beyond technocratic approaches, and learning how to take into account the openings and constraints presented by

⁴⁵ Devarajan and Khemani 2016.

⁴⁶ Devarajan and Khemani 2016.

shifting politics, are key to the ability of foreign aid to induce and sustain governance reforms that promote development.

Rethinking governance for development

0.76 Seventy years after the Bretton Woods conference that launched the World Bank and the International Monetary Fund, the international community recognizes that promoting sustained development requires taking seriously the underlying determinants related to governance. Policies do not occur in a vacuum. Rather they take place in complex political and social settings, in which individuals and groups with unequal bargaining power interact within changing rules as they pursue conflicting interests. This WDR shows that taking into account how the distribution of power in the policy arena enables or constrains institutions to effectively promote commitment, coordination, and cooperation is critical for ensuring progress toward achieving security, growth, and equity.

0.77 Past *World Development Reports* have shed light on how to solve some of the most challenging problems in key areas of development such as jobs, gender equality, or risk management. This WDR is part of a trilogy of recent reports, alongside *Mind, Society, and Behavior* (2015) and *Digital Dividends* (2016) that examine how policy makers can make fuller use of behavioral, technological, and institutional instruments to improve state effectiveness for development. This Report starts by acknowledging that policies such as those to strengthen labor markets, overcome gender barriers, or prepare countries against shocks are often difficult to introduce and implement because certain groups in society, who gain from the status quo, may be powerful enough to resist the reforms needed to break the political equilibrium. Successful reforms thus are not just about “best practice.” They require adopting and adjusting institutional forms in ways that solve the specific commitment and collective action problems that stand in the way of pursuing further development.

Three guiding principles

0.78 The WDR 2017 proposes three simple principles to guide those thinking about reform. First, it is important to think not only about what form institutions should have, but about the functions that institutions must perform: “Think of function, not only form.” Second, while capacity building matters, how to use the capacity and where to invest in capacity depends on the relative bargaining powers of actors: “Think of power, not only capacity.” Third, in order to achieve the rule of law, countries must first strengthen the different roles of law to enhance contestability, change incentives, and reshape preferences: “Think of the role of law, not only the rule of law” (table 0.2).

Table 0.2 Three principles for rethinking governance for development

Traditional approach	Three principles for rethinking governance for development
Invest in designing the right <i>form</i> of policies.	Think not only about the form of institutions, but about their <i>functions</i> .
Build the <i>capacity</i> to implement those policies.	Think not only about capacity building, but about <i>power asymmetries</i> .
Focus on strengthening the <i>rule of law</i> to ensure those policies and rules are applied impersonally.	Think not only about the rule of law, but about the <i>role of law</i> .

Source: WDR 2017 team.

0.79 When facing a specific policy challenge, what do these principles mean in practical terms? The first aspect is to identify the underlying functional problem. What is standing in the way of the development objective: is there a problem of time consistency or policies being changed due to changes in incentives? There could be a lack of voluntary compliance or low levels of take up of specific public programs. Second, in addressing the institutional function that needs to be performed, what are the available interventions or changes in rules to solve the specific functional challenge. While institutional pathways can take many forms—including international best practices—the emphasis is on finding the institutional arrangement that allows to effectively enable commitment, coordination, or cooperation. The “form” of policies is certainly not to be ruled out, but it is crucial to also think about their “function”: for instance, beyond what the fiscal rule looks like, is commitment to the rule credible? This implies considering the specific constraints and context.

0.80 When thinking about potential reforms of policies, it is helpful to consider three “levels” of rules.⁴⁷ First-level rules, or R1, refer to specific policies (for example, budgetary allocations and restrictions). Medium-level rules, or R2, refer to organizational forms—such as central bank independence. Higher-level rules, R3, relate to “rules about changing rules”, namely constitutional and electoral norms. Some functional challenges may require a combination of reforms at all three levels.

0.81 Understanding how the policy arena constrains the functions of institutions is the next critical aspect to consider in order to enhance policy effectiveness. In addition to constraints that are typically considered—such as physical and administrative capacity—policies may still be ineffective if groups with enough bargaining power have no incentives to pursue adoption or implementation. Taking into account power asymmetries means focusing on implementable (if not necessarily ideal) policies that can generate incremental progress towards inclusive growth and equitable development. Looking at the incentives, as well as at the norms and preferences of actors is instrumental to understand what agreements are feasible in the policy arena.

0.82 Different levers of change can help reshape the policy arena to expand the set of policies that can be implemented. Instead of taking the existing policymaking environment as given, the idea is to analyze how to lift the existing constraints to expand the space of what is politically feasible. Different levers of change can contribute to this shift. Often, institutional capacity that is

⁴⁷ Acuna and Tommasi 1999.

spurring change exists at the local level, and building upon it can further enhance credible commitment, cooperation and cooperation towards development goals. Levering change includes looking at what opportunities do elite interests and dynamics of the bargain point to? What opportunities are there for citizen collective action? What is the role of international influence?

0.83 Finally, when designing and evaluating policies, anticipating opposition and considering potential unintended consequences must be part of the process. Particularly, when thinking about evaluation, it must be understood that trajectories might not be linear and thus assessment requires complex methods. Anticipating the changing balance of power around the reform process and adopting an adaptive approach, such as building coalitions in anticipation of the reform, can reduce the risk of reversal. Box 0.11 offers a simple diagnostic roadmap for bringing these insights more concretely into development programming in an effort to enhance effectiveness.

Box 0.11 What does the WDR 2017 framework mean for action?: The policy effectiveness chain

This Report argues that policy effectiveness cannot be understood only from a technical perspective, but rather must consider the process through actors bargain about the design and implementation of policies, within a specific institutional setting. The consistency and continuity of policies over time (commitment), the alignment of beliefs and preferences (coordination), as well as the voluntary compliance and absence of free riding (cooperation) are key institutional functions that influence how effective policies will be. But what does that mean for specific policy actions?

Figure 0.10.1 presents a way to think about specific policies in a way that includes the elements that can increase the likelihood of effectiveness. This “policy effectiveness chain” reads from right to left, starting with a clear definition of the objective to be achieved and following a series of well-specified steps.

Step 1 What? Define the development objective.

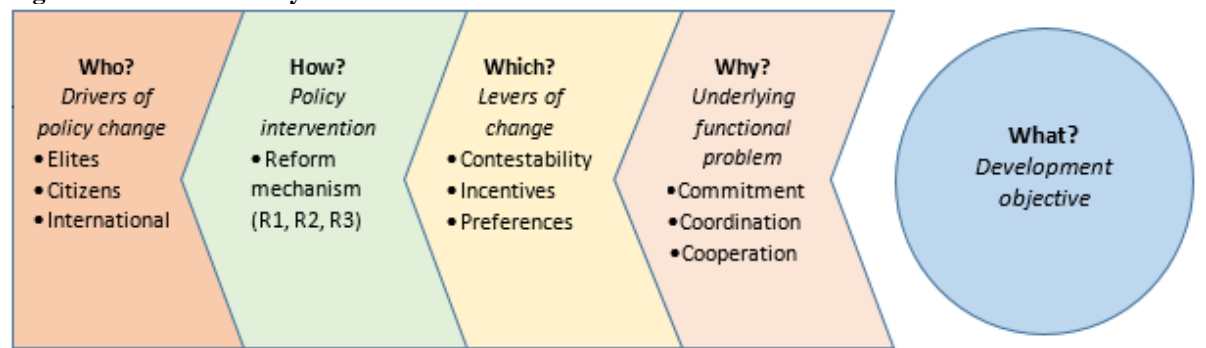
Step 2. Why? Identify the underlying functional problem (commitment, coordination, cooperation).

Step 3. Which? Identify the relevant entry point(s) for reform (incentives, preferences/beliefs, contestability).

Step 4. How? Identify the best mechanism for intervention (menu of policies and laws).

Step 5. Who? Identify key stakeholders needed to build a coalition for implementation (elites, citizens, international partners).

Figure B0.11.1 The Policy Effectiveness Chain



Source: WDR 2017.

Note: R1 = first-level rules; R2 = medium-level rules; R3 = higher-level rules.

Creating conditions for adaptability

0.84 When can meaningful changes occur in the nature of governance? The development path is bumpy: shocks (such as terms of trade shocks and natural disasters) and gradual developments (such as urbanization or a growing middle class) alter the bargaining influence and preferences of actors, often benefitting one at the expense of another. In the face of these changes, governance arrangements that cannot accommodate new actors or demands may collapse. For example, *violence traps* can be understood as unstable bargains in which elites are highly polarized and the costs of losing control are great—where the stakes are sufficiently high—leading to violent conflict. *Middle-income traps* can be understood as situations in which interest groups, currently benefiting by extracting rents, have incentives to oppose new economic conditions and thus prevent efficiency oriented reforms from happening, leading to an unproductive equilibrium.

0.85 Adaptability to changes in the relative bargaining power, incentives, and preferences of different actors matter. Although the conditions that determine whether countries will adapt in ways that allow for more security, growth, and equity are contingent on history and are highly specific to context, there are a few circumstances that make such adaptability more likely. In particular, when elites have reasons to find common ground, bargains can expand and adapt. When national institutions produce more effective leaders, countries are more capable of long-term development. When countries have more balanced, diversified, and organized business interests, they may be more capable of reforming institutions to adapt to changing economic conditions. Bargains that can adapt to evolving elite interests may nevertheless struggle to adapt to growing citizen demands. Regimes may lose legitimacy when decision-making processes are insufficiently inclusive, even when other developmental outcomes appear successful. For example, even effective growth policies may alienate the population if public voice in the policy process is lacking. Overcoming delegitimization necessitates greater inclusion in the political process.

0.86 A focus on creating conditions, like those discussed in this Report, that prepare societies to adapt as the needs and demands of society change over time is critical for ensuring inclusive and sustainable development progress. Traditional development orthodoxy has so far emphasized the centrality of three assumptions in improving governance for development: the forms of policies, the capacity to implement them, and the impersonal application of the rules. These assumptions have shaped the conventional solutions of the international community to the problem of policy failure in developing countries: first, invest in “good” laws and policies; second, build organizational and technical capacity to implement them; and third, strengthen the “rule of law.” This Report moves beyond these approaches, and emphasizes that while it is important to look at forms that have worked in others contexts, gauge what capacity is needed, and stress the importance of the rule of law, these aspects are not enough.

Navigating this Report

Part I. Rethinking governance: A conceptual framework

0.87 Part I of the Report presents a conceptual framework for rethinking the role of governance and law in development. Chapter 1 motivates by unpacking critical questions facing the development community today, while chapter 2 proposes a new analytical approach to answer them. The framework takes a “functionalist” approach rooted in the game theory, arguing that the

functional role institutions play in terms of ensuring credible commitment, inducing coordination, and enhancing cooperation is fundamental to the effectiveness of policies to promote development. Moreover, the framework explores how the unequal distribution of power in society (power asymmetry) is a key factor which underpins the effectiveness of these functions, and identifies different entry points for mitigating potentially harmful consequences. Chapter 3 approaches the conceptual framework from the perspective of law, and explains the different roles that law plays in shaping and reshaping the policy arena.

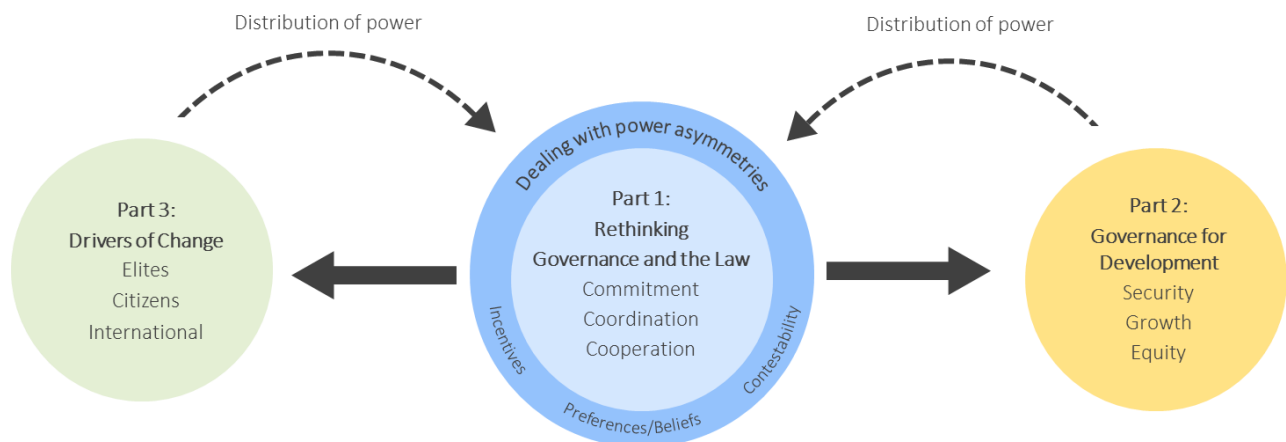
Part II. Governance for development

0.88 Part II applies the conceptual framework to three core development outcomes: security in chapter 4, growth in chapter 5 and equity in chapter 6. It looks at how commitment, cooperation, and coordination fundamentally underlie the effectiveness of policies to promote these outcomes. It then unpacks how the distribution of power can constrain that effectiveness, taking into account how the process of development itself—such as the composition of growth or the level of inequality—influences the relative bargaining power of certain actors, de facto. Ultimately, it explores how enhancing contestability in the policy arena, effectively changing incentives, and reshaping preferences and beliefs of different actors—for example, through leadership—can make policies more effective to deliver on development over time.

Part III. Drivers of change

0.89 As discussed in part II, to improve policy effectiveness and ultimately to expand the set of possible implementable policies it is necessary to reshape the policy arena where actors bargain. While the dynamics of governance can be very persistent and are intricately interconnected, change is possible over time. Part III of the Report explores how these types of changes can be brought by about looking at the conditions under which elites may choose to establish limits on their own power in chapter 7, how citizens can overcome collective action problems to pressure for reform in chapter 8, and how international influences can reshape local bargaining dynamics in chapter 9. In the end, change is manifested by introducing new formal rules that reshape de jure power. A roadmap to the Report is presented in figure O.10.

Figure O.10 A roadmap to the Report



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Part I

Rethinking Governance for Development: A Conceptual Framework

Part I

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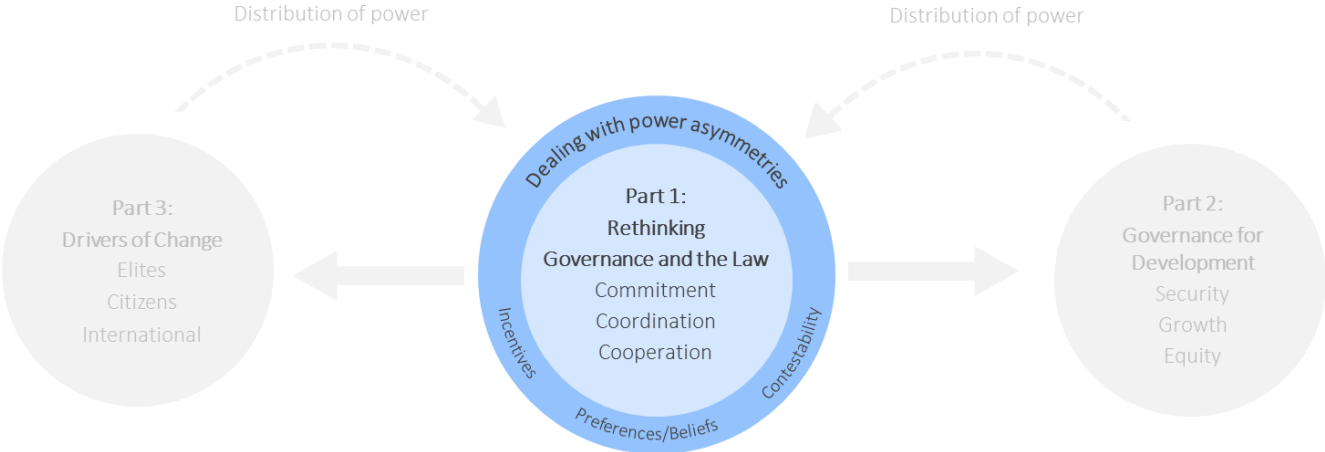
Part I of the Report presents a conceptual framework for rethinking the role of governance and law in development. Chapter 1 motivates by unpacking critical questions facing the development community today: in particular, what are the underlying determinants of policy effectiveness? Chapter 2 proposes a new analytical approach to answer these questions, using a game theoretic approach to argue that the functional role institutions play in terms of ensuring credible commitment, inducing coordination, and enhancing cooperation is fundamental to the effectiveness of policies to promote development. The framework presented in the chapter explores how the unequal distribution of power in society (power asymmetry) is a key factor underpinning the effectiveness of these functions. Chapter 3 approaches the conceptual framework from the perspective of law, explaining the different roles that law plays in shaping and reshaping the policy arena, in which actors bargain over policy design and implementation.

Chapter 1. *Governance and development: the challenges.* As ideas and resources spread increasingly rapidly across countries, policy solutions to promote further progress abound. However, policies that should be effective in generating positive development outcomes are often not adopted, are poorly implemented, or end up backfiring over time. While the development community has focused a great deal of attention on learning *what* policies and interventions are needed to generate better outcomes, it has spent much less attention on learning *why* those approaches succeed so well in some contexts, but fail to generate the same results in others. Confronting the challenges faced by today's developing countries requires a rethinking of the processes by which state and nonstate actors interact to design and implement policies, what this Report calls governance.

Chapter 2. *Enhancing governance for development: On why policies fail.* Governance reform often focuses on what "type" of institutions to build and how to build them. However, development progress has been made in places with many different types of institutions, and its progress has been uneven in places with very similar types of institutions. While institutional forms are necessary and important, they only affect security, growth, and equity outcomes insofar as they perform an intended function. Specifically, they need to solve commitment, cooperation, and coordination problems to make policy promises credible and effectively influence behavior. Moreover, without considering how the underlying power structure affects commitment, cooperation, and coordination, traditional "best practice" interventions may have limited effects in promoting development. In order to improve policy effectiveness, it is necessary to reshape the policy arena where actors bargain by changing: who can participate in the decision making process ('contestability'), what are the incentives they have to pursue certain goals, and what are their preferences/beliefs.

Chapter 3. *The role of law.* Law is a powerful instrument which shapes the policy arena. While the "rule of law" is often touted as a fundamental condition required to improve development, it should be seen as the result of a long historical process, rather than a structure that can simply be engineered. In fact, the rule of law may be conceived as an ideal configuration that can be achieved only by strengthening the different roles of law in society. These roles that law plays--shaping the bargaining power of actors, defining and implementing policies, and enabling change--are

fundamental to understanding governance. In addition, formal law does not exist in a vacuum. In order for formal law to effectively perform its roles, it needs to be understood in the context of many intersecting layers of rules—formal and informal—that jointly shape behavior.



Chapter 1 Governance for development: The challenges

Understanding Development Policy: Proximate factors and underlying determinants

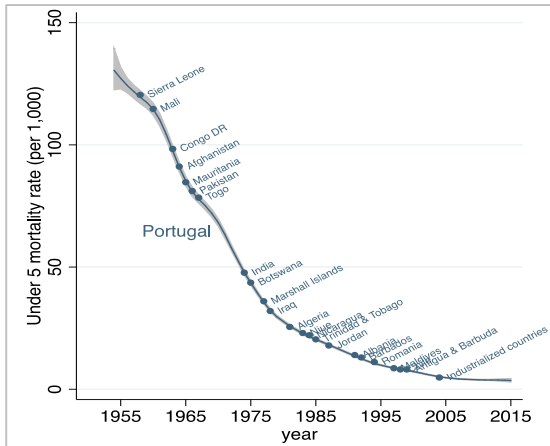
1.1 Societies worldwide have made enormous progress in improving socioeconomic conditions for large groups of people over the last century. Just in the past 20 years, more than 1.2 billion people have been lifted out of poverty (World Bank 2015). Economics Nobel Prize winner Angus Deaton labels this “The Great Escape”: “the story of mankind’s escaping from deprivation and early death, of how people have managed to make their lives better, and led the way for others to follow” (Deaton 2013).

1.2 Such positive performance hides, however, great variations within and among countries and regions in terms of important aspects of the quality of life. Extreme poverty is still a reality for about 1 billion people, or 14 percent of the total global population. Inequalities are striking—and in many cases increasing. This persistent disparity in social and economic achievement has long concerned policy makers, academics, and development practitioners, particularly in today’s world, where the links among countries are stronger and technology diffusion can be fast and cheap.

1.3 Consider, for example, the under-five child mortality rate. This indicator is regarded as one of the most significant measures of how a society is doing in addressing the needs of its population, given its reflection of the quality and incidence of service provision (Buckley 2003, in Andrews and others 2010). Despite substantial improvements over the last 45 years, developing countries today still lag many years behind the rate in developed countries for this indicator. For instance, Sierra Leone and India trail, respectively, 45 and 30 years behind the average of industrialized economies (figure 1, panel a). Moreover, within countries, individuals at the bottom of the income distribution systematically lag behind those at the top. For instance, the poorest twenty percent of the population in India lies approximately 25 years behind the wealthiest twenty percent (figure 1, panel b).

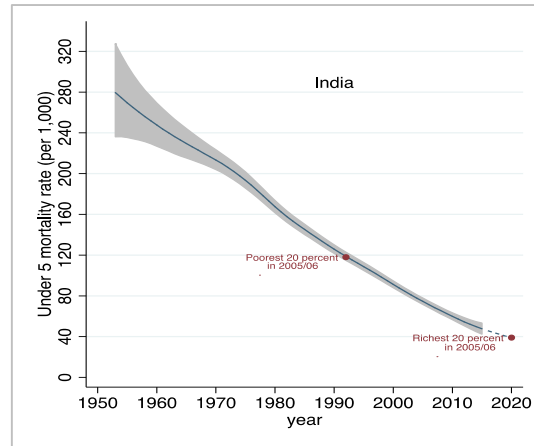
Figure 1.1 Despite declining under-five child mortality rates, inequality among and within countries is still sizable

a. Child mortality rates in developing countries compared to the trajectory of Portugal since 1955



Source: WDR 2017 team on data from the UN Inter-agency Group for Child Mortality Estimation (IGME).

b. Child mortality rates of the poorest and the richest 20 percent in India compared to the national average since 1950



Source: WDR 2017 team on data from the UN Inter-agency Group for Child Mortality Estimation (IGME) and India Demographic and Health Survey (DHS) for data by quintile.

1.4 Explanations of such vast disparities in development performance typically focus on *proximate factors*, such as the provision of health services, connectivity infrastructure, or access to finance. “The intensive study of the problem of economic development,” Hirschman (1958) noted, almost six decades ago, “has had one discouraging result: it has produced an ever-lengthening list of factors and conditions, of obstacles and prerequisites.” This Report argues that while proximate factors are indeed crucial for development, the adoption and implementation of successful pro-development policies often depends on deeper *underlying determinants*. Ultimately, confronting the challenges faced by today’s developing countries—poor service delivery, violence, slowing growth, corruption, and the natural resource curse, to name a few—requires a rethinking of the process by which state and nonstate actors interact to design and implement policies, what this Report calls governance (box 1.1).

Box 1.1 What is governance?

Governance is the process through which state and nonstate actors interact to design and implement policies, within a given set of formal and informal rules that shape and are shaped by power.^a This Report defines *power* as the ability of groups and individuals to make others act in their interest and to bring about specific outcomes (Dahl 1957; Lukes 2005).

Depending on the context, actors may establish a *government*, as a set of formal state *institutions* (organizations and rules) that enforce and implement policies. Also depending on context, state actors will play a more or less important role with respect to nonstate actors, such as civil society organizations or business lobbies. In addition, governance takes place at different levels, from international bodies, to national state institutions, to local government agencies, to community or business associations. These dimensions often overlap, creating a complex network of actors and interests.

a. This general definition is consistent with the World Bank’s corporate definition, which emphasizes formal institutions and the role of state actors.

1.5 An understanding of governance as an underlying determinant of development helps us examine cases of successful and unsuccessful policy adoption and implementation in pursuit of security, growth, and equity, and helps explain apparent contradictions in the development trajectories of countries around the world. Consider some recent cases that have attracted global attention.

1.6 *State building in Somalia and Somaliland.* Somalia is one of the world's most fragile countries. It has been racked by violence for more than two decades. Insurgent attacks and regional conflicts have prevented the emergence of a centralized state with monopoly over the legitimate use of force. Warring factions, many with their own regional sources of power, have been unable to reach a credible deal that determines the make-up and responsibilities of the central state. In contrast, in Somalia's autonomous region of Somaliland, an area with similar tribal and clan tensions, 20 years of stability and economic development have followed a 1993 clan conference that brought together leaders from both modern and traditional sectors, successfully institutionalizing these clans and elders into formal governing bodies.

1.7 *Confronting corruption and the resource curse in Nigeria.* Just a year after a decade-long bounty of windfall revenues from high oil prices, Nigeria was requesting budget support from its development partners. Instead of saving to invest in the future, Nigeria's government has squandered its oil wealth. According to a former president of the central bank, billions of dollars have been lost to corruption by the National Petroleum Company. Nigeria's institutional context did not provide the capacity to safeguard natural resource revenues to reduce fiscal volatility and promote a macroeconomic environment conducive to long term investment. Corruption has become a built-in feature of government interactions, rather than a discrete problem to be eradicated. Several countries have demonstrated that the "resource curse"—the paradox that countries with abundant natural resources have slower growth and worse development outcomes than countries without resources—can be avoided through effective economic and fiscal policies. These policies, however, were not credibly adopted in Nigeria.

1.8 *China's growth performance and growth challenges.* For four decades, as China has increasingly integrated with the global economy, it has grown at double-digit rates and lifted more than 700 million people out of poverty. This successful track record of economic growth is well known. Yet, according to frequently used indicators, China's institutional environment during this period remained static. Does this imply that institutions do not matter for growth? No. Rather, a deeper understanding of China's development shows that the adaptive policy decisions and state capacity that enabled economic success were facilitated by significant changes to mechanisms of accountability, leadership and credible commitment. China's experience highlights the need to pay more attention to how institutions function and less to the specific form they take. Meanwhile, China today faces a growth slowdown. Maintaining rapid growth and avoiding a "middle-income trap" requires the political will to switch to a growth model based on firm entry, competition, and innovation. In many middle-income countries, this transformation has been blocked by actors that benefited from early growth and have mixed incentives to join coalitions for further reforms. Going forward will involve addressing these governance challenges.

1.9 *Slums and exclusion in India's cities.* Urban development that stems from coordinated planning and investment by coalitions of developers, bureaucrats, citizens, and politicians can lead to cities that are centers of growth, innovation, and productivity. Planners can help ensure that infrastructure meets the demands of investors who seek to maximize land rents; businesses that

need connectivity to their consumers; and citizens who want access to services and jobs. But many cities fail to deliver on these promises. In India, massive urban slums—about 49,000 at the latest count, with tens of millions of inhabitants—represent failures to align public investments and zoning with the needs of a diverse set of urban constituents. Underinvestment in housing, and inaccessible or unaffordable transportation options have driven workers into informal settlements, often in peripheral areas. While many developers and politicians have exploited the system to generate rents for themselves, this uncoordinated urban development has prevented cities from achieving their growth potential, and has resulted in large slums where most citizens are deprived of basic services.

1.10 *Demanding better services in Brazil.* In 2013, the world watched when protests erupted in Brazil’s streets, with citizens complaining about the quality of public services—transport, education, and health—as the 2014 FIFA World Cup soccer tournament approached. Brazil had gone through twelve years of inclusive and sustained growth, which had lifted more than 30 million people out of poverty and strengthened the middle class. But these same middle classes that contributed with their taxes to the provision of public services were now demanding better quality and coverage, including “FIFA-standards for our schools.” Why did this change come about? Brazil’s social contract has historically been weak and fragmented. Low-quality public services were provided to the poor, while the upper-middle classes relied upon private services and were thus unwilling to contribute to the fiscal system. The creation of an expanded middle class and the reduction of poverty paradoxically heightened the perceptions of unfairness as the new middle class expected more than low-quality public services for its contributions.

1.11 *“Brexit” and the rise of populist parties.* In June 2016, voters in the United Kingdom elected to leave the European Union (EU). The British pound immediately fell in value, and fear set in over the potential medium- and long-term economic consequences and costs of this decision. Across the European continent, far-right populist parties campaigning against further European integration enjoyed unprecedented electoral success, and in 2016, held power in Finland, Hungary, Latvia, Lithuania, Norway, and Switzerland. In these countries, despite high incomes (Western Europe) and rapid economic growth over the past two decades (Eastern Europe), populist “anti-Europe” messages resonated as citizens feel increasingly disenfranchised and excluded from European decision making, while a perception of free-riding by specific groups grew without much objective assessment. With the perceived ineffectiveness of “voice” in European decision-making bodies, they have opted for “exit,” most clearly in the case of Britain’s vote to leave the EU.

1.12 As these examples illustrate, contradictions occur in the real world. Somalia is as close as it gets to a failed state, while Somaliland seems to be doing well. China grew rapidly, even though its formal institutions apparently did not (and may need to do so now). India grew, but cannot control the propagation of slums. Nigeria has an abundance of resources, but is persistently poor. Brazil experienced inclusive growth, but is now facing widespread protests from the middle class. Britain had low unemployment, but voted to quit the EU. The common thread explaining these contradictions is governance, which helps us explain why ineffective policies persist, why effective policies are often not adopted or implemented, and why unorthodox institutional arrangements may nevertheless generate positive outcomes. In other words, governance drives policy effectiveness. This is the main theme in this Report.

Development Objectives...and Constraints

1.13 This Report assumes that all countries share a set of developmental objectives: minimizing the threat of violence (*security*), promoting prosperity (*growth*), and ensuring that prosperity is shared (*equity*), while also protecting the sustainability of the development process for future generations. But policies do not always translate into these development outcomes in expected ways.

Box 1.2 Governance for what? Achieving the goals of security, growth, and equity

Many aspects of governance are valuable in and of themselves (that is, that they have intrinsic value)—in particular, the notion of freedom. In economic terms, freedom can be seen as an opportunity set, and development can be seen as “the removal of various types of unfreedoms” (exclusion from opportunities), where these unfreedoms reduce people’s capacity of “exercising their reasoned agency” (Sen 1999). As essential as such an intrinsic value of freedom is, its instrumental value also matters because of the “effectiveness of freedoms of particular kinds to promote freedoms of other kinds” (Sen 1999). These positive relationships are what economists call complementarities. The Report acknowledges the intrinsic value of various dimensions of governance, and the notion of development as positive freedom, while also recognizing their instrumental value to achieve equitable development.

The analysis of this Report starts from the normative standpoint that every society cares about freeing its members from the constant threat of violence (*security*), about promoting prosperity (*growth*), and about how such prosperity is shared (*equity*). It also assumes that societies aspire to achieving these goals in environmentally sustainable ways. The Report assesses governance in terms of its capacity to deliver on these outcomes.

This approach is consistent with the transition from a dialogue based on ideology to a dialogue based on ideals, which has transpired in the global development community over the past few decades. The establishment of the Millennium Development Goals (MDGs) in 2000 and the recent ratification of the Sustainable Development Goals (SDGs) by member countries of the United Nations are examples of these efforts to set common goals for social and economic advancement. SDG 16 calls for promoting “peace, justice, and strong institutions,” and is explicitly related to governance. Nevertheless, as this Report will argue, beyond its intrinsic value, the SDG 16 goal also holds important instrumental value because its attainment will aid in the attainment of all the other SDGs. Indeed, the achievement of all the development goals will require a solid understanding of governance in order to enable more effective policies.

1.14 The first condition that societies want to establish in the pursuit of development is *security*—that people are safe from violence and the threat of violence. It is a fundamental dimension of well-being, and a first-order characteristic of development (Sen 1999, UNDP 1994).

1.15 Yet, in 2014, more than 1.4 billion people lived in countries affected by violence (OECD 2014). Violence is a major problem in 37 countries (map 1.1).¹ The list includes not just weak, low-income states such as Afghanistan, Somalia, and South Sudan, but also strong, rising economic giants like Brazil, Mexico, and South Africa. More than 740,000 people die each year as a result of armed violence. Remarkably, the majority of these deaths—about 490,000—occur in countries not affected by ongoing wars (Geneva Declaration Secretariat 2015). Homicides claimed an average of 377,000 lives between 2007 and 2012²; civil wars, rebellions, and other forms of political violence caused 101,400 fatalities in 2014 alone (UCDP/PRIO 2015). There

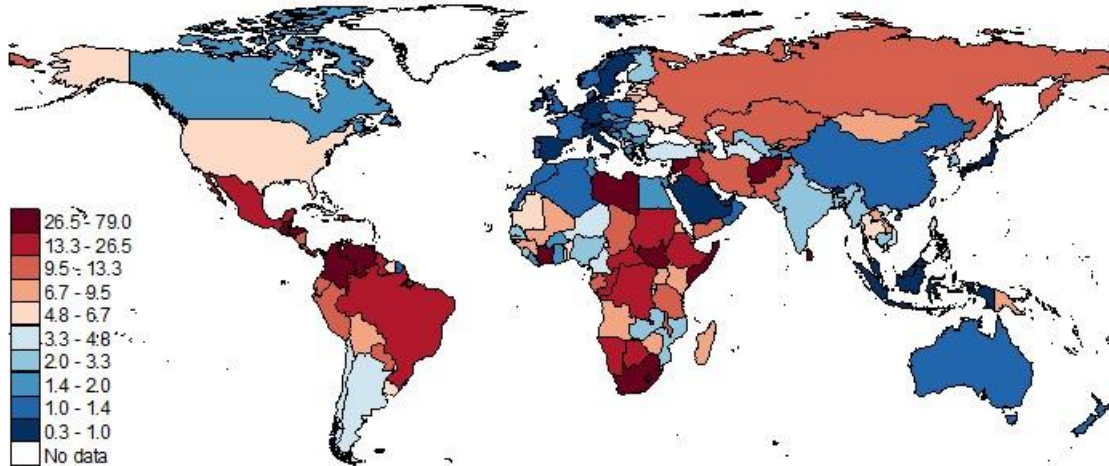
¹ This is the number of countries in the first quintile of Map 1.1, where the incidence of violence is measured by the number of deaths in armed conflict, in addition to the number of homicides.

² WDR 2017 team based on Global Burden of Armed Violence Report 2015. These figures are for intentional homicides. The number rises to 3,864,000 if unintentional homicides are included. The World Health Organization (WHO) defines homicides as “injuries inflicted by another person with intent to injure or kill, by any means.”

were 57.7 million displaced persons worldwide at the end of 2014 (UNHCR 2015). As these figures regrettably reflect, policies to achieve security are too often ineffective; indeed, certain policies and their poor implementation can cause or exacerbate the societal problems contributing to violence.

Map 1.1 Violence is a major problem for more than 1.4 billion people

Violent deaths per 100,000 residents per year, 2008–12



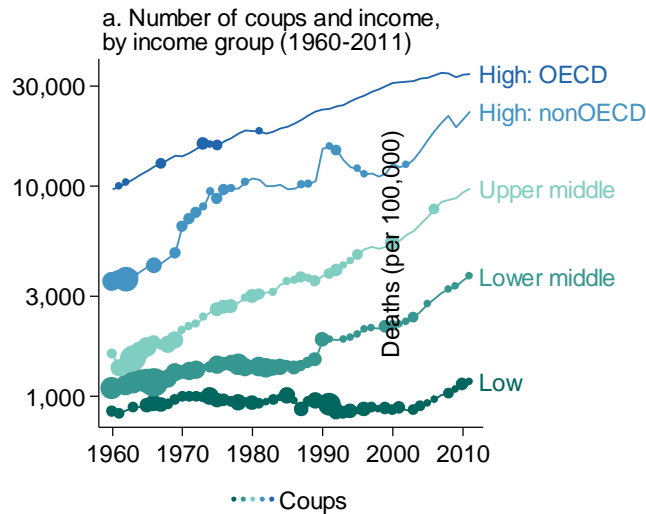
Source: WDR 2017 team based on COW 2015; Global Burden of Armed Violence 2015; WDR 2011.

Note: Violent deaths comprise organized violence and homicide deaths.

1.16 More secure societies are also more prosperous (figure 1.2, panel a). Most of the relatively faster growth of higher-income countries between 1950 and 2011 results not from experiencing faster growth, but rather from shrinking less—and less often—from crises or wars than lower-income countries (figure 1.2, panel b). In the even longer run, annual data on 14 European countries and the United States starting in 1820 shows a sharp reduction in the frequency of the shrinking of economic growth after 1950—the period following World War II, which was the last mass scale episode of organized violence in these countries (Wallis 2016).

Figure 1.2 Economic growth requires security

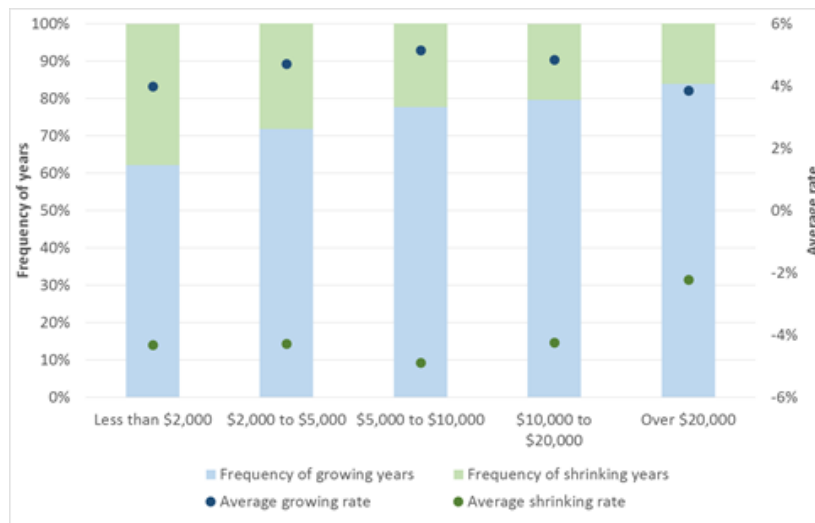
a. Countries with fewer episodes of violence are more prosperous



Sources: WDR 2017 team with data from COW 2010; Eisner 2014; The Maddison Project 2013; Penn World Tables 2015; and Powell and Thyne 2011.

Note: The size of the circles on each time series in panel a. is relative to the number of coups per country for each income group in a given year. Panel b comprises 11 countries for which full data are available: Belgium, Finland, France, Germany, Republic of Ireland, Italy, the Netherlands, Spain, Sweden, Switzerland, and the U.K.

b. Long-term growth is less about how fast you grow than about not tripping along the way



Sources: WDR 2017 team based on Wallis 2016, with data from the Penn World Tables 2015.

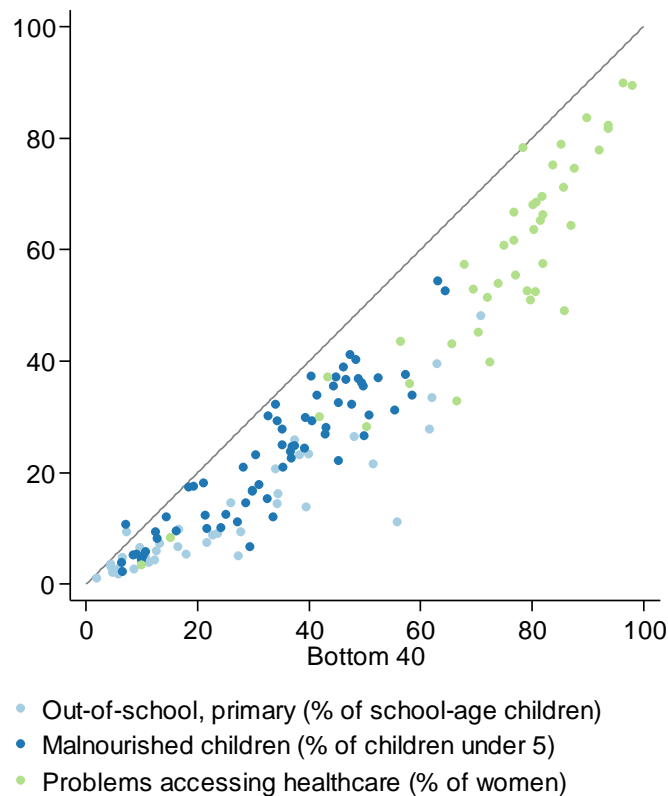
Note: Real GDP per capita (constant prices: chain series). Countries first sorted into income categories based on their income in 2000, measured in 2005 dollars. Average annual growth rates are the simple arithmetic average for all the years and all the countries in the income category, without weighting. The sample underlying the figure includes 141 countries, which have data available from at least 1970 onward.

1.17 Security, however, is not sufficient to achieve growth. In their quest toward prosperity, countries require sustained improvements in efficiency and investment to spur economic growth. Economic growth comes from accumulation—such as the mobilization of savings for industrial investment—and efficiency—how well inputs are being put to use. Low-income countries tend to grow as surplus labor reallocates from agriculture to industry. Once the gains from this early industrialization process are exhausted, however, new sources of growth are needed. Many middle-income countries, however, appear incapable of achieving gains in either accumulation or efficiency, becoming stuck instead in low-growth traps. Indeed, in contrast with the predictions of several growth theories, there is no evidence that low and middle income countries tend to converge towards high-income ones (figure 1.3) (Jones 2015).

1.18 Yet several countries have managed to ‘escape’ this middle-income trap. How? The evidence suggests that the continuous reallocation of resources across sectors and firms is a substantial source of efficiency (*total factor productivity*, or TFP). In a dynamic setting, where new companies enter the market while uncompetitive firms exit, inputs reallocate between firms, giving way to innovation, competition and productivity. Countries that escape the low-growth trap also tend to have a diversified export base, where coordination between domestic companies and governments contribute to shape industrial investment. Indeed, the literature and policy fora are ripe with discussions about the right sets of policies that can enable efficient resource allocation and investment upgrading. Nevertheless, as the persistent stagnation of many middle-income countries around the world reflects, very often these policies are not adopted or fail to achieve expected results.

1.19 In addition to being prosperous, societies care about being equitable. The *Occupy* movement’s slogan “we are the 99%” in the United States denounced the concentration of wealth among the top 1 percent. As these and other demonstrations around the world reflect, there are growing concerns about increasing inequality. The evidence indicates that these concerns are not without foundation. Even though there are signs that global income inequality is falling, inequality within countries is on the rise, and the concentration of income at the top has increased over recent years (World Bank 2015). In addition to normative concerns, a more equitable distribution of income is associated with positive outcomes, including stability and economic growth. So how do countries become more equitable?

1.20 Inequality and growth are structurally linked. Making growth more equitable involves policies that look at the bottom half. Consider the differences in the structure of economic activity and public services in low- compared to high-income countries. Traveling across a low-income country, one frequently observes a pattern of homogenous economic activity—for example, large groups of people relying on agricultural activities—but a provision of public services that is rather heterogeneous—connectivity is uneven, availability and quality of services, such as education and health, vary dramatically from rural to urban sectors. Quality and access for low income people are much lower (Figure 1.3). Indeed, a low commitment to provide quality public services is one of the main characteristics of the most unequal countries in the world. The opposite tends to be true in advanced countries. In these, one would find a more diversified economic structure and a rather homogeneous coverage and quality of public goods and services, independently of individuals’ circumstances. The quest for development could thus be summarized as the transition towards more diversified economic opportunities and a more homogeneous response of public services to all individuals.

Figure 1.3 Provision of basic services systematically fails the poor in developing countries

Sources: WDR 2017 team with data from WDI 2016.

Note: Portrays access to services, by income category (bottom 40 percent versus top 60 percent in per capita income terms), in developing countries.

1.21 The provision of public goods and services as a way to level opportunities and to reduce poverty is undisputed. These and other social policies allow individuals to increase their stock of assets and the opportunity to use them; and protect the most vulnerable. Fiscal policies enable the public spending behind these social transfers through taxation and help reshape the distribution of resources. Yet, policies to achieve equity are often not adopted, or fail.

Governance for the bottom half

1.22 Why do best practice policies to achieve security, growth and equity so often fail to produce desired outcomes? Why are so many potentially transformative policies not adopted? And what makes some unlikely policies succeed? This Report shows that the answer to all of these questions has to do with how policies affect the interests of actors who have the power to block them, whether actors who would benefit from policies are able to influence the decision making process, and whether rules and norms sustain the existing equilibrium. In the following chapters we propose a framework to think about these questions in pursuit of a larger objective: how can policies for security, growth and equity be made more effective by taking governance seriously?

1.23 The analysis in this Report calls for particular attention to understanding the implications for those groups who tend to have less power to influence the decision making process because of their economic or social circumstances. Groups which are typically marginalized from the policy arena—such as those at the bottom of the income distribution—should have the same access to opportunities as all others. This is an essential pillar of development progress.

1.24 In order to make sustained progress in development, governance needs to be responsive to all groups in society, regardless of their circumstances. Even though power is unequally distributed in every society—an inevitable fact—promoting *governance for the bottom half* means promoting a process through which development dividends can still be equitably distributed.

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Chapter 2 Enhancing governance for development: On why policies fail

Policies do not occur in a vacuum

2.1 “Amka and the Three Golden Rules” is a beautifully crafted film about a Mongolian child, Amka, whose life turns into a nightmare after he finds a golden coin and hops onto a path of overspending, abandoning family duties and taking on unmanageable levels of indebtedness. Under pressure to repay his debts, he runs away, through the astounding Mongolian landscape, to settle with an eccentric uncle who teaches him the three golden rules of life.

2.2 A Mongolian newspaper, the *UB Post*, noted in 2014 that “the story is in many ways a symbol of how Mongolia must decide its own fate” to manage its growing levels of debt.¹ Indeed, as the movie was released, the country was going through a third attempt to establish a rainy day fiscal fund, the Future Heritage Fund, to manage the windfall derived from mining revenues—the country’s largest source of revenue. The attempt to transplant the design of a “future generations” fund from international best practices had failed twice already.

2.3 Experts from around the world had visited Mongolia over the previous decade, providing advice on the best existing rules for the distribution and management of revenues from natural resources. Technical solutions were available and political will was palpable among several state actors. Yet since 2007, attempts to establish rules for the use of mining revenues have been thwarted by political pressures. Hard-fought parliamentary elections in the country have led political parties to promise increased spending on programs like cash allowances, untargeted social benefits, and investments in specific regions in order to garner support. Such promises could be fulfilled only by depleting the resources going into the reserve fund (Chimeddorj 2015). Thus, no matter how well policy makers designed the “future generations’ fund,” unless the interests of powerful groups in society were to change, the *commitment* to a policy of fiscal prudence would continue to fail and the country would remain in debt. The process to reach and sustain agreements among decision makers with respect to these policies had not created the conditions for people to be willing to *cooperate* and *coordinate* actions around specific long-term goals.

2.4 The parallels between the Mongolian state of affairs and the story in the movie were not a coincidence. The metaphor in Amka’s tale was a deliberate attempt, supported by opinion leaders and artists, to create awareness in Mongolian society regarding the importance of prudence when it comes to the management of resources (in the case of Amka’s story, the golden coin). The movie was seen as an instrument to reinforce the values of prudential management of wealth in the population in an effort to coordinate support for the pursuit of the necessary long-term goal of fiscal sustainability in Mongolia.

2.5 As this example illustrates, policies are not designed and implemented in a vacuum. They are the result of a bargaining process among actors, frequently with diverse and even opposing preferences and interests. More importantly, those actors have very different bargaining power, derived from a variety of sources such as existing formal rules, informal norms, their ability to represent and mobilize other groups in society, or their control over resources. The complex

¹ "Movie Review: Amka and the Three Golden Rules | The UB Post". *ubpost.mongolnews.mn* (April 16, 2014). Retrieved July 21, 2016.

process in which actors bargain to design and implement policies, in a very specific social, historical, and economic context, is what we call *governance*.

Diverse pathways to success: Moving beyond institutional transplants

2.6 For decades, academics as well as practitioners have acknowledged the importance of *institutions*—organizations and rules—for development. Countries that are more secure, prosperous, and equitable tend to rank higher in terms of existing indicators that emphasize certain institutional forms. This pattern has created a perception that certain types of institutions unambiguously determine higher levels of development, and has led many well-intentioned policy makers and development agencies to promote institutional reforms that aim at achieving those institutional standards—often referred to as institutional transplants. In other words, in acknowledging that governance matters for development, it is implicitly accepted that the effects of governance are determined by the characteristics of formal institutions.

2.7 However, institutional forms are not enough. Consider the challenge that Mongolia faced in following its own “golden rules.” The Mongolian government decided to adopt international best practices in order to manage fiscal revenues from natural resource extraction, but failed to administer them with a long-term perspective. While the countercyclical management of fiscal policy to manage volatility has been seen as a key characteristic of institutions to promote long-term development, the form which those institutions took in Mongolia was not enough to affect outcomes (Gill and others 2014). Political constraints, pressures from interest groups, existing social beliefs about the need to accelerate progress in specific areas, and historical inertia had eroded the credibility of the commitment to prudential management of mining resources.

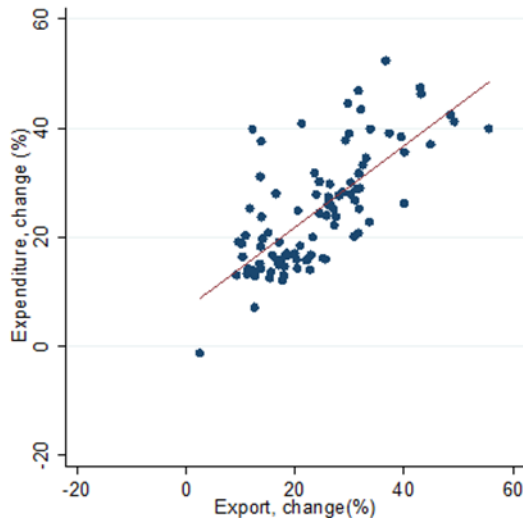
2.8 Contrast the case of Mongolia with those of countries seen as examples of effective management of natural resources, such as Chile and the Netherlands. Interestingly, Chile and Mongolia have the same institutional forms for the allocation of revenues from the extractive industry—as Mongolia followed the Chilean example—but very different outcomes. Fiscal spending in Mongolia is considerably more procyclical, in spite of having the same rules (figure 2.1, panel a). Chile and the Netherlands, on the other hand, have very different institutional forms, but are similarly effective in managing resources (as shown for Chile in panel b). What do the Chilean and Dutch cases have in common? Many factors determine effectiveness, but certainly the fact that actors are willing to accept and follow the rules, or act collectively, is one of them. In Chile, political agreements after the return to democracy in the 1990s have included a long-term perspective on economic management, a principle accepted by all actors in the political spectrum. In the Netherlands, basic principles of fiscal management have been broadly accepted in the Dutch political culture for years—reinforced by the experience of living through a period of mismanagement and the so-called Dutch disease in the second half of the twentieth century.²

² The importance of fiscal prudence is embedded in the Dutch value system, as much as the importance of an open debate about policies that involve the use of public resources. Nicolaas Gerard Pierson, Dutch Minister of Finance and one of the most respected economists in the world toward the end of the nineteenth century, said more than 120 years ago that taxes should be invested wisely or they would be just unjustified, and that opportunities for investments should be taken when “a concurrence of favorable circumstances generates a temporary budget surplus *e.g.* abundant harvests leading to extra tax revenues” (Pierson 1890).

Figure 2.1 Despite similar rules for the management of natural resource revenue in Chile and Mongolia, Chile’s expenditure patterns reveal a stronger commitment to compliance

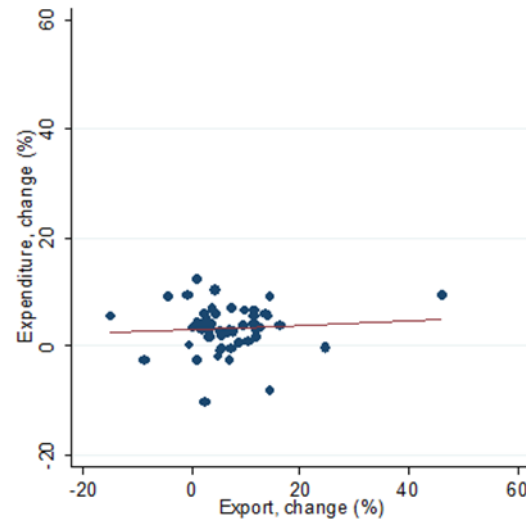
a. Procyclical management in Mongolia

(Steeper regression line reveals a weaker commitment to comply with rules)



b. Countercyclical management in Chile

(Flatter regression line reveals a stronger commitment to comply with rules)



Source: For Mongolia, Mongolia Statistical Information Services, monthly data 2005–15; for Chile, World Bank World Development Indicators (WDI), 1960–2014.

2.9 Often, when policies and technical solutions fail to achieve intended outcomes, blame falls on institutional failure, and the proposed solution is to “improve” institutions. But development can occur under a wide variety of institutional trajectories, as examples around the world and throughout history demonstrate. It thus then becomes essential to uncover the underlying drivers of policy effectiveness. What makes some policies work while others fail? While the development community has been focused on what types of institutions matter, perhaps a more relevant starting point is asking what it is that those institutional forms are trying to achieve, or what *functions* they are meant to perform.

Drivers of effectiveness: Commitment, cooperation, and coordination

2.10 This Report draws attention to *commitment*, *coordination*, and *cooperation* as the three core functions of institutions that are needed to ensure that rules and resources yield desired development outcomes. Policy effectiveness can be explained by whether and how well institutions are performing these functions. *Commitment* is about supporting consistent policies over time to ensure that promises are delivered. *Coordination* is about shaping expectations to enable complementary action. *Cooperation* is about limiting opportunistic behavior to prevent free riding. Coordination and cooperation imply voluntary compliance: that is, that the preferred social action is the one that individuals are actually willing to take. Box 2.1 discusses the ways in which commitment, coordination, and cooperation can be understood from the perspective of game theory. While policy makers may not think in terms of game theory, they play these games every day, and the models lends precision and objectivity to understanding their actions.

Box 2.1 The microfoundations of commitment, coordination, and cooperation: A perspective from game theory

The framework of this WDR highlights commitment, coordination, and cooperation as the key institutional functions that shape the effectiveness of policies for development. Those terms come from game theory and are better explained using its language.^a Table B2.1.1 presents an example.

Table B2.1.1 Coordination and cooperation as modeled in game theory

		Actor 2	
		Take action A (A)	Do not take action A (NA)
Actor 1	Take action A (A)	2, 2 (A, A)	0, x (A, NA)
	Do not take action A (NA)	x, 0 (NA, A)	1, 1 (NA, NA)

The table is read in the following way: the top left-hand corner symbolizes the net benefits (hereafter referred to as the *payoffs*) for actors when both of them decide to take action A (for example, mobilize, pass a law, or monitor a provider). The first number (2) stands for the *payoff* of actor 1 when he/she decides to take action A and actor 2 does the same. The second number (2) symbolizes actor 2's payoff when he/she decides to take action A when actor 1 does it, as well. In the top right-hand corner, the first number (0) is actor 1's payoff when he/she decides to take action A although actor 2 decides not to. The second number (x) is actor 2's payoff when he/she decides not to take action A and actor 1 does. The actors' payoff values can be read in the other scenarios in the same way. According to the matrix of payoffs, the value of x will determine whether it is a coordination or a cooperation game. Both are *collective action problems*.

Coordination

If $x < 2$, the actors are engaged in a *coordination game*. In this game, the actors' incentives are aligned, but their action depends on their expectations about what the others will do. Both of them prefer to take the same action; both outcomes—(A, A) and (NA, NA)—are *equilibriums* of this game. The problem is how to achieve the equilibrium that is efficient and yields the highest payoff (A, A) because players are unsure about what the other one will do. In game theory, this game is known as the *assurance game*, where it is in each player's own interest to take a particular action (Y) if there is assurance that everyone else is also taking action Y (box 2.3). To achieve coordination, policies need to create common knowledge that everyone will take the desirable action. Sometimes this requires providing incentives for some actors to take the desirable action first so others will follow.

Cooperation

If $x > 2$, the actors are engaged in a *cooperation game*. In this game, actors' incentives are not aligned. In equilibrium, both of them do not take action A—(NA, NA)—which is the worst outcome from the point of view of maximizing the group payoff. In game theory, this is referred to as a *prisoner's dilemma game*: where the collective gain would be greater if the actors could cooperate, but each actor individually has a greater incentive to *free ride* (take action NA). To induce cooperation, policies need to put forth a credible mechanism of reward or penalty conditioned on players' actions to prompt actions yielding the jointly preferred outcome.

Commitment

Commitment refers to the ability of actors to enforce agreements. For example, if the players were allowed to communicate with one another, they would have incentives to promise to take the action that maximizes the group's payoff. However, because there are no mechanisms to enforce those agreements—hereafter called *commitment devices*—it is still in the interest of the actors to renege on their promises. Commitment devices allow actors to transform the game so that their incentives are aligned.

a. Example adapted from Weber (2008) and reprinted in Bartolini (2013).

Commitment: Backing consistent policies over time to ensure promises are delivered

2.11 Policies are not spot transactions like buying a book or using a taxi; they require consistency over time. However, reaching and sustaining agreements can be difficult because economic and political conditions may change, and the incentives for policy makers to deviate from established goal-oriented policies can be strong. In order to promote sustained development, it is particularly important to ensure that those in power can credibly deliver on promises made to citizens beyond the political cycle. Imagine that you would like to save for retirement by contributing funds to a pension. If you do not believe that the government can credibly commit to not expropriating those funds and returning them back to you in the future, you will likely choose not to save. In line with the economic theory of incomplete contracts, policies require commitment devices in order to ensure their credibility. *Commitment* enables actors to rely on the credibility of policies, and thus to calibrate their behavior accordingly. In this sense, institutions can be thought of as technologies that allow society and individuals to engage in the pursuit of long-term goals, even in the face of changing circumstances.

2.12 In all countries, but mainly in low-income or fragile contexts, commitment is a fundamental condition to prevent the escalation of conflict to violence. Whether conflicting parties are able to reach credible agreements to renounce violence and endow the state with a monopoly on the legitimate use of violence is a crucial condition to prevent escalation (see chapter 4). When commitment to deals is not credible, contending sides tend to walk away from the bargaining table and violence prevails: warring factions may renege on peace agreements, policy makers may default on promises to transfer resources to discontented groups or regions, disputants may fail to abide by court judgments, or policemen may abuse citizens instead of protecting them. The influence of commitment is not exclusive to security. Economic growth requires an environment in which firms and individuals feel secure in investing their resources in productive activities. Credible commitment to pro-growth policies and property rights is, in this way, also essential to ensure macroeconomic stability and to enable growth.

2.13 The perception about the credibility of commitments can also increase people's willingness to cooperate—say, through tax compliance—and to coordinate, following rules as a response to the belief that others will follow as well. Theoretically, delivering on commitments builds trust in institutions over time and strengthens voluntary compliance (box 2.2). Empirical results from lab experiments carried out for this Report are consistent with this notion, whereby binding commitments lead to higher cooperation and more redistribution of resources among players (Banuri and others 2016) (box 2.3).

Box 2.2 Trust in institutions as a result of delivering on commitment

Trust is a central aspect of strengthening governance and delivering on development. Trust is related to positive outcomes in terms of economic growth (Knack and Keefer 1997; Zak and Knack 2001; Whitely 2000), as well as government performance (Putnam 1993; La Porta and others 1997). But what exactly is trust, where does it come from, and why does it matter? This Report defines *trust* as the probability that an actor assigns to other actors delivering on their commitment, conditional on their past behavior. In the game theory literature, this is referred to as reputation. The literature distinguishes between two key kinds of trust: interpersonal trust and institutional trust.

Interpersonal trust refers to trust among individuals. It can arise from their relations such as shared ties, or it can be present as a social norm (table B2.2.1). The notions of “bonding social capital” and “bridging social capital” are relevant to interpersonal trust (Putnam 2000). *Bonding social capital*—the horizontal ties within communities and among organizations—can bring about a sense of purpose and identity, encouraging social cohesion. *Bridging social capital* consists of the cross-cutting ties that breach social divides, such as economic class, ethnicity, and religion. If bridging social capital is missing, it can lead to balkanized societies where strong ties within communities actually work against the collective interest, holding back development (Portes and Landholt 1996).

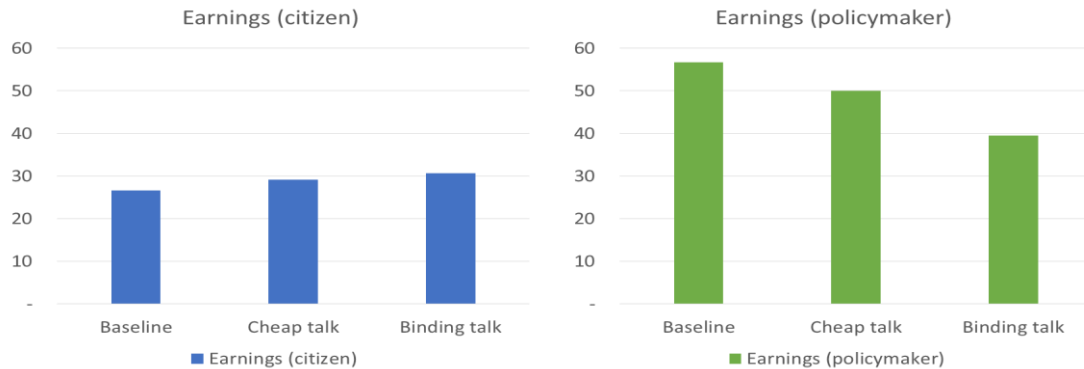
Institutional trust refers to society’s trust in organizations, rules, and the mechanisms to enforce them. Institutional trust can arise from elements based on relationships or as a function of repeated commitment (table B2.2.1). This Report focuses on institutional trust, built by repeatedly delivering on commitments, such as by enforcing contracts or by not defaulting on pledges and obligations. This type of trust is important because it strengthens the capacity to commit (outcome legitimacy), and ultimately enables cooperation and coordination by inducing voluntary compliance (box 2.8).

The importance of trust for enabling collective action can be illustrated in the context of game theory. In the traditional prisoner’s dilemma game, even though it would be in the best interest of both prisoners to cooperate—refusing to confess—the inability to trust that the other party will indeed cooperate means that the outcome for purely rational prisoners is to defect, betraying each other (in a one-off game). Game theory predicts that cooperation comes into play in repeated games. Axelrod (1984) finds that the most successful strategies in the basic prisoner’s dilemma game have to do with mutual trust, engendered from paying support with support and defection with defection. This finding is supported by a lab game played for WDR 2017 (figure B2.2.1).

Table B2.2.1 Sources of trust

	Types of trust	
	Institutional trust	Interpersonal trust
Sources of trust	Relationships	Relationships
	<i>Commitment</i>	Norms

Source: WDR 2017 team, based on Lach and Lopez-Calva 2016, for WDR 2017.

Figure B2.2.1 Welfare is higher for citizens under commitment in the lab game

Source: Banuri and others 2016, for WDR 2017.

Note: As background work for WDR 2017, a series of lab experiments were carried out to explore the behavioral responses of agents in terms of cooperation and redistribution under different protocols. The basic lab game design has three citizens and one policy maker. The citizens provide resources to a group account, which the policy maker is in charge of distributing. The policy maker observes the total amount in the group account and can then distribute the resources in any manner he or she sees fit. The game is repeated over twenty periods. In the “cheap talk” treatment, the policy maker makes public his intended distribution rule prior to citizens’ contributions, but the rules are not binding and can be modified after citizens make their contributions. In the “binding talk” treatment, the policy maker again makes public the distribution rule prior to citizens’ contributions but in this case he or she cannot amend it after citizens make their contributions. In this second case, there is credible commitment because the announcement is binding.

Significance level: ** = significantly higher earnings in binding talk compared to baseline ($p < .05$), but not compared to cheap talk (and cheap talk is not different from the baseline).

*** = significantly lower earnings of policy makers in binding talk ($p < .01$) relative to both baseline and cheap talk ($p < .01$). Cheap talk not is significantly different from the baseline ($p = .133$).

Source: WDR 2017 team.

Coordination: Shaping expectations to enable complementary action

2.14 What makes people choose to coordinate to reach socially preferred outcomes? The answer to this question is at the heart of understanding development progress. As Douglass North contends, “The disparity in the performance of economies and the persistence of disparate economies through time have not been satisfactorily explained by development economists... What has been missing is an understanding of the nature of human coordination and cooperation” (North 1990b, 11). By shaping beliefs and coordinating expectations, institutions can push societies on favorable paths toward better development outcomes. When actors are uncertain about what others will do, they may not make decisions that could induce socially preferred outcomes. In contrast, in the presence of strategic complementarities, coordinated actions can lead to better outcomes for all. Since Rosenstein-Rodan’s (1943) classic work on the problems of industrialization in Eastern Europe, and the idea of the “big push” formalized by Murphy, Shleifer, and Vishny (1989), this has been seen as a central issue in both economic and noneconomic realms.

2.15 In all countries, but mainly in middle-income contexts, in addition to commitment, coordination is required to induce investment and innovation. Investment and innovation require

that firms and individuals believe that others will also invest. Institutions can help solve market failures by coordinating investment decisions and coordinating the expectations of market participants. The insight that a failure to coordinate investment activity can lead to underdevelopment is decades old.³ Consider the case where large-scale factories are more efficient, but investing in them is not profitable for individual firms unless done simultaneously in a group. This could be because the market size is too small to justify large-scale investments, unless all industries expand together, providing markets for one another. There are two possible outcomes, or “equilibria,” in such a situation. The first is one in which no firms invest in large-scale factories, and efficiency levels stay low. The second, better outcome, is one in which firms are able to coordinate a simultaneous move to large-scale, efficient production.

2.16 Such problems of coordination can occur in many contexts, ranging from finance and adoption of technology to innovation and industrial clusters.⁴ Consider a country that wants to invest in green technologies such as electric cars in order to improve the environmental sustainability of its growth process. This requires the complementary investment of car manufacturers, battery producers, electricity providers, and city planners. If each individual actor is unsure of the willingness of the others to invest, the electric cars may never be produced. However, if institutions are able to reduce that uncertainty by creating common knowledge that other firms will also invest, or by providing incentives to first movers, they can help coordinate investment across firms and push the adoption of greener technologies (World Bank 2012). Infant industry protection and other industrial policies are ways—not always effective—in which governments have provided these types of incentives to avoid being trapped in a situation where everyone waits for the others to invest first.⁵ What kind of instruments policy makers have to coordinate expectations and lead societies to socially preferred outcomes will very much depend on the kind of complementarities involved.

Cooperation: Limiting opportunistic behavior to prevent free riding

2.17 Another basic type of collective action problem that institutions solve is cooperation, or reducing opportunistic behavior. By limiting free riding, institutions can help build more cohesive societies and turn zero-sum games with no winners into positive-sum games in which all parties gain (“win-wins”) (Ostrom 1990). Cooperation problems are often observed in reference to the provision of public goods (such as collecting taxes to fund public schools or hospitals) or solving environmental concerns related to the overuse of common pool resources (such as over exploitation climate change) (box 2.3).

2.18 Perhaps the most well-known example of a cooperation problem is the tragedy of the commons (Hardin 1968). In this example, open grassland—the “commons”—is available for all herdsmen to graze their animals without restrictions. As increasingly more cattle graze in the pasture, the land becomes unable to grow back fast enough, ultimately depleting until it is not useful for anyone. The notion is that rational individuals acting independently, according to their own self-interest, will deplete a shared resource, even if it is contrary to the best interest of the

³ See Rosenstein-Rodan (1943). Murphy, Shleifer, and Vishny (1989) model a more recent version of this idea.

⁴ Hoff (2000) reviews models of coordination failures in a wide range of contexts, including social norms and corruption. Cooper (1999) reviews macroeconomic models of coordination failures, while Rodríguez-Clare (2005) reviews microeconomic models of coordination failures.

⁵ See Hoff and Stiglitz (2001) for several other examples of coordination problems that are key for development.

group. This type of problem is common in situations where agents obtain immediate gain for their action but do not experience the losses from the impact until later. A key notion behind cooperation problems, which differentiates them from coordination problems, is that the preferable action from a social point of view is not necessarily an equilibrium. In the case of coordination problems, multiple equilibria exist, and policy is a matter of helping “make the jump” to the optimal one. Solving cooperation problems, in contrast, typically requires credible mechanisms of reward or penalty to prompt actions that lead to the jointly preferred outcome.

2.19 In all countries, but particularly those that have achieved higher levels of prosperity, the degree to which prosperity is shared requires cooperation, particularly citizens’ willingness to contribute to public goods and not free ride on others. The extent to which societies can ensure opportunities for all individuals relies on their ability to provide high-quality services, such as health, education, or connectivity, and to ensure access to economic opportunities, especially access to markets that allow individuals to use the assets acquired. Collecting the taxes needed to fund investments in public goods requires individuals’ willingness to cooperate. Lack of cooperation is a typical cause of segregated outcomes: for instance, differential treatment of different ethnic groups. One group may not be willing to contribute to the provision of public goods if a different group will benefit. Willingness, however, can come about if the commitment to the provision of public goods can be credible—regardless of which group is in control of the resources. This can be achieved, for example, by constraining the power of those to whom authority is delegated, or by sharing power in cabinets.

2.20 Sometimes, societies face a breakdown of cooperation and people “opt out” or “exit,” failing to comply with the rules or to contribute to the provision of public goods (Hirschman 1970). Cooperation becomes more difficult to induce as the number of people involved increases, if there is less information and greater uncertainty about others, and when the interaction is finite. Inequality may also matter for sustaining cooperation. In theory, the relationship between wealth inequality, and the successful provision of a common resource pool can be ambiguous. Consider a situation with high wealth inequality. On one hand, a few dominant members may reap enough benefits from having a public good so that they have the incentives to provide and maintain it independently, even if other less wealthy individuals free ride on it (Olson 1965). On the other hand, some individuals with better outside options (often the rich) may not want to contribute to the provision of the good, and there may be higher costs to enforce cooperation, thereby nurturing distrust that the other(s) will pay, and undermining cooperative behavior.⁶ For example, Brazil, where citizens organized to demand higher quality of public services, faced a problem common to many other countries: namely, the fragmentation of the social contract (box 2.3). In these cases, the low quality of service provision leads the upper-middle-classes to demand private services, which in turn weakens their willingness to fiscally cooperate and contribute to the provision of public goods, in a perverse cycle (Ferreira and others 2013).

2.21 In this way, *commitment*, *coordination*, and *cooperation* make up core institutional functions that contribute to the effectiveness of policies to achieve development outcomes. Nonetheless, these functions are only effectively fulfilled under certain conditions.

⁶ Examples of the cohesion and inequality-conflict cycle are found in Esteban and Ray (2011) and Gintis (2000). Bardhan (2005) discusses cooperation in the context of scarcity and conflict.

Policy effectiveness in the presence of power asymmetries

2.22 Effective policies in this Report are those that perform three key functions to improve development: enabling credible *commitment*, inducing *coordination*, and enhancing *cooperation*. But why are policies so often ineffective in doing so? The failure of policies that are good “on paper” to perform their intended function and the persistence of bad ones is often not the result of policy makers’ lack of resources, will, or knowledge. Consider a society run by a benevolent social planner who cares about security, growth, and equity. He or she will choose policies that maximize these three objectives. However, as soon as societies deviate—as they do in real life—from this idealized monolithic planner, failures to cooperate, coordinate, and commit might take them far from the social optimum. Where these societies will end up will depend on the depth of these failures.

2.23 One of the key—though not the sole—contributing factors to determine policies and resulting equilibria is the unequal distribution of power in society. This Report refers to this as a *power asymmetry*. Because policy effectiveness depends not only on *what* policies are chosen, but also on *how* they are chosen and implemented, the relative degree of bargaining power of different actors may condition what kind of commitment, coordination, and cooperation come about (box 2.3).

Box 2.3 Game theory and the roots of political power

It has long been recognized that power is an important determinant of how a society functions and how the gains of economic activity are shared within and across nations. The early writings on power were imprecise as social scientists grappled for ways to express these embryonic ideas (Dahl 1957). This began to change with the rise of game theory. We are now able to formalize some of these difficult concepts and, in particular, the idea that, in the end, power depends on the beliefs and mores of ordinary people. Václav Havel had expressed this beautifully in a paper smuggled out of prison, where he was locked up for dissenting against Czechoslovakia’s post-totalitarian state in the early 1980s. He argued that, in modern dictatorships, it is not always easy to separate the perpetrators from the victims. In his aptly titled essay, “The Power of the Powerless” (Havel 1978 [1991]), he argued that many of the oppressed are complicit in propping up the power of such regimes.

This idea can be formally expressed with game theory. Consider a society with one dictator, *D*, and two citizens, 1 and 2. These two citizens are expected to provide some beck-and-call service and display their loyalty to *D*. Expressing this loyalty costs each citizen 5. Both being loyal to *D* is what gives *D* her power.

But why will people show loyalty to a dictator when it is costly to them? The answer lies in the nature of interaction among the citizens themselves. Let us capture this by assuming that they can be cooperative (*C*) towards each other or noncooperative (*N*). The payoffs from such behavior are described in table B2.3.1.

Table B2.3.1 Payoffs to cooperation or noncooperation

	<i>N</i>	<i>C</i>
<i>N</i>	10, 10 (<i>N,N</i>)	5, 0 (<i>N,C</i>)
<i>C</i>	0, 5 (<i>C,N</i>)	20, 20 (<i>C,C</i>)

Note: *C* = cooperation; *N* = noncooperation.

This game, named the assurance game by Amartya Sen (1967), is often also called the coordination game (see box 2.1). Keep in mind that the assurance game has two equilibriums—both players choosing *C* and both players choosing *N*.

The full game involves each citizen first deciding whether to display loyalty to the dictator before interacting among themselves. Suppose that it is common belief that if you are not loyal to the dictator, others will not cooperate with you. It is now entirely possible to get locked into a societal equilibrium where everybody displays loyalty to the dictator and plays cooperatively among themselves. Their net return or payoff is 15: that is, 20 from the Assurance game and minus 5 from loyalty or obsequiousness—call it what you want—to the dictator, which props up the dictator's power.

All citizens would prefer not to be loyal to *D*, but fear that, if they dissent, others will not cooperate with them. It is this 'triadic interaction' that props up power (Basu 2000). The behavior just described is a Nash equilibrium—but it is more than that. It is what in game theory is called a "subgame perfect equilibrium," which is a Nash equilibrium supported by credible threats.

Dictators may not know what a subgame perfect equilibrium is but they know how to create an atmosphere of mutual fear that props up the regime.

This example illustrates how power can be modeled without bringing any extraneous assumptions into the analysis. A pure economic analysis can lead to manifestations of power through the interplay of beliefs. But if we go a step further and bring in behavioral economics—in particular, the idea of "stigma"—into our analysis, there are many other phenomena that can be modeled, from political mass movements to child labor (Lopez-Calva 2003).

This analysis is closely related to the concept of a "social contract" that goes back to ancient Greek thinkers. Underlying all stable societies is some form of social contract, which enables individuals to anticipate the behavior of others. The preceding analysis can yield insights into societal uprisings, such as those in the Arab world in 2010–11, which can be viewed as shifts in societal equilibria (Devarajan and Mottaghi 2015).

The analysis is a warning that, since these manifestations of power arise from the beliefs and behavior of ordinary people, all societies, even democracies, run the risk of having to confront them. The early-1950s McCarthy era in the United States and the Emergency in India (1975–77) are illustrations.

Source: Kaushik Basu for WDR 2017.

Inside the policy arena: Policy bargaining and the distribution of power

2.24 The processes of policy-making and policy implementation entail a bargaining process between different actors. The *policy arena* can be thought of as the setting where (policy) decisions are made; where different groups and actors interact and bargain over aspects concerning the public space; and where resulting agreements eventually also lead to changes in the formal rules (law). It is the setting where governance manifests itself. Policy arenas exist at the local, national, and international levels. They can be formal (parliaments, courts, intergovernmental organizations, government agencies), traditional, and informal (backroom deals, Old Boys networks). Policy arenas are issue specific. For example, the policy arena for defense policy may not be the same as that for health or infrastructure policy.

2.25 Who bargains in this policy arena, and how successfully they bargain, is determined by the relative *power* of actors. Power is expressed in the policy arena as the ability of groups and individuals to make others act in their interest and to bring about specific outcomes. It is the "production of intended effects" (Russell 1938). Actors can exercise their power by setting the agenda, by vetoing specific options, or by influencing other actors' preferences. Agenda-setting power refers to actors' ability to influence the alternatives over which decisions are made (Persson and Tabellini 2000). Veto power, on the other hand, refers to the ability of actors to block a change

from the status quo (Tsebelis 2002). In all cases, it is about restricting the effective choices of other actors.⁷

2.26 The policy arena is shaped by both de jure and de facto power. *De jure power* refers to power that it is conferred to the actors by the formal rules. For example, what the electoral rules are, whether there is a presidential or a parliamentary system, whether there is an independent judiciary, or whether the central bank is autonomous are all formal rules that confer de jure power to different actors. *De facto power* refers to the actual power to influence other actors. It can come from many sources, including control over resources, control over coercive instruments, ideational persuasion, or the capacity to mobilize. Often, the formal de jure rules that confer power to actors in the policy arena do not necessarily translate into de facto power relations (box 2.4).

2.27 Actors in the policy arena can be grouped into elites and citizens according to their relative degree of influence. This Report defines *elites* in a positive (as opposed to a normative) sense, in that what distinguishes them from *citizens* is their ability to directly influence the design and implementation of a certain policy. Thus, elites are not necessarily bad or self-interested, and citizens are not necessarily good and public spirited. Both groups act as people do in other spheres of life: understanding their motivations matters to anticipate their conduct.⁸ The classification of elites and citizens is not intended to be a strict dichotomy, but rather a spectrum in which different actors have different degrees of influence.^{9,10} The relative degree of power of actors to influence policy design or policy implementation may vary by issue. For example, while large export firms in some societies may have power to influence trade policy and thus are an elite in this area, they may not be an elite in the areas of security or health policy.

⁷ Lukes (1986) presents an extensive discussion of the concept of power from different perspectives, summarized in the definition used in this Report.

⁸ In the literature of public choice tradition this has been described as “politics without romance.” See Buchanan and Tullock (1962) and Mueller (2003).

⁹ While the term “elite” is frequently used in popular writing and in academic literature, it is not often defined. A search of the word “elite” returned 913,000 results in Google Scholar, while a search in the writings rarely finds a clear definition.

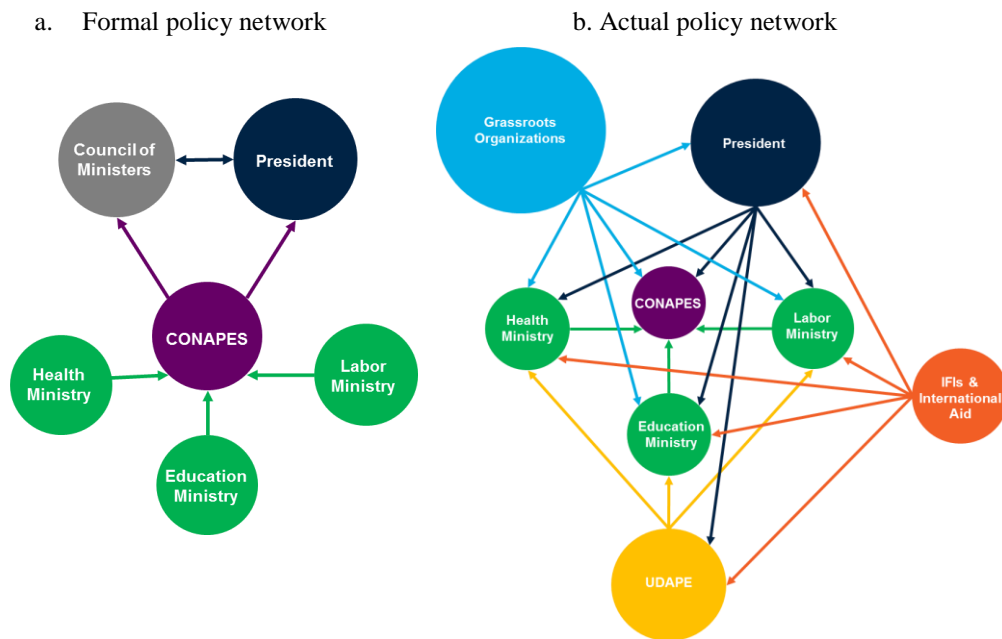
¹⁰ As Gould (1987) notes, dichotomies are either “useful or misleading, not true or false” as they “are simplifying models for organizing thought, not ways of the world.”

Box 2.4 Who is who in the policy arena: The case of Bolivia’s social policy

The divergence between the formal rules and the actual practice of formulating and implementing social policy is clearly illustrated by the process of making social policy in Bolivia. Officially, ministries are designated as the policy initiators in Bolivia, since ideas and information flow from them to CONAPES (the National Council of Economic and Social Policy), to the Council of Ministers, and to the president (figure B2.4.1, panel a). However, studies of the actual process of social policy making in the country, based on social network analysis, reveal a strikingly different picture (panel b). In the actual policy-making network, coordination is vertically exercised by the president, ministries interact very little, and grassroots organizations are key actors in the arena. Ideas and information for policy formulation flow not from the ministries to the Council and the president, but from the grassroots organizations that constitute the electoral bases of the government party to the president, and only then to the ministries and their deputies. In the figure, the size of each circle represents the importance of the actor in the policy-making process.

The policy-making dynamics uncovered by the social network analysis reveal two main effects that significantly shape the features of social policies. One is that social policy-making units are technically weak: they are typically staffed not by specialists but by political supporters who are subject to frequent turnover and do not necessarily possess adequate skills. For example, the average tenure of the interviewees in the study was 14 months, and 22 percent of them had no prior experience in any social policy-making capacity. The other effect is that the actors do not have incentives to coordinate and cooperate with one another. Rather, they compete to influence policy making, often hindering the coherence and coordination of policy design as well as the quality of implementation.

Figure B2.4.1 Formal and actual policy networks in Bolivia, 2010



Source: WDR 2017 team based on Bonvecchi 2016.

Note: CONAPES = National Council for Economic and Social Policy; grassroots organizations = CSUTCB (Unified Central Union of Peasant Workers of Bolivia), CONALCAM (National Coordination for Change), and MAS (Movement toward Socialism); IFIs (international financial institutions) and international aid = World Bank, Inter-American Development Bank, UNICEF (United Nations Children’s Fund), and cooperation agencies from several industrialized countries; UDAPE = Analytical Unit for Social and Economic Policies.

Source: WDR 2017 team based on Bonvecchi and others 2015. See also Bonvecchi 2016, for the WDR 2017.

2.28 The effectiveness of policies hinges on the ability of elites and citizens to reach and sustain agreements. Agreements are situations where actors reach policy compromises that can be

enforced, meaning that actors can make sure that the other actors will fulfill their part of the agreement. In order to reach and sustain agreements in the policy arena, citizens and elites rely on two types of mechanisms. They can rely on *deals-based mechanisms*, in which personal relations or mechanisms such as rent distribution are used to enforce agreements. Or they can rely on *rules-based mechanisms*, in which formal laws and legal institutions are used to enforce agreements. Deals-based mechanisms can take a range of forms, from gossip and stigmatization to informal threats, physical injury, and even execution (Boix 2015). When the size of the community and its heterogeneity increases, it becomes more difficult to use relation-based mechanisms to enforce agreements and hold actors accountable. As social distance increases, societies tend to move toward rules-based mechanisms such as courts, legislatures, and political parties in order to enforce agreements. While deals-based mechanisms can function well for smaller and more homogenous groups, rules-based mechanisms become necessary to facilitate cooperation in larger and more heterogeneous groups (Li 1999; Dixit 2003, 2004). In general, mechanisms to regulate decision making and implementation through formal rules render legitimacy and induce further positive dynamics.

When power gets in the way: Exclusion, capture, and clientelism

2.29 The distribution of power in the policy arena can be a fundamental enabler—or constraint—to policy effectiveness. Unequal distributions of power in society (power asymmetries) are not necessarily harmful, and can actually be a means to achieve effectiveness—for example, through delegated authority. However, in the presence of *transaction costs* to reach political agreements, it becomes increasingly difficult to mediate power asymmetries effectively (box 2.5).¹¹ If powerful actors fear the outcome may reduce their relative power now or in the future, they may attempt to block the adoption or undermine the implementation of policies that could enhance welfare.¹² This tendency has especially significant implications for households at the bottom of the income distribution and other marginalized groups because their bargaining power tends to be more limited. Power asymmetries, in these cases, can lead to harmful consequences for society. Some common manifestations—though not the only ones—of how power asymmetries can negatively impact policy effectiveness are exclusion, capture, and clientelism.

¹¹ The problem of sustaining cooperation in transactions or agreements is known in the economics and political science literature as transactions costs. The term originated with Coase (1960) and Williamson (1989), and was later expanded to politics by North (1990a) and Dixit (1996).

¹² This is usually referred to as the social conflict view. It emphasizes that policies arise not because they are efficient but because of their distinct distributional consequences (Bardhan 1989; Knight 1993; Acemoglu and Robinson 2006). This section builds upon the work of these as well as others scholars, including Buchanan and Tullock (1962); Weingast and Marshall (1988); Dixit 1996; Spiller and Tommasi (2003); Acemoglu (2003); IDB (2005); Stein and others (2007); North, Wallis, and Weingast (2009); Besley and Persson (2011).

Box 2.5 Transaction costs, incomplete contracts, and political agreements: Why land redistribution policies often fail

Land distribution schemes have been tried—and have failed—repeatedly around the world. This box attempts to explain some of the reasons why. Consider the case of Surekha, a farmer who owns a large plot of land and must decide whether to lease it to smaller farmers or buy the necessary equipment and hire employees in order to farm the land herself. If economies of scale are not significant and there are no transaction costs,^a Surekha would be better off dividing the land and leasing it to farmers, who would be willing to pay more than if she farms it by herself, as they would be more productive. This is a classic problem in economics. In the absence of transaction costs, the initial allocation of property rights should have no effect upon the efficient operation of an economy (Coase 1960).

However, in the real world, transaction costs abound because institutions do not always allow parties to effectively commit, coordinate, and cooperate. Because transaction costs exist—and because individuals have limited cognitive capacity to process every possible contingency (bounded rationality)—contracts will always be incomplete. When there is room for interpretation—and renegotiation—of the contract, the nature of the relationship between the parties changes because they need to cooperate over time to enforce the contract. The process of bargaining, then, never really ends because parties to a contract will be continuously adjusting their actions in response to changing circumstances (Epstein and O’Halloran 1999).

In the presence of high transaction costs, Surekha would rather hire labor and buy her own equipment to farm the land.^b Owning the land will not only increase Surekha’s control over contingencies but it may also give her special social status or political power to control other transactions (Bardhan 2005). For example, Surekha could threaten her employees to accept her conditions or she will influence the village merchants not to trade with them (Basu 1986).

Consider that a local leader in Surekha’s country proposes to redistribute land holdings—including compensating current landowners for the value of the land—to increase overall productivity in the economy. Why has this type of policy failed so often and in so many places? Because in the presence of transaction costs and incomplete contracts, the economic and political value of the land for Surekha is higher than the fair compensation. Surekha’s bargaining power would be reduced if land were redistributed. As a result, she will have an incentive to block or undermine the policy.

Like economic agreements, political agreements are not independent of the distribution of power and are the result of a bargaining process among a wide set of actors. For example, state institutions emerged in history not as a voluntary contract between society members (such as producers willing to pay taxes in exchange for protection from stationary bandits), but rather because some groups imposed their coercive power on others (see chapter 4). As a result, institutions and the outcomes of the bargain within those institutions reflect the power structure in a given society.^c

Source: WDR 2017 team.

a. A world of no transaction costs is one in which there is no costs to specify, monitor, or enforce contracts between the parties (Dixit 1996). In this case, it means that the owner and the renters can foresee all possible contingencies, such as the probability of a drought or a war. It also means that a third party can observe and verify that both parties are honoring the contract and can act to enforce it in case of a dispute.

b. When transactions cost are high Surekha would rather do the work herself, buying the machines and hiring employees because ownership over the assets gives her more bargaining power over the employees in case of disputes than if she just leases the land (Hart and Moore 1990).

c. See Carneiro 1970; Tilly 1985; Boix 2015; and De la Sierra 2015. See also Boix 2016, a WDR 2017 background paper on state origins and state consolidation.

2.30 The *exclusion* of individuals and groups from the policy arena can have particularly important implications for security outcomes (see discussion in chapter 4). When powerful actors are excluded from the policy arena, violence may become the preferred—and rational—way for certain individuals and groups to pursue their interests. It can lead to failed bargains between participants in the bargaining arena. In these cases, actors use informal mechanisms to sustain short-term transactions among themselves, but are unable to achieve long-lasting agreements.

Policies in these cases will tend not to be consistent or coherent over time, but rather to reflect which group has more power at a given moment, deeply undermining the institutional function of commitment.

2.31 Countries with ongoing violent conflict where groups fight for control over territory, such as in South Sudan, present a compelling illustration of why power gets in the way of commitment to sustain mutually beneficial agreements. The outlook for the groups involved in such violent conflict is far from favorable. At best, they are looking at a costly victory, only to inherit a shattered economy. An agreement to put a stop to such violent conflict, encourage productive investment, and share its benefits in proportion to the power that each group currently holds is mutually desirable. Why are such agreements rarely reached? The reason is a commitment problem known as the *political hold-up problem*. Consider a situation in which the groups that are in control of different territories agreed to allow those with business skills to make efficient investments in their territories, in exchange for a “fee.” Such an agreement could maximize the size of the benefits while redistributing them in proportion to the strength of these violent groups. But for this policy to be credible to potential investors, the violent groups would need to give up some power and establish, among other things, a system of impartial courts.¹³ The fear of not receiving a return to their “investment” makes it hard for them to give up power.

2.32 A second manifestation of power asymmetries, the ability of influential groups to *capture* policies and make them serve their narrow interests, is helpful to understand the effectiveness (or lack thereof) of policies in promoting long-term growth. For example, if a powerful interest group derives its power from being the most productive firm, it will advocate for policies that allow it to continue to be productive and reach new markets. On the other hand, if those groups with power have the coercive capacity to cause economic and social disruption and are in the least productive sector of the economy, they will advocate for policies to protect their economic power and will block competition. The effects of capture can be widespread and detrimental to the well-being of society (see discussion in chapter 5).

2.33 Consider the case of regulatory capture in the building sector, which can undermine the implementation of safety standards and risk-sensitive construction. This is illustrated by the case of Turkey following the 1999 Kocaeli earthquake, when the government was unable to implement a number of innovative building control regulations due to the strong influence exerted by powerful interest groups. The new regulations would have introduced higher standards for building controls, including higher qualification requirements for building designers, certified private construction supervision of building design and code compliance, and mandatory 10-year professional liability insurance for building designers. However, implementation was undermined by the strong opposition of the building and real estate industries, which perceived that the new requirements could disadvantage current professionals and translate into higher marginal costs to new construction.

¹³ Klein, Crawford, and Alchian (1978) note that the level of specific investments in a contractual relationship depends upon the expectation of obtaining a fair rate of return on that investment. In this case, the investment refers to the fact that violent groups will need to give up power to pursue growth-enhancing policies. However, once they give up power, they fear not obtaining a fair return on their investment. Dixit (1996) extended the reasoning to political transactions.

2.34 A third manifestation of power asymmetries is *clientelism*, the exchange of goods and services for political support. Clientelism can shape the adoption and implementation of policies in two main ways. First, in clientelistic settings, commitment to long-term objectives is broken by the lack of accountability of those to whom authority is delegated (see discussion in chapter 6). Accountability becomes up for sale. In addition, when commitment breaks down systematically, it can erode people’s incentives to cooperate and some groups may “opt out” by demanding private services and avoiding to contribute to the provision of public goods (Ferreira and others 2013). In clientelistic settings, states tend to have low tax revenues and provide few public goods, undermining economic activity and future taxation.

Best-practice or best-fit? Revisiting the notion of “first best”

2.35 Efforts to strengthen the ability of institutions to effectively enable commitment, coordination, and cooperation, viewed from the perspective of power asymmetries, calls into question many traditional practices of the development community.

2.36 The development community has largely focused its reform attempts on designing best practice solutions and building state capacity to implement them. In this sense, capacity is often considered a prerequisite for policy effectiveness.¹⁴ While capacity is certainly important at a given point in time and can explain differences in performance across countries (Fukuyama 2014), capacity interacts with—and can be explained by—power. At a given point in time, capacity can be thought of as a stock. While in many cases capacity constitutes an overriding constraint, it is also a proximate cause because it is an outcome of a bargaining process in which actors decide how and where to invest (or not) in building such capacity. Even in the presence of existing physical and administrative capacity, policies may still be ineffective if groups with enough bargaining power have no incentives to pursue implementation. An example is the low investment in statistical capacity in Africa that limits the ability to monitor policy effectiveness (box 2.6, case 1). Moreover, prevailing norms, understood as socially accepted rules of behavior, can reinforce existing power asymmetries and further undermine the effectiveness of capacity building interventions (box 2.6, case 2).

¹⁴ This includes material (physical and financial) resources and technical ability.

Box 2.6 How capacity and norms influence and are influenced by power asymmetries*Case 1. The need to strengthen incentives to gather development data*

For years, the development community has invested heavily in developing statistical capacity in Africa. It has done so through economic resources as well as technical expertise. However, the results have been disappointing (Devarajan 2013). Many countries in the region still lack the data to monitor socioeconomic conditions such as poverty, inequality, and service delivery. Many voices are now demanding more money and more capacity building to solve this problem. However, this view neglects the fact that in order for countries to develop statistical capacity, there is a need for political incentives to do so.

In many countries, political incentives lead those in power to avoid investing in capacity or to actively undermine capacity. Some elites in African countries consider high-quality data systems a tool that the opposition could use to audit their performance. They thus have incentives to establish either weak statistical offices or partisan ones, staffed with political supporters rather than with technical experts (Beegle and others 2016). Of course, this practice is not unique to Africa.

The argument is as valid for the use of existing capacity as it is for building such capacity. In Latin America, a region well known for its capacity for data collection, the political dynamics have led to a weakening of the credibility of official statistics in some cases. For example, in Argentina, after building a reputation for high-quality data collection and independence from the political sphere, the Kirchner administration decided to replace the technical experts with political appointees who first manipulated the data to reduce the poverty estimates and then stopped measuring poverty altogether (Noriega, 2012; Roitberg and Nagasawa 2016).

Case 2. The reinforcement of existing power asymmetries through norms

Sometimes norms reinforce existing power asymmetries—and can constrain the effectiveness of interventions. For example, in Ghana’s small-scale fisheries, men, (often referred to as *Fish Papas*) and women (often referred to as *Fish Mamas*) have historically had different roles in fishing. Because women are forbidden from fishing at sea—a norm that has been in place for over 200 years and is respected to this day—men fish while women smoke, dry, and cook the fish for sale. *Fish Mamas* traditionally buy the fish directly from the men and exercise control over the local market by setting prices and selling the day’s catch.

A well-intentioned project by the government of Ghana supported by the World Bank attempted to improve women’s livelihoods by making the harvesting and processing of fish more sanitary and efficient. In particular, they built a facility where all fish can be processed and sold. However, by pooling together the catch in one place and making it easier to process the fish, the project undermined the *Fish Mamas*’ power to set the price because it made it easier for men to do both the fishing and selling of the catch.

As a result, men began selling the fish themselves and thus reducing women’s engagement in fisheries management. This project, which aimed at improving women’s role in the value chain, ended up undermining their livelihood.

Source: WDR 2017 team based on Bezeredi (2016).

2.37 In the presence of powerful actors who can block or otherwise undermine the policy, optimal policies from a strict economic standpoint (*first-best policies*) may not be the optimal implementable policies (*second-best*, but feasible policies). Consider the case of Kenya’s recent education reform. Based on rigorous evidence on best practices (Duflo, Dupas, and Kremer 2015), the government introduced a new policy in 2009 to allow 18,000 contract teachers to be hired. It was thought that contract teachers, as opposed to civil servant teachers, would have greater incentives to perform well because they were on short-term contracts that—in principle—would be renewed only if their performance was satisfactory. Yet experimental evidence from 64 government-run schools showed that learning outcomes did not improve (Bold and others 2015).

2.38 A central explanation for why the policy failed is that despite the introduction of short-term contracts on the books, there was no credible commitment in practice to sanction underperforming

teachers. Once the newly contracted teachers were in place, leaders of the teachers' union successfully mobilized to convert those new teachers into civil servants under permanent contracts, thereby undermining the reform. The children attending those schools and their families—who had little say and found it more difficult to organize and demand better service—were left with the same low-quality education. In the end, the government spent scarce budget resources on a policy that did not improve learning outcomes. As this example illustrates, the best technical solution was not necessarily the best-fit solution to enact change, given the distribution of power in the policy arena.

2.39 Even when feasible, implementing what seem like first-best economic policies, from a static perspective, can lead to worse outcomes for society because they affect the dynamics of power. For example, in cases where governments are captured by firms and there is high inequality, unions may be the only way for workers to solve their collective action problem, even if representation is not perfect. If so, passing a law that makes labor contracts more flexible undermines unions' membership and may lead to more inequality, which, in turn, can perpetuate the power of the wealthy (Acemoglu and Robinson 2013).

2.40 The nature of the policy arena is crucial to predict whether or not actors will be able to reach and sustain agreements to enact welfare-enhancing policies. For example, it may be more difficult to reach lasting agreements in contexts where the relative bargaining power of actors often shifts, causing a high turnover of actors entering and exiting the policy arena, or when the short-term benefits of renegeing on promises are high, compared to the benefits of maintaining a reputation for honoring the agreements. Box 2.7 describes several factors that influence the likelihood that agreements will be sustained.¹⁵

¹⁵ See Ivaldi and others (2003) and Spiller and Tommasi (2003, 2007).

Box 2.7 Factors that make sustaining cooperation over time more likely

Stability of actors' bargaining power. When the actors that interact in the policy arena change frequently, it is more difficult to sustain cooperation. There are two reasons for this: actors will be less able to *punish* those that deviate from the agreement; and building a reputation for honoring agreements becomes less valuable when the interactions with the same actors are not frequent.

Low probability of shocks. In cases where there is a high frequency of shocks that require continued policy adaptations, cooperation will be harder to reach. For example, it is easier to sustain cooperation on regulating a commodities market than a technology market. The rapid innovation in the technology market requires regulation to constantly adapt to obtain the desired objective. Moreover, shocks may create losers and winners, thereby creating competing and shifting interests that make cooperation over time (intertemporal cooperation) more difficult to sustain.

Transparency. Inability to observe or verify whether actors have honored or will honor the agreement makes cooperation more difficult to sustain (Stigler 1964; Green and Porter 1984). For example, in the case of agreements between voters and politicians, if citizens cannot observe politicians' efforts and must rely on outcomes to infer their actions, cooperation will be more difficult to sustain.

Actors' certainty about the distributional effect of policies. When there is uncertainty about who the winners and losers of a policy are, it is more difficult to sustain cooperation. Faced with this uncertainty, actors cannot establish a compensation mechanism (Fernandez and Rodrik 1991).

Actors' structural links. Bargaining for many different policy issues allows actors to have repeated interactions, which facilitate cooperation in two ways: first, by increasing the likelihood that there will be some overlapping interest over a set of policies; and second, by reducing the cost of punishment because actors can use bargains concerning various other policies to punish those that deviate in any one of the agreements.

Enforcement technologies. Some policy issues have multiple enforcement technologies; this allows actors to choose the one they trust the most and increases the set of issues over which they can cooperate. Recent experience in Guatemala shows that importing a court, the International Commission Against Impunity in Guatemala (CICIG), can be a way to increase commitment to enforce the rules, and as a result, increase cooperation of potential witnesses, at least in the short term (box 2.9).

Source: WDR 2017 team.

Levers for change: Incentives, preferences, and contestability

2.41 In order to more effectively enable commitment, coordination, and cooperation, it is important to understand what agreements are feasible in the policy arena and how the policy arena can be reshaped to expand the set of policies that can be implemented. This occurs when changes take place in who can participate in decision-making processes (the *contestability* of the policy arena), when *incentives* to pursue certain goals change, and by changes in actors' *preferences and beliefs*.

2.42 Depending on the primary functional challenge (that is, whether the institutions need to enable commitment, coordination, and/or cooperation), the entry point may be different. Because these functional challenges are interdependent, these entry points act as complements to one another. In all cases, for the entry points to be effective, they must lead to changes that induce voluntary compliance from actors. This process of inducing voluntary compliance can be thought of as expression of what the literature calls *legitimacy*, related to the voluntary acceptance of an act of authority (box 2.8).¹⁶

¹⁶ The importance of process legitimacy is captured by Levi (1998): "...citizens are willing to go along with a policy they do not prefer as long as it is made according to a process they deem legitimate, and they are less willing to comply with a policy they like if the process was problematic."

Box 2.8 Voluntary compliance and the building blocks of legitimacy

This Report identifies three principal types of legitimacy that matter for the effectiveness of interventions: outcome legitimacy, relational legitimacy, and process legitimacy.

Outcome legitimacy is derived from delivering on commitments, such as those to provide public services, protect property rights, or respect term limits in elections. It is related to the degree in which individuals feel that they can trust institutions (see box 2.2 for an extended discussion on the notion of trust). In this way, incentives are aligned between government and citizens. A public officer will deliver on her promises because citizens will vote for her, and citizens will vote for her because they trust that the officer will deliver on her promises. Trust is in this way a building block of outcome legitimacy (the capacity to commit). An important way to enhance outcome legitimacy is to enhance ex post accountability, so that actors will face potential consequences if they do not deliver the outcomes of a promised policy or action. Enhancing ex post accountability to bring about potential adverse consequences for not delivering on the outcomes of promised decision is a critical entry point for strengthening outcome legitimacy: such accountability, in effect, acts as a negative reward system.

Relational legitimacy is derived from the alignment between the beliefs held by specific individuals or groups and the normative content of the rules—both formal and informal—governing the power relation in question. It is related to the degree in which individuals share beliefs either about the qualities of the power holder, or the degree to which the power arrangement serves a recognizable general interest (Nixon, Mallet, and McCullough 2016). In certain extreme cases, even if the process is not fair, a constituency could be willing to accept a government's authority because it shares its values. This arrangement is related to how the content of the law reflects people's own social norms and views of morality. In these cases, the law can be considered irrelevant because people comply for reasons independent of its existence.

Process legitimacy is derived from a perception of fairness in the way that decisions, policies, or laws are designed and implemented. It is related to the degree to which individuals feel represented in the policy arena. When procedures for selecting and implementing policies are more contestable, those policies tend to be perceived as "fair" and to induce cooperation more effectively. Process legitimacy can exist to the extent that people feel like they are represented, independently of the outcome. If individuals believe that the process has followed the rules, it leads to higher compliance with the law, even if the outcomes are not always those that favor them (Tyler 1990; Tyler and Huo 2002). The opposite—exclusion from the process—leads to lack of legitimacy. Enhancing ex ante accountability to enable more a participatory or inclusive decision-making process can play a key role in strengthening process legitimacy.

Ultimately, legitimacy is a combined function of outcome, relational, and process legitimacy. However, while governments cannot always control outcomes directly or change beliefs quickly, they can control processes. Investing in strengthening process legitimacy may induce more voluntarily compliance and enable governments to deliver more effectively. As discussed, delivering on commitments in turn feeds back into building trust in institutions and strengthening outcome legitimacy. Thus investing in process legitimacy is an important foundation of igniting positive dynamics between governance and development over time.

Solving commitment problems: The role of incentives

2.43 The incentives that actors have to comply with agreements are fundamental to enable commitment in the policy arena. What types of institutional arrangements can provide the right incentives to help ensure credible commitment? How can those in power bind themselves in such a way that their promises become credible, even when it is in their short-term interest to break them?

2.44 Think of the myth of Ulysses in Homer's *Odyssey*: in order to resist the short-term temptation of the Sirens' luring song, Ulysses has his sailors bind him to the ship's mast to remove the option of jumping overboard. In order to understand why powerful actors would "tie their own hands" in this way and whether or not that agreement will be credible, it is necessary to examine the context of a specific set of actors, rules, and potential incentives to break the agreement. For

example, granting independence to the central bank is a mechanism that governments use to tie their hands in an attempt to gain credibility that they will not use inflation to finance public expenditure (Cukierman and Lippi 1999). Similarly, anticorruption agencies play an important role in constraining the use of public office for private gain. However, these institutions will be ineffective if they are unable to alter the existing incentive structure in a way that makes it credible to enforce the new regulations and the underlying contract of the new agency (Acemoglu and others 2008). See spotlight 1 for a more detailed discussion on corruption as seen from the perspective of the WDR 2017 framework.

2.45 Around the world, different institutional forms have been established in order to make commitment credible. In Guatemala, for instance, in the aftermath of the peace agreements of the 1990s, and after an increase in the political violence that raised concern among many actors, an agreement was reached to turn to international actors and create the International Commission against Impunity (CICIG) (box 2.9), which has changed society's perception about its capacity to hold powerful actors accountable.

Box 2.9 How an international commission enabled a credible commitment to fight criminals' impunity in Guatemala

"If you are watching this message, it is because I was assassinated by President Álvaro Colom, with help from Colom's private secretary Gustavo Alejos." The release of a YouTube video in 2009, in which Rodrigo Rosenberg makes this statement accusing the president of Guatemala of his murder, precipitated a political crisis in the country. Opposition to the president asked for his immediate resignation, and only a rapid and effective independent investigation of the situation prevented an escalation of political instability in Guatemala. The investigation revealed that the hitman who had killed Mr. Rosenberg was not hired by the president, but was in fact hired by Mr. Rosenberg himself: Mr. Rosenberg had ordered his own assassination.

The investigation was conducted by the International Commission against Impunity in Guatemala (CICIG), and provided the credibility needed to resolve this crisis in a peaceful manner. This institution, backed by the United Nations (UN), was approved in 2007 by the Guatemalan congress and was mandated to help the Guatemalan judiciary authorities in their fight against illegal criminal organizations that had infiltrated security and judicial state institutions. The approval came following a broad wave of homicides that infuriated citizen organizations and the mass media. The growing perception was that national authorities had lost any capacity to credibly prosecute large and powerful criminal networks.

To fight impunity meant to dismantle these criminal organizations and eradicate their corrupting power within state institutions, which protected them from being effectively prosecuted. Three of the greatest strengths of CICIG's mandate were its independent capacity for criminal investigation, its prosecution capacity through a specific *fiscalia* of the office of the Attorney General (AG) (which allowed it to investigate even in the face of internal opposition within the AG),^a and its independent voice in relation to mass media. These arrangements enabled CICIG's ability to credibly commit to prosecuting impunity.

Since 2007, CICIG has had a deep impact on the Attorney General office's capacity to credibly prosecute criminal networks, even leading to a peaceful resignation of the president in 2015 after the discovery of his involvement in "La Línea," a criminal network linked to customs fraud. Moreover, national security forces, judges, and members of congress have been empowered in their public roles and the renewed commitment to prosecution has increased pressure to reduce participation in illegal activities. CICIG's political power today is well beyond that which was originally thought for an international organization, which raises both concerns and enthusiasm in Guatemala.

Source: Carrera 2016, for the WDR 2017.

a. A *fiscalia* is a district attorney or public prosecutor.

2.46 Often commitment devices at a certain level may need to be complemented by devices at another level for the commitment to be taken seriously by market players. For example, international and bilateral agreements, such as multilateral trade agreements or bilateral investment agreements, can be a commitment device.¹⁷ However, the mere presence of such agreements may not lead to strong commitment, as shown by numerous examples of violations of the provisions of bilateral investment agreements. Thus, complementary arrangements may be needed to provide a stronger signal about commitment. An example is the existence of mechanisms that systematically capture investor grievances, especially those related to violations of investment agreements, and help resolve them. The effective working of such mechanisms gives investors comfort and strengthens the commitment that governments make when they sign investment agreements. Here the important thing is the effective working of the grievance mechanism, rather than the particular form it takes.

Solving coordination problems: The role of preferences and beliefs

2.47 Preferences, norms, beliefs, and ideas play an important role in the case of coordination. Coordination of beliefs can help understand phenomena ranging from discrimination to corruption to technological revolutions to tax compliance (Tirole 1996; Mokyr 2013). For instance, when Berlusconi in Italy said publicly that he considered the tax burden and tax enforcement for entrepreneurs to be excessive, he was sending a signal that, as long as he was in charge, tax enforcement would be weaker, actually leading to lower tax compliance by businesses (Raitano and Fantozzi 2015). On the other hand, in the United Kingdom when citizens received letters informing them that most of their neighbors had already paid their taxes, tax compliance increased (BIT 2012).

2.48 Consider the case of a society with a significant degree of corruption. The higher the incidence of corruption, the lower the cost of being corrupt, in terms of damage to the public's perceptions of politicians. In such a situation, where corruption has become a norm, policies to deter corruption will be less effective or will require high and potentially unfeasible sanctions (Tirole 1996). However, policies to induce coordination can help countries break free from path dependence and are often needed only as a temporary intervention. For example, it may be possible for a temporary anticorruption program to move an economy from a high-corruption equilibrium (based on expectations of high corruption) to a low-corruption one (based on low-corruption expectations with respect to the behavior of others), as Tirole (1996) discusses.

Solving cooperation problems: The role of contestability

2.49 Who is included and who is excluded from the policy arena is determined by the relative power of the competing actors, as well as by the barriers of entry to participate (that is, the *contestability* of the process). A more contestable policy arena is one in which actors or groups who have reason to participate in the decision-making process have ways to express their interests and exert influence (box 2.10). As contestability determines who is included and who is excluded from the bargain, it is closely linked to the notion of inclusion, but it also emphasizes the barriers to participation. While the inclusion of more actors in the decision-making process is not

¹⁷ See Tornell and Hernández (1995). Also see Gonzalez-Reyes (2016) for a discussion of the North American Free Trade Agreement in the early 1990s.

necessarily a guarantee of better decisions, a more contestable policy arena tends to be associated with higher levels of process legitimacy and cooperation.

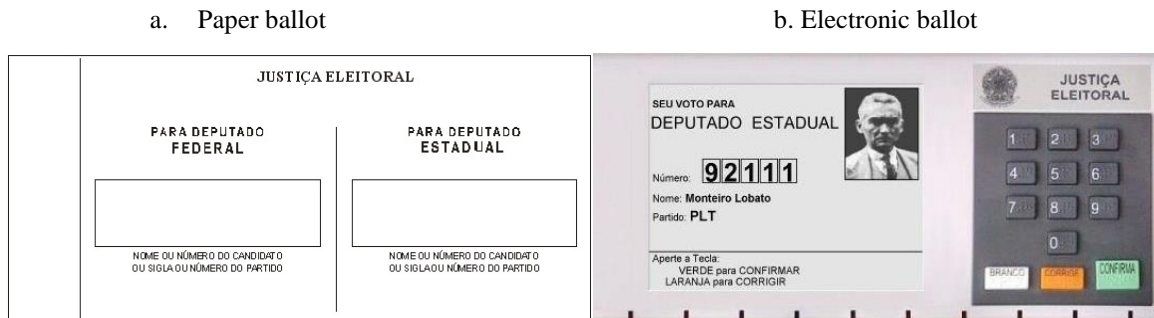
2.50 Consider the case of managing local water resources in India. In the southeastern Indian state of Tamil Nadu, cooperation to manage public irrigation systems at the community level is crucial to avoid free riding and efficient water use. A large survey conducted in the state was used to study the determinants of cooperation in these communities. The empirical analysis looked at the effect of institutional, socioeconomic and topographic factors on cooperative behavior, measured by how well the systems are maintained, the absence of conflict, and the extent of violations of rules. The results from the analysis highlight the importance of being involved in the crafting of the rules. The study finds that when a farmer believes that rules have been created jointly (along with the elite or government), the farmer is more likely to have a positive perception both about the allocation system and about the compliance of other farmers with the rules. Similarly, elites violate water allocation rules less when they are the ones that crafted the rules (Bardhan 2005).

2.51 Actors marginalized from the decision-making process have fewer incentives to comply with the policy. In Tyler's classic study, individuals abide in the law primarily not out of fear of punishment (deterrence) but because they believe it to be fair (Tyler 1990). Tyler and Huo (2002) look at the role that being treated fairly plays in individuals' acceptance of the legal system. Based on a survey of citizens in Los Angeles and Oakland, California who have been in contact with judges, prosecutors, or the police, they find that members of minority groups who perceive that they have been treated unfairly are less likely to trust subsequent decision of law enforcement authorities, and to cooperate. Being treated with respect and dignity, and the belief that the process has followed the rules, lead to higher compliance with the law, even if the outcomes are not always those that favor individuals.

Box 2.10 How the introduction of electronic voting in Brazil reshaped the policy arena and led to more pro-poor policies

In developed countries, filling in a ballot is a trivial task; one reason is the level of education of the average citizen. The same might not be true of many illiterate or poorly educated citizens in rural and other areas in the developing world. This was the case for Brazil, where until 1985 illiterate citizens were not legally allowed to vote. A process that started in 1986 led to enfranchising these groups in the 1988 Constitution. However, until 1996, the system involved a complex paper ballot. Given the country’s electoral rules, it is common for hundreds of candidates to run for state legislatures, making it impossible to list candidates in paper ballots. Voters were thus asked to write the name (or number) of the candidate on the ballot (figure B2.10.1).

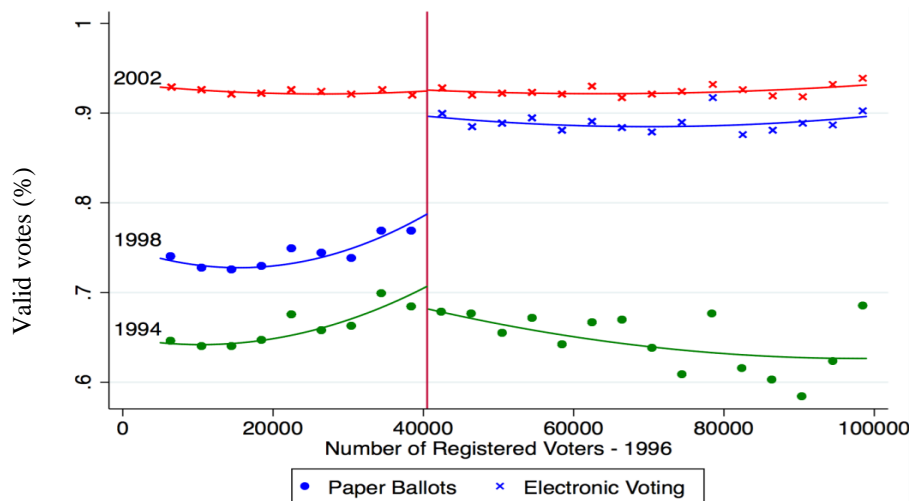
Figure B2.10.1 An electronic ballot made it much easier for those with little or no education to cast their vote than the paper ballot



Source: Fujiwara 2015.

At the time, roughly one-quarter of Brazilians were not functionally literate. These complex paper ballots led to the de facto disenfranchisement of a large fraction of voters. It was common for more than one-quarter of the votes to be deemed invalid and not counted. However, that changed in 1996 with the introduction of electronic voting devices. Their simple interface allowed voters to select the number of their candidate, and a picture of the candidate appeared on the screen before the voters validated their vote. This simplification of the voting procedures greatly reduced the number of invalid votes and effectively enfranchised more than 10 percent of the Brazilian electorate, whose votes previously had not been counted.

Figure B2.10.2 Electronic voting reduces the number of invalid votes



Source: Fujiwara 2015.

Figure B2.10.2 shows the effect of electronic voting on valid votes. The analysis exploits the fact that in 1994, all Brazilian municipalities used paper ballots. In the 1998 election, while smaller towns still used paper ballots, municipalities with more than 40,500 voters had switched to electronic voting. By the 2002 election, electronic voting was the sole method of voting in Brazil.

The effects of the transition are illustrated by the towns of Altamira and Paracatu, which were otherwise similar. Because Altamira had 40,461 registered voters—39 less than the threshold of 40,500 for electronic voting—the municipality used paper ballots for the 1998 election, while Paracatu, just over the threshold with 40,917 registered voters, used electronic voting. This led to a significant difference in valid votes, from 79 percent in Altamira to 90 percent of Paracatu’s registered voters. Multiplied across many towns in Brazil this de facto enfranchisement of millions of previously excluded voters had substantial consequences on policy making and development outcomes.

These newly enfranchised voters chose more progressive legislators for the state assemblies, which then increased spending in public health care by 34 percent from 1998 to 2006. In Brazil, public health care is largely a pro-poor policy, given that better-off citizens rely on private health services. This additional spending then increased access to prenatal health care, and had an impact on health outcomes. Fujiwara (2015) estimates that electronic voting was responsible for lowering the prevalence of low-birth weights (a common measure of infant health) among mothers without primary schooling by 6.8 percent.

Source: WDR 2017 team based on Fujiwara 2016.

Three guiding principles

2.52 In thinking about reform, the WDR 2017 proposes three simple guiding principles. First, it is important to think not only about what form institutions should have, but about the functions that institutions must perform: “Think of function, not only form.” Second, while capacity building matters, how to use the capacity and where to invest in capacity depends on the relative bargaining powers of actors: “Think of power, not only capacity.” Third, in order to achieve the rule of law, countries must first strengthen the different roles of law to enhance contestability, change incentives, and reshape preferences: “Think of the role of law, not only the rule of law” (table 2.1).

Table 2.1 Three principles for rethinking governance for development

Traditional approach	Three principles for rethinking governance for development
Invest in designing the right <i>form</i> of policies.	Think not only about the form of institutions, but about their <i>functions</i> .
Build the <i>capacity</i> to implement those policies.	Think not only about capacity building, but about <i>power asymmetries</i> .
Focus on strengthening the <i>rule of law</i> to ensure those policies and rules are applied impersonally.	Think not only about the rule of law, but about the <i>role of law</i> .

Source: WDR 2017 team.

A dynamic process: Drivers of change and the role of law

2.53 When can meaningful changes occur in the nature of governance? Overcoming harmful power asymmetries by adopting rules that change incentives, reshape preferences, or enhance contestability may be difficult because those currently in power have incentives not to introduce reforms that would limit their power. Moreover, even dramatic shifts in who has power in the policy arena may not be enough, if the new elites, once in power, have incentives to use the same

mechanisms to extract rents from society used by the previous elites (Acemoglu and Robinson 2008).

2.54 However, despite the difficulties, history has shown that change can happen; many societies where power at a point in time was in the hands of a few have managed to develop into more open, more prosperous, and more secure societies (Deaton 2013; Boix 2015). Political pressure for reform can come from the top down (elite bargains) or from the bottom up (citizen engagement), and in many cases is the results of coalitions *between* elites and citizens. Citizens and elites are also influenced by international factors, which can play a role in influencing the local bargaining dynamics. While external actors cannot engineer domestic development, they can play a role in strengthening or weakening the relative power of different actors. Part 3 will explore these dynamics.

2.55 Moreover, governance and development dynamics are a two-way street: the process of development is constantly reallocating resources, conferring new *de facto* power to actors, and shifting norms over time.¹⁸ This process includes external (exogenous) shocks (such as a regional or worldwide financial crisis), and internal (endogenous) structural changes (such as a demographic shifts) or norms-based changes (such as changes in gender roles). This in turn affects the ability of different groups of citizens and elites to solve their collective action problems and influence the policy arena. These triggers provide opportunities for actors to change the system because they alter the distribution of power.

2.56 Law is a powerful instrument to reshape the policy arena because it is the tool through which policies are codified and implemented, as well as the tool through which power is allocated and contested. While laws generally reflect the interests of those actors with greater bargaining power, law has also proven to be an important instrument for change. By its nature, law is a device that provides a particular language, structure, and formality for ordering things, and this characteristic gives it the potential to become a force independent of the initial powers and intentions behind it. Law, often in combination with other social and political strategies, can be used as a commitment and coordination device to promote accountability, and also to change the rules of the game to foster more equitable bargaining spaces. Effective laws are those that are able to shape bargaining spaces that increase contestability by under-represented actors, change preferences by enhancing substantive focal points around which coordination can occur; and change incentives by changing payoffs to lower the cost of compliance (or increase the cost of noncompliance). The next chapter looks at these various roles of law in greater depth.

¹⁸ Hirschman 1958; Streeten 1959; Ray 2010.

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Spotlight 1 Corruption

S1.1 Corruption is often defined as the use of public office for private gain. In the WDR 2017 framework, corruption is a deals-based way to sustain agreements among certain individuals or groups. While in the short term corruption may be able to “grease the wheels of the economy,” in the long term it negatively affects growth by diverting resources from more productive uses and negatively affects equity by disproportionately benefiting those in power. Moreover, it undermines legitimacy because it affects public perceptions of the fairness of the decision-making process (Rose-Ackerman 2016).

S1.2 The first generation of high-income OECD states has achieved a high control of corruption through development processes and institutional forms that many other countries around the world have since tried to replicate without achieving the desired results. These anti-corruption strategies often wrongly assume that aggregate levels of corruption can be reduced through a top-down combination of policies that improve the enforcement of a rule of law, change the expected returns to corruption (for instance through bureaucratic pay increases, greater transparency, or harsher punishments), and simplify procedures to reduce the opportunities for corruption. These strategies have generally delivered modest reductions in corruption in contexts where the configuration of social power does not support the enforcement of generalized rule-following behavior (Khan 2016).

S1.3 From the perspective of this Report, replicating these reforms may be ineffective if approaches do not also tackle the underlying reasons why they are not performing their intended function: credible commitment of those in power not to abuse that power for private gain. These underlying reasons are related to systemic features in the policy arena such as entrenched power structures or social norms. Consequently, corruption is less about individual transactions and more about networks of actors (Schmidt 2016). Thus changes in formal rules and anti-corruption strategies are only likely to be effectively enforced when they are aligned with the interests of powerful actors in a country and are able to trigger broader changes in social expectations.

Corruption and social order: Is corruption inescapable?

S1.4 The first step in rethinking corruption is to recognize that corruption is not a social “malady” or “disease” to be eradicated, but rather a built-in feature of governance interactions. Countries today are on a continuum of governance between a system in which rules are applied by virtue of personal status, and one in which they are applied impersonally. Unfortunately, presuming that a particularistic system is the exception and an impersonal system is the norm is not historically accurate. In fact, the public-private separation in public affairs and the complete autonomy of state from private interests are relatively recent. All societies start from being “owned” by a few individuals who control all resources. As states develop historically, individual autonomy grows, but so do the material resources available for spoiling. (Mungiu-Pippidi 2016)

S1.5 In less developed societies, powerful groups are fewer in number and less dependent on competitiveness and market transactions for their revenues. They can feasibly interact with each other in informal or deals-based ways and generate rents through political connections. If the most powerful groups in a country do not want the enforcement of formal rules, it is unlikely that the rule of law will emerge through enforcement efforts from above. Policymakers and political parties

in these countries may only be able to raise significant revenues in informal and deals-based ways as powerful groups prevent formal rules to raise taxation from being implemented. As a result, the most feasible way of rewarding their supporters for political parties is to allow them to violate rules. For example, when parties buy political support in exchange of jobs in the public sector they hold supporters accountable for their political success in the voting booth not for their performance on the job. In general it is difficult for political leaders to exercise ‘political will’ to enforce rules when their tenure depends on doing otherwise (Khan 2016). If the demand for control of corruption is poor because spoils are used efficiently to buy off certain strategic groups, then collective action becomes impossible to achieve and the equilibrium remains with particularism as the norm.

S1.6 Countries become more advanced when they have a more diverse set of productive organizations in different sectors and activities. As the economy becomes more productive, corruption become more costly as it restricts the functioning of the market. Business elites have an increasing interest in the enforcement of the formal rules required to conduct complex business and transactions as they pay more taxes, fund political parties, and employ more people (Khan, 2016). Moreover, as countries develop, emergent socioeconomic classes can strengthen coalitions to demand better governance. In particular, larger middle classes have historically played an important role in pressuring governments to deliver better public services, such as education and health care. These forces are illustrated by the shift of the political system in the United States away from patronage toward meritocracy in the 19th century (Fukuyama 2014). As economic development advanced in the nation, the emerging industrial urban elites began demanding more efficient government services. Moreover, the business elites found an ally against corruption in a newly emerging civil society, with a better-educated middle class. When the newly elected president James A. Garfield was assassinated in 1881 by a would-be office seeker, this coalition of new social groups was ready to mobilize and the Pendleton Act (which established the principle that public officials should be chosen on the basis of merit) was passed by Congress.

S1.7 As incentives of powerful actors change throughout the process of development, this can feed back into changing social norms which reinforce existing dynamics of corruption. In this sense corruption can become an equilibrium, as corrupt systems make it very costly for individuals to behave honestly. For example, if the majority of government bureaucrats favors their in-group or takes bribes individuals who do not do so will be criticized by their in-group and lose out on an often indispensable source of additional income. Thus, entrenched corruption may lead to a higher tolerance for corrupt behavior. Because governance interventions not only affect development outcomes, but development outcomes also affect governance constraints one is confronted with a complex, coevolutionary transition process that does not follow a predictable path and requires continuous adaptive interventions.

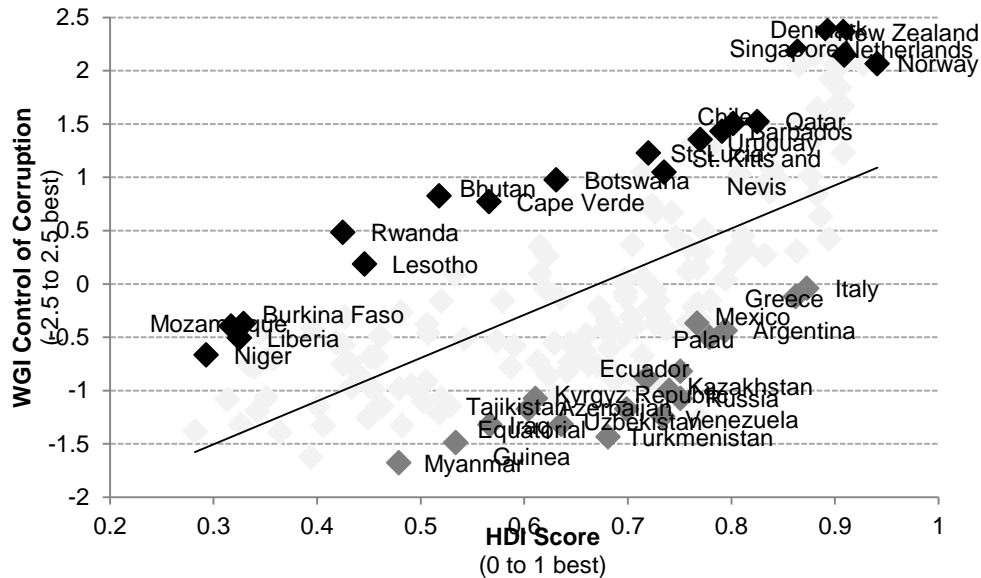
What can be done?

S1.8 While development progress plays an important role in reducing corruption by redistributing power and changing norms in the policy arena, development only explains about half the variation in control of corruption (Mungiu-Pippidi 2015). A large sample of countries shows how some countries overperform and others underperform in their expected levels of controlling corruption, given their levels of development as measured by the Human Development Index (figure S1.1). This heterogeneity in progress suggests that reform is possible, even in countries with lower levels of development. In contexts where levels of development and political

arrangements do not yet allow the effective enforcement of formal rules, anti-corruption strategies should sequentially attack corruption at critical points where anti-corruption is both feasible and has a high impact on development.

Figure S1.1 Development accounts for only about half the variation in control of corruption

Predicted control of corruption scores based on Human Development Scores



Source: Mungiu-Pippid 2015.

Note: Dots show the values for the Control of Corruption indicator (World Bank) and the Human Development Index (United Nation Development Program). Only outliers are shown.

HDI = Human Development Index; WGI = [World Governance Indicators].

S1.9 The anti-corruption priorities will depend on the country and the sectors and processes that are most important for accelerating development progress. A common error is to equate the impact of corruption with the magnitude of bribes. An activity with relatively small bribes can have a high development impact, for instance if bribes prevent the enforcement of regulations on food adulteration. Other activities with significant bribes may be profit-sharing transfers to politicians with a lower impact on development if the corruption does not distort policy. The high-impact anti-corruption approach therefore has to assess anti-corruption priorities but it also has to be feasible. It has to assess if strategies can be designed to make enforcement easier by aligning with the interests of important stakeholders, or developing new coalitions (Khan 2016).

S1.10 While this way of looking at corruption control does not allow for rigid, straightforward policy prescriptions, it is possible to identify a series of key strategies in countries that have managed to get make progress in controlling corruption in recent times. In order to reduce corruption reform coalitions will need to change incentives to limit the payoff of corrupt officials through increased accountability of elites and enhancing contestability by engaging actors in civil society and the media. One particularly promising avenue of action is to take advantage of technology. Digitalization helps transparency and rationalization of fiscal management on the

government side, and creates empowered citizens on the society side. Internet media in general and social networks in particular are now indispensable components of citizen empowerment and collective action.

S1.11 International actors, such aid donors, also play a key role in local fight against corruption and should take care that they do not increase resources for corruption themselves. Meaningful international anticorruption efforts should coordinate and engage with actors outside the state, including local communities, nongovernmental organizations (NGOs), and multinational businesses to support domestic anticorruption reforms through tools such as the provision of information (reform evaluations and cross-country data) or legal mechanisms (international treaties and arbitration) (Rose-Ackerman 2016).

* * *

This spotlight is based on special contributions to the WDR 2017 from Alina Mungiu-Pippidi, Mushtaq H. Khan, and Martin Schmidt.

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Spotlight 2 Managing risk in the face of a changing climate

S2.1 Tackling environmental and sustainability challenges effectively depends on the availability of commitment mechanisms society can devise to address natural hazards once they are realized and to protect the environment and resources for future generations, who are not represented in the policy arena. When it comes to natural resources—and its links to risk management—cooperation is also challenging, as opportunistic overexploitation of resources presents itself as the norm in many societies.

What is an acceptable level risk?

S2.2 Many natural risks are systemic—and therefore collective—by nature, and governments play a key role in the management of such risks (WDR 2014). For example, individuals cannot protect themselves against floods independently, and thus must rely on what is put in place at the collective level. This is particularly the case in high density population areas with geographically concentrated (agglomerated) infrastructure. Despite regular claims that “disasters are unacceptable,” removing all risks would be prohibitively costly. Thus a certain amount of risk must be accepted. Deciding the acceptable level of risk which individuals must bear needs to be made through a collective political process. What risks are mitigated through markets and what risks –and whose risks—are dealt with through public action is thus a governance-related decision.

S2.3 In *The Great Risk Shift*, Jacob Hacker showed in 2006 that a larger share of economic risks were borne by US households compared to the 1970s and 1980s, increasing their vulnerability with respect to shocks such as health, unemployment and retirement. In Western European countries, on the other hand, there is a tendency for governments to bear some of the risks and protect households from shocks, which also has implications for the fiscal sustainability of that social contract, particularly due to current demographic trends (World Bank, 2016).

S2.4 Defining an acceptable level of risk is difficult because of the complexity of the process for determining its distribution and because of the wide differences in preferences, values, and beliefs. Some individuals are more risk averse than others and may prefer a more cautionary approach. Defining a social level of acceptable risk is also difficult because of differences in sensitivity—for instance, people have very different sensitivity to local air pollution. In the presence of such heterogeneity, designing homogenous regulations is challenging and highly dependent on considerations of equity (especially when sensitivity is correlated with other social factors). The selected regulation is also unlikely to satisfy all individuals and may require compensatory action, which requires a process to decide who deserves compensation and ensure that compensation is proportional to the losses and does not create long-term irreversible costs.

Allocating risk: Across households and over time

S2.5 When risks are borne by households, existing inequities can be manifested and reinforced. For example, when a big snow storm in the Washington DC area leaves many roads blocked and public transportation disrupted for two weeks, the option of removing the snow in order to get to work is open only for those who can afford to pay for it. Less well-off people are left not only unable to move, but also unable to generate income because of the lack of mobility, deepening the effects of the shock on their welfare.

S2.6 Risk is distributed not only across households but also over time. Even more complicated are cases which involve situations where the benefit from risk management extends over the very long term. For example, in the case climate change the beneficiaries are not even born yet to protect their interests. Dispersed—or unrepresented—interests represent a classic issue leading to government failures.

Disperse benefits and political will

S2.7 Even when an acceptable level and allocation of risk is agreed upon, politicians may be reluctant to devote financial and political capital to risk management efforts because the costs tend to be immediate, concentrated, and observable, while the benefits are longer term, distributed more broadly, and often less visible. For example, when prohibiting development in flood-zones, decision-makers impose a cost on landowners who will naturally tend to oppose this new regulatory constraint. On the other hand, the people protected by the regulation—e.g., future buyers of apartments in the newly developed flood-prone areas—are often not aware that the regulation may eventually protect them and therefore rarely take action to support it.

S2.8 In order to garner political support, policy packages need to be socially acceptable, and thus consistent with a country's social objectives, such as protecting the poor. What does this mean in practice for designing policies which are more likely to succeed? Consider the case of countries seeking to adopt climate change policies. While the poor are expected to benefit in the long run from mitigation policies, given that they are the most vulnerable to climate change, climate policies are necessarily pro-poor in the short run. It is therefore critical to use the savings or new proceeds generated by climate policies to compensate poor people, promote poverty reduction, and boost safety nets. One way to do that is by recycling revenue from carbon pricing instruments through tax cuts and increasing transfers to the population. A modeling exercise carried out using data from developing countries shows that taking \$100 away from fossil-fuel subsidies and redistributing the money equally throughout the population would on average transfer \$13 to the bottom quintile and take away \$23 from the top quintile. Redistribution has been shown to significantly increase the odds of reforms succeeding. A review of reforms in the Middle East and North Africa classifies all reforms with cash and in-kind transfers as successful, as opposed to only 17 percent of the cases without (Sdravovich and others 2014).

S2.9 Moreover, in order for reforms to succeed the incentives in the policy arena need to be aligned in such a way that commitment to long term objective can be credible. Returning to the example of climate change policies, consider the role of carbon pricing. Carbon prices are critical for the efficiency of the transition toward the zero carbon emission economy that is required to stabilize climate change. However, a carbon price alone is unlikely to provide enough incentive to invest in new, radically-different technologies or to change long-term investment, because the long-term price signal is hardly predictable and credible. Given the expected lifetime of power plants, a credible carbon price pathway would need to be announced at least three decades in advance to spur the optimal amount of investment in low-carbon power plants. But doing so is difficult, because governments have a very limited ability to commit over such long periods (Brunner, Flachslund, and Marschinski 2012; Helm, Hepburn, and Mash 2003). Thus, to reduce emissions through investments with long-term consequences (such as infrastructure, R&D, and long-lived capital), additional regulations, norms, or direct investments are needed. Policy makers could for instance kick-start the transition either by temporarily supporting investments in low-

carbon technologies (Acemoglu and others 2012) or by imposing additional regulations or performance standards (Rozenberg and others 2014).

S2.10 The lack of well-accepted indicators for risk makes it difficult to measure the performance of decision makers and to make them accountable for their choices in terms of risk management. However, evidence from environmental issues like asbestos, lead paint and tobacco shows that increasing transparency and providing a voice to dispersed interests help avoid capture by interest groups and improve policy decisions. Contributing factors, such as when civil society organizations are able to develop independent expertise and free communicate their conclusions through the media, internet, and social networks as well as when there is free access to data and some legal protection for whistleblowers, can help to strengthen the effectiveness of risk management policies.

* * *

Source: Prepared for WDR 2017 by Stephane Hallegatte, based on World Development Report 2014 on “Risk and Opportunity” and “Decarbonizing Development” (Fay et al. 2015).

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Chapter 3 The role of law

Law and the policy arena

3.1 Long before the Code of Hammurabi set the law for ancient Mesopotamia, people subjected themselves—sometimes by cooperative agreement, sometimes under threat of force—to rules to enable social and economic activities to be ordered. As societies evolved from closely-knit kinship groups to larger and more diverse communities with more complex activities, the need for ever more formal rules increased (Fukuyama 2010). In modern states, law serves three critical governance roles. It is through law and legal institutions that states seek to *order behavior* of individuals and organizations, so as to convert economic and social policies into outcomes. Law defines the structure of government by *ordering power*, that is, establishing and distributing authority and power among government actors and between the state and citizens. Law also serves to *order contestation*, by providing the substantive and procedural tools to promote accountability, resolve disputes peacefully, and change the rules.

3.2 It has long been established that the *rule of law*, which, at its core requires that government officials and citizens are bound by and act consistently with the law—is the very basis of good governance needed to realize full social and economic potential. Empirical studies have shown the importance of law and legal institutions to improving the functioning of specific institutions, enhancing growth, promoting secure property rights, improving access to credit, and delivering justice in society.¹

3.3 However, as everyday experience makes clear, the mere existence of formal laws by no means leads to their intended effects. In many developing countries, laws on the books are just that; they remain unimplemented, selectively implemented, and sometimes are impossible to implement. Governments may be unable to enact ‘good laws,’ that is, those reflecting first best policy; in other cases ‘good laws’ may lead to bad outcomes. And law itself may be used as a means of perpetuating insecurity, stagnation and inequality. For instance, for decades, South Africa sustained a brutal system of apartheid rooted in law. It has become common for political leaders in illiberal regimes to legitimize nondemocratic rule through changes to the constitution, such as referendums on extending term limits. Every day, actions that exert power over others, such as displacing the poor from their land, detaining dissidents, and denying equal opportunities to women and minorities, are taken within the authority of the law. In well-documented cases, laws intended to secure property rights have served to privilege powerful actors by allowing them to seize land and register it at the expense of rural farmers, or to perpetuate class systems and power relations.²

3.4 But law has a double edge: while law may serve to reinforce prevailing social and economic relations, it can also be a powerful tool of those seeking to resist, challenge, and transform those relations.³ At the local, national and global levels, states, elites, and citizens increasingly turn to law as an important site for bargaining, enshrining and challenging norms, policies and their implementation. By its nature, law is a device that provides a particular language, structure, and

¹ Acemoglu 2003; Besley and Persson 2014; Galiani and Shargdrosky 2010.

² See, for example, Thompson 1975; Lund 2012; Mattei and Nader 2008.

³ Thompson 1975; McCann 2004; Rodriguez-Garavito 2011; Epp 1998.

formality for naming and ordering things, and this characteristic gives it the potential to become a force independent of the initial powers and intentions behind it, even beyond the existence of independent and effective legal institutions. Law is thus simultaneously a product of social and power relations, and a tool for challenging and reshaping those relations. Law can change *incentives* by establishing different payoffs; law can serve as a focal point for coordinating *preferences*; and law can establish procedures and norms that increase the *contestability* of the policy arena.

3.5 Like policy, law does not live in a vacuum. Following the discussion in chapter 2, the nature and effectiveness of laws is primarily endogenous to the dynamics of governance in the policy arena. The ability of law—‘words on paper’—to achieve its aims depends on the extent to which it is backed up by credible commitment so as to coordinate expectations about how others will behave, and to induce cooperation to promote public goods. This ability, in turn, is shaped by the interests of elites and by prevailing social norms.

Law and norms

3.6 The task of defining law has captured the minds of legal scholars, philosophers, and sociologists for centuries. H.L.A. Hart (1961: 1) observed that “few questions concerning human society have been asked with such persistence and answered by serious thinkers in so many diverse, strange and even paradoxical ways as the question “What is law?” Theorists have debated the essence of law for centuries, including the extent to which law refers to custom and social ordering, requires state-backed coercion, and encompasses notions of justice (box 3.1).

Box 3.1 What is law?

Countless theorists have attempted to define law. The answers generally fall into one of three categories, which were initially set forth two millennia ago in the Platonic dialogue *Minos*: law involves principles of justice and right; law is an institutionalized rule system established by governments; law is fundamental customs and usages that order social life. Adherents of the first category are natural lawyers, like Thomas Aquinas, who assert that the defining characteristic of law is its morality, justice, and fairness. Evil legal systems or evil laws are disqualified as law in this view. The second category aligns with H.L.A. Hart and other legal positivists, who base their definition on the existence of a legal system that consists of substantive laws (primary rules), and laws governing how those rules are made (secondary rules), without regard to the justness of the law. Under this approach, evil legal systems count as law, but customary law and international law, which lack centralized enforcement systems, are not considered fully legal. The third category is represented by anthropologists and sociologists like Eugen Ehrlich and Bronislaw Malinowski, who focus on customary law or living law, rejecting the notion that law must consist of an organized legal system, instead recognizing that the central rules that individuals within groups abide by in social intercourse count as law. Three key fault lines run across these conceptions of law: one regarding the normative value of law, the second concerning the systematic form of law, and the third concerning the function of law.

Source: Brian Tamanaha, *Washington University in St. Louis*.

3.7 This Report sidesteps these philosophical debates and uses the term *law* or *formal law* in its most conventional sense to mean positive state law—that is, laws that are officially on the books of a given state—at the national or subnational level, whether they were passed by a legislature, enacted by fiat, or otherwise formalized. Law here means the *de jure* rules. The operation of law requires a *legal system*, composed of *actors* and *processes* whose function it is to make, interpret,

advocate and enforce the law. This includes legislatures, judicial and law enforcement institutions, administrative agencies, as well as the legal profession, advocates and civil society groups.

3.8 In all societies state law is but one of multiple rule systems that order behavior, authority and contestation. These include customary and religious law, cultural and social norms, functional normative systems (rules systems developed for the common pursuit of particular aims such as sports leagues or universities), and economic transactional normative systems (Tamanaha 2008). Such legal and normative pluralism (box 3.2) is neither inherently good nor bad: it can pose challenges, but it can also generate opportunities.

Box 3.2 Legal and normative pluralism

The phenomenon of “legal pluralism”—the coexistence of multiple legal systems within a given community or sociopolitical space—has existed throughout history and continues today in developing and developed countries alike. Modern forms of legal pluralism have their roots in colonialism, through which Western legal systems were created for colonists, while traditional systems were maintained for the indigenous population. That traditional or customary law still dominates social regulation, dispute resolution, and land governance in Africa and other parts of the developing world is well-documented. In some cases, customary law, including a variety of traditional and hybrid institutional forms of dispute resolution, are formally recognized and incorporated into the legal system, such as in Ghana, South Africa, South Sudan, the Republic of Yemen, and several Pacific Islands states. In others, such forms continue to provide the primary means of social ordering and dispute resolution in the absence of access to state systems that are perceived as legitimate and effective, such as in Afghanistan, Liberia, and Somalia. Customary legal systems reflect the dominant (yet evolving, not static) values and power structures of the societies in which they are embedded, and as such are often seen to fall short of basic standards of nondiscrimination, rights, and due process. The extent to which they are considered legitimate and effective by local users is an empirical question and a relative one in light of available alternatives.

A further source of normative pluralism comes from the less visible, but highly influential role of social norms—generally accepted rules of behavior and social attitudes within a given social grouping. A vast literature documents how social norms derived from communal and identity groups, professional associations, business practices, and the like govern the vast majority of human behavior.^a Social norms are a fundamental way of enabling social and economic transactions by coordinating peoples’ expectations about how others will act. Social sanctions, such as shame and loss of reputation, or, in some cases, socially sanctioned violence, are a powerful means of inducing cooperation to prevent what is regarded as antisocial and deviant behavior (Platteau 2000).

Yet another source of normative pluralism is generated by today’s globally interconnected world, in which a multitude of governmental, multilateral and private actors establish and diffuse rules about a wide range of transactions and conduct (see chapter 9). Increasingly, local experiences of law are informed by these broader interactions covering topics such as trade, labor, environment, natural resources, financial institutions, public administration, intellectual property, procurement, utility regulation, and human rights. These can take the form of binding international treaties and contracts (hard law) or voluntary standards and guiding principles (soft law). These rules may reinforce, complement, and/or compete with state law to govern public and private spaces. (Halliday and Shaffer 2015; Braithwaite and Drahos 2000).

^a. Sunstein 1996; Ellickson 1991; Basu 2000; Posner 2000; Dixit 2004.

3.9 Plural normative systems can complement state laws by providing order where state institutions are not accessible, by alleviating the burden on state institutions or by enabling diversity of preferences. For example, informal mediation of land disputes by community authorities, customary or religious determination of personal and family matters, and arbitration of contract disputes by business associations complement the state legal system in many countries. In some cases, multiple rule systems can create confusion, undermine order and may lead to perverse outcomes. This occurs when people can no longer rely on the expectation that people will

act in accordance with a certain set of rules (Basu 2000). In West Africa, violent communal land conflict is 200 percent to 350 percent more likely where there are competing legal authorities because the lack of certainty reduces incentives to solve disputes peacefully (Eck 2014). Where formal state laws differ sharply from the content of other prevailing social norms and rule systems, they are less likely to be obeyed and may undermine trust in the state (Isser 2011).

3.10 Pluralism can also enable constructive pathways to development outcomes most importantly by enabling contestation and shaping of preferences. Throughout history, social entrepreneurs and clever intermediaries have proven to be deft at opportunistically selecting from among legal and normative claims and authorities to advance their aims.⁴ Thus, legal pluralism can serve to expand the languages and sites in which contests over power are made. In India's Gujarat and Uttar Pradesh states, advocate groups established informal *nari adalat* (women's courts) to provide an alternative legal avenue for women in situations of domestic violence. These courts enabled women to draw on community norms, state law and international human rights to contest unequal power relations and to shape emerging norms.⁵

3.11 The interaction of law, norms, and power is fundamental to understanding how law works to underlie persistence or change in the dynamics of the policy arena across its three core roles, to which we now turn.

Ordering behavior (the command role of law)

3.12 In this role, law is an instrument of policy. It is the means by which government codifies rules about how individuals and firms are to behave so as to achieve economic and social policy outcomes, including in the criminal, civil, and regulatory domains. What makes these laws—essentially words on paper—lead to the expected outcomes, or not? How do laws interact with power, norms, and capacity to create incentives, change preferences, and generate legitimacy? This section will draw on legal, sociological, and economic scholarship to look at three interrelated ways that law serves to induce particular behavior, and why these may fail. These are the *coercive power of law*; *the coordination power of law*, and *the legitimating power of law*. While operating with distinct logics, these three mechanisms rarely work alone but rather in combined ways that interact with power, norms and capacity to provide commitment and collective action needed to produce results.

⁴ See, for example, Benton 2001; Belmessous 2011; Yannakakis 2015.

⁵ Merry 2012.

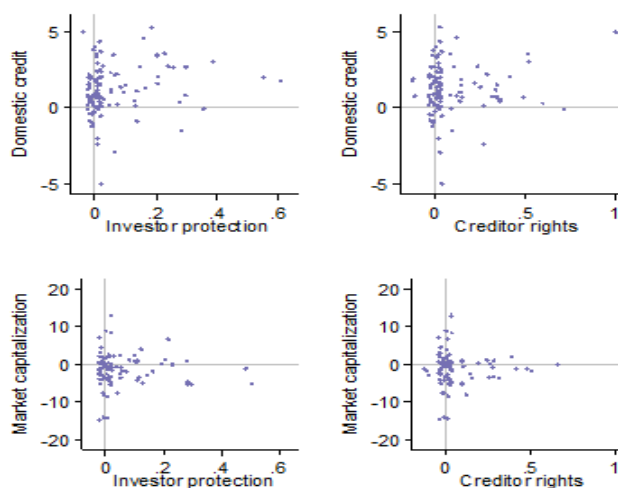
Box 3.3 Legal origins: Theory and practice

One of the most influential explanations of why some countries have legal systems that support more dynamic market economies than others is the Legal Origins Theory put forward by La Porta, Lopez-de-Silanes and Shleifer (1998, 2008, 2013). The theory posits that countries that inherited a common law rather than civil law system from their colonial occupiers have stronger investor and creditor rights, lower legal formalism, more efficiency of contract and debt enforcement and higher judicial independence. This is attributed to the strong role of private property as well as the adaptability of the case law system that characterize British common law.

The Legal Origins Theory sparked a significant effort to reform laws and regulations to imitate common law rules (Besley 2015). Yet, empirical analysis shows that there is no clear relationship between changes in legal rules and changes in economic outcomes, reinforcing the idea that changes in the form of laws do not necessarily changed the way the systems function. This is further backed by evidence finding only weak correlations between changes in Doing Business indicators and firm level enterprise surveys. (Hallward-Driemeier and Pritchett 2011). Additionally, the degree of legal convergence also takes place through the application and interpretation of law, making the differences based on legal traditions less clear. Indeed, recent work argues that the common law does not generally lead to legal outcomes superior to those provided by the French civil law, empirically, when precolonial population density and/or settler mortality are high. Additionally, it is found that the form of colonial rule in British colonies mediates between precolonial endowments and postcolonial legal outcomes (Oto-Peralias and Romero-Avila, 2014).

Figure B3.3.1 Changes in investor protection and creditor rights have little impact on financial outcomes

Changes in legal indexes versus changes in financial indicators



Source: WDR 2017 team with data from Oto-Peralias and Romero-Avila (2017), background paper for WDR 2017.

Note: Domestic credit to the private sector by banks and market capitalization of listed domestic companies expressed as the percentage of GDP.

These findings are in line with this Report's argument that the effect of laws and policies is endogenous to governance dynamics. The extent to which particular laws are able to facilitate commitment and collective action in light of existing power, capacity and norm constraints is far more predictive of economic outcomes than the content of the rules themselves. As critics of the Legal Origin Theory have argued, the manner in which legal systems were transplanted and adapted over time—that is, whether colonial law became embedded in and responsive to local context and demand or remained superficial—is more indicative of any path dependencies than the origin of the law. (Oto-Peralías and Romero-Ávila 2014; Berkowitz, Pistor, and Richard 2003).

Source: WDR 2017 team, based on Daniel Oto-Peralias and Diego Romero-Avila, "Legal Reforms and Economic Performance: Revisiting the Evidence," background paper for WDR 2017.

The coercive power of law: Incentivizing behavior change through coercion/sanctions

3.13 Perhaps the most conventional reason that people obey the law is out of fear of sanction.⁶ If people, acting according to their narrow self-interest, would not behave in the socially desirable way, sanctions can be used to induce cooperation by changing incentives. Another way of explaining this is to say that the coercive power of law shapes the options available to people by making some actions unfeasible or just too costly. The traditional law and economics approach uses a cost-benefit analysis: people will obey the law as long as the costs of being caught (factoring in the likelihood of being caught) are higher than compliance. Thus, state bureaucrats will refrain from accepting bribes if the cost and likelihood of being caught are higher than the benefit of accepting the bribe. Manufacturing companies will comply with environmental regulations if there is a high likelihood of being fined an amount greater than their profit margin gained from noncompliance. Families can be induced to send their girl children to school if the consequence of noncompliance is sufficiently severe. The converse holds true as well, as in the case of a law that generates a credible reward for compliance—for example, a law requiring people to register for an identity card in order to get access to welfare benefits. In the case of a state entity, compliance with the regulations of the European Union, World Trade Organization, or the World Bank Group depends on the belief that the rewards of membership will outweigh the alternative.

3.14 The coercive power of law depends on the existence of a credible threat of being caught and punished, or a credible commitment to obtaining the reward for compliance. This requires three conditions. First, the state needs the technical, physical, and human *capacity* to carry through with consistency. Second, the law must provide strong enough incentives to overcome the gains from noncompliance (taking into account that many people may not exhibit “rational behavior” (World Bank, WDR 2015), as well as adherence to any alternative conflicting *normative* order. Third, the law needs to be in line with the incentives of those with enough *power* to obstruct implementation, so they will go along with it (unless truly effective restraints on such power exist). Together, these conditions will create a credible commitment so as to induce rational compliance. Basu (2015) argues that the existence of the law itself does not change the payoff, but rather serves to coordinate people’s beliefs and expectations about what the others—fellow citizens and the officials who implement and enforce the law—will do.⁷

3.15 Take, for example, a law prohibiting bribery. First people need to believe that the state has the capacity to detect and punish those engaged in the practice, meaning it needs effective administrative and law enforcement institutions. Even if the state does not have adequate reach to detect violations everywhere, it could be aided by private enforcement to the extent the law (in combination with a broader range of related laws) incentivizes whistleblowing by those in a position to do so. And finally, the sanction for violation must leave the perpetrator worse off than any benefits from engaging in bribery. Getting this formula right is complicated and costly. For example, too low a sanction will be absorbed as part of the cost of doing business, while too high a sanction for the behavior of potential whistle blowers will reduce the number of people who will engage in private enforcement.⁸

⁶ See Schauer (2015) for an extensive argument about the importance of the role of force in law.

⁷ See also Mailath, Morris, and Postlewaite 2001.

⁸ Quoted in d’Iribane and Henry 2015. See Acemoglu and Jackson 2014; for a debate on legalizing bribe-giving, see Basu 2011 and Dufwenberg and Spagnolo 2014.

3.16 But even with the “right formula,” the law must contend with powerful interests; to the extent they benefit from bribery, enforcement will likely be blocked, or in any case, not consistent or credible. Norms may also compete in ways that undermine implementation. Several studies have looked at the effect of “practical norms” or “culture” on the impact of laws. Laws establishing meritocratic civil service have gone unimplemented in Cameroon and Niger because of an overpowering norm that people should not be sanctioned for breaking the rules unless it is an egregious violation. The importance of social networks and neo-patrimonial logic also undercuts the willingness of officials to sanction workers. As Olivier de Sardan (2015: 3) notes, “[t]he gap between official rules and actual behavior is, per hypothesis, not a space where norms are forgotten or missing, but a space where alternative norms are in use.”⁹

3.17 Competing normative orders can lead to perverse effects. Rigorous prosecution of domestic violence in Timor-Leste during the time of the United Nations administration resulted in a significant reduction in the reporting of domestic violence because of the devastating social stigma and economic consequences for women (Chopra, Ranheim, and Nixon 2011). Similarly, stricter mandatory arrest laws for crimes related to domestic violence in the United States were found to be associated with higher murder rates of intimate partners because reporting to the police of episodes of escalating violence decreased (Iyengar 2009; Goldfarb 2013). In India, a recent law providing the death penalty for convicted rapists is expected to have similar effects because of the heightened pressure faced by women not to report the rape (Pande 2015). India has had strong laws on the books prohibiting a range of gender-based violence, including child marriage, sex selective abortion, dowry payment, and domestic violence, but these have barely made a dent in behavior, as the social sanctions associated with abandoning customary practice to follow the law are far stronger (Pistor, Holder, and Amirapu 2010). Here the norm is likely operating at several levels. It undercuts the incentive created by the legal sanction, and it also likely undermines credible commitment, as powerful interests (and individuals in the legal institutions) may also adhere to such norms.

3.18 Social norms that are not based on deep rooted attitudes can also serve to undercut the intended outcome of a law. As Ellickson (1991) famously documented in a study called *Law without Order*, laws that conflicted with the social norms developed to regulate cattle herding in a California county confused cattlemen and led to increased conflict. A law introduced by the British in colonial India allowing agricultural lenders to enforce debts in court was intended to make credit markets more competitive to the benefit of farmers. However, in practice, the law had the opposite effect, as it undercut the incentives that lenders had under an informal enforcement regime to lend at favorable interest rates (Kranton and Swamy 1998).

3.19 An effective system of legal compliance based on sanctions is therefore quite difficult to achieve. It requires significant investment in capacity and infrastructure, and careful analysis of the types of incentives most likely to work. However, even those measures will not suffice in the face of power and norm constraints. These considerations lead to the second and third mechanisms through which law affects behavior, which do not rely on force.

⁹ See also d'Iribane and Henry 2015.

The coordination power of law: A focal point for change

3.20 The second way that law leads to outcomes is by serving as a focal point to coordinate behavior. This is also known as the expressive power of law (Cooter 1998; McAdams 2015). Here law acts as a sign post—an expression—to guide people as to how to act when they have several options, or, in economic terms, when there are multiple equilibria (Basu 2015; McAdams 2015). People comply with the law because doing so facilitates social and economic activities.

3.21 The easy case is when law establishes rules about a neutral activity, to which citizens have no particular normative attachments. Thus, when the law mandates driving on the right or the left side of the road, people generally comply, not because they fear punishment, but because it facilitates road safety. The harder question is whether law in its expressive role can coordinate behavior around more highly charged issues, where alternative norms and preferences are strong. In such cases the law would need to shift norms and preferences away from alternative options in such a way that the law becomes the salient focal point.

3.22 Consider the astonishing success of the ban on smoking in public places in many parts of the world even in the absence of rigorous state enforcement. Here scholars have demonstrated that the law served to empower those who adhered to its substantive point—nonsmokers—to pressure smokers to refrain. In a short period of time, this shifted societal norms so that the wrong of smoking in public places became internalized (McAdams 2015). In other words, the law served to change the balance of power and norms in the policy implementation arena by legitimizing the claims of some over others. Cass Sunstein (1996) explains this phenomenon as a *norm bandwagon*—when the lowered cost of new norms leads an increasing number of people to reject old norms until a tipping point is reached, at which the old norm elicits social disapproval.

3.23 For this process to work, a critical mass of supporters of the new norm is needed, who are able to engage in collective action to push toward the tipping point. “When there are contestations in local norms, formal law can strengthen the stance of those whose norms are most closely aligned with the legal rule” (Shell-Duncan and others 2013). The more deeply held the old norm, and more weak the supporting coalition for the new norm, the more care is needed to introduce a new norm through law, so that it does not backfire. Gradual or partial enforcement, coupled with education, awareness, and coaxing campaigns, allow time for norms to shift. (Acemoglu and Jackson 2016). This process of norm shifting has been analyzed and documented by legal anthropologists as a process of “translation” or “vernacularization” involving intermediaries who act as bridges between the world of formal law and the real experiences of local people (Merry 2006).

3.24 For instance, the introduction of an inheritance law in Ghana that was not in line with customary systems resulted in slow evolution of custom and social change. The formal law was not enforced through coercion, but rather served as a “magnet” to provide people with an alternative to custom (Aldashev and others 2012). Similarly, legal prohibition of female genital mutilation in Senegal provided an “enabling environment” for those who wished to abandon the practice. Together with a robust education and awareness campaign, it shifted more people to this category. However, among those who adhered strongly to the practice, the fear of prosecution (even though not a sanction carried out) drove the practice underground, seriously impairing the health of some young women. (Shell-Duncan and others 2013).

3.25 This is not to overstate the expressive power of law. Law does not do the work of norm shifting by itself, but rather depends on the incentives it provides to those who already accept the new law, as well as a range of support programs that drive the process of internalizing the new norm more broadly. While rigorous enforcement can backfire, sometimes enforcement is needed to kick-start the process of norm shifting and internalization. For example, the first term in which a constitutional amendment was implemented that mandated gender quotas in village councils in India, voter attitudes to women were generally negative. After two terms of repeated exposure to women candidates, however, men's perceptions about the ability of women to be leaders significantly improved (Beaman and others 2009). Aspirations of parents and their adolescent daughters for education were positively affected (Beaman and others 2012), and women's entrepreneurship in the manufacturing sector increased (Ghani and others 2014). In the United States, racial desegregation laws required significant coercive force to implement in the face of mass and even violent resistance, but over time they contributed to internalizing the norm change (Schauer 2015).

3.26 One way in which development affects governance is by changing norms. Certain norms are more responsive to a higher level of development. The introduction and effectiveness of child labor regulations has been shown to be related to income levels; as households rely less on children's incomes, the impact of formal regulations increases (Basu 1999). In India, however, child labor regulations led to a decline in child wages and a shift to greater child labor among poorer families (Bharadwaj and Lkdawala 2013). Some norms are much more persistent and less responsive to change, such as those founded on some religious or philosophical principles.

The legitimizing power of law: Creating a culture of compliance

3.27 While sanctions can be used to control deviant behavior, and law can, under the right conditions, gradually shift certain norms, these are extremely costly and ad hoc ways of inducing behavior change. Ultimately a culture of voluntary compliance with the law depends on its legitimacy. Scholars point to two kinds of legitimacy. *Substantive legitimacy* refers to a situation where the content of the law reflects people's own social norms and views of morality. In such cases, law is largely irrelevant, as people would comply for reasons independent of the existence of the law. While the threat of sanctions lurks in the background, it is primarily there to handle the exceptional cases of deviance (Schauer 2015).

3.28 In heterogeneous societies, substantive legitimacy requires the law to strike a balance between recognizing differences in world views while enabling society to function as a cohesive entity (Singer 2006). Thus, debates over how states formally take account of religious law or customary law are deeply political issues, with significant implications for legitimacy. For example, in Bolivia, Colombia, and Ecuador, constitutional recognition of communal rights and indigenous law was critical in expanding state legitimacy through a sense of shared citizenship (Yashar 2005). Formal incorporation of Islamic law is at the heart of contests to define national identity in states and regions with large Muslim populations from Libya to Mindanao. And official recognition of forms of traditional or customary law remains an important issue in defining state-citizen relations in much of Sub-Saharan Africa.

3.29 *Procedural legitimacy* refers to a situation in which law is respected and observed to the extent it emerges from a system deemed fair and trustworthy. Max Weber argued that rational legal

authority (in contrast to traditional or charismatic authority) depends on society's belief in the legitimacy of the order. In his seminal study, Tom Tyler offers empirical support for the argument that people obey the law for reasons other than for fear of punishment when they believe the laws are the product of a system they believe legitimate. Legitimacy here refers to procedural regularity, opportunity for citizen input, and the respectful treatment of citizens by those in authority (Tyler 2006) what this Report refers to as *contestability*. These findings were confirmed in a study of cross-country survey data in Africa. People's compliance with the law was found to be related to their normative judgment about the legitimacy of government, based on assessments of government competence and performance, but particularly on perceptions that government is procedurally just (Levi, Tyler, and Sacks 2012).

3.30 Transplanting laws from one country to another has often failed in the absence of a process of adaptation and contestability. Based on an econometric study of 49 countries that were recipients of foreign law, Berkowitz, Pistor, and Richard (2003) found that countries that have adapted the transplanted law to meet their particular socioeconomic conditions, or had a population that was already familiar with basic principles of the transplanted law, or both, have more effective legality than countries that received foreign law without any similar predispositions. Similarly, legal transplants in the context of integration into the European Union were more successful to the extent that they were accompanied by efforts to empower a variety of domestic state and nonstate actors through multiple methods of assistance and monitoring, and their ability to merge monitoring and learning at both the national and supranational levels (Bruszt and McDermott 2014). By contrast, the transplantation of judicial reform and anticorruption laws into parts of southeastern Europe, which bypassed legislative processes and other forms of adaptation, did not produce the desired effects (Mendelski 2015).

Ordering power (the constitutive role of law)

Rules about making rules

3.31 In this second role, law plays the more foundational constitutive role of defining the de jure governance process. It is through law—generally constitutions¹⁰—that states establish and confer power to state actors, defining the authorities and responsibilities of different agencies and branches of government and their role in the policy-making and implementation process, as well as formal constraints on their power.¹¹ This is typically done through provisions that set out a range of checks and balances, including through horizontal allocation and separation of powers between different branches; by requiring special procedures for amendment; the establishment of independent supervisory and review bodies; and increasingly, bills of rights. These formal de jure arrangements, as modified by informal and de facto arrangements, are what establish the nature of the policy bargaining arena. In this way, constitutions are effectively rules about making rules. This section addresses the question of why and when the formal rules in fact determine the

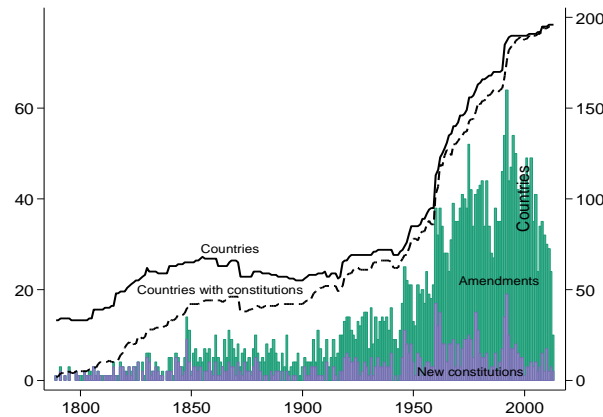
¹⁰ Constitutions are certainly not the only instrument that set out rules about power, but they are the most visible ones and the most systematically studied. A range of other laws that confer authority and define responsibilities and limitations on power, such as local governance laws and enabling laws for various state agencies, are also relevant.

¹¹ Acuña and Tommasi (1999) propose a similar classification of rules applied at a more practical level (policies, organizational forms, rules about making rules).

allocation and limits on power, or when they act only as ‘parchment barriers,’ and what other roles constitutive laws play in shaping the dynamics of governance.

Figure 3.1 Constitutions have become ubiquitous, but are often replaced or amended

Number of countries with constitutions and constitutional events, 1789–2013



Source: WDR 2017 team with data from Comparative Constitutional Project 2015.

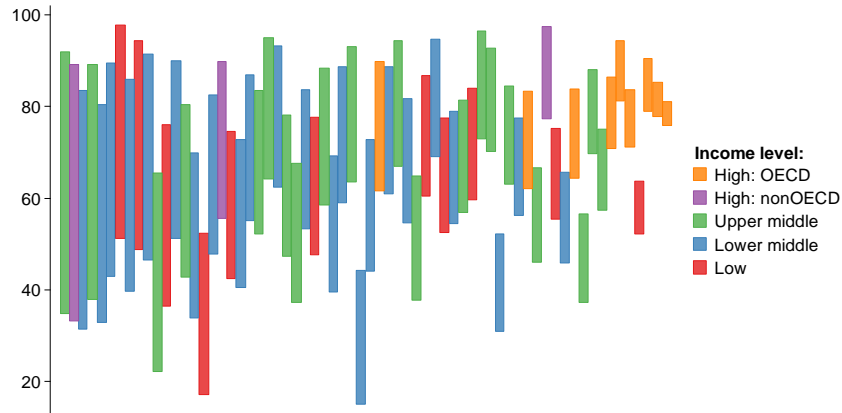
3.32 Constitutions are proliferating (see figure 3.1). The increase corresponds to both an increase in the number of independent states as well as the mass transition of Central and Eastern European countries in the post-Soviet era. It also reflects the fact that constitutions are generally short lived. The average life span of a constitution is 19 years, and in Latin America and Eastern Europe, it is a mere 8 years (Elkins, Ginsburg, and Melton 2009; Negretto 2008). Constitutions are thus an important site of political bargaining and ordering, with significant energies invested in designing and adopting them. This is true across all types of political regimes (Ginsburg and Simpser 2014).

3.33 Yet their effectiveness in constraining power through rules is mixed, leading to two kinds of governance failures. The first—as reflected in their short life span—is when the bargain itself fails. The second is when the words on paper persist, but the rules are ignored in the face of power and deal making. In the former case, the result could be positive, to the extent that it leads to a new, more stable bargain. But it could also be detrimental to development outcomes if conflict ensues, and if chronic failure undermines the credible commitments needed to support investment and pro-poor policies. Empirical evidence regarding the extent to which constitutional endurance matters is mixed. Elkins, Ginsburg, and Melton (2009) demonstrate significant associations between longer-lived constitutions and various social and political goods, including protection of rights, democracy, wealth, and stability, but establishing causality is problematic. In any event, the entrenchment of fundamental principles and its positive impact on credible commitment and coordination generally strengthens as constitutions age.

3.34 The second type of failure—widespread divergence between constitutional limitations on power and actual practice—is more directly associated with poorer development outcomes (see figure 3.2). As will be explored in chapters 5 and 6, failure to uphold security of property rights and basic civil, political, and economic rights has negative impacts on both growth and equity. More generally, failure to enforce rule-based limits on power skews the bargaining process in favor of elite interests. Nonetheless, divergence from the rules may also represent an important means

of holding together elite bargains. To understand what accounts for divergence between the rules and practice, it is helpful to first examine the conditions under which rules stick.

Figure 3.2 In every country, there is a gap between laws on the books and the laws implemented, but high-income OECD countries generally do better than low- and middle-income countries



Source: WDR 2017 team with data from WDI 2015 and Global Integrity 2012.

Note: Global Integrity’s legal index measures the quality of laws “on the books” in six categories: nongovernmental organizations, public information and media; elections; government conflict of interests, safeguards and checks and balances; public administration and professionalism; government oversight and controls; anticorruption legal framework, judicial impartiality, and law enforcement professionalism. The implementation index measures actual practice. The implementation gap is the difference between the two indexes, and thus the length of the bar.

Constitutions as a commitment and coordination device

3.35 Why would rulers adhere to constitutional rules on the limits of power? Unlike regular laws that have organized institutions of enforcement, constitutions pose the ultimate question of who guards the guardians.¹² The answer is that effective constitutions need to be self-enforcing. Constitutions are essentially bargains among major interest groups about how to allocate power. As long as these groups feel that they are better off with the rules than without them, the rules will stick. Thus an effective constitution establishes an equilibrium by addressing problems of coordination and commitment (Weingast 2005). Constitutions facilitate elite cohesion by coordinating what institutions play which role, thereby minimizing costs of renegotiation and conflict. The so-called “entrenchment of provisions,” requiring a high standard for change in the form of amendment, provides credibility over time by guarding against shifts in preference, thus enhancing the credibility of commitments (Ginsburg 2009; Ginsburg and Simpsen 2013). Once entrenched, the rules become “sticky” as institutionalized arrangements develop around them, and it is far less easy for major interest groups to exit if they become unhappy with the allocation of power. Significantly, constitutions also serve as a coordinating device to enable collective action by citizens in the event of transgression by those in power.

3.36 Analysis of a dataset of every constitution since 1789 finds that enduring constitutions generally have certain common characteristics. They need to be sufficiently inclusive to give

¹² Regular laws are also plagued by this same question. It is for this reason that Basu (2015) emphasizes that laws work only to the extent that they establish credible expectations about what others will do.

potential spoilers an adequate payoff for staying inside the bargain. (How to do so is explored further in chapter 4). They need to be flexible and adaptive so as to be resilient in the face of shocks that can change the balance of power among interest groups. And the degree of specificity also appears to correlate positively with endurance, perhaps because it reduces the scope for subsequent disagreement and requires more investment in negotiation, giving people a bigger stake in success. (Elkins, Ginsburg, and Melton 2009). They are more effective in facilitating monitoring and information, so as to enable citizen collective action for enforcement.

3.37 This latter point relates to the way that constitutions act as a focal point. Even when there is little intention to adhere to constitutional provisions—as in the case where constraints on power and rights are adopted as aspirational or rhetorical appeasement—the words on paper can matter to the extent that they enable collective action. This is particularly important during times of conflict among elites, where constitutions can serve as devices of horizontal accountability. Thus, for example, Tunisia’s adoption of international human rights treaties by the prior regime was largely seen as an empty gesture. Yet during the transition, these provisions were seized upon by opposition forces and used to structure the new government. In China and Vietnam, the language of constitutional protection has also been used as a basis for mobilization for politics within elites (Ginsburg and Simpser 2013). As will be discussed more fully, constitutions also serve as an important device of vertical accountability, as the special status accorded to constitutional rights can enable citizen collective action for their fulfillment.

Explaining divergence between law and practice

3.38 A number of studies have sought to demonstrate empirically how different institutional designs optimize coordination and commitment for different configurations of elite interests. In theory, different political institutions—such as presidential versus parliamentary, or majority vote versus proportional representation—create different incentives that favor certain outcomes.¹³ Actual outcomes, however, depend on the extent to which these de jure rules are in fact used as the main locus of political activity: that is, whether or to what extent political actors choose to invest in these institutions, such that they become a self-reinforcing equilibrium (Caruso, Scartascini, and Tommasi 2015).¹⁴

3.39 In many developing countries—and to a certain extent, in developed ones as well—power is often exercised through means other than those prescribed by law, sometimes referred to as “alternative political technologies” (Caruso, Scartascini, and Tommasi 2015), or “informal institutions” (Helmke and Levitsky 2004; Khan 2010). These include a variety of means of making bargains and deals outside the rules, including conventions for brokering power; clientelism; and purchasing favor (bribery, vote buying); as well as through nonstate authority structures, such as traditional or religious mechanisms. In some cases, the use of means of exercising power not based on law is simply a matter of deviance and abuse. But often it is serving the purpose of solving commitment and collective action problems in ways more in line with elite incentives and the de facto distribution of power. In such cases, as Mushtaq Khan (2010) explains, “[i]nformal institutions like patron-client allocative rules, and informal adaptations to the ways in which particular formal institutions work play a critical role in bringing the distribution of benefits

¹³ See, for example, Buchanan and Tullock 1962; Persson and Tabellini 2003; Voigt 2011.

¹⁴ This discussion draws on Aoki 2001 and Greif 2006.

supported by the institutional structure into line with the distribution of power.” In other words, divergence between the law and practice is rarely an absence of rules, but rather a replacement of law with rules that may be better suited—under the circumstances—to generate and meet shared expectations so as to uphold basic stability through elite bargains (North and others 2013). The conditions under which deals-based elite bargains evolve into rule-based governance constrained by law is the subject of chapter 7.

Ordering contest: The change role of law

It is true that in history the law can be seen to mediate and to legitimize existent class relations. Its forms and procedures may crystallize those relations and mask ulterior injustice. But this mediation, through the forms of law, is something quite distinct from the exercise of unmediated force. The forms and rhetoric of law acquire distinct identity which may, on occasion, inhibit power and afford some protections to the powerless.

—E.P. Thompson (1975)

3.40 Law’s role in ordering behavior and ordering power is primarily about how elites use law to implement policies and to exercise authority. The third role of law examines how citizens—non-elites—use law to challenge and contest the exercise of power. As the preceding quotation by the historian E. P. Thompson shows, law is simultaneously a product of social and power relations, and a tool for challenging and reshaping those relations. This section will examine how law, often in combination with other social and political strategies, can be used as a commitment and coordination device to promote accountability, and also to change the rules of the game to foster more equitable bargaining spaces.

3.41 In well-developed legal systems, it is the role of legal institutions to promote accountability through horizontal checks on authorities and by providing a forum for vertical claims by citizens. These legal institutions include courts and associated agencies such as prosecutors and police; special purpose adjudicative and oversight bodies, such as ombudsmen, auditors, and anticorruption or human rights commissions; and the public administrative law functions of executive agencies: for instance, those involved in property allocation and registration, the issuance of identity documents, or the provision of health, education, and sanitation services. The extent to which these institutions are accessible and effective forums for citizens to challenge the more powerful varies considerably from country to country, as a function of historical circumstances as well as political calculus of elites. Spotlight 3 on effective legal institutions discusses this in depth.

3.42 Even while legal systems in many countries continue to lack effectiveness and autonomy, there has been a marked trend toward juridification of social and political contest across the globe. As Rodriguez-Garavito (2011: 274–275) has noted, “the planetary expansion of the law is palpable everywhere, from the avalanche of constitutions in the Global South in the growing power of judiciaries around the world; in the proliferation of ‘law and order’ programs and the ‘culture of legality’ in cities; in the judicialization of policy through anticorruption programs led by judges and prosecutors; in the explosion of private regulations, such as the voluntary standards on corporate social responsibility; and in the transmutation of social movements’ struggles into human rights litigation.” Law increasingly provides the common language for, and demarcates the

arenas of contest among, very different contenders: citizens and states; multinational corporations and indigenous people; states, citizens and international organizations.¹⁵

Law and social rights

3.43 In one example of how law is changing the contestability of policy arenas, a majority of developing countries have adopted social and economic rights in their constitutions, and citizens are increasingly using these provisions to advance development goals. (Brinks, Gauri, and Shen 2015). This trend has been most striking in Latin America, where courts have transformed from weak, dependent and ineffective institutions to central players on issues at the forefront of politics and development. A key reason for this shift in role is that judicial actors have been emboldened by political fragmentation to assert the power of their institutions at the same time that citizens are demanding this role. (Helmke and Rios-Figueroa 2011; Huneus, Couso, and Sieder 2010). In India, legal institutions—at least at the level of the Supreme Court—have also proven to be an important site of contest, with an extensive tradition of public interest litigation and high-profile legal challenges to dominant power interests and social norms.¹⁶ The Indian Supreme Court has served to uphold the rights of the disadvantaged and enhance government accountability over such issues as child and bonded labor, environmental hazards, public health, and nondiscrimination (Deva 2009; Shankar and Mehta 2008). Courts in South Africa have also made important judgments holding government accountable to the provision of housing and to affordable antiretroviral drugs, among other things (Berger 2008; Klug 2005).

3.44 Importantly, in social justice litigation, the legal action itself need not result in a favorable judgment to be a successful part of contest. Even judicial defeats can be leveraged by activists to coordinate collective action around rights consciousness. (McCann 2004; Rodríguez-Garavito and Rodríguez-Franco 2015). As will be explored further in chapter 8, the success of such efforts depend to a large degree on the ability of claimants to ground the language of rights in local social and political structures of demand—a process Brinks, Gauri, and Shen (2015) call “vernacularization.” As Santos and Rodriguez (2005) argue, political mobilization at the local—and often international—level is a necessary precursor to effective rights-based strategies for the disadvantaged. Hence, efforts to empower the aggrieved to use law and courts must combine legal awareness with broader strategic coalition building.

3.45 Law has also proven to be a powerful tool of accountability even outside of legal institutions, by framing claims and serving as a coordinating device. For example, in China, citizens are increasingly deploying official laws and policies in efforts to hold district officials accountable for illegal extraction, rigged elections, and corruption: a process dubbed “rightful resistance.” Courts seldom feature in these efforts, which tend to “operate near the boundary of authorized channels, employ the rhetoric and commitments of the powerful to curb the exercise of power, hinge on locating and exploiting divisions within the state, and rely on mobilizing support from the community” (O’Brien and Li 2006). The use of legal discourse, without recourse to courts, has also played a central role in tenant associations’ claims to adequate housing in Kenya, indigenous groups’ contests over land and natural resources in Mexico, and garment workers’

¹⁵ Comaroff and Comaroff 2001; Hirschl 2004; Santos and Rodriguez-Garavito 2005; Rajagopal 2003.

¹⁶ The trend of public interest litigation in India, however, has been criticized as shifting in recent years from pro-poor causes to promoting interests of upper classes (Gauri 2009). Indeed, if law and legal institutions can be used for pro-poor ends, they can likewise be used for other causes (Scheingold 2004).

efforts for fair labor conditions in Bangladesh. (Newell and Wheeler 2006). In these cases, law serves to ‘name and frame’—that is, to structure dialogue and provide a coordination device for more contentious strategies for accountability.

Legal institutions and credible commitment

3.46 Where state legal institutions have lacked the capacity for credible commitment, they have, in some cases, sought support from international actors. Thus, for example, aware of the inability to commit to fair anticorruption procedures against powerful interests, Guatemala sought United Nations support to establish the International Commission against Impunity in Guatemala (Cicig), which has successfully prosecuted over 150 current or former government officials, and charged the sitting president, leading to his resignation. A number of countries, including Bosnia and Herzegovina, Cambodia, Fiji, Kosovo, and the Solomon Islands, have allowed international judges and prosecutors on their courts to enhance credible commitment around sensitive and political cases. While these initiatives have led to successful prosecutions of sensitive war crimes and corruption cases, they have also been criticized for lack of sustainability in that they bypass rather than engage directly in the domestic bargaining arena. Where domestic courts are perceived as weak in the face of powerful interests, citizens have brought legal cases to other jurisdictions. This has been facilitated by a growing recognition of the concept of universal jurisdiction for very severe crimes, as well as by the increasingly transnational character of powerful interests. For example, local communities affected by severe environmental damage caused by a mining company in Papua New Guinea sought redress in an Australian court, the home jurisdiction of the company. While the legal case itself was settled and was not wholly successful in containing the damage, it triggered a change in the local bargaining arena, mandating that community representatives be engaged in negotiating community development agreements with the company and government (Kirsch 2014).

Transnational legal pluralism and contestability

3.47 The legal arena today spans beyond nation states in other ways as well. As will be discussed further in chapter 9, we are in an era of ‘global governance’, characterized by a proliferation and fragmentation of global, regional, and transnational instruments including binding laws (so-called hard law, including treaties and conventions) and soft law (voluntary guidelines, standards, principles and codes of conduct). The domains covered by these instruments go far beyond relations among nation-states to reach deep into the way national state and non-state actors govern in many areas, including business, labor, crime, information, public financial management, intellectual property, procurement, utility regulation, human rights, food and safety standards, and environmental sustainability. The formation of these transnational governance regimes parallels this Report’s framework: they are the product of contests between multiple actors—state, private, civic—that are shaped by power, interests, and norms, which in turn are shaped and reshaped by the outcomes of these regulations (Braithwaite and Drahos 2000).

3.48 This web of legal pluralism creates opportunities for domestic actors seeking to contest prevailing power and norms. Sweat shop workers in Mexico and Guatemala successfully appealed to international labor standards and company codes of conduct to improve working conditions and unionization where domestic laws did not allow for it. Critical to success was their linkages with transnational advocacy networks that exerted pressure on local governments. (Garavito-Rodriguez

2005). Cambodian garment workers also benefited from international labor standards that served as a commitment device for the government in order to gain favorable trade conditions. (Adler and Woolcock 2009). Indigenous groups have been key players in the formation of international standards for extractive industries, in particular the norm of free prior, informed consent. (Garavito-Rodriguez 2011). In these examples legal standards were converted into institutional arrangements that enhanced the contestability of the bargaining arena: collective bargaining arrangements, a tripartite labor arbitration council, and procedural requirements for consultations between extractive companies and local communities.

Getting to the rule of law

“In establishing the Rule of Law, the first five centuries are always the hardest.”
—Gordon Brown¹⁷

3.49 The *rule of law* is widely recognized as necessary to the achievement of stable, equitable development. Over the past few decades, no other governance ideal has been as universally endorsed.¹⁸ There is far less agreement, however, on what it means. At a minimum, the rule of law requires that government officials and citizens are bound by and act consistent with the law (Fukuyama 2014; Tamanaha 2004). This, in turn, requires certain characteristics: namely, that law is clear, certain, and public; and that it is applied equally to all through effective legal institutions.¹⁹

3.50 “Thin” versions of the rule of law have largely given way to “thicker” versions that move beyond the focus on procedure to a focus on substance requiring adherence to normative standards of rights, fairness, and equity.²⁰ The United Nations exemplifies this normative stance, defining the rule of law as “a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and a principle of standards.”²¹

3.51 Correlations between indicators of the rule of law and income levels are strong (figure 3.3). But the direction of causality and the mechanisms that determine this association are less well understood (box 3.4).

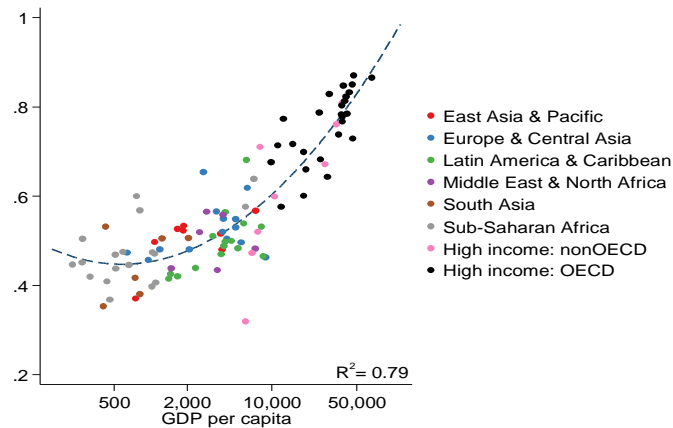
¹⁷ Cited in OECD 2014: 178.

¹⁸ Tamanaha 2004; Carothers 2006; Desai and Woolcock 2015.

¹⁹ Hadfield and Weingast (2014) model how these characteristics are necessary to achieve an equilibrium of behavior in line with the rule of law.

²⁰ This aligns with the views of legal and moral philosophers such as Lon Fuller and John Rawls who define law in terms of natural justice and fairness.

²¹ The definition continues: “It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness and procedural and legal transparency” (UN 2004: 4).

Figure 3.3 Rule of law is strongly correlated with high-income*Rule of law index versus GDP per capita*

Sources: WDR 2017 team with data from the World Justice Program 2015 and World Development Index 2015.

Box 3.4 Transitions to the rule of law

Compared to the extensive literature on transitions to democracy, a surprisingly small amount of systematic work has been done on transitions to a modern rule of law. There are actually three separate transitions to consider: first, the shift from a customary, informal, and often highly pluralistic system of law to a unified modern one; second, how powerful elites come to accept legal constraints on their power; and third, how countries successfully adapt foreign legal systems to their own purposes.

The shift from a customary and/or pluralistic system to a codified modern one is usually motivated, at base, by actors who see a single formal system as better serving their interests, particularly economic interests in expanded trade and investment. Scale matters: at a certain point, the personal connections that characterize customary systems become inadequate to support transactions between strangers at great remove. However, transition costs are high, and customary rules are often preferred by existing stakeholders. This means that political power is critical in bringing the transition about.

Formal law is usually applied first to non-elites (“rule by law”); we shift to “rule of law” when the elites themselves accept the law’s limitations. North and Weingast have argued that constitutional constraints become self-reinforcing when power in the system is distributed evenly and elites realize that they have more to gain in the long run through constitutional rules. What this theory doesn’t explain, however, is why these same elites stick to these constraints when the power balance subsequently changes and one group is able to triumph over the others. Similarly, independent courts are always a threat to elite power; why do rulers come to tolerate them when they have the power to manipulate or eliminate them? This suggests that constitutionalism needs to be underpinned by a powerful normative framework that makes elites respect the law as such. Subsequent respect for law depended heavily on the degree independence maintained by legal institutions—the judiciaries, bars, law schools, and other structures that persisted even after their religious foundations disappeared.

Finally, with regard to the import of foreign legal systems, perhaps the most important variable determining success is the degree to which indigenous elites remained in control of the process, and could tailor it to their society’s own traditions. Thus Japan experimented with a variety of European systems before settling on the German civil code and Bismarck constitution. Later in the 20th century, China, Korea, and other Asian countries similarly adapted Western legal systems to their own purposes. In other cases like Hong Kong, Singapore, and India, the colonial power (Britain) stayed for a long time and was able to shape the local legal norms in its own image. Even so, India today practices a far higher degree of legal pluralism than Britain itself, as part of the process of local adaptation. Less successful were cases in sub-Saharan Africa where customary systems were undermined by colonial authorities, but not replaced by well-institutionalized modern systems.

Much more research is needed into the question of legal transitions. It is clear that a fully modern legal system is *not* a precondition for rapid economic growth; legal systems themselves develop in tandem with modern economies. It may be that the necessary point of transition from a customary to a formal legal system occurs later in this process than many Western observers have thought. But we know relatively little about the historical dynamics of that transition, and thus have too little by way of theory to guide contemporary developing countries as they seek to implement a rule of law.

Source: Prepared by Francis Fukuyama for the WDR 2017.

3.52 This chapter has focused instead on the *role of law*—the instrumental way through which groups and individuals in society use law as a means of promoting, enforcing, and institutionalizing interests or objectives. Attention to the micro-foundations of laws effectiveness can help policymakers and citizens design laws and strategies more likely to achieve success (box 3.5). Ultimately, it is through this dynamic between power and contestation that societies shape their transitions to the rule of law.

Box 3.5 Understanding the role of law in context

As this chapter has argued, law is not an unqualified good. Depending on the context, law might functionally:

empower change actors	or	reinforce existing power
provide order and certainty	or	create conflict and exacerbate confusion
build legitimacy	or	undermine legitimacy
structure contests	or	distract from real sites of contest

In order to produce the effects on the left side rather than the right side, legal interventions should ensure that the forms prescribed by law are able to demonstrate commitment and to induce collective action toward the desired end. Specifically, effective laws are able to:

- Change preferences by enhancing substantive focal points around which coordination can occur
- Change incentives by changing payoffs to lower the cost of compliance, or increase the cost of non-compliance
- Shape bargaining spaces that increase contestability by under-represented actors

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Spotlight 3 How do well-functioning legal institutions emerge?

S3.1 Closing the gap between law on paper and in practice requires the existence of well-functioning legal institutions. Effective and equitable legal institutions operate as safeguards against abuses of power and channels for the protection of rights and peaceful resolution of conflict. Well-functioning legal institutions are important to elicit voluntary compliance by signaling legitimacy. By reducing transaction costs and increasing the predictability of behavior and certainty of process, they underpin credible commitment, which is needed to modernize socioeconomic relations.

What are well-functioning legal institutions?

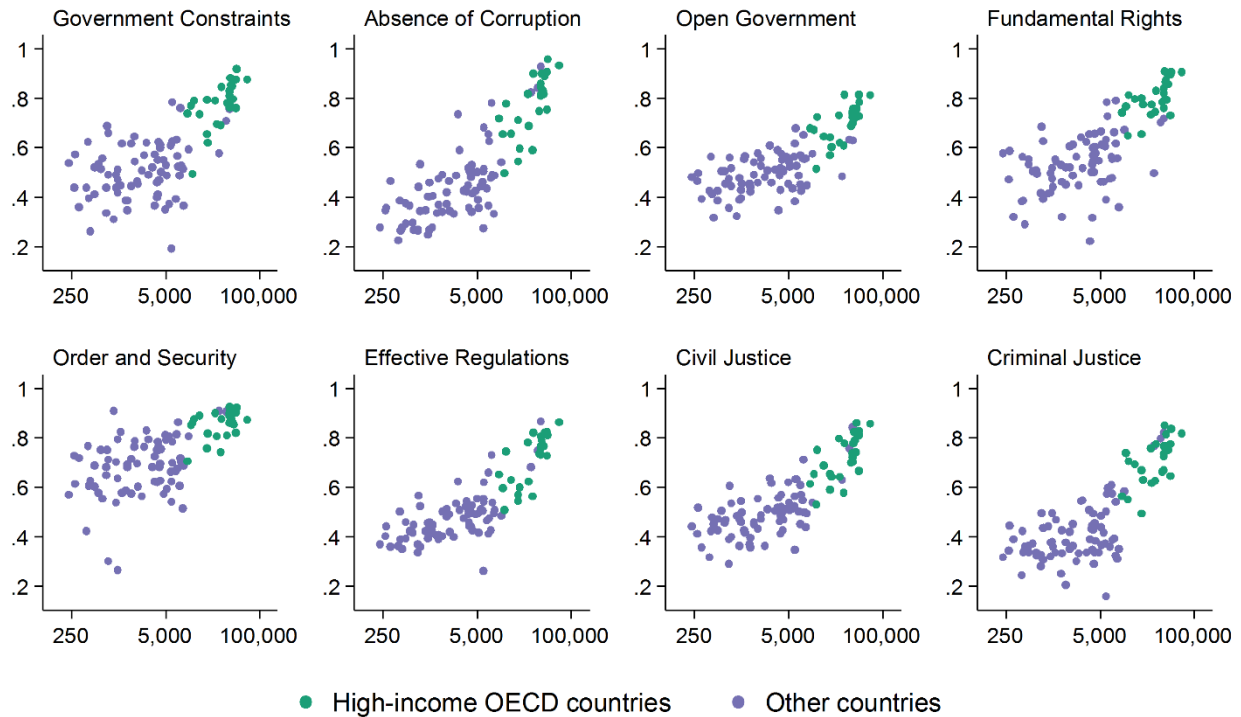
S3.2 Core state legal institutions include those that declare law (legislatures, government agencies); enforce law (prosecutors, regulators, police, prisons) and apply law to individual instances (courts). These institutions must operate in an integrated fashion with the cadre of private lawyers, academics and civil society engaged in legal activity—the so-called “legal complex” (Karpik and Halliday 2011). They also require an appropriate enabling environment, including legal mandates, functional institutional systems and rules, and financial, human, and material resources. They need to be physically and financially accessible to the population, while resonating with peoples’ needs and perceptions of fairness so as to generate trust. To act as an effective check on power, courts especially need to be *independent* of political pressure, while remaining *accountable* and *effective* in that they are able to compel compliance with their decisions.

Under what conditions do well-functioning legal institutions emerge?

All high-income OECD countries score well on de jure and de facto indicators of rule of law, including judicial independence, accountability, and effectiveness. This relationship illustrates the need for such institutions to support sophisticated and diversified economic models. But as this Report has emphasized, simply transplanting institutional forms to developing countries does not work; they need to emerge in a homegrown fashion from internal governance dynamics that reflect socioeconomic demands and other incentives. As figure S3.1 shows, there is a positive correlation between rule of law and income observed today, but this does not explain causality nor how countries move up the scale. The empirical and theoretical literature points to four factors that are most likely to contribute to the development of judiciaries that can act as an effective check on power: historical factors, institutional factors, strategic factors, and ideational factors.

Figure S3.1 While high-income OECD countries generally have well-functioning legal institutions, the relationship between institutional quality and income varies in developing countries

Various rule of law indexes versus GDP per capita (log scale)



Source: WDR 2017 team with data from World Justice Project (2014) and World Development Indicators (2016).

S3.3 Historical factors. One explanation for why some judiciaries emerge as credible and effective, while others do not, is rooted in the historical circumstances—in particular, colonial legacies—in which the modern justice system developed. Where colonial legal systems and their national aftermaths sought to incorporate, accommodate, and adapt to the contending normative orders of society, national law and courts have emerged as relatively effective and legitimate institutions, as has been the case in India. By contrast, where colonial systems created fragmented spaces of Western law and indirect rule through which native authorities were often invented, as in Nigeria and Kenya, national law and courts faced an uphill battle in establishing credible commitments to legality. While these dynamics tend to persist in some ways (through path dependency), they are constantly renegotiated in response to underlying patterns of social and economic change (Daniels, Trebilcock, and Carson 2011).¹

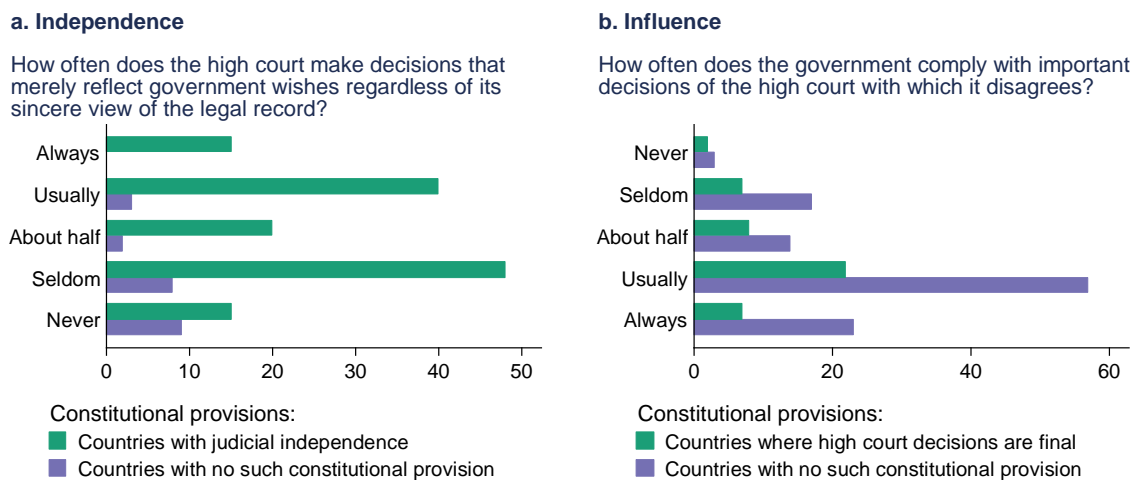
S3.4 Institutional factors. Courts are governed by an array of rules—constitutional and otherwise—that shape the independence, accountability, and effectiveness of the judiciary, including judicial appointment and disciplinary procedures, the scope of judicial review, case management systems and procedures, legal standing, and access. Judicial reform efforts often

¹ For more nuanced discussion of how legal cultures were forged by a dynamic interplay between imperial policies and native agency, see Yannakakis (2015).

focus on strengthening the formal rules, systems and human capacity to protect judges from political pressure, incentivize efficiency, and promote access and transparency. These are important and necessary interventions, but often insufficient.

S3.5 As figure S3.2 shows, even the most stringent constitutional guarantees of independence and best practice forms of judicial appointment often do not correlate with de facto measures of independent judicial behavior (Feld and Voigt 2003; Rios-Figueroa and Staton 2012). Moreover, the same formal rules can produce different incentives, depending on broader contextual factors (Helmke and Staton 2011). At the same time, empirical studies show that seemingly minor technical rule changes can have major effects on a court’s role and assertiveness. For example, obscure rules regarding who has the right to bring a case (“standing rules”) were instrumental in the rise to prominence of the Indian and Costa Rican courts. In short, rules and capacity matter, but their relationship to judicial effectiveness in practice is mediated by strategic and ideational factors (Helmke and Rios-Figueroa 2011).

Figure S3.2 The correlation between de jure and de facto measures of judicial independence is weak



Source: WDR 2017 team with data from Varieties of Democracy (2016) and Comparative Constitutional Project (2016).

S3.6 *Strategic factors.* The first set of strategic factors relates to the calculus elites undertake to determine under which conditions they would endow courts with autonomy and effectiveness, given that this may be used against elite interests. The literature points to five key reasons. First, elites may strengthen judiciaries to *signal credible commitment for commercial investment* by raising the cost of political interference with economic activity, as has been the case in several fast-growing economies like China. The establishment of robust judicial institutions may also be in response to requirements for engagement in international organizations and transnational trade regimes (Moustafa and Ginsburg 2008). Second, elites may endow courts with capacity in order to use them to *enforce central policy, control agents, and maintain elite cohesion*. This was a key

aim behind Mexico's introduction of the mechanism of *amparo*, allowing citizens to challenge arbitrary action by individual bureaucrats (Magaloni 2008).

S3.7 Third, elites may bind their hands by establishing powerful courts during periods of political uncertainty as *political insurance* to protect their policies from being undermined in the event of a government transition (Ginsburg 2003; Staton and Moore 2011). Fourth, judicial review of legislation can serve an important *information-gathering role* for policy makers when they are unsure of how laws and policies will play out in practice (Staton and Moore 2011). Finally, elites may empower courts in order to *channel controversial political questions away from majoritarian institutions*. The Egyptian Supreme Constitutional Court was able to overturn socialist-era policies while shielding the executive from opposition (Moustafa 2007).

S3.8 In being used strategically by elites in these five ways, courts may be empowered with autonomy for some types of cases, but not others—and that power may be taken away when it no longer serves elite interests. But even limited autonomy may create spaces for judicial actors to assert themselves and to strategically expand their role. Judges' calculus must take into account their institutional powers, but also the likelihood of compliance with their rulings. There is strong evidence that judiciaries are more likely to exercise power in cases of political uncertainty or fragmentation because this reduces the ability of others to put political pressure on courts. This accounts for the emergence of autonomous judicial behavior in Brazil, Indonesia, and Mexico, among other countries (Helmke and Rios-Figueroa 2013; Dressel and Mietzner 2012). Public expectations and demands on courts are also an important factor in this calculus, as is the broader role played by the private bar, legal academia, and other legal actors (Shapiro 2013; Halliday 2013). Judicial autonomy and effectiveness is thus an outcome of strategic interactions among the judiciary, other branches of government, and the public (McNollgast 2006).

S3.9 The experience of the Supreme Court of India illustrates this process. While endowed on paper with expansive constitutional powers of judicial review and rights protection, the Court initially played a very limited role in practice. The executive sought to keep it away from the regime's policies by packing the Court with regime supporters and declaring emergency rule, curbing its powers. As India transitioned to multiparty politics and a coalition government, the Court began to assert its independence by expanding popular access to the Court through public interest litigation. Initially limiting its activism to issues that did not directly challenge elite interests, the Court gradually consolidated its strength through popular support (Mate 2013).

S3.10 *Ideational factors*. Despite having favorable institutional rules and strategic opportunities to consolidate power, some judiciaries remain constrained. The final factor concerns what is called legal culture: that is, the "contested and ever-shifting repertoires of ideas and behaviors relating to law, legal justice and legal systems" (Couso, Huneeus and Sieder 2010). Simply stated, ideas, norms, beliefs, and values matter. For example, judges in Chile have been constrained by a tradition of legal formalism. By contrast, in Colombia, judges' perceptions of their own role have shifted as indigenous groups have increasingly employed rights-based strategies (Domingo 2010). A social network analysis of Mexican judges depicts how professional networks can diffuse fundamental ideas about the role of judges (Ingram 2016).

Implications for judicial reform efforts

S3.11 Analyzing how these factors play out in a given context can help identify what kind of reformist activities are most likely to have traction. Investments to improve the efficiency and effectiveness of commercial courts, for example, may take root where elite incentives and business demands align in favor of effective impartial courts. Investments to strengthen citizen access and empowerment and improve judges' perceptions of their own roles are more likely to prove fruitful where strategic opportunities exist to expand the judicial role to limit abuse of power and protect rights. Conversely, the absence of such conditions may undermine efforts to build the capacity of legal institutions.

S3.12 Where conditions do not favor empowerment of formal legal institutions, reformists can look to a broader set of formal and informal institutions that may be relevant in terms of meeting the key functions of commitment, coordination, and cooperation for particular issues. Commitment devices for commercial transactions include reputational considerations that might be served by industry mechanisms of alternative dispute resolution.² A range of customary, communal, and/or nonstate institutions may serve as effective cooperation mechanisms to resolve social and economic disputes peacefully. Neighborhood mediation in urban Papua New Guinea has proven functionally capable of managing disputes within communities in ways that formal police and courts have not. Tribal and customary courts in Afghanistan, Liberia, and South Sudan have brought closure to vengeance killings, land disputes, and a range of social concerns, where formal mechanisms in some cases have exacerbated tensions (Isser 2011). In such cases, efforts to improve desired functions will be better served by understanding the strengths of existing institutions, and seeking to enhance and complement their functional capacity by expanding accountability.

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Part II

Governance for Development

Part II

Governance for Development

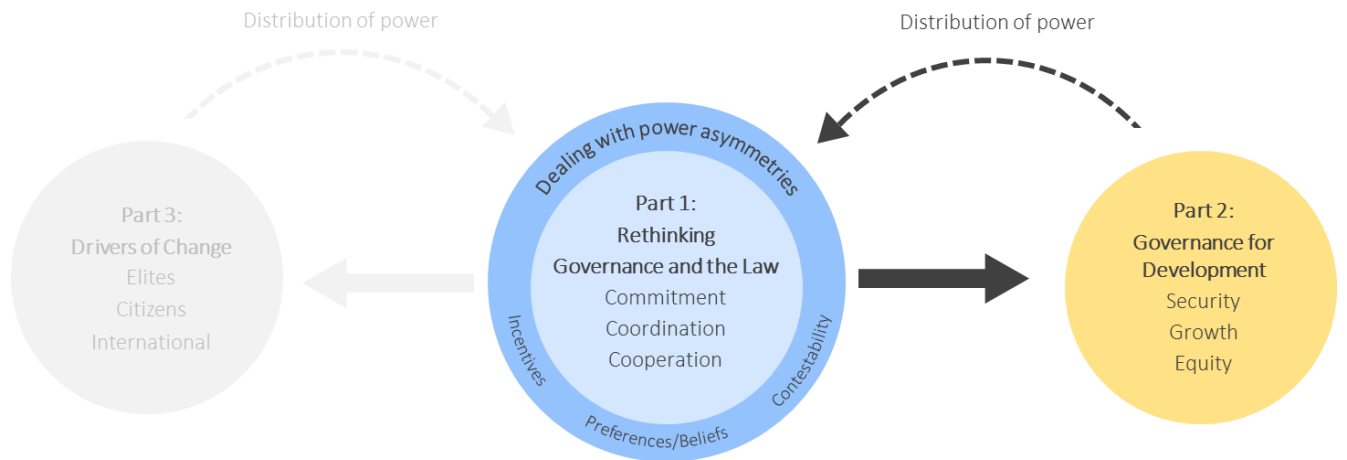
Part II of the Report applies the framework presented in Part I to better understand three core development outcomes: security (chapter 4), growth (chapter 5), and equity (chapter 6). Commitment, cooperation, and coordination fundamentally underlie the effectiveness of policies to promote these outcomes, but the unequal distribution of power can constrain policy effectiveness. Moreover, characteristics of development itself—such as the composition of growth or the level of inequality—influence the relative bargaining power of certain actors. Enhancing contestability in the policy arena, effectively changing incentives, and reshaping preferences and beliefs of different actors—for example, through leadership—can make policies more effective to deliver on development over time.

Chapter 4. *Governance for security.* Governance can lead to better security and less violence—under certain conditions. Security prevails when certain forms of governance, such as power sharing, resource redistribution, dispute settlement, and sanctions, create incentives for actors not to use violence. Solving cooperation and commitment problems is critical. When cooperation is lacking, contending sides may walk away from the bargaining table, and citizens may not comply with governments' rules. When commitment is not credible, violence may become the preferred way to resolve conflicts. Warring factions may renege on peace agreements, policy makers may default on promises to transfer resources to discontented groups or regions, disputants may fail to abide by court judgements, or policemen may abuse citizens instead of protecting them. The degree of cooperation and the credibility of commitments can be improved by establishing constraints on unchecked power, and by establishing mechanisms which do not exclude relevant individuals and groups from the policymaking process. This can lower the likelihood of violence and open the door to economic growth.

Chapter 5. *Governance for growth.* Governance matters for investment and productivity, the two drivers of economic growth. The credible commitment of governments to protect property rights, enforce contracts, and enhance market competition gives individuals and firms incentives to reinvest their profits, innovate, and increase their productivity. The relative power and influence of different interest groups determines the credibility of this commitment. The capture of the policy-making and policy implementation processes by private interests can undermine the effectiveness of institutions and slow down economic growth. Preferential treatment for connected firms and barriers to entry for newcomers—such as access to loans, ease of licensing requirements, or import barriers—stifles competition and leads to resource misallocation, with a toll on innovation and productivity. Consequently, designing policies that are compatible with the existing balance of power may be more effective than designing policies that are best from a technical point of view but have a high risk of capture by powerful groups. To elicit government commitment and compliance by citizens and firms, policies need to address, and eventually overcome, incentive structures that allow small numbers of self-interested individuals and groups to capture policy making and resource allocation, undermining not only growth, but also equity.

Chapter 6. *Governance for equity.* Policies that allocate and redistribute resources—including the proceeds of growth—within and across generations enhance equity. The two main redistributive policy instruments are the provision of public goods and services, and fiscal policies for public

spending and revenue collection. Commitment to broad-based redistribution may be weak when power imbalances are strong. Officials may target benefits to narrow groups of citizens in exchange for political support, or may divert public financial resources to their own pockets if accountability mechanisms are not strong. In other cases, officials may be responsive only to those citizen groups that wield greater influence, such as favoring the interests of teacher unions over those of students. Giving powerful actors incentives not to block the adoption and implementation of redistributive policies can improve equity. At the same time, collective action to improve citizen participation and reduce the capture of the policy-making and policy implementation processes is essential for adopting and sustaining equity-enhancing reforms.



Chapter 4 Governance for security

Can governance solve the problem of violence in society?

4.1 Sometime around 1775 B.C., Zimri-Lim, the king of the ancient Mesopotamian city of Mari, in today's Syria, left us with the world's earliest account, engraved on a clay tablet, of the use of governance to settle a dispute between two of his vassals. He wrote, addressing one of them: "*You have raided his country. Everything you took, gather it together and return it*" (Munn-Rankin 1956: 95). On another occasion, the king negotiated a power-sharing agreement over a contested city with a more famous rival, king Hammurabi of Babylon. Bargaining extended over several years—"Remove [that city] from the treaty tablet and I shall commit myself!" offered Hammurabi at one point—but no agreement could be reached, a consequence of the uneven balance of power between the two kingdoms (Heimpel 2003: 379). Violence ensued, and in 1759 B.C., the king of Babylon destroyed Mari, boasting that he "*turned the land into rubble heaps and ruins,*" and displaced its entire population (Heimpel 2003: 177).

4.2 Can dispute settlement, power sharing, and other forms of governance solve the problem of violence in society? Yes, under certain circumstances. Violence recedes when individuals, groups, and governments have *incentives* not to use it to pursue their objectives, and when not using it eventually becomes the norm. Institutions of governance create *incentives* to reach agreements (that's cooperation) and enforce them (that's commitment) that prevent, reduce, or end violence. When power sharing, resource redistribution, dispute settlement, and sanctions solve commitment and cooperation problems in ways that create *incentives* not to use violence, security prevails. When they do not, violence prevails. In the absence of cooperation, contending sides walk away from the bargaining table, and citizens do not comply with governments' rules. When commitment is not credible, warring factions renege on peace agreements, policymakers default on promises to transfer resources to discontented groups or regions, disputants fail to abide by court judgements, policemen abuse citizens instead of protecting them, and violence ensues.

4.3 The framework this Report adopts emphasizes the centrality of three elements of governance for development: the relative distribution of power among individuals and groups with conflicting preferences; the bargaining arena where conflicting interests and policy choices are made and implemented; and the barriers to entry to this arena. Accordingly, violent conflict is the respective result of three types of breakdowns in governance, all three rooted in commitment and cooperation problems: the unchecked power of individuals, groups, and governments; failed agreements between participants in the bargaining arena; or the exclusion of individuals and groups from this arena. Power sharing, resource redistribution, dispute settlement, and sanctions have long been identified as potential ways to prevent, reduce, or end violent conflict, yet they succeed only when they constrain the power of ruling elites, achieve and sustain agreements and do not exclude relevant individuals and groups.

Security, governance and power are heavily interlinked

Security is a precondition for development

4.4 *Security*—the security of people—is the freedom from violence and the threat of violence (coercion).¹ Rather than representing discrete, opposed situations, security and violence are on a continuum. This is why this Report measures security as the reduction in the incidence of violence.² The threat of violence, however, is more difficult to measure. Compounding the measurement challenge is the overlapping and coexistence of situations of violence and security (Raeymaekers 2013).³

4.5 The cost of violence to development outcomes is staggering (figure 4.1). In 2015, violence cost the global economy \$14.3 trillion, or 13.4 percent of world GDP, and this cost has risen by more than 15 percent since 2008 (Institute for Economics and Peace 2015). Violent conflict has a negative impact on GDP per capita (figure 4.2). Civil war reduces growth by around 2.3 percent a year (Collier 2007; Dunne and Tian 2014). Violent crime also hinders economic development (Dell 2015). A 1 point decrease in homicide rates per 100,000 people results in an increase of 0.07 to 0.29 percent in GDP per capita growth over the next five years (World Bank 2006).

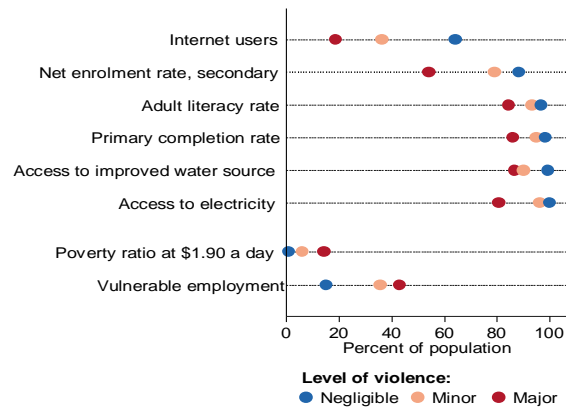
4.6 At the micro level, violence results in changes in household composition; losses in the productive capacities of household members; the destruction of productive assets and livelihoods; and displacement (Justino 2009; Ibáñez and Vélez 2008). Violence and its threat also indirectly impacts trade, investment, and growth through the uncertainty and the loss of trust and cohesion they generate (Zak and Knack 2001; Knack and Keefer 1997). For example, the Syrian war and the emergence of the so-called Islamic State directly cost Iraq and Syria 16 percent and 14 percent in per capita welfare from April 2011 to April 2014, respectively, but adding the foregone benefits of trade integration between the two countries and their neighbors almost doubles the total costs of war, to 28 percent and 23 percent (Ianchovichina and Ivanic 2016).

¹ This chapter is about the security of people, as opposed to national security, or the security of territories. Also, the particular threat it discusses—violence—means that the definition of security used here is narrower than “human security” (where threats are multiple, ranging from loss of income to food shortages, infectious diseases, and environmental threats, in addition to violence) yet broader than “citizen security” (where the threat is violence, but mainly that stemming from crime). The chapter does not discuss other threats, but recognizes that they can lead to conflict and even violence. In addition, the chapter defines violence as the use of physical force intended to kill, harm, or destroy.

² Peace, a concept even broader than security, is not addressed in this chapter.

³ This chapter uses a single framework—a unifying model of violence—to address the relationships between governance, security, and development, and applies the same framework to all types and actors of violence. There are many typologies of forms of violence, which often overlap, including violence from civil war, repression, rebellion, coups, interstate conflicts, and genocides; also violence from gang activity, terrorism, piracy, and organized crime; communal violence; urban violence, riots, and civil strife; and interpersonal and gender-based violence. A particular characteristic of modern violence is that these forms of violence can combine and the lines between them become blurred (Geneva Declaration Secretariat 2015; World Bank 2010, 2011). Violence has also many agents or actors. Governments, political militias, rebels, criminal gangs, communal militias, rioters, and external armed forces can all be sources of violence in a country. Sometimes it can be difficult to tell them apart. Different actors of violence often operate side by side at a given point in time; violence also mutates from one type to another over time, and so do the identities and affiliations of its perpetrators, making the conceptual distinctions between actors of violence less useful for the purposes of this Report.

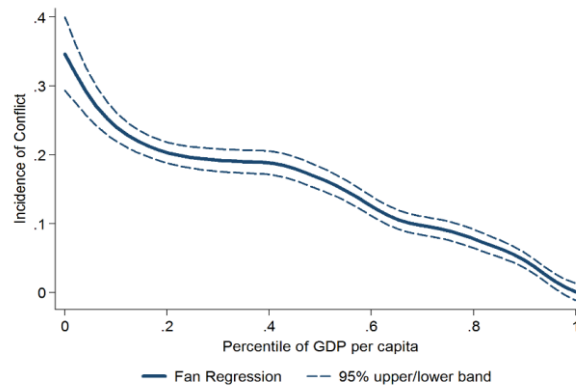
Figure 4.1 Violence has a high cost on development



Sources: WDR 2017 team, using data from WDI 2015; Geneva Declaration Secretariat 2015; WDR 2011; UCDP/PRIO 2015.

Note: Displays median values for all countries, by level of violence, for which development outcome and violent deaths data are available, ranging from 91 countries for poverty ratio data to 170 countries for access to electricity. Vulnerable employment is expressed as a percentage of total employment.

Figure 4.2 Violent conflict reduces GDP per capita



Source: WDR2017 team based on Blattman and Miguel 2010 using data from WDI 2015 and UCDP/PRIO 2015.

The state’s monopoly over violence is a precondition for security

4.7 In traditional agrarian societies, when security was still in the hands of private individuals and groups, the credible threat of violence through retaliation served as a deterrent against violence, and was the main determinant of order and security (Evans-Pritchard 1940; Bates 1983).⁴ The threat of revenge largely helped reduce violence, but security was fragile, and the specter of violence always loomed (Bates 2001; North, Wallis, and Weingast 2012). Similar security arrangements based on deterrence persist in many parts of the developing world, such as the informal institution of bride exchange (“*watta satta*”) in rural Pakistan (Jacoby and Mansuri 2010).

⁴ “The very readiness of the Nuer to employ violence provides a reason, then, that violence so rarely takes place” (Evans-Pritchard, 1940, quoted in Bates 2001). The Nuer are an ethnic group in today’s South Sudan.

4.8 Modern societies, by contrast, are fundamentally characterized by the concentration of security arrangements in the hands of the state, which has a monopoly over the means of violence and coercion (Mann 1984; Weber 1965). At its core, the state’s monopoly over violence is the outcome of a collective agreement between powerful actors—an elite bargain, really—over who can use violence and when its use is acceptable (Wallis 2016).⁵ The use of violence and coercion under this agreement is organized by the state, which typically enforces the agreement.

4.9 The state’s monopoly over violence is an ideal, which few states attain in all places all the time. It is the outcome of complex historical processes that unfold over decades, if not centuries (box 4.1). The elite bargains that give rise to it are contested, renegotiated, and reasserted every day, everywhere. The stock of capacity to enforce these bargains and deter groups tempted to defect or renege on them is uneven and discontinuous over time and space.

Box 4.1 How modern governance was born offers lessons for today’s “fragile” countries

Today’s governance is the child of yesterday’s violence. From the earliest records of human societies until the modern era, violence has been the norm (Pinker 2011). It was not until violence was constrained by the state that development began to occur on a large scale (North, Wallis and Weingast 2009). Even the countries that enjoy the highest per capita incomes and most peaceful societies in the world, such as most of Europe, emerged out of wars and violent contests for power (Tilly 1985, 1990). They were “fragile states” for most of their historical trajectory.

How these countries made this transition from violence and underdevelopment to security and prosperity reveals intriguing patterns. As commerce expanded in medieval Europe, *violence specialists*—individuals or groups that procured resources for themselves primarily through force or the threat of force—traded the provision of security for financial resources to finance their wars (Braudel 1966). They allowed economic activity to flourish under their protection, founded states, and ceded some power and rights to business and other elites (Duby 1987; Bates 2001). These rights were gradually expanded and eventually conceded to the majority of the population (Acemoglu and Robinson 2006). Constraints on unbridled power and other outcomes of these bargains between elites were formalized into laws. Violence did not disappear—on the contrary, more revenues were available to finance more external wars—but it was now monopolized by these emerging states, and was channeled toward the provision of law and order, the combating of crime, and the protection of property rights (Bates, Greif, and Singh 2002). Modern governance was born.

Today, millions of people live under the rule of non-state armed groups, contemporary equivalents of the medieval violence specialists who gave rise to the Western European states.^b *Wartime institutions*—the “rules of the game that result from the interaction between civilians and armed factions”^c—have created new, enduring realities on the ground, with profound implications for processes of state and nation building in the aftermath of violence (Justino 2016). The relative security of places such as Somaliland provide a compelling illustration of the sustainability of the governance arrangements that arise organically—and without donor intervention—from the bargains struck between armed rebels, business communities, and civilians. They exemplify the significance of these homegrown rules for the future governance of post-war countries, and the puzzles they pose to the international development community (Philips 2013).

^a This narrative has been extended by some authors to contemporary states in Eastern Africa and Southeast Asia, too. See Weinstein 2005; Slater 2010.

^b See Gambetta 1996; Weinstein 2007; Mampilly 2011; Ahmad 2015; Arjona, Kasfir, and Mampilly 2015; Sanchez de la Sierra 2015.

^c Justino 2016, background paper for the WDR 2017

Source: WDR 2017 Team

⁵ Max Weber, in his essay, “Politics as a Vocation,” originally theorized the monopoly over violence as one agreement between powerful groups over the use of violence. The authors are grateful to John Wallis for making this important point, and for clarifying the distinction between violence “under” the state’s monopoly over violence and violence “over” it.

Bargaining failures can lead to violence

4.10 Violence of another kind occurs when agreements like the state’s monopoly over violence fall apart (Bates 2008a; 2008b). This violence, the result of a bargaining failure, becomes the preferred—and rational—way for certain individuals and groups to alter the distribution of power in their favor or to pursue their interests (Fearon 1995; Walter 2009). Such is the case of broken states, like Libya, Somalia, and the Central African Republic; peripheral areas of many stronger states, such as in the Arab Republic of Egypt, India, Nigeria, and Pakistan; but also the so-called “ungoverned spaces” (which are often just “differently governed”), such as inner-city neighborhoods of Baltimore and Chicago, even some French “*banlieues*” (Pujol 2016).

The unchecked power of the state can lead to violence

4.11 While the state’s monopoly over violence is a necessary condition of security, it is by no means sufficient to guarantee the long-term security of people and property. Violence can, and often does, come at the hand of the state itself, particularly through its military and its police. Ruling elites often resort to military force against civilians to avoid having to share power (Acemoglu and Robinson 2006). Police forces often threaten and brutalize the population of gang-ruled urban slums instead of protecting them, as occurs in some U.S. and Latin American cities. Governments, or the private interests that have captured them, often violently expel local communities from their land for reasons ranging from granting concessions to mining corporations to expanding infrastructure projects (Hall, Hirsh, and Murray Li 2011; Moyo, Tsikata, and Diop 2015).

The exclusion of powerful actors from the bargaining arena can also lead to violence

4.12 Violence can also emerge when powerful actors are excluded from the policy bargaining arena. Lack of access to state institutions, resources, and services usually takes place along identity fault lines. The distribution of power among ethnic groups, measured by their access to central state power, is a strong predictor of violent conflict at the national level, whether in the form of repression by the state or rebellion against the state.⁶ Cross-country statistical analyses using the Ethnic Power Relations dataset indicate that countries where large portions of the population are excluded from access to the state based on ethnic background are more likely to face armed rebellions, and to experience violent repression by the state (Wimmer, Cederman, and Min 2009; Røæbek and Knudsen 2015). The level of such exclusion seems to matter, too: the more excluded from state power ethnic groups are, the more likely their members are to initiate conflict with government, especially if they have recently lost power (Cederman, Wimmer, and Min 2010).

4.13 Qualitative comparative and case-study analysis of violent conflict in post-colonial Africa share the same finding that exclusionary elite bargains have led to trajectories of civil war, while countries where elites have struck more inclusive elite bargains succeeded in avoiding violent conflict. The extent of groups’ access to state structures (in the form of jobs in the government and the military) and to state resources (such as land, commercial licenses, and other rents) determine the degree of inclusiveness or exclusiveness of these elite coalitions (Lindemann 2008; 2010).

⁶ Other factors not related to governance also determine governance, such as the capacity and opportunity to mobilize against governments (Cederman, Wimmer, and Min 2010, Fearon and Laitin 2003, respectively).

Violence affects governance by changing power and norms

4.14 Violence and security change the distribution of power between groups, and consequently impact governance—how these groups interact within a set of rules, which are themselves a function of the groups’ relative power (see chapter 2 and Tilly 1978).⁷ One group’s use of force can strengthen or weaken, even annihilate, the power of other groups, almost by definition: assassinations, mass killings, repression, coups, and revolutions do just that. New actors emerge and gain power as a result of rebellions and wars. Historical and contemporary examples abound.⁸ Indirectly, individuals and groups can use violence and coercion to concentrate the proceeds of growth and development in their hands and increase their relative power, by strengthening networks of patronage or gaining informational advantages (Levitsky and Way 2012).

4.15 Moreover, violence also affects norms of behavior and can shape new values and attitudes, including attitudes toward violence itself (see box 4.2). This impact can be positive as well as negative. Exposure to violence from war has surprisingly salutary and persistent effects on altruism (Burundi), empathy (Liberia), and political participation and social mobilization (Sierra Leone). It has also been linked to increased trust in government (Uganda), voluntary compliance with authority (Liberia), as well as higher levels of social capital, reciprocity, and interpersonal trust (Nepal).⁹ It can also shape attitudes toward women along several aspects—including labor force participation, marriage and divorce (Germany after World War II), political participation (Peru), and bargaining among household members—and contribute positively to changes in gender roles.¹⁰ Violence also changes identities and beliefs, including as a result of migrations and changes in the composition of households (Justino, Leavy, and Valli 2009).

4.16 Violence’s effect on norms and attitudes can also be negative. The increase in cooperation brought about by exposure to violence is mostly observable within groups, rather than between groups, leading to forms of parochialism, or identity-based insularity (Bowles and Gintis 2011). This could in theory generate more violence by reinforcing within-group cohesion based on distrust of others. Violence has the observed effect of hardening attitudes toward others and can also help construct identities in more rigid ways (Grossman, Manekin, and Miodownik 2015). These new norms and identities increase the support for elites who favor the continuation of violence to strengthen or extend their hold on power (Fearon and Laitin 2000; Fearon 2006). The power and resources that accrue to political elites who benefit from the use of violence then fuel more violence (Besley and Persson 2011).

4.17 So violence affect norms, and norms affect violence. Violence affects power, and power affects violence. These two-way relationships highlight the broader point that violence can be persistent and self-sustaining. It tends to occur in interlinked episodes, with its intensity subsiding between cycles (World Bank 2011). Within-country and cross-country analysis of historical violent conflict in Africa between 1400 and 1700 CE shows that it is associated with more post-

⁷ As Tilly (1978), p.62 notes: “Great shifts in the arrangement of power have ordinarily produced—and have often depended on—exceptional moments of collective violence.”

⁸ For an historical example, see Bieber 1999; for a recent one, see Boone 2011.

⁹ Voors and others 2012; Hartman and Morse 2016; Bellows and Miguel 2006; Blattman 2009; Blair 2015; Gilligan, Pascale, and Samii 2011.

¹⁰ Buvinic and others 2013; Justino and others 2012; Akbulut-Yuksel, Khamis, and Yuksel 2016; García-Ponce 2015; Calderon, Gafaro, and Ibáñez 2011.

colonial violent conflict, in addition to lower levels of trust and a stronger sense of ethnic identity (Besley and Reynal-Querol 2014).

Box 4.2 Gender-based violence, power and norms

Gender-based violence (GBV) reflects power inequalities between women and men. Women and girls are more commonly the victims of GBV—a manifestation of power imbalance tilted in favor of men that characterizes many, mostly patriarchal cultures around the world. “Violence against women is not only a manifestation of sex inequality, but also serves to maintain this unequal balance of power” (Watts and Zimmerman, 2002, 1232). Collectively shared norms about women’s subordinate role in society, which potentially lead to violence against them, perpetuate the power imbalance.

Female genital mutilation (FGM), sex selection, child marriage, dowry-deaths, honor killings, and widowhood rituals are harmful cultural practices that are supported by various social norms and beliefs. For example, FGM is traditionally believed to preserve a girl’s virginity until marriage; not conforming to the practice may lead to social exclusion, stigma, and the inability to find a husband (UNICEF 2013). Sex selective abortions, infanticide, neglect of female children, and mistreatment of women who did not bear male children are manifestations of pervasive son preference, typically grounded in rigid patrilineal and patrilocal family systems and the special role of male children in religious rituals (Das Gupta and others 2003; Jayachandran 2015, Milazzo 2014). Dowries—a practice that strengthens son preference, as it leads parents to consider daughters as liabilities—has often been linked to brutal violent acts against women as a way to extract a higher dowry from the wife’s family, including harassment, domestic violence, murders, and suicides (UNFPA 2013). Honor killings involve murders, often committed by close relatives, in the name of “family honor,” as a way to sanction the refusal to enter an arranged marriage, attempts to marry outside their own social group, or being the victim of rape (UNFPA 2000; Pande 2015). Widows are sometimes victims of violence by in-laws and humiliating rites and isolation as part of the mourning process to demonstrate grief and innocence for their husband’s death (Chen 2000; Sossou 2002).

The continuation of these practices is supported by both women and men. The power imbalance can become internalized, and violence can even become acceptable for the victim, who may be afraid of challenging shared norms out of fear of backlash (they may not even be aware of alternatives to the norm). More positive attitudes toward FGM are typically found in countries where prevalence is higher. Interestingly, support for the continuation of FGM is generally similar among women and men, but considerably higher among women in four high-prevalence countries: Guinea, Sierra Leone, Eritrea, and Chad. Among women, greater support is expressed by those who have themselves undergone FGM. Acceptability of wife beating is higher among women than men in many countries (panel b). Likewise, reported preference for sons over daughters is consistent among women and men in India: 22 (20) percent of women (men) report that they want more sons than daughters (IIPS 2007).

Biased formal laws restricting women’s economic opportunities reinforce (and are reinforced by) discriminatory gender norms, which in turn strengthen the power imbalance. While many countries have recently carried out reforms to remove legal restrictions, about 90 percent of the 173 countries reviewed in a recent study still have at least one legal gender difference on the books (including laws requiring husband’s permission to work, to travel, to register a business, and prohibitions to work in certain industries or hours) (World Bank 2015).

The persistence of these cultural practices partly depends on reciprocal expectations about the behavior of others (Mackie 2000, with specific reference to FGM). As long as discriminatory norms are broadly shared by a critical mass of individuals who expect that others will conform to the practice, there will be no incentive to deviate from it. A shift requires coordination of beliefs, as each individual’s action depends on expectations of what the others will do. Strategic interdependence of individual beliefs will maintain the unequal distribution of power. Many state laws (such as those prohibiting FGM, domestic violence, child marriage, sex selective abortions, and dowries), often introduced under domestic and international pressure from women’s movements, have been ineffective in reducing the prevalence of harmful practices because of the failure to understand the conditions for norms shifting and the need to translate laws in the context of the local culture (see chapter 3). Other forces may lead to persistence that do not depend specifically on social reciprocal expectations, but rather on private motives that vary considerably across individuals and may require specific policy interventions (Efferson and others 2015).

Source: WDR 2017 team.

Governance can prevent conflicts from becoming violent

Development is a conflictual process

4.18 Social choices, political change, and development itself are all inherently contentious and conflictual processes. The status quo benefits some segments of society; any change will benefit others, and conflict ensues (Acemoglu and Robinson 2006). This Report defines *conflict* as an active disagreement or dispute that arises when two or more individuals or groups believe that their policy choices, interests, preferences, or concerns are incompatible. Accordingly, conflict in itself is not necessarily negative, and can even be a constructive force for social change (Keen 1998). It is an integral element of human interactions, and exists in all societies at all times.

4.19 Poverty, inequality, and other manifestations of the unevenness of the development process generate tensions and distributive conflicts (Hirschman 1958; Bardhan 2005; Knight 1992). In addition to uneven development, three other broad sets of factors can cause conflicts, too: identity and ideology; resources, including land; and shocks. More often than not, these factors combine (box 4.3).¹¹

Box 4.3 Four broad sets of factors can cause conflicts, and they often combine

Identity is perhaps the broadest set of drivers of conflict. It encompasses ethnicity, race, language, territory, caste, gender, sexual orientation, religion, belief, and potentially all “markers” of difference between human beings. Identity carries the seeds of conflict in its womb: those who share the same identity are part of the “in-group,” while those who do not are the “out-group”—the others. When people acquire a strong and exclusive sense of belonging to a single group, the stage is set for conflict (Sen 2006). Just as identities are a primary driver of conflict, conflict is the main way identities are shaped (Fearon 2006; Berman and Iannaccone 2006): “There is nothing like conflict to determine, delineate, and accentuate the sense of belonging” (Lianos 2011).

Resources are another major driver of conflict, whether they are natural resources such as oil, minerals, and gemstones; common pool resources like fisheries, forests, grazing land, or water basins; or private resources such as agricultural land or cattle. A rich literature associates natural resources with the onset of violent conflict (Ross 2015; Caselli, Morelli, and Rohner 2015). Resources can trigger conflict whether they are scarce or abundant (Bardhan 2005; Collier and Hoeffler 1998). Conflict over the mismanagement and overuse of common pool (or open access) resources is ubiquitous and has been the subject of landmark analysis and case studies (Ostrom 1990; Ellickson 1991). Resources also generate rents, which can be used to fuel and sustain conflict (Besley and Persson 2011).

Economic and other shocks may also drive conflict: An external (*exogenous*) event or condition (such as a drought, climate change, the discovery of a new trade route, or a hike in commodity prices) or an internal (*endogenous*) event or condition (such as technological change or demographic shifts) can disrupt a stable situation by introducing tension for the control of scarce or expanding resources.^a

Finally, the *development process* itself, or rather its unevenness, in the form of poverty, inequality, and urban migration can be a powerful driver of conflict.^b

Drivers of conflict can combine. Horizontal inequality—the confluence of ethnic identity and income inequality—is a particularly explosive combination (Esteban and Ray 2008; Esteban, Mayoral, and Ray 2012). Extreme scenarios feature all drivers. Such was the case of the Darfur civil war in Sudan, where local conflicts over land

¹¹ WDR 2011 identified a range of factors associated with violent conflict. It referred to them as internal and external “stresses,” whether economic, security-related, or political, adding that “they can combine and precipitate actual violence.” This WDR calls a subset of these factors “drivers” and shows instead that they cause all conflicts, not just violent ones.

and water resources, droughts, poverty and inequality, and ethnic and religious polarization all conspired, at a time when local governance broke down, to make this conflict one of the biggest tragedies of our time (De Waal 2007).

Source: WDR 2017 team.

a. For droughts, see Miguel, Satyanath, and Sergenti (2004). For climate change, see Burke, Hsiang, and Miguel (2015). For commodity price shocks, see Dube and Vargas (2012); Bazzi and Blattman (2014). For demographic shifts, see Goldstone (2002).

b. For poverty, see Justino (2009). For income inequality, see Fajnzylber, Lederman, and Loayza (2002); Montalvo and Reynal-Queyrol (2008); Stewart (2008); Enamorado and others (2016). For urban migration, see World Bank (2010).

Conflict and violence are not the same and have different determinants

4.20 Yet conflicts, irrespective of what causes them, need not erupt into organized violence. Examples are numerous. At the micro level, peaceful protests, strikes and lockouts, boycotts, and mass resignations are all examples of nonviolent manifestations of conflicts over any of these sets of drivers. At the country level, Australia, Botswana, and Norway all have oil or mineral wealth, yet none has experienced significant violent conflict in generations. Singapore and Switzerland are ethnically, religiously, and linguistically diverse, but enjoy some of the lowest levels of violence anywhere. Belgium recently experienced acute political conflict between groups representing its two main ethno-linguistic components, including 541 days without central government, but no violence erupted. Why? The answer lies in the existence of effective institutions of governance. They make all the difference for why and when a conflict turns violent. A main message of this chapter is that institutions of governance—the specific institutions for policy making and policy implementation—can address conflicting interests and preferences without the recourse to violence.¹²

4.21 There are converging indications that the use of organized violence to resolve a conflict is the outcome of a rational decision: leaders go to war when they believe the expected benefits of a war outweigh its expected costs (Tilly 1978; Fearon 1995); young men join gangs and rebellion movements when this option is superior to the next best opportunity foregone (World Bank 2011). Institutions and norms shape behavior—including violent behavior. They create incentives for individuals and groups to use violence, or refrain from using it, to resolve conflicts by determining the expected gains from each option. These incentives differ under different institutional settings. For example, the existence of a credible threat of sanctions will discourage individuals from using violence. The absence of this deterrent will likely decrease the cost of the violent option. Violent conflict, then, regardless of the factors or combinations of factors that cause it, it is the outcome of a failure of institutions.

4.22 Ironically, some of the clearest insights into how institutions of governance shape incentives to prevent and reduce violent conflict have come from recent work on the ways violent groups maintain order and security within their own ranks (Justino 2016). Prison bands and slum gangs create informal governance rules to adjudicate disputes, divide resources, and enforce sanctions among their members (Skarbek 2014; Venkatesh 2006); so do criminal associations such as the Sicilian Mafia (Gambetta 1996). Pirate organizations provide a fascinating illustration of the emergence of rules of governance aimed at resolving conflicts driven by material inequalities and perceptions of unfairness, and at eliciting cooperation among members of the group (Leeson

¹² Engerman and Sokoloff 2002; Boix 2003; Acemoglu and Robinson 2006; North, Wallis, and Weingast 2009.

2011). “Rebelocracies” give rise to war-time institutions that often take on the basic functions of states (Arjona, Kasfir and Mampilly 2015; Arjona 2014). Examples of rebel governance include dispute resolution mechanisms, property rights arrangements, systems for resource distribution and the provision of security and public services (Mampilly 2011; Stojetz and Justino 2016).

4.23 Formal and informal institutions of governance solve commitment and cooperation problems in ways that create incentives not to use violence. What these governance institutions exactly are, how they solve these functional problems, and the conditions under which they work (or fail) to prevent, limit, or end violence is the subject of the rest of this chapter.

Governance can improve security in four ways

4.24 This Report identifies four categories of governance institutions that directly create incentives for individuals, groups and governments to refrain from using violence to resolve conflicts.¹³ Other types of institutions, such as markets, play only indirect roles.

Sanction and deterrence institutions. Governance institutions that punish and deter opportunistic behavior reduce *incentives* for violent behavior by increasing the cost of violence. Over time, they shift *preferences* away from violence by changing norms and attitudes toward violence, leading to the internalization of new norms (spotlight 4.1). Ultimately, they foster a culture of voluntary compliance based on legitimacy (see chapter 2). Examples include rules ranging from speed limits and penalty fees to prison sentences.

Power-sharing institutions. Governance institutions that balance, divide, and share power reduce the *incentives* to engage in violence by increasing the benefit of security. They may increase the *contestability* of policies, too. Examples include constitutions and proportional representation electoral systems.

Redistributive institutions. Governance institutions that allocate and redistribute resources and resource rents reduce incentives to use violence in the same way as power sharing institutions. Examples include budgets, social transfers, and victim compensation schemes.

Dispute resolution institutions. Governance institutions that resolve and arbitrate disputes reduce incentives for using violence by stabilizing expectations. They can shift preferences toward non-violent outcomes. Examples include institutions of property rights such as contracts and titles, and courts.

Sanctions and deterrence can reduce violence by changing incentives and preferences

4.25 Deterrence and sanctions maintain order and security by raising the cost of engaging in violence before and after it occurs, and by limiting opportunities to use violence. Formal institutions of deterrence and sanction include the military, as well as the array of institutions falling under the criminal justice system, such as the police, prosecutors’ office, courts, prisons,

¹³ There are institutions of governance that are intended to produce and sustain violence, such as concentration camps, slavery, or apartheid, but this chapter is not concerned with these.

penalties, and fines. Under the state’s monopoly over violence, the coercion emanating from these institutions deters and constrains those tempted to use violence to pursue their objectives.

4.26 There is no definite academic consensus on whether increased police presence and higher incarceration rates reduce violent crime (Chalfin and McCrary 2014; Cameron 1988). In theory, other factors being equal, increases in incarceration rates and in police forces should reduce violent crime by way of deterrence and incapacitation, respectively (Becker 1968; Levitt 1997). Some statistical analyses confirm these findings, with application to Latin America, where violent crimes are the highest in the world (Di Tella and Schargrotsky 2004; Soares 2004). Empirical evidence from a sample of Latin American countries indicates that the countries with the lowest levels of criminal violence (Argentina, Chile, and Costa Rica) make the most intense use of sanction and deterrence, while the countries with the highest level of crime (Brazil, Colombia, and Venezuela) had the lowest incarceration rates and numbers of police (Soares and Naritomi 2010).

4.27 However, analytical studies suggest that *mano dura* approaches—“heavy hand,” a set of aggressive government policies to combat criminal gangs in Latin America—are counterproductive (Kleiman 2011). They posit that the penal system can harden youth criminals and make them more prone to more serious crimes upon release, and that heightened police engagement in marginalized communities might increase the risk of police abuse of citizens and undermine citizen trust and community cohesion (World Bank 2010; Berkman 2007). Conversely, programs such as the “Youth and the Police” project in Belo Horizonte, Brazil, which sets up workshops and seminars between police and youth groups, have been shown in some preliminary evaluations to improve local police-community relations (Berkman 2007).

4.28 In Rio de Janeiro, Brazil, “Pacifying Police Units” (UPPs) combine increased police presence to regain control of urban territory from armed criminal groups with a new model of “proximity policing.” This program seeks to build closer ties with local residents by holding community meetings and social events, providing soccer courses to teenagers, and engaging in informal dispute settlement. In addition, it starkly reversed policemen’s financial incentives by offering performance bonuses for reducing police homicides, to replace an earlier policy that offered higher salaries to police officers who shot suspects in acts of legitimate defense. A recent evaluation of the impact of the introduction of the UPPs indicates that homicides by police would have been a massive 60 percent higher without UPP intervention (Magaloni, Franco, and Melo 2015).

Power-sharing can reduce violence by changing incentives and increasing contestability

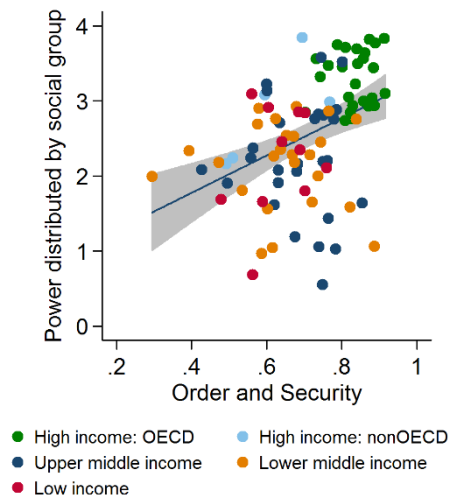
4.29 Power-sharing mechanisms give multiple contending elites a stake in the decision-making process and can rebalance power in the governance arena. Some form of power sharing aimed at coopting elites and constraining majority rule has been attempted to end violence in nearly all conflicts within states in the past few decades. Power-sharing arrangements are especially relevant for societies divided along ethnic and religious identity lines, such as in Bosnia and Herzegovina, Northern Ireland, Kenya, Lebanon, and South Africa, but also in countries where the conflict is a legacy of opposing ideologies, like Colombia.

4.30 Power-sharing institutions can take many forms. They can be inclusive, when particular offices or processes in national government guarantee the representation of certain groups.

Examples include: designated executive positions for individuals or factions (Iraq, Kenya, Lebanon, Somalia); ensured minority voice in policy making, through vetoes for minorities in coalition governments or supermajority requirements; positive action mechanisms, such as legal quotas for women and marginalized groups in public office (India); and forms of legislative selection that guarantee representation of all factions and groups, such as electoral systems with proportional representation. A second set of forms is dispersive institutions, which distribute power among groups at the subnational level. Examples include federalism (Belgium, Nigeria); administrative decentralization (Nepal, Sierra Leone); or regional autonomy (Aceh, Indonesia; Bougainville, Papua New Guinea; Catalonia, Spain; Corsica, France) (Gates and others 2016).

4.31 Cross-country statistical analyses robustly associate institutions of power sharing with better security outcomes (Gurr 1993; Linder and Bächtiger 2005) (figure 4.4). Executive power sharing in broad multiparty coalitions, executive-legislative balance of power, multiparty systems, and proportional representation electoral systems are all significantly correlated with less incidence and risk of internal conflict, and less vulnerability to domestic terrorism, after controlling for economic and population characteristics. Statistical and empirical evidence in favor of decentralized and federal governance institutions is not as strong (Lijphart 2012).

Figure 4.4 An even balance of power is associated with positive security outcomes



Source: World Justice Project, Rule of Law Index 2015 Factor 5, “Order and Security” (consisting of “Crime is effectively controlled”; “Civil conflict is effectively limited”; “People do not resort to violence to redress personal grievances”) and V-Dem v.6 (“Power distributed by social group”) (where a score of 0 means political power is monopolized by one social group and a score of 4 means that social groups have equal political power).

Power-sharing can reduce violence by giving parties in a conflict incentives to cooperate

4.32 Mechanisms of power-sharing manage conflict by encouraging cooperative behavior among rival factions. They give leadership elites incentives to collaborate, bargain, and compromise with one another, and to encourage conciliation and tolerance among their followers. They also help mitigate the effects of the exclusion of minorities by majorities, reducing the likelihood of the onset of identity-driven violent conflict. Where violence has already occurred,

they give rebel factions incentives to lay down arms, by offering them alternative avenues for contesting power in nonviolent ways, such as in Bosnia and Herzegovina, Liberia and South Africa.¹⁴ Over time, cooperation builds trust in the power-sharing mechanism, and enhances its legitimacy—the extent to which people voluntarily comply with institutions and decisions.

Cooperation is more likely when parties in a conflict can credibly commit to deals

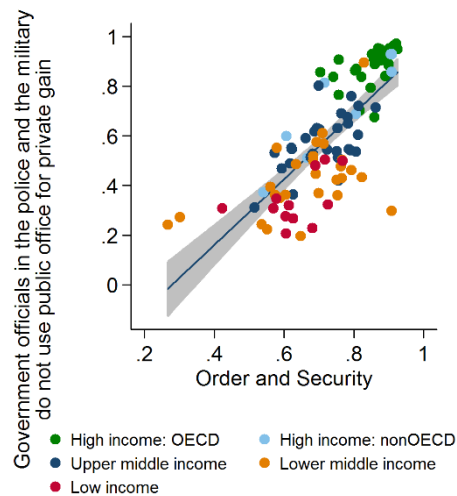
4.33 Fighting parties are significantly more likely to cooperate and sign peace agreements to end wars if the deals contain specific power-sharing assurances (Hartzell and Hoddie 2003; Walter 2002). Enshrining power-sharing arrangements in peace agreements removes motives to continue fighting and has been negatively and significantly associated with renewed violent conflict (Walter 2015). Given the lack of trust among warring factions, mechanisms that ensure the credible commitment of elites, both to one another and to their followers, play a major role in ensuring that, once reached, power-sharing arrangements are implemented and that violence stops (Keefer 2012).

4.34 Independent third-party mechanisms are the main mechanisms for ensuring the credibility of commitments in general (Schelling 1960; Bates 2008b). The same mechanisms can work to credibly commit parties in a conflict in the specific case of implementing power-sharing deals. For example, the deployment of international peacekeepers provided security guarantees for the agreements that ended the civil wars in Bosnia and Herzegovina, Liberia, and Sierra Leone. The commitment of regional and international powers played a similar role in reaching power-sharing accords in Lebanon, the Former Yugoslav Republic of Macedonia, and Mali. However, third-party external enforcers and internal checks and balances cannot always ensure that power-sharing arrangements end the violence and restore order. Under which conditions do power-sharing arrangements promote order and security, and when do they fail?

Commitment to share power is weak when power asymmetries are large

4.35 Large power asymmetries between contending factions make it easy for the stronger side to renege on its promises and hard for the weaker side to hold it to account for failing to commit (Walter 2009). Power asymmetries rooted in governments' monopoly over of taxation resources account for the likelihood of violent repression (Besley and Persson 2009). They also explain why some wars last more than others (Fearon 2004). Conversely, power-sharing institutions can reduce violence when they constrain the power of ruling elites (figure 4.3). The more accountable a government is to a large share of the population, the easier it will be able to credibly commit to share power, and the fewer incentives the sides will have to return to violence (Walter 2015; Gates and others 2016).

¹⁴ Lijphart 1969, 2004; Hartzell and Hoddie 2007; Norris 2008; Reynolds 2011; Gates and Strom 2013.

Figure 4.3 Constraining state power ensures security

Source: World Justice Project 2015, Rule of Law Index Factor 5, “Order and Security” (consisting of “Crime is effectively controlled”; “Civil conflict is effectively limited”; “People do not resort to violence to redress personal grievances”) and Factor 2.3 (“Government officials in the police and the military do not use public office for private gain”). Results presented as residuals after controlling for the natural logarithm of income per capita.

Redistributing wealth can reduce violence by changing incentives

4.36 Sharing power and redistributing wealth go hand in hand and follow the same logic. Access to power and decision making opens the door to control of resources and opportunities to extract rents. But elites can also redistribute wealth without having to share power, by simply using fiscal policy to transfer resources to groups that threaten to use violence to pursue their interests (Acemoglu, Robinson, and Verdier 2004; Bueno de Mesquita and others 2003). Budgets then become the true battlegrounds for distributive decisions, and the reflection of bargains among elites and between elites and citizens (Dorotinsky and Pradhan 2007).

4.37 Redistributive mechanisms address conflicts driven by poverty and inequality, usually in combination with the three other drivers. They can address conflicts rooted in grievances about the lack of access or unequal access to land and natural resources; inequalities along identity fault lines (horizontal inequality); and economic or environmental shocks. Redistribution can also address conflicts from the greed of groups vying for access to the natural and material resources of the state and the opportunities to extract rents these resources generate.¹⁵

4.38 Forms of redistributive governance institutions, and policies include fiscal decentralization, intergovernmental transfers, taxation, social security systems and safety nets, subsidies and cash transfers, funds like pension funds and permanent funds, and by extension, social services like health care and education. Other institutions of governance can also serve redistributive purposes in addition to productive ones, such as the civil service.

¹⁵ This chapter finds that the traditional division in the literature between conflicts motivated by greed and conflicts motivated by grievance cuts across drivers, actors, and cycles of conflict. This chapter does not find this distinction useful, in concept or in practice.

Redistribution can buy peace by strengthening the social contract between states and citizens

4.39 Historically, governments used social policy and other broad redistributive programs as a way to maintain order and reduce civil unrest. The causal effect of these redistributive social policies on improving security is well documented. In Latin America, where levels of both inequality and violence are among the highest in the world, levels of political violence gradually decreased in 16 countries in the 1990s and 2000s as government expenditure on social welfare steadily increased. Similarly, government expenditure on social services like health, education, and welfare in 16 Indian states from 1960 to 2011 was associated with a significant decrease in both the outbreak and escalation of riots across the country (Justino 2015; Justino and Martorano 2016). In Afghanistan and India, more government spending on public services appears to have played a role in reducing insurgent violence (Beath, Christia, and Enikolopov 2012; Khanna and Zimmermann 2015). Government interventions to reduce urban crime in Latin America display a comparable pattern of increasing security by reducing poverty and inequality. Brazil’s conditional cash transfer program, Bolsa Familia, had a strong negative causal effect on urban crime in São Paulo as a result of increases in household incomes and changes in peer group membership (Chioda, De Mello, and Soares 2012). Colombia’s Familias en Accion Program in Bogotá displayed similar results (Camacho and Meija 2014).

Redistribution can buy peace by coopting elites

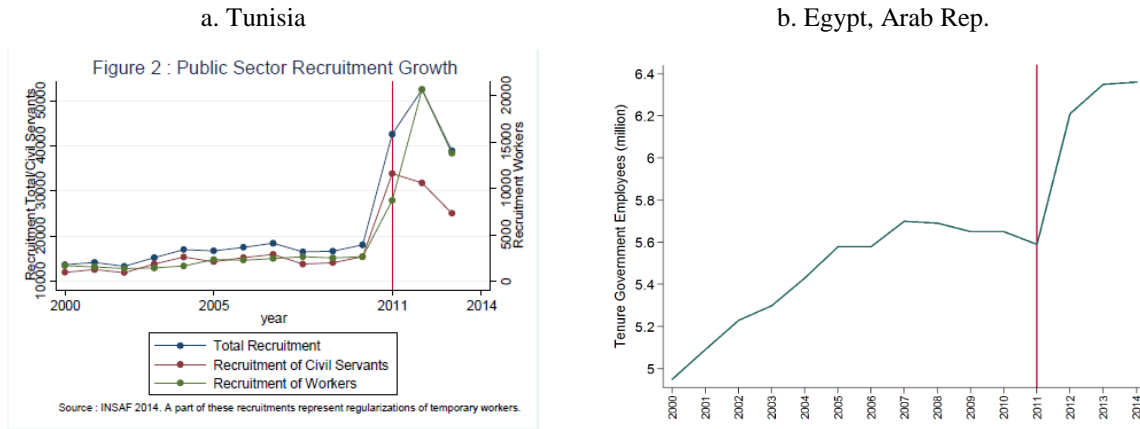
4.40 Short of committing to universalistic redistribution—usually as a concession in return for ending or at least for abstaining from violent contestation—governing elites credibly commit to narrower subsets of the population, whether groups with a strong capacity for mobilization, or elites with veto power (Acemoglu and Robinson 2006). Bringing these smaller groups, or other elites, into the bargaining arena usually happens by way of *patronage*, a mode of governance where politicians, or patrons, attribute public jobs and benefits to supporters or clients (Keefer and Vlaicu 2008; Robinson and Verdier 2013). A time series cross-section study of 40 African countries found that expanding the size of cabinets by one additional minister reduces the risk of a coup more than the effect of a 1 percent increase in GDP (Arriola 2009).

4.41 Governments often resort to patronage in public employment to maintain the stability of coalitions and ensure the loyalty of key constituencies whose discontent could jeopardize security (North, Wallis, and Weingast 2012). During the Arab uprisings, oil-rich governments, confronted with mounting dissent at home and concerned about the contagion from neighboring countries, hiked both the numbers and the salaries of public employees, in an effort to “buy the peace” and maintain the loyalty and quiescence of a constituency deemed essential for the survival of the regime (Yom and Gause 2012; Brownlee, Masoud, and Reynolds 2013). In Egypt, some 600,000 temporary government contracts were converted to regular civil servant jobs between 2011 and 2014 (figure 4.5b).

4.42 Large increases in the public sector wage bill have ruinous effects on budgetary sustainability and administrative efficiency. Attempts at curbing the trend have generally failed or have not been sustained (World Bank 1999). Despite these problems, public sector employment can solve the first-order problem of violence. Timor-Leste is a case in point. Following widespread unrest in 2006, the new government used revenues from the oil windfall to increase the budget fourteen-fold, from \$135 million in 2006 to \$1,850 million in 2013. Public employment spiked

from 20,000 to more than 35,000 during the same period, along with social transfers to veterans (Srivastava and Blum 2016).

Figure 4.5 Recruitments of civil servants increased exponentially in Tunisia and Egypt in the aftermath of the Arab Spring



Source: Brockmeyer, Khatrouch, and Raballand 2015 for Tunisia; Darwish 2015 for Egypt, based on figures from the Egyptian Central Agency for Organization and Administration (CAOA).

Redistribution can become corruption

4.43 The rent redistribution and patronage that accompany the bargains often necessary to maintain security and solve the first-order problem of violence often come at the expense of public integrity (Szeftel 1998). In few countries are these trade-offs between “buying the peace” and the control of corruption more salient than in the Republic of Yemen. Before the revolution of 2011, Yemeni tribes were a central part of the elite bargain that ensured relative security in this historically weak state. An essential element to these armed tribes’ loyalty to the central government was a vast patronage network, both formal and informal, which benefited cooperating tribal elites. The Ministry of Tribal Affairs handed out formal, monthly stipends to more than 4,500 tribal leaders across the country. The regime also favored local tribal elites in elections, who used their position as parliamentarians to secure public employment for their followers. While some of this employment was real—particularly in the army and security forces—an informal mechanism awarded government jobs to more than 40,000 “ghost workers”—clients and relatives of tribal leaders who received salaries without being expected to work. Patronage figures from this fictive employment amounted to as much as 6 percent of the national budget in the education sector alone (Egel 2013).

Redistribution can reduce violence by increasing trust in government and interpersonal trust

4.44 The exact mechanisms by which redistributive policies achieve security entail the resolution of commitment and cooperation problems between governments and groups pressing for redistribution—whether these are powerful elites or mobilized citizens (Addison, Le Billon, and Murshed 2002). Sustained and steady increases in government expenditure on social welfare, such as those in Latin America in the 1990s and 2000s, signaled governments’ commitment to the social contract that ties the state and the citizens—or at least to the groups that would otherwise

threaten elite control over the state (Bueno de Mesquita and others 2002, 2003). The political difficulty of rolling back these social welfare programs, which have come to be seen as entitlements, make them very credible commitment devices (Acemoglu and Robinson 2006).

4.45 Such commitment, coupled with the demonstrated and repeated capacity of governments to make good on their promises, could increase trust in government over time, and reduce the chances of engaging in political conflict. Conversely, the poor credibility of governments in committing to transfer resources can lead to violence, if the chances of overthrowing the government by violent means are greater than the probability of its credibly transferring the resources (Acemoglu and Robinson 2006; Murshed and Tadjoeeddin 2009).

4.46 Social welfare policies can also reduce political conflict by helping strengthen interpersonal trust between citizens. Interpersonal trust has been classically linked to increased social cohesion and hence less social conflict in both theory and analytical case studies. Empirically, it is linked to reductions in crime levels (Lederman, Loayza, and Menéndez 2002). Quantitative evidence linking social welfare to interpersonal trust is more limited, but empirical studies do show that interpersonal trust is higher between members of communities that are economically homogeneous and more equal. Conversely, participation in social activities, a close proxy of social cohesion, is lower in places where economic and social inequality is high (Alesina and La Ferrara 2002a, 2002b).

4.47 The link between fiscal decentralization and security levels is less well documented. One empirical before-and-after analysis of 98 districts in Java, Indonesia, shows that the incidence of routine violence in the form of neighborhood and village brawls and vigilante justice decreases as fiscal decentralization is implemented. It suggests that the commitment to devolve resources and autonomy from distant central governments to local governments may increase local government legitimacy, which in turn translates into more cooperative behavior and stronger cohesion among groups (Murshed and Tadjoeeddin 2008).

Restitution and compensation also reduce incentives to engage in violence

4.48 Governance institutions to recognize and redress grievances present a special case of redistribution. They reduce incentives to engage the state through the use of violence by seeking to right past wrongs, and may help avoid repeated conflict (Walter 2015). They include truth and reconciliation commissions such as in South Africa after the apartheid; victim compensation schemes such as in El Salvador; and an array of material and nonmaterial measures, including symbolic ones, intended to restore people's dignity. The latter are not to be underestimated. Indeed, the restoration of a sense of dignity and self-worth as citizens and human beings appears to have been an essential element of the set of factors that triggered the Arab uprisings.

Dispute settlement can reduce violence by changing preferences

4.49 Dispute resolution institutions are critical to security and development. They help reduce violence and protect property rights. Mechanisms of dispute resolution include mediation, conciliation, and negotiation, where parties try to reach mutually satisfactory, self-enforcing agreements on their own. They also include litigation and arbitration, where disputants rely on a third party such as a judge or a jury for resolution and for providing the credible commitment

needed to enforce the resolution. These institutions can be informal, like elders councils in a village, or formal, like courts, ombudsmen, and peace negotiators. Institutions of dispute resolution aim at resolving conflicts over material resources, whether scarce or abundant, such as land, water, extractives, and movable assets. They also aim at resolving conflicts over breaking norms of socially acceptable behavior—usually codified into laws—including the use of violence and other types of offenses.

4.50 In the absence of strong formal institutions like the courts or police, individuals and communities resort to alternative dispute resolution mechanisms: a set of informal skills, practices, and norms of negotiations and mediation that aim to help parties reach self-enforcing bargains and reduce the cost and length of disputes. Alternative dispute resolution mechanisms improve cooperation by building trust and improving communication and mutual understanding among parties, and by cultivating a set of norms that encourage them to stay at the bargaining table (Blattman, Hartman and Blair 2014). When strong, centralized, third-party institutions that enforce contracts are weak or do not exist, disputants have incentives to renege on their agreements. Informal social sanctions solve this commitment problem (Bardhan 1993). The norms promoted by alternative dispute resolution mechanisms, such as the shaming of would-be defectors, help enforce the bargains reached.

4.51 In Liberia, a large education campaign to promote alternative dispute resolution mechanisms in 86 treated communities in 2009 resulted in a 32 percent decrease in property destruction relative to the control group (Blattman, Hartman, and Blair 2014). Such land disputes are endemic in countries where property rights are not well defined or protected, and often result in communal violence (Onoma 2010). In addition to reducing violence, changing norms of behavior also had unintended consequences: it exposed more disputes, reflecting power struggles between village elders and youth, but these were overwhelmingly peaceful. This particular finding underscores some of the main points this chapter makes: that conflict is a normal element of the change process, and is qualitatively distinct from violence; and that what matters for security is not the occurrence of conflict per se, but rather its peaceful resolution by institutions.

Power asymmetries and norms of exclusion affect the effectiveness of dispute resolution mechanisms

4.52 Dispute resolution mechanisms do not always achieve security. The field experiment in Liberia remains an example of self-enforcing dispute resolution institutions helping resolve low-intensity communal conflict, where the distribution of power between parties is relatively even. Such is not the case in the more acute conflicts over land and water resources that plague so many developing countries. These conflicts involve significant power dynamics, such as land grabs by governments and closely connected local elites, or extractive and agricultural concessions to multinational firms (Boone 2013; Hall, Hirsch, and Murray Li 2011). An evaluation of a donor-funded land mediation program also in Liberia indicates that once such power dynamics are at play, self-enforcing dispute resolution mechanisms no longer achieve reductions in violence (Hartman, Morse, and Kitt 2014).

4.53 The uneven distribution of power among parties to a dispute stands in the way of reaching and enforcing mutually satisfactory bargains. Stronger disputants have few incentives to make concessions and concede power and resources, and many incentives to renege on agreements over

time, as the literature on bargaining power suggests.¹⁶ Solving disputes and enforcing contracts through the threat or use of force then becomes the more rational strategy for a powerful actor because the benefits of its use outweigh its costs, like the risk of sanctions (Schelling 1960; Walter 2015). The existence of norms that exclude certain groups like women and minorities from the bargaining arena where disputes are settled reinforce power asymmetries and perpetuate inequitable and insecure outcomes (Platteau 2000).

Conclusion

4.54 Security is a precondition for development (chapter 1). However, the way governance solves the first-order problem of violence requires reaching and sustaining stable elite bargains, and inevitably involves tradeoffs between development outcomes. The rent redistribution that accompany the bargains necessary to maintain security can constrain development (North, Wallis and Weingast 2012; Acemoglu, Naidu, Restrepo and Robinson 2014). In specific cases, power sharing arrangements between elites helped avoid violent conflict but also shackled the economy (Lindemann 2011). Similarly, elite bargains that enshrine existing inequalities can ensure security in the short term, but are not sustainable in the long term. Resolving these tensions constitutes the new frontier of the development research agenda.

¹⁶ Wagner 2000; Powell 2004, 2006; Fearon 2004; Walter 2015.

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Spotlight 4 Crime

How much reduction in crime is possible?

S4.1 A look at past trends provide some evidence of how much crime can be reduced globally in the coming fifteen years: the broad crime drop in the United States between 1991 and 2014 amounted to an annual decline by about 2.9 percent per year—including a range of manifestations of interpersonal violence such as homicide, child maltreatment, assault, and violence in schools. Meanwhile, Singapore achieved its very low crime rates—including the lowest homicide, robbery, and domestic violence rates known in the world—through a sustained decline by about 5 percent per year over the past 25 years. Italy experienced an annual decline of homicide by about 6 percent since the early 1990s. In South Africa, homicide fell by over the past two decades was about 4 percent per year since the mid-1990s, approximately the same yearly rate of decline as in Colombia since the early 1990s. Yearly reductions in serious crime and violence by 2–5 percent over two decades or more have been seen in many countries in the recent past. An average annual decline by 3 percent may hence be possible at a global level, leading to a reduction by around 40 percent by the end of 2030 (Eisner and Nivette, 2012).

Why do interpersonal violence and crime decline?

S4.2 Why declining trends in interpersonal violence and organized crime occur is still not possible to predict with any real accuracy. However, it is currently possible to disentangle the mix of factors that influence both cross-sectional variation in crime rates between countries and trends of crime levels over time. First, it appears that trends in levels of interpersonal violence and organized crime are only partly due to factors that governments can directly influence. For example, analyses of time series going back to the 1970s suggest that factors such as changing demographics, unemployment, technological change, drug epidemics, and changes in norms and attitudes towards violence affected trends in crime levels generally, and homicides specifically (Baumer and Wolff 2014). On the other hand, changes in income inequality over the past 100 years seem to be entirely unrelated to changes in homicide rates, despite income inequality being a robust and consistent cross-sectional correlate of homicide (Brush 2007).

S4.3 However, there is increasing evidence of a positive correlation between levels of homicide rates and organized crime on the one hand, and corruption levels on the other (Pinotti, 2016, Lappi-Seppälä and Lehtii 2014). This can be interpreted as empirical evidence for a role for governance in the reduction of interpersonal violence, and specifically for the theory that the failure of governments to sanction and deter organized criminal groups is one important factor contributing to high levels of homicides.

Three sets of factors explain homicide drops in the past

S4.4 Comparisons of major sustained homicide declines in different countries and historical periods across the globe suggest that declines in murder rates occurred when three factors came together (Eisner 2012, 2014). First, changes in relative power: homicide rates declined where states gained control over private organized providers of protection, and enhancing their legitimacy through effective institutions that produced benefits for broader segments of society (chapter 4 and Rotberg 2004).

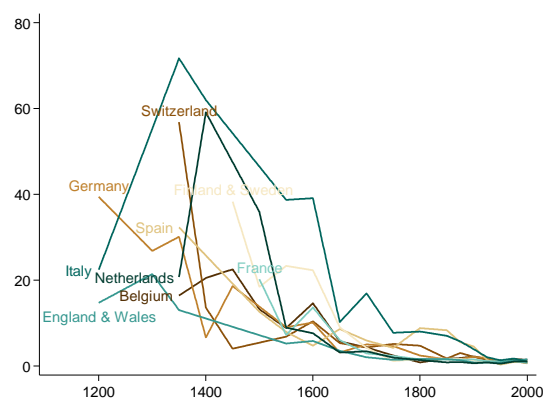
S4.5 Second, changes in technological and human capacity: homicide declines regularly appear to be linked to the spread of new social control technologies such as the monitoring and management of daily behaviors; increased control over disorderly conduct and substance use, especially alcohol; and systems aimed at early identification and treatment of offenders and victims (Eisner 2014). For example, the international fall in crime over the past 20 years is best seen as a result of investments in security technologies that have affected almost every aspect of daily routines (Farrell and others 2011). This includes electronic immobilizers to prevent car theft, burglar alarms, CCTV cameras in hotspots of disruptive behavior, a less cash-based economy, more private security personnel, and mobile telephones to call help and record crimes more easily. Many of these security and surveillance technologies are designed to reduce property crime, but they may well have had an effect on violent crime, too.

S4.6 Third, changes in norms of behavior: historical homicide declines appear to have been catalyzed by a decreasing acceptability of violence and intentional harm on others. Historically such change in social norms manifests itself in growing repugnance about public executions and torture, the disgust about blood revenge and duels, or the increasing sensitization to child maltreatment and neglect. Political or religious leaders, philanthropists, intellectuals, and teachers are among those ushering such change in societal preferences (Pinker, 2011).

The state's monopoly over the means of violence is the overarching factor

S4.7 This report argues that the changes in capacity and in norms of behavior that affect development outcomes, including reductions in levels of violence and crime levels, are ultimately derived from changes in relative power between actors. The sharp declines of homicide rates that occurred in more than 10 Western European countries after 1650 AD provides an illustration of how shifts in the balance of power toward the state and away from private providers of security, and the resulting expansion in state capacity, brought about changes in societal attitudes towards homicide that over time led to a drastic reduction in homicide levels (figure S4.1) (Eisner 2003).

Figure S4.1 Homicide rates across Europe have declined dramatically over the past 800 years



Source: WDR 2017 team based on Eisner (2003) with data from Eisner (2014).

S4.8 Before the expansion of the capacity of courts' and bureaucracies that accompanied the rise of the states' monopoly over violence in XVIIIth century Europe, government attitudes toward homicide were lenient if the motives were passion or the defense of honor, and society perceived

private retaliation as an acceptable way of restoring order. Between the sixteenth and seventeenth centuries, dispute settlement moved out of the private sphere and became the prerogative of judges and government officials, and perpetrators of homicide came to be seen as criminals. Campaigns of social awareness; societal acceptance of increased bureaucratic control of everyday life; improved trust in and legitimacy of the state as an overarching institution; the evolution of the notion of honor, which lost its cultural significance; and the liberation of the individual from his or her obligations to the group—in short, a change in norms—eventually led to this historical decline in homicide rates (Rousseaux 1999; Tilly 1992).

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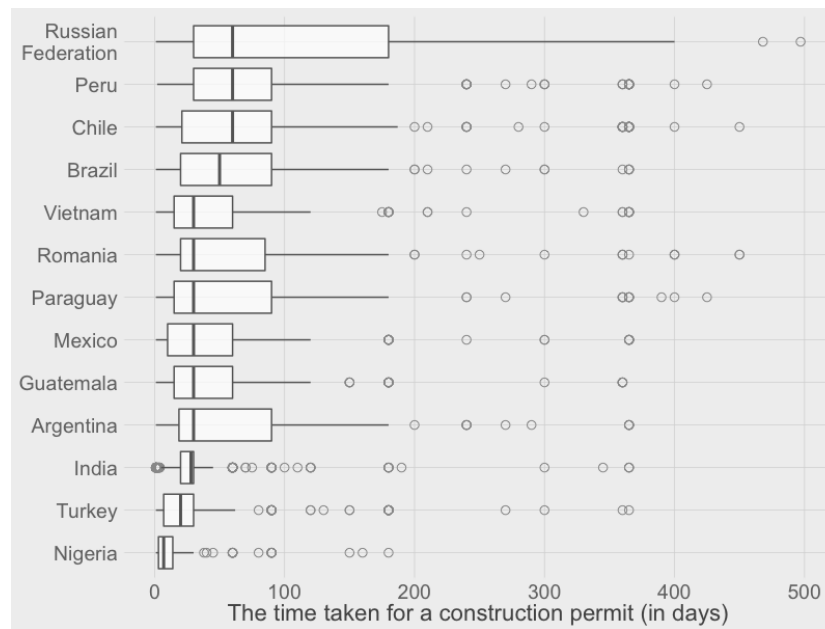
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Chapter 5 Governance for growth

How policy “capture” slows economic growth

5.1 If you were to ask a firm in Brazil or Mexico how long it had to wait to get approval for new construction, the answer could range from as little as 1 day to more than 100 days (Figure 5.1). Such remarkable variation in the wait time experienced by firms within the same country is true of almost any basic regulatory procedure in most low- and middle-income countries, such as getting a license to set up a new firm or a permit to import some item.¹

Figure 5.1 Time needed for firms to obtain a construction permit varies widely



Source: WDR 2017 team, using data from the World Bank Enterprise Survey.

Note: The figure shows a box and whiskers plot. The box ranges from the 25th percentile to the 75th percentile. The line in the middle of the box shows the median. The two lines on either side of the box extend to minimum and maximum values, excluding outliers. The dots indicate outliers.

5.2 One reason for the variance in regulatory implementation could be that some firms have more influence over the policy arena than others do. For example, a number of recent firm-level studies suggest that firms with powerful political connections are unduly favored in the way certain policies are designed or implemented, to the detriment of long-term economic growth. These firms get preferential access to state credit, land, and import licenses. The sectors in which they operate are protected from competition from other firms through high regulatory barriers to entry. This form of policy subversion has significant negative effects on the economy.

5.3 This chapter seeks to explain how, and when, powerful groups with narrow interests can have undue influence over policy (“capture”) and slow down economic growth, even in contexts

¹ In recent research, Hallward-Driemeier and Pritchett (2015) use firm-level data to analyze how the implementation of simple business regulations varies across firms within the same country. They find that procedural reforms, which simplify these regulations, are not associated with a reduction in this variation.

of high state capacity.² Such dominant groups can include politically connected firms, or lobbies for industry, farmers, or consumers. The chapter also analyzes cases when shortsighted, opportunistic state actors renege on policy commitments, harming investors. In some cases, existing norms such as tolerance toward corruption in public agencies can reinforce such policy failures.

5.4 However, the influence of interest groups, while ubiquitous, does not always render growth policies ineffective; sometimes, it can even improve them. How this process plays out depends on the characteristics of government agencies that enact the policies in question, and the incentives of influential groups, such as industry associations, that interact with those agencies. Understanding what drives this difference can help identify ways to improve policy effectiveness.

5.5 One lesson that emerges is that designing second-best policies that can achieve at least partial goals of growth, equity, and/or security may be more effective than designing ideal policies that are at high risk of capture (such second-best policies are considered *implementable*). Another lesson is the value of avoiding policies that look good in the short term but could end up reinforcing the power of dominant groups that could block further reforms, hindering the effectiveness of policies in the future. A third lesson is that undue influence from dominant groups can be counterbalanced by appropriate design of incentives within public agencies, checks and balances between agencies, and mechanisms that extend accountability to a broad group of firms and individuals. Such reforms can expand the set of implementable policies.

5.6 This approach assumes that the interests of high-level policy makers are aligned in the direction of reform. Whether that is the case depends on the evolution of the broader governance environment, a topic examined in part 3 of this Report.

How governance matters to growth: A microeconomic perspective

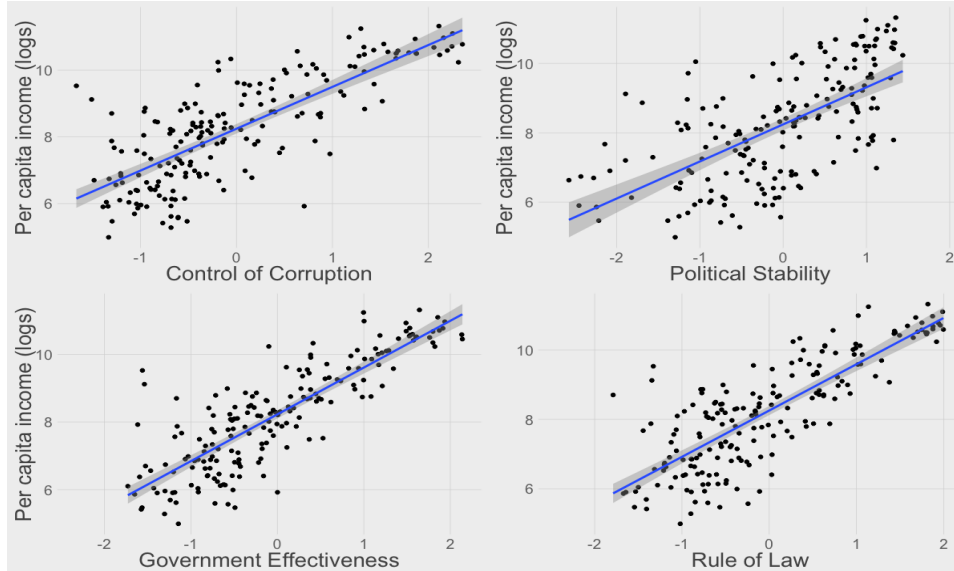
What is the aggregate impact of governance on growth?

5.7 There is a clear positive correlation between aggregate measures of governance and per capita income across countries (figure 5.2).³ Since countries had similar levels of per capita income in the distant past, current differences in their per capita income are largely reflective of differences in their long-term growth rates.⁴ Thus, governance and long-term growth are positively associated.

² Traditionally, in the economics literature, capture is said to occur when the design of a regulation reflects the narrow interests of specific groups of firms and/or consumers (Stigler 1971; Peltzman 1976). This chapter applies the term more broadly to include not only regulations but any policy related to economic growth.

³ The governance measures are from the Worldwide Governance Indicators (WGI) database.

⁴ GDP per person differed only modestly across countries before 1600, so much so that the rising difference in GDP per person across higher-income and lower-income countries since then has been termed the “Great Divergence” (Jones forthcoming).

Figure 5.2 Per capita income and governance are correlated

Source: WDR 2017 team, using data from the World Governance Indicators (WGI).

Note: Per capita incomes and WGI values are for 2010.

5.8 This correlation should be viewed with some caveats. It could reflect reverse causation from growth to governance, or some third factor (such as accumulated knowledge and skills) that affects both governance and income growth. Bearing in mind these caveats, many cross-country studies do suggest that the nature of governance—as reflected in broad institutional measures such as protection of property rights, rule of law, and absence of corruption—matters to long-term growth.⁵

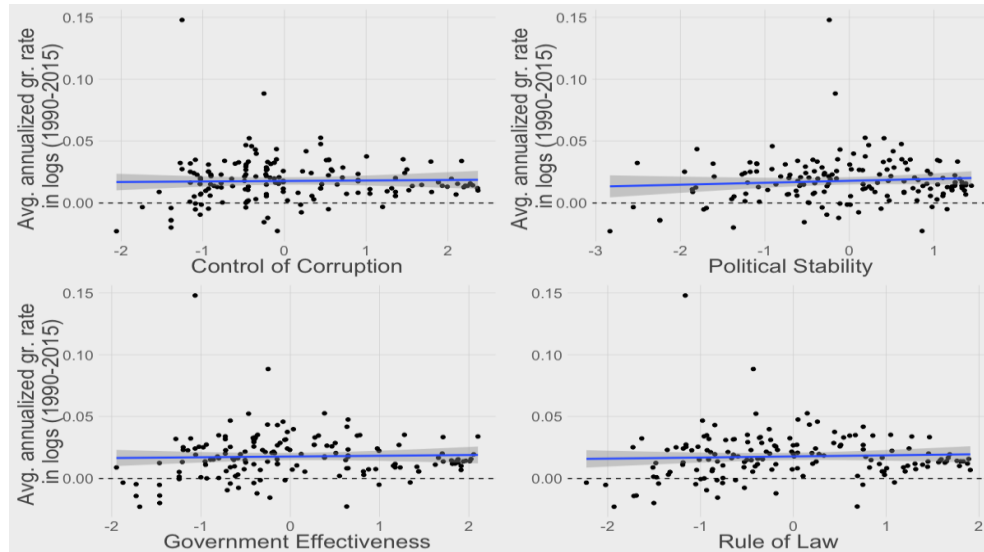
5.9 Even within countries, historical differences in institutions that affect property rights and collective action are associated with persistent differences in levels of economic development. For instance, in some regions of Peru, an extensive system of forced mining labor (the *mita*) was in effect from 1573 to 1812. Today, average household consumption levels in those regions are about 25 percent lower than in adjoining regions. One explanation is that in areas without the *mita*, a landowning class emerged, which had an incentive to set up stable property rights institutions. Areas that did not have the *mita* system still have more secure property rights and do a better job of providing public goods (Dell 2010).

5.10 Viewing change over the shorter span of decades rather than centuries, the relationship between broad, aggregate measures of governance and economic growth is weaker (Figure 5.3). In the past century, growth accelerations and slowdowns that lasted as long as a decade do not

⁵ For example, Mauro (1995), Hall and Jones (1999), and Acemoglu, Johnson, and Robinson (2001) show that historical and/or culturally driven sources of difference in some dimensions of governance (such as security of property rights, corruption, and policies of economic openness) have had an impact on long-term growth in per capita GDP. Building on such approaches, Kaufmann and Kraay (2002) propose a methodology to investigate the two-way causality between governance and per capita income. Their results also suggest a positive causal effect from governance to long-term growth, but a weak and even negative effect running from income per capita growth to better governance. See Pande and Udry (2006) for a critique of such approaches.

seem to have been correlated with major changes in governance; nor have sustained periods of high growth lasting as long as three decades.⁶ It is possible for economies to grow without big changes in the nature of governance, but it is not clear how long such growth can be sustained.

Figure 5.3 Medium-term growth and governance are *not* correlated



Source: WDR 2017 team, using data from the World Governance Indicators and the World Development Indicators.

Note: The governance indicators are for 1996, the earliest year for which WGI data are available, while per capita income growth is measured for the 15-year period between 1990 and 2015. The observed patterns are robust to measuring growth over 1996–2015.

5.11 What are the mechanisms behind the aggregate relationship between governance and growth? Since different dimensions of governance are correlated across countries, it is not easy to delineate their impacts on growth through cross-country analysis alone. A more microeconomic analysis of the mechanisms through which governance affects growth is therefore a vital complement to the macroeconomic analysis of governance and growth (Pande and Udry 2006).

5.12 On the surface, growth in per capita income has two sources—investment and efficiency. Investment is the process by which economies accumulate physical capital, skills, and knowledge. Efficiency, on the other hand, determines how well this labor and capital are put to use. In general, at least half the per capita income differences across countries is accounted for by differences in their efficiency (total factor productivity, or TFP) levels, while the rest is due to differences in investment (accumulation) (Caselli 2005; Caselli 2016, for WDR 2017). Both accumulation and efficiency, therefore, matter to growth.

5.13 Countries place different emphasis on various forms of accumulation and efficiency in their growth models. Some growth models emphasize accumulation, such as the mobilization of savings for industrial investment. Other models emphasize growth in efficiency through innovation and

⁶ See Hausmann, Pritchett, and Rodrik (2005); Jones and Olken (2008); Eichengreen, Park, and Shin (2012); Rodrik (2005), and Levy (2014).

competition among firms. Growth models based on factor accumulation may require a different governance configuration than those based on efficiency. Transitioning from one model to another has proved to be a complex policy challenge (Gill and Kharas 2015). (See spotlight 5 on the “middle-income trap” at the end of this chapter.)

5.14 Governance can affect investment and efficiency through two types of institutional “functions.” The first deals with commitment: that is, creating an environment in which firms or individuals feel secure in investing their resources in productive activities, and have the incentives to use them efficiently. The second pertains to socially beneficial collective action to coordinate investment decisions and promote cooperation between investors to solve potential market failures.

The key governance functions: Enhancing commitment and collective action

5.15 In the absence of credible commitment to the security of property rights (that is, when there is a risk of expropriation), the incentives for investment or innovation will be limited. Firms and individuals that experience lower security will invest less in productive activities. Moreover, differences across firms in the level of security from expropriation will affect the efficiency of resource use. If the more productive firms in an economy experience less security than the less productive ones, then investment by productive firms will be inefficiently low, leading to misallocation of resources and thwarting growth.

5.16 Consistent with theory, household-level studies find that farmers are more likely to make long-term investments in their land when their tenure is more secure, and urban households are more likely to renovate homes when the risk of being dispossessed is lower.⁷ Secure rights also improve labor allocation because protecting one’s property is no longer a prime motive in decisions about where to work (Field 2007). Similarly, studies find that firms that perceive themselves to be more secure from expropriation reinvest more of their profits in their business (Johnson, McMillan, and Woodruff 2002b). Theory also suggests that well-defined property rights should improve the functioning of credit and other asset markets, but empirical evidence for these predictions is weak.

5.17 Enforcement of contracts governing economic transactions is also critical because problems with contract enforcement prevent specialization and optimal division of labor (North 1990; Costinot 2009). Suppose a firm is considering whether to specialize in producing parts for a bigger firm. Once committed to this specialization, it will have no alternative but to sell those parts at whatever price that particular buyer offers. Hence, the firm will hesitate to specialize unless both parties can agree to an enforceable contract with a fair price. In small economies, reputation and relationships can be effective means of enforcement, but as growth leads to greater market size, impersonal interactions become more likely, and thus formal contract enforcement start to matter more (Dixit 2007). Empirical studies find that a strengthened formal enforcement system can foster the creation of new business relationships, promote trade in goods, and increase the flow of credit to firms.⁸

⁷ This evidence is reviewed in Galiani and Schargrotsky (2011).

⁸ Well-functioning courts help firms switch to new suppliers (Johnson, McMillan, and Woodruff 2002a). Better contract enforcement is also associated with higher lending and less default (Japelli, Pagano, and Bianco 2005;

5.18 The design and implementation of regulations that affect competition between firms is another policy dimension central to growth. For example, poorly designed licensing requirements for new firms can make it difficult for entrepreneurs to bring new investment ideas to fruition, and reduce competitive pressure on existing firms to innovate and become more productive.⁹ A case in point was a policy of industrial licensing in India that required firms to obtain government permission before setting up a new factory or expanding output in an existing factory. The process of license approval was onerous and unpredictable. Loosening these requirements in some industries in the 1980s may have increased the efficiency levels by as much as 22 percent (Chari 2011).

5.19 Some forms of collective action, such as coordinating investment and ensuring cooperation to prevent free riding, can solve potential market failures that can impede growth and investments in public goods. While discussing all possible market failures is beyond the scope of this chapter, this chapter will illustrate the key issues by looking at a specific type of failure.

5.20 The insight that a failure to coordinate investment activity could lead to underdevelopment is decades old.¹⁰ Suppose that an industry could upgrade to a modern technology that relies on a range of specialized skills. For a worker, investing in those skills does not make sense if it is not clear that the modern technology will be adopted. For a firm, investing in the new technology does not make sense unless there is a forthcoming supply of specialized skills. Thus, without some way of coordinating the decisions of workers and firms, the industry could remain trapped in a low-level equilibrium.¹¹ Such coordination problems can occur in many contexts, ranging from finance and adoption of technology to innovation and industrial clusters.¹²

5.21 Policies to address coordination and other collective actions problems are difficult to design and implement. For example, when complementarities between firms could lead to a coordination failure, governments could use subsidies or taxes to encourage firms to invest in a coordinated manner (Rodrick 1996). But targeting such a subsidy scheme to the right set of firms requires information on precisely which firms could have spillovers on others, and on how much they are investing (Bond and Pande 2007). Such implementation challenges make policies to address collective action problems in growth particularly sensitive to the quality of governance.¹³

How policies are affected by undue influence from powerful groups

5.22 Poor capacity to design or implement policies could be one reason why governments do not enact policies that are functionally optimal for aggregate growth. Yet even when such this

Castelar and Cabral 2001; Cristini, Moya, and Powell 2001). Better contract enforcement can also enhance the productivity impact of trade liberalization (Ahsan 2013).

⁹ Among others, Haskel, Pereira, and Slaughter (2007) and Aghion and others (2009) present firm-level evidence on how competition (from entrants) affects productivity growth.

¹⁰ Rosenstein-Rodan's (1943) theory of a "big push" in industrialization is an early example. Murphy, Shleifer, and Vishny (1989) model a more recent version of this idea.

¹¹ This example is from Rodríguez-Clare (2005), which reviews microeconomic models of coordination failures.

¹² Hoff (2000) reviews models of coordination failures in a wider range of contexts, including social norms and corruption. Cooper (1999) reviews macroeconomic models of coordination failures.

¹³ Wade (1990), Evans (1995), and Kohli (2004) examine the role of governance in the industrial policy of the East Asian countries from the 1960s to the 1990s. Robinson (2009) discusses how governance issues have constrained industrial development policies in most parts of the world.

capacity exists and a first-best policy has been identified, those in power may not have the incentive to choose that policy. Indeed, specific actors in the policy arena may be able to design or implement a policy that maximizes their private benefits, rather than social welfare because they have so much bargaining power. This Report defines this arrangement as *capture*. Capture is not easy to identify, and there is a risk of mistaking what was simply a misinformed policy choice for deliberate subversion. Recent years have seen a burgeoning of quantitative research into this question. This research has detected specific forms of capture, and in some cases has even measured its efficiency costs.

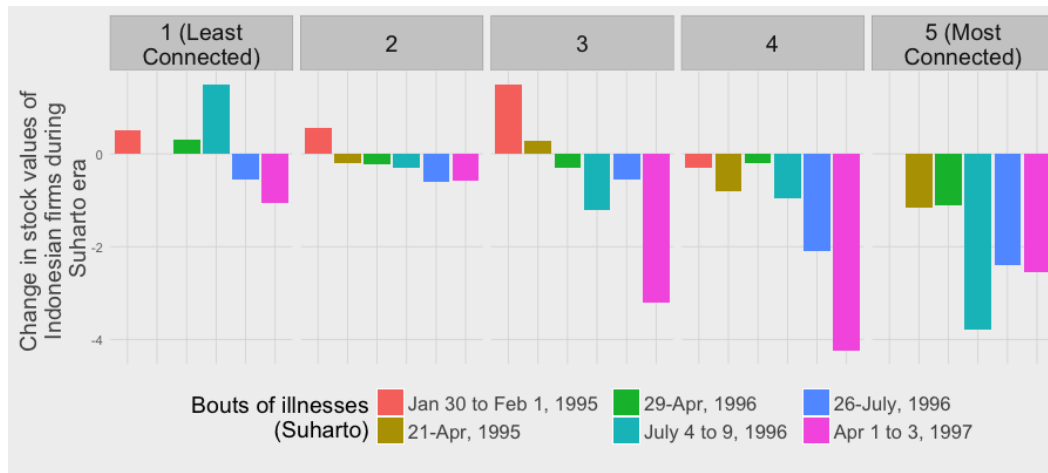
5.23 For instance, studies of trade policy suggest that even in high-income countries, policy choice can unduly reflect the preference of groups with high levels of influence in the policy arena. While low trade barriers are generally good for long-term growth, domestic industries that compete with imports stand to lose from them in the short term. Political influence or campaign contributions from industry lobbies and labor unions have been shown to affect the setting of import tariffs. Larger and better-organized industries that compete with imports tend to win more import protection.¹⁴

5.24 The potential power to influence policy is distributed unevenly not only across industries, but also across firms within industries. In most countries, some firms are much better connected to the government than others. Sometimes, state actors collude with such politically connected firms to subvert a policy in the interest of those firms, possibly to the detriment of unconnected firms in the same industry. Such capture by connected firms may not be as visible or as large scale as, say, setting high tariffs in import-competing industries. However, the evidence suggests that it is far from trivial in economic terms.

5.25 In the 1990s, for example, some of Indonesia's largest industrial groups had strong connections to then-President Suharto.¹⁵ Between 1995 and 1997, negative rumors about President Suharto's health circulated on several occasions. In every episode, the more closely that industrial groups were connected to the president, the more their stock market returns fell (figure 5.4). This fall in value was greater the more severe the health rumor. Because this decline was not connected to other changes in market conditions or the productivity of connected firms, the drop in share price is a proxy for the private benefits of being able to capture policy through political connections (Fisman 2001). Using a similar method, the estimated value of political connections in the Arab Republic of Egypt in the Mobarak era was about 13 percent to 16 percent of firm value (Chekir and Diwan 2014).

¹⁴ For evidence from developed countries, see, for instance, Goldberg and Maggi (1999), Gawande and Bandyopadhyay (2000), Mitra, Thomakos, and Ulubaşoğlu (2002), and Esfahani (2005).

¹⁵ Suharto was the second President of Indonesia, holding the office for 31 years from the ousting of the first President Sukarno in 1967 until his resignation in 1998.

Figure 5.4 The stock value of politically connected firms falls when the connection is jeopardized

Source: Fisman (2001, figure 1).

How politically connected firms gain undue advantage

5.26 The benefits of policy capture to connected firms can be economically significant. Understanding the ways in which it occurs is therefore important.

5.27 *Diverting credit.* One way in which state actors favor connected firms is to divert government loans to them. In Pakistan, for example, between 1996 and 2002, politically connected firms borrowed 45 percent more and had 50 percent higher loan default rates than other firms (Khwaja and Mian 2005). This preferential treatment was related entirely to loans from government banks. Moreover, it increased when the power of the connected politician increased, and fell when there was more electoral competition in his constituency. In Brazil, firms that made campaign contributions to winning candidates in the 1998 and 2002 elections had higher returns and subsequently received greater credit from banks (Claessens, Feijen, and Laeven 2008). A study of Malaysia at the time of the Asian financial crisis finds that the market value of politically connected firms improved relative to other firms after international capital controls were imposed, suggesting that connected firms had easier access to domestic credit (Johnson and Milton 2003).

5.28 *Granting import licenses to favored firms.* Another way to channel favor to connected firms is to grant import licenses only to specific (favored) firms. In Suharto-era Indonesia, being politically connected tripled the likelihood of receiving a license relative to a firm's competitors. The licenses conferred monopolistic power on the licensee. For example, a highly connected firm in the milk industry was granted import licenses for 12 inputs necessary to produce milk, whereas some other firms in the same industry had 3 to 4 licenses, at most. This forced competitors to rely on the connected firm or on inferior domestic supplies (Mobarak and Purbasari 2008).

5.29 *Using market regulations to favor firms.* Market regulations can also be used to favor connected firms. For example, regulatory barriers to the entry of new firms can be a means of protecting incumbents, to the detriment of market entry and competition. In Tunisia during the regime of Zine El Abidine Ben Ali, firms under the control of the ruling clan accounted for a

disproportionately high share (21 percent) of total private sector profits (Rijkers, Freund, and Nucifora 2014). The superior profits of these connected firms may have been due to the heavy regulation of firm entry, investment, and foreign direct investment in the sectors where they had a heavy presence. The gap in profits between connected firms and others was higher in more regulated sectors, suggesting that entry regulation served to shield connected firms from competition. There is similar evidence from Mobarak-era Egypt (Diwan, Keefer, and Schiffbauer 2015).

Political cycles and populism

5.30 Potentially, any group of firms, workers, or consumers that is politically influential can exert influence on policies. For example, the adoption of "Green Growth" policies that are socially beneficial and would not necessarily slow down economic growth could be blocked by influential groups of farmers or consumers who stand to lose from them in the short term (box 5.1). And sometimes it is hard to predict which side will manage to tilt policies in its favor. Regulation of utility industries is a typical case. In such industries, the unregulated price can be inefficiently high, and there is a valid economic argument for regulating the price. Regulators might set too high a price if they collude with the utility firm. On the other hand, regulators might set too low a price if countervailing influence from consumer advocacy groups prevails.¹⁶

5.31 *Tilting policies in the favor of politically influential groups.* Sometimes, politicians direct public investment to benefit narrow groups of supporters (*clientelism*) (see chapter 6). Such client-based allocation of public investment is likely to be highly inefficient. More generally, public resources can be allocated in favor of politically influential groups without necessarily involving a strict patron-client relationship.

¹⁶ See, for example, Stigler (1971) and Peltzman (1976) for theory; and Dal Bo (2006) for a review of the empirical evidence on capture, largely from the United States.

Box 5.1 Why some people see red when they hear Green Growth

“Green growth is about making growth processes resource-efficient, cleaner and more resilient without necessarily slowing them.”^a There are many reasons why environmental conservation is also good for long-term economic growth and development. Economic production depends on the stock of natural resources and on environmental quality (“natural capital”). Green growth strategies can increase natural capital by preventing environmental degradation. Environmental protection can also contribute indirectly to growth by correcting market failures. For example, a policy that addresses market failures leading to urban congestion can improve air quality and increase urban productivity. Greener growth can also improve well-being directly by improving air and water quality.

However, switching to greener growth strategies could impose short-term costs on some groups in society. Take the case of organic fertilizer. Smaller and more targeted doses are better for the environment in the long run, but conventional fertilizer is less costly and easier to use. Malawi faced this problem in 2005, when to cope with food insecurity, it introduced a fertilizer subsidy for smallholder maize farmers. Intensive use of conventional fertilizer did lead to an immediate increase in farm output. Because small farmers would not find it easy to adopt greener approaches using smaller, targeted doses and more organic fertilizers, efforts to phase out the subsidy could have hurt maize farmers for some years.^b

It could be that the groups that stand to lose from green growth policies in the short term have oversized influence over the policy arena, and are able to block reforms and undermine commitment. Because the costs are concentrated, and many of the benefits from cleaner technologies are intangible and dispersed, the potential losers from such reforms are likely to be better able to organize. They can also constitute a strong electoral constituency. Malawi’s fertilizer program, for instance, has been popular among small farmers—an important constituency. In other cases, switching to greener growth strategies can entail losses for influential groups of consumers and firms. For example, South Africa announced an ambitious climate change plan in 2010, one that would necessitate a large reduction in the share of electricity generated by coal-fired plants, in a country where electricity is in short supply and coal is a relatively abundant source. The plan, despite being watered down a year later, has been opposed by consumers, labor unions and business interests, particularly those in mining and heavy industry.^c These examples show that the design of green growth policies must take into account how the potential resistance from short-term losers.

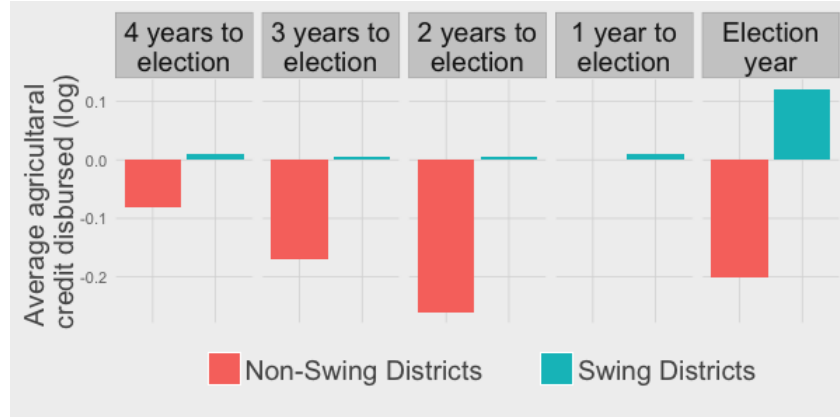
Sources: Hallegatte and others 2012; Resnick, Tarp, and Thurlow 2012.

a. Hallegatte and others 2012.

b. Resnick, Tarp, and Thurlow 2012.

c. Resnick, Tarp, and Thurlow 2012.

5.32 For example, many countries have developmental programs that direct state credit to small firms, rural enterprises, and farmers. This credit can be used to favor groups that have outsized political influence. One study finds that in India during 1985–2009, agricultural credit from state banks would increase by 5–10 percentage points in an election year (figure 5.5) (Cole 2009). This increased lending during election years targeted places where the electoral race was particularly close, hinting at the political motives behind the credit boom. Such political cycles in government lending during elections years have been observed in many countries (Dinc 2005). In Italy, the interest rates charged in the 1990s by politically affiliated banks varied with the election cycle, which is also suggestive of political influence on lending (Sapienza 2004).

Figure 5.5 Government credit to electorally competitive districts increases during election years in India

Source: WDR 2017 team, using data derived from Cole (2009, figure 1).

Note: The data cover 1985 to 2009.

5.33 *Misallocating public investment.* Failed industrial development programs provide another example of how political influence can undermine growth by misallocating public investment. Governments often direct public investment to specific sectors or regions, ostensibly to address coordination failures. Such programs could become a vehicle for providing hidden benefits to politically influential groups (Coate and Morris 1995). For instance, landowners and workers in politically important regions might gain if an industrial zone is located in their region and raises land prices and wages.

5.34 The disappointing experience of Sub-Saharan Africa with industrial coordination policies is illustrative. Defying economic logic, one program in Ghana involved the transport of cattle hides to a tannery 500 miles to the south of the country, only to send the leather back north to a footwear factory 200 miles away, all to serve a market a further 200 miles north. Poor siting of the tannery thus rendered the program economically unviable (Robinson 2009). Some of these case studies conclude that poor location decisions were the outcomes of political influence. In Zambia, for example, the Industrial Development Corporation evidently chose economically infeasible locations for many subsidiary firms mainly on the basis of providing employment in rural areas (Robinson 2009).

The cost of capture

5.35 The most obvious cost of policy capture is the inefficient allocation of public resources. For example, bank loans should go to the most productive firms, but that is not necessarily the case when lending is based on a firm's political connections. In Pakistan, connected firms got a disproportionately large share of credit but were more likely to default on their loans than other firms, and were less productive. Based on the gap in productivity between connected firms and other firms, the annual loss from giving disproportionate amounts of credit to connected firms could have been as high as 1.6 percent of GDP (Khwaja and Mian 2005).

5.36 Such misallocation can also have a long-term cost on growth through detrimental effects on the basic economic process of creative destruction: that is, the entry of new firms, investment

by existing firms to become more productive, and the exit of unproductive firms.¹⁷ Entrepreneurship is likely to be discouraged in an environment where firms with political influence earn rents (disproportionate benefits) at the expense of more efficient or more innovative firms that lack influence. By tilting the playing field against ordinary firms, such capture can also make growth less inclusive. Measuring such long-term costs is difficult.

5.37 This reckoning of the costs of undue influence on policies is relative to a benchmark in which resources are efficiently allocated. However, the removal of means of rent seeking by influential firms could have other systemic effects on the economy. Indeed, there is a view according to which many low-income economies are characterized by socioeconomic relationships based not on impersonal rules, but on personal connections and privilege.¹⁸ In this political order, the elites manipulate the economy to maintain rents for powerful groups. This serves to maintain social order and restrain violence. In such a world, “capture” is just one manifestation of deeper political economy problems, and so long as those are not addressed, simply prohibiting means of capture and rent seeking will not lead to efficient outcomes (Acemoglu and Robinson 2013).

When interest group influence is not necessarily bad for policies

5.38 Sometimes, the self-interest of powerful businesses can coincide with policies that are good for long-term growth. The expansion of trading opportunities in the Mediterranean in the tenth to twelfth centuries, for example, led to the establishment of a broad-based merchant class in that part of the world. This merchant class was interested in market-supporting institutions that would enable trade for all its members. It used its economic power to push for the establishment of robust contracting institutions and constraints on the executive (by ending the practice of hereditary Doges in Venice and instituting a de facto parliament). Similarly, the merchant class that arose in Great Britain because of the growth of Atlantic trade in the 1600s pushed for better property rights and contracting institutions.¹⁹

5.39 Case studies that are more contemporary suggest that business associations have helped governments improve various dimensions of the business environment (such as secure property rights, fair enforcement of rules, and provision of public infrastructure) for their collective benefit, through lobbying efforts or better monitoring of public officials (Doner and Schneider 2000). They have also helped in solving coordination problems. The Republic of Korea’s phase of growth through export-oriented industrialization, which lasted for three decades, exemplifies this kind of pro-growth state-business interaction.²⁰ Other cases include the footwear manufacturers’ association in Brazil, the coffee federation in Colombia, and the textile manufacturers’ association in Thailand, all of which played a coordinating role in reducing the costs of information about export markets (Doner and Schneider 2000).

¹⁷ See Aghion, Akcigit, and Howitt (2014) for a summary review of this theory of growth.

¹⁸ See Pritchett and Werker (2012) for a discussion of “deals-based” systems. A similar concept of “limited access order” is discussed in North, Wallis, and Weingast (2009).

¹⁹ See Puga and Trefler (2014) (on Venice) and Acemoglu, Johnson, and Robinson (2005) (on Atlantic trade). The background note for WDR 2017 by Levchenko (2016) provides a summary of recent research on impact of trade on institutions.

²⁰ See, for example, Evans (1995). However, the story of the Republic of Korea also suggests that productive business-state relationships can sometimes degenerate into instruments of capture. There is evidence that large businesses eventually captured some of the state support that was meant to kick-start investment (Eichengreen 2012).

5.40 *Broad-based business associations* are more likely to have an interest in pushing for better institutions rather than narrow rents. It is in the collective interest of firms in an industry to prevent policy capture by a few of them. Industry groups can develop collective mechanisms that prevent members from colluding with state officials and subverting policies in their narrow interest (Dixit 2015). Case studies suggest that business associations whose membership represents a large segment of the industry tend to be more influential, and more “developmentally oriented” in their influence (Doner and Schneider 2000).

5.41 *The extent and type of transparency* also affects the nature of state-business interaction. When a state agency and the firms with which it interacts have a monopoly over critical information, there is a greater scope for them to collude and subvert policy in their mutual interest. Consider the regulation of a natural monopoly such as a public utility. Typically, the regulatory agency would cap prices and compensate the utility firm based on an assessment of the latter’s cost of production. In such situations, the firm could gain by colluding with the regulator to overstate its cost. The gain to such collusion is larger (and the chances that it will be detected, lower) when the regulator and the firm know more about the cost than others do (Laffont and Tirole 1991, 1993).

5.42 *The nature of the government agencies that interact with firms* also determines when state-business links will degenerate into narrow interest group capture. One example is the design of some industrial development agencies in East Asia from the 1950s to 1970s. Japan’s Ministry of Trade and Industry (MITI), for instance, combined bureaucratic autonomy with strong business ties. While this was necessary for the agency to be effective in coordinating industrialization, it also exposed it to capture. MITI, however, was also highly meritocratic, with bureaucrats following long-term career paths, clear rules, and established norms. It drew staff largely from a select group of elite technocrats who had strong informal ties to one another, giving the agency an unusually high level of internal coherence. This organizational strength may have prevented MITI from being captured by narrow interests (Evans 1995; Wade 1990).

Policy design under risk of capture

5.43 How should the risk of undue influence from dominant groups be taken into account in the design of policies and the government agencies responsible for their implementation? This chapter first discusses a pragmatic approach to policy design that duly considers the probability of capture.

Designing policies that are implementable

5.44 Sometimes, when the possibility of capture looms large, policies that are first best on the basis of economic efficiency are less implementable than second-best ones. Why? Even a powerful interest group must expend effort and resources to gain influence. The benefits of a second-best policy might be too small to make it worth the cost for interest groups to expend such effort and resources. Building on this insight, policies are often designed to give less room for discretion at the implementation stage. For instance, when a regulator mainly enforces rigid rules, there is less

scope for subverting the enforcement of those rules to award undue favor. As a result, the benefit from capture is too low.²¹

5.45 Admittedly, designing policies that are less susceptible to capture involves a trade-off with efficiency. Replacing regulatory discretion with rigid rules gives the regulator less room to adapt enforcement to changing conditions. Rigid regulation thus imposes excessive costs on firms.

5.46 The risk of capture by self-interested, myopic state actors can also be addressed through pragmatic policy design—although with the same efficiency trade-offs. Think of a situation where a government wants to attract foreign direct investment (FDI), but there is a history of FDI disputes, and investors are hesitant because they perceive a high risk of expropriation. While strengthening checks and balances on state actors can reduce the perceived likelihood of expropriation, such institutional reforms take time. In the meantime, there are ways to design the FDI contract that make expropriation less likely. Efficiency dictates a revenue-sharing scheme in which the host country gets a fixed amount every period, leaving the investor with strong incentives to increase profitability. However, when expropriation is a possibility, a more practical revenue-sharing scheme is one in which the host country automatically gets more (less) revenue when profits are high (low) (Engle and Fischer 2010). This scheme reduces the government’s incentive to expropriate when profits are high.

5.47 To put it in general terms, policies that are compatible with the existing balance of power may not be ideal, but they can effectively deliver growth. For example, in China, the Township Village Enterprise (TVEs) policy yielded strong investment growth until the mid-1990s (Qian 2003; Yao 2014). This was an unusual way of committing to property rights because TVEs were under the control of local community governments, and not, as is more common, under fully private or central government control. Nevertheless, it was effective, given China’s context at that time. China had inherited a strong ideology opposing private property from the era of central planning, and firms lacked legal protection for their private property rights. However, the central government was less likely to interfere with the property rights of TVEs because it needed the political support of local governments. This made the commitment to TVEs’ property rights credible.

Anticipating how a policy could change the balance of power

5.48 Beyond its immediate impact on investment and production, an economic policy could have far-reaching consequences for governance—and hence growth—by altering the balance of power. Consider how a policy that promotes international trade could have such an effect. As discussed earlier, in both eleventh century Venice and seventeenth century Britain, the growth of trade led to a rising merchant class, which in turn helped establish strong contracting and property rights institutions. But theory suggests that these effects were not inevitable, for trade does not always affect the distribution of economic power and incentives in the same way (Do and Levchencko 2009). Indeed, over time, Venetian wealth from trade became concentrated in a narrower set of merchant families. No longer needing the support of smaller merchants, they used their power to institute an oligarchy (Puga and Trefler 2014).

²¹ Laffont and Tirole (1993) formalize this idea. Glaeser and Shleifer (2003) present a theory along similar lines in their study of the rise of regulation in the United States in the early decades of the twentieth century.

5.49 The sugar boom that swept over the Caribbean islands around the 1650s, and lasted for more than 200 years, also illustrates this point. Before the advent of large-scale sugar production, these islands were typically smallholder peasant societies. The sugar boom concentrated power in the hands of large plantations owners—a development that has been associated with the rise of slavery, as well as the persistent undermining of the property rights of small farmers in the region. This institutional stunting had serious adverse consequences for long-term growth (Levchenko 2016, for WDR 2017).

5.50 Thus, when assessing a policy that seems optimal in theory, it is important to ask if in the given context, it could concentrate economic power in a way that would ultimately undermine institutions.²² Consider the experience of Russian Federation and Eastern European countries in their transition toward market economies. At the time, there was a consensus among economists that privatization of state-owned enterprises (SOEs) was a priority for improving the efficiency of these economies. Thus, Russia and many Eastern European countries focused on rapid, large-scale privatization of SOEs. But the way in which this was implemented created a new class of oligarchs that were able to block other policies that could promote competition (such as easing the procedure for setting up a new business). As a result, many of these economies are still struggling with inefficient, oligopolistic industries. In contrast, Poland chose to focus first on reforms making it easy for new firms to enter, and privatized existing firms more gradually. This sequencing created a class of young firms that were collectively interested in further reforms, while preventing the sudden emergence of a powerful group of large firms that could block reforms (Jackson, Klich, and Poznanka 2005).

How the design of public agencies mediates the influence of powerful groups

5.51 Why is it that some public agencies are able to work with different interest groups to design and implement policies without being unduly influenced by any particular group, while others get captured by dominant groups? The answer depends on a number of features of the internal design of bureaucracies, such as how officials are selected, how the performance of officials is assessed and rewarded, and how much discretion they have in implementing those goals. The allocation of functions across agencies, and the role of oversight agencies such as auditors, also matters (Tirole 1994). Finally, as discussed in the *World Development Report 2015*, bureaucratic norms can emerge that facilitate or obstruct capture.²³

Selection methods, incentives, and intrinsic motivation

5.52 Recently, a number of studies have empirically examined how selection and incentive structures in bureaucracies affect the behavior of officials. This research can be useful for understanding how agency design could make officials less susceptible to bribery or other forms of undue influence by those seeking to capture a policy.²⁴

5.53 Consider tools that provide incentives, such as pay-for-performance schemes. Randomized evaluations of these schemes in the context of frontline provision of public services finds that the

²² See Acemoglu and Robinson (2013) for an evidence-based discussion of this argument.

²³ See spotlight 1 of WDR 2015 (World Bank 2015, 60).

²⁴ Some of the discussion in this section is based on a review paper by Finan, Olken, and Pande (2015).

performance of public officials in fulfilling their tasks improves.²⁵ Pay-for-performance could also weaken the incentives of officials to collude in policy capture, if that would mean missing performance targets.

5.54 But there are settings in which an overreliance on financial incentives could backfire. One issue with incentive schemes is that many government agencies have multiple objectives. Making officials' pay too dependent on achieving any one objective can lead to a disproportionate focus on that objective, to the exclusion of others (Tirole 1994). For example, when police agencies in the United States are allowed to keep the revenue they obtain from assets they seize in drug arrests, they increase drug arrests, but at the cost of reducing enforcement of other petty crimes (Baicker and Jacobson 2007). Focusing on one-dimensional incentives could also encourage overzealous or biased behavior by officials. This concern is especially salient among officials whose jobs involve the exercise of expert judgment, such as regulators and judges. Making their rewards dependent on taking a particular position could induce them to distort their judgment routinely in favor of that position. For example, a regulator who is rewarded according to the number of violations detected might become too zealous in detecting "violations," or demand even higher bribes to not report violations.

5.55 In such settings, the design of selection methods may be a more effective lever. It has been shown that selection methods can influence the degree to which officials are responsive to particular interest groups. A study that compares direct election with political appointment of power utility regulators across U.S. states finds that elected regulators have a more pro-consumer stance (Besley and Coate 2003). Regulatory policy is just one of many policy areas that politicians are responsible for, and it is not very salient to voters. As a result, appointed regulators are more likely to respond to the interests of political elites than voters. But when regulators are appointed through voting, regulatory policy becomes salient to voters.

5.56 "Intrinsic motivation" is another lever for influencing the behavior of officials. Surveys and lab experiments suggest that public officials are intrinsically more motivated toward public service than private sector employees are.²⁶ Such pro-social motivation is also correlated with better job performance (Perry and Hondeghem 2008).

5.57 It is possible to design the work environment in ways that enhance intrinsic motivation. For instance, reduced caseloads and increased salaries have a more positive effect on the performance of judges in U.S. state supreme courts when those judges are given more discretion in selecting cases (Ash and MacLeod 2015). This is consistent with the hypothesis that judges are intrinsically motivated to work hard on important cases. Reducing caseloads and increasing salaries give them the time and financial security to focus on producing high-quality judgments, especially when they have the discretion to choose important cases.

5.58 The extent to which officials are already motivated in a pro-social direction could have an important impact on how changes in the operating environment in a public agency play out. If officials care only about monetary rewards and are susceptible to bribes, reducing the extent of

²⁵ See, for example, Banerjee, Glennerster, and Duflo (2008), Glewwe, Illias, and Kremer (2010), Basinga and others (2011), Muralidharan and Sundararaman (2011), Duflo, Hanna, and Ryan (2012), and Gertler and Vermeersch (2012).

²⁶ See Cowley and Smith (2014) for survey-based evidence, and Banuri and Keefer (2013) for evidence from lab experiments.

discretion in decision making can restrict the scope for capture. But this approach might not be effective in an agency where levels of intrinsic motivation for public service are already high because it could undermine that intrinsic motivation.

5.59 Designing selections methods that attract more intrinsically motivated officials is another promising approach, but evidence on it is limited. A recent field experiment randomized salaries for public sector job offers in Mexico to test whether higher wages attract more motivated officials (Dal Bó, Finan, and Rossi 2013). Higher compensation was associated with increased quality of the applicant pool: that is, the applicants were smarter, had better personality traits, higher earnings, and a better occupation profile. Remarkably, the high-wage applicant pool was also more motivated toward public service. But some other studies suggest that offering higher wages attracts quality (as reflected in previous wages and work experience) at the expense of pro-social motivation (Finan, Olken, and Pande 2015).

Norms in public organizations

5.60 Conformity to accepted norms of behavior in one's organization could be a powerful driver of individual behavior in government organizations. Honesty can become a self-reinforcing norm in some agencies, while corrupt norms of behavior can set in in others.²⁷ In organizations where corruption is considered acceptable because "everyone does it," a temporary reform that shocks some officials into behaving more honestly could disrupt this bad norm, leading to a permanent, self-reinforcing improvement.

5.61 Although systematic evidence on such norm-shifting reforms is lacking, an example from the Republic of Korea's past suggests that an intervention that operates on multiple fronts to shift norms could work. "Park Chung Hee, president of Korea from 1961 to 1979, inherited from Syngma Rhee a corrupt bureaucracy that chose policies based on self-enrichment. Within a month of seizing office, Park dismissed the top 10 percent of bureaucrats, jailed a number of the country's leading businesspersons for corruption, and sent the rest of the bureaucracy to two-week training courses in management, efficiency, and public spiritedness. He then monitored the performance of economic bureaucrats and quickly shifted them from one bureau to another so that they could not develop corruption networks. These efforts transformed the government's functioning" (Hoff 2000, 19).

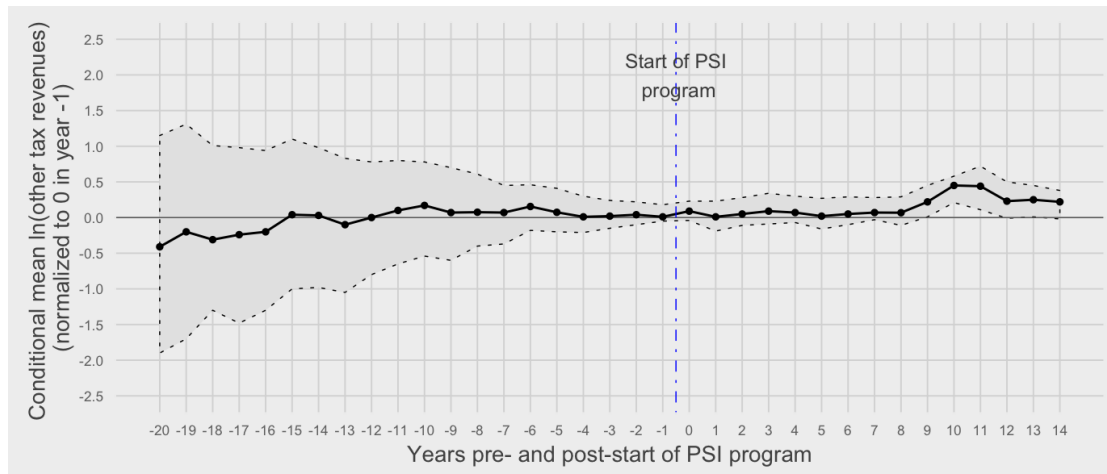
Monitoring

5.62 Monitoring by higher agencies can deter officials from colluding in policy capture, and generate useful information for third parties that are interested in preventing capture. Audits, for example, have been shown to reduce leakage in village-level public investment programs (Olken 2007). Informed third parties can also be recruited as monitors. Consider customs fraud (such as the underreporting of import values), one way in which firms can subvert the implementation of trade policy through bribery or other means of influence (Fisman and Wei 2001; Sequeira and Djankov 2014). In this case, foreign inspectors at the point of origin have accurate information about the value of shipments, and are less susceptible to the influence of domestically powerful firms. A study using data from 104 developing countries between 1980 and 2000 finds that

²⁷ This, in the language of game theory, is the existence of "multiple equilibria" in organizations: one in which honesty is a self-reinforcing norm, another in which corruption is the norm. See Bardhan (1997) and Hoff (2000).

countries that hire foreign inspectors to verify the tariff classification and the value of shipments before they leave their origin country increase import duty collections 15 to 30 percentage points, on average (Yang 2008) (figure 5.6).

Figure 5.6 Third-party monitoring increases tax revenue by reducing customs fraud



Source: Yang 2008.

Note: PSI = Pre-shipment Inspections. Data are for 104 developing countries between 1980 and 2000. The scale in the y-axis is normalized to 0 in year -1.

5.63 But monitoring has its limits. Monitoring can make officials overcautious, worsening their performance.²⁸ And monitors themselves are not immune from capture. Such was the case of a system of environmental audits of firms in an Indian state (Duflo and others 2013). In the prevailing audit system, auditors who had been hired by the firms themselves were conducting pollution audits. A study found that such auditors underreported the incidence of pollution by firms. Replacing this system with one in which auditors were randomly assigned to firms and paid fixed wages from a central pool reduced the underreporting of pollution by auditors.

Accountability through horizontal checks and balances

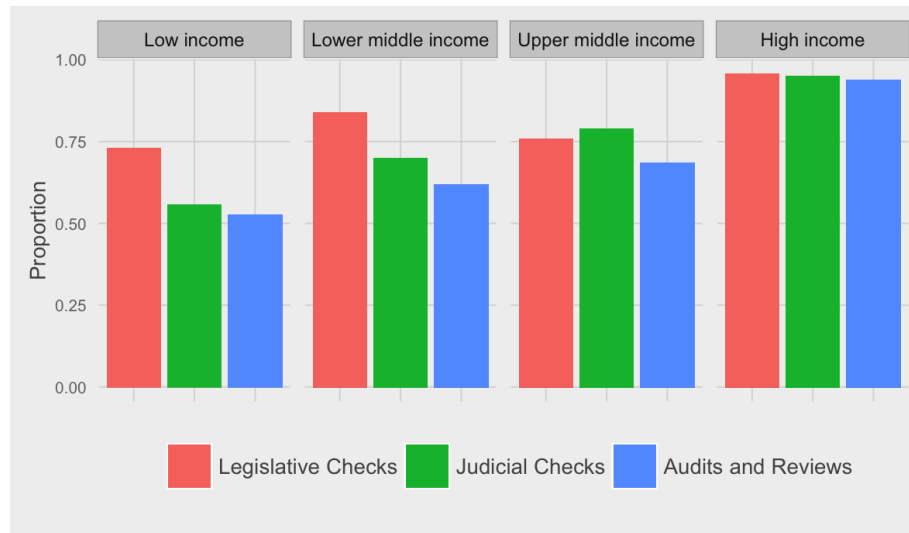
5.64 *Effective checks and balances* within the government should reduce the risk of short-term, opportunistic behavior by a few state actors. Consistent with this hypothesis, there are fewer disputes about foreign direct investment in counties with stronger horizontal political constraints, as measured by the number of independent branches in government with veto power over policy change, and the degree of party alignment across different branches of government (Jensen and others 2012). Even in authoritarian regimes, the existence of legislative bodies increases investment by raising the cost of expropriation (Wright 2008).

5.65 Compared to high-income countries, formal checks and balances within government in low- and middle-income are weak, on average (figure 5.7). Strengthening these institutions is a long-term project. However, the principle of accountability through horizontal checks and balances

²⁸ Lichand, Lopes, and Medeiros (2015) find evidence that monitoring of municipal audits reduced procurement, and thereby worsened health outcomes.

lends itself to other approaches tailored to the specifics of the context. In post-Mao China, for example, the ruling party instituted mechanisms that increased the flow of information to party cadres and gave them the potential to organize collectively in the face of any expropriation by the state. In effect, this was a mechanism of accountability within the ruling party, underpinning the security of investments made by party cadres (Gehlbach and Keefer 2011).

Figure 5.7 Formal checks and balances are weaker in low- and middle-income countries



Source: WDR 2017 team, using data the World Justice Program and the World Development Indicators.

5.66 *Dividing power between government agencies and creating independent oversight agencies* can reduce the chances of “grand” capture of policy by dominant special interest groups. This principle can be illustrated by considering the design of regulatory agencies.

5.67 When regulators and regulated firms have a monopoly over information pertinent to the regulation (such as the firms’ cost structure), they can collude over regulatory design. In such circumstances, the division of power across regulatory agencies can reduce the monopoly over information and thus deter collusive capture (Laffont and Martimort 1999). But such a division of power is not without its drawbacks. It can make it harder to coordinate regulatory policy, and slow down decision-making. Further, suppose that the regulator is in fact motivated by public interest, while acquiring information and expertise for regulatory design is difficult. In such cases, splitting functions between agencies could be counterproductive because a single agency would find it easier to consolidate information and expertise.

5.68 There is evidence that review and oversight of regulatory agencies by other government branches, such as the judiciary, can help prevent or invalidate regulatory decisions that are not in the public interest. Looking across countries, the strength of judicial independence and constitutional review (the power of courts to check laws passed by the legislature that go against a rigid constitution) are associated with stronger protection of property rights and less regulation of firm entry (La Porta and others 2004). In the United States, the delegation of decision-making authority to bureaucratic agencies and of arbitration authority to courts helped make regulatory policies more consistent (Spiller and Tommasi 2005). It has also helped to level the playing field for

less powerful actors. However, judicial review has its limits; in particular, the judiciary can only step in after being approached by an affected party with the legal standing to do so (Magill 2013).

5.69 Experience with the U.S. Office of Information and Regulatory Affairs (OIRA) suggests that the existence of an agency tasked with cross-cutting oversight of regulators, based on cost-benefit analysis, can also help prevent capture. It has been hard for any particular narrow interest group to capture OIRA because it is a generalist institution, and not focused on a single regulatory issue. Moreover, its practice of using standardized cost-benefit analysis in assessing regulations also helps counteract the potential use of biased information and analysis by industry or consumer interest groups to influence regulations (Livermore and Revesz 2013).

5.70 Institutions of accountability are also politically embedded, and could be subverted by powerful narrow interests. Nonetheless, even in countries with complicated and far-reaching governance environments, the state is rarely monolithic, and accountability institutions often manage to preserve autonomy. A recent case study of telecommunications in three middle-income countries—Mexico, South Africa, and Turkey—is illustrative. While the telecom sector remains monopolistic or oligopolistic in all of these countries, recent years have seen clear improvements in access, technology, and market competition. One reason is that accountability institutions—the judiciary, competition commissions, and telecom regulators—have often acted autonomously against anticompetitive practices (Atiyas, Levy, and Walton 2016, for WDR 2017).

Mechanisms of vertical accountability and increased contestability

5.71 While economically dominant groups such as large firms have the resources to gain influence in the policy arena, consumers and citizens are a diffuse interest group, facing a collective interest problem when advocating for their policy preferences.²⁹ Hence, mechanisms of vertical accountability that facilitate contestability by citizen (or consumer) groups could help balance influence in the policy-making process.

5.72 *Media coverage* can help reduce the influence of special interest groups on policies by increasing the influence of ordinary voters, recent research suggests. A study documenting the effect of “muckraking” magazines on the voting patterns of U.S. representatives and senators in the early part of the 20th century shows that media coverage induces more populist legislative outcomes (Dyck, Moss, and Zingales 2013). When the benefits of preventing special interest capture of a policy are diffuse, individual voters may lack the incentive to exert effort to gather information about that policy. The media can therefore substitute for “collective action” in information gathering. This populist tilt is likely to be stronger when the policy issues are more newsworthy and the media is profit maximizing because these factors increase the incentives of the media to cater to a wider consumer base, especially low-income groups.

5.73 *Procedural requirements on government agencies to seek diverse inputs during policy design and rollout* can also balance influence. In the United States, the Administrative Procedure Act has put in place a series of procedural requirements that provides for participation of different interest groups in the regulatory process. Under this Act, “Regulatory agencies must provide notice, must inform about proposed rule makings, must make their decisions taking into account

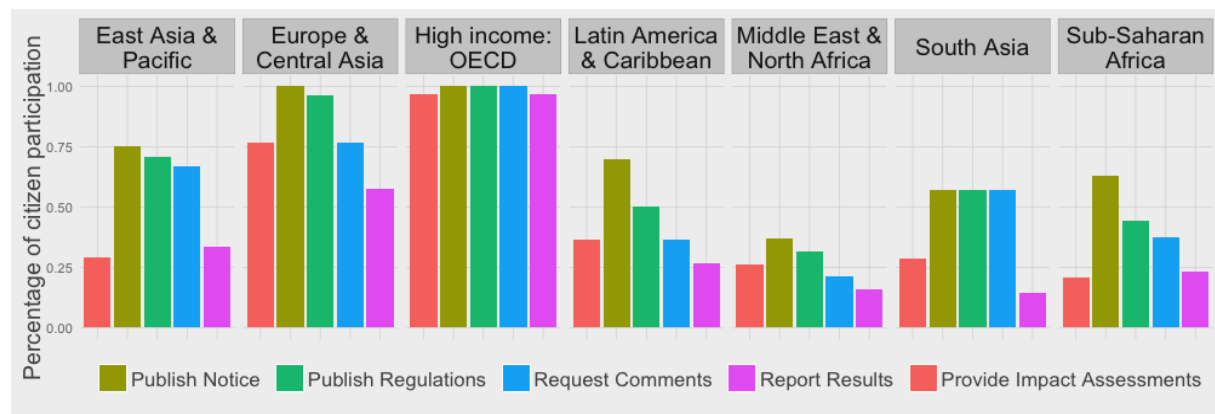
²⁹ A classic exploration of this idea, in the context of regulation, is Stigler (1971).

the submissions of interested parties, and cannot rush nor make decisions in the dark” (Spiller and Tommasi 2005, 535).

5.74 *Mechanisms that facilitate policy input from consumer and citizen advocacy groups* can also countervail the influence of dominant industry lobbies. There is evidence to this effect from the context of regulatory bodies in the United States, which have devised a range of mechanisms that facilitate consumer advocacy.³⁰ In the 1970s, the big oil price shocks ended a period of declining prices, and many energy utilities sought an increase in the prices that they were allowed to charge. In response, many states introduced consumer advocacy groups to balance the pressure from producers. Price increases were lower in these states, indicating an increased influence of consumers in regulatory price setting (Holburn and Spiller 2002).

5.75 Participatory mechanisms in regulatory institutions are still relatively uncommon in low- and middle-income countries (figure 5.8).³¹ For instance, most high-income countries provide advance notice of regulatory changes, and make information about existing regulations publicly available. This is relatively uncommon in low- and middle-income countries. Mechanisms to collect feedback from the public are also rare in those countries, as are those that report on the results and impact assessments of regulatory policies.

Figure 5.8 Formal avenues for broad-based participation in regulatory decision making are limited in low- and middle-income countries



Source: WDR 2017 team, using the World Bank’s citizen engagement in rulemaking data.

Finding the right approach

5.76 In conclusion, there are ways to alter both policy and institutional design that can reduce the harm from capture. In terms of policy design, it is important to think pragmatically about the risk of undue influence and identify implementable policies—if not first-best ones. Another lesson is to avoid policies that look good in the short term but could end up reinforcing the power of dominant groups that could block further reforms.

³⁰ Dal Bó (2006) reviews the empirical evidence on advocacy and other accountability interventions in the context of regulatory bodies. Schwarcz (2013) presents a case study of some citizen advocacy mechanisms in the context of insurance regulation across U.S. states.

³¹ <http://rulemaking.worldbank.org>.

5.77 Better public agency design can help expand the set of implementable policies. First, how public officials are selected into service and the incentive structure they face within their organizations matter. This should take into account not only economic motivation, but also intrinsic motivation for public service and norms of behavior. In policies where there is a significant role for discretion during implementation, credible monitoring mechanisms can further discipline implementation. Second, mechanisms of horizontal and vertical accountability in public agencies also help balance influence in the policy arena. For instance, general-purpose oversight agencies can act as a check on the capture of agencies in charge of specific policy areas. Mechanisms that facilitate less powerful, diffuse interest groups in having a bigger say in the policy arena could help even out influence from more powerful, narrow interest groups.

Translating reform principles into solutions

5.78 The discussion of regulatory agency design in the United States served to illustrate some key principles for reform. But this is not to say that low- and middle-income countries with difficult governance environments should simply copy the formal structures of horizontal and vertical accountability that are found to work in high-income countries. Adapting these blueprints to specific governance environments is ultimately a matter of experimentation, but the capacity of existing agencies and the existing balance of power should both factor into this process.

5.79 For example, consider the design of mechanisms for strengthening regulatory advocacy by citizens and small firms. In the United States, some states have created a public agency tasked with acting as a proxy advocate for consumers, while others have opted to offer incentives and support for existing advocacy groups to participate in regulatory decision-making (Magill 2013). Neither approach is likely to be effective in settings where public agencies and consumers advocacy groups have low capacity. However, case studies suggest that some low- and middle-income countries have successfully used participatory mechanisms such as public-private dialogues (PPDs) as an intermediate institutional design for vertical accountability (box 5.2). PPDs do not necessarily rely on the existence of proxy advocate agencies or strong citizen and small business advocacy groups, and instead mobilize local communities in the context of specific reforms. Successful PPDs can go on to become institutionalized more formally.

Box 5.2 Participatory mechanisms in policy design: The “Bulldozer Initiative” in Bosnia and Herzegovina

Strengthening mechanisms to promote inclusive public-private dialogue could lead to better information flows and accountability in the design and implementation of reforms of the business climate. A case in point is the “Bulldozer Initiative” in Bosnia and Herzegovina. The initiative mobilized local business communities to give suggestions for reforms, and to become more engaged with the authorities during implementation. In the process, it reduced the influence of narrow interest groups.

Remarkably, the first phase of the initiative collected 250 proposals to reform the business climate. Independent experts, including economists, lawyers, and industry experts, assessed the proposals through a process designed to minimize undue influence from narrow interest groups. This process was very selective: for example, only 5 percent of proposals made the final list in the second phase. The work of the initiative did not end at designing and selecting proposals: members of the initiative also provided feedback and helped with monitoring during implementation, which lasted more than two years for some reforms. A biannual Bulldozer publication served to inform the public about this process, with the relevant government body receiving a score for each reform being implemented.

An independent evaluation of the initiative suggests that it had positive impacts in terms of identifying and effectively implementing a range of reforms. Following this experience, Bosnia and Herzegovina decided to institutionalize a system of grassroots public-private dialogue for future business climate reforms.

Current evidence on the impact of such initiatives is based on case studies, and large-sample, rigorous evaluations have not been conducted. Given the promising evidence from cases, more pilot initiatives with rigorous evaluations should be encouraged.

Source: Herzberg 2007.

5.80 Countries with difficult governance environments could also experiment with “ring-fencing” reforms—or in other words, building “islands of effectiveness” (Fisman and Werker 2011; Levy 2014). For example, in many countries, the dominance of powerful business groups or other political considerations makes it difficult to liberalize firm entry or to enact other business climate reforms that would increase competition between firms. In such settings, creating Special Economic Zones (SEZs) with their own rules is a way to ring-fence competition within specific locations. China’s extensive use of SEZs, beginning with coastal SEZs that were focused on export-oriented firms, is a case in point. Studies suggest that SEZs led to significant increases in investment and productivity in local economies.

Reforms at the top: The overall governance environment

5.81 Chances are that the agency-level reforms discussed so far will not be pursued seriously absent commitment at the highest levels of policymaking. Consider the varying experience with the introduction of anti-corruption agencies. In 1974, Hong Kong introduced an Independent Commission Against Corruption (ICAC) that reported directly to the governor general of Hong Kong, recruited employees from the civilian population, and paid relatively high salaries. The ICAC was remarkably effective: Hong Kong, China today ranks in the top twenty worldwide of Transparency International’s corruption perceptions index. Nevertheless, the ICAC model has not had much success in other countries. The success of Hong Kong’s ICAC was partly because its governor general reported to the prime minister of England. Its authorizing environment was well governed and stable, and the commitment to making ICAC work did not depend on a fortuitous, fragile configuration of interests at the highest levels (Fisman and Werker 2011). This issue—how the broader governance environment becomes more committed to reform—is discussed in part 3 of this Report.

Trade-offs between growth and equity

5.82 Sometimes, a “solution” to an institutional function such as commitment can deliver growth, but with adverse consequences for equity. For example, coalitions of powerful actors can monopolize resources for investment, solving internal commitment problems but excluding less powerful actors from access to productive resources. The wave of industrialization in Latin America at the end of the nineteenth century and the first part of the twentieth century was characterized by just such an arrangement: the state would protect politically connected, powerful business interests in exchange for a commitment to investment, rent sharing, and political support (Haber, Razo, and Maurer 2003). This arrangement delivered growth, but that growth was not shared widely. A more broad-based form of commitment to property rights would have led to a more equitable path of development. Thus, issues of equity and growth cannot always be considered in isolation when thinking about governance reforms. This chapter is therefore complementary to chapter 6, which focusses on equity and governance.

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Spotlight 5 Middle-income trap

S5.1 Contrary to what many growth theories predict, there is no tendency for low- and middle-income countries to converge toward high-income countries (figure S5.1) (Jones 2015). Recently, considerable attention has focused on countries experiencing growth stagnation at middle-income levels, a condition that Gill and Kharas (2007) coined the “middle-income trap.” Although middle-income economies are no more likely to stagnate than economies at any other income level (Bulman, Eden, and Nguyen 2014), a compelling economic theory that can guide growth for middle-income countries is still lacking. Indeed, this lack of a “satisfactory growth theory” to inform development in middle-income countries was the original reason for referring to a “middle-income trap” (Gill and Kharas 2015). This spotlight uses the Report’s framework to argue that the difficulty many middle-income countries have in sustaining growth can be explained by power imbalances that prevent the institutional transitions necessary for productivity growth.

Figure S5.1 Many countries have not converged toward high-income



Source: WDR 2017 team using Penn World Tables Version 8.1.

Is middle-income growth different?

S5.2 Middle-income countries may face particular challenges because growth strategies that were successful while they were poor no longer suit their circumstances. For instance, the reallocation of labor from agriculture to industry is a key driver of growth in low-income economies. But as this process matures, the gains from reallocating surplus labor begin to evaporate, wages begin to rise, and decreasing marginal returns to investment set in, implying a

need for a new source of growth. Middle-income countries that get “trapped” fail to sustain total factor productivity (TFP) growth; in contrast, “escapees” find new sources of TFP growth (Daude and Fernández-Arias 2010). Indeed, 85 percent of growth slowdowns at middle-income levels can be explained by TFP slowdowns (Eichengreen, Park, and Shin 2013).

S5.3 For middle-income “escapees,” evidence suggests that one source of sustained TFP growth is an increasingly efficient allocation of resources. At a broad level, escaping countries experience much more rapid transitions out of agriculture and more rapid increases in manufacturing/industry (Bulman, Eden, and Nguyen 2014). Perhaps more important is the allocation of resources across subsectors, and across firms within sectors. Because the productivity levels of firms in the same subsector can be markedly unequal, the entry of new firms and exit of unproductive firms (“creative destruction”) and the extent to which productive firms are able to gain a bigger market share by reallocating inputs between firms, is important for TFP growth (Hsieh and Klenow 2009; Bartelsman, Haltiwanger, and Scarpetta 2013; Melitz and Polanec 2015). For example, when capital and labor in Indian and Chinese manufacturing firms are hypothetically “reallocated” to match the level of efficient allocation observed in the United States, the two countries experience TFP gains of 40–60 percent and 30–50 percent, respectively (Hsieh and Klenow 2009).

S5.4 Other analyses of the middle-income trap have focused on a lack of industrial upgrading (Ohno 2009; Doner and Schneider 2016). Evidence suggests that middle-income “escapees” have more diversified and sophisticated exports than those that remain stuck (Felipe, Abdon, and Kumar 2012). Such upgrading requires proactive government policies and coordination between domestic firms. A related view is that market failures may occur in many countries when private incentives to enter new sectors are less than social returns, necessitating a process of economic development as “self-discovery” (Hausmann and Rodrik 2003).

S5.5 Efficient resource allocation and industrial upgrading require a different set of institutions than those that enable growth through resource accumulation. Efficient allocation requires new institutions to manage competition and “creative destruction.” Industrial upgrading requires the institutional capacity for greater intersector and government coordination, possibly through a strategic alliance between government and business (Doner and Schneider 2016). Product differentiation to succeed in new export markets requires “modern and more agile” property rights institutions and capital markets (Kharas and Kohli 2011).

Political economy traps

S5.6 The creation of these institutions may be stymied by vested interests. “Creative destruction” and competition create losers—and in particular may create losers of currently powerful business and political elites. This is a more politically challenging problem than spurring productivity growth through adoption of foreign technologies, which tends to favor economic incumbents (Acemoglu, Aghion, and Zilibotti 2006). These political challenges may be particularly great in middle-income countries because actors that gained during the transition from low- to middle-income may now be powerful enough to block changes that threaten their position.

S5.7 In this sense, the challenges that middle-income countries face go beyond policy choice to the challenge of power imbalances. Yet with few exceptions, discussions of the middle-income trap have generally focused on the *proximate causes* of transition difficulties, and on selecting the

right policies, rather than the *underlying determinants* of these transitions. Understanding the policy arena in which elites bargain is essential for explaining the political economy traps faced by middle-income countries.

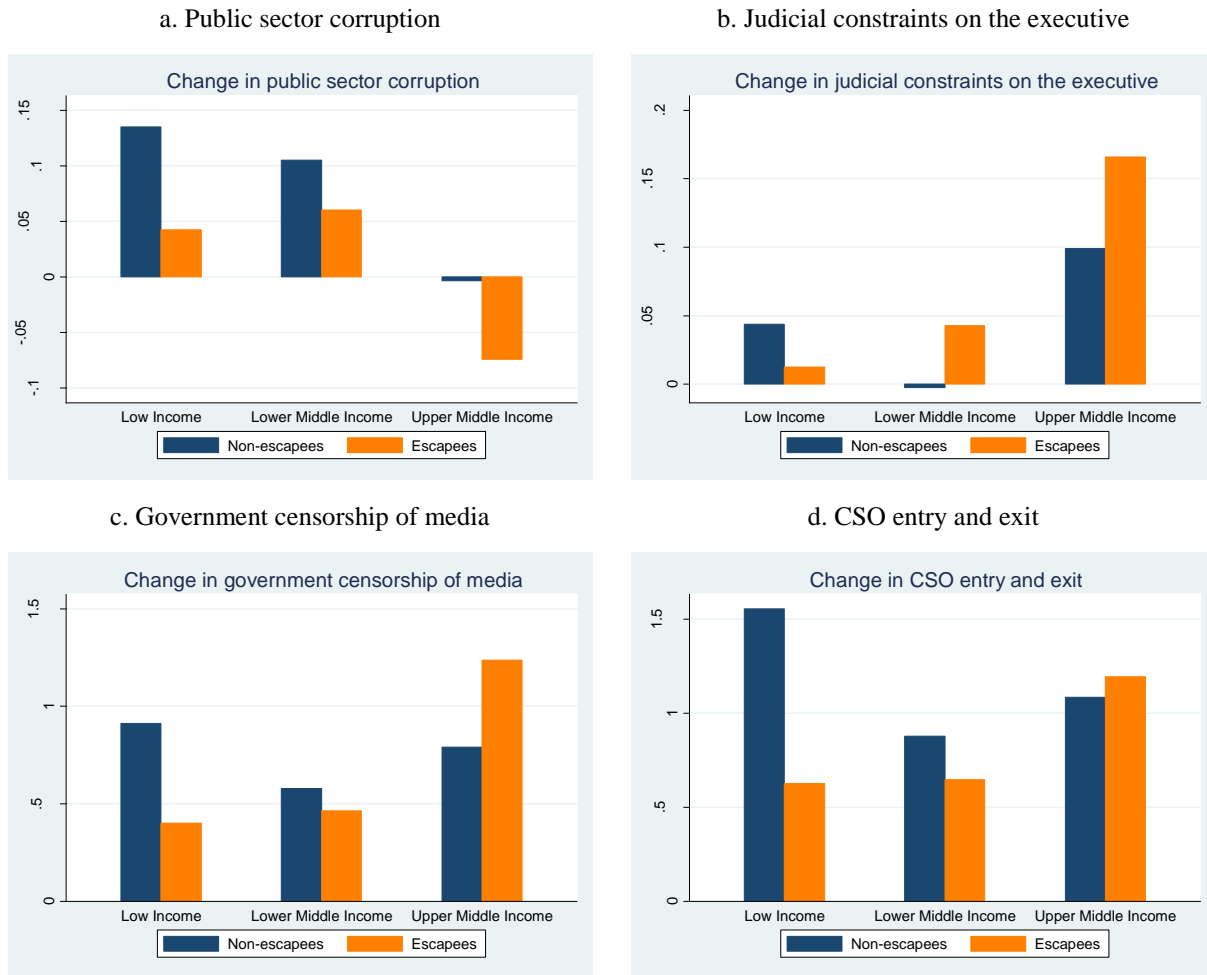
S5.8 One such political economy trap is a persistent deals-based relationship between government and business. Deals-based, sometimes corrupt, interactions between firms and the state may not prevent growth at low income levels; indeed, such ties may actually be the “glue” necessary to ensure commitment and coordination among state and business actors (see spotlight 2 on corruption). But they become more problematic for upper-middle-income countries. For instance, theory suggests that as markets expand and supply networks become more complex, deals-based relationships can no longer substitute for impersonal rules-based contract enforcement become (Dixit 1997). Consistent with this hypothesis, upper-middle-income “escapees” lower their levels of corruption significantly before becoming high-income economies, while “non-escapees” do not see an improvement in corruption (figure S5.2, panel a). In “non-escapees,” corruption may prop up the status quo, undermining competition and the creation of new growth coalitions.

S5.9 Combatting entrenched corruption and creating a level playing field for firms implies a need for accountable institutions. At upper-middle-income levels, legislative, judicial, media, and civil society checks become increasingly important. Indeed, “escapees” tend to see much larger improvements in these institutional checks when they are at upper-middle-income levels than “non-escapees,” although the differences between successful and unsuccessful countries are less distinct at low- and lower-middle income (figure S5. 2, panels b, c, d).

S5.10 The sources of these rules-based institutions for contestation and accountability are discussed in part 3 of this Report, but comparing “escapees” and “non-escapees” helps identify several conditions that make institutional reforms and thus successful transitions more likely. Recently, many countries that have transitioned have had strong and representative business groups, including East Asian economies and Chile. Well-represented business groups helped lead to pro-growth coalitions that could push for “non-particularistic” policies benefiting broad interests to enable broad-based growth. Other recent transitioning countries have had a source of external support/pressure for reform: nearly half of the countries that have grown recently from middle- to high-income are in Europe, where the external commitment provided by European Union accession and membership has made institutional development credible.

S5.11 Moreover, lower levels of inequality may also help prevent institutional sclerosis at middle-income levels. High levels of inequality can generate societal cleavages that prevent the emergence of the growth coalitions necessary for reform (Doner and Schneider 2016). The data show that “escapees” not only have lower levels of inequality when they become middle income, but they do not experience the large increases in inequality that characterize “non-escapees” on average (Bulman, Eden, and Nguyen 2014). Middle-income countries should therefore value equity not just as an aim in itself, but also as a precondition that increases the likelihood of escaping the middle-income growth trap.

Figure S5.2 Checks on corruption and accountability institutions improve more in countries that escape upper-middle-income status to high-income status than “non-escapees”



Source: WDR 2017 team based on VDem 2015.

Note: The bars represent average change in the relevant category for all “non-escapees” (blue) and “escapees” (orange) during the time when a country is at the income level specified. “Escapees” are defined as those countries that reach the subsequent income levels during the sample period (1950-2011). “Non-escapees” are those that remain trapped at the same income level or move to a lower income level. All four panels use the same methodology. Public sector corruption (v2x_pubcorr) is an index ranging from 0 to 1, with 1 representing the most corruption. Judicial constraints on the executive (v2x_jucon) is an index ranging from 0 to 1, with 1 representing the greatest constraints. Government censorship of media (v2mecenefm) and CSO entry and exit (v2cseeorgs) are ordinal variables ranging from 0 to 4, with 4 representing the most accountability (i.e., the least media censorship and the most civil society entry and exit).

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Spotlight 6 Public-private partnerships

S2.1 In 318 BCE, the ancient Greek city of Eretria signed a contract with a wealthy citizen, Chairephanes, to drain a lake in its territory in an effort to create more useable land for agriculture. According to the contract, Chairephanes was responsible for financing and managing the drainage operation. In return, he was granted the right to use the land for 10 years and exemption from tax duties on the imported materials for the project. The contract foresaw a four-year construction schedule, renegotiable in case of war, and binding heirs in case of the contractor's death. Anyone attempting to rescind the contract was subject to extreme sanctions. The contract was carved in marble and placed on public display (Bresson 2015: 165). Similar contracts may date as far back as the Achaemenid (First Persian) empire (sixth to fourth century BCE), when by royal decree, all individuals who dug a *quanat* (a subterranean gallery used to intercept water sources for irrigation) had the right to retain all profits for up to five generations (Goldsmith 2014: 11).

S2.2 Contracts such as these are examples of what today are referred to as public-private partnerships (PPPs). A public entity contracts the construction and maintenance of public infrastructure to private entities, in exchange for the exclusive rights to profit for a fixed period of time. More specifically, PPPs are defined as “long-term contracts between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance” (World Bank, ADB, and IDB 2014). PPPs are considered an alternative to both public provision and private provision. Unlike public provision, where a private firm is responsible only for building the infrastructure, under PPPs the concessionaire builds, manages, maintains, and retains control over the assets for the duration of the contract, which can last more than thirty years. Unlike private provision, in PPPs the private firm has only a temporary and partial ownership of the asset. PPPs have been adopted for the provision of different services, mainly infrastructure in network industries such as electricity, telecommunication, water, and transport. PPPs have also been used for delivering other services traditionally connected to public provision, such as health and education, garbage collection, agriculture extension services, and social housing.

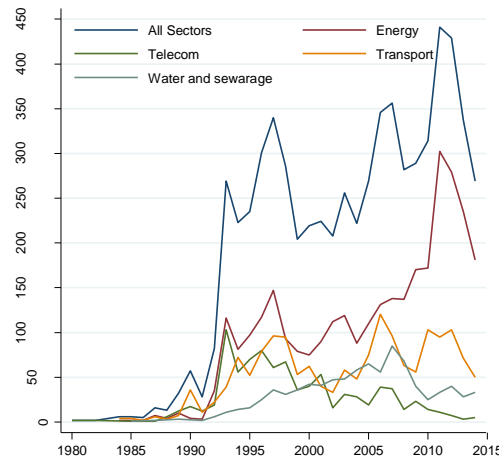
S2.3 PPPs were recognized as playing a key role in infrastructure financing at the recent Addis Ababa International Conference on Financing for Development (UN 2015, paragraph 48). While the participation of the private sector in infrastructure projects has grown considerably in the last 25 years in developing countries, especially in the energy sector (figure S2.1), private financing still remains a limited share of aggregate infrastructure investment. In developing countries, it remains less than 25 percent (IMF 2014; World Bank 2014).

S2.4 The most common argument in favor of PPPs is that they free up resources in budget-constrained governments for other projects.¹ If the country is too poor to collect enough resources domestically, or if the government cannot credibly commit to use revenues for providing public services or to repay investors in the long term, it might be difficult to collect enough funds to finance the initial investment, either in the form of taxes or public debt. Another reason PPPs may be appealing is that they can increase efficiency in providing public services because private firms

¹ Economic theory also predicts that the present value of all the user fees that the government could have been collecting under public provision of the service equals the initial saving under PPPs. For a formal discussion, see Engel, Fisher, and Galetovic (2014).

obey the rules of financial markets. In contrast to state officials, who obey political considerations, they introduce competition in markets characterized by the features of natural monopolies, and they prevent investment in projects with negative social values because the profitability of the investment depends on the demand for the service.

Figure S2.1 Private participation in infrastructure projects



Source: WDR2017 team based on data from World Bank Private Participation in Infrastructure Database.

S2.5 A key challenge for PPPs to provide public services efficiently is designing them in a way that takes into account the incentives of both the public and private entities, given that PPPs allocate risks between the contracting parties over a long period of time, when circumstances often change. Actors will likely fail to reach an agreement or the PPP may be ineffective if there is no mechanism to allocate the risk in a credible way. Auction bids are based on long-term forecasts of the expected demand for the service. In reality, however, the demand may vary from the forecast. For example, forecasts may fail to accurately take into account the impact of service fees on user demand or the service may become obsolete as technology advances. Similarly, because the government agenda may change with the political cycle and pressures for reelection, private firms may worry that the profitability of their investment could be undermined.

S2.6 For this reason, many PPPs have not resulted in the expected efficiency gains. For example, without credible commitment to enforce the terms of the agreement, contracts are frequently renegotiated in favor of the private contractor, with considerable outlays for the government often supplied in questionable noncompetitive ways. Renegotiation often occurs as a consequence of an aggressive bid strategy at the time of auction. After having been awarded the contract, the concessionaries can lobby the government to renegotiate the terms, voiding the potential efficiency gains of the auction. For instance, 68 percent of the 1,700 PPP projects financed in Latin America from 1990 to 2013 (and 78 percent in the transport sector) were renegotiated on average one year after the contract award, according to Guash and others (2014).

S2.7 Taking into account actors' incentives and making sure that the contract's terms are consistent over time may reduce the likelihood of opportunistic behavior, as in the case of renegotiation. However, depending on the circumstances, the form in which this commitment is credibly reached may vary. In the case of the ancient Greek city of Eretria, a contract carved in

marble made it very difficult to renegotiate the terms. The publicity of the contract in a public square also helped bind the contracting parties by increasing scrutiny. This clearly may not be the best solution for PPPs today. The optimal contract may depend on whether or not it is possible to collect user fees, whether or not there is high demand, and whether or not the quality of the service is easily contracted. For example, the commitment device needed to effectively deliver on highway infrastructure may be very different from that needed for health services.

S2.8 Take the case of financing a new highway, where demand is high, user fees can be collected, and quality is easily contactable. However, returns on investment depend on future demand, which cannot be controlled by the concessionary. If the contract is fixed term, the risk is borne by the private contractor, which will internalize the volatility linked to traffic forecasts, and ask for a higher subsidy ex ante, or renegotiate the terms of the contract once the bid is won. In turn, the higher state subsidy will blunt the role of PPPs in ruling out bad investments, and renegotiation will undermine the competitive benefits of the auction. In such a context, it would be better for the planner to bear the demand risk.²

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² For instance, the tender could specify a discount rate and a user fee schedule, and the bids could be made on the present value of revenue. The contract term would then last until the winning contractor collects all the fees demanded in the bid, hence deterring any form of re-negotiation and chances for the government to subsidize with transfers the private firm (see Engel, Fisher, and Galetovic 2014).

Chapter 6 Governance for equity

6.1 In August 2011, “we are the 99%” became the slogan of street demonstrators in the US demanding public action against the rising income inequality and the growing perception of the unfairness of the economic system after the 2009 global crisis. The growing concentration of income and wealth was seen as a threat to the sustainability of well-functioning democratic governance (Stiglitz, 2011). The concern about how to tackle the unjust features of the system spread throughout the world.

6.2 Indeed, the philosopher John Rawls starts his classic *Theory of Justice* saying that “Justice is the first virtue of social institutions, as truth is of systems of thought.” Though a complex concept, the notion of justice involves dimensions related to outcomes and others related to process—thus the Rawlsian idea of “justice as fairness.” Independently of the normative importance of the notion of justice, social systems that are perceived as unjust are likely to be unsustainable and usually lead to conflict. When it comes to socioeconomic achievement, these elements allow us to differentiate between inequalities related to outcomes and those related to the process that generated such outcomes.

6.3 This Report views equity both in terms of equal opportunities for individuals to pursue a life of their choosing, independently of their circumstances; as well as in terms of inequality in outcomes, such as income, educational attainment, and indicators of assets ownership, such as land (box 6.1). Outcomes are particularly important in the context of this Report, because they are a manifestation of asymmetries in the influence of actors and groups to make governance responsive to their needs and interests. Empirical estimates of the (lower bound) contribution of circumstances to explain inequality in outcomes (measured by socioeconomic achievement) are typically around 40 percent—with high heterogeneity among countries (Ferreira and Peragine, 2015). These results support the view that inequality in outcomes must be a matter of concern for public policies, as much as inequality of opportunities.

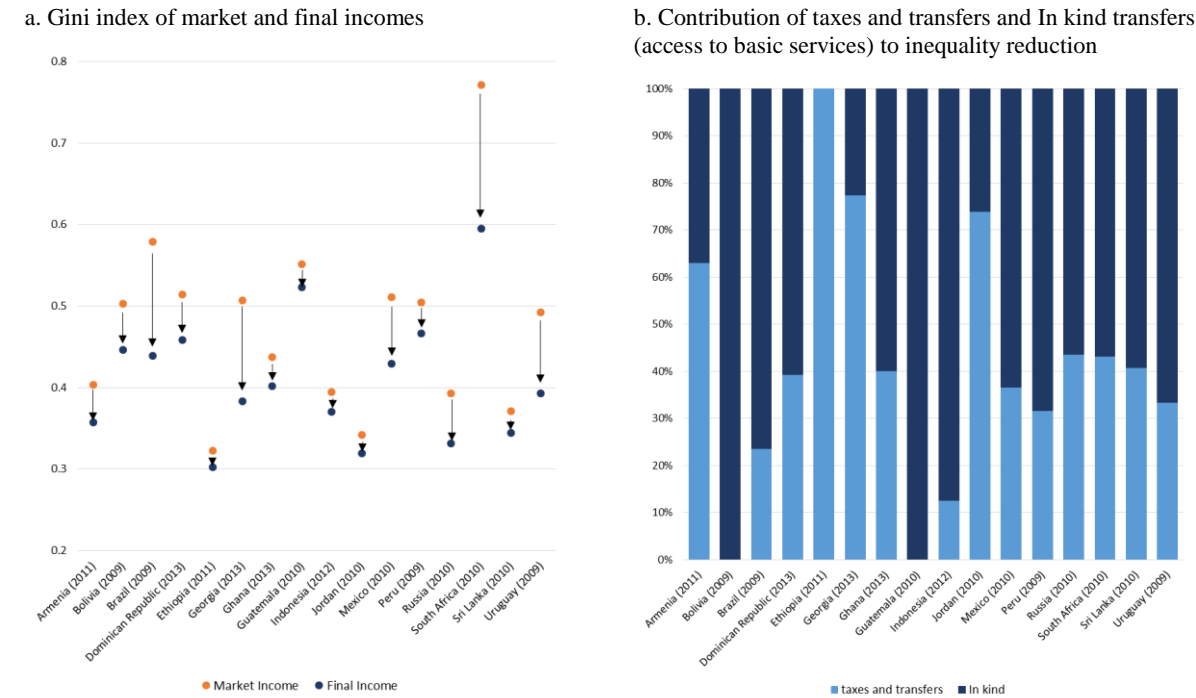
Box 6.1 What Is Equity?

This Report views equity both in terms of *equal opportunities* for individuals to pursue a life of their choosing, independently from initial circumstances; as well as in terms of *inequality in outcomes*, such as income.^a

Equality of opportunities reflects that all individuals have the same chances, independently of circumstances beyond their control. Inequality in outcomes, reflects the notion that differences in the levels of outcomes among individuals, such as income, also matter. Equity thus also includes *poverty*, defined as extreme deprivation in outcomes. The “acceptable” level of inequality in outcomes is a decision that is up to each society. Yet, in addition to its normative value, the concept is of particular interest in the context of this report in terms of its role in shaping the bargaining power of current and future actors, which can influence the opportunities of the next generation.

^a This definition builds on the definition of the 2006 *World Development Report* (WDR) on Equity and Development (page 2): “By equity we mean that individuals should have equal opportunities to pursue a life of their choosing and be spared from extreme deprivation in outcomes.” This WDR extends this definition to cover inequality in outcomes, as well.

Figure 6.1: State intervention may improve equity by intervening on the distribution of final outcomes via taxes and transfers, and by providing access to basic services (lower-bound estimates of redistributive impact).



Source: WDR2017 Team based on Inchauste and Lustig (2016), Table 1.1.

Note: Market income refers to incomes before taxes and transfers and final income is defined as income after direct and indirect taxes and transfers, taking into account also transfers in kind.

6.4 Policies that can enhance equity are multifold. Governments use fiscal instruments—taxes and transfers—to redistribute income ex-post, in addition to using public spending—via the provision of public goods and services—to reshape the distribution of “opportunities” and foster intra- and inter-generational mobility (see figure 6.1). The provision of quality public goods and services can help equalize opportunities, allowing individuals to increase their stock of assets (for example, in terms of human capital, such as education, health, or skills; financial capital; or physical capital, such as land, or machinery). Promoting an environment of investment and innovation can expand access to opportunities, as individuals use their capital and labor to generate income, utilizing their skills to participate in the labor market, for instance, or using their land for agricultural production. Social protection systems—including safety nets, subsidies and transfers—also act as a mechanism for equity, redistributing resources toward the most vulnerable.

6.5 Ultimately, growth and inequality are jointly determined (Ferreira, 2010; Chenery and others, 1974). In a given moment in time, the productive assets and opportunities that individuals have determine their capacity to generate income and contribute to growth, given market conditions. Economic growth, in this way, reflects the aggregate productive capacity of different individuals and the access and functionality of markets. In the long run, however, the potential for people to accumulate and use those assets is influenced by policy decisions, such as on the allocation of public education, health, or infrastructure. The triad inequality, growth and equity must be understood as a dynamic process in which inequality and growth are (mechanically)

associated, while equity is the result of existing rules and decisions made in the policy arena. The way in which the benefits from growth translate into socioeconomic achievements across different groups can be viewed as the result of how actors interact and make policy decisions to redistribute.

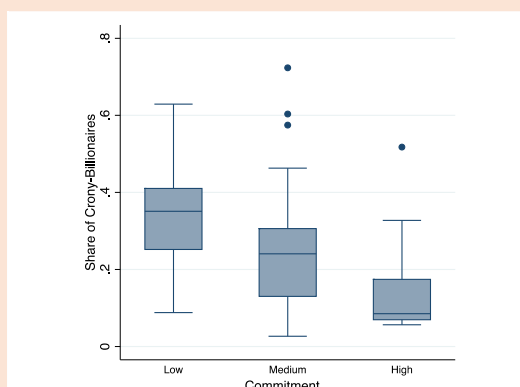
6.6 While pro-equity policies can be potentially beneficial for growth in the medium and long run, they can affect adversely the interests of specific groups, particularly in the short term. The provision of public goods—from services to national security and infrastructure—is supported on taxation and public spending. Resources must be raised and redistributed; policies adopted and implemented. Those affected by equity-oriented policies may be concerned about losing rents or about seeing their relative influence reduced, and thus may attempt to undermine the adoption or implementation of those policies. Members of local elites may undermine land reform policies or shape the allocation of public spending for their benefit. Civil servants may directly influence the access and quality of public services. Additionally, elites can take advantage of measures that countervail equity-enhancing de jure reforms: for instance, by finding loopholes in tax systems. When societies have high levels of inequality, such inequalities are reflected in the unequal capacity of groups to influence the policy making process, making inequality more persistent (box 6.2).

Box 6.2 A vicious cycle: How inequality begets inequality

In societies with high inequality, the effectiveness of governance to deliver on equity outcomes can be structurally weakened, as those at the “top” not only have control over a disproportionate amount of wealth and resources, but also have a disproportionate ability to influence the policy process. This type of power asymmetry may lead even a fair, efficiency-seeking and freely elected benevolent planner (and even more so a corrupted official) to end up systematically favoring the interests of those at the top over those at the bottom, resulting in a more inefficient allocation of resources and ultimately further entrenching existing inequalities over time (Esteban and Ray, 2006).

This undue influence can be illustrated by looking at countries where lobbying is integrated in the political system and there is data to analyze these dynamics. Igan and Mishra (2014) find compelling results using data on the politically targeted activities of the financial industry (including lobbying, campaign contributions, and political connections) from 1999 to 2006 in the United States. They find that lobbying expenditures and network connections are associated with a greater probability that legislators switch their position from advocating tighter financial market regulations to voting in favor of deregulation. In general, countries with high levels of cronyism (as measured by the share of billionaires whose wealth comes from sectors which are prone to capture) is associated with weak levels of commitment (figure B6.1.1). Sectors which are the most prone to capture and rent seeking tend include those which are heavily dependent on government concession, such as the financial sector, real estate, and natural resources.¹

Figure B6.2.1 Capture is associated to lower levels of commitment



Source: WDR2017 staff estimates on Forbes list of Billionaires and WDR2017 governance indicators.

Note: The figure shows a box and whiskers plot. The box ranges from the 25th percentile to the 75th percentile. The line in the middle of the box shows the median. The two lines on either side of the box extend to minimum and maximum values, excluding outliers. The dots indicate outliers. Classification of commitment levels are the following: Low (<0); Medium (0-2); High (>2) and includes 11, 29 and 9 countries respectively.

From the point of view of those at the top, policies that increase inequality are preferable than policies that would enable a more efficient allocation of public resources and lead to higher overall growth in the economy. In fact, theory would suggest that the gains from equity-enhancing redistribution policies are in most cases greater than gains from inequality-neutral growth policies for the top 1% or 5% (Milanovich, 2016). For example, Stiglitz (2011, 2012) finds that as market income became more unequal in the United States, the government also approved more generous tax cuts on capital gains. Unsurprisingly, these tax cuts mainly favored those who were already at the top of the income distribution (including members of the Congress who were voting for those policy reforms).

Inequality affects governance not only by means of capture, but also by weakening the perception of fairness of excluded groups in the society. When a country fails to deliver on its commitment to improving and equalizing opportunities for all citizens, and it responds only to the interests of those at the top of the distribution, citizens may decide to *opt out* or *exit* from the existing political processes instead of contesting the decisions in the policy arena. This leads to a weakening of cooperation. Even in countries where benefits of economic growth reach all members of society, the discontent arising from a perception of an increase in relative deprivation (when those at the top are moving ahead more quickly than those at the bottom of the distribution) may be larger than the contentment from an absolute improvement in living standards, as documented for instance in Dávalos and others (2016) for the case of Europe and Central Asia.

The concern about the vicious cycle of inequality and governance, in which initial conditions of inequality promote a policy arena which further entrenches that inequality, is made more salient by the surge in the concentration at the top of the income and wealth distributions in many countries in the world (Atkinson and others, 2011; World Bank, forthcoming). Understanding the entry points to break this persistent loop is crucial to restoring a social contract which can promote greater and more equal access to opportunities for everyone.

¹ During the 2015-2016 election cycle in the United States, the largest disbursement (27 percent of all outlay) came from the financial sectors, which includes insurance companies, securities and investment firms, real estate interests and commercial banks, the sectors with the largest amount of Billionaires (Center for Responsive Politics and WDR2017 team on Forbes List of Billionaires).

6.7 To increase the success of reforms that require profound changes, it may be necessary to modify the bargaining process: changing the incentives or preferences of actors who bargain, or allowing new actors to contest policies. In some case, the incentives of elites may be aligned with taxation and public spending reforms in favor of the poor. For example, the first antipoverty programs in nineteenth century Great Britain were pushed by the top one percent of landed elites. These schemes aimed to keep labor in the countryside and prevent it from migrating to urban areas, against the backdrop of the French Revolution, which may have spurred some fear of revolts (Lindert 2004). In other cases, there is a need to increase the participation of disadvantaged groups in order to help change the incentives of actors who bargain over policies. Direct participation in decision-making can also improve cooperation. For instance, in Ghana, when businesses are involved in the design of tax policies, they are more likely to pay their taxes (Joshi and Aye 2009). Greater transparency and better information can also help to change incentives by monitoring of the actions of members of political elites and service providers. However, such reforms can be complex, frequently involving setbacks.

6.8 This chapter explores how power asymmetries matter for equity. Specifically, it looks at how they can lead to breakdowns in institutional functions, constraining the effectiveness of policies.

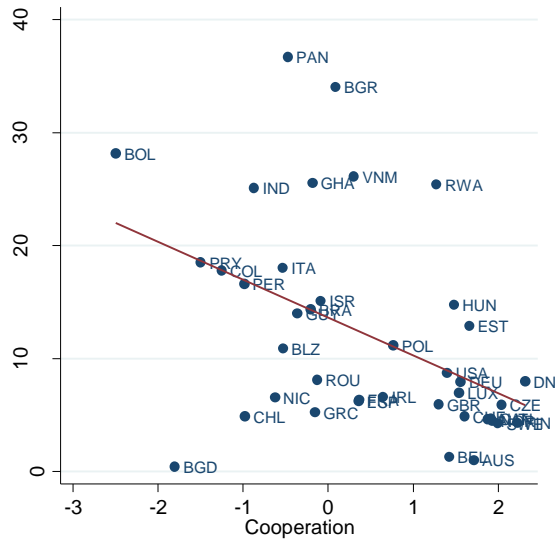
The second part of the chapter looks at levers of change, and how these constraints can be alleviated to level the playing field, and make the system more responsive to all.

Investing in public goods and expanding of opportunities

6.9 In terms of income inequality, there has been an important reduction in the dispersion *between* countries over the last 20 years. This is mainly due to the higher average growth rate of countries that are not at the top of the world income distribution—that is, the rise of the “global south.” However, this has largely coexisted with an increase in level of income inequality *within* countries (Milanovic, 2016; Bourguignon, 2015; Atkinson, 2015). How can governance help to explain these trends?

6.10 As figure 6.2 illustrates, there is indeed an empirical association between functional indicators of governance and inequality. Higher levels of inequality of opportunity are associated to lack of cooperation, measured by trust in institutions and the willingness to comply and abide by existing rules. Moreover, as discussed further below, a low commitment to provide quality public services is one of the main characteristics of the most unequal countries in the world in terms of opportunities. Such general associations, however, are not causal and miss the understanding of the mechanisms that link governance and equity, which can work in both directions. The best way to understand these interactions and to observe the mechanisms behind the association is to view them at the microeconomic level, as suggested by the literature.

Figure 6.2: Lack of cooperation is associated to higher inequality of opportunity



Source: WDR 2017 for Cooperation (defined as voluntary compliance); Ferreira et al (2014) for Inequality of Opportunity as a share of total inequality.

6.11 This chapter considers two key policy areas that matter for equity. The first area refers to investments to expand the opportunities, particularly investments in human capital—health and education. These investments require taxation and public spending. The second area refers to

increasing access to economic opportunities. As emphasized in the 2006 World Development Report on Equity and Development (WDR 2006), the opportunities of individuals, to a considerable extent, arise from investments that they receive, particularly in terms of health and education. For such investments to take place, resources need to be collected and redistributed. This is particularly important for the poor and disadvantaged, as they are most likely to be affected by market failures (see Spotlight 7). Indeed, no high-income country has achieved improvements in terms of equity without significant taxation and public spending in order to protect individuals against shocks (such as illness, unemployment, and old age) and reduce welfare disparities within and across generations (Barr 2001; Lindert 2004). In addition, for individuals to realize the returns of such investments, they need access to economic opportunities in adulthood, especially access to assets that allow them to use the human capital that they acquired.

6.12 While the focus of the chapter is not on labor markets, it does touch upon important determinants of labor (and non-labor) income inequality.¹ Consider Latin America, the most unequal region in the world, which has experienced an important decline in inequality over the last two decades (Rodriguez-Castelan and others, 2016). This decline in income inequality is largely explained by a fall in labor income inequality—associated with an expansion of education—and a decline in non-labor income inequality, largely explained by more progressive government transfers (Lustig and others 2013). Indeed, the provision of quality public goods and services as a means to level the playing field and to reduce poverty has been evidenced unambiguously (World Development Report 2006).

Equity and institutional functions: the role of commitment and cooperation

6.13 As argued in this Report, the effectiveness of these policies to achieve equitable development is related to how well institutions perform certain key functions. Policies that require long term objectives, for instance, often get truncated, in a breakdown or an aberration of *commitment*. Effective pro-equity policies tend to have long term objectives (extending beyond the political cycle), resources to match, and pertinent incentives for the actors involved. Actors trust that promises will be kept, even in the face of changing circumstances. Often, however, the incentives of public officials can become misaligned with those of the constituency they are meant to serve. In clientelistic settings, the interaction between public officials and citizens is distorted, whereby the former “buys” the vote of the latter in exchange for short-term benefits. In other cases, authorities become accountable only to certain groups wielding great influence, or “clients”, favoring their interests in exchange for their political support.

6.14 When commitment to deliver on policies, such as the provision of quality services, breaks down over time, individuals tend to “opt out”, decreasing *cooperation*. This is particularly evident regarding citizens’ willingness to contribute to public goods. Collecting the taxes needed to fund investments in public goods crucially requires taxpayers’—individuals and firms—willingness to cooperate and comply with the rules. Being excluded from policy design, the perception of free-riding by others, or the low quality of services, are all cases that can lead to breakdowns in cooperation. Figure 6.3 shows how the size of the “shadow economy,” as individuals opt out by not complying with existing rules, is associated with commitment.

¹ For a thorough discussion of labor market institutions see WDR 2013 on Jobs.

Figure 6.3: When commitment is low, countries show low compliance (high shadow economy)



Source: WDR2017 for Commitment; Schneider et al (2011) for Shadow Economy

Note: The “Shadow Economy” is defined as the share of all market-based legal production of goods and services that are deliberately concealed from public authorities for any of the following reasons: (1) to avoid payment of income, value added or other taxes, (2) to avoid payment of social security contributions, (3) to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc., and (4) to avoid complying with certain administrative procedures such as completing statistical questionnaires or other administrative forms (Schneider et al, 2011). Shadow Economy shows the predicted value of the measure controlling for GDP per capita.

6.15 A low commitment to provide quality public services is one of the main characteristics of the poorest countries in the world, as well as of the most unequal ones. Pro-equity policies require state capacity, including, for instance, an able bureaucracy to collect taxes, and well-trained teachers to educate children. A professional bureaucracy has been identified as a significant feature for states to achieve development (Rauch and Evans 2000). “Weak states,” particularly in Sub-Saharan Africa, are characterized by a limited state presence outside of the capital and coastal areas, and by a limited ability to tax (Migdal 1988; Herbst 2000). In middle-income countries with high inequality, such as in Latin America, “truncated” welfare states exclude a large share of the population from public spending (De Ferranti and others 2004; Ferreira, et al, 2013).

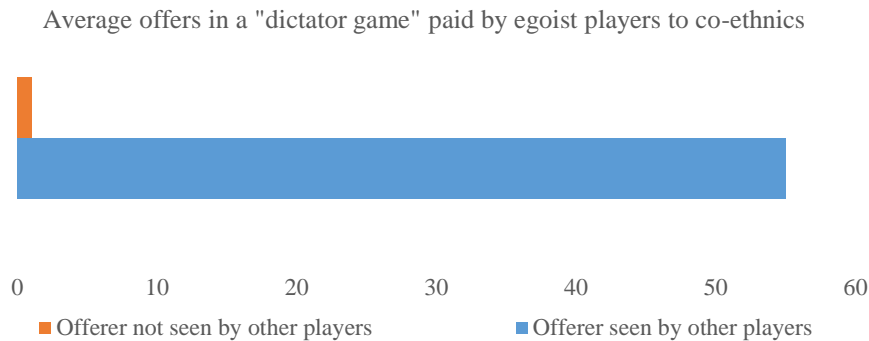
6.16 When quality of services is low, individuals sometimes ‘opt out’ of the social contract, leading to failures of cooperation. In middle-income countries with high inequality, such as in Latin American, citizens may “exit”—for instance opting out of basic public education—because they obtain little from the state (Hirschman 1970; Perry and others 2007). The low quality of service provision leads upper middle classes to demand private services, which in turn weakens their willingness to fiscally cooperate and contribute to the provision of public goods, in a perverse cycle. At other times, actors potentially affected by policies may be excluded from their design, undermining their incentive to cooperate, and weakening compliance.

6.17 What makes people cooperate? What compels individuals from not free-riding on others and complying with the rules? Cooperative behavior is partly the result of the credibility of sanctions against non-compliers. For instance, ethnic networks may be able to induce cooperation, in the form of school funding, among their members because they have credible sanctions against free-riders (Miguel and Gugerty 2005). This view was tested in a lab game with players from a multi-ethnic neighborhood in Kampala. Players who are in charge of allocating resources share much higher amounts with other players when they can be seen by others, compared to when they are not seen. In both cases, other players are from their same ethnic group. These results indicate that a social sanction for individuals who are not willing to share shapes their behavior, rather than altruism toward co-ethnics (figure 6.4, panel a, based on Habyarimana and others 2007).

6.18 Perceptions of fairness also matter for cooperation. Experimental evidence indicates that individuals adjust their behavior, and are willing to incur a cost in order to sanction behaviors that they perceive as unfair. More specifically, the fairness of the processes through which decisions are made matters. Participation in the decision process has an intrinsic value in allowing more legitimate choices (Habermas 1996; Rawls 1997). But participation may also have an instrumental value, by increasing cooperation, for instance in the form of contribution to the funding of projects, or in the form of compliance with decisions made. Experimental evidence supports this view (Goeree and Yariv 2011; Dal Bó, Foster, and Putterman 2010). A study from Indonesia indicates increased cooperation when participatory processes are in place: individuals are more willing to contribute to projects when the whole village can cast a vote directly in plebiscites, compared to the usual decision-making meetings, run by representatives (figure 6.4, panel b, based on Olken 2010).

Figure 6.4 Fear of sanctions and participation in decision-making processes promote cooperation

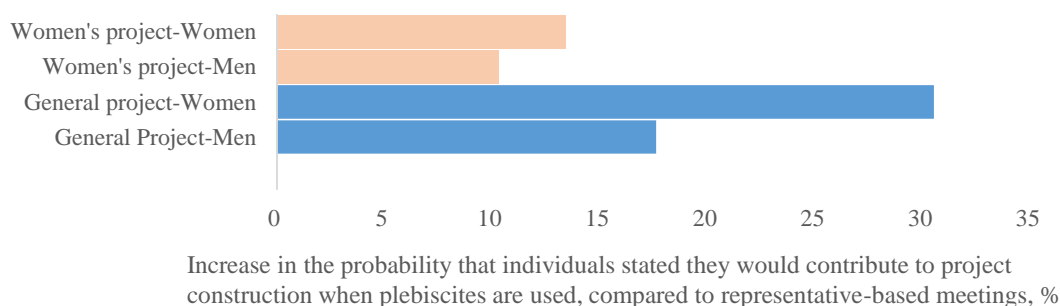
a. In a laboratory experiment in Uganda, when individuals in charge of allocating resources are seen and fear sanctions from their co-ethnics, they cooperate more



Source: WDR 2017 team based on Habyarimana and others 2007.

Note: The figure shows the average offer paid by egoist players (those who always employ the most selfish strategy available in all rounds of the game) in a "dictator game": a game in which a player, "the dictator," determines how to split an endowment with other players. Subjects were given ten 100 Ugandan Shilling (USh) coins and asked to divide this sum between themselves and the two other players in any way they pleased. The figure shows the "benchmark co-ethnic" measure: any pair of players that identified themselves as belonging to the same ethnic category in their pre-experiment questionnaire were coded as co-ethnics.

b. In rural Indonesia, cooperation is higher when decision making is broadened through plebiscites in which the whole village takes part



Source: WDR 2017 team based on Olken 2010.

Note: In an experiment conducted in rural Indonesia, villages are randomly assigned to choose development projects through either meetings where representatives decide (the majority of attendees are government officials, neighborhood heads and those selected to represent village groups) or through direct election plebiscites (where all adults eligible to vote in last national parliamentary election can vote). The villages had to select a general project and a women's project. After the project-selection process was concluded, respondents were asked about their plans for making voluntary contributions to the project (labor, money, food).

6.19 “Process-legitimacy” and fairness also matter for economic opportunities. The credible and consistent enforcement of laws and regulations, including property rights, can help expand opportunities and level the playing field. For instance, if property rights are secure only for some, those who are not protected as much as others will respond by underinvesting (Goldstein and Udry 2008). Furthermore, if individuals think that their effort will not be rewarded because of discrimination, they may exercise less effort (Hoff and Pandey 2006).

6.20 Cooperation is enhanced by commitment. The credibility of policy makers is key for the enforcement of sanctions and compensation when redistribution reforms take place. Consider the difficulties in reforming energy subsidies. Such subsidies are often inequitable because they benefit relatively richer households, which devote a larger share of their total consumption to energy-related goods. They are inefficient because their high fiscal cost precludes other public spending (Coady and others 2015). Therefore, eliminating these subsidies while setting up compensatory measures for the poor has the potential to improve both efficiency and equity. Yet virtually all of the countries that have attempted energy subsidy reforms have faced varying degrees of social and political unrest. This is often because policy makers are not credible in their commitment to redistribute the savings made from efficiency gains.

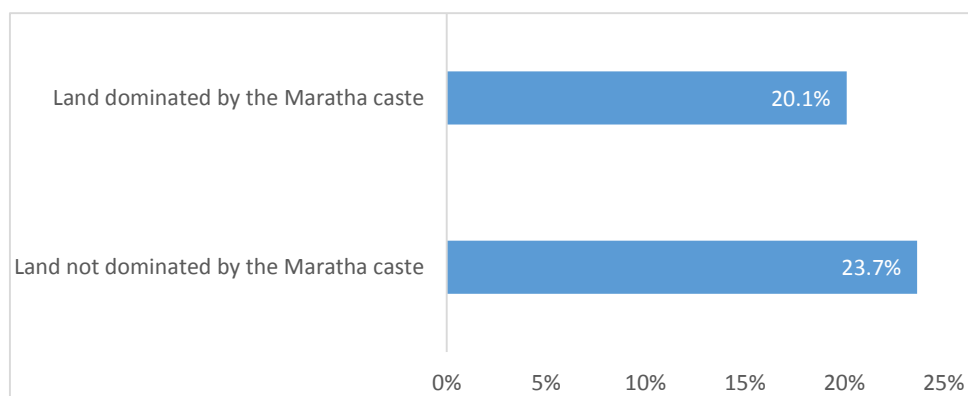
How policies for equity can be affected by power asymmetries

6.21 Asymmetries in bargaining power shape how commitment, cooperation and coordination are sustained, ultimately affecting whether equity-enhancing policies are adopted and implemented. Consider the following puzzle. In the Indian state of Maharashtra, villages that are dominated by the Maratha caste are 10 percent less likely to implement national antipoverty programs than other villages, even though the population—who votes in free elections—consists largely of poor or landless laborers (figure 6.5). Why? A credible explanation is that the local

landed elites from the Maratha caste hold political power and use it to block national antipoverty programs, exchanging votes against the provision of—informal—insurance to voters in times of financial crisis. The Marathas are particularly successful in clientelist strategies thanks to other “services” that they can provide, such as their trading networks. Prevailing social norms in the villages—the caste system—help the Marathas maintain their political influence, as they are the traditionally dominant caste in Maharashtra and are better able to enforce sanctions (Anderson, Francois and Kotwal 2015).

Figure 6.5 Clientelism leads to blocking antipoverty programs

In the Indian state of Maharashtra, villages dominated by the Maratha caste are less likely to implement antipoverty programs because of clientelism



Source: WDR 2017 team, based on Anderson, Francois, and Kotwal 2015.

Note: The graph presents the mean percentage of programs that were implemented in Maharashtra's villages, of the total of below poverty line programs and the Employment Guarantee Scheme. These programs are supposed to be available in the full universe of the villages.

6.22 This example illustrates several important aspects that shape the economic opportunities of the poor and, more broadly, the disadvantaged. Some members of elites that face little competition may choose to influence policy adoption and implementation, blocking policies that go against their interests. On paper, it looks promising to make village councils decide on beneficiaries, in a setting where the councils are freely elected: local governments can seemingly be held accountable, and the beneficiaries can seemingly better observe and control their efforts because they are closer to them. In theory, village councils are also better able to target beneficiaries and select public works projects that are most useful for the community. In reality, however, some members of the local elites may take advantage of their role in the allocation of resources to block redistribution, exchanging political support for short-term benefits.

6.23 While policies that have important for equity payoffs may look good on paper, for example strengthening access to land, they may also be prone to clientelism and capture (Box 6.3). Groups that directly influence policies, labeled as elites in this Report, may have more bargaining power due to existing inequalities in income or wealth and in some cases due to the difficulties faced by other actors to organize and lobby effectively. Indeed, in the presence of weakly organized constituencies, political elites may have fewer incentives to invest in public goods and improve equity, and may, instead, engage in narrow patron-client relationships that maintain their ability to influence decision making.

Box 6.3 Efforts to change land tenure often lead to capture

Expanding and securing access to land is an important policy area for efforts to increase economic opportunities: 75 percent of the world's poor live in rural areas and their incomes depend, directly or indirectly, on agriculture. Thus improving and securing their access to land is important to increase investments and productivity. More equitable access to land has also been associated with both higher equity and efficiency, including because of better institutions and increased citizen participation—an important element of collective action.

Land tenure reforms, however, can be used for patronage. The security of land tenure varies considerably across and within countries, depending greatly on social hierarchies or gender, and hampering the ability of disadvantaged groups to improve their livelihoods. In Vietnam, for instance, individuals who have connections to politicians and bureaucrats have much more tenure security than others. In Ghana, property rights are particularly insecure for women, who are less likely than men to hold local political or social roles.

Interventions to change land tenure, including in cities, have often been captured and used for patronage. In many African cities, there is a range of land interventions such as land regularization or resettlement operations that have been captured by local elites and used for political patronage, including through corruption of civil servants (such as staff of the land registry). Bribes may be used to facilitate access to land, obtain formal tenure, or obtain plots for friends and political clients (Durand-Lasserve, Durand-Lasserve, and Selod 2015).

Because land inequality is often entrenched, reforms to improve access to land often take place at times when political elites are experiencing substantial change, including as a result of collective action by citizens. When inequality is too entrenched to expect sales and rental markets to reallocate land, land reforms become necessary. The difficulty to reach agreement on such reforms however, means that they often take place at times of significant political changes such as the end of colonial rule, or with strong pressure from outside, as in the Republic of Korea. When no such major political changes have occurred, land redistribution has been spurred by peasant movements that increased pressure for reform, such as in Brazil (Binswanger-Mkhize, Bourguignon, and van den Brink 2009).

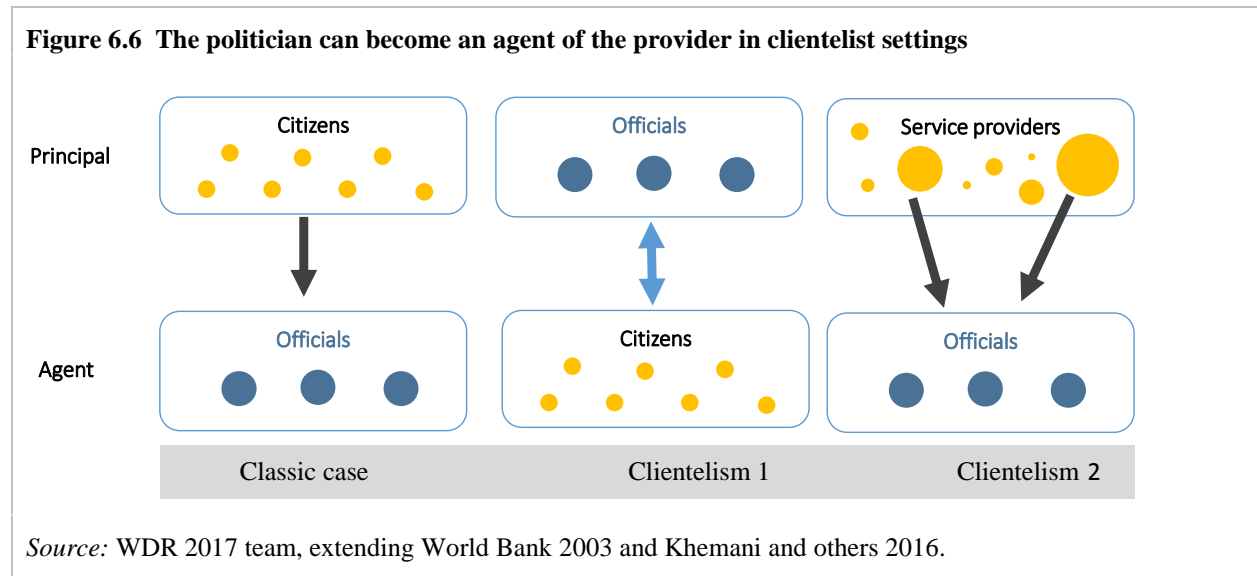
Source: WDR 2017 team.

Clientelism and capture weaken commitment to deliver on redistributive policies

6.24 This Report, like the World Development Report 2004 (WDR 2004), *Making Services Work for Poor People*, views service provision as a series of relationships whereby principals must monitor agents. WDR 2004 describes two routes for service delivery. In the long route, policy makers are the agents of citizen-voters, as well as the principals of providers (World Bank 2003). In the short route, citizens are principals who monitor the providers more directly. However, politicians are initially political candidates. In order to be elected—given their difficulty in credibly committing to broad public policies that are difficult to monitor—political candidates commit to targeted benefits for narrow groups of “clients”- such as their ethnic group or their caste - because they can more credibly deliver them. Thus they may become dependent on the support of certain groups, including public sector workers (figure 6.6).

6.25 Indeed, in clientelist relationships (see box 6.4 for a definition of clientelism), where public sector workers are able to extract rents due to the influence they wield to elect politicians, those politicians can become the agents of the providers. For instance, politicians can target input subsidies for farming to supporters, maintaining a threat of removing the subsidies. Such arrangements ensure that supporters credibly commit to supporting politicians, while politicians also have a credible tool to “punish” supporters if they defect (Bates 1981). By contrast, the benefits of public goods might be diluted among non-supporters and might be more difficult to reverse, making them less attractive as tools for political support. In such settlements, citizens expect less from politicians (because they receive some targeted benefits), while providers extract rents

(because they play a role for politicians' reelection) (Bold and others 2016a). There are two main ways in which clientelism can affect the adoption and implementation of policies. Both cases lead to breakdowns in commitment toward long term objectives.



6.26 In the first form of clientelism, the interaction between public officials and citizens is distorted: rather than a situation where the official is the agent of the citizen—where the voter can monitor and sanction the agent—the dynamic is turned into a bargain, where the politician “buys” the citizen’s vote, for what usually are short-term gains (Khemani, et al., 2016). These bargains tend to be more frequent where individuals have a higher time preference for the present vis-à-vis the future (reference). The higher discount rates of the poor and the disadvantaged for the present make them particularly vulnerable to this sort of exchange, where they receive short term benefits in the form of transfers, in exchange for their vote (which potentially could be placed, instead, on politicians or campaigns aligned with longer term but higher gain policies). This myopic exchange tends to lead to a breakdown in commitment to programmatic objectives, limiting the achievement of equitable outcomes. Evidence suggests that clientelism, in the form of vote-buying, is associated with lower provision of public services (Khemani 2015).

6.27 In a second form of clientelism, as specific groups capture their favor, public officials may not have the incentives to adopt and implement policies for the constituency as a whole. This takes place when public officials grant benefits in exchange for the political support of a homogenous, usually powerful, group. In this equilibrium, public officers become accountable to such groups, including—but not limited—to service providers, whose support becomes indispensable for the officers’ political survival. Public sector providers, such as teacher unions, may extract rents through the diversion of public resources, or withhold their effort in the form of absenteeism or low quality provision, or engage in corrupt practices, which can hamper the delivery of services – such as education, health, or infrastructure. Other groups may exert influence, pushing away from the socially preferred equilibrium for instance, when potential losers from reforms, such as on fiscal policy, form a cohesive group to prevent their adoption. In this form of clientelism, which can also be thought of as capture, accountability becomes up for sale.

6.28 Unions are a particularly relevant player in this scenario, given their direct role in shaping policies (such as in the area of education) and, in some cases, they play a direct role in politics. In the Indian state of Bihar, for example, a case study documents that a large number of deputies of the state assembly are teachers. Through their political role and ability to shape policies, teachers have improved in-work benefits; there has however been less progress for broader improvements in the education system (Kingdon and Muzammil 2009). In some cases, unions grow to play such an important role in education policies that they have a direct role in job appointments, further undermining the supervisory role of policy makers. In such settings, workers may consider that their “principal”, the actor responsible for monitoring them, is the union rather than policy makers.

Box 6.4 Defining and measuring clientelism

Clientelism is a political strategy characterized by the giving of material goods in return for electoral support (Stokes 2009). Clientelism can be viewed as a two-party encounter between a politician and a voter (Hicken 2011). It is, however, often organized in networks, which can be based on districts or regions. As a result, a central part of clientelism’s organizational structure is an intermediary or a broker, whose role is to mobilize a network of local voters in exchange for financial payment or patronage jobs. The behavior and strategy of a broker and the contractual arrangement with the national politician is thus an important element of clientelism.^a

A number of studies mentioned in the Chapter emphasize the negative impact of clientelism on the provision of public goods. Clientelism can entail significant welfare costs to societies (Bardhan 2002). When it is prevalent, voters act to pursue short-term benefits rather than focus on broad policy considerations, such as durable reforms.

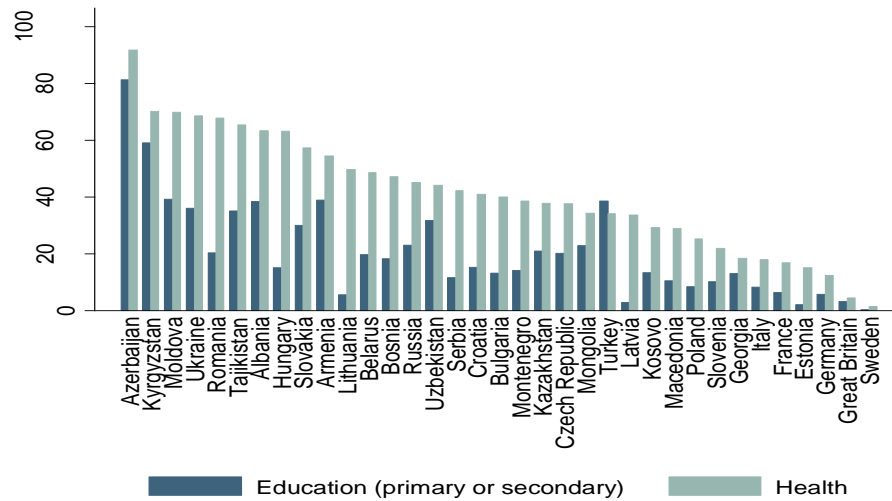
Measuring clientelism is, however, a challenge. Distinguishing empirically between public goods and private goods can be complex: infrastructure projects, typically considered a public good, can be “locally targeted” to a specific geographic area (see review in Bouton, Castanheira, and Genicot 2016). On the other hand, redistribution promised by politicians to win votes can be beneficial to broad groups. For instance, in the cases of the Peruvian Social Fund (Schady 2000) and the investment in infrastructure in Spain from 1964 to 2004 (Solé-Ollé 2013), even though welfare-enhancing transfers were targeted for electoral gain, the policies benefited large swaths of the population, beyond those targeted to win elections.

Source: WDR 2017 team based on Wantchekon 2016.

^a See Cruz 2013; Holland and Palmer-Rubin 2015; Schneider 2015; Stokes 2005.

6.29 Public spending can also be captured by public sector workers in charge of providing services, such as those related to education or health. The most blatant form of capture is the diversion of financial resources. In the case of service delivery, public sector workers are “elites”, since they have direct influence on policy implementation. In some cases, they can use their influence to capture resources. For instance, in most countries in Eastern Europe and Central Asia, more than a third of individuals report that informal payments (such as bribes and under-the-table payments) are made to access health services; this proportion rises to nine out of 10 individuals in Azerbaijan (figure 6.7). Corruption affects learning outcomes. In Brazil, students’ test scores in mathematics and Portuguese are higher when corruption is lower in the municipalities where the schools are located (figure 6.8, based on Ferraz, Finan, and Moreira 2012).

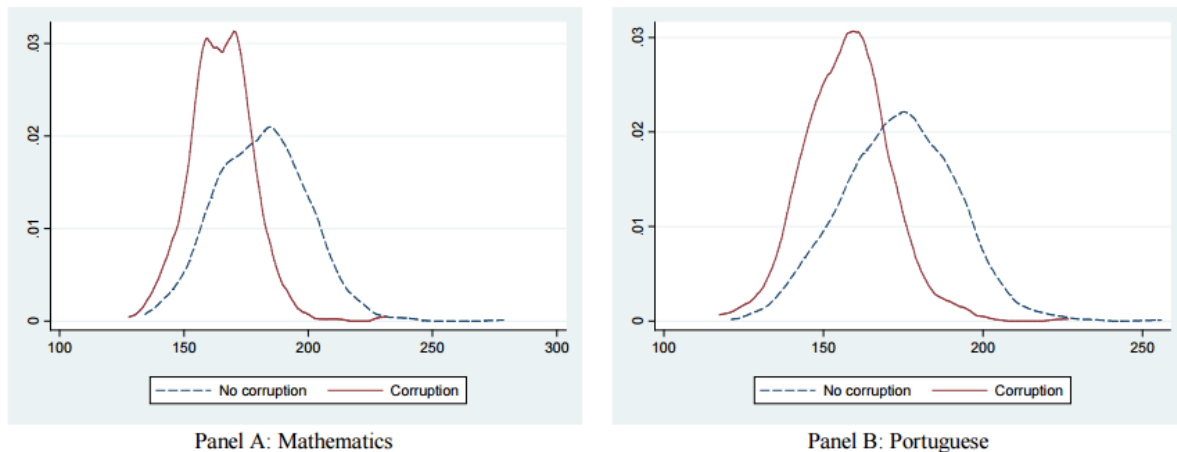
Figure 6.7 Unofficial payments for education and health services are widespread in Europe and Central Asia



Source: WDR 2017 team using Life in Transition Survey 2010.

Note: The figure shows the percentage of each country’s respondents that answered "Always," "Usually," or "Sometimes" to the question: "In your opinion, how often do people like you have to make unofficial payments or gifts in these situations? Receive public education (primary or secondary)/ Receive medical treatment in the public health system?" Other possible answers are "Seldom" and "Never." Results computed using democratic weights.

Figure 6.8 Corruption hampers service delivery: The case of education in Brazil



Source: Ferraz, Finan, and Moreira, 2012 (Figure 4)

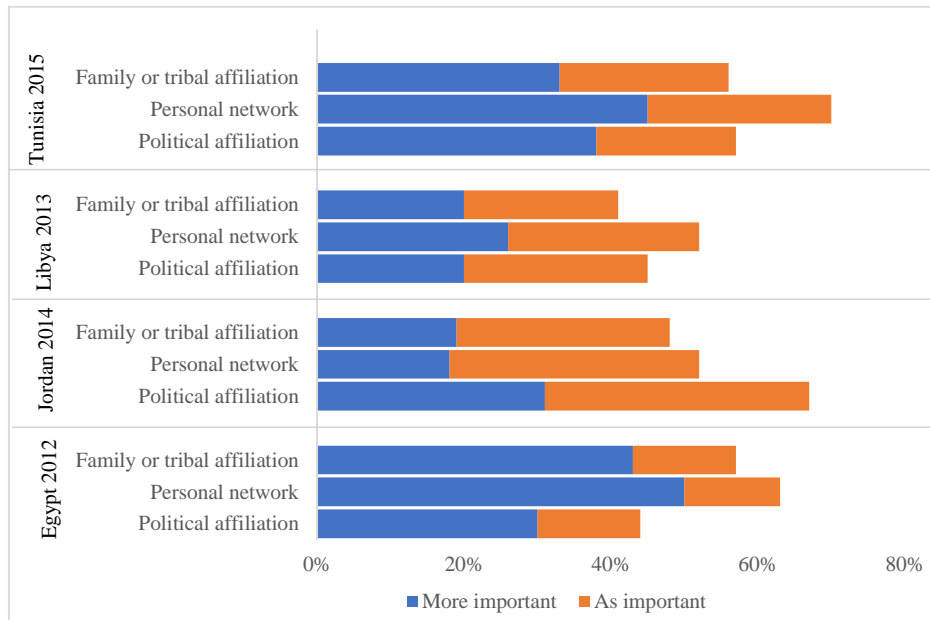
Note: Panels A and B display kernel densities of 2005 test scores aggregated at the school-level by subject matter. The densities were estimated separately depending on whether the school resided in a municipality where corruption was detected in education. The densities were estimated using the Epanechnikov kernel, with an optimally computed bandwidth.

6.30 Capture goes beyond the diversion of financial resources: absenteeism and lack of work effort are also forms of capture. Many teachers are absent from their schools: about 19 percent, averaging across Bangladesh, Ecuador, India, Indonesia, Peru, and Uganda (Chaudhury and others

2006). Absence rates for health workers in the same countries are even higher: 35 percent. Recent data measuring teacher absence in the classroom in seven countries in Sub-Saharan Africa finds even greater rates: as much as 60 percent in Mozambique. When teachers are in the classroom, often they are not teaching or not teaching well—another form of capture. Similarly, health workers often exert little effort, for instance as found in rural Madhya Pradesh in India (Das and others forthcoming; spotlight 7). In Senegal, clinicians only spend an average of 39 minutes per day counseling patients (Bold and others 2011). Capture reflects the lack of credibility of policy makers in monitoring and sanctioning service providers. A policy experiment in Kenya illustrates this point. It compared the impact of contract teachers in interventions managed by nongovernmental organizations (NGOs) and interventions run by the government. Test scores increased only in the intervention run by NGOs, indicating that the latter were more credible in implementing sanctions—through firing— than the government (Bold and others 2012). The lack of credibility of policy makers in sanctioning public sector workers may result from the role that the latter play in politics. In clientelist contexts, public sector jobs may be awarded in exchange for political support. In theory, a job is an attractive way for politicians to reward supporters. Politicians can exercise control over the careers of public sector workers, such as their location and promotions, and thus have a credible threat to maintain the workers' support. And it is in the interest of public sector workers to support politicians, to obtain help for their careers (Calvo and Murillo 2004; Gordin 2002, Robinson and Verdier 2013).

6.31 There is some evidence of links between political connections, government jobs, and poor service provision. In Pakistan, more politically connected doctors are more likely to be absent and less likely to be sanctioned for their absences (Callen and others 2014). In a number of countries in the Middle East and North Africa, between 40 and 60 percent of the respondents think that political connections are as important as or more important than qualifications to obtain a government job (figure 6.9). In India, despite rules that are supposed to protect the independence of the India Administrative Service, politicians frequently intervene in the careers of bureaucrats. In particular, bureaucrats of the same caste as the incoming politicians' party base secure important positions. In states with less interference from politicians in the transfers of civil servants, suggestive evidence indicates that poverty rates declined faster (Iyer and Mani 2012).

Figure 6.9 In the MENA region, a large proportion of citizens believe that connections are as or even more important than professional qualification to obtain a government job



Source: Program on Governance and Local Development - University of Gothenburg 2016 for the WDR 2017.

Note: The question used is "What is the importance of a person's professional qualifications in obtaining a government job relative to other factors? Please indicate whether each is more important, equally important, or less important as a person's experience and professional qualifications? 1. A person's political affiliations 2. A person's personal network, relation to influential people 3. A person's family or tribal affiliation". The graph shows the percentage stating that each factor is more important (or as important) than (as) experience and qualifications in obtaining a government job in each country.

6.32 Clientelism and capture further hampers the ability to raise resources and expand capacity in the future. Providing few public goods can undermine economic activity and future taxation. In theory, this can be a way for politicians to maintain power with “clients” by decreasing alternatives in the private sector (Robinson and Verdier 2013). For instance, in Sierra Leone, President Siaka Stevens dismantled the railway leading to the region with a high presence of supporters from the competing party. In this case, even the “presence” of the state in certain parts of the country was deliberately maintained as low. In addition to capture and clientelism, power asymmetries are reflected in exclusion. This occurs when individuals feel left out of the design of policies, or of the provision of public services, with consequences on their cooperation for these policies.

Social norms can hinder the effectiveness of de jure reforms aiming to increase cooperation

6.33 Social norms and individuals' beliefs about how other people—both fellow citizens and public officials—will behave also matter for equity. Policies may fail to expand opportunities, when deeply rooted social norms, related to gender or racial discrimination for example, are not addressed. For instance, evidence suggests that entrenched norms and beliefs about women's ability to be effective political leaders are related with lower representation of women in national parliaments, which has negative effects on the introduction of inclusive policies (see Chapter 7). Policies to induce *coordination* can help shift expectations toward a better equilibrium.

6.34 In some cases, while a specific reform may pass and may not be captured, entrenched power or norms may make it ineffective. Often, de jure reforms are not enough to improve economic opportunities sustainably. A clear example is provided by the very limited improvements for the black population in the U.S. South following the Civil War in 1865, despite radical changes on paper. Although slavery had been abolished, little else changed in the U.S. South. The white elites adopted measures to maintain low wages and restricted mobility for black workers (Ransom and Sutch 2001). A measure to grant each freed slave 40 acres of land failed to pass (Wiener 1978) and it took another hundred years for more profound changes to take place.

6.35 De jure reforms are particularly at risk of not being implemented when they clash with prevailing social norms, including customary law (see Chapter 3). Efforts to expand opportunities—such as legal reforms to improve women’s rights and opportunities—can remain ineffective if norms that consolidate existing asymmetries in bargaining power are not changed (Milazzo 2016). Norms can hinder the effectiveness of land titling programs in improving women’s access to land, for instance. Women may be afraid to claim their titles for fear of social sanctions and backlash from their husbands and families, as occurred in Bolivia and Lao PDR (World Bank/FAO/IFAD 2009; Giovarelli and others 2005).

Leveling the playing field and making the system more responsive to all

6.36 Expanding opportunities for disadvantaged individuals is potentially beneficial for growth in the medium and long term, but may threaten the interests of certain groups. When such groups have direct influence on policy design or implementation, including because of existing patterns of inequality in income or wealth, they may be able to block or undermine reforms. Effective policy design thus needs to take into account the bargaining power of the different actors involved. Threats to policy adoption and implementation need to be fully considered, building in ways to increase the cost of blocking reforms. Designing policies that are based on the existing bargaining power among actors may be more likely to make them successful in the short run. Ultimately, however, it might be necessary to modify the policy arena in order to increase the set of policies that can be successfully adopted and implemented.

6.37 To expand the set of equity-oriented policies that can be implemented, it is necessary to modify the policy bargaining process by changing the incentives, by reshaping the preferences of actors who bargain, or by reducing entry barriers for actors who are more likely to adopt redistributive policies—including those from disadvantaged groups. Enhancing *contestability* is a key entry point to help solve power asymmetries. For instance, when an increase in the direct representation of disadvantaged individuals in legislative assemblies promotes policy makers’ commitment to reforms that improve equity. Moreover, in order to adopt policies that imply losses for certain powerful actors, it may be helpful to provide *incentives* for them to support the reform (such the bundling of the policy with others that benefit them). A third entry point, shaping *preferences*, can enhance coordination, for instance by building common interest around certain policies.

Enhancing contestability

6.38 Increasing the direct representation of disadvantaged individuals in legislative assemblies and other political bodies can improve policy makers’ commitment to reforms that improve equity.

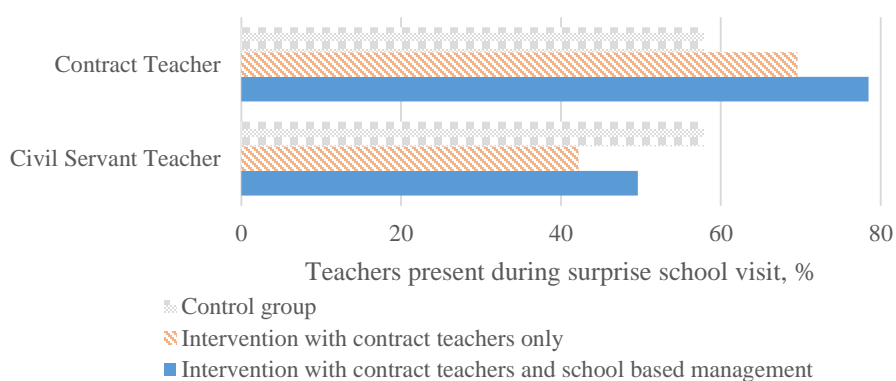
The proportion of women in national legislative assemblies has increased significantly in the past 20 years (even though currently below 30 percent, it still remains low). The case for this increase is that it can help bring about policies that are more aligned with women's preferences. Women may also feel more accountable to other women because of their shared identity. Indeed, in India, women taking part in village councils vote for public goods that are more aligned with their preferences and that improve health, such as greater investments in safe drinking water (Chattopadhyay and Duflo 2004). Other studies find that political reservations (electoral quotas) for scheduled tribes and castes lead to higher social welfare spending for scheduled tribes, and to more jobs for scheduled castes (Pande 2003). Ultimately, the political representation of disadvantaged groups seems to be effective in reducing poverty (Chin and Prakash 2011).

6.39 Marginalized groups can also be more directly involved in the design of specific policies, such as taxation. One promising example is explicitly taxing the informal sector in developing countries.² In Ghana, informal public transport workers were successfully incorporated in formal tax policy starting in 1981, thanks to the delegation of tax collection to informal sector associations. This arrangement is believed to have increased tax revenues (Joshi and Ayee 2009), and it was extended to 32 other informal sector associations (Joshi, Prichard, and Heady 2014). More importantly, it introduced a culture of tax compliance in a sector previously neglected by the tax authorities. An important element behind the success of this policy is that it improved taxpayer services, providing incentives for cooperation. Ultimately, the associational form of taxation moved, in 2003, to a more cost-efficient presumptive tax regime, where drivers are requested, every quarter, to buy a sticker and display it on their vehicle's windshield (Prichard 2009).

6.40 In the case of service delivery, “empowering” users by involving them in management can help improve services and reduce capture. For example, when parents' councils at schools are well trained and have credible sanctions, they can improve school results (Bruns, Filmer, and Patrinos 2011). In a reform experiment in Kenya to hire contract teachers, capture by civil service teachers was lower by one-third in the subgroup of schools where school committees received training in school-based management. In this subgroup, the school committee was better able to monitor the hiring of contract teachers, and capture—in the form of absenteeism and hiring of relatives—was reduced (figure 6.10, based on Duflo, Dupas and Kremer 2015).

² The informal sector may already be indirectly affected by taxation on intermediate goods or trade taxes (Stiglitz 2010).

Figure 6.10 Empowering parents with school-based management training helps decrease capture (teacher absenteeism) in Kenya



Source: WDR 2017 team using Duflo, Dupas, and Kremer 2015.

Note: Bars show the percentage of teachers present in school during a surprise visit. In schools that did not receive a school-based management (SBM) training, civil servant teachers were less likely to be present than in schools of the control group: their presence decreases in response to the availability of additional contract teachers.

6.41 Reducing power asymmetries through contestability mechanisms is not without challenges. As the evidence suggests, capture can take place even in participatory programs, such as community-driven development, which specifically look to include disadvantaged individuals in policy making processes. Disadvantaged individuals may participate less in these processes due to the higher opportunity costs of their leisure time, or because entrenched social norms make it hard to oppose those who traditionally hold more power (Box 6.5). This case is a good example of how good institutional ‘forms’ sometimes fail to perform their ‘function’.

Box 6.5 Local elites may capture public spending in decentralization reforms, particularly when local inequality is entrenched, even in participatory programs.

Reforms to increase public spending in favor of disadvantaged individuals may be captured by members of the local elites, who can shape expenditures to benefit their interests disproportionately (Galasso and Ravallion 2005). Capture occurs even in the case of participatory programs, such as community-driven development (CDD)—despite the fact that one of the programs’ objectives is to include disadvantaged individuals in spending decisions. CDDs are a form of decentralization of spending seeking to allow decisions to be better aligned with the preferences of local communities and, through participation, foster collective action. A review of participatory programs, however, finds evidence that the poor benefit less from these programs than the better-off (Mansuri and Rao 2013).

Existing patterns of inequality and poverty shape how collective action takes place in villages. One of the reasons why CDDs may not benefit poor people as much as hoped is that even when, on paper, the poor are supposed to take part in decisions, they do so less often and to a lesser extent than more advantaged individuals. That is, in the framework of this Report, CDDs often fail to improve contestability: decreasing entry barriers for the poor in decision-making. Participants in “civic activities tend to be wealthier, more educated, of higher social status (by caste and ethnicity), male, and more politically connected than nonparticipants” (Mansuri and Rao 2013). The poor have a higher opportunity cost to participate because they have less leisure and need to work longer hours to generate income. In addition, when they participate, it is more difficult for them to influence outcomes because they are less educated or can find it difficult to debate with and contradict individuals who traditionally hold influence and authority (Abraham and Platteau 2004).

Local elites may also be better able to shape outcomes in their favor and consolidate their bargaining power when they are not divided. Inhabitants in villages in Sierra Leone that have a smaller group of potential chiefs are more satisfied with civic participation than in villages with more competition among elites. This is the case even though social and economic outcomes are worse in those villages with less competition. A possible interpretation of this

result is that in villages with less competition, chiefs are able to capture civic participation (Acemoglu, Reed and Robinson 2014).

Source: WDR 2017 team.

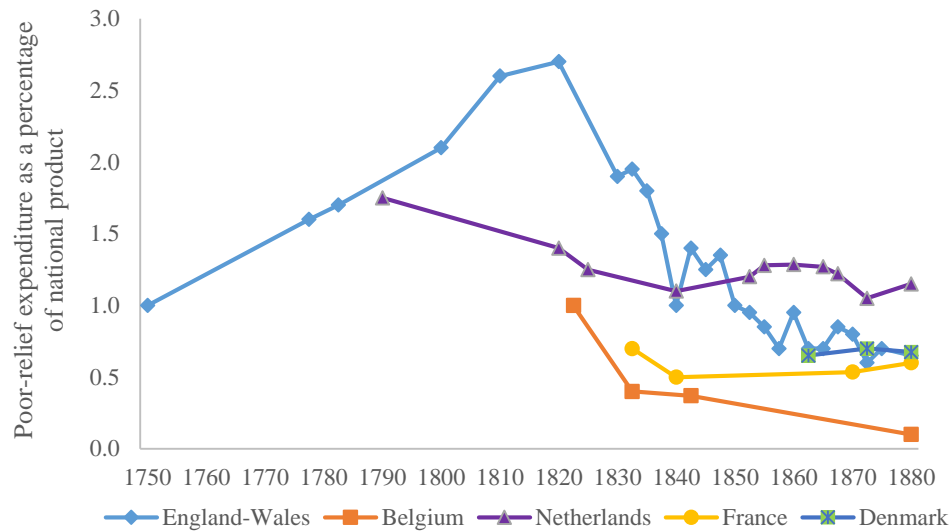
6.42 Measures to empower users may work best if they are linked to political authorities, in order to change the power dynamics with providers. In Indonesia, for instance, a field experiment compared various mechanisms to strengthen school committees. The results suggest that linking school committees, which are considered relatively powerless, to elected village councils—through joint meetings and action-plans—was the most cost-effective method to increase test scores. Linking school committees to village councils allowed alleviating some of the power constraints that committees faced on their own (Pradhan and others 2014).

6.43 If the credibility of sanctions by parents and communities is limited, “empowering” parents may be ineffective and may increase inequality. In the absence of formal sanctions to hire and fire (such as in well-trained school councils), school-based management may exercise influence by exerting social pressure on providers. However, when teachers or health workers are wealthier or more influential than users, the latter may not be able to exercise social pressure. Interventions to “empower” communities to monitor health clinics in Uganda are less successful in areas with higher ethnic heterogeneity and, to a lesser extent, higher inequality (Bjorkman and Svensson 2010). In Mexico, grade failure and drop-out rates were not reduced in poorer communities after a school-based management program was rolled out (Gertler, Patrinos and Rubio-Codina 2012).

6.44 Given the limits of local actors, what matters for more significant reforms is the balance of power between providers and politicians and how they bargain. Some reforms that managed to include unions and balance their power have succeeded. For instance, in Chile, ambitious education reforms were passed thanks to the inclusion of unions, in a setting of high credibility of the executive, in order to increase spending in exchange for performance pay reforms (Mizala and Schneider 2014).

Changing actors’ incentives in the policy arena through voting and information

6.45 Understanding the incentives needed to get influential actors to adopt and implement policies that will benefit the poor and disadvantaged is key to improving equity. In the Kenya example above, even though involving parents in school monitoring helped improve the outcomes from the hiring of contract teachers, the whole experiment ultimately failed to be scaled up because the government lacked the credibility to implement sanctions. This illustrates the need to change the incentives of elected leaders. Faced with new incentives in the face of changing economic conditions or potential fear of citizen-led regime change, elites may push for surprising reforms such as increased taxation and social spending. For example, the first antipoverty programs in nineteenth century England and Wales were pushed for by the landed aristocracy, in order to keep cheap labor in the countryside and prevent it from migrating to urban areas, at a time when the French Revolution spurred fear of revolts (see figure 6.11)

Figure 6.11 Economic elites can push for increased taxation or social spending as their incentives change

Source: Lindert 2004.

Note: The figure shows direct assistance to the poor from government funds as a percent of nominal national product. In the cases of Belgium, France, and Netherlands, figures include private as well as government funds

6.46 In some contexts, when political elites face stiffer competition as well as higher demand for public goods, they may have more pressure to deliver services, since they may need to broaden their base of supporters. There is evidence of this relationship in the case of building infrastructure in the United States (Besley, Persson, and Sturm 2010). In Brazil, there is also evidence of less corruption among mayors facing reelection (Ferraz and Finan 2011). When politicians face increased competition, they may delegate implementation decisions to better-trained bureaucrats, to whom they also give more autonomy (Rasul and Rogger 2015). That said, in clientelist settings, more competition may not always result in more public goods. Whether it does or not depends on the constituencies that politicians seek for support and whether they are easier to gain with public goods, as opposed to targeted policies. For instance, competing for the votes of the middle class—who demands public goods—can make politicians opt out of clientelism (Weitz-Shapiro 2012).

6.47 The engagement of disadvantaged groups through voting can change the incentives of political leaders. In the United States, laws that extended women's suffrage were followed by increases in public health spending and door-to-door hygiene campaigns (Miller 2008). In Brazil, the effective enfranchisement of poorer and less educated voters, thanks to improvements in voting technology with electronic ballots, led to an increase in the number of prenatal visits by health professionals, and possibly to a decrease in the prevalence of low-birth weights among the less-educated voters (Fujiwara 2015).

6.48 To overcome clientelism, new experimental evidence indicates that communication and deliberation can help. Increased avenues for communication can allow politicians and voters to uncover common interests. They also allow voters to learn about each other's preferences and

expectations and to update beliefs about candidate quality. The effects may be ambiguous, however, since increased communication may also allow better identifying targeted short-term benefits. Experimental evidence from Benin suggests that town hall meetings reduce the prevalence of clientelism (Fujiwara and Wantchekon 2013).

6.49 The provision of information can help transform incentives, and build coalitions. In the case of tax reforms, individuals may misinterpret how a redistributive reform would affect them, and they may oppose it even if they would gain from it (Cruces, Perez-Truglia and Tetaz 2013). For example, Bolivia tried to introduce a progressive personal income tax in the form of a flat rate of 12.5 percent and a no-tax threshold of twice the minimum wage. The announcement of the reform led to massive public protests, including by certain professionals that perceived that they would bear the largest cost of the reform, even though their salaries fell in the no-tax area. The government's inadequate effort to explain that the tax would have affected only a small group of high-earners, and mistakes in communicating the reform, such as addressing the group of potential losers as the "middle class," contributed to the demise of the tax (Fairfield 2013). By contrast, in Uruguay, during the successful personal income tax reform in 2006, the government effectively communicated that only wealthier individuals would be affected (Rius, 2013). Information can also help to sequence and pass difficult reforms. Publicizing assessments of student learning outcomes is a first step to start discussing changes in education policies between policy makers and teachers (see spotlight 6; Bruns and Luque 2014).

6.50 Information is, in theory, a critical tool to monitor elites—including service providers. Results, however, are limited and contrasting. An experiment on primary healthcare in Uganda, mimicking traditional community-driven development approaches, finds that the quality of care or health outcomes improved only in the subgroup where communities were also provided with information on the relative performance of the facilities. Such relative information helps identify what is within the control of policy makers or service providers (Bjorkman, De Walque, and Svensson 2014). Another promising result on the impact of information comes from Pakistan, where a randomized experiment that provided information to parents on the performance of private and public schools increased test scores, decreased private school fees, and increased primary enrollment (Andrabi, Das and Khwaja 2015). On the other hand, there are cases in which the provision of information on its own did not improve delivery. In an experiment in Kenya, providing information on children's performance in schools and how parents could take action did not increase their participation in monitoring (Lieberman, Posner, and Tsai 2014). The authors emphasize the many implicit assumptions that link the provision of information to improving services; two important ones in this case are whether parents think that monitoring services is their responsibility and whether they can do anything about it.

6.51 In particular, information in local interventions may improve outcomes only when constraints related to asymmetries in bargaining power are alleviated. While solid evidence is lacking, some information-related interventions may have been more successful because they did not face constraints related to a lack of bargaining power among actors. For instance, two information campaigns on the performance of local schools in northern India had contrasting outcomes. One campaign that was supported by the Department of Education was successful in improving outcomes (Pandey, Goyal and Sundaraman 2009). Another campaign that was supported by an NGO did not improve the performance of schools (Banerjee and others 2010). One interpretation is that in the case of the campaign supported by the Department of Education,

constraints related to the top-down delivery of services had already been alleviated (Khemani and others forthcoming). When such constraints are still present, information may have little or no impact.

Shaping preferences to increase cooperation

6.52 Collective action—particularly cooperation—can be enhanced by building common interest, as opposed to stressing the identity of policy makers. Stressing the identity of certain groups and improving their participation in policies may improve outcomes for these groups but this may come at the expense of other groups, or at the expense of longer-term benefits. For instance, in the case of political reservations in India, reservations for scheduled tribes increased social welfare spending in their favor, but decreased education spending (Pande 2003). Scheduled tribes may perceive that they will receive low returns to their education and thus may decide to invest less in it. While increasing social welfare spending is beneficial to them, it comes at the expense of redistribution that could benefit other groups and that may be more beneficial in the long term. External conflicts have played a role in development by helping build common interest against a common enemy (Besley and Persson 2010).

6.53 Rigorous work and evidence on how to build common interest in times of peace is lacking but education can play a role. A study of border regions in Kenya and Tanzania that were “artificially” divided by colonial powers and thus share many common characteristics. It finds that ethnic fractionalization does not lead to under-provision of public goods on the Tanzanian side of the border as much as it does on the Kenyan side of the border. Miguel (2004) attributes this to the practice in schools in Tanzania to foster a national identity to a much greater extent than schools in Kenya, thus improving cooperation for public goods.

6.54 Other mechanisms, such as earmarking of resources, can also aggregate preferences. Bundling reforms that improve equity with other reforms that matter to opposing elites may increase their buy-in. For example, in the case of tax reforms, earmarking can help garner support. Earmarking has been criticized for generating rigidities in the fiscal system, but it has been used often to improve commitment and convince elites to accept reforms (Fairfield, 2013), including in ancient Greece (box 6.6). Colombia, for instance, managed to pass a wealth tax levied on the richest 1 percent of the population because it explicitly devoted tax revenues to security and crime reduction. Although security is a public good, it was perceived as being particularly beneficial by the business community, which was heavily represented in the top 1 percent of the population. Credible commitment helps enable reforms: the reform was credible because of the president’s reputational risk, as well as his linkages with the business communities. To increase commitment, an ad hoc committee including members of the business community, was set up to monitor the administration of the funds (Flores-Macias 2014).

Box 6.6 Success and failure of progressive tax reforms: Lessons from ancient Greece

In ancient Greece, the wealthy were responsible for the financing of public services and public goods especially festivals and military campaigns—through a practice called *liturgies*. As a reward for their cooperation in fiscal affairs, the wealthy liturgists enjoyed the prestige of being appointed to public offices and could claim leniency if tried in court. One of the incentives for them to fund war expeditions was that they benefitted most from the expansion of Athen’s empire.

However, as Athens's supremacy in the Mediterranean was coming to an end in the midst of an economic crisis in the fourth century BC, the wealthy liturgists became increasingly reluctant to pay taxes. They tried to conceal their wealth or transfer the role of paying taxes to wealthier individuals (a practice called *antidosis*).

The success and decline of Athens's ability to tax its wealthy elites provides some useful lessons for difficult tax reforms today. First, it is important to provide an appealing set of tax expenditure policies that can promote tax compliance. Some of the taxpayers in Athens began contesting the kind of public goods that their taxes were financing: instead of frivolous festivals, they would rather finance the fleet, or even relief for the poor. Second, appealing to horizontal equity can also help pass reforms, by committing to fighting tax evasion and avoidance. In Athens, many of the complaints came from the perception that individuals with the same level of wealth could end up being subject to a very different tax levels. Finally, the introduction of formal rules may undermine social norms and voluntary compliance. In Athens, liturgies changed from being voluntary to compulsory. This change resulted in a diminished social recognition of the taxpayers, who could no longer claim privileges before the judges on the basis of their cooperation.

Source: WDR 2017 team based on Christ 1990.

Lessons for improving policy effectiveness by taking into account asymmetries in bargaining power

6.55 Policies can be blocked, captured, or rendered ineffective because their design did not account for asymmetries in bargaining power. To expand the set of policies that can be adopted, the policy arena may need to change: allowing new actors to contest policies, or shifting the incentives or preferences of those who bargain over policies. Assuming that some actors want to implement reforms that improve equity, how can these be passed and implemented effectively? A cross-cutting message that emerges from these insights is the need to understand how existing patterns of inequality matter. It is also necessary to understand how existing inequalities may be modified by reforms. For instance, increasing resources that aim to fund pro-poor policies may increase the incentives of local elites to be involved in policy making in order to capture these new resources (Mansuri and Rao 2013).

6.56 In order to design more effective policies, it is necessary to understand the context of existing inequality in the policy arena. For example, it is important to take into account how national and local elites shape policies when considering at which level reforms should be implemented. While on paper, decentralization or participatory development may seem promising, elites may be more entrenched at the local level than at the national level (Bardhan 2002). One of the founding documents of the United States, the Federalist Papers, argued for the need for federal intervention because of the risk of capture of local governments by vested interests, leaving minorities to be less protected (Hamilton, Madison, and Jay 1787). Decentralization can also create spaces where *de jure* power and *de facto* power conflict, potentially undermining policies. In a number of Sub-Saharan African countries, opportunities for bribes partly stem from incomplete decentralization; central authorities try to retain power over land allocation in practice despite decentralization *de jure* (Durand-Lasserve, Durand-Lasserve, and Selod 2015). Policy design needs to be comprehensive and reduce room for local elites to adversely intervene.

6.57 Beyond national and local elites, weighing how the effective implementation of policies will be shaped by different groups in society matters. In the case of social safety nets, failing to take into account the different bargaining power of the actors involved, at every stage of their design, may lead to the failure of reforms. For instance, while targeted policies for the poor may

help win the support of certain groups, by arguing for their cost-effectiveness, they may be opposed by those who do not benefit from them (box 6.7). Project design can partly improve the performance of community projects and decrease the adverse impacts of local inequality. For example, in 99 rural communities in northern Pakistan, projects that required more labor inputs (which villagers can contribute directly and hence monitor) and less capital (which is more difficult to monitor) were better maintained, even in communities where land inequality is high (Khwaja 2009).

Box 6.7 Designing social safety nets to account for asymmetries in bargaining power

Asymmetries in bargaining power matter at every stage of the design of social safety nets. Policy makers and development practitioners need to decide, among other things, whether to target a particular group, how to target it, how to operationalize the programs, and the nature of the benefits.

Considering the influence and bargaining power of actors matters at the earliest design stages: when deciding *whether to target a particular group at all*. Given financial constraints, targeting the poor may be the most cost-efficient policy to reduce poverty. This can be the “first-best” approach in the case of the reform of consumer subsidies, to protect the poor from price increases. However, in order to pass the reform, compensation may be needed for other groups who may be more connected to political elites or better able to organize to demonstrate. For instance, in the case of the gasoline subsidy reforms in the Dominican Republic, the transport industry was influential enough to obtain compensation for the reform. This may not be cost-efficient, but failing to compensate the industry may have stopped the reform from passing altogether. Similarly, the compensatory cash transfers for the electricity subsidy removal also covered part of the middle class, to thwart opposition (Gallina and others 2016).

The choice of *targeting methodology* also needs to take into account the existing structure of bargaining power among actors. Indeed, when it is not easy to target the poorest, putting communities in charge of allocating benefits may appear to be the best technical solution. However, in practice, it may allow members of the elites to block or capture programs or to use them for political gain.

For a given design of the reform, *the operationalization is also subject to taking into account asymmetries in bargaining power*: who registers applicants, who validates applications, who is present during the process. Politicians may want to be involved at every step for political gain. Although there is no clear evidence about the extent of the bias, when they do, this may distort the benefits toward political supporters (Weitz-Shapiro 2012).

In choosing the *amount and nature of benefits*, the approach that is technically first-best may not be the preferred tool of policy makers. Giving cash to households is, in most cases, the technically first-best approach, as it allows households to better allocate their total expenditure. Incumbent authorities, however, may prefer to distribute food because it is easier to publicize and exploit for political gain. This loss of efficiency may be further aggravated if they prefer food for more lucrative motives—because it may benefit influential food-importing and transporting groups (Graham 1994).

All the initial choices in program design can have longer-term or spillover negative consequences by further entrenching power relations. These choices, on the other hand, may help pass reforms in the short term. Reforms, by improving the livelihoods of the poor and their investment in human capital, can ultimately help rebalance power in their favor. Some cash transfer programs in Latin America are credited with contributing to the empowerment of the poorest as citizens. However, these trade-offs may also reinforce vested interests, such as food importers when benefits are in kind, or local elites when the only way to implement reforms is to involve them in the allocation of benefits. Such trade-offs need to be carefully considered when designing reforms.

Source: Aline Coudouel of the World Bank Social Protection and Labor Global Practice and the WDR 2017 team.

6.58 Asymmetries in bargaining power need not result in failed policies: reforms can be successful in improving equity if their design takes into account the bargaining power of different actors will affect policy implementation, including at the national and local level, across income groups, and between service providers and users. This chapter has described various mechanisms to adopt and effectively implement equity-oriented policies, but these mechanisms only come into

play if processes for change have already started. Part 3 delves into these processes. Chapter 7 examines when and how elites allow for the participation of new actors to bargain over policies, including due to changes in incentives or preferences. When elite bargains are not conducive to more accountability to citizens, disadvantaged groups may organize in order to have more voice in society; this is discussed in chapter 8. Furthermore, chapter 9 examines the role of international actors and processes in influencing the domestic policy arena

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Spotlight 7 Service delivery: Education and Health

S6.1 Improving access to health and ensuring that students learn are essential to expand opportunities. Various market failures explain the need for collective action to deliver these services. However, in many cases, power asymmetries prevent the successful implementation of policies that improve health and education.

Public interventions are needed for investments in human capital

S6.2 Various market failures may make individuals underinvest in health and education. First, certain parts of health and education are public goods: many individuals can benefit from the investment without paying for it. For instance, spraying against mosquitoes in a given neighborhood benefits all residents; those who do not pay for spraying cannot be “excluded.” As a result, some residents may free ride and not pay for the spraying because they will benefit from it anyway. If all residents adopt this logic, spraying will ultimately not be funded.

S6.3 Second, such investments present externalities: the benefits to society from educating or promoting the health of individuals can be larger than their private benefits. Some may, for instance, argue that education does not only matter because of the economic gains from it but that it also contributes to shaping civic behavior (Andrabi, Das and Khwaja, forthcoming). In addition, some levels of education may only be optimal if all actors move together. Individuals may not invest in skills if they think that firms are not investing in complementary technologies, and firms may not invest in new technologies if they think they will not be able to find workers (Acemoglu 1998). In some cases, such as the fight against communicable diseases, an individual has no incentive to invest in his or her own welfare if others do not invest, as well.

S6.4 Third, failures in other markets affect investments in human capital: individuals may not be able to borrow to make investments or they may be misinformed about the gains from them. This is especially true for poorer or disadvantaged individuals. For instance, given credit constraints, only those who have enough wealth may be able to invest in education. In the case of information, poorer children can be more likely to underestimate how wages increase with education, as a study in the Dominican Republic found (Jensen 2010).

Education: Challenges of delivering learning for all

S6.5 The problems outlined in chapter 6 hamper education systems from achieving their goals. Bureaucratic forms do not necessarily play their intended functions, often because power relationships prevent systems from promoting student learning equitably and efficiently; while norms consolidate power further and prevent laws and policies from being implemented as written.

S6.6 In Mozambique, for example, in 2014, 45 percent of the primary school teachers and 44 percent of directors were absent from school during an unannounced visit by the Service Delivery Initiative (SDI). However, even if schools managed to reduce teacher absence to zero, pupils would not be able to learn what their teachers do not know. In Mozambique, the survey found out that only 60 percent of mathematics teachers could subtract 86 minus 55 and just 17 percent of teachers were able to develop a sound lesson plan.

How power dynamics undermine education reforms

S6.7 In many cases, while policies seem to be in place to improve outcomes—for instance, governments train teachers or carry out national assessments of student learning—they are nevertheless not effective in improving outcomes.

S6.8 Reforms have failed because they were thwarted by power dynamics. This has happened a number of times with reforms hiring contract teachers. The idea behind hiring contract teachers is to decrease class size and employ teachers who are easier to discipline (thanks to the threat of firing or at least contract nonrenewal) and thereby face stronger incentives.

S6.9 However, teachers and their unions form a potent political force. Contract teachers, allied with civil service teachers, are able to form a potent political force and lobby to be absorbed into the civil service. Over the past decade or two, large numbers of contract teachers have been "regularized" (given civil-service status) in Kenya, Peru (Webb and Valencia 2006), Indonesia, and other countries. As discussed in Chapter 6, this power dynamic reflects that while policy-makers should monitor teachers to ensure that they deliver better learning; policy makers may in fact be dependent on teachers for political support. This dependence decreases the willingness of policy-makers to monitor and enforce performance.

S6.10 The contract teacher example shows that if policy design ignores power dynamics, a reform can leave the system worse off than it had been before the reform. Teachers hired on contract are often less qualified than civil-servant teachers are, at least in terms of formal qualifications. Yet schools, communities, and governments are willing to hire these contract teachers because they are willing to trade qualifications for effort. Yet in the end, they have gotten the worst of both worlds, from a service delivery perspective: once the less-qualified contract teachers have been incorporated into the civil service, the country ends up with the same low effort, lower skills and higher budgetary cost.

How can difficult education reforms be effectively adopted and implemented

S6.11 How can reforms change power dynamics to improve the outcomes of education systems? Despite the gloomy picture overall, change can happen, most likely when reforms are successful in changing incentives of teachers and policy makers; involving new actors in the policy bargaining arena; and changing norms.

Changing the incentives of policy makers and teachers through public awareness

S6.12 Information is often viewed as a way to allow policy makers to better monitor providers. However, information as pure technical tool may not be enough. Rather, information is useful when it can be easily understood and is targeted to those with incentives to act.

S6.13 Improving public awareness of the unacceptably low levels of learning in many areas of a country has proven to be a successful policy for changing the incentives of teachers and policy makers, and improving education quality. This theory underlies citizen-led assessments of student learning, such as the ASER program in India and the Uwezo program in East Africa, both of which aim to improve data on and public awareness of the levels of learning. The same theory inspired initiatives such as the Service Delivery Indicators initiative (SDI) in Sub-Saharan Africa. SDI

gathers data on both inputs and outcomes in representative samples of schools in many countries, and its data are useful for diagnosing problems and targeting support. But ultimately, the SDI effort is not just about fine-tuning an education system by turning technocratic dials, but about shifting the equilibrium by marshalling public awareness to support reform.

Combining information and sequencing to build support for reforms

S6.14 Many important education reforms have taken place over the past two decades, including in settings in which teacher unions play important roles. Policy makers who want to implement reforms can reach out to build support from other actors by first using information on student performance and directly communicating with the public. In some cases, including in Ecuador, Mexico, and Peru, confrontation has been unavoidable. On the other hand, in Chile, where policy makers had high credibility with respect to unions because they were traditional allies, a process of continuous negotiation paved the way for the passage of important reforms, such as bonus pay, including by bundling them with increased spending on education (Bruns and Luque 2014).

Bringing new actors in education policy: The role of parents

S6.15 Directly involving parents in school policies is another way to change power dynamics. It can only work, however, when parents can credibly enforce sanctions. For instance, why did giving more power to parents through school based management (SBM) reforms work in Honduras and fail in Guatemala? Ganimian (2016) argues that in Honduras, teachers' unions were focused on higher order problems such as wages and the investment from the national government was small, especially in the beginning, and as a result SBM was able to endure through different administrations. In Guatemala, by contrast, the high cost of maintaining the program made it more vulnerable to special interest groups, who managed to organize and successfully advocate to revert the reform.

Changing norms

S6.16 Changing education systems also means promoting norms that support better behavior and promoting teachers who share these norms. Many teachers throughout the developing world make heroic efforts to educate children in extraordinarily difficult circumstances, contending with a lack of learning materials, student absenteeism, and threats to their safety. When they do this, it is sometimes because of altruistic concern for children, but sometimes it is also because they subscribe to a norm of teacher professionalism and a sense of duty. Ensuring that more such teachers are selected into public service and rewarded appropriately can help shift the composition of the teacher body and change power dynamics.

Health: Challenges for improving access

S6.17 Investments in health early in life are key for health later in life, as well as for education and learning outcomes (Almond Chay, and Lee 2005; Black, Devereux, and Salvanes 2007). However, in many developing countries, and especially in low-income countries, the quality of health care is poor: as discussed in chapter 6, doctors are absent, and when they are present, they exert low effort or make mistakes in diagnosing and treating patients. In addition, household out-of-pocket expenditure dominates health financing in low-income countries and in many middle-income countries (World Bank 2007).

An illustration of poor quality of care: India

S6.18 The poor availability and quality of care is evident in India. In a representative sample of rural areas of Madhya Pradesh, 40 percent of doctors in public health facilities are absent at any given time. Doctors in public facilities spend on average 2.4 minutes with a patient and complete only 16 percent of a checklist of examination item and questions on medical history. The same doctors perform better when they are in the private sector—indicating the importance of incentives. However, virtually no doctors conducted all the examinations indicated when a child had diarrhea. Patients are much more likely to receive an unnecessary treatment than a correct treatment. Only 3 percent gave only a correct treatment (Das and others, forthcoming).

An illustration of out-of-pocket expenditures, including informal payments: Ukraine

S6.19 Ukraine illustrates the problem of out-of-pocket expenditures—including a gap between formal rules and actual practice. Like several other countries of the Former Soviet Union, everybody has the constitutional right to access free health services. Nevertheless, direct payments by patients account for more than 40 percent of total health expenditures and are a heavy burden for the majority of Ukrainians.¹ *De facto*, patients pay an informal fee for almost every service offered by public health providers. These informal payments seem to be partly pocketed as informal income and split between the care providers (physicians and nurses), other health care personnel (chief doctors, hospital administrators), and political authorities at various levels. They are also used to finance recurrent expenses of health facilities, such as various supplies, refurbishment, and reconstruction (Belli, Dzygyr and Maynzyuk 2015).

How to reform health care

S6.20 Poor quality of care and high out-of-pocket payments are partly the result of a political equilibrium between the different actors involved in the process of adopting and implementing health policy.

Change the actors involved in health policy adoption and implementation

Involve more actors in hiring practices to break patronage

S6.21 In Ukraine and other countries, patronage plays a decisive role in the recruitment and placement of doctors, especially for attractive positions: those where it is possible to extract more and larger informal payments. This consolidates networks of personal connections and erects high entry barriers. Several Ukrainian health workers reported they had to pay to secure a job or to retain their positions, and also needed to maintain their discipline and loyalty to their line managers (Belli, Dzygyr, and Maynzyuk 2015).

S6.22 Reforms should try to change the patronage system, especially among doctors. In Ukraine, for instance, broadening the set of actors involved in the process to hire doctors holds promise.

¹ In 2010, for instance, about 60 percent of individuals had at least partially forgone health care services because they could not afford them (Tambor and others 2014).

Some cities have introduced the requirement that the municipal health care department should approve any appointment and dismissal of medical staff, to stem the power of chief doctors.

Involve users, including through good use of information and monitoring

S6.23 Involving communities can work to strengthen the quality of care and decrease absenteeism, provided that they have clear mandates and tools to monitor providers. An intervention designed to strengthen local accountability and community-based monitoring in the primary health care sector in Uganda was remarkably successful in improving both health services and outcomes in the participating communities (Björkman and Svensson 2009). The intervention consisted of a series of community meetings facilitated by a nongovernmental organization, using report cards on the quality of services, and resulting in action plans. Utilization of outpatient services increased by 20 percent, and there were significant improvements in treatment practices, waiting time, examination procedures, and absenteeism. Most importantly, the weight of infants increased significantly and the under-five mortality rate fell by one-third in the treatment villages.

Change the incentives of politicians and providers

S6.24 However, there are limits to how much local control can achieve—in part because there are important components to the quality of service delivery that are not determined locally. It may be necessary to change the incentives at a higher level or through top-down approaches to improve the delivery of health services.

Better incentives for policy makers can work, if effectively implemented through decentralization

S6.25 Decentralization is often seen as an attempt to increase accountability because users/voters may better observe the efforts of policy makers. In Brazil, the public system, managed and funded by states and municipalities, is the main source of health care for the poor. Given competition for the votes of the uninsured (poor) who want public health care and the insured (richer) who do not, spending on health care is higher in municipalities where the proportion of poor is higher and where voter turnout is higher (Mobarak, Rajkumar and Cropper 2011).²

S6.26 However, decentralization may also be ineffective, simply adding a bureaucratic layer. This is what happened in Ukraine. In the 1990s, following the disintegration of the centralized Soviet Union and the collapse of central revenues, most public services financing and administration, including health, was decentralized to region, district, and municipal levels. However, only the Municipal level was governed by elected officials, while all other levels were governed by officials appointed from the center, thus limiting the representativeness of local authorities. In addition there was no clear assignment of new accountability arrangements. The process increased fragmentation, since several levels of government financed, owned, and ran health facilities. Decentralization ended up “crystalizing” the status quo: for example, making it impossible to streamline the excess infrastructure, since health services became a source of

² Although voting is supposed to be mandatory in Brazil, penalties for noncompliance are low and the average voter turnout is much lower than 100 percent: it was 77 percent in the 1996 elections, for example. The authors assume that variation in turnout is more likely to be driven by voter turnout by the uninsured, since those who are insured are more likely to be formal workers, on whom it is easier to impose penalties.

patronage and informal revenue for local elites and senior doctors (Belli, Dzygyr and Maynzyuk 2015).

Better incentives for providers can work if effectively implemented

S6.27 The introduction of performance-based budgeting schemes may improve the level and distribution of key health outcomes and change incentives of health providers by making them more accountable. There is need for more research to assess the effectiveness of these schemes, and their impact may depend on existing conditions. For instance, in Ukraine, the introduction of a program-based budgeting collided with the existing detailed spending requirements and just added a layer of bureaucracy. On the other hand, in Argentina, the introduction of performance incentives to finance a provincial insurance scheme for maternal and child health care (Plan Nacer) improved not only the number of prenatal care visits, but also the quality of prenatal care and delivery. The incidence of low birth weight and neonatal mortality decreased (Gertler, Giovagnoli and Martinez 2014).

* * *

This spotlight is based on special contributions to the WDR 2017 from Paolo Belli from the Health Global Practice and Halsey Rogers from the Education Global Practice of the World Bank.

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Part III

Drivers of Change

Part III

Drivers of Change

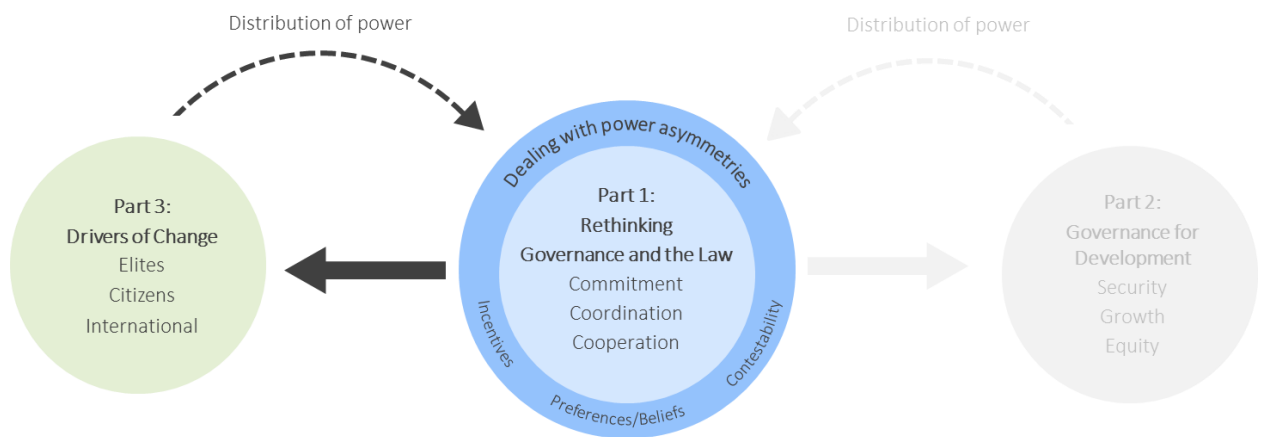
As discussed in Part II, to improve policy effectiveness and ultimately to expand the set of implementable policies it is necessary to reshape the policy arena where actors bargain. This can be done by enhancing contestability, that is, by enabling the entry of new actors into the bargaining space; by changing the incentives of the actors involved; or by reshaping their preferences and beliefs. While the dynamics of governance can be very persistent and are highly endogenous, change is possible over time. Part III of the Report explores the dynamics of how change occurs from the perspective of elite bargains, citizen engagement, and international influences. In the end, change is manifested by bringing about new formal rules that reshape *de jure* power.

Chapter 7. *Elite bargaining and adaptation.* Elite actors constantly face the need to adapt to changes, as the development process alters their relative power, incentives and preferences. Bargains among elites may collapse when powerful interests resist change and negotiations are unable to accommodate new interests. However, cooperative agreements, where elites adapt by generating more capable, contestable, and accountable institutions, can lead to successful long-term transformation. Self-interested elites may agree to bind their own hands as a means of sustaining power in the long term, and as a form of political insurance. When the potential for conflict arises, elites may choose to broaden coalitions by bringing new actors into decision-making spaces to improve stability. When elites recognize threats to their power, they may introduce rules to constrain power, hoping that they will bind not only themselves, but also their successors. The polarization of elite preferences, the competitiveness of bargains, and the presence of effective leadership all play a role in whether elites adopt rules-based mechanisms, and the sustainability of changes.

Chapter 8. *Citizens as agents of change.* Mechanisms of citizen engagement such as voting and political or social organization allow individuals to coordinate and cooperate with one another, increasing their bargaining power to engage with elites and affect change. Elections can change the incentives of elected officials by coordinating individual actions to sanction officials who fail to deliver on electoral promises. Political parties represent and articulate citizens' collective interests, helping integrate different groups into the political process, aggregating preferences, and channeling demands into the policy-making process. Engagement through social organization—including through social movements and public deliberation—provides an alternative entry point for change and can enhance contestability. However, each of these mechanisms of engagement has inherent limitations and may be subject to capture and clientelism. Since these mechanisms are imperfect, they complement, rather than substitute for, one another. When effective, the interaction of these mechanisms can bring about changes in formal rules, particularly in areas that affect groups and individuals who are generally excluded from the policy arena.

Chapter 9. *International influence.* Governance dynamics are not limited to the borders of sovereign nations. Elite bargains and citizen engagement are increasingly influenced by transnational flows—of ideas, capital, goods, technology and people. These flows directly affect domestic governance, presenting both challenges and opportunities. International factors influence change through two main channels: norms and regulations, and international cooperation (including overseas development assistance). These instruments influence bargaining dynamics by

altering the relative power of actors and by bringing new goals to the table. They can enhance contestability in the policy arena, effectively changing the incentives of actors and eventually reshaping preferences in society through “demonstration effects.” By referring to international norms, ordinary citizens can at times strengthen the legitimacy of their claims and successfully challenge prevailing norms. However, international instruments can also reinforce existing balances of power, sustaining outcomes that are socially undesirable. For instance, when aid is used without taking the development objective of the recipient country as the priority, it can reinforce local power dynamics that favor entrenched elites. Such development assistance failures can be avoided by taking into account how different instruments can also help legitimize policies and coordinate collective action to broaden the policy arena and lead to better, more sustainable, outcomes.



Chapter 7 Elite bargaining and adaptation

Understanding elite bargains

7.1 For the past four decades, China has been the world's fastest growing country and has lifted over 700 million people out of poverty. According to many commonly used indicators, China's institutional environment during this period remained static. Yet a deeper understanding shows that the adaptive policy decisions and enhanced state capacity that enabled China's economic and social transformation were facilitated by deep changes to the policy arena.

7.2 Despite maintaining a one-party state without elections at the national level, and restrictions to information flows and association, China has nevertheless significantly broadened the space for contestability at both central and local levels; this, in turn, has led to greater adaptability that has enabled improvements in growth and equity. In the years following Deng Xiaoping's 1980 assertion that "over-concentration of power is liable to give rise to arbitrary rule by individuals at the expense of collective leadership," the Communist Party of China (CPC) broadened horizontal accountability and institutionalized collective leadership through norms on leadership transitions, rules on selection and retirement, consultative decision making, greater Party institutionalization, bureaucratic professionalization, and the introduction of village elections. The growth of state and Party bureaucracies, as well as organized business and societal interests, combined with decentralized economic power, led to a proliferation in the number of organizational bases with bargaining power (Lampton 1987). All these reforms reflected the incentives and preferences of those in power: broadened accountability and a more rules-based space for contestability helped solve commitment and collective action challenges within the ruling elite, and thus enhanced the stability of the ruling party during a period of tremendous change.

7.3 When powerful interests resist change, governance institutions that stunt inclusive development can persist. Yet history is rife with examples of countries that improved rules, institutions, and processes that constrained powerful interests and facilitated developmental progress. All of today's high-income countries were once poor and had unaccountable governments. These countries sustained economic growth over long periods while improving social welfare and preventing violence. Sustained inclusive growth was facilitated by evolving institutions and rules of the game that constrained arbitrary behavior by decision makers, enhancing contestation in policy making and increasing the accountability of decision makers. Such changes have been accomplished using different institutional forms: some countries have broadened accountability within dominant political parties or opened the space for contestation only in specific domains or at local administrative levels; others have introduced free and fair competitive elections and broad corporatist consultative arrangements.

7.4 The institutions and rules these countries established facilitated nonviolent and equitable development. But *why* did these durable institutions develop? Changes to the "rules of the game" that determine policy formulation and implementation result from a bargaining process among elite actors acting in their own interests. Reforms that limit the arbitrary exercise of power today may be necessary for maintaining or enhancing power or providing insurance against a loss of power in the future. Formal institutions—moving from deals to rules—can enhance the credibility of commitments, overcoming coordination challenges between elite actors and strengthening the

stability of elite bargains. In cases of long-term successful transformation, elite actors have adapted to changing circumstances by generating more capable, contestable, and accountable institutions; these institutions themselves helped enable further development.

7.5 Elite bargains are dynamic, constantly adapting to changes in the relative power, incentives, and preferences of elite actors. The development path is bumpy: shocks (such as terms of trade shocks and natural disasters) and gradual developments (such as urbanization or a growing middle class) alter elite power and preferences, often benefitting one group of elites at the expense of another. In the face of these changes, many deals-based bargains that cannot accommodate new actors or demands collapse. At other times, elite bargains successfully adapt to changes in the relative power, incentives, and preferences of societal interests by accommodating new demands through credible rules for elite-elite and elite-citizen interactions (see chapter 2).

7.6 Long-term developmental progress is predicated on this ability to adapt to changing circumstances. The institutional forms that are selected to solve commitment and collective action challenges at particular junctures in a country's development may produce trade-offs: growth with higher inequality; more redistribution or less violence accompanied by lower long-term growth; successful growth episodes with increasing environmental costs; or growing levels of injustice or exclusion, despite good growth outcomes. The introduction of contestability and accountability mechanisms can help countries adapt when tensions related to these trade-offs arise. When adaptation takes place through rules-based mechanisms, virtuous cycles of continued adaptation and developmental progress are more likely. However, the conditions under which such rules-based adaptation occurs are limited: in most of the world and most of human history, unstable deals-based bargains have dominated.

Who bargains?

7.7 Actors in the policy arena bargain over the design and implementation of policies and the definition of rules. This chapter focuses on “*elites*”—those actors with the ability to directly influence outcomes within a given sector or issue. But identifying these elites may be difficult (Box 7.1).

Box 7.1 Expert survey to identify elites

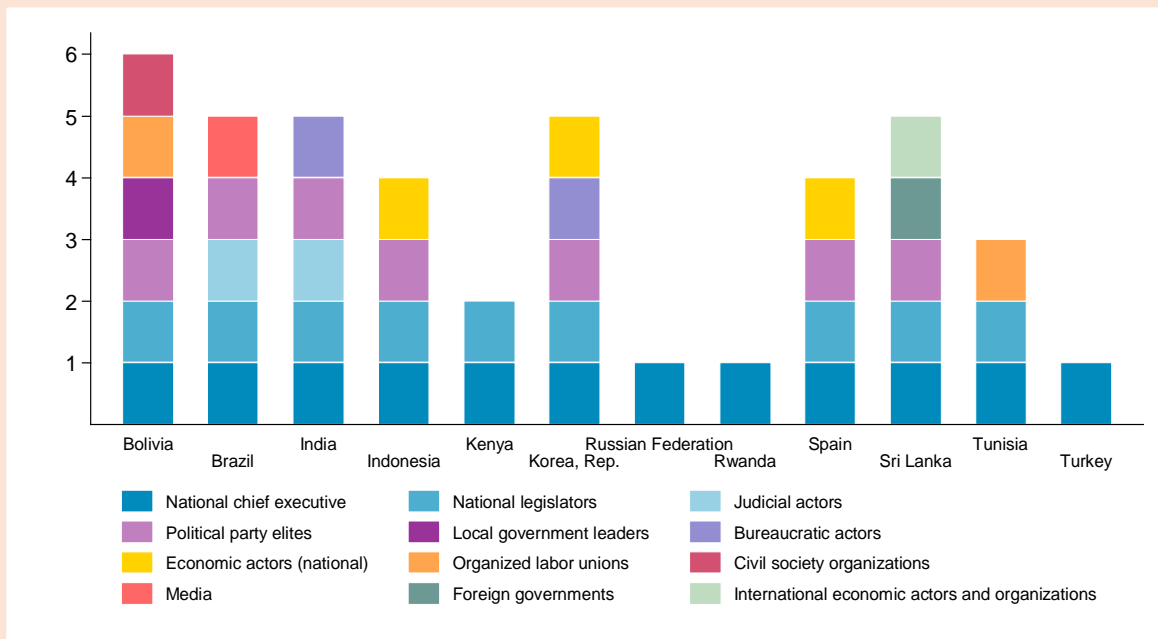
All social science disciplines and development practitioners recognize the importance of elite actors in determining development outcomes: from Aristotle’s “oligarchy” to early twentieth century “elite theorists,” including Michels ([1911] 1996), Pareto ([1927] 1971), and Mosca (1939), to recent grand theories of economic and institutional co-evolution, including North, Wallis, and Weingast (2009), and Acemoglu and Robinson (2012). The international donor community increasingly looks at the consequences of different “political settlements,” which can be understood as elite bargaining equilibria that emerge at critical junctures in a country’s development (Khan 2010; Di John and Putzel 2009). Yet the set of conceptual research tools available to scholars of elite bargaining and to development practitioners remains limited, as does agreement on who exactly are elites.

To help fill this gap, as part of *World Development Report 2017*, the World Bank, in collaboration with the V-Dem Institute, has conducted expert surveys to generate cross-national indicators that enable comparison of who holds power and how they wield this power. The surveys cover over 100 years of data in 12 countries across 6 regions. Resulting data help to identify how the distribution of elites maps into national power and the formulation and implementation of laws governing the exercise of power.

The survey reveals that the identity of the powerful elite actors that bargain over national policy decisions differs greatly over space, time, and issue area. For instance, while national chief executives are part of the elite ruling coalition in all 12 survey countries in 2015, the other actors vary greatly, both in number and representativeness (figures B7.1.1, panel a). Although in 2015 in Russian Federation, Rwanda, and Turkey, the national chief executive monopolizes decision making, in Bolivia, the ruling coalition is much more varied, consisting of legislators, party elites, local governments, labor unions, and civil society organizations.

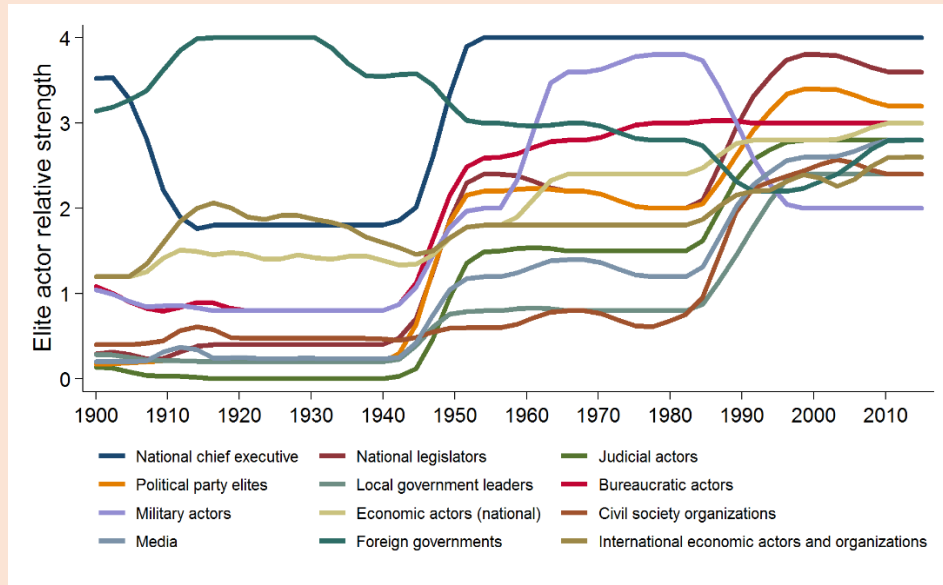
Figure B7.1.1 Elite actors within national ruling coalitions vary greatly across countries and over time

a. Twelve-nation comparison of the number of groups in the ruling coalition, 2015

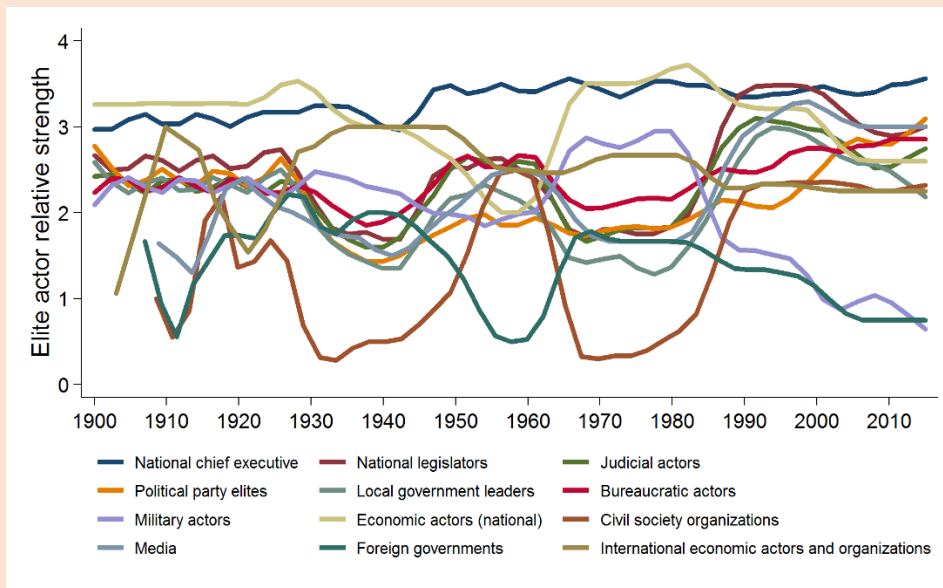


Ruling elites also differ within countries over time. In the Republic of Korea, during the Park regime, the bargaining strength of military actors, bureaucratic actors, and economic actors increased steadily (panel b). The post-1987 transition to democracy resulted in greater strength for new actors, particularly political parties, legislators, and the judiciary, but economic and bureaucratic actors remained highly empowered. In contrast, Brazil has experienced much more volatility in empowered elites, particularly before the 1990s (panel c).

b. Relative strength of elite actors in the Republic of Korea, 1900–2015



c. Relative strength of elite actors in Brazil, 1900–2015

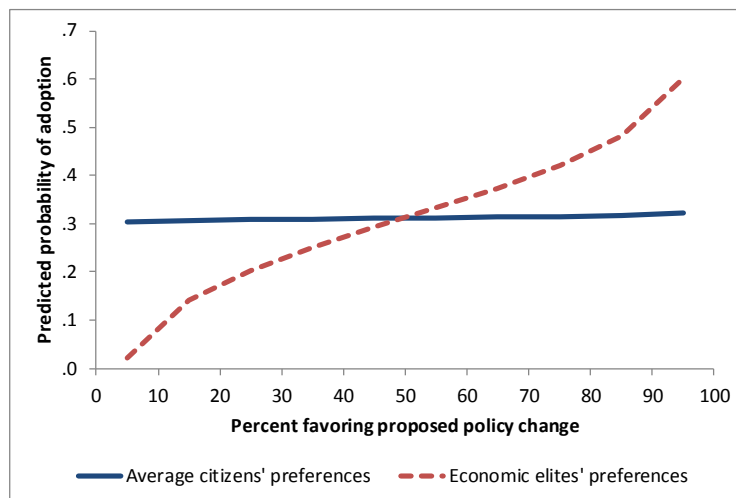


Source: WDR 2017 team.

Note: Panel a shows the number of elite groups that have relative strength greater than 3 (on a 0–4 scale), but does not show the relative strength of these groups. More information on specific variables and survey methodology can be found in World Bank and V-Dem (2016) and Coppedge and others (2015).

7.8 This chapter focuses on *national elites*—those who have direct influence over national policy formulation and implementation, as well as the *rules of the game* by which national power is allocated, exercised, and constrained.¹ Even at the national level, elites differ by sector: those with agenda-setting or veto control over health policy may not have control over constitutional reforms. At the national level, political (state) elites are of particular importance. However, formal political elites wield variable amounts of de facto power. In highly institutionalized countries, political power may flow from official positions, but in most countries—developed and developing alike—nonstate elites also directly influence bargaining outcomes. In the United States, a high-income institutionalized democracy, policies are much more likely to match the preferences of economic elites than they are to match the preferences of average citizens, despite a de jure commitment to equal representation (figure 7.1) (Gilens and Page 2014). Elsewhere, relational or ideological informal power may trump economic or military might: Rasputin, despite his peasant background, was among the most powerful figures in Nicholas II’s tsarist Russia.

Figure 7.1 Preferences of economic elites predict policy adoption more than citizen preferences in the United States



Source: Gilens and Page 2014.

Note: Analysis is based on 1,779 policies in the United States between 1981 and 2002 in which public opinion polls were carried out.

7.9 Organizations empower elites and also help elites overcome coordination problems and enable them to credibly commit to one another. Elites differ in their capacity to organize: can they credibly commit to those they seek to influence and thus coordinate their behavior? Certain wealthy oligarchic elites may not depend on internal organization directly, but money is fungible, and it can buy collective action when necessary. For instance, during periods of political unrest in Thailand, economic elites bought “protestors” to occupy public spaces and demand a change in government (Winters 2011). Similarly, intellectual or charismatic leaders may become powerful elites due to their ability to generate large mass followings by shifting preferences. In this sense,

¹ The same analysis can also consider the subnational level and agency-specific reforms.

elites are elite by virtue of their capacity to organize collective action and thus exercise influence (Mosca 1939; Mills 1956).

7.10 The processes through which elite actors and the organizations that support them coordinate and commit to one another to determine outcomes can be thought of as *elite bargains*. Using an elite bargaining framework helps move beyond the “black box” view of the state. “The state” is not monolithic, but rather a reflection of bargaining outcomes among groups of empowered economic and political actors. All governments have some sort of power-sharing arrangement, regardless of their regime type (Bueno de Mesquita and others 2003). Even in many regimes seemingly dominated by single individuals, the ethnic compositions of ministerial cabinets are inclusive and proportional to the population, reflecting political bargaining rather than “Big Man” rule (Francois, Rainer, and Trebbi 2012). As they engage in elite bargains, actors not only have different degrees of relative power, but also different incentives and preferences.

7.11 For the broad sweep of human history, elites have bargained using deals-based mechanisms. The transition toward more rules-based governance is often thwarted by the incentives that elites face to maintain or maximize *utility*—be it wealth, influence, or reputation. Preserving or maximizing utility depends on preventing expropriation and exploitation by other powerful actors—but the ability of elites to credibly commit not to expropriate from one another is limited, given coordination and common agency challenges. This difficulty in establishing credible internal commitment tends to lead to unstable and nonadaptable short-term bargains. When elite bargains are deals-based, there is a natural tendency to keep coalitions small (Riker 1962). It is easier to coordinate preferences among a small group because bargains become less efficient with many actors (Mailath and Postlewaite 1990), and closer relationships make commitments more credible.

7.12 Commitment within the elite bargain may be credible because of the low threshold for small group coordination, but this credibility depends on maintaining the exclusivity of the bargain.² Borrowing from the economic literature on oligopolies, when incumbent elites seek to prevent entry into the ruling coalition by currently excluded (opposition) elites, they have three potential strategies: blockade (to prevent entry); deterrence (modifying incumbent behavior to deter entry); and accommodation (allowing other elites to enter, and modifying the behavior of incumbents and new elites). Despite a tendency for limited deals-based bargains, under certain circumstances, elite bargains may expand and generate formal rules to help overcome collective action and commitment challenges, often to bring about effective deterrence or accommodation.

How do bargains adapt to changes in the relative power, incentives, and preferences of elites?

7.13 Most elite bargains are deals-based and “exclusive,” and tend to resist adaptation. Bargains with few actors that are less open to external influences have less accountability, and this can undermine future adaptability as new actors become powerful. The nonadaptability of deals-based bargains helps explain why regimes in low- and middle-income countries are tenuous; they experience violent transitions every eight years, on average (Cox, North, and Weingast 2015).

² This leads to the “limited access orders” described in North, Wallis, and Weingast (2009) and the “extractive” political institutions described in Acemoglu and Robinson (2012).

7.14 In states with deals-based bargains, the distribution of rents tends to be the glue that provides political stability and enables development (North, Wallis, and Weingast 2009). Commitment to distributing rents to those within the coalition may suffice to generate security and tie the state together, but such a state faces difficulties incorporating new elites that may be necessary to generate growth and equity (see discussion on security in chapter 4). Indeed, these stable bargains can quickly deteriorate when the source of rents breaks down. For instance, in South Sudan from the period of the Comprehensive Peace Agreement (CPA) in 2005 through the formation of the state in 2011, the distribution of rents held together heterogeneous factions and structured power relations that were reflected in patronage networks, including well-connected (but unproductive) “tenderpreneurs” who survived on government contracts. However, these rents were unreliable, and undoing them proved difficult: a period of austerity in 2012–13 undermined South Sudan’s patronage-based elite bargain, making the country one of the world’s most fragile (Twijnstra 2015).

7.15 However, under certain circumstances, elite bargains adapt to changing circumstances by improving state capacity and moving from deals-based agreements to formal rules-based mechanisms for contestability and accountability. In these bargains, elites institutionalize increasingly broad commitments to one another; they move from narrow deals to broad rules.

7.16 Elites adopt rules-based mechanisms for two general reasons: to sustain power, or to provide insurance against a future loss of power. When actors who have been excluded become stronger, bringing these new actors into credible institutions and granting concessions may be less costly than repressing these actors. Similarly, expanding the formal accountability space may help provide internal commitments that facilitate agreement. As Tancredi says in *The Leopard*, “If we want things to stay as they are, things will have to change.”³ When ruling elites are no longer confident of their hold on power, the introduction of rules may lower future costs of losing power by providing “insurance.”

7.17 The introduction of rules-based mechanisms will coincide with elite self-interest only under certain circumstances. When the costs to ruling elites of losing power are high, they will be less inclined to increase the space for contestability and accountability, and less inclined to cede power. If ruling elites believe expropriation or violent punishment will result from ceding power, they will reject electoral results that support the opposition (figure 7.2). The most important determinant of the costs of losing is the level of polarization between the preferences of elite groups; starkly opposed preferences raise the likelihood of violence and instability (Vu 2007). Similar or overlapping elite preferences—low levels of polarization—tends to facilitate coordination across different elite groups. When polarization is high, accommodating new groups becomes more challenging, as concessions may be too costly to ruling elites. When elite polarization decreases, countries are more likely to institutionalize elite interactions and generate rules for contestation and accountability.

7.18 The context in which bargains take place also differs according to how much competition or political uncertainty the ruling coalition faces. This relates both to the “contestability” of access to decision making as well as to the degree of internal cohesion in the ruling coalition. When ruling

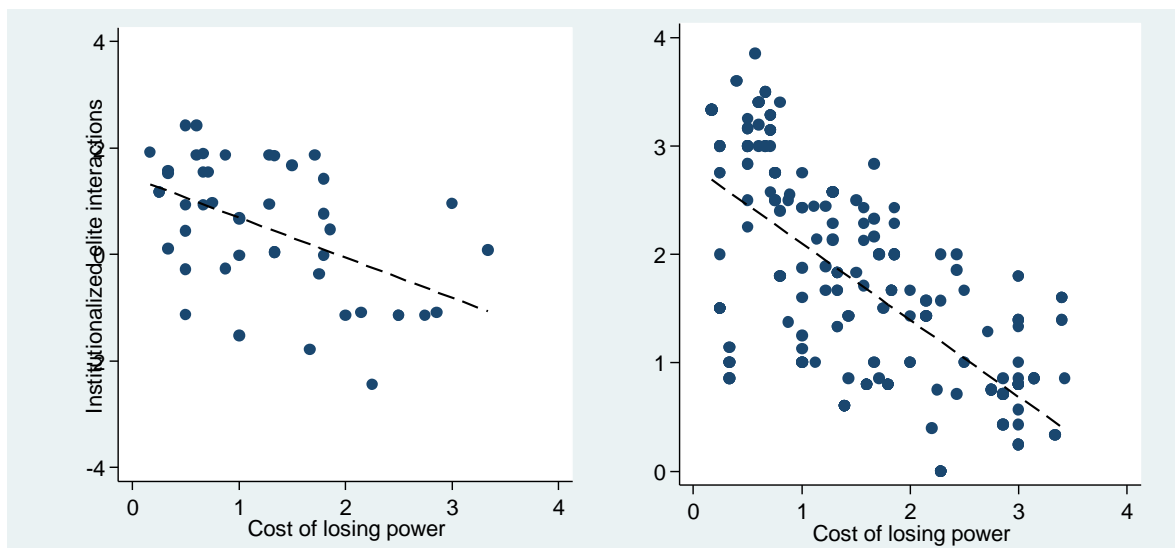
³ From the Italian novel by Giuseppe Tomasi di Lampedusa, published in 1958. The quotation is from the Colquhoun translation, Pantheon edition, page 40.

coalitions face competition, or when they have only a weak hold on power, political uncertainty about who will be in power in a future period is high; thus threats to losing power are credible.⁴ Uncertainty does not necessarily imply instability, but rather simply the unpredictability of who will hold power in the future. When uncertainty is high, ruling coalitions are more likely to implement reforms that will serve as “insurance” to protect them in the event of losing power. Alternatively, when uncertainty is low and ruling coalition elites are confident in their power, they may take a longer-term perspective and accommodate the demands of other elites through the introduction of new rules that can increase or sustain power.

Figure 7.2 When the costs of losing power are high, elites are more likely to reject electoral results that support the opposition and less likely to move toward rules-based contestability and accountability

a. Election losers accept results versus costs of losing power

b. Institutionalized elite interactions versus cost of losing power



Source: WDR 2017 team based on Elite Bargaining Survey and V-Dem 2015.

Note: Costs of losing power, election loser accepting results, and institutionalized elite interactions are all measured on an ordinal 0 to 4 scale, as determined by expert surveys.

7.19 The costs of losing power and the degree of political uncertainty interact to help determine the likelihood that elites will generate rules for contestability and accountability (Box 7.2). Historical contingencies and specific country circumstances ultimately help determine outcomes, but low costs of losing, and thus low polarization, may be a necessary condition for the emergence of bargains that adapt through the adoption of rules. The discussion that follows provides examples of institutions and rules that ruling coalition elites introduced to enhance power or insure against loss. In some cases, elites generate more capable states; in others, they expand the formal space

⁴ This can happen in both autocratic and democratic settings. In autocracies, elites face a “dictator’s dilemma”: their hold on power is tenuous, and they usually get overthrown from within (Svolik 2012). In democracies with significant oppositions, voting regularizes (institutionalizes) uncertainty, given that a change of administration entails a loss of power for incumbents.

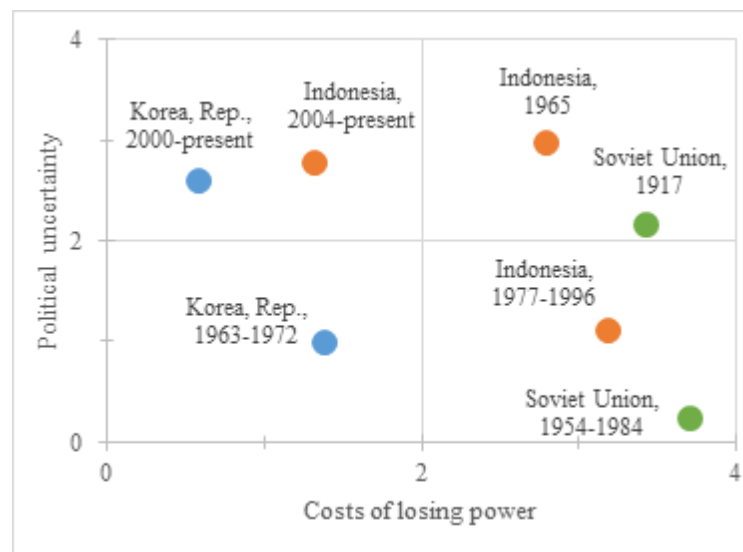
for contestability and accountability. The concluding section of the chapter discusses when and why these rules persist through continuous adaptation.

Box 7.2 When do elites have incentives to introduce rules for contestability and accountability?

The costs of losing power—largely determined by the polarization of elite preferences—and the degree of political uncertainty act together to shape elite incentives for introducing rules for contestability and accountability. There are four broad possibilities, considering high and low values of these two dimensions:

- When uncertainty is high, elites may implement “insurance” reforms to protect themselves in the event of losing power (upper left quadrant of figure B7.2.1).
- “Insurance” reforms are unlikely to happen, however, if the costs of losing are too high, because in this case, commitments of one group of elites to another through either deals or rules are not credible. The result is frequently state collapse or a cycle of violence (upper right quadrant).
- When uncertainty is low and ruling coalition elites are confident in their power, they may take a longer-term perspective and accommodate the demands of other elites through the introduction of new rules that can increase or sustain power (lower left quadrant).
- When uncertainty is low but the costs of losing are high, repressive states may arise, in which the preferences of opposition elites are in stark contrast to ruling elites. Repression sustains a large power imbalance between the ruling coalition and the opposition (lower right quadrant). In this context, it is unlikely that credible rules to regulate contestation and accountability will be introduced.

Figure B7.2.1 The interaction between political uncertainty and the costs of losing power



Source: WDR 2017 team based on Elite Bargaining Survey.

Note: Political uncertainty is calculated as the average of four variables, each ranging from 0 to 4: elite cohesion in the ruling coalition, elite ideological unity, the relative strength of opposition elites, and the de facto competitiveness of multiparty elections. The costs of losing power variable ranges from 0 to 4.

Results from the Elite Bargaining Survey conducted for the WDR 2017 offer empirical evidence to help demonstrate how the costs of losing and political uncertainty can change elite incentives to institute rules-based contestability and accountability. Figure B7.2.1 shows selected historical data points for three countries in the survey: the Republic of Korea, Indonesia, and the Russian Federation (which shows up as the Soviet Union from 1922 to 1991 in the data).

Indonesia in 1965 and the Soviet Union in 1917 lie in the top right quadrant: both the costs of losing and political uncertainty were high. In both countries, elite polarization was extremely high and elite conflict became violent. Neither state had a ruling coalition willing or able to institute credible rules.

Both Indonesia and the Soviet Union slowly transitioned toward more stable repressive states (bottom right quadrant), one ruled by a dominant individual (Suharto in Indonesia) and the other ruled by a dominant political party (the Communist Party of the Soviet Union). Although both states generated economic growth and reduced political uncertainty, neither broadened contestability or developed strong institutions for accountability. When shocks hit and societal demands increased in Indonesia during the Asian Financial Crisis and the Soviet Union in the late 1980s, neither system could adapt.

The Republic of Korea during the presidency of Park Geun-hye was also highly stable and nondemocratic, but low elite polarization, identified by high degrees of elite cohesion across political, military, bureaucratic, and business realms, reduced the potential costs of losing to opposition elites, enabling the development of rules-based institutions (Campos and Root 1996). This institutionalization included broader space for civil society and media and institutionalized interactions between business and the state.

Finally, in the past two decades, both Indonesia and the Republic of Korea have transitioned toward increased democratic competition. The Republic of Korea did so while maintaining low degrees of elite polarization. As Indonesia moved away from a personalistic system to more rules-based decision making, a winner-takes-all mentality declined and reduced elite polarization. Both systems have experienced turnover of political parties and the establishment of rules by outgoing parties that seek to tie their successors' hands (to provide "insurance" for the outgoing elite's eventual loss of power).

Source: WDR 2017 team.

Elite bargains and uneven state capacity

7.20 Over time, state capacity is largely a function of power; ruling elites invest in the capacity of governing structures when it is in their interest to do so—and neglect those investments when it is not (see chapter 2). Such investments tend to improve institutional functions and development outcomes, but undertaking them is largely a problem of redistributing political power. Increasing the strength of bureaucratic actors is risky, creating the possibility of institutional champions that can contradict ruling elite preferences. And bureaucracies often serve purposes of patronage and rent-distribution; undermining these arrangements is politically challenging and can destabilize elite bargains. Despite these challenges, elites may strengthen the state through bureaucratic and civil service reforms and party institutionalization in search of what this Report calls *outcome legitimacy*: that is, enhancing cooperation and coordination by delivering effectively on commitments.

7.21 Under certain conditions, broad administrative reforms that move from patronage to meritocracy may be possible. Although high levels of education and historically strong states may make meritocratic reforms easier, there are no foregone conclusions. Throughout post-independence Africa, individual capacity (education levels) increased while institutional capacity declined as civil service recruitment policies were placed under presidential authority, leading to politicization and deprofessionalization (Van de Walle 2001). The Republic of Korea, often assumed to have a "Confucian tradition" of meritocratic civil service, actually undertook massive improvements in bureaucratic quality during the 1960s and 1970s. During the era of the Republic's first president, Syngman Rhee, the bureaucracy was legally meritocratic, yet between 1949 and 1961, only 336 bureaucrats passed the High Civil Service Examination, while 8,263 received "special appointments" (Cheng, Haggard, and Kang 1998).

7.22 Reforms to limit patronage frequently arise from top-down initiatives or elite accommodation (Grindle 2012). At times, broad meritocratic reforms may be initiated as part of an effort to strengthen the ruling coalition. In China, Deng Xiaoping’s “Four General Principles” calling for more revolutionary, younger, more professional, and more educated cadres was a politically motivated and politically savvy move: the inclusion of a “revolutionary” (*geminghua*) requirement made the reform difficult to oppose among older Party elites, while enabling Deng to force into retirement older cadres who often formed the political opposition to his intended reforms.

7.23 Although at times broad administrative reforms are possible, elites are more likely to direct scarce resources and political capital only toward those agencies that help achieve specific goals, resulting in uneven development capabilities. An elite bargaining framework can help explain the emergence of these bureaucratic *pockets of effectiveness*—public agencies that effectively carry out agency objectives despite existing within an environment in which most other agencies are ineffective and subject to predation (Leonard 2008). In these cases, influential elite actors have incentives to ensure the effectiveness of the agency and use their own political capital to shield the organizations from external interference (Box 7.3).

Box 7.3 Islands of excellence in Nigeria

Political support from powerful elite actors is a necessary condition for the emergence of “pockets of effectiveness.” The professionalization and autonomy of an individual government agency often precedes wholesale reform of the bureaucracy as political elites may seek effective management of a particular sector. High-level political interest in and commitment to the agency’s success and political insulation from other elites whose interests the autonomous agency may harm are essential for effectiveness. Agency autonomy is most likely to be supported when the agency provides benefits that are immediate, identifiable, and beneficial to an important group of elite actors who “have a conception of the state as a public good, rather than simply as a target of predation or a tool for gaining advantage over others” (Leonard 2008). But autonomy and political support are not enough: bureaucratic pockets of effectiveness require adequate resources as well managerial factors that support rational decision making, including meritocratic recruitment, internal discipline, and performance-based management.

Consider the National Agency for Food and Drug Administration and Control (NAFDAC) in Nigeria (Pogson and Roll 2014). The agency was created in 1999. In 2001, then-President Olusegun Obasanjo had a personal interest in combating counterfeit and dangerous drugs as a way to improve Nigeria’s international image, partly to seek debt relief, but also to boost his personal reputation and international prestige. He selected Dora Akunyili to head NAFDAC because of her reputation for incorruptibility. NAFDAC was then granted autonomy from the Ministry of Health to recruit staff, have an independent budget, and operate free of political control. Under Akunyili’s leadership and Obasanjo’s direct support and clearance, NAFDAC returned to Nigerian ports, from which it had been banned in 1996, and NAFDAC clearance of imported goods again became compulsory, which broke the clearance monopoly of the Customs Service and plugged a major leak for imported counterfeit products. Challenging the interests of these powerful elite interests (the Customs Service) would not have been possible without agency autonomy and direct support of the president. In 2007, NAFDAC ranked first in a national poll of agency effectiveness (at 70 percent, it was 12 percentage points higher than the second-place agency).

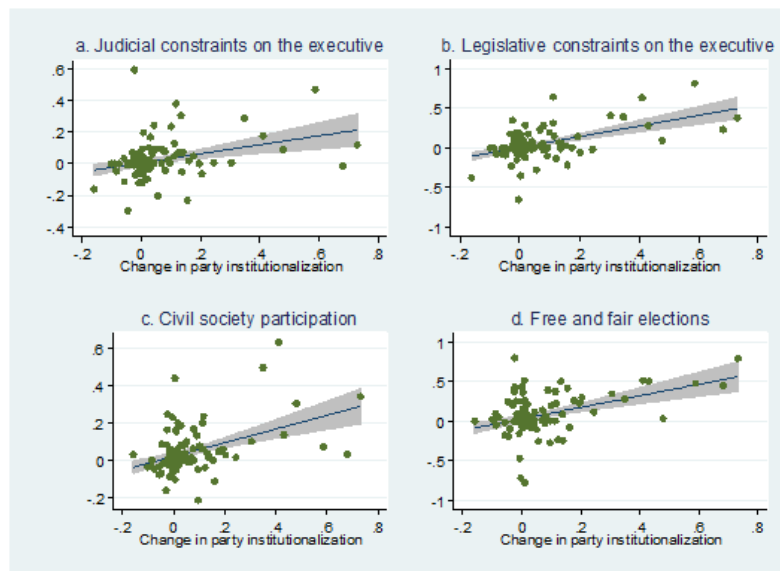
Sources: Leonard 2008; Pogson and Roll 2014.

7.24 Extending the state’s presence to new areas or gaining legitimacy through economic growth may be particularly compelling reasons for developing noncoercive state capacity. For instance, the need for states to know the extent and make-up of their own population (increase “legibility”) has led them to increase investment in statistical and census capacity (Scott 1998). In particular, economic goals may be essential for regime legitimacy. In Brazil under its military dictatorship, industrial promotion agencies were turned into islands of excellence to ensure growth (Schneider 1991). In Korea, General Park installed technocrats in ministries related to economic

development, but filled nondevelopment ministries (such as home affairs, construction, and transportation) with military cronies (Kang 2002).

7.25 Often, the institution that elite groups choose to invest resources in is a political party. Chapter 8 looks at political parties as mechanisms for *citizen* collective action, but parties are also key channels to resolve coordination and commitment challenges among elites. Institutionalization constrains party elites from arbitrary decision making by making them more accountable to party subordinates and constituents—thus solving the internal commitment problem, and making parties more effective (Panebianco 1988). Party institutionalization may facilitate collective action by supporters of the regime, helping lead to credible commitments and greater private investment by binding leaders' hands (Gehlbach and Keefer 2012). In doing so, parties contribute to regime durability (Brownlee 2008). When parties become more institutionalized, other formal accountability mechanisms also tend to emerge (figure 7.3).

Figure 7.3 Horizontal and vertical accountability become more common as party institutionalization increases



Source: V-Dem 2015.

Note: The data are for 2010 and cover 166 countries. All variables range from 0 to 1. Change in party institutionalization is calculated as the difference between the 2010 and 2000 value.

Broadening the policy arena to enhance elite power

7.26 In 16th century France, Jean Bodin advised absolutist French monarchs to voluntarily relinquish power, arguing that “limitations placed upon [a monarch’s] caprice markedly increase his capacity to govern and to achieve his steady aims” (Gandhi 2009, 186). Many elites have followed this advice, institutionalizing bargains among elites through greater contestability and accountability in order to increase and sustain power. Elites in these cases make concessions in order to enhance their own position. This can be done by co-opting newly powerful actors into formal institutional mechanisms for contestation (institutionalizing horizontal contestability) or by increasing horizontal and vertical accountability.

Institutionalizing horizontal contestability (broadening coalitions)

7.27 To maintain their own power, ruling coalitions may provide payoffs to rising elites or co-opt potential opposition by creating formal mechanisms to channel their preferences. Sustaining coalitions requires that elites provide benefits to coalition partners. Despite a preference for keeping coalitions small, politicians may broaden coalitions when the potential for conflict rises (Riker 1962). Indeed, broadened coalitions help improve regime stability, though there are difficulties quantifying this effect. In Africa, the addition of one additional cabinet member lowers the risk of a coup by 23 percent to 25 percent, all else equal (Arriola 2009).

7.28 Broadening the bargaining arena by including new actors in formal decision-making bodies of the state—*institutional co-optation*—may be cheaper and more sustainable than increasing payoffs. When rising elites are paid off rather than included in decision making, systems may become overly dependent on the source of rents, making them unable to withstand shocks that undermine this rent source, as illustrated by the case of South Sudan earlier in this chapter.

7.29 Ruling coalitions may be strengthened by bringing local or communal elites into the ruling coalition, often by co-opting existing informal institutions into more formal structures. Co-opting local elites rather than replacing them can increase the power of the ruling coalition. In Somaliland, the 1993 *shir beeleed* (clan conference) in the capital city of Borama brought 500 elites from modern and traditional sectors and institutionalized these clans and elders into formal governing bodies, a “*beel*” (clan) system that has led to 20 years of stability in a fragile region (Kaplan 2008). In Sub-Saharan Africa more broadly, when ruling authoritarian coalitions incorporated local authorities rather than replacing them, these authoritarian incumbents had more support and were stronger during democratic transition (Riedl 2014).

7.30 However, the participation of new actors is a two-way street: it mitigates conflict and creates “insiders” with incentives to support the ruling coalition, but in providing commitments to new actors, it also tends to empower these actors and the sectors they represent at the expense of the current elite, giving them the ability to influence policy formulation and implementation. Decision-making elites likely see co-optation solely as a means of staving off opposition demands, rather than a means of changing the balance of power within the arena, but both processes inevitably occur. Rising elites can in this sense be considered Trojan Horses for expressing new demands internally.

7.31 Often, co-opted parties are new economic interests that have grown more powerful over the course of development. The inclusion of business interests in formal institutions can lead to improved economic outcomes through more successful state-business coordination (see chapter 5 on growth). Formal rules for inclusion provide a credible commitment that noninstitutionalized efforts at coordination would not achieve. In Chile, Pinochet’s co-optation of business elites to lead ministries and agencies during the 1980s arose out of fear of these elites turning to the opposition. Their entry into the state led to systematic consultations with peak industries, benefiting business elites themselves while also improving coordination and strengthening the state beyond Pinochet’s rule (Silva 1996). In China, the Communist Party’s decision to add entrepreneurs to its ranks in the early 2000s signaled an increased commitment to the private sector, helping spur subsequent growth and also leading to further changes in regime policy and legal development, including constitutional change in 2004 that legalized private property.

7.32 Ruling coalitions may also introduce formal institutional “checks” on their behavior to maintain power and sustain rents. Consider the case of authoritarian legislatures. They are not mere window dressing, but instead provide a safety valve to vent political pressures; co-opt opposition; signal regime strength; help regimes withstand leadership transitions; and distribute rents.⁵ However, authoritarian legislatures not only serve the political purposes that spawn their creation, but can also lead to positive feedback loops. For example, the existence of legislatures in authoritarian regimes increases investment by raising the cost of expropriation (Wright 2008; Gandhi 2009), helping foster negotiations among private actors (Jensen, Malesky, and Weymouth 2014), and providing useful policy information that improves resource allocation (Boix and Svulik 2013).

Institutionalizing vertical accountability

7.33 The introduction of elections or electoral reforms may be a rational elite strategy to maintain power or privilege, particularly in the face of rising demands from opposition elites. When there are splits among elite actors, the introduction of vertical accountability mechanisms and responsiveness to citizens may enhance the power of one faction. For instance, authoritarian regimes may introduce local elections to appease local interests, gain information, and solve principal-agent control problems of local elites by recruiting citizens to monitor local elites on the behalf of central elites. These local elections may strengthen the regime, but may also lead to better social outcomes, as is the case with the introduction of village elections in China (Martinez-Bravo and others 2011).

7.34 When bottom-up citizen movements (discussed in chapter 8) threaten elite interests, elites may introduce mechanisms to respond to societal demands before such pressures reach a tipping point. When asked “Why liberalize?”, for instance, former President of Tanzania Julius Nyerere responded, “When you see your neighbor being shaved, you should wet your beard. Otherwise you could get a rough shave” (Levitsky and Way 2010). In the case of 19th and 20th century Europe, the extension of suffrage was predicted by the threat of revolution, proxied by revolutionary activity in neighboring countries (Aidt and Jensen 2014) and by strikes or riots in the home country (Kim 2007; Przeworski 2009).

7.35 Even without a direct threat from below, many democratic transitions are initiated from a position of strength to ensure maximum benefits for empowered elites. In a “conceding-to-thrive” scenario, the ruling coalition recognizes a future threat to the regime, but maintains enough strength relative to the opposition so as to not fear losing an election (Slater and Wong 2013). It may be rational for elites to engage in democratization *now* in order to maintain power, as the stronger ruling elites are during democratic transitions, the less economic redistribution takes place after transition (Albertus and Menaldo 2014). For instance, in Spain after the autocratic Franco era, the left had been undermined, so conservative elites did not think that the advent of democracy would threaten property rights (Alexander 2002). In Latin America, economic elites allowed democratization when conservative parties were in charge and could protect their interests (Rueschemeyer, Stephens, and Stephens 1992).

⁵ For safety valves, see Malesky and Schuler (2010). For co-optation, see Gandhi (2009); Gandhi and Przeworski (2006); and Langston (2006). For signaling, see Geddes (2006). For leadership transitions, see Ezrow and Frantz (2011). For rent distribution, see Lust-Okar (2006).

7.36 In cases where elections are introduced to strengthen an elite bargain, electoral rules may serve to favor continued dominance. Following democratization in post-war Japan, rural voters had twice the voting power of urban voters (Hata 1990). In Korea, Japan, and Taiwan, China, the combination of single nontransferable votes with multimember districts undermined the power of emerging parties by creating nationwide coordination challenges for smaller parties, allowing dominant parties to maximize legislative seats.⁶

When binding rules for accountability serve as political insurance

7.37 Sometimes, ruling coalition elites, acknowledging threats to their continued dominance, introduce power-constraining rules that they hope will bind not only themselves, but also their successors. In particular circumstances, the adoption of cohesive and constraining institutions increases with the likelihood that incumbents will be replaced (Besley and Persson 2011).

7.38 Although greater political competition may increase the likelihood that elites introduce binding rules, the credibility of these new rules depends critically on continued competition. When power imbalances grow between ruling elites and opposition forces, rules may fail to bind. For instance, in Bangladesh in the 1990s, equal power between ruling and opposition parties led to a constitutional amendment in 1996 that established a neutral caretaker government to be set up at the end of each term, headed by the last Supreme Court chief justice, in order to facilitate rules-based transitions. This constitutional arrangement collapsed in 2007 when the ruling Balochistan National Party (BNP) interfered with Supreme Court retirement dates, resulting in a violent standoff (Khan 2013).

Horizontal accountability as political insurance

7.39 Competition between elites helps explain the emergence of horizontal checks and autonomous institutions in new or weak democracies. Competitive systems facing political uncertainty are more likely to adopt independent judiciaries, as current ruling elites know they will be better off subject to independent actors than to the machinations and retaliations of political rivals. For instance, although Argentina's ruling Peronist party agreed as early as 1994 to strengthen an independent judiciary, such reforms were not implemented until the Peronists thought they would lose power, at which point judicial independence was granted in order to control the opposition after ceding power (Finkel 2004).

7.40 Other judicial reforms, including judicial review, also become more common when greater competition increases the likelihood of ruling coalition elites losing power. In new democracies, the constraint on arbitrary power imposed by judicial review can serve as insurance to potential electoral losers, providing support for democracy, as was the case during democratic transitions in some East Asian democracies such as the Republic of Korea and Mongolia (Ginsburg 2003). The adoption of constitutional review in 204 countries from 1781 to 2011 was largely driven by electoral politics, serving as political insurance when the ruling party was in jeopardy (Ginsburg and Versteeg 2014).

7.41 The same logic holds with regard to accountability, oversight, and transparency laws. In Eastern European economies in transition in the 1990s, governments were less likely to extract

⁶ Brady and Mo (1992); Cox (1996); Cox and Niou (1994).

resources from the state when political competition was high, and they were more likely to introduce institutions of accountability and oversight, particularly those related to civil service, accounting, and anticorruption (Grzymala-Busse 2006). In Brazil, audit courts are more effective in localities with greater turnover of elites (governors), as these localities have delegated authority to independent auditors as an insurance mechanism (Melo, Pereira, and Figueiredo 2009). Fiscal transparency ties not only the hands of current elites, but also those of successors (Alt, Lassen, and Rose 2006). In Mexico, state-level Freedom of Information laws are more likely to be passed when opposition parties are stronger and when there is greater executive office turnover (Berliner and Erlich 2015).

Vertical accountability as political insurance

7.42 While elites sometimes introduce elections from a position of strength, at other times they may do so to insure themselves against exploitation from other elites. Movements toward democracy may result as new economic elites seek to safeguard (ensure commitment to) their new position and wealth. Under authoritarian regimes, commitment to protect resources and property is often weak.⁷ Broken commitments can lead empowered economic elites to part ways with the ruling coalition and support the democratic transition, as it is seen as more likely to prevent further exploitation. For instance, expropriation of banks following the 1982 financial crisis in Mexico by the ruling Partido Revolucionario Institucional (PRI) led to a mass defection to the opposition party (the Partido Accion Nacional), weakening the PRI and resulting in the PRI's loss of the majority in the lower house in 1997 and the presidency in 2000.

7.43 When elites introduce elections as a way to insure themselves against exploitation by other elites, the electoral rules are also likely to reflect the interests of these declining powers. When power is weakened, the manipulation of the terms of democratization can serve as a source of political insurance. During Venezuela's democratic transition in 1958, three main political parties signed the "Punto Fijo Pact" that established respect for constitutions and elections, but also determined that electoral winners should put members of all three parties into positions of power to create national unity governments (excluding the Communists); the pact helped ensure the survival of democracy, but also made outcomes less likely to reflect the will of the people.

When do elites adapt through rules-based mechanisms?

7.44 In the cases previously discussed, elites enhanced state capacity or introduced rules to manage contestation and increase accountability to adapt to changes spurred by the development process that affected the relative power, preferences, and incentives of actors (see part 1 of this Report). Such adaptation is essential for long-term development.

7.45 Adaptation is not a one-off trait; rather, it is a continuous process, as the needs and demands of society change over the course of development. At low-income levels, deals may be sufficient to overcome elite coordination and commitment challenges; patronage can effectively provide credible commitment and give cohesion to elite ruling coalitions. At middle-income levels, however, rising societal demands make the transaction costs of coordinating interests greater, potentially undermining deals-based bargains. This helps explain why low-income countries that

⁷ From 1950 to 2002, the majority of Latin American countries under autocracy engaged in at least one large-scale expropriation of private finance, land, or natural resources (Albertus and Menaldo 2012).

are successful in terms of medium-term economic growth tend not to have governments that are appreciably cleaner than comparator countries, while upper-middle-income countries that grow to high-income levels experience a sharp decline in perceived corruption relative to those that stay “stuck” at middle incomes; they also experience greater increases in horizontal and vertical accountability (see spotlight on middle-income traps in chapter 5).

7.46 Bargains that can adapt to accommodate evolving elite interests may nevertheless struggle to adapt to growing citizen demands. Many countries experiencing rapid growth spells have engaged in rights violations, particularly of student and labor organizations, as a way to support the interests of state, bureaucratic, and business elites in the ruling coalition (Leftwich 1995). In these cases, tensions have increased between growth outcomes and equity outcomes, and between legitimizing outcomes and legitimizing processes. Regimes may be delegitimized when decision-making processes are insufficiently inclusive, even when other developmental outcomes appear successful: process legitimacy may become more important than outcome legitimacy. As discussed in part 1, cooperation and coordination—collective action—are weakened as a result of a “legitimacy deficit.”

7.47 Overcoming delegitimization necessitates greater inclusion in the political process. As elite ruling coalitions grow in size, coordination difficulties increase, making elite splits more likely and thus broadening the space for citizen groups to enter. Here, the interaction between citizens and elites becomes key, particularly in the development of social movements. When bureaucratic interests diverge from political interests, for instance, they may attempt to organize citizens in their support. But this co-optation of citizens follows the same logic as the institutionalized co-optation of other elites: once citizens gain a seat at the table, vertical accountability increases and citizen interests are articulated and reflected in elite bargains. The interaction between elites and citizens is thus a two-way dynamic with both sides playing decisive roles: elites in seeking citizen support and opening up new spaces for contestation; and citizens in organizing to overcome collective action problems and apply pressure on elites, as discussed in chapter 8.

7.48 Adaptation is necessary for long-term development, but most elite bargains do not adapt. Adaptability in elite bargains requires feedback mechanisms, as well as an ability to accommodate rising and falling powers. The free flow of information and greater freedom of association make such accommodation more likely. Many of the reforms described previously are complementary and make further reform more likely, leading to a virtuous circle. For instance, many reforms that tie the hands of elites are embodied in new organizations, including independent bureaucracies, anti-corruption agencies, and legislatures. The actors in these organizations can then directly contest in the policy bargaining arena. Stronger organizations want institutional improvements that support themselves, leading to a self-reinforcing virtuous circle (North, Wallis, and Weingast 2009).

7.49 Many of the reforms previously described also tend to lead to further adaptation because the degree of institutionalization of the policy bargaining arena itself influences the level of uncertainty and the costs of losing. The rules under which elites formally bargain help them overcome common agency problems and also provide venues for repeated interactions that can lead to credible commitments. Credible institutions can lower the costs of losing by tying the hands of competing elites, decreasing polarization and making change more likely. Conversely, informal

patrimonialism makes regimes resist democratic reforms because the costs of transition are higher (Bratton and Van de Walle 1997).

7.50 Although the conditions that determine whether elites will adapt through rules are historically contingent and highly context-specific, there are a few circumstances that make such adaptability more likely. In particular, adaptation is more likely when elites have exogenous reasons to find common ground, when national institutions produce leaders who effectively shape the incentives and preferences of other elites, and when countries have more balanced, diversified, and organized business interests.

Common ground: Reducing polarization by maximizing shared elite interests

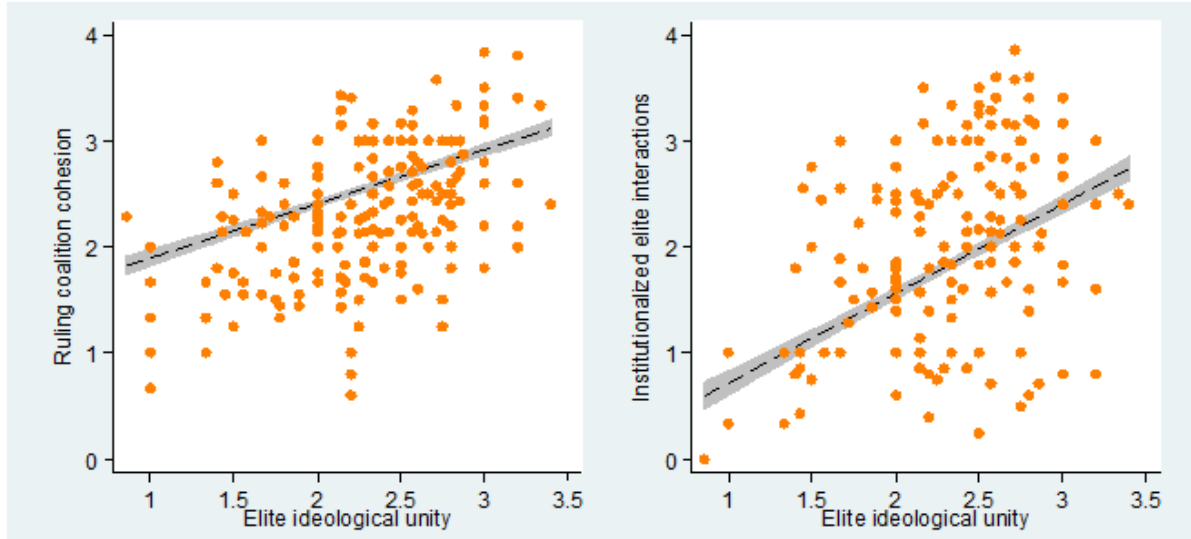
7.51 When elite preferences converge and polarization decreases, coordination and cooperation become less challenging. There are often exogenous reasons for such reductions in polarization. External threats or internal threats from non-elites increase the fusion between ruling elites and opposition elites. When citizens are united against elite interests, the opposition and ruling coalition can more easily find common ground—the cost of losing to the opposition becomes smaller. In Southeast Asian countries that feared class revolution, elite groups with opposing class and ethnic backgrounds made “protection pacts” with one another to resist mass mobilization (Slater 2010). For instance, in Malaysia, the threat of urban communists enabled ethnic Chinese businesses to unite across ethnic and ideological lines with traditional Malaysian elites.

7.52 Polarization can also decrease through shared ideologies and shared experience. When elites share an ideology, they can more readily solve internal collective action challenges, enhancing cohesion and making rules-based bargains more viable (figure 7.4). Shared military and revolutionary backgrounds help to explain the cohesion and long-term stability of Mexico’s PRI and China’s CPC (Knight 1992). Shared schooling can achieve similar outcomes. Public schooling with nationally determined curricula can generate a national identity that may help overcome underlying schisms. However, education can also increase polarization; ideologically diverse societies may prefer school choice, which can result in greater ideological and cultural segmentation over time (Kremer and Sarychev 2000).

Figure 7.4 Greater ideological unity among elites is associated with greater cohesion of the ruling coalition, as well as more institutionalized elite interactions

a. Level of ruling coalition cohesion versus elite ideological unity

b. Level of institutionalized elite interactions versus elite ideological unity



Source: WDR 2017 team based on Elite Bargaining Survey.

Note: All variables are ordinal and range from 0 to 4, based on expert survey responses. The charts plot non-overlapping decadal observations for 12 countries.

7.53 Specialized “elite” schools may be able to decrease the polarization of elite preferences and facilitate bargains. In Somaliland, elite secondary schools played a crucial role in generating a unified leadership; the highly selective Sheekh Secondary School, which takes only 50 students each year, included students from all clans and produced three out of four presidents and numerous vice presidents and cabinet members. According to one graduate: “The graduates of Sheekh School have had a huge influence on Somaliland, on its development, its politics...Elite leadership was trained in us there” (Phillips 2013, 70).

Effective leadership: Shaping elite preferences and incentives

7.54 Effective leadership can change the parameters of elite bargains. In an elite bargaining framework, the importance of leaders is not in selecting the “right” policy, but in spurring “new ways of interacting within and between organizations” (Andrews 2013). Leaders are instrumental in determining outcomes by solving coordination challenges or by transforming the beliefs and preferences of followers (Ahlquist and Levi 2011). The ability to solve coordination challenges corresponds to a “transactional” role of leaders.⁸ Using an array of bargaining tactics and strategies, these leaders coordinate among elite actors to overcome common agency problems and reach positive sum (“win-win”) outcomes. They may change the incentives of other elites, taking into consideration who wins and who loses over time (the intertemporal dimensions).

⁸ For the distinction between “transactional” and “transformational” leaders, see Burns (1978).

7.55 Transactional leaders, through “good politics,” can reduce the polarization of elite preferences *without* shifting norms. Lyndon B. Johnson, as the Senate Majority Leader in the United States before becoming the president, pushed through the Civil Rights Act of 1957 despite opposition from the opposition as well as the anti-civil rights southern bloc of his own party. He overcame a natural tendency of congress to avoid risk by taking personal risks to force a resolution (Schofield 2006). And he did this less by changing beliefs than through good politics, including deals, trades, threats, and ego stroking (Caro 2002).

7.56 In contrast, “transformational” leaders can change elite preferences or gain followings by shaping preferences. They are entrepreneurial in coordinating norms and can effect large changes in society by changing the environment in which politics are played, often by reducing the polarization of elites. Continuing the example of civil rights in the United States, Lyndon Johnson would not have been able to push through the more far-reaching Civil Rights Act of 1964 had not Martin Luther King, Jr. and fellow civil rights activists successfully shifted the contours of the conversation on race, nonviolence, and human rights in the United States through self-sacrifice, nonviolent struggle, moral courage, and oratorical brilliance.

7.57 Transformational national leaders can indelibly alter the nature of the policy arena and the state itself. Perhaps most notably, ideological nation-building efforts can create political and social stability and identity that can lead to greater trust, cooperation, and commitment to ethnically neutral policies (Gellner 1983). In Tanzania, Julius Nyerere’s *ujamaa* (“extended family”) socialism served as the ethnically unifying basis for national development: although economic development did not initially improve, mass compulsory education and widespread use of Swahili helped overcome tribal cleavages and produce a more unified and stable state. In Indonesia, Sukarno introduced the Five Pillars (*Pancasila*) to unite disparate elements of society during the process of state formation; the concept survived a military coup as well as the transition to democracy, helping to maintain a coherent national state during destabilizing times (Fukuyama 2014).

7.58 National institutions help determine leader quality both through selection (ex ante accountability) and punishment (ex post accountability) (Maskin and Tirole 2004). When subsets of the population—for example, women (Box 7.4)—are excluded from leadership positions, competitive selection is less likely to produce effective leaders. In democracies, political leaders must be elected, and local competition can prove a fertile ground for demonstrating capacity for higher office (see spotlight 7 at the end of this chapter). Even informal means of selection can help ensure commitment through policy continuity. In Mexico, “*dedazo*” (“the tap of the finger”), the process by which the outgoing president informally but bindingly selected a successor, enabled stable PRI dominance for 71 years until 2000, and minimized conflict within the party (Ferejohn, Rosenbluth, and Shipan 2009). Regardless of whether citizens or a small elite “selectorate” choose leaders, transparency and information provision are critical for screening good candidates (see chapter 8).

7.59 For leaders to be effective, there is a need not only to generate well-meaning leaders, but also for leaders to be constrained by strong norms or formal institutions, including parties and legislatures (Ezrow and Frantz 2011). Term limits can encourage party-based decisions rather than personalistic decisions, while encouraging the cultivation of successors (Ginsburg, Melton, and Elkins 2011). Term limits help with informal coordination by signaling to rivals; indeed, in

autocratic settings, successful cases of economic and human development are also characterized by higher leadership turnover (Besley and Kudamatsu 2007).

Box 7.4 Female elites and female leaders

When half the population is excluded from leader competition, political processes are half as likely to generate good candidates. Although gender gaps are narrowing around the world in several domains, female elites remain underrepresented. The proportion of seats held by women in national parliaments is 22.5 percent worldwide; in the world's largest 200 companies in 2014, women accounted for only 17.8 percent of board of director members; and the average share of female justices in constitutional courts worldwide is 22.4 percent.^a Even when women do gain positions of power, they are often constrained: for instance, when women are appointed ministers (in a sample of 117 countries worldwide), they are largely assigned to less strategic and more “feminine” policy areas (Krook and O'Brien 2012).

The lack of female elite representation has negative effects on the introduction of inclusive policies (see chapter 6) because the preferences of female leaders may be systematically different than male preferences. In the context of elite bargaining, female leaders are also more likely to engage in inclusive decision-making processes. In the United States, female city managers are more likely to take citizens' inputs into account in decision making (Fox and Schuhmann 1999); female mayors tend to favor cooperation rather than a hierarchical approach to governing (Tolleson-Rinehart 1991); and female chairs of state legislature committees act more as facilitators in committee hearings than male chairs, who instead use their power to control the direction of the hearings (Lyn 1994).

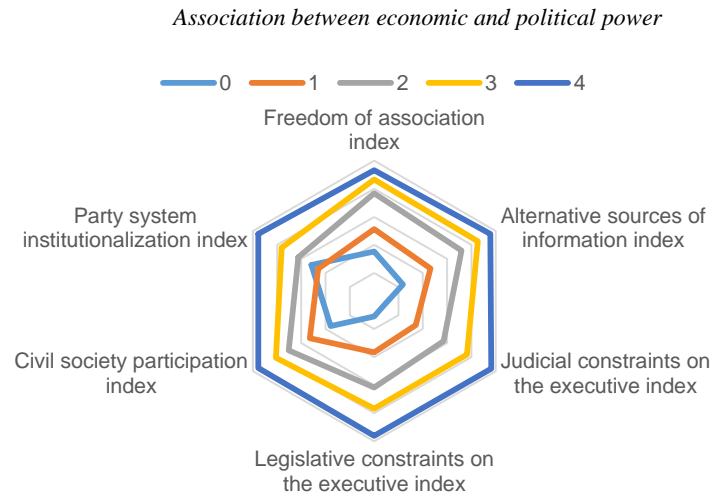
There is also evidence that female leaders are less prone to patronage politics and corruption. In Africa, women are less likely to become ministers in settings where incumbents use patronage to support ethnic constituencies (Arriola and Johnson 2014). In India, the 1993 constitutional amendment that mandated the reservation of one-third of local government council positions to women in India also led to reduced incidence of corruption (Beaman and others 2011). In Brazil, random audits of government administrations showed that female municipal mayors were less likely to be corrupt than male mayors, and were also less engaged in patronage (Brollo and Troiano 2015). More broadly, countries with a higher representation of women in parliament have lower levels of corruption (Dollar, Fisman, and Gatti 2001).

Source: WDR 2017 team.

a. Data come from the World Development Indicators, Corporate Women Directors International, and Women, Business and the Law databases.

Balanced, diversified, and organized business interests

7.60 Economic conditions help determine the adaptability of elite bargaining. Where productive business interests dominate, ruling coalitions are likely to be more dynamic and adaptive; where monopoly interests dominate, policies are more likely to prevent the emergence of new economic elites. Concentrated economic power makes adaptability to external shocks and internal change less likely, with important political consequences: more concentrated economic power tends to lead to concentrated political power that reflects this economic distribution; and when economic power translates into political power, institutions of accountability are less likely to develop (figure 7.5). For this reason, reforms that concentrate economic power without institutions in place to deal with new powerful interests may be ineffective, as in many post-communist countries, where the initial beneficiaries of market reforms became economically and politically powerful enough to block further reform (Hellman 1998).

Figure 7.5 When economic power maps onto political power, there are fewer institutional checks on power

Source: WDR 2017 team, based on V-Dem 2015.

Note: Analysis based on data for 170 countries in 2012. The variable indicating how economic power maps onto political power comes from V-Dem, based on expert surveys. A score of zero means that economic elites have a monopoly on political power; a score of four means that all citizens have equal power, regardless of economic position.

7.61 When diverse productive interests gain in strength because of external shocks and internal change, they can improve elite bargains. For instance, during the conflict between the English parliament and the monarchy during the 17th century civil war, traders provided financial assets and company shares to parliamentary moderates who lacked mercantile interests, creating a broad parliamentary majority that overcame monarchic rule and changed the mechanisms by which parliament operated (Jha 2015).

7.62 Business associations can help diverse business interests overcome collective action problems and gain influence in elite bargains. They can push for institutionalized consultations that can enhance coordination and serve to decrease elite polarization. Chile's movement from particularistic state-business relations in the 1970s to peak business association consultations in the 1980s improved economic efficiency, and by aligning the interests of political insiders and business elites helped pave the way for a smoother democratic transition (Silva 1996). Business associations can also act as to balance the power of entrenched political elites. In Korea, the nature of empowered businesses led to a form of business-state collusion that was pro-development, in contrast to corrupt anti-development business-state relations in the Philippines (Kang 2002). In these cases, the key to effective business associations is the representation of diverse interests: when business associations represent a diversity of interests, they are more inclined to push for universalistic rules and institutional reforms (Maxfield and Schneider 1997).

Entry points for change through elite adaptation

7.63 How can a deeper understanding of elite bargains point to entry points for change? First, changes to the rules of the game of the policy arena are driven by the relative power of self-

interested actors. Trying to impose reforms for contestability or accountability is not likely to gain traction. This chapter focused on national elites, but the same analysis can also consider the subnational level and agency-specific reforms. In all of these cases, reform of the rules by which actors interact can only change successfully when they reflect the actual distribution of power and interests. Rules that do not reflect this power distribution or change this power distribution will not stick.

7.64 Second, under certain circumstances, elites do choose to bind their own hands, so there is room for optimism. Trying to create these circumstances by altering contestability, incentives, and preferences at the margins may be an effective way to help change rules. Although there are not many entry points, there are ways to facilitate this process and support development of homegrown rules:

- *Making the policy arena more contestable.* When more actors are allowed to contest in the policy arena, elites are more likely to move from limited deals-based bargains to broader rules-based bargains. When newly powerful elites are allowed to contest in formal institutions, bargains can adapt to the changing balance of power. Empowering agencies by increasing their resources or the technical skills, information, and data available to them can enable them to bargain more effectively. And helping groups of elites or citizens overcome collective action challenges can also lead to newly powerful actors who can directly influence the policy arena (see chapter 8). Chapters 8 and 9 discuss the potential influence of other actors (citizens and international actors) to change the nature of elite bargains.
- *Effectively changing the incentives of elite actors.* Even when the relative power of actors remains the same, the nature of elite bargains can change when elites in power face changed incentives, often as a result of shocks or gradual processes of economic development. Economic diversification can undermine rent-based elite bargains, changing the incentives of ruling elites to support more broad-based policies. Effective “transactional” leaders can engage in “good politics” to change the incentives facing other elites in the policy arena. When citizens overcome their collective action challenges to pressure elites, they change the incentives of elites to respond to their demands (see chapter 8). External actors can help change elite incentives when they present inducements or threats, such as conditional development assistance or the possibility for membership in the European Union or World Trade Organization (see chapter 9).
- *Reshaping preferences in the policy arena.* The nature of elite bargains can also change when actor preferences evolve. Often, changes in preferences occur slowly over extended periods, such as global trends over centuries to view the practices of slavery and torture as immoral. In the shorter term, “transformational” leaders can coordinate norms and change beliefs. Increasing the frequency and depth of interactions between elite actors can help them find common ground. And increased cross-border flows of ideas and information can change the preferences of domestic actors through diffusion of norms and interactions between communities of experts (see chapter 9).

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Spotlight 8 Decentralization

Local experimentation and innovation

S7.1 At their most effective, decentralized systems can spur experimentation that helps localities adapt proactively to changing circumstances. In the United States, Supreme Court Justice Louis Brandeis famously referred to the 50 states as “laboratories for democracy” that could “try novel social and economic experiments without risk to the rest of the country.”

S7.2 By multiplying the number of more or less autonomous arenas within which public authority is exercised, decentralization increases the opportunities for policy innovations and the emergence of effective leaders (Tendler 1997; Campbell 2003). Often, these innovations are spurred by political outsiders who may not have access to the national policy arena, but are more likely to acquire citizen support locally and spur local institutional reforms. For instance, after direct mayoral elections were introduced in Colombia in the 1990s, municipalities led by “political outsiders” invested heavily in upgrading their administrative capacities (Fiszbein 1997).

S7.3 Although decentralization increases *opportunities* for innovation and the entrance of political outsiders, only certain arrangements provide the correct *incentives* for experimentation. To generate adaptive and innovative local governance, it is essential to have a well-defined assignment of responsibilities across levels of government and a clear expectation that subnational governments will be held responsible for their performance. To prevent clientelism or capture at the local level, citizens or central elites must have both the ability to hold local elites accountable, and the incentives to do so.

S7.4 Decentralized governance can create incentives for competent individuals to pursue political leadership, societal groups to invest in building political parties, or existing subnational governments to adopt innovative policy solutions. Competitive local elections can enable entrance of political outsiders and provide incentives for incumbent administrations to strive to show competence in governance. In India, with a decentralized system, several regionally based parties have grown to form national coalitions, whereas two dynastic parties have dominated the politics of Bangladesh, a more centralized state. As a result, India has introduced a far greater range of policy innovations in spheres such as language and management of internal conflict than Bangladesh (Norris 2008).

S7.5 If the career prospects of subnational officials depend on their performance in running subnational governments, this can serve as a strong incentive for them to seek policy innovations to address local governance challenges. In China, local policy autonomy has served as an incentive for local institutional innovations, while personnel decisions remain under central political control, in an arrangement dubbed “experimentation under hierarchy” (Heilmann 2008).

S7.6 The nature of decentralization and the nature of central-local relations shape local incentives for innovation. For instance, different incentives and pressures arise when local parties are in opposition to central parties. In Lagos, Nigeria, the opposition leadership could not rely on intergovernmental transfers from the center, and thus put in place innovative approaches to secure greater internally generated revenues. Because new actors needed to be persuaded to cooperate in

order to secure these revenues, this led to more contestability in the local policy bargain (Watts 2016).

National diffusion of local innovations

S7.7 Even when successful, idiosyncratic local innovations in isolated local governments may not translate into systemic adaption; these innovations must be diffused across jurisdictions. Decentralization can increase policy experimentation, but it may also increase the number of veto players. In some cases a nimble unitary state may be more agile in policy adaptation, compensating for the reduced number of opportunities for experimentation and outsider entry.

S7.8 Certain governance environments and power relationships encourage efficient diffusion of local innovations. Diffusion through “demonstration effects” requires both competition among local governments in different jurisdictions and relatively free flows of information, so that elites and citizens can identify innovations in other jurisdictions. In Brazil, participatory budgeting started in a handful of municipalities in southern parts of the country and eventually spread to hundreds of local governments. In this case, diffusion followed more or less partisan lines, demonstrating the effectiveness of political parties as institutional mechanisms to transmit information (see chapter 8).

S7.9 Diffusion may also be facilitated by strong central control. In China, where subnational governments have acquired significant levels of autonomy over fiscal and economic affairs but are subordinated to central political control, individual jurisdictions have emulated successes from other jurisdictions. When provinces faced a challenge of controlling local inflation soon after market-oriented reforms were introduced in the late 1980s, more effective approaches (such as a market-oriented measure adopted by one of the reform frontrunners, Guangdong) drove out less effective ones (such as a price control policy introduced by more conservative Heilongjiang bordering Siberia) (Montinola, Qian and Weingast 1995).

S7.10 Local innovations can translate into nationwide reforms through processes of political renewal when local leadership—whether through parties or as individuals—wins national power and leads the country in a new direction. Subnational political leaders are more likely to “step up” to the national level in a political system where decentralization is institutionalized, and political leaders have opportunities to demonstrate their competence and deliver performance in numerous subnational governments (Myerson 2011). In recent years, Mauricio Marci of Argentina, Narendra Modi of India, and Joko Widodo of Indonesia all demonstrated effectiveness as state/provincial governors before winning national office.

S7.11 Decentralized democracies allow opposition political parties to gain support in specific localities or regions and eventually challenge the dominant national party. In India, Bharatiya Janata Party (BJP), which carried Modi into the national government, gained strength over time by winning several elections at the state level. Chandrababu Naidu won state election on the basis of a good governance agenda, and his successful reforms led him to win a landslide reelection. A number of aspiring political entrepreneurs in other states drew on Naidu’s model to design their own good governance campaigns (Rudolph and Rudolph 2001).

The politics of decentralization

S7.12 The decision to decentralize can be spurred by many different combinations of incentives and arrangements of relative power among various actors. A split may arise among central actors; to gain strength, they may turn to supportive local actors. Sometimes ruling elites have attempted to diffuse popular discontent with the performance of the national government by decentralizing roles and responsibilities to subnational governments. The military regime that governed Brazil from 1964 to 1985, for instance, formed tacit alliances with subnational political elites to maintain both a modicum of political legitimacy and coalitional support (Hagopian 1996). In other instances, elites have tried to preempt rising demands for regional autonomy through greater decentralization (Bolivia in the 1990s; Indonesia in the early 2000s); or have introduced more decentralization to signify a move away from authoritarian centralization of power and resources (Philippines after the fall of Marcos). Formalization of a decentralized governance structure can also be a form of “settlement” after the end of prolonged internal conflict (see chapter 4).

S7.13 Even after a political system decides to decentralize, the central-local relationship constantly develops; it is not linear. Changing power dynamics can generate pushes for recentralization if national and subnational elites are in competition. For instance, in the Philippines, during legislative consideration of the Local Government Code in 1991, members of the House of Representatives, who were elected from electoral districts (typically smaller than a province), opted to weaken the fiscal resource base of provincial governments because they saw provincial governors as potential rivals as dispensers of local patronage. Senators, who were elected nationally, were more willing to devolve more power to provinces (Eaton 2001; Matsuda 2011).

S7.14 As these cases demonstrate, political incentives shape important aspects of the design of intergovernmental relations, with lasting consequences for the ability of the decentralized governance arrangement to adapt to emerging challenges. Decisions to decentralize (or recentralize) are primarily politically motivated and involve bargains among multiple stakeholders in which technocratic criteria often take a back seat. Outcomes reflect the relative bargaining powers of competing interests, mediated by existing political institutions. Understanding how these bargains take place can help lead to more effective, adaptive, and context-specific decentralization designs.

* * *

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Spotlight 9 Public service reform

S8.1 In the United States, the Pendleton Civil Service Act of 1883 aimed to abolish the spoils system then seen in the federal government. To this end, it established a meritocratic public service, governed by rules restricting politicians' power over their administrative agents (Horn 1995). These rules took a long time to implement: half a century later, about 75 percent of public servants were subject to them (Grindle 2012:1). Fast-forward to April 2003, when Mexico's president, Vicente Fox, signed into law the *Servicio Profesional de Carrera* (SPC) setting up meritocratic rules for middle- and high-level positions in the federal public administration. As of early 2015, the SPC covered only a tiny fraction (1.8 percent) of all federal public servants (World Bank 2016).

S8.2 Public services have yielded to reformers—but *slowly* and *incrementally*. Change has been messy and non-linear: new color added to an old painting, not a clean slate. This pattern holds regardless of the direction or objectives of change—whether reformers were fighting against *patronage*¹ and for a *meritocratic*, (politically) *neutral* and *stable* Weberian-style career public service² (Weber 1956), or hoping to make rule-bound bureaucracies more responsive and performance-oriented, as during the New Public Management (NPM) movement in the 1980s. Why has it been so difficult to change institutional logics within the public service? What does this imply for reformers' strategies?

A case in point: Mexico's *Servicio Profesional de Carrera*³

S8.3 The fate of Mexico's SPC is a case in point. The SPC law of 2003 was a historical milestone, passed at a moment of opportunity, after the Partido Acción Nacional (PAN) had won the presidency. It aimed to put an end to the spoils system of the Partido Revolucionario Institucional (PRI), in place for over 70 years, by establishing meritocratic rules for middle and senior management positions. Patronage had served the PRI well: the prospect of landing a public job mobilized citizens for its electoral campaigns, and the system permitted it to deliver on presidential agendas, recruiting both expertise and loyalty while also coopting dissenters.

S8.4 A context of growing electoral competition, and thus a growing risk of losing power enabled cross-party support for the SPC's adoption in Congress, which had been conceived by an elite coalition of presidential advisers, academics and legislators. Legislators from all major parties supported the SPC law, in view of protecting their partisans in government positions.

S8.5 However, the SPC's implementation encountered resistance and was rapidly subverted. Initial challenges did not assuage the critics: it often took months to fill vacant positions according to the new recruitment processes. Managers, accustomed to the flexibility afforded by patronage, felt overly constrained and unable to build their own teams. Ministries, departments and agencies (MDAs) bypassed the SPC law by appointing large numbers of staff to temporary positions and

¹ Following Reid and Kurth (1988), patronage is here defined as the power to hire and fire an employee at will.

² The key feature of a meritocratic civil service is that it restrict politicians' power over their administrative agents. Meritocracy is here understood broadly to comprise a variety of forms. In the narrow Weberian sense, it refers to a career-based public service, with entry through competitive exams, and government by principles of political neutrality.

³ The argument in this spotlight, and the opening example, strongly draw on Grindle (2012).

advisory roles. In 2007, new regulations gave MDAs autonomy to run the SPC recruitment process themselves, which the Ministry of Public Service (MoPS) had originally conducted centrally. Today, the SPC remains alive: In early 2015, it covered about 79 percent of the positions that it should cover according to the law (World Bank 2016). But challenges persist: For example, MDAs continue to exploit a loophole in the SPC legislation (Art. 34⁴) to bypass its competitive process. In 2014, about 45 percent of all SPC appointees entered through this loophole.

Adverse politics

S8.6 As in Mexico, reformers have frequently capitalized on *moments of crisis* or *political change* to advocate for enacting new public service legislation (Grindle 2012:256). In Mexico, the opportunity was afforded by increasing party competition. The United States' Pendleton Act was only passed in the wake of President James Garfield's assassination,⁵ although voters' discontent about politicians buying and selling offices had been growing beforehand (Wilson 1989: 239). Advocates of meritocratic reform have depended on such rare windows of opportunity because the balance of power has often been skewed against it, facing opposition from powerful veto players.

S8.7 Patronage—or “deals-based”—systems have served political elites and their constituents well, in many ways. Patronage, employed rightly, can drive government performance. It can enable political principals to pick the most *able* and *loyal* candidate for the job. But it can also serve to reward constituents with public jobs, helping politicians survive in office, as in Mexico before 2000, especially where each politician's base, is narrow (see chapter 6). As Robinson and Verdier (2013) argue, the promise of revocable public jobs is a politically attractive form of clientelistic transfer, because it ensures *mutual commitment*. Politicians can easily fire disloyal constituents, and constituents can easily observe if they receive the promised jobs in return for votes. *Short electoral cycles* also favor clientelism. A public job is an immediate and secure reward for constituents, whereas political investments in meritocratic principles may translate into better services only in the distant—and uncertain—future.

S8.8 Meritocratic reforms have had to be *politically constructed* (Grindle 2012) because they require *collective action* (Schneider 2000). They have rarely figured prominently on electoral platforms, because they benefit a dispersed and disorganized broad electorate (Schneider 2000). Meanwhile, reform opponents—political and public service elites and civil servants themselves—tend to be powerful veto-players, concentrated and well organized. Within elite circles, legislators must commit to tie their own hands and give up patronage. This is more credibly when electoral competition (Geddes 1994) makes future alternations of power likely, as after Mexico's 2000 elections. In this case, meritocracy can serve as *insurance* (see chapter 7) that partisans will retain their jobs. Meritocracy can also help politicians credibly commit to policies beyond their own time

⁴ Article 34 of the Law of the Professional Career Service establishes that in exceptional cases and in cases of public emergencies the ministers or the chief administrative officers may authorize the appointment of a public servant to a career position without the need for an open competition and on a temporary basis (OECD 2011:195). These exceptions are only vaguely defined.

⁵ Reform required a political crisis triggered by the assassination of President James Garfield by an infuriated benefactor of the spoils system. Charles J. Guiteau killed the president in an act of revenge when Garfield had refused to appoint him as the U.S. Ambassador to France.

in office. President Roosevelt, for example, expanded merit protection to his liberal appointees out of fear that his New Deal policies might not outlast his administration (Horn 1995:103).

S8.9 *Programmatic political parties* can help overcome these collective action problems, by disciplining legislators to act collectively in their party's interest (chapter 8), as for example in Mexico. Statistical analysis of over 160 World Bank civil service reform projects around the world supports these findings. Cruz and Keefer (2015) find that these projects, on average, performed better⁶ where programmatic political parties were present. Concentrated *decision-making power* can also help.⁷ Some authoritarian developmental states, ranging from Prussia to China and Rwanda, have employed concentrated power to enforce meritocratic reforms.

Reinterpreting ambiguous rules

S8.10 Even when new public services rules get adopted, *notoriously vast gaps* between paper and practice tend to persist. In Mexico, much of the battle over the SPC was fought over the (re)interpretation of the new rules, *after* they had been signed into law. Public service rules are vulnerable to such "political skirmishing" (Mahoney and Thelen 2009:12) because they are *ambiguous* (compared to, for example, a change in tax rates) and because of *principal-agent problems* (Schneider 2000).

S8.11 Public servants, the very agents asked to implement the new rules, may be reluctant to follow them because they do not reflect the social norms (and beliefs) that shape their identities—i.e., prevailing informal institutions. Identities can be slow to adapt, despite changes in formal rules. In Austria, for example, about a decade after the adoption of NPM-style reforms, 58 percent of surveyed officials continued to identify themselves as "servants of the state," consistent with longstanding bureaucratic-legalistic (Rechtsstaat), rather than managerial, virtues (Meyer and Hammerschmid 2006). In bargains over how to interpret, new public service institutional logics, they resemble thin layers of paint, revealing the older layers underneath.

S8.12 Not least, political principals themselves may seek to only partially implement reforms, in a hunt for legitimacy rather than performance (DiMaggio and Powell 1983). Moynihan (2006), for example, documents that U.S. states only partially adopted performance management reforms in the 1990s. Managers were held to account more tightly for results, which were politically attractive to announce. But in the face of union resistance, among other factors, many states failed to, in return, give managers more discretion over their staff.

⁶ Project performance is measured based on the Independent Evaluation Group's project outcome ratings. These ratings are meant to assess the extent to which there were [. . .] shortcomings in the operation's achievement of its *objectives*, in its *efficiency* or in its *relevance*, on a six-point ordinal scale, ranging from "highly satisfactory" to "highly unsatisfactory". It is important to note that these ratings have severe caveats. Among others, they are corporate measures of project-, not of government-performance, they suffer from endogeneity-bias (as objectives are project-specific) and they inevitably contain elements of subjectivity.

⁷ Besides concentration of power and programmatic political parties, the literature highlights many contextual factors that can influence public service reforms including the (i) the degree of fusion between bureaucrats and politicians (Schneider and Heredia 2003) and (ii) the prior influence of class elites in the public service (Grindle 2012). See (Pollitt and Bouckaert 2011) for a comprehensive discussion for NPM reforms.

Implications for public service reform strategies

S8.13 In sum, public service reform paths have been non-linear and messy because reform initiatives often face adversity and because new rules risk being subverted in practice. What does this imply for reform strategies?

S8.14 Above all, realistic public service paths and strategies depend on context. Paths vary because of distinct points of departure. *Historical legacies*—beyond political institutions—have limited reformers’ margin of maneuver. Pollitt and Bouckaert (2011:94), for example, highlight how *administrative traditions persist*. Countries in the Rechtsstaat or Napoleonic tradition,⁸ such as Austria, Germany, and France, have been much more cautious in dismantling a unified public service and assimilating it to private sector employment than their Anglo-Saxon “public interest” peers. China’s unique cadre management system has successfully married long-standing norms of loyalty to the Communist Party of China (CPC) with meritocratic recruitment and cadres’ accountability for achieving performance targets, far from the apolitical Weberian model (Rothstein 2015).

S8.15 Realistic reform strategies also need to balance *competing* and *evolving* objectives. In the OECD countries, problem-definitions have shifted from containing patronage through meritocratic reforms in the 19th century, toward ensuring equal access and treatment (1950s) and increasing responsiveness (1970s) and performance (1990s), as reflected in the NPM movement (Blum and Manning 2009). Post-conflict settings perhaps most starkly illustrate competing ends: discretion over public jobs may be the price for peace, trumping all concerns over merit. South Sudan’s Comprehensive Peace Agreement (CPA) of 2005, for example, provided its 10 states with vast discretion over recruiting public servants to hold a fragile coalition of formerly warring tribes together and prevent them from reverting to violence (Blum, Ferreiro-Rodriguez, and Srivastava 2016).

S8.16 Skillfully “bundling” public service reforms with other policies can help mobilize a broader electorate (Schneider and Heredia 2003:18), beyond a small elite of reformers. Reformers in Brazil and Argentina, for example, framed administrative reforms as essential to making popular stabilization programs viable (Schneider 2000). Such bundling may, however, come at the price of tying the longer-term prospects of public service reform to the “fortunes of the larger agenda” (Schneider 2000).

S8.17 Especially where political cohesion is weak, *selective* and *asymmetric reform strategies* can reduce resistance, seeking to build “islands of performance” in selected agencies. Indonesia’s Bureaucracy Reform (BR), for example, successfully increased pay and accountability for performance in a few priority agencies, and was later gradually rolled out to others (World Bank 2014). In Afghanistan in 2003, reformers adopted an asymmetric reform approach to rebuilding the administration, recognizing that political divisions made comprehensive administrative reforms impossible (Hakimi et al. 2004:11). Yet, selective strategies are risky and no panacea. They can entail generalization pressures, as in Afghanistan (Blum, Ferreiro-Rodriguez, and

⁸ From the Rechtsstaat perspective, the state is a central integrating force within society, and its central concern is with the preparation and enforcement of laws. By contrast, the public interest model “accords the state a less extensive or dominant role within society” and government is regarded as “something of a necessary evil” (Pollitt and Bouckaert 2011:62).

Srivastava 2016); interagency competition for skills, as in Brazil (Shepherd 2003); or well-paid jobs becoming the target of political patronage, as in Uganda's Revenue Authority (Robinson 2007).

S8.18 Not least, the process of formulating reform ideas matters. Where leaders frequently engage with stakeholders—especially public servants—in defining problems and solutions, public servants may be more ready to accept and identify with new rules (Andrews 2013). New research corroborates the promise of influencing employees' beliefs and organizations' cultures, short of changing formal practices. In a quasi-experimental study, Blader et al. (2015) show that merely introducing drivers of a US trucking company to “lean management ideas”—which emphasize continuous improvement through teamwork and collective responsibility—was associated with higher employee engagement, and in turn, better driving performance. Understanding how public servants' identities matter and change remains a promising field for future empirical research.

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Chapter 8 Citizens as agents of change

8.1 Clientelist practices were the norm in Uruguay for most of the nineteenth and twentieth centuries. The overall quality of public services was low, and political connections were the main vehicle to access goods and services provided by the state. Yet in recent decades, government performance in Uruguay has steadily improved, making the country a rare “contemporary over-achiever”—a society that has succeeded in curbing corruption and promoting a virtuous cycle of institutional change toward better governance (Mungiu-Pippidi 2015; Buquet and Piñeiro 2016). Today, Uruguay ranks as the world’s twenty-first least-corrupt, according to the latest Transparency International corruption index.

8.2 What accounts for Uruguay’s successful transformation? Although a complex set of circumstances and contingencies were ultimately responsible, evolving action on the part of Uruguay’s citizens and their interaction with elites in the policy arena was an essential ingredient. The creation of programmatic parties after civilian rule was re-established in 1985 played an important role. Social groups made efforts to build coalitions with interest groups sharing the same preferences—such as the urban sector hit by the economic crisis—and channel popular demands through a new political party (Frente Amplio) that became a new political option besides the traditional coalition of parties. The new political party increased contestability and managed to bring into the policy arena new demands for equitable access to public resources, accountability, and better quality services. Eventually, elections rewarded politicians who delivered on—credibly committed to—their announced reforms, changing the incentives of elites and increasing the opportunity costs of old clientelist practices. Over time, political, administrative, and economic reforms increasingly reduced politicians’ opportunities to capture state resources for private purposes.

8.3 The experience of Uruguay illustrates how multiple mechanisms of engagement can help citizens influence the policy arena by changing contestability, incentives, and preferences to generate more equitable development. Modes of citizen engagement can include elections, political organization, social movements, and direct participation and deliberation. Since all these expressions of collective action are imperfect, they complement, rather than substitute for, one another. As the case of Uruguay shows, it is their strategic combination that makes governments more responsive to citizens’ needs and opens up opportunities for sustainable change.

8.4 As chapter 7 shows, elites are not monolithic; rather, they engage in bargains that reflect diverse preferences and incentives and ultimately shape policy formulation and implementation. Such differences in objectives among elites can open up opportunities for citizens to support change. Indeed, important changes in history have been driven by coalitions between reforming elites and organized citizens that support reform initiatives and overcome the opposition of other elites (Fukuyama 2014; Fox 2015).

8.5 The ways in which elites and citizens interact to create coalitions for change is often shaped by existing institutions of vertical and horizontal accountability that define the “rules of the game” in the policy arena. As discussed in chapter 7, these “rules” are often the result of elite-elite bargains and are primarily designed to serve elite interests. As this chapter shows, however, certain accountability institutions can perform new functions and create an “enabling environment” for citizen agency, opening up opportunities for enhanced contestability and elite-citizen interaction

in ways often not anticipated by the actors who originally designed them. The outcomes of such institutional reforms, however, are not predetermined. Citizen agency can help to translate favorable conditions into effective reforms that drive positive change.

8.6 This chapter focuses primarily on conditions under which citizen engagement can be a driver of positive change, while recognizing that each mechanism of engagement—elections, political organization, social movements, and deliberation—has inherent limitations. Indeed, none of these mechanisms is a panacea: at times, elections may legitimize socially undesirable policies, political and social organizations can lead to violence and rent-seeking, and deliberation can be captured by private interests and opportunistic elites. They play, however, a fundamental role in the process of interaction among state and non-state actors to design and implement policies and to bring about changes in formal rules, particularly in areas that affect minority groups and those generally excluded from the policy arena. When effective, the interaction of these mechanisms of citizen engagement can bring about significant changes in governance through non-violent means.

Bringing change through the ballot box

Elections are a well-established—though imperfect—mechanism of vertical accountability

8.7 Elections are among the most well-established mechanisms available to citizens to strengthen accountability and responsiveness to their demands.¹ When effective, they can help improve the level and quality of services provided by the state by effectively selecting and sanctioning leaders based on their performance in providing *public goods*; however, elections can be an “unhealthy” form of citizen engagement when they instead serve to select and sanction leaders based on their provision of *private goods* (Khemani and others 2016). When effective, elections help citizens overcome collective action problems to incentivize leaders to support public goods favored by the majority of citizens. But elections can be subject to manipulation, fraud, violence, vote-buying, and patronage to certain groups and individuals, which undermine their effectiveness in holding leaders to account, resulting in perverse incentives.

8.8 Elections can be particularly effective at the local level, where voters might be better able to coordinate and shape the incentives of local politicians to deliver—including by curbing corrupt behavior. In China, for example, the introduction of village-level elections increased total local expenditures on public goods by about 50 percent and helped curb rent-seeking behavior of local officials and reduce inequality by promoting land redistribution to local villagers (Martinez-Bravo and others 2011; Shen and Yao 2008). In Indonesia, districts in which governors were directly elected experienced more efficient revenue collection and spending compared to districts ruled by centrally appointed governors (Skoufias and others 2011; Martinez-Bravo 2014).

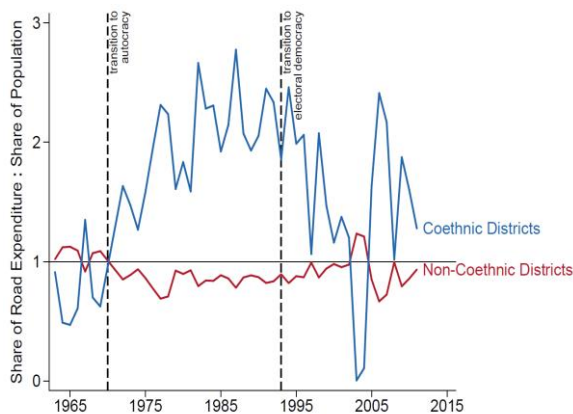
8.9 Elections can also curb ethnic favoritism in the allocation of public resources by posing constraints on executive power. In Kenya, for example, during the authoritarian period, districts that shared the ethnicity of the president received three times as much public investment in roads. However, under multiparty electoral democracy, this effect has disappeared, suggesting that elections successfully constrained the ability of leaders to divert public resources for partisan goals (Burgess and others (2015) (figure 8.1). Likewise, a comparison of fertility rates across 28 countries in Sub-Saharan Africa shows that multiparty elections and leadership changes associated

¹ This section builds upon Khemani and others (2016).

with electoral mechanisms significantly reduced infant mortality rates through improved health care (Kudamatsu 2012).

8.10 Encouragingly, opportunities for citizens to engage in the public decision-making process through voting have increased substantially over the past half century. At the beginning of the so called “Third Wave” of democratization in 1974, there were only about 40 electoral democracies in the world, mostly confined to the industrialized “Western” world (Huntington 1991). Today, the number has more than doubled (to about 100), with more than half of the world’s countries choosing their leaders through elections in which a change in government is a real possibility. Elections have become a fast-spreading norm to legitimize state authority and organize human societies (Diamond 2008). Even in places where open contestation at the national level is absent or restricted, elections have been introduced at the local level to improve oversight of local officials, opening opportunities for participation and contestation of public policies (Gandhi and Lust-Okar 2009).

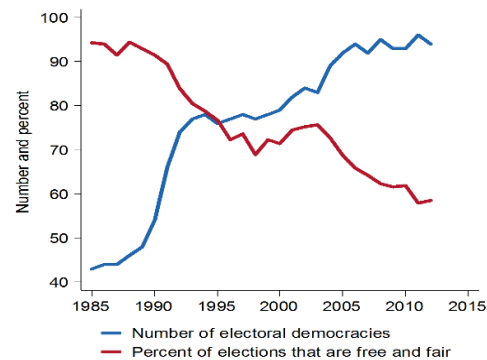
Figure 8.1 In Kenya, elections have changed incentives of ruling elites, reducing the scope of ethnic favoritism



Source: WDR 2017 team based on Burgess and others 2015.

Note: The share of road development expenditure and the share of population are relative to district populations in 1936. A district is defined as co-ethnic if more than 50 percent of its residents are from the same ethnic group as that of the president in the given year. A ratio above one indicates the presence of ethnic favoritism.

Figure 8.2 Electoral democracies are spreading, but the integrity of elections is declining



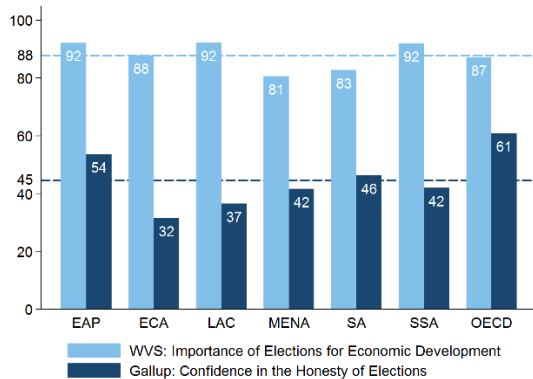
Source: WDR 2017 team based on Polity IV (number of electoral democracies) and Bishop and Hoeffler 2014 (free and fair elections).

8.11 But despite the global spread of elections, the space for effective citizen engagement is compromised by the fact that, according to perceptions, the quality of the electoral process is declining (figure 8.2). Although regular elections can improve the overall level of economic policies by disciplining leaders, this structural effect is conditional on the quality of those elections (Chauvet and Collier 2009). Newly established democracies in low-income countries are especially vulnerable to electoral manipulation. Indeed, the experience of many developing countries suggests that the principle of “one person, one vote” is often undermined in practice by incumbent leaders who seek to minimize the risk of losing power. Elites can resort to multiple strategies of manipulation that undermine the integrity of the electoral process, including the use

of legal instruments that ban certain political parties or individual candidates from joining the electoral contest, the adoption of complex voting registration regulations that effectively disenfranchise certain groups of voters, the resort to electoral fraud, and, in extreme cases, voter intimidation and physical repression of political opponents (Schedler 2002).

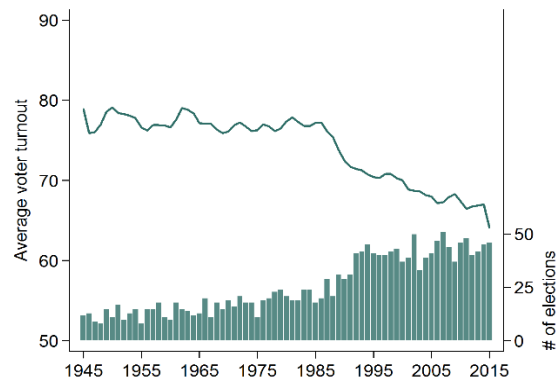
8.12 Challenges to free and fair elections are reflected in widespread dissatisfaction and disillusionment among citizens. While on average almost 90 percent of respondents worldwide view free and fair elections as an important instrument to improve economic conditions in their country, they often do not trust their quality. Less than half of respondents to the latest world Gallup survey, on average, have confidence in the integrity of the electoral process; mistrust is especially high in Eastern Europe and Central Asia, Latin America and Caribbean, and Sub-Saharan Africa (figure 8.3). These perceptions matter, as they shape citizen engagement and their propensity to vote (Birch 2010). Figure 8.4 is consistent with this claim, showing that voter turnout is declining worldwide. Moreover, the lack of electoral integrity and a persistent climate of mistrust over time undermine the legitimacy of the political system, fueling protests, mass demonstrations, and, in extreme cases, outbreaks of electoral violence and civil war (Norris, Frank, and Martinez 2015; Bekoe 2012; Collier and Vicente 2011). The 2007 Kenyan election, with an estimated 1,200 deaths and the displacement of more than 300,000 people, dramatically illustrates this point.

Figure 8.3 While citizens value elections as an important channel to bring economic development, less than half of respondents worldwide have confidence in the integrity of elections



Source: WDR 2017 team based on World Value Survey Wave 6 (2010–14), covering a sample of 41 countries, and Gallup World Poll 2010–15, covering a sample of 142 countries. Dotted lines indicate global averages.

Figure 8.4 Voting turnout is decreasing worldwide, indicating unequal citizen participation and risk of biased representation of policy preferences



Source: WDR 2017 team based on IDEA Voter Turnout Database 2016.

Note: The line refers to average voter turnout using locally weighted smoothing, while the bars indicate absolute number of elections in a given year. Voter turnout is based on the percentage of the voting-age population.

De facto enfranchisement of voters: Enhancing contestability

8.13 Even where de jure voting rights exist and direct electoral manipulation is limited, elections may fail to effectively sanction and select leaders when citizens “opt out.” Voter turnout is not uniform and is often biased toward certain income groups, which leads to unequal influence in the policy arena; in this sense, the extent to which citizens engage in the electoral process is an important determinant of the effect of elections. In high-income countries, wealth and literacy rates predict turnout, suggesting that poor voters face constraints that reduce their propensity to vote (Gallego 2010; Mahler, Jesuit, and Paradowski 2013; Fumagalli and Narciso 2012). The lack of engagement of disadvantaged groups in turn shapes politicians’ incentives to adopt pro-poor, redistributive policies, reducing social spending and reinforcing existing inequalities (see also chapter 6 in this Report).

8.14 This logic implies that the de facto enfranchisement of disadvantaged voters can improve accountability by better capturing their policy preferences. In Brazil, for example, the introduction of electronic voting technology has simplified the process of casting ballots and substantially reduced the number of error-ridden and undercounted votes among the poor. The intervention effectively enfranchised 11 percent of the electorate, mainly the less educated, and led to increased spending toward public health care, increasing poor pregnant women’s access to prenatal care, and reducing incidence of under-weight births (Fujiwara 2015).

8.15 Enfranchising poor voters, however, is not sufficient to bring changes in public policies. As a matter of fact, poor people in developing countries are *more* likely to vote. This implies that higher levels of turnout might not necessarily reflect greater political mobilization by the poor, but rather their tendency to be more receptive to clientelist practices used by elites to mobilize them (Pande 2011; Beramendiz and Amat 2014). Consistent with this logic, Kasara and Suryanarayan (2015) find that in poor societies rich voters are less likely to vote because the state’s extractive capacity is low, and the threat of wealth redistribution through taxation is not credible. As the bureaucratic capacity of the state improves and political competition becomes primarily programmatic in nature, however, the rich are more likely to engage and influence fiscal policies through voting. In other words, the effect of poor voters’ enfranchisement on public policies is contingent on the nature of political competition, the specific mobilization strategies adopted by political parties, and the presence of “credible political alternatives for marginalized citizens” (Kasara and Suryanarayan 2015, 624). Programmatic political parties and social movements play an important mediating role in this respect, as discussed later in this chapter.

Transparency, information, and media: Changing incentives

8.16 Transparency and the provision of timely and relevant information can help improve the quality and effectiveness of elections (Khemani and others 2016). The average voter might not have the information required to properly assess government performance and clearly assign responsibilities. The provision of accurate and credible information to voters—which comes from trustworthy sources such as independent media or oversight institutions—can change prevailing social norms, reducing information asymmetries and increasing voters’ willingness to punish incumbents for poor performance and bad practices such as corruption. For example, in 2003 the federal government of Brazil launched a national anticorruption program that targeted municipal governments with random audits by the national audit agency, whose results were publicly

disseminated through media (radio, television, and newspapers). When audit reports disclosed information about corrupt practices, corrupt mayors were punished at the polls, while mayors with no irregularities were rewarded with reelection. These effects were stronger in municipalities with local radio stations, pointing to the important role played by the media in amplifying and disseminating campaign messages (Ferraz and Finan 2008). Similar results have been reported in Mexico and Puerto Rico, using information disclosed in audit reports (Bobonis, Cámara Fuertes, and Schwabe 2015; Larreguy, Marshall, and Snyder 2015); and in India, using report cards on the performance of incumbent politicians (Banerjee and others 2011).

8.17 Information can strengthen the quality of citizen engagement even in environments where partisan loyalties are strong and a dominant party has been entrenched for some time. In Sierra Leone, for example, increased access to information about local politicians through radio campaigns had a significant effect in shaping behavior and increasing voters' willingness to "cross the ethnic-party lines" to vote for a politician of a different party and outside their own co-ethnic group (Casey 2015).

8.18 However, as discussed in the *2016 World Development Report: Digital Dividends*, when the content of the information disclosed is not salient to voters, or attributing individual responsibility is harder, the incentives of politicians to respond with better service provision remain low, and transparency can have no effect on vertical accountability. In Uganda, for example, the provision of scorecards on the performance of members of parliament did not have any impact on politician's selection or performance (Humphreys and Weinstein (2012). Likewise, radio-based information campaigns on public health and primary education in rural Benin had no effect on shaping politicians' incentives to improve health and education services, despite reducing voters' support for patronage practices (Keefer and Khemani 2014). Sometimes, politicians can respond to the disclosure of information by increasing their vote-buying efforts, thereby preempting its potential effect on voting behavior. In the Philippines, for instance, an initiative to share information about a large public spending program ahead of municipal elections led incumbent politicians to increase vote buying; in the end, the campaign had no discernible effect on voting behavior (Cruz, Keefer, and Labonne (2015).

8.19 In the presence of preexisting preferences and entrenched social norms, transparency alone is unlikely to trigger change and might even lead to more polarized preferences (see spotlight 10 on the media). In these circumstances, citizen engagement through sustained processes of policy deliberation might increase the likelihood of better results.

The challenge of persistent preferences

8.20 Citizen's expectations of what politicians can and should deliver can also be shaped by social norms and "mental models" (World Bank 2015),² leading to inefficient demands. As discussed in chapter 6, many societies are organized around patron-client (or clientelist) exchanges, in which voters expect politicians to deliver private benefits in return for political support, and reward or punish politicians based on these expectations.³ An attempt by either party involved to break the terms of the exchange is costly and likely to fail: in the terminology of this

² "Mental models" include categories, concepts, identities, prototypes, stereotypes, causal narratives, and worldviews (World Bank 2015, 62).

³ Stokes 2005; Schaffer 2007; Kitschelt and Wilkinson 2007; Stokes and others 2013.

Report, these relationships often constitute self-reinforcing equilibria. A field experiment during the 2001 presidential elections in Benin illustrates this point. National candidates who adopted clientelistic messages were more effective in mobilizing electoral support than competitors who used broad-based policy messages (Wantchekon 2003).

8.21 Recent empirical studies on voting behavior in the United States illustrate the perverse effects citizens' beliefs can have in shaping public policies, challenging the conventional logic of democratic theory. Achen and Bartels (2016) argue that the average citizen has little incentive to study complex political issues, engaging in what public choice theorists define as "rational ignorance." As a result, voting behavior is based not on policy preferences but on citizens' social identities and partisan loyalties. Caplan (2008) goes a step further and argues that citizens demand policies based on ideological positions without considering the tradeoffs and costs they might entail: voters not only lack information, but also hold systematic biases in favor of economic policies that have been proven wrong empirically. The persistence of popular demands for energy and fuel subsidies despite their proven fiscal and environmental costs illustrate how these behavioral dynamics are also relevant for many developing countries, undermining the opportunity to bring change through elections alone (Clements and others 2013).

Why elections alone are not enough to bring change

8.22 These analyses suggest that the common belief that elections are a sufficient mechanism to produce responsive and accountable government rests on questionable assumptions. Even when elections are more effective in changing voters' preferences and the incentives of politicians, voting is a limited instrument of control. Voting is an individual action, and citizens face significant coordination challenges when considering whether or not to remove poorly performing governments, limiting the credibility of the threat to punish elected officials (Manin, Przeworski, and Stokes 1999). Moreover, even when citizens manage to remove politicians when their performance is poor or diverges from their preferences, elections alone offer no credible guarantee that, once elected, new leaders will not shirk from their electoral promises and credibly commit to the citizens' demands.

8.23 As discussed in the following sections, organizations representing citizens' collective interests, including political parties, interest groups, and civic associations, are required to overcome the limits of collective action and electoral representation, potentially strengthening citizens' ability to monitor government performance and, in so doing, increasing the costs for politicians to shirk on their electoral promises, thus making political commitments more credible (Ashworth 2012; Keefer 2013). As Achen and Bartels 2016) indicate, "ordinary citizens' interests are likely to matter only insofar as the organized groups representing those interests...are themselves politically engaged, well-resourced, and internally accountable." It is to these organized groups that this chapter now turns.

Bringing change through political organizations: The role of political parties

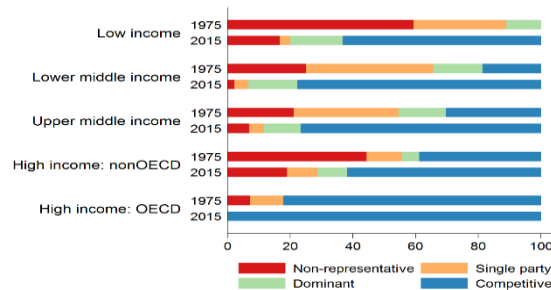
Political parties: Why do they matter?

8.24 Through voting, individual actions can shape collective outcomes. It is also important to understand how citizens shape outcomes by acting collectively, for example, through political organizations. Political parties represent a mechanism to solve collective action problems and can

represent and articulate citizens’ collective interests, aggregate their preferences, and channel their demands in the policy-making process (Kitschelt and Wilkinson 2007; Sartori 1976).⁴ By solving citizens’ coordination problems and providing them with information cues needed to evaluate the performance of incumbents, political parties play a critical role in strengthening vertical accountability (Aldrich 1995). By recruiting and socializing political leadership, political parties also play an important social function to integrate citizens into the political process and to allow different social groups to have a stake in supporting the system, thereby promoting a culture of compromise and reducing societal tensions (Diamond and Gunther 2001, 7–8; Randall and Svåsand 2002). In Tanzania, for example, the power-sharing agreements within the Chama Cha Mapinduzi party have been instrumental in accommodating the demands of various ethnic and religious groups, allowing an alternation in power between Christian and Muslim leaders (Ezrow and Frantz 2011). This arrangement helps explain why the country has not been plagued by the ethnic conflicts that prevailed in many countries in the region, despite the presence of more than 140 distinct ethnic groups.

8.25 Over the past 40 years, the global landscape of political party systems has changed: across all income groups, unelected legislatures and single-party systems have become increasingly rare, and multiple political organizations are increasingly allowed to enter the policy arena, articulating societal interests and citizens’ demands. However, a closer look reveals important differences: in many developing countries, competition is *de-facto* constrained by the dominant nature of the party system (figure 8.5). Where one party dominates the legislative and executive offices, the ability of citizens to influence the policy-making process through representation is reduced (Sartori 1976; Manin, Przeworski, and Stokes 1999: 48). Although, as discussed in chapter 7, dominant party systems may still facilitate cooperation and commitment among elites, they undermine citizen collective action by reducing the attractiveness of electoral politics as a mechanism to alter power asymmetries. Over time, the exclusionary nature of this bargaining might undermine the legitimacy of the political system and lead excluded groups of citizens to channel their demands through noninstitutionalized channels.

Figure 8.5 While the spread of multiparty systems has increased opportunities for citizens’ engagement, dominant parties pose de facto limits on electoral competition



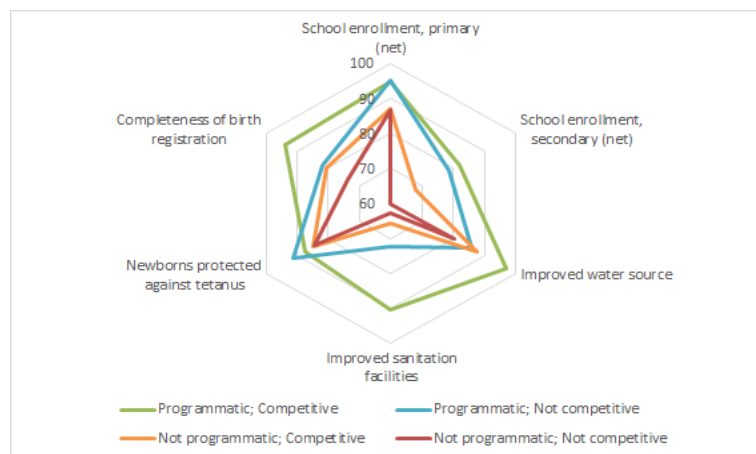
Source: WDR 2017 team based on the Database of Political Institutions (Cruz, Keefer, and Scartascini 2015). Income groups reflect the latest categorization by the World Bank. A party system is classified as “dominant” when incumbents control 75 or more of seats in parliament.

⁴ As discussed in chapter 7, political parties can also be an instrument to solve coordination and commitment problems among elites.

8.26 The strategies adopted by political parties to mobilize voters have important implications for development, as they directly shape the nature of elite-citizen bargaining. On one end of the spectrum—as discussed in chapter 6—*clientelistic political parties* mobilize support through targeted transfers, cash payments, “pork barrel” public investment projects, patronage jobs, and other private goods (Kitschelt and Wilkinson 2007). On the opposite end of the spectrum, *programmatic political parties* maintain a coherent position over key policy issues, stick to these policy commitments over repeated electoral rounds as their main appeal to attract votes, and deliver on them once in office.⁵

8.27 Because the electoral success of programmatic parties—and their own political survival—depends heavily on the credibility of their policy commitments, these parties are more likely to develop organizational arrangements that prevent free riding and shirking by party members and are therefore more likely to deliver on their electoral promises. Consequently, the quality of public services is significantly higher in countries where the main parties (government and opposition alike) exhibit programmatic characteristics, and the effect is larger under conditions of electoral competition (figure 8.6). Likewise, programmatic parties increase the likelihood of adopting and successfully implementing public sector reforms (Keefer 2011, 2013; Cruz and Keefer 2013).

Figure 8.6 Programmatic parties perform better than clientelist ones in improving the quality of public services, especially in competitive party systems



Source: WDR team based on Keefer 2011, 2013; Database of Political Institutions (Cruz, Keefer, and Scartascini 2015); and World Development Indicators (WDI).

When do programmatic parties emerge?

8.28 Unfortunately, entrenched clientelistic political parties can be difficult to remove, as clientelistic parties that deliver on their commitment to provide private benefits to constituents constitute a self-reinforcing equilibrium: Under these circumstances, increased party competition can lead to more—not less—clientelism, because poorer voters are more vulnerable to vote-buying and therefore less likely to demand programs/policies. The experience of many low-income

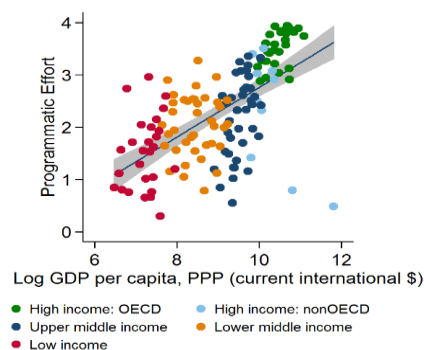
⁵ In the real world, political parties do not fall into neat divisions of programmatic or clientelistic. Rather, they are located along a spectrum, and might display different strategies simultaneously. The focus is on the *extent* to which a specific strategy prevail over competing alternatives (Kitschelt and Wang (2014).

countries in Sub-Saharan Africa is consistent with this argument and illustrates how multiparty competition has fueled, rather than reduced, clientelism (Bates 2010; Keefer and Vlaicu 2008; Kitschelt and Kselman (2013)).

8.29 Voters selecting between a programmatic and a clientelistic party must weigh the credibility of each party's commitments and also compare the expected benefits promised by each party. For programmatic parties to be viable, they must successfully deliver on their promises; however, even well-intended politicians often cannot credibly commit to deliver because of weak state capacity and the absence of institutional arrangements—such as strong checks and balances, a well-functioning parliament and independent judiciaries—that can sanctions leaders who shirk on their promises. Historical evidence suggests that where meritocratic civil service recruitment pre-dated the development of mass-based political parties, politicians were prevented from capturing the bureaucracy for patronage purposes and programmatic parties were more likely to develop (Shefter 1977). However, where clientelistic parties already exist, making the commitments of programmatic parties more credible in the short term is difficult, as it depends on building state capacity that may itself require the elimination of clientelism, leading to a circular argument.

8.30 At times, however, a clientelistic equilibrium can be broken by a change in the relative benefits of clientelistic versus programmatic parties. Indeed, decreasing benefits to clientelism help explain why more developed countries are more likely to have programmatic parties (figure 8.7). At low levels of economic development, average voters tend to reward clientelist practices rather than supporting uncertain programmatic platforms because they lack alternative means to secure basic services and are most vulnerable to adverse economic shocks. However, as societies develop, the marginal impact of targeted benefits on the welfare of the average voter is negligible relative to the potential benefits they can derive from public policies. Consequently, citizens' expectations change: they demand higher-quality services and public goods, and become less credible in their commitment to “sell” their vote to politicians. (Kitschelt and Wilkinson 2007; Stokes and others 2013).

Figure 8.7 Programmatic parties tend to emerge at higher levels of development, but significant variation exists among countries at similar stages of development



Source: WDR 2017 team based on World Development Indicators (2016) and V-Dem 2016.

Note: Income is represented by the natural log of the average per capita income in purchasing power parity terms in 2008–09. A given party's “programmatic effort” refers to the set of “goods” that the party offers in exchange for political support. The ranks range from 0 (= clientelistic efforts) to 4 (= policy/programmatic efforts). Intermediate values reflect combinations of both strategies (V-Dem 2016: 102).

8.31 A similar logic explains why political parties tend to diversify their “portfolio” across the national territory, and adopt a combination of clientelist and programmatic strategies to mobilize voters, depending on their expected electoral benefits (Kitschelt and Wilkinson 2007: 30–31). In Mexico and Argentina, for instance, municipalities that exhibited higher levels of electoral competition and had a larger middle class received the largest influx of public goods, changing politicians’ incentives to “opt out” of clientelism as a strategy to maintain political support (Magaloni, Diaz-Cayeros, and Estévez 2006; Weitz-Shapiro 2014).

8.32 At other times, economic crises or stagnation can undermine systems of patronage, triggering the emergence of programmatic parties. In the Republic of Korea, for example, the financial crisis of 1997 reduced the resource base for clientelist practices and triggered policy reforms—such as regulations aiming to improve transparency in political party finances—that reconfigured partisan competition around programmatic lines (Wang 2012; Hellmann 2011). The outcome of these shocks, however, is not predetermined: worsening economic conditions can also trigger populist appeals that lead political outsiders to gain power on the basis of vague policy proposals. By subordinating the execution of these proposals to the will of a charismatic leader, populism undermines the emergence of programmatic parties and can lead to shrinking bargaining space, reducing opportunities for citizens to hold elites accountable.⁶

8.33 Finally, the commitments of programmatic parties may be more credible at the local level. Decentralization reforms can lower barriers to entry for grassroots movements and local civic associations that may be able to compete in elections on a programmatic platform. In Bolivia, for example, indigenous peoples’ movements took advantage of decentralization reforms and newly institutionalized spaces for citizens’ participation to overcome their divisions, organize collectively through autonomous political parties, and effectively bargain for collective and territorial rights in various municipalities.⁷ These experiences created demonstration effects in other municipalities, strengthening the electoral base of indigenous parties and paving the way for their access to the presidency (Van Cott 2005; 2006).

Why political parties alone are not enough to bring change

8.34 When political parties become tools in elite bargains to help solve intra-elite coordination and commitment challenges, they may fail to represent and articulate the demands and preferences of ordinary citizens. Political parties can act as “gate-keepers,” adopting laws and regulations that

⁶ While programmatic parties can have charismatic leaders, the organizational strength and autonomy of the party constrains the power of individual leaders, subordinating them to the party program. Under populism, the relationship is reversed, and the party has no internal mechanisms to sanction leaders if they fail to deliver on their programmatic agenda. This also explains why populist leaders tend to resist efforts to strengthen the party as an autonomous organization, and why such parties are often nothing more than electoral machines that disappear soon after the charismatic leader leaves office. In Peru, for instance, Alberto Fujimori won the presidential elections as “outsider” through his own party (Cambio 90). After Fujimori was removed from office in 2000, the party quickly evaporated, gaining only 3 out of 120 seats in congress and eventually being dissolved in 2013 (Mainwaring and Torcal 2005).

⁷ The 1995 Law of Local Participation provided legal recognition to the territorial rights of peasant and indigenous communities, allowing over 15,000 grassroots territorial organizations to participate in local planning (Kohl and Farthing 2006: 125–36). Decentralization, however, was a necessary but not sufficient condition to enable programmatic parties to emerge, as its effects were mediated by the geographic distribution of indigenous groups. Indigenous population accounted for at least 25 percent of the population in 79 percent of subnational districts in Bolivia, but only 28 percent of subnational districts in Peru, accounting for less successful indigenous mobilization in Peru (Van Cott 2005, 218–19).

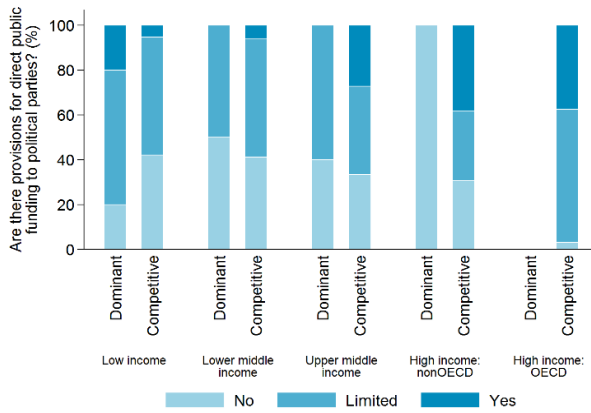
grant ruling elites special advantages and increase the barriers to entry for potential challengers. This behavior can undermine vertical accountability because certain groups of citizens (and the interests they represent) might find themselves systematically excluded from the policy arena or unable to bargain on a level playing field. In South Africa, for example, the National Party enforced the apartheid regime through formal legislation from 1948 to 1994, denying basic political, social, and civil rights to the black majority on the basis of ethnic prejudice.

8.35 Political parties can also deliberately try to reduce contestability in the policy arena by adopting political financing laws and regulations that work in their favor. Because of the rising costs of politics and often in reaction to major political corruption scandals, many countries across the world have introduced public funding regulations. These aim to create a level playing field, helping new interest groups and small opposition parties compete on a more equitable basis with incumbent parties, while also reducing the influence of big corporations and private interests in shaping party agendas. However, countries with dominant party systems are *less* likely to introduce public funding regulations (figure 8.8), reducing the level of contestability. In Africa, for example, only a minority of countries have adopted and effectively enforced public funding laws, contrary to global trends. This regional trend is often coupled with limited transparency on party financing and heavy reliance on funding from private—often illicit—sources (Pinto-Duschinsky 2002; Van Biezen and Kopecky 2007; Norris, Abel van Es, and Fennis 2015).

8.36 Well-established political parties can also become risk-averse and opportunistic in the way that they articulate citizens' demands. They may “sponsor” societal preferences only when the expected returns in terms of electoral gains are positive and large, ignoring demands that are salient only to a small section of the electorate or appear too risky because they deviate from established social norms. As a result, the policy arena can shrink considerably and become biased against disadvantaged citizens such as women, indigenous people, and ethnic and sexual minorities.

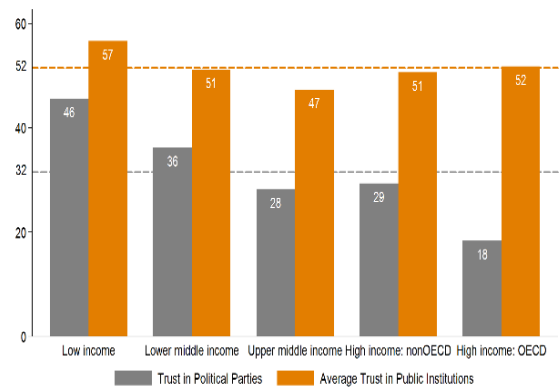
8.37 Taken together, these tendencies often make political parties part of the problem, rather than the solution. Public opinion surveys suggest that political parties are now the least trusted political institution worldwide (figure 8.9). While significant variation exists across income-groups as well as between and within regions, these perceptions highlight an important crisis of representation for traditional representative institutions, leading citizens to look for alternative mechanisms to organize collectively and bring their demands into the policy arena. The decline of party activism and membership in OECD countries is consistent with this argument (Whiteley 2011). Through social movements, civic associations, and spaces of deliberation, citizens can enhance contestability and change the incentives of existing political parties, making them more likely to adapt and respond to new societal demands, as discussed in the following sections.

Figure 8.8 Dominant party systems are less likely to introduce legal provisions for public funding to political parties, suggesting efforts to narrow the policy bargaining space



Source: WDR 2017 team based on IDEA Political Finance Database (2016) and the Database of Political Institutions (Cruz, Keefer, and Scartascini 2015). Countries are classified based on the presence or absence of legal provisions for direct public funding to political parties. Income groups reflect the latest categorization by the World Bank.

Figure 8.9 Political parties are the least trusted political institution; trust in parties also decreases as societies develop, suggesting growing demands and expectations from citizens



Source: WDR 2017 team based Afrobarometer (Round 6, 2014–2015); Arab Barometer (Wave 2, 2010–11); Asian Barometer (Wave 3, 2012–14); Eurobarometer (2015); LAPOP (2014).

Note: “Average Trust in Public Institutions” is the average of trust in the government, parliament, judiciary, police, and army. Trust is calculated as the sum of all positive answers. Dotted lines indicate global averages.

Bringing change through social organizations

Understanding the operating environment: Recent trends

8.38 Across the world in recent years, thousands of citizens have taken to the streets to question the legitimacy of fiscal austerity policies, condemn corruption scandals, and protest government failure to address growing inequalities within societies, among other issues (Ortiz and others 2013; Carothers and Youngs 2016).⁸ These trends suggest that ordinary citizens are becoming increasingly able and willing to peacefully mobilize to hold government accountable and voice their discontent when their confidence in public institutions is undermined, and they perceive that formal mechanisms of representation—such as elections and political parties—have weakened their capacity to articulate their interests and channel their demands.⁹

⁸ The spread of civil society groups and citizens’ activism, however, does not necessarily imply their effectiveness in bringing about change. Only about 37 percent of the reported protests that occurred from 2006 to 2013 were successful in producing demonstrable achievements and prompting authorities to respond with policy changes and reforms (Ortiz and others 2013).

⁹ In other words, rather than simply “exiting” the political process—for example, by abstaining to vote, or even migrating (Hirschman 1970; Clausen, Kraay, and Nyiri 2009)—citizens seek to “voice” their opinions and directly influence the policy bargaining arena.

8.39 By coordinating action among citizens around specific issues, social movements can bring to prominence new demands and interests¹⁰ (Heller 2013). In doing so, social movements can potentially affect the key dimensions of change in three main ways. First, they can *change the incentives of elites* by increasing the political cost of opposing specific policies. Second, they can *reshape the preferences of actors* through the creation of new collective identities and integration of new interests in the policy arena. Third, they can *enhance contestability* by aligning with actors that can effectively challenge existing elites and limit their bargaining power.¹¹ These “change” dimensions are often mutually supportive and overlapping because the ability to achieve one of them can increase the chances to fulfill other roles. By acting on these dimensions, social movements can broaden policy debates and push for new laws and policies that rebalance access to (and distribution of) power among groups within societies, including gender equality laws, indigenous territorial rights, and transparency and right to information laws. However, social organization can also lead to undesirable social outcomes, opposing reform, creating violence and reinforcing rent-seeking for specific clientelistic groups. In what follows, the chapter emphasizes cases of social organization for positive change.¹²

8.40 Social movements are embedded in broader institutional and socioeconomic environments that shape the strategies and choices available to political actors (Tarrow 1998). Over the last 40 years, the institutional environment has become increasingly more permissive for civic activism and social movements: the spread of democratic norms and practices has widened the civic space, with an increasing number of countries enacting laws and regulations to enable and support the formation and functioning of autonomous civic society organizations. Likewise, government interventions to control or censor the media have decreased globally (figure 8.10), allowing independent media actors to bring new issues into the national debate, publicizing social movements’ claims and magnifying their demands (see spotlight 10). The diffusion of new information and communication technologies has further enabled citizens’ collective action by facilitating access to information, lowering transaction costs for the creation and development of associational networks, and providing effective coordination tools for disadvantaged groups spread across the globe (Bennett and Segerberg 2012). As a result of these processes, social movements are now increasingly organized across national boundaries (figure 8.11) (Goodwin and Jasper 2015:157).

8.41 Evidence from the past decade, however, suggests that the global trend might be changing toward a shrinking civic space (figure 8.10). Many governments are changing the institutional environment in which citizens engage, establishing legal barriers to restrict the functioning of

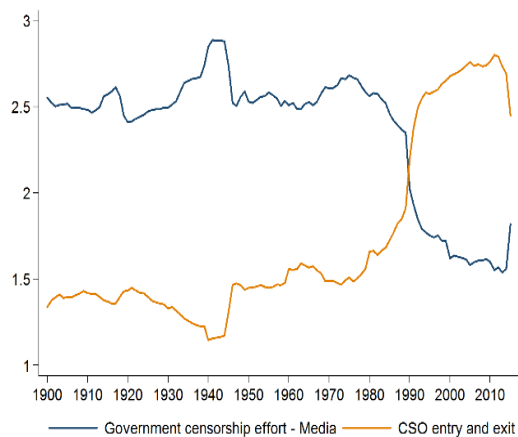
¹⁰ Social movements are defined by scholars in different ways. This Report uses a common definition among political scientists and sociologists: “*Social movements* [are] a sustained series of interactions between powerholders and persons successfully claiming to speak on behalf of a constituency lacking formal representation, in the course of which those persons make publicly visible demands for changes in the distribution or exercise of power and back those demands with public demonstrations of support” (Tilly 1984: 306).

¹¹ Defining the impact or “success” of social movements continues to be a subject of debate among scholars. On the one hand, social movements are not homogenous organizations, and not all members might perceive a given change as an indicator of success. On the other hand, social movements often generate impact in different areas of human affairs (political, cultural, and social), as well as consequences for individuals and societies at large. These are difficult to disentangle and capture empirically, making causal inferences problematic (Giugni 1999; 2007; Amenta and others 2010).

¹² Khemani and others (2016) label this positive change “healthy citizen engagement.”

media and civic society organizations, and reducing their autonomy from the state. These initiatives might include, in the case of media, politically motivated awarding of broadcast frequencies, withdrawal of financial support, or complex registration requirements that raise barriers to entry into a government-controlled media market. In the case of NGOs, governments might resort to legal measures to restrict public and private financing, or pass stricter laws that restrain associational rights (Carothers and Brechenmacher 2014). While these initiatives are sometimes motivated by legitimate concerns for public order and national security, they can be used by elites as a strategy to narrow the policy space and limit the channels available to citizens to engage and influence the policy arena.

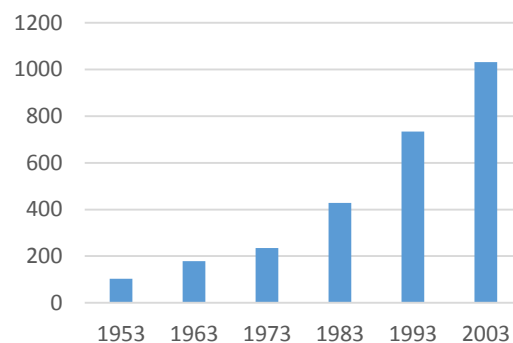
Figure 8.10 After decades of progress, civic space is shrinking globally, driven by higher governments' restrictions on media and CSO entry



Source: WDR 2017 team based on V-Dem (2016).

Note: The scale was reversed for the media censorship variable (low score indicates less censorship). The average is based on a sample of 167 countries, with smaller coverage in 2013–15. CSO = civil society organization.

Figure 8.11 Taking advantage of the digital revolution, social movements are increasingly organized across national boundaries



Source: WDR 2017 team based on Smith 2008. The bars measure the number of Transnational Social Movement Organizations (TSMOs), defined as organizations that combine activists from multiple countries around common social change goals.

Changing incentives: How social organization can effectively build coalitions for change

8.42 Differing preferences and incentives among elite actors open up potential opportunities for social organization to support change by forming coalitions with reforming elites (Fukuyama 2014; Fox 2015). When economic crises or other external shocks shift the incentives and relative power of elite actors, they may be more likely to defect from the ruling coalition and build alliances with excluded citizen groups. In the Philippines, for example, business elites that originally supported Ferdinand Marcos' coup in 1972 started to defect under pressures of economic decline. When a major event—the assassination of the main opposition leader in 1983—triggered a wave of protests, grassroots associations exploited the opportunity to forge an anti-Marcos reform coalition—the so called 'People Power' movement, comprising members of the private sector, representatives of the opposition, religious leaders, and civic organizations. The mobilization culminated in peaceful demonstrations that brought millions of citizens to the streets, forcing Marcos to resign in 1986 and paving the way for the restoration of democratic institutions (Blitz 2000).

8.43 In the absence of an identifiable shock, social organizations may be able to shift elite incentives to form a coalition through sustained efforts over a longer period of time. In India, for instance, the Right to Information Act (RTIA) was passed in 2005 after a prolonged struggle lasting 10 years (box 8.1). Factors including ideology, religion, leadership, and provision of selective incentives can help sustain commitment to social movements despite lack of short-term success. Labor unions, for example, may provide services to members to sustain participation in the aftermath of failed bargains.

Box 8.1 Social movements and bottom-up pressures for reform: The case of right to information legislation in India

Since independence, the Indian government has operated under the colonial Official Secrets Act (OSA) of 1923. Officially conceived as a legal instrument to prevent disclosure of information that can affect security and national sovereignty, in practice the OSA has empowered authorities to withhold information from citizens at their discretion. This has created a culture of secrecy that came to characterize administrative and political practices, undermining the accountability of state institutions. Despite several attempts at reform by technical working groups and parliamentary commissions, the OSA has never been repealed (Mander and Joshi 1999).

In the 1990s, a rural-based social movement emerged in Rajasthan, demanding access to information on behalf of wage workers and small farmers. The rural poor were often cheated and not paid their full wages, as they could not challenge the paymasters because they were denied access to attendance registers. The movement eventually spread nationwide, leading to the formation of the National Campaign for People's Rights to Information (NCPRI) in 1996. Members of the NCPRI built strategic alliances with other societal groups, including journalists, lawyers, and human rights activists, creating a strong constituency for reform that moved demands for transparency to the forefront of the political agenda, and eventually succeeded in pushing adoption of the Rights to Information Act in 2005 (Bari, Chand, and Singh 2015).

Changing preferences: How social organization can bring new interests into the policy arena

8.44 As discussed in chapter 7, elite bargains can have unintended consequences. Sometimes, they can create the conditions for social movements to emerge and bring new interests into the policy arena. In Tunisia, for example, progress on gender equality following independence was largely the byproduct of an elite bargain—namely, the joint incentives of political and business elites to get skilled labor for the growing manufacturing sector—rather than the outcome of feminist mobilization. However, these top-down policy choices created an enabling environment in which women's organizations emerged and were strengthened over time. In 2011, the Jasmine revolution provided women's organizations with a window of opportunity to leverage their organizational strength and successfully lobby for a mandatory gender quota for elections to the National Constituent Assembly, boosting women's representation in the Assembly to 26 percent. This initial success in turn allowed women organizations to change elite preferences—shaping the agenda of political parties—leading to the integration of gender provisions in the new constitution (Domingo and O'Neil 2016).¹³

¹³ In one specific instance, they also successfully fulfilled a veto-player role and resisted attempts by the Islamic party to undermine women's family rights, eventually pushing the elites to withdraw regressive clauses from the final legislation, despite the party had the majority in the parliament.

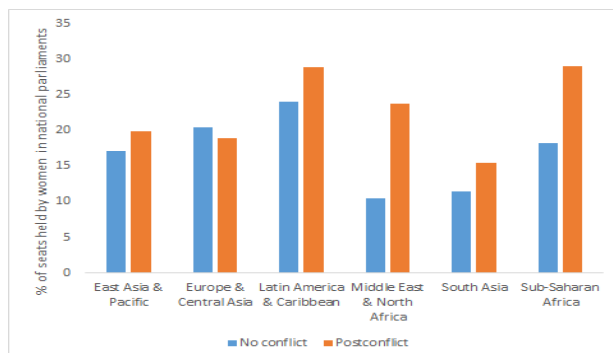
Box 8.2 Women’s mobilization and the promotion of gender-based policies in post-conflict settings: The case of Sub-Saharan African countries

Across the world, women’s political representation is on average higher in post-conflict countries than in countries that have not experienced conflict (figure B8.2.1).^a This trend is particularly evident in the Middle East and in Sub-Saharan Africa, where women’s presence in parliament is almost double the level of countries with no conflict. Tripp (2015) provides a possible explanation for these patterns, with a focus on Sub-Saharan Africa, where post-conflict countries have been more successful in promoting gender equality laws across multiple policy areas. Rather than looking at a single driver, the study highlights the interaction among three drivers. The first is the disruption in gender relations that is specific to conflict-prone countries, with women taking over many of the men’s traditional tasks, leading to shifts in gender norm (see chapter 4). The second is the rise of domestic women’s movements, facilitated by the inclusive and competitive nature of the post-conflict environment. The third is the influence of international processes and actors involved in promotion of gender laws and international norms on gender inclusion (further discussed in chapter 9).

The contrasting experience of Rwanda and Angola reflect the interplay and relative strength of these three factors. In Rwanda, women played a critical role within the Rwanda Patriotic Front (RPF), holding executive positions within the movement while in exile. Women activists have been powerful agents of transformation in the post-conflict period, advocating for greater responsibilities in light of the leadership roles played by women in the armed struggle. Even before the establishment of quotas, women held nearly 50 percent of the seats that RPF controlled in parliament (Powley 2005). Moreover, women’s involvement in the constitution-making processes and—later on—in parliament provided them with the organizational strength and legitimacy to advocate for the passage of many gender equality and anti-discrimination laws, including the 1999 inheritance law, the 2004 National Land Policy, the 2005 Organic Land Law (Powley 2005), and the 2009 legislation against gender-based violence. This influence also explains why—once the new 2003 constitution introduced a 30 percent women quota in the legislatures—Rwanda far exceeded the target, becoming a frontrunner of gender equality and women’s political participation in the world, with 64 percent of total seats occupied by women, followed by Bolivia (53 percent) and Cuba (49 percent).^b

In contrast with Rwanda, Angola’s progress in promoting gender policies has been much slower, despite the adoption of gender quotas. This can be explained by the lack of a strong and autonomous women’s movement, a less prominent presence of international donors and development agencies—Angola’s heavy dependence on oil has helped insulate the country from the international pressures and gender norms—and, most importantly, the lack of an enabling environment (including the lack of a peace negotiation process) due to the substantial continuity in the political elites in power at the end of the conflict. This in turn undermined inter-elites competition and closed up opportunities for new groups and interests to emerge in the policy-bargaining arena.

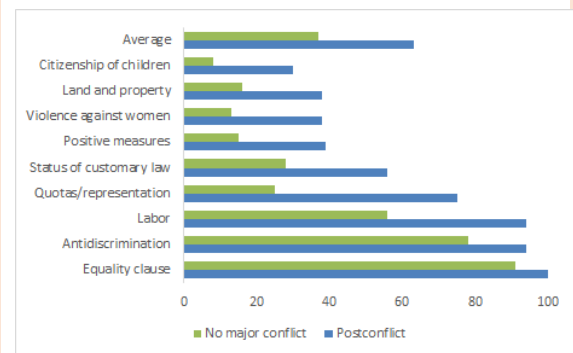
Figure B8.2.1 The rate of women political participation is up to three times larger countries emerging from conflict



Source: WDR 2017 team based on UCDP/PRIO 2015; WDI 2016.

Note: The figure indicates the proportion of seats held by women in national parliaments. Post-conflict countries are those that had at least one year of conflict after 1985 with more than 1,000 deaths. Countries with ongoing conflict as of 2014 and high-income OECD countries were excluded.

Figure B8.2.2 In Africa, post-conflict countries have been more likely to integrate women’s rights in their constitutions



Source: Tripp 2015: 1275.

Note: The figure shows the percentage of African countries with constitutional provisions relating to women’s rights.

- a. This box largely relies and builds upon Tripp 2015.
- b. Hunt 2014. For the world classification, see <http://www.ipu.org/wmn-e/classif.htm>.

8.45 Major political events such as wars and post-conflict constitutional design processes can also alter the balance of power within societies, playing the role of coordination devices to enable collective action among marginalized groups to mobilize and influence the policy arena (box 8.2). In Afghanistan, for instance, sustained efforts by domestic women’s organizations—in collaboration with international donors and NGOs—played a key role in changing preferences of members of parliament and state officials within the bureaucracy, influencing the drafting process of a controversial law on the Elimination of Violence Against Women, which introduced criminalization of gender violence for the first time in the Afghan history (Larson 2016).¹⁴

Changing contestability: How social organizations use the law to claim rights

8.46 As discussed in chapter 3, law plays different roles: it orders behavior, legitimating social hierarchies and power relationships in society; it can also be used by citizens to contest power and make legal claims to challenge the status quo and push the boundaries of citizenships rights (McCann 2004). It is not a coincidence that the most transformative cases of social movements of the 20th century—including labor, women’s rights, and civil rights, and, more recently, indigenous and environmental movements—have all explicitly adopted the language of law and the discourse of rights as *legal* entitlements, creating a “shared normative base” that has facilitated collective action (Heller 2013: 4).

8.47 Legal institutions of horizontal accountability such as national courts and ombudsmen offices can also be a strategic asset for organized groups of citizens. By ‘activating’ these institutions, social movements can raise awareness about collective entitlements and citizenship rights, forging the collective identities of disadvantaged citizens and raising the salience of individual grievances (Peruzzotti and Smulovitz 2006; Fox 2015). Moreover, the ability to achieve legal victories in court can boost confidence among social actors, strengthening the commitment to organize by effectively using legal instruments in their favor. Mass media campaigns are often used as a complementary strategy to publicize court victories and put the new at the forefront of the national agenda (see spotlight 10 on Media). As the history of US civil rights movements suggests, legal mobilizations have often generated a “contagion effect,” transforming local victories into nationwide struggles for rights (McCann 1994). Similar dynamics are also spreading in developing countries: in Botswana, for example, women’s groups have successfully challenged discriminatory customary laws and pushed for the implementation of gender equality principles enshrined in the constitution by adopting litigation strategies that culminated in a series of victories in far-reaching cases before national courts. (Hasan and Tanzer 2013).

8.48 The effectiveness of legal strategies, however, often depends on the presence of a well-functioning and independent judiciary and a strong network of legal aid experts that can support the claims of social organizations and resist pressures to deny them. Unfortunately, judicial independence is often undermined in many countries, leading some scholars to criticize the faith placed in courts as mechanisms of social change as nothing more than ‘hollow hope’ (Rosenberg

¹⁴ Despite ongoing implementation challenges, the law has become a critical reference point for women’s activists who increasingly use it for litigation purposes, contributing to strengthen gender equality (Larson 2016: 23).

1991). Other studies, however, contend that the spread of international courts and legal bodies associated with international human rights laws provide social movements with additional toolkits to overcome the limitations of state courts and change the incentives of elites, pushing for compliance with laws and regulations ratified by national governments (Keck and Sikkink 1998). The role of these international bodies is explored in chapter 9.

Why social organization is not enough to bring change

8.49 Social movements can give voice to powerless groups and put pressure on public authorities, but they often fail to consider the tradeoff associated with the proliferation of competing interests in the policy arena. In many developing countries, state capacity is weak and political parties are unable to perform their function to filter these demands and subordinate them to higher public priorities. In these circumstances, public institutions might become overloaded with multiple pressures, undermining the coherence and effectiveness of public policies. This can generate frustrations and discontent among citizens that, if not properly addressed, can eventually lead to violence, conflict, and political decay (Huntington 1968). Chapter 4 explores in depth violence as a manifestation of governance failure.

8.50 Moreover, social movements are not necessarily motivated by a vision of a more equal and just society. On the contrary, they can also be captured by narrow interests or used by reactionary and extremist groups for exclusionary purposes. As discussed below, civil society is subject to “failure,” i.e., the risk that social groups “may also face significant problems of coordination, asymmetric information, and inequality, which may limit their ability to respond to and resolve market and government failures” (Mansuri and Rao 2013). When social movements are captured by narrow interests, they may reinforce existing inequalities rather than overcoming them. Even when not captured, social organizations may be decidedly “uncivil” and specifically designed to deny equal rights to other groups (Heller 2013). Examples include anti-Muslim groups in India and the Ku Klux Klan in the United States.

The role of induced participation and public deliberation

8.51 Social movements drive “organic participation” through which citizens contest state policy from outside of the state; also important for articulating citizen interests and overcoming collective action challenges is “induced participation,” through which citizens deliberate policies through formal state interventions.¹⁵ With regard to development assistance, induced participation takes the form of decentralization and community-driven development, but in a broader context includes various forms of direct democracy and democratic deliberation. Public deliberation—spaces and processes that allow group-based discussion and weighting of alternative preferences—can help level the playing field in the policy arena. In certain contexts, deliberation can leverage marginalized groups’ efforts to re-balance power relationships in their favor. And citizen participation can be instrumental in improving the quality of deliberation and the legitimacy of decisions made, by clarifying needs and demands of local constituencies.

8.52 Induced participation and public deliberation not only increase the contestability of the policy arena, but also have the potential to aggregate preferences and reshape them through dialogue and argumentation. In *The Social Contract*, Rousseau argues that participation is not

¹⁵ This section builds on Mansuri and Rao (2013).

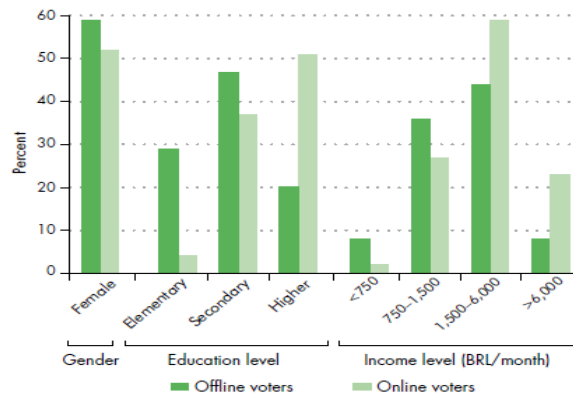
merely a way of reaching a decision, but also a process through which citizens develop a civic consciousness, develop empathy for other views, and learn to take the public interest into account. In other words, participatory processes can help to achieve cooperation by shifting preferences.

8.53 Public deliberation is most feasible, and thus most successful, at the local level, and is often seen as a complement to decentralization reforms. In Brazil, following decentralization in 1988, Porto Alegre introduced participatory budgeting in 1990, and a decade later participatory budgeting assemblies drew over 14,000 participants, many of them poor. Participatory budgeting led to improved outcomes, with more money dedicated to pro-poor investments, resulting in improved sewerage and water coverage, higher school enrollment, and more affordable housing (Baiocchi 2005). In India, the 73rd amendment to the constitution in 1993 mandated village elections at three levels—panchayats (village councils), block panchayats (block councils), and zila panchayats (district councils)—as well as regular village meetings (gram sabhas) that were open to the entire village. In the state of Kerala, authorities subsequently devolved 40 percent of the development budget to village councils, increasing the demand for local participation (Mansuri and Rao 2013).

8.54 However, participatory approaches to development sometimes fail to consider the possibility of “civil society failures,” where, in weakly institutionalized environments, the poor are less likely to participate and participatory mechanisms can be captured by local elites (Mansuri and Rao 2013; Devarajan and Kanbur 2012). Contestability depends on de facto participation, but demand-driven participation can exclude the weakest individuals, groups, and communities, especially given that the poor may face a higher opportunity cost of participation. Evidence suggests that participants in public deliberation are wealthier, more educated, male, and more politically connected. Moreover, deliberations often attract similar types of people and fail to promote cross-group cohesion. When only homogenous groups of the relatively powerful are included, participation neither enhances contestation nor serves to shift preferences. Additionally, efforts at induced deliberation might be captured by narrow interest groups whose preferences might be over-represented, reinforcing existing inequalities rather than overcoming them. This explains why efforts to “export” participatory budget initiatives sometimes do not work (Baiocchi, Heller, and Kunrath Silva 2011). Local level deliberation might be especially subject to capture because of the entrenched influence of local elites (Abraham and Platteau 2004). Consequently, evidence shows that the poor often benefit less than the non-poor from participatory processes, particularly in communities with high levels of inequality and those with particularly salient and significant caste, race, or gender disparities (Mansuri and Rao 2013).

8.55 Such failures are not necessarily ameliorated by the availability of new digital technologies (Gaventa and Barrett 2012). On the contrary, as discussed in WDR 2016, ICT instruments might actually reinforce socioeconomic inequalities in citizens’ engagement. In Brazil, for example, the use of internet voting on municipal budget proposal reveal stark demographic differences between online and offline voters—online being more likely to be male, university educated, and richer (figure 8.12).

Figure 8.12 Citizen engagement in participatory budgeting via online voting can reinforce existing inequalities



Source: WDR 2017 team, based on Spada and others 2015. R\$ = Brazilian real.

8.56 The design of deliberative mechanisms can help to overcome problems of exclusion and capture, particularly when such mechanisms are designed in conjunction with other reforms to improve accountability and transparency. For instance, there is evidence that participatory community programs are more likely to be successful when occurring in conducive political environments: i.e., when local governments have discretion and are already downwardly accountable (Mansuri and Rao 2013).

8.57 Providing information on specific policy issues and creating conditions favorable to making informed decisions can also change citizens' preferences and act as an important input mechanism to improve the terms of a policy debate and open the way for future changes in public policies. Recent experiences in deliberative polling (Fishkin 2011) illustrate this point, providing an innovative approach to ascertain informed, thoughtful, and representative public views on complex policy issues.¹⁶

Understanding citizen agency as a collective action problem: Entry points for change

8.58 This chapter has analyzed the role that ordinary citizens play in driving processes of societal transformation and institutional change. Surveying historical and contemporary experiences, it argues that citizens face collective action problems that prevent them from effectively bargaining and holding government to account. To strengthen their influence in the policy arena, citizens need to engage through multiple mechanisms designed to solve collective action problems including voting, political parties, social movements, civic associations and other less-conventional spaces for policy deliberation. Since all these expressions of collective action are imperfect, it is their strategic combination that maximizes the chances to promote change and make governments more responsive to citizens' needs.

8.59 An important pattern emerging from the chapter is that citizen-led change is possible, but it is often a difficult and long-term process fraught with uncertainties. In India, grassroots organizations spent 10 years to scale-up local mobilization efforts, translate rural activism into a multi-stakeholder coalition for reform, and finally shift incentives of state authorities toward the

¹⁶ For short summaries of recent applications of DP, see <http://cdd.stanford.edu>.

adoption and implementation of RTIA legislation. In Uruguay, labor associations and sections of the working class started to challenge the clientelist apparatus of the state in the early 1970s, but it took three more decades to strengthen their organizational structures and expand their support base in the urban sector to promote change.

8.60 The analysis of the chapter highlights multiple drivers whose interaction can contribute to lower barriers to collective action and facilitate citizens' mobilization through the mechanisms identified above: *first*, institutions that enhance 'contestability' in the policy arena—such as media regulations, political finance regulations, and constitutional provisions that establish mechanism to protect citizens rights—can create an 'enabling environment' for citizen agency by facilitating cooperation and promoting more inclusive and equitable bargaining spaces. Often the outcome of elite bargains, these institutions can nevertheless open up opportunities for previously marginalized groups to mobilize and bargain for their collective interests. *Second*, external shocks—i.e. corruption scandals, economic crises—can act as important triggers that help citizens overcome otherwise unfavorable circumstances and create opportunities for change. *Third*, coalition-building strategies matter for results: chances to promote institutional change and policy reforms are maximized when the incentives of reformers 'from above' (elites) and mobilization 'from below' (citizens) converge and mutually reinforce each other against defenders of the status quo (Fox 2015). This points at the important role that agency and leadership plays in seizing windows of opportunities for action.

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Spotlight 10 Media

S9.1 Under the presidency of Alberto Fujimori in Peru, ruling elites systematically bribed politicians, judges, and news media companies to weaken accountability and coopt opposition. The architect of the system, Fujimori's security chief Vladimiro Montesinos, kept a detailed record—both on paper and on video—of all payments made. Montesinos was unable to secure support of one TV channel, which rejected bribes and continued to publicize independent analysis and investigations on the regime's performance (McMillan and Zoido 2004). It was this TV channel that made public the first “*Vladivideos*” in 2000, uncovering the magnitude of the corruption and rent-seeking behavior of elites. The popular outrage generated by the disclosure of the videos helped opposition forces mobilize, leading to the disintegration of the regime and ouster of Fujimori a few months later.

S9.2 This case highlights the central role that the media can play as an agent of accountability. By publicizing information that is reliable and salient for citizens, the media can make the policy arena more contestable, change the incentives of elites by increasing costs of certain behavior or policy decisions, and reshape preferences (Khemani and others 2016). Precisely because of their role, however, media can be captured by powerful interests and undermine—rather than support—possible entry points for change.

Changing contestability: The political economy of media capture and competition

S9.3 Controlling media is one instrument through which elites bargain. Elites can capture the media to shape coverage and content, reducing contestability. Bribery is one strategy, and as shown in Peru, it can be especially valuable. Bribing the media was 10 times more expensive than bribing legislators and judges in the Fujimori regime. The television channel with the largest viewership received \$US1.5 million monthly (McMillan and Zoido 2004). Another strategy governments can use is to adopt regulations that favor a specific media outlet or buy advertising space in exchange for political support. For instance, in Argentina, the amount of coverage of corruption scandals significantly decreased for newspapers that received government-related advertising from 1998 to 2007 (Di Tella and Francheschelli 2011). Private interests can also capture media market: as of 2016, about 6 percent of all billionaires are involved in some media business, reaching peaks of more than 20 percent in countries like Mexico, Poland and Venezuela.¹ Other research shows that media capture by narrow interest groups is more likely when media ownership is more concentrated and income inequalities are higher (Corneo 2006; Petrova 2008).

S9.4 These findings suggest that more competition and entry into the media market is fundamental as a way to increase the contestability in the policy-making arena. Ensuring the media's independence from government ownership works toward the same effect. However, ownership of media and press freedom are also the by-product of elite bargains and power relations, creating an equilibrium that is difficult to change. One important factor driving the growth of independent media is the advertising market. Independent media are more likely to emerge in places with higher advertising revenues, a study of U.S. newspapers in the 1800s shows (Petrova 2011). When advertising revenues increase, media outlets have alternative revenue sources and thereby less willing to distort news coverage to protect the interests of subsidizing

¹ WDR2017 team based on Forbes List of Billionaires.

groups, especially if such distortion undermines their ability to secure advertising revenues. Beyond this advertising's effect, elite bargains can open up opportunities for more competitive media markets and lead to unexpected changes in contestability. In Malaysia, for example, ruling elites invested in internet infrastructure as a way to attract foreign investment. This led to a “democratizing” effect in the media market, with independent bloggers publicizing news on government performance. This has had an important effect on voting behavior: in districts with higher internet access, the loss of political support for the ruling party has been more pronounced (Miner 2012). Similar effects have been found in Russia, where the access to a privately owned and independent television channel (NTS) was associated with higher propensity to vote for the opposition (Enikolopov and others 2009).

S9.5 Media content is often decided by elites. The effect of media bias as an instrument to reduce contestability, reinforce prior beliefs, and increase polarization among social groups is well documented in the literature (Strömberg 2015, 2016). Elites can also use media as a coordinating device for propaganda purposes and—in extreme cases—for repression. For example, 10 percent of the reported killings during the genocide in Rwanda have been attributed to radio broadcasting, which facilitated militia targeting of the Tutsi population (Yanagizawa-Drott 2012).

S9.6 New social media can counteract elite control of the media market, under certain circumstances. The anti-G20 movements following the world economic crisis in 2008 (Bennett and Segerberg 2011), the Occupy Wall Street movement, the Arab Spring, and the massive protests that erupted in Brazil surrounding the 2014 World Cup (Lemieux and others 2015) all demonstrate the instrumental role played by the internet and new social media in facilitating citizens' collective action. The same events, however, also highlight the limitations of social media. They can be effective in generating sudden spikes of protests and coordinate uprising, but cannot alone yield sustained representation of interests and promote social change (Ackland and Tanaka 2015). To follow the terminology of the 2016 *World Development Report* (WDR) on digital dividends, “analog” complements are needed to maximize the potential of social media as drivers of change. Political and social organizations can act as such complements.

Changing incentives: The watchdog role of media

S9.7 Media can also play a role as “public sentinels” (Norris 2013), generating and publicizing information about government performance, shaping incentives of politicians to deliver, and making governments more responsive to voters, thereby improving the quality of public policies. By making information public, media companies can strengthen the bargaining power of citizens, increasing the costs for public officials to engage in rent-seeking behavior (see chapter 8). Media can facilitate the efforts of civic associations to mobilize citizens around an anticorruption agenda and help citizens monitor the quality of government services, acting as important agents of “social accountability” (Peruzzotti and Smulowitz 2006). In Uganda, for example, elite capture undermined public service provision, with local schools receiving only 24 percent of central government grants they were entitled to, on average. After a media campaign publicized the amount the schools were supposed to receive, the average funding increased to 80 percent, improving school enrollment and learning outcomes. The effects were larger in schools that were closer to a newspaper outlet (Reinikka and Svensson 2005).

S9.8 Access to media makes government more responsive to citizen needs. For instance, a comparison of Indian states from 1958 to 1992 finds that government spending was more responsive to local needs in areas where newspaper circulation was higher (Besley and Burgess 2002). However, this type of relationship can also generate biases against citizens without access to media, especially poor living in rural areas (Strömberg 2015).

Reshaping preferences: The agenda-setting role of media

S9.9 As discussed in WDR 2015 on mind, society, and behavior, media can play an important role in reshaping preferences and social norms within societies.² Media “both entertain and educate, in order to increase audience members’ knowledge about an educational issue, create favorable attitudes, shift social norms, and change overt behavior” (Singhal and Rogers 2004, 5). A growing body of studies based on randomized control trials and quasi-experimental design provides empirical support to this claim, pointing at the transformative potential of “educational entertainment” (or “edutainment”). For example, in Brazil, watching a soap opera with female characters with few or no children has been associated with significant drops in fertility rates, changing preferences for family size (La Ferrara, Chong and Duryea 2012). In India, access to television improved gender norms, son preference, and decreased fertility (Jensen and Oster 2009). In Tanzania, exposure to a radio program was associated with a significant increase in condom use and reduction in the number of sexual partners (Vaughan and others 2000). In Rwanda, exposure to radio programs changed citizens’ attitudes toward authorities, promoting more pro-social behavior and more active participation in conflict resolution (Paluck and Green 2009).

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² This section largely relies and builds upon WDR 2015. A background paper for that Report, “The Impact of Entertainment Education,” provides a recent review of the literature, analysis of selected cases, and evidence on results.

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Chapter 9 International influence

Governance in an interconnected world

9.1 The dynamics of governance do not occur solely within the boundaries of nation-states. Countries today face an interconnected, globalized world characterized by a high velocity and magnitude of flows of capital, trade, ideas, technology, and people. From 1960 to 2011, the share of global trade in global GDP more than doubled, from 25 percent to over 60 percent.¹ The share of foreign direct investment (FDI) increased from less than 10 percent to over 40 percent from 1992 to 2010.² Meanwhile, the share of foreign debt to global GDP grew from only 11 percent in 1970 to 90 percent in 2010.³ The world is very different from the one in which today's developed countries emerged: cross-border flows were low; they received no aid; they were not subject to a proliferation of transnational treaties, norms, and regulatory mechanisms. For developing countries, the era of globalization and “global governance” presents both opportunities and challenges.

9.2 Globalization can greatly benefit countries in search of sustained and inclusive development. The rapid diffusion of technology and greater access to capital and world markets have enabled annual growth rates of over 7 percent for a subset of developing countries, a previously unfathomable rate of growth that helped lift over one billion people out of poverty from 1981 to 2012 (Spence 2011).

9.3 Globalization can also present great challenges. By making it possible to send money and resources abroad, transnational flows increase the capacity for domestic actors to “opt out” of local bargains (see spotlight 11). These flows have also been associated with a marked rise in inequality within countries, and to a greater vulnerability to global economic crises, such as the 1997 Asian Financial Crisis and 2008 Global Financial Crisis.⁴ Global interactions can undermine domestic social and economic development by exerting power in ways that prevent the adoption of policies fit for the domestic or local context, or by reinforcing preexisting conditions that sustain socially undesirable outcomes. The resurgence of populist politics and its rejection of trade and migration in several Western countries today can be seen as a reaction to these negative effects.

Transnationalism and the domestic policy arena

9.4 The policy bargaining framework discussed in this Report provides a lens for seeing how to maximize the positive impact of transnational flows and international actors to achieve security, growth, and equity. These flows can be critical instruments for enhancing the ability of domestic actors to commit, coordinate, and cooperate to advance development outcomes. But they can also serve to disrupt these functions by confusing expectations, competing with social norms, and undermining citizen-state accountability. Unpacking these effects requires understanding how

¹ Data from the World Development Indicators, referring to the sum of exports and imports of goods and services worldwide.

² Data from the updated and extended version of dataset constructed by Lane and Milesi-Ferretti (2007).

³ Data from the updated and extended version of dataset constructed by Lane and Milesi-Ferretti (2007).

⁴ Bourguignon (2015) and Milanovic (2016) have shown that inequality *among* nations has decreased substantially, while inequality *within* countries has soared, with the exception of Latin American countries, where income inequality has decreased slightly in the past fifteen years.

transnational factors affect contestability in the policy arena, shape the incentives of domestic actors, and influence their preferences to change outcomes.

9.5 At times, international actors enter directly into the policy arena (figure 9.2, panel a). Foreign states, multinational corporations, development agencies, or transnational nongovernmental organizations (NGOs) can gain a seat at the domestic bargaining table as they pursue specific goals or support domestic efforts that are aligned with their interests. However, in most cases, international actors and mechanisms affect the policy arena indirectly.

9.6 International actors can shape the arena in which policy making and contestation occur by creating alternative spaces in which actors can bargain (figure 9.2, panel b). For instance, foreign investors can bring states to the International Centre for the Settlement of Investment Disputes (ICSID) for independent arbitration, rather than rely on legal mechanisms of the host state. Citizens of countries party to the European Court of Human Rights can bring claims against their home state. Several international human rights treaties require states to report and answer to an international expert body. And a vast number of international and transnational forums exist for the development of industry specific rules, monitoring their application, and sanctioning violations to various degrees.

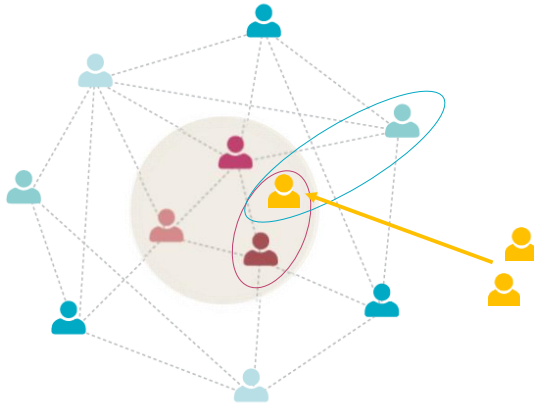
9.7 Transnational flows and mechanisms can change the payoff structure and incentives of domestic actors by providing inducements or threats (figure 9.2, panel c). For instance, conditions attached to foreign aid (conditionality) makes assistance dependent on specific behavior by domestic actors. Similarly, the desire to attract foreign investment can incentivize positive changes in domestic governance. For instance, the pursuit of foreign investment in China and Vietnam spurred institutional improvements for economic management at the provincial level, with greater flows leading to even more institutional reforms (Long, Yang, and Zhang 2015; Dang 2013). International trade agreements, by changing the incentives of domestic actors, can serve as a commitment device. A government may sign a trade agreement to tie its hands in the face of domestic vested interests that might induce it to implement suboptimal policies, such as high tariffs (Maggi and Rodriguez-Clare 1998, 2007).

9.8 International actors and transnational interactions also shape preferences by influencing the ideas and beliefs of actors in the domestic policy arena (figure 9.2, panel d). Improvements in technology, by facilitating greater global connectivity, have helped spread international ideas and norms. Transnational networks of technical experts can play an important role in changing preferences and internalizing new norms through the diffusion of evidence and authoritative expertise.⁵ In China, the National Environmental Protection Agency's (NEPA) interaction with experts brought new perspectives, peer standards, data, and research findings that NEPA drew on to shape the debate over accession to the Montreal Protocol to protect the ozone layer, shifting the views of other political actors and successfully bargaining against more domestically grounded agencies, including the State Meteorological Administration (Economy 2001). Beyond finance and other forms of leverage, development actors can be most influential through the dissemination of knowledge and evidence.

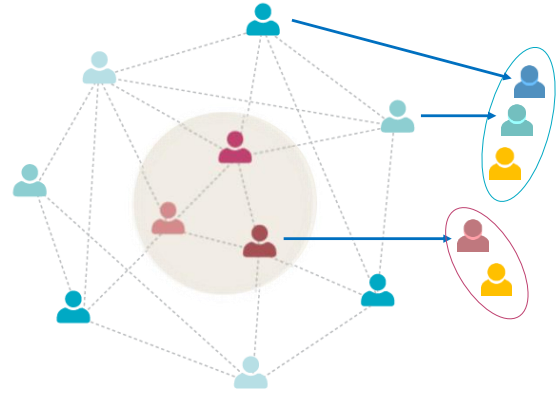
⁵ Haas (1992) describes an epistemic community as “a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy relevant knowledge within that domain or issue-area.”

Figure 9.2 International actors can affect the domestic policy arena by changing the dynamics of contestation, shifting actor incentives, or shaping actor norms

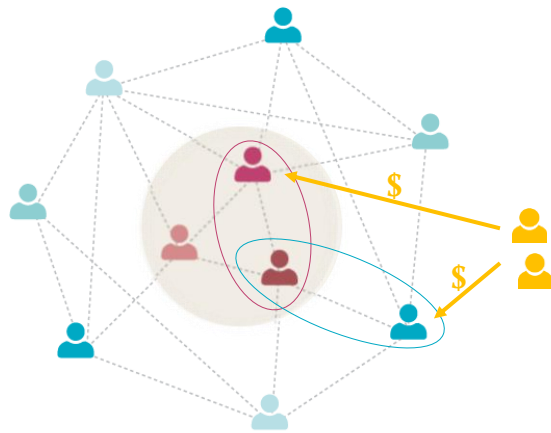
a. International actors can themselves enter the policy arena



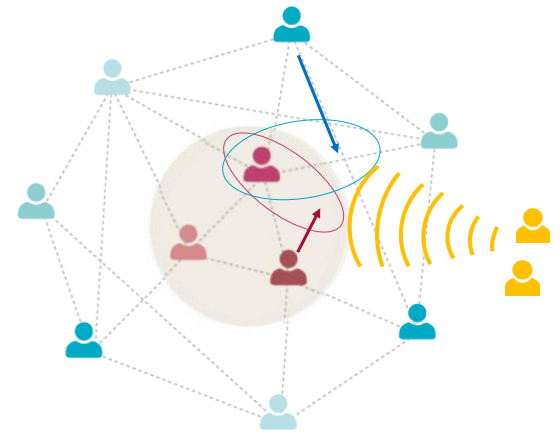
b. International actors can provide alternative sites for contestation



c. International actors can empower or shape the incentives of citizens and/or elites by providing resources



d. International actors can shift the preferences of citizens and/or elites



Source: WDR 2017 team.

9.7 This chapter looks at how international actors can influence domestic governance dynamics through two primary instruments: the introduction and diffusion of transnational rules, norms, and regulations; and overseas development assistance or foreign aid. In discussing both instruments, the chapter focuses on the mechanisms through which these instruments act on the contestability of the policy arena and the incentives and preferences of actors in the arena.

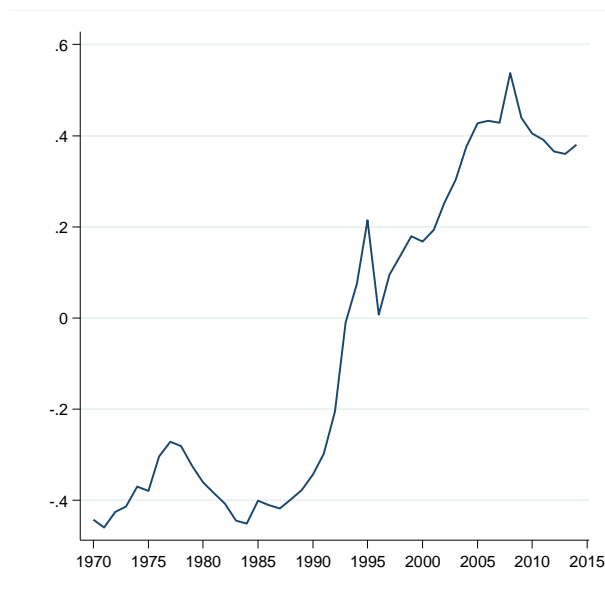
Transnational rules and regulations: Enhanced cooperation and focal points for change

9.8 As the flows across borders expand, so too do the instruments and mechanisms that are used to manage these flows (figure 9.3). Since the late twentieth century, there have been an ever increasing number of international and transnational efforts to govern activities, relationships, and behavior that transcend national frontiers. This is due, in part, to the nature of today’s global challenges—such as climate, finance, and cross-border crime—which require solutions that go beyond the traditional state model of regulation. Unlike traditional international relations, these transnational efforts involve a broad array of actors—nation-states, multilateral organizations, private actors, and advocacy groups—and cover a wide range of issues—business transactions, labor, crime, information management, intellectual property, procurement, utility regulation, human rights, food and safety standards, and environmental sustainability (Hale and Held 2011).

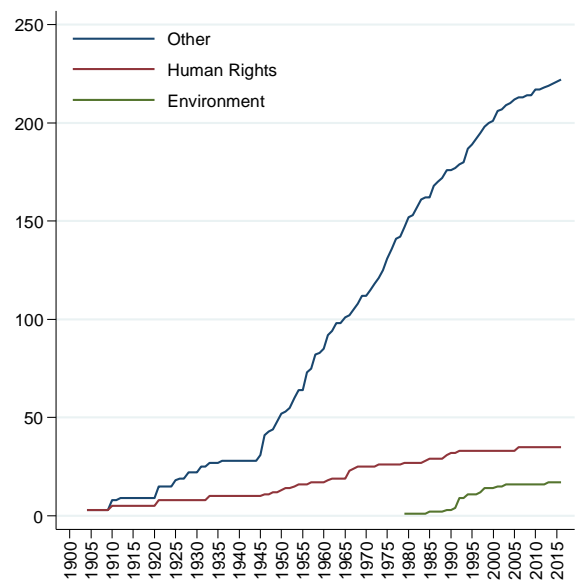
9.9 Much of this proliferation of regulation has been in pursuit of further deregulation, as exemplified by the increasing de jure openness of capital accounts (figure 9.3, panel a). Other regulations and treaties are intended to enhance coordination on issues of global import. For instance, there are now over 1,000 multilateral and more than 1,300 bilateral environmental agreements (Green 2014).

Figure 9.3 Regulations and legal agreements have proliferated across borders

a. Average (de jure) capital account openness across countries



b. Multilateral Treaties Deposited with the United Nations Secretary-General



Source: WDR 2017 team, based on updated database from Chinn and Ito 2006 (panel a) and WDR 2017 team based on United Nations Treaty Collection (2016) (panel b).

Note: The category “Human rights” in panel b refers to treaties related to human rights, human trafficking, refugees and displaced persons, and the status of women.

9.10 The formation and diffusion of this overlapping web of transnational rules mirrors this Report’s framework on a transnational level. The nature and content of each regime is a product of contest among multiple actors with varying incentives, preferences, and relative power. They are institutionalized in some form of instrument, from authoritative/binding legal instruments to nonbinding declarations of norms and voluntary standards and regulatory regimes.⁶ These instruments perform the functions of commitment, coordination, or cooperation through various mechanisms, from coercion to socialization (table 9.1). They might directly target state governments, as do European Union fiscal and monetary rules, or labor and tax standards aimed at avoiding a race to the bottom. They might bypass state governments to directly regulate private actors, as do voluntary industry regimes such as the Roundtable on Sustainable Palm Oil. Or they might reach directly to citizens by legitimating local grievances through international rights and norms (Braithwaite and Drahos 2000; Shaffer 2013).

Table 9.1 Transnational actors, instruments, and mechanisms for influencing domestic governance through incentives, preferences and contestability

Actors	Instruments	Mechanisms
International governmental organizations <ul style="list-style-type: none"> • United Nations (multiple agencies) • International financial institutions • World Trade Organization • International courts and tribunals 	Legal and rule-based instruments <ul style="list-style-type: none"> • International and regional treaties and conventions • International and regional standards, principles, guidelines • Bilateral treaties • Voluntary standards and norm regimes • Contracts • International courts and arbitration mechanisms 	Incentives <ul style="list-style-type: none"> • Coercion (economic, military, political) • Rewards • Reciprocity
Regional organizations <ul style="list-style-type: none"> • European Union • African Union • ASEAN • OECD 	Expert knowledge and evidence	Preferences <ul style="list-style-type: none"> • Knowledge and capacity transfer • Persuasion • Socialization • Demonstration
International nongovernmental organizations <ul style="list-style-type: none"> • Multinational corporations • Professional associations • Advocacy organizations • Epistemic communities 	Public and private capital flows	Contestability <ul style="list-style-type: none"> • Coalition building • Substitution for domestic arena • Empowerment
Domestic actors <ul style="list-style-type: none"> • Government officials • Political actors • Private sector actors • Local civil society groups • Grassroots organizations 	Migration and professional exchanges	
	Security operations	

Sources: WDR 2017 team, drawing on Braithwaite and Drahos (2000); Hale and Held (2011); and Shaffer (2013).

Note: ASEAN = Association of Southeast Asian Nations; OECD = Organisation for Economic Co-operation and Development.

⁶ Transnational rules are similar to what are called “international regimes” in the international relations and international political economy literature. See, for example, Ruggie (1975) and Krasner (1983).

9.11 This chapter next examines how transnational rules interact with the policy arena. First, it looks at rules that seek to achieve international cooperation on global goods by changing incentives. Second, it looks at rules that help induce credible commitment to domestic reform through trade and regional integration incentives. Third, it looks at those rules that serve as focal points for domestic actors to shift preferences and improve coordination to overcome collective action challenges.

International cooperation: Changing incentives to prevent races to the bottom

9.12 In the same way that firms in competitive markets lower prices in order to attract consumers, whenever goods, services, and capital are freely exchanged and move internationally, countries have an incentive to adopt competitive strategies to gain market share or attract investment. To attract productive investments, countries may lower taxes on corporate income for foreign companies. Competition among countries on these forms of taxation has the effect of depleting the domestic tax base and considerably decreasing revenue. It also tends to shift taxation onto less mobile factors, such as labor. In turn, lower revenue means that countries need to shrink spending, with detrimental effects on the well-being of the poorest and least powerful in society. Moreover, competition to boost exports may result in lax labor and environmental standards (Chau and Kanbur 2005). These are examples of *races to the bottom*.

9.13 Once competition pushes countries to a low equilibrium, they have no incentive to change policy. An attempt by one country to raise taxes on goods and services, capital, or corporate income would result in a loss of sales or investments. Any intervention that could enhance employees' welfare or the sustainability of production would also raise costs and hence reduce exports and output. Because of the sensitivity of global capital to domestic adjustments and perceptions of investment risk, policy makers seeking global investment may become largely accountable to external actors, rather than to domestic constituents. For instance, policy makers seeking to increase domestic debt levels to finance an expanded education budget may be prevented from doing so by the fear that international ratings agencies will downgrade their sovereign bond rating, leading to capital flight.

9.14 Global coordination is needed to prevent races to the bottom, underprovision of global public goods, and negative cross-border externalities. International actors can strengthen the commitment capacity of states through agreements on specific issues—such as investment or environmental standards, labor standards, or tax coordination. If all countries coordinate and adopt the same policy, such as international labor standards (Basu and others 2003), they will all be better off. For instance, in parallel with the creation of a common market, the European Union set up a Code of Conduct to prevent countries from engaging in harmful tax competition and to harmonize value added taxes on goods and services, and, less successfully, corporate taxes and capital income taxes.

9.15 Such agreements can strengthen the commitment of countries to specific minimum standards that prevent the occurrence or perpetuation of an undesirable equilibrium. However, in the absence of credible sanctions, incentives to defect are very high. Preventing defection requires a recognition that achieving sustainable agreement is a *two-level game*, involving both an international and a domestic bargaining process (see box 9.1). Ultimately, the preferences and

relative power of relevant domestic actors determine that credibility of commitment and the effectiveness of international sanctions.

Box 9.1 Legitimizing the second best: Governance options for global public goods and the Paris Agreement on Climate Change

Climate change is a global public goods problem. Solving it requires universal participation (all countries need to reduce emissions), but there is an incentive to free ride any agreement. An obvious solution is to have a global governance body ensuring participation of all countries and fair distribution of efforts. From the United Nations Framework Convention on Climate Change (UNFCCC) in 1992 through the Kyoto Protocol in 1997 and the Copenhagen negotiations, international negotiations have tried to create such a framework to decide on a global target for temperature change, country-specific emission targets, and a set of processes to ensure flexibility and compliance.

The Kyoto Protocol failed to achieve universal participation. Developing countries were reluctant to take on commitments that could slow down their economic growth, and many countries were reluctant to expose themselves to possible sanctions from a supranational body (Wiener and Stewart 2003). As predicted by economic theory, in the absence of a supranational governance body, credible commitment was impossible to achieve (Carraro and Siniscalco 1992; Barrett 1994). The 2015 Copenhagen conference was a paradigm shift, moving away from the first-best option of sanctions to a system of “pledge-and-review,” by which countries make unilateral commitments that are reviewed and monitored by the international community (Barrett, Carraro, and De Melo 2015).

This led the way to universal participation in the Paris Agreement, underpinned by 162 unilateral commitments to contribute to global emission reductions. The Agreement also includes provisions to facilitate the adaptation to climate change, support to cope with unavoidable loss and damage, financial flows and financing instruments, and processes for the monitoring and revision of commitments.

The pledge-and-review scheme has two obvious limitations. First, there is no reason to expect that the sum of unilateral commitments will meet the global target of maximum temperature change, and indeed they currently do not meet the goal of the Paris Agreement (limit warming to 2 degrees and make efforts to achieve 1.5 degrees). The hope is that commitment revisions will lead to a progressive increase in ambition (van Asselt 2016). By providing a “ratcheting mechanism” that encourages countries to follow the lead of others in increasing commitments, the Paris Agreement is an important coordination mechanism (Keohane and Victor 2016). But if the problem is one of cooperation—that is, some countries care more than others about climate change than others—then such a cycle of revisions could lead to a stagnation of ambition, or even to a race to the bottom (Nordhaus 2015).

The second limitation is the lack of a compliance mechanism, beyond monitoring that enables “naming and shaming” countries that are not delivering on their commitment (Aldy 2014). But climate negotiations are part of a broader network of agreements: failing to deliver on climate commitments may not lead to direct sanctions, but could have a cost in other areas of cooperation, such as trade or technological cooperation. Nordhaus (2015) suggests that even a minimum trade-related cost for noncompliance would lead to much greater participation and ambition.

While the Paris Agreement is far from an optimal mechanism to govern global public goods (Stiglitz 2015), it is an attractive second-best option building on countries’ self-interest in implementing climate policy actions at the country level (Busby 2016; Keohane and Victor 2016).

Source: Prepared for WDR 2017 by Stephane Hallegatte.

Transnational rules to incentivize credible commitment for domestic reform: Trade agreements

9.16 The desire to attract investment and expand trade can also provide incentives for improvements in domestic governance; international agreements on economic integration can be credible commitments that domestic actors will follow through on economic reforms. The success of the European Union (EU) integration process, for example, demonstrates the power of inducements. Prospective member countries had to change domestic rules to abide by 80,000 pages

of regulations in the *acquis communautaire*. For these countries, the potential economic benefits of joining the EU outweighed any loss of domestic autonomy in specific areas, and the benefits of accession were used by elites to overcome domestic resistance to the required reforms. EU membership contributed to the consolidation of democratic institutions in former dictatorships in the European periphery, such as Greece, Portugal, and Spain in the 1980s and central and eastern European countries in the former communist bloc in the 1990s and 2000s.

9.17 The possibility of accession to the General Agreement on Tariffs and Trade/World Trade Organization (GATT/WTO) has induced considerable domestic reforms in nations that seek to develop through global trade. WTO accession had the strongest growth-promoting effects in countries that undertook deeper commitments as part of their accession negotiations, including China and Vietnam. Moreover, this pro-growth effect of accession was strongest in countries with the weakest domestic governance (Tang and Wei 2009).

9.18 In China, the process of WTO accession at the turn of the millennium led to a major restructuring of the economy toward more market- and rules-based mechanisms, with accession acting as a “wrecking ball” for the closed command economy (Woo 2001; Jin 2002). China’s leadership leveraged foreign competition and external commitment to accelerate domestic reforms, including reductions in tariff and nontariff barriers, market access for foreign firms, and intellectual property protection. China’s commitments to liberalize trade in services have been the most radical of any country acceding to the WTO (Mattoo 2004). The accession helped China’s leadership overcome domestic opposition to reforms, and also signaled to the emerging private sector that reforms were credible. The reforms enhanced the commercial legal environment and forced state-owned enterprises and state-owned banks to restructure and compete on a market basis, facilitating a more modern financial system, and rapid private sector growth (Lardy 2002).

9.19 Another example is the emergence of the Multi Fibre Arrangement (MFA) beginning in 1973 under the General Agreement on Tariffs and Trade (GATT). Under U.S. pressure to protect its domestic clothing industry, the MFA set quotas for textile exports from developing countries, but excluded some of the world’s least developed countries from the quota system. This gave “quota rents” to countries such as Bangladesh, Cambodia, and Tunisia, which could produce more and set prices higher than their competitors. In Bangladesh, this positive shock induced high-level support from President Zia to facilitate institutional innovations, including back-to-back letters of credit and the bonded warehouse, which enabled a transformation of the Bangladeshi economy and an evolution of the elite bargain that determined governance dynamics and political reform (Khan 2013).

9.20 Trade agreements can help achieve commitment to domestic reforms by empowering new domestic actors. For instance, workers at a Nike factory in Mexico succeeded in unionizing by leveraging corporate codes of conduct and transnational advocacy networks that developed following the North American Free Trade Agreement (Rodriguez-Garavito 2005). In Cambodia, a surge in garment exports to the United States following the MFA led to a bilateral trade agreement in 1999 that used export quotas as a mechanism for improving domestic labor standards, giving greater bargaining power to Cambodian workers. Specifically, the United States agreed to increase garment quotas by 14 percent annually if working conditions complied with international standards, and an International Labour Organization (ILO) project was established to independently monitor worker conditions in Cambodian garment factories. This enhanced

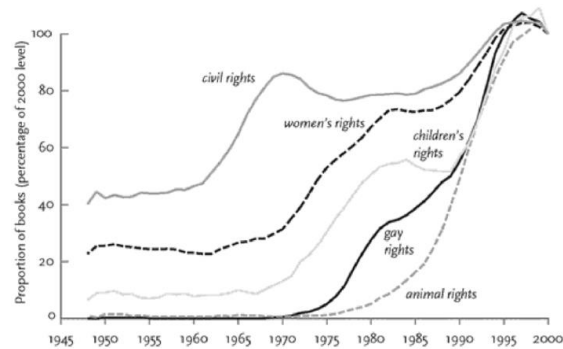
commitment led to significant improvements in freedom of association in the few years following the agreement, with the share of unionized garment workers rising from only 12 percent in 2000 to nearly 50 percent by 2005. (Adler and Woolcock 2009).

Transnational rules as focal points to shift preferences and induce coordination

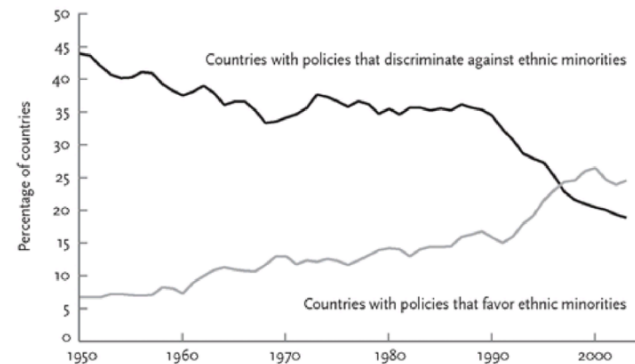
9.21 The past century has seen a “Rights Revolution” through which global treaties and norms have facilitated the spread of the notion of rights (Pinker 2011) (figure 9.5). The examples of international human rights and gender quotas illustrate the ways in which transnational ideas diffuse and the mechanisms through which they affect domestic governance arrangements. While a range of incentives can lead to formal adoption of such norms, they eventually become effective and internalized according to the extent to which they reshape societal preferences.

Figure 9.5 The “Rights Revolution” has led to a global spread of rights-related norms, facilitated and supported by global treaties and agreements

a. Use of “rights” terms in English-language books soared between 1948 and 2000



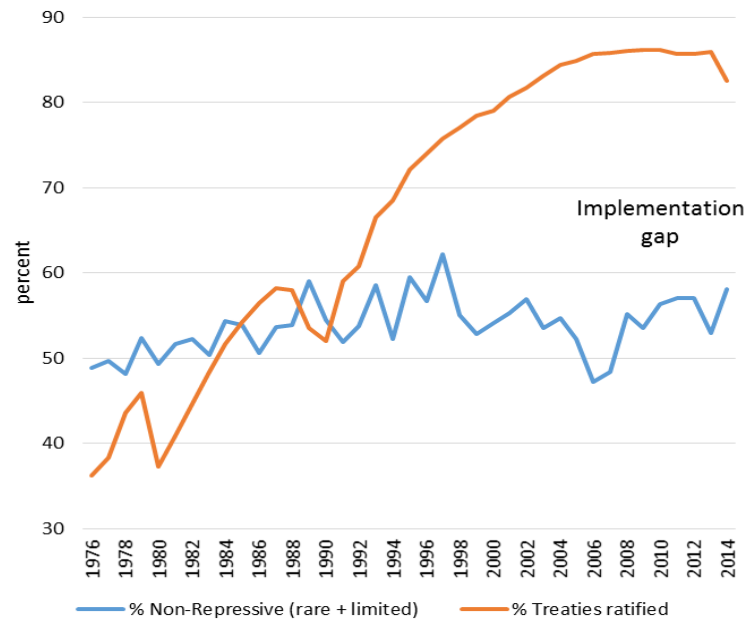
b. More countries have policies helping ethnic minorities than discriminating against them



Source: Pinker 2011.

9.22 Since the passage of the Universal Declaration of Human Rights in 1948, human rights have been increasingly specified and embedded in international treaties, institutions, and organizations. Country adoption and participation have been widespread. However, international treaties are not always effective in changing state behavior and practices. There is a persistent implementation gap between the de jure pledge to protect human rights—measured by states’ ratification of major international human rights treaties and conventions—and actual compliance (figure 9.6). Some scholars argue that human rights are nothing more than “window dressing” or empty promises unable to constrain power or change the behavior of domestic actors (Posner 2014).

Figure 9.6 Human rights treaties are spreading, but de facto changes in state performance are lagging behind



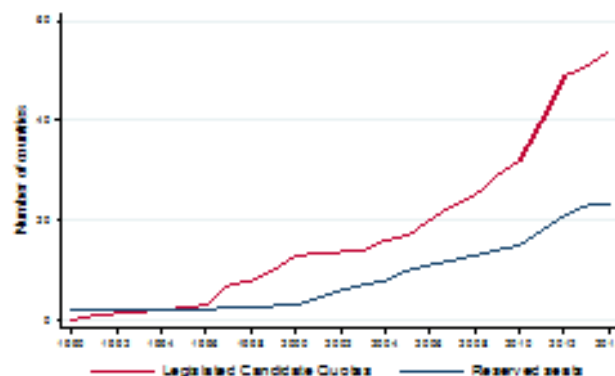
Source: WDR 2017 team, based on Hafner-Burton and Tsutsui 2005. “Percent treaties ratified” measures the percentage out of six core human rights treaties the average state has ratified in a given year. “Percent nonrepressive” measures the percentage of states that reported very rare or limited violations of personal integrity rights in a given year, based on data from the Political Terror Scale (www.politicalterrorscale.org).

9.23 Explaining why state compliance with human rights treaties and conventions varies requires unpacking the interaction between international norms and the domestic bargaining process. Once signed, international treaties “empower individuals, groups, or parts of the state with different rights preferences that were not empowered to the same extent in the absence of the treaties” (Simmons 2009, 125). By referring to international norms, ordinary citizens and disadvantaged groups that are otherwise weak can strengthen the legitimacy of their claims and successfully challenge prevailing norms, putting pressure on governments to transform state institutions and reform public policies. Elite resistance often increases the incentives for domestic actors to build transnational alliances to support their claims. Often referred to as the “boomerang effect,” this dynamic process increases the costs for state actors to resist change and eventually leads to compliance (Keck and Sikkink 1999). The experience of human rights struggles in Latin America countries during military dictatorships illustrates this point, as well as the mobilization against the apartheid government in South Africa. Indeed, the most transformative cases of social movements of the twentieth century—including labor rights, women’s rights, and civil rights, and, more recently, indigenous and environmental movements—have all explicitly adopted the language and instruments of international rights (Heller 2013).

9.24 Over the past 25 years, different forms of gender quotas for representation in national legislatures—including legislated quotas, reserved seats, and voluntary party quotas—have spread

to more than 100 countries around the world (figure 9.7).⁷ These new provisions have helped double the percentage of women in the lower house of national legislatures from approximately 10 percent in 1995 to 22 percent in 2015 (Norris and Dahlerup 2015). Quotas for women in local government positions, as in India, are also increasingly common.⁸ Domestic social movements and left-leaning political parties were especially influential in the case of early adopters, mainly European countries that introduced voluntary party quotas in the 1980s (Ramirez, Soysal, and Shanahan 1997). In contrast, international nongovernmental organizations and multilateral organizations have become increasingly influential for late adopters among developing countries, especially in the case of post-conflict countries largely dependent on international assistance (Krook 2006; Celis, Krook, and Meier 2011).

Figure 9.7 Gender quota laws have spread worldwide since 1990



Source: WDR 2017 team based on Polity IV data, Norris and Dahlerup 2015, and gender quota project <http://www.quotaproject.org>.

Note: The figure only includes quotas introduced at the nation level. Moreover, it does not include voluntary party quotas (adopted in 32 countries) as the adoption year varies across parties in a given country.

9.25 These processes of international norm diffusion interact with domestic factors to strengthen the bargaining power of women's organizations and improve their capacity to influence constitutional reforms and lobby for the adoption of gender-sensitive policies. Many countries, however, still face important challenges in closing their implementation gap and achieving the target level of political participation for women as defined in the quota laws. The gap is larger in the case of legislative quotas. While this might be in part reflect overly ambitious targets, the short time since the adoption of the quota, and the weakness of mechanisms to sanction noncompliance, evidence suggests that social norms also play a role. In Spain, for example, a recent study shows that political parties nominate female candidates in seats where they had little chance to be elected, to reduce risk of losing decision-making power within the party (Esteve-Volard and Bagues 2012).

⁷ Legislated gender quotas and reserved seats are typically introduced through changes in electoral laws or the constitution, while voluntary party quotas are adopted by individual parties committing to a specific share of women among their candidates.

⁸ About 40 percent of the world's countries have some form of gender quota, according to the 2016 Women, Business and the Law database. In particular, 73 countries have quotas at the national level, and 65 countries have quotas at the local government level (World Bank 2015). Some countries have quotas at both the national and local levels; others have one but not both. For example, India adopted a quota at the local level but not at the national level.

Major shocks—such as conflict—can speed up the process of changing norms and create new windows of opportunity for disadvantaged groups. In other cases, a process of “policy learning” occurs; initially ineffective quotas laws have been revised to improve their effect on de facto political representation for women (Norris and Dalerup 2015).

Foreign aid and governance

9.26 Since the end of the Second World War, foreign aid has been one of the most prominent policy tools used by high-income countries to promote security, growth, and equity in low-income countries.⁹ Primarily intended to fill capital shortfalls, official development assistance (ODA) has become a means to affect a range of developmental, humanitarian, strategic, and commercial purposes. In addition to finance, aid includes the transfer of knowledge, expertise, and ideas intended to influence norms, capacity, and power (box 9.2). Between 1960 and 2013, member-countries of the Organisation for Economic Co-operation and Development (OECD) that are also members of the Development Assistance Committee (DAC) provided some \$3.5 trillion (in constant 2009 U.S. dollars) in aid. Non-OECD economies are an increasingly important source of aid: in 2014, the flow of aid to developing countries from both DAC and non-DAC contributors amounted to over \$161 billion in 2014 (map 9.1). While aid has ebbed and flowed over time, its significant increase over the past two decades coincides with the establishment of the Millennium Development Goals, as well as with the surge in flows toward conflict-affected countries in the aftermath of the Cold War.¹⁰ Still, few donors have met the official development assistance (ODA) target of 0.7 percent of gross national income (GNI) first agreed in 1970.

Box 9.2 Aid as a delivery mechanism for transnational rules and ideas

Development actors, especially the international financial institutions, have been among the most influential generators of transnational rules, norms, and ideas, using aid as a diffusion mechanism. Just as economic orthodoxy has evolved over time—from an emphasis on the role of the state in planning and investment in the 1960s and 1970s, to the macroeconomic discipline and market liberalization of the Washington Consensus in the 1980s, to poverty alleviation and market institutions in the 1990s, to achievement of the Millennium Development Goals and improvement of governance institutions in the 2000s—so too have aid modalities evolved in search of more effective means of translating these norms into development outcomes.

Ex ante conditionality. Structural adjustment lending policies in the 1980s marked the high point of *ex ante* conditionality: that is, aid transfers made only upon the recipient’s adoption of preset conditions. This has been largely regarded as a failure because of the ineffectiveness of conditional loans to act as a commitment device. In theory, the threat of nondisbursement, or reward of disbursement, was an incentive to government actors to overcome obstacles to reform because of either opposing objectives or domestic political economy factors. While *ex ante* conditionality could sometimes strengthen the hand of reformist governments who needed to swing domestic opinion behind these changes, it proved ineffective in changing incentives and preferences of opposing elites (Collier and others 1997). This was due in large part to the lack of a credible threat and the time consistency problem: more often than not donors submitted to pressures to disburse despite the failure of recipients to meet the prescribed conditions (Kanbur 2000; Killick 1997). More fundamentally, the content of the prescribed conditions were often politically unfeasible, since they sought to disable the systems of patronage needed to hold coalitions together (Mbembe 2001). In short, the diffusion of norms through coercion was incapable of changing the much stronger dynamics of the domestic bargaining arena (Temple 2010).

⁹ Foreign aid refers to official development assistance as defined by the Organisation for Economic Co-operation and Development (OECD).

¹⁰ This increase in foreign aid has accompanied the steep rise in peacekeeping operations in the 1990s, and the post 9/11 interventions in Iraq and Afghanistan.

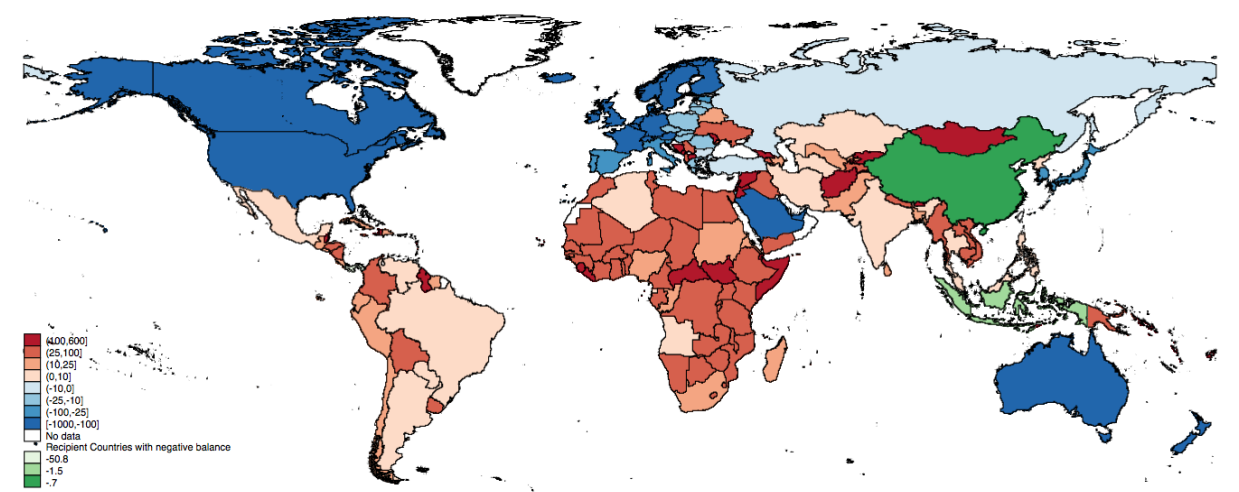
Ex post conditionality. In the 1990s, ex ante conditionality was largely replaced by aid modalities that encompass principles of partnership and ownership, on the theory that aid will be more effective in good policy environments (World Bank 1998; Dollar and Burnside 2000). Many donors adopted a form of ex post conditionality, under which aid in the form of budget support (mostly unconditional funds) was directed to countries that themselves adopted good economic and governance policies. While aid still served as an incentive, its primary role was to amplify reform efforts and maximize poverty reduction by selecting places most likely to achieve results. A further feature has been the emphasis on social participation in the development of policies, as introduced in the Poverty Reduction Strategy Paper (PRSP) process, as a means of enhancing the contestability of the policy arena. These developments have also been subject to criticism, most notably around the imperfect science of measuring institutional performance for purposes of aid allocation, and the questionable concept of “ownership,” given the power imbalance both between donors and recipients and between government elites and other domestic constituencies (Wilhelm and Krause 2008). At worst, this can give rise to enhanced legitimacy for governments that go through the motions of “ownership,” while in fact cutting off space for local contestation and innovation. Some question the extent to which this method improves on the flaws of ex ante conditionality).^a

Outcome-based conditionality. The most recent generation of aid instruments seeks to overcome the difficulty of influencing the bargaining arena to yield “good” policies by focusing instead on outcomes. Donors have introduced a range of results-based approaches, such as the World Bank’s Performance for Results instrument (PforR), which disburses upon achievement of results according to agreed performance indicators. This outcome-based conditionality is particularly suited to social sector outcomes such as those set out in the Millennium Development Goals. In theory, by setting clearly defined objectives, indicators, and verification protocols for programs initiated by the government, this method seeks to enhance government accountability to its own goals (Temple 2010). Another noteworthy development is the New Deal for Engagement in Fragile States, which established a mutual compact between OECD (Organization of Economic Cooperation and Development) donors and a group of fragile states known as the g7+ to support country-led strategies based on a set of overarching peace-building and state-building goals.

Source: WDR 2017 team.

a. Van de Walle 2005; Craig and Porter 2003; Andrews, Pritchett, and Woolcock 2013.

Map 9.1 Aid flows amounted to over \$161 billion from donor countries (blue) to recipient countries (red and green) in 2014

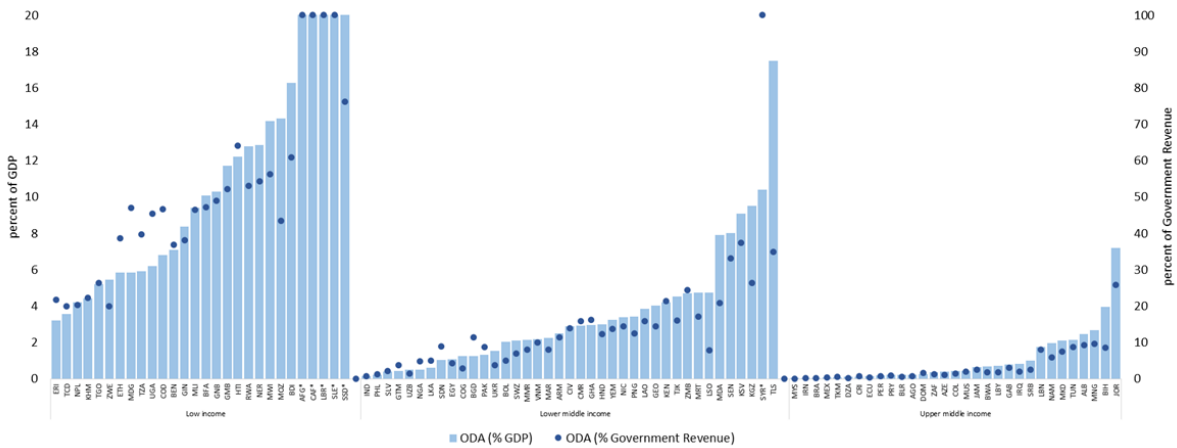


Source: WDR2017 team on data from OECD.

Note: Data are on a per capita basis, as of 2014. Shades of red denote recipient countries. Shades of blue denote donor countries. The darker the country, the higher the amount of aid received or transferred. Green countries (China, Indonesia, Panama) are recipient countries where payment of debt to donors is higher than aid received.

9.27 While the volume of aid is increasing, its share relative to flows of private capital and other sources of finance is decreasing. In middle-income countries, aid makes up a median of only 1.9 percent of GDP, compared to 9.6 percent in low-income countries. Foreign direct investment—largely reflecting new and increased exploitation of natural resources—and remittances have overtaken aid as a percentage of GDP in 21 out of 43 African countries with available data¹¹. Nevertheless, aid represents more than 10 percent of GDP for half of all low-income countries, and over 30 percent of total revenues for approximately 40 countries (figure 9.8b).

Figure 9.8 Aid is a large share of GDP and revenue in many developing countries

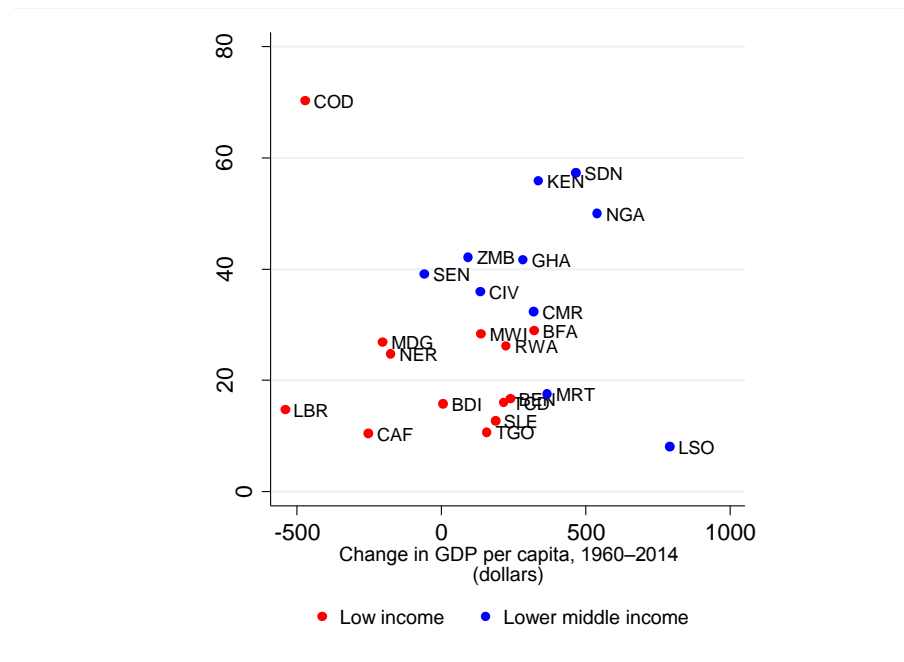


Source: WDR2017 Team on OECD data (ODA) and IMF, Economic Outlook, for General Government Revenue

Note: ODA from all donors, to all recipients in low and middle income countries with a population of at least 1 million individuals. Figures for ODA (% GDP) are capped at 20 percent of GDP for sake of visualization. The underlying uncapped data are AFG (24.1), CAF (35.4), LBR (37.0), MWI (21.8). Figures for ODA (% Government Revenue) are capped at 100 percent for sake of visualization. The underlying uncapped data are AFG (105.2), CAF (260.6), LBR (126.0), SLE (143.2).

9.28 A look at the impact of more than five decades of development aid on growth, equity, and security shows great variation across regions and countries (figure 9.9). As this Report explores, aid has to be understood as it interacts with existing domestic power imbalances and in terms of how it affects the decision-making processes and the allocation of resources. Some groups and actors are better positioned to channel foreign aid flows to their benefit or to that of their constituencies, whether in government or outside, and thus strengthen their position of influence. In this way, aid, like other resources, can reinforce or offset existing power imbalances, thus resulting in heterogeneous outcomes when it comes to growth and equity, depending on the specific context.

¹¹ WDR2017 team based on data from OECD (for ODA); World Bank Africa Development Indicators (for FDI/GDP); World Bank World Development Indicators (for GDP and remittances/GDP). FDI and remittances refers to the latest available data point

Figure 9.9 There is great variation in the amount of aid received and improvement in GDP per capita

Source: WDR 2017 team.

Note: Dollar amounts in the x-axis are in constant 2005 U.S. dollars, while those in the y-axis are in constant 2013 U.S. dollars. ODA = official development assistance.

Understanding the impact of aggregate aid flows on governance

9.29 Two decades ago, an influential study concluded that the link between aid and growth is much stronger in countries with sound policy and institutions, leading to calls for donors to target assistance to those states that could demonstrate good governance (Burnside and Dollar 2000).¹² But what effect can aid have on governance? This question has been the subject of considerable debate among leading scholars, spawning an array of attempts to empirically measure whether aid in the aggregate promotes or undermines the quality of institutions in recipient countries. Some of the pessimists, including Deaton (2013) and Easterly (2006), claim that large amounts of aid can deepen pathologies in countries with poor governance.¹³ Conversely, the optimists argue that aid can help overcome resistance to good policies and support the development of political institutions, including democracy.¹⁴ Unfortunately, the evidence belies clear answers, in large part due to inherent methodological flaws, including the fact that aid aggregations lump together different sources (bilateral and multilateral); different modalities (budget support, project finance, technical assistance); different desired outcomes (development, democracy, humanitarian relief); and different local contexts. Ultimately, aid is neither inherently good nor bad for governance. What

¹² See also World Bank (1998). The findings of Burnside and Dollar (2000) have been called into question by Easterly, Levine, and Roodman (2003).

¹³ This leads to the unsettling view that “when the ‘conditions for development’ are present, aid is not required. When local conditions are hostile to development, aid is not useful, and it will do harm if it perpetuates those conditions” (Deaton 2013). See also Easterly (2006).

¹⁴ See, for example, Goldsmith (2001); Dunning (2004); Wright (2009); Dietrich and Wright (2013).

matters is how aid interacts with prevailing domestic context and which groups or actors see their influence enhanced.

9.30 While empirically inconclusive, the literature converges on a set of analytical arguments that shed light on the conditions under which aid can have a positive or negative impact on governance. Studies of aid in the aggregate include large amounts of bilateral aid, which has historically been used to project a dynamic mix of the donor’s strategic, commercial, and programmatic priorities. Significant correlations have been documented between the allocation of aid and a range of donor interests, including former colonial ties, voting record in the United Nations, business opportunities, and supply-side factors such as food surplus (Alesina and Dollar 2000; Qian 2015). In inherently unstable or institutionally fragile environments, the multiple purposes often projected through ODA—stability, security, humanitarian assistance, state-building—frequently have contradictory and—most often—unintended effects (Paris and Sisk 2007). When aid is granted without taking the development objective of the recipient country as the priority, it is more likely to have negative effects on governance

9.31 Another argument focuses on the high potential for aid funds to be misused by those in power, whether through outright embezzlement (perhaps best illustrated by the case of Mobutu Sese Seko, former dictator of Zaire, known to have appropriated \$12 billion in aid money) or by diverting aid money—or government funds freed up by the injection of aid money—to nondevelopmental aims that reinforce extractive, patrimonial, and exclusionary power structures (Ahmed 2012; Deaton 2013). Several econometric studies have found a negative correlation between high levels of aid and the accountability of political institutions.¹⁵ This risk is increased where aid is unconditional, and where political elites do not face organized opposition (Acemoglu, Robinson, and Verdier 2004).¹⁶ Some have argued that large amounts of aid may encourage political instability and coup attempts, as individuals and groups vie for the opportunity to control aid-financed assets (Grossman 1992).

9.32 Underlying these arguments is the claim that aid can undermine the relationship between the state and its citizens by making the state less responsive to their demands. The more the state relies on revenues from the international community, the fewer incentives it has to build the public institutions necessary to mobilize domestic revenues through taxation. And the less that states rely on their domestic tax base, the more state-citizen accountability erodes (Moore 2004). Aid has thus been likened to the natural resource curse: a windfall of unearned income that enables irresponsible government spending and behavior, unconstrained by the kind of state-citizen social contract thought to lie at the heart of modern democracies.¹⁷ But the empirical evidence linking aid flows to domestic taxation is mixed (box 9.3).

¹⁵ Among the cross-country studies that find a negative correlation between aid and governance quality are Brautigam and Knack (2004), Rajan and Subramanian (2011), Moss and others (2006), Djankov, Montalvo, and Reynal-Querol (2008), Bueno de Mesquita and Smith (2009), and Busse and Gröning (2009).

¹⁶ But see Tavares (2003).

¹⁷ The “aid curse” argument is made by Collier (2007), Moss, Pettersson, and van de Walle (2006), and Djankov, Montalvo, and Reynal-Querol (2008).

Box 9.3 The impact of aid on domestic resource mobilization: What does the evidence say?

There is a growing consensus that increasing domestic resource mobilization can enhance accountability, particularly if such efforts are explicitly linked to the provision of public goods. If policy makers need to depend on broad-based taxation—or indebtedness, which implies more taxation in the future—they are more likely to include citizens and elites in policy discussions. The need for revenue to finance wars led European states to bargain with subject populations for greater taxation (Tilly 1990). Once taxed, citizens demand a greater say in state affairs: as 18th century American colonists claimed, “taxation without representation is tyranny.” More recently, paying taxes has been shown to increase political interest in Sub-Saharan Africa (Broms 2015).

Does foreign aid undermine domestic resource mobilization—and hence accountability to citizens? Studies testing that hypothesis initially showed a negative correlation between the two (most notably Gupta and others 2004). More recently, these studies have been refuted by the adoption of different datasets (Morrissey and Torrance 2015) or econometric techniques.^a Although the behavioral effect of aid flows undermining accountability has been tested and isolated in experimental settings (Martin 2014; Paler 2013), in reality the relationship is more complex and seems to depend on three factors: the type of aid (for instance, whether it is grant or debt; budget support or project specific); the contemporaneous effects of policies associated with the aid; and, more importantly, the governance setting specific to each country.

The effects of domestic resource mobilization also depend on the nature of taxation. Some taxes do not to enhance accountability (resource taxation) or may have distortionary effects (trade taxes). International corporate tax competition has diminished states’ capacity for domestic resource mobilization (see earlier discussion on races to the bottom). In environments with low savings rates or the potential for capital flight and tax evasion, consumption taxes are most likely to be effective, but also likely to be regressive. In 9 out of 25 countries with available household survey data around 2010, the net effect of all governments taxing and spending was to leave the poor worse off in terms of actual consumption of private goods and services (Lustig 2016).

a. Clist and Morrissey (2011) invalidate the contemporaneous negative correlation found in Gupta and others (2004) by introducing a lagged effect of aid on taxation, concluding that the relationship is negligible.

Aid and the policy arena: Incentives, preferences, and contestability

9.33 A growing theoretical and empirical literature examines how development projects interact with the policy arena to produce three possible outcomes on governance: no effect, negative effect, or positive (generative) effects.

9.34 The first category includes projects that—intentionally or not—miss opportunities to reshape elite incentives and preferences. Projects that deliver goods directly, and thus circumvent government systems, may succeed in the immediate effort (and indeed this can be a worthy result), but may have little to no effect on the quality of governance. Some community-driven development initiatives fall into this category.¹⁸

9.35 Projects that aim to directly improve governance arrangements, such as public sector reform or demand-side initiatives, may end up creating negative dynamics by providing incentives that reinforce preexisting power imbalances. The tendency of donors to introduce reforms based on “best practice” solutions that worked elsewhere, with an expectation that tight monitoring of top-down implementation will yield similar results, has been seen as an example of “isomorphic mimicry,” a term drawn from organizational sociology (DiMaggio and Powell 1983). These

¹⁸ See Casey, Glennerster, and Miguel (2012), King (2013), Humphreys, Sanchez de la Sierra, and Van der Windt (2015), Wong (2012), and Mansuri and Rao (2013).

reforms focus on forms—such as laws, systems, and procedures—without attention to how they change the nature of the policy arena. This practice can create “capability traps” when recipient governments adopt these forms in order to ensure flows of donor financing and reap legitimacy gains, while evading more fundamental reforms to make the functioning of institutions more effective. Not only does this leave recipients with unsustainable and dysfunctional institutions; it may also cut off room for local innovation and collective action (Pritchett, Woolcock, and Andrews 2010; Andrews, Pritchett, and Woolcock 2013).

9.36 Positive effects are also possible when donor engagement supports the emergence of more accountable and equitable governing arrangements embedded in the domestic context. Certainly many projects do succeed in doing so, but when and how generative effects take place, is difficult to predict in advance, given the web of intersecting and evolving factors that determine how donor initiatives engage with local spaces—including the vagaries of internal politics, shocks of various sizes and effects, and a range of contextual factors. Many people have been trying to think “politically” about aid, in order to overcome challenges to its effectiveness (box 9.4). A burgeoning literature on ways to increase the chances of generative outcomes points to a common set of principles, which are discussed next.

Box 9.4 Beyond technocratic approaches: Opening the door to considerations of politics and power in development policy

The past ten years have seen a striking rise in discussions of politics and power in development policy circles. This new focus reflects a reaction against technocratic approaches that rely on the provision of capital and injections of technical know-how to overcome developmental challenges. It grows out of the evolution of governance programming, which encountered serious limits after emerging in the 1990s when well-intended efforts to strengthen governance institutions in poor countries encountered entrenched resistance to reform and other structural obstacles.

One result has been the progressive incorporation of political economy analysis by many development organizations and practitioners as a basic tool of program design. Debates over how much the growing use of political economy analysis is actually resulting in more effective development programs remain heated, but few organizations are now willing to argue that attempting to operate in complex, challenging, and diverse national contexts does not require at least some concerted efforts to understand the local political economy of reform—who are the winners and the losers, and who holds the balance of power in such processes.

Potentially much deeper change involves establishing new types of development programming that embody the recognition of development as an inherently political process—one that consists, in the words of the late Adrian Leftwich (2004), of “conflict, cooperation and negotiation in taking decisions about how resources are to be owned, used, produced, and distributed.” Adherents of the “Doing Development Differently” manifesto emphasize the importance of focusing on local solutions advanced by local conveners in processes legitimized at all levels, while proceeding through rapid cycles of planning, action, and reflection and managing risks by making small bets. The Developmental Leadership Program stresses the importance of leadership in development, defining leadership as a political process involving authority and capacity to mobilize people and resources and to forge coalitions. The recently launched Global Partnership on Collaborative Leadership for Development seeks to put leadership and coalitions at the center of development, while the Global Delivery Initiative is developing an evidence base for using principles of the science of delivery. At the U.K. Department for International Development, giving serious attention to how political settlements are established and sustained in fragile states is a central element of politically smart development work. An informal coalition of practitioners organized under the rubric of “Thinking and Working Politically” aims to advance innovative efforts to move politics and power from the margins to the core of development thinking and action. This entails ensuring that attention to these issues extends well beyond their original home in governance work to all major areas of development practice, from health and education to transportation, food, and others.

A strong sense of “at last” accompanies this push to take politics in development seriously—relief that outdated, artificial walls created in the early days of development assistance are finally being dismantled. Yet changing developmental practice is hard. Many of the operational imperatives that arise from greater attention to politics and power—such as the need to increase flexibility of implementation, tolerate greater risk and ambiguity, devolve power from aid providers to aid partners, and avoid simplistic linear schemes for measuring results—run up against long-established bureaucratic structures, practices, and habits. In addition, taking politics seriously in development points directly to the need to challenge the interests of the power holders that control institutions— something that many development organizations have still not yet decided they are willing to do, especially in the current global environment of heightened sensitivity in many countries over national sovereignty. The development community is talking the talk of politics. How much it will walk the walk is not yet clear.

Source: Prepared for WDR 2017 by Thomas Carothers, Vice President for Studies, Carnegie Endowment for International Peace.

Using aid to foster positive governance dynamics for development

9.40 That development is an inherently contentious process that implicates power imbalances and social norms is not a new insight. Hirschmann documented this most eloquently in the case of World Bank projects in his 1967 classic, *Development Projects Observed*. Building on the literature and knowledge base that has emerged over the past few decades, the framework explored in this Report points to the following four principles to guide efforts to use aid in ways that foster positive governance dynamics for development outcomes.

Diagnose the underlying functional problem

9.41 As discussed in chapter 2, diagnoses of development problems—and proposed prescriptions—often focus on proximate causes. *The World Development Report 2015 (Mind, Society and Behavior)* called for expanding diagnostic methods to identify individual psychological, behavioral, and social obstacles underlying development problems. This Report has emphasized the need to understand the underlying governance challenges that hinder the adoption and implementation of policies that can improve security, growth, and equity outcomes. Diagnostic approaches should hone in on the specific commitment and collective action problems that stand in the way of achieving outcomes, and on the ways that power asymmetries in the policy arena constrain these functions.

Target development cooperation in ways that overcome obstacles in the policy arena

9.42 There are times that it is most appropriate for aid to steer clear of the policy arena so as to deliver direct benefits to populations in need. Emergency and disaster response, humanitarian aid, and in some cases direct service delivery may warrant aid approaches that work in parallel to domestic governance.¹⁹ However, where aid is intended to support sustained improvements in development outcomes, the most important role it can play is to facilitate changes in the policy arena that will alleviate existing constraints to the adoption and implementation of development-oriented policies. As emphasized in this Report, this means focusing on three key levers of change: incentives, preferences and contestability.

9.43 The use of financial forms of aid as an incentive to influence the policy arena is discussed in box 9.2. Beyond providing monetary support, aid in the form of technical assistance, analytical

¹⁹ But even these interventions can have significant indirect impacts on governance in both negative and positive ways.

expertise, and knowledge sharing can be a powerful means of changing preferences, especially where it enables internal debate and adaptation. Supporting the generation of evidence about the effectiveness of policies and making such evidence publicly available in transparent ways is a way to enhance informed public debate about policy (Devarajan and Khemani 2016; Banerjee 2007).

9.44 Our understanding of the role of aid in promoting contestability is at an earlier stage. The last decade has seen a proliferation of demand-side, participatory, and multi-stakeholder donor-funded aid initiatives under the rubrics of social accountability, legal empowerment, open governance and transparency and citizen engagement. Evaluations of such programs have pointed to the need to strengthen information dissemination and bottom-up approaches, but also to focus on creating enabling environments that activate collective action and promote commitment to respond (Khemani and others 2016; Fox 2015).

9.45 Time frames are critical. Ultimately, aid can only nudge or accelerate a development trajectory that is determined by a complex set of intricately connected, self-reinforcing factors. Indeed, when pursuing development aims that confront deep vested interests or threaten a delicate stability, it may be ill-advised to use aid in ways that disrupt existing agreements in the policy arena. While interventions may have little impact within a project lifespan, they can aim to set in motion a collective dynamics that, over time, will reduce power asymmetries, effectively change incentives, and reshape preferences. Attention to the dynamics of elite bargains, as discussed in chapter 7, can help identify strategic opportunities to invest in ways that align with the interest of influential groups and also bring other actors into the policy arena, enhancing the adaptive capacity of societies in more inclusive ways.

Anticipate opposition, shifting interests, and unintended consequences

9.47 In the last few years, development practitioners have seized on a principle long established in organizational change literature: that complex problems require solutions based on incremental and adaptive efforts supported by strong learning feedback loops (see box 9.4). This is particularly important in recognition of the reality that efforts to change the policy arena will often trigger opposition and backsliding, and may yield unanticipated consequences—both positive and negative. It should be assumed that reform progress will not be linear, that adaptations will be necessary, and that domestic coalitions for reform must be supported to reduce the risk of reversal.

9.48 Applying this in practice requires not only particular skillsets and methodologies, but most importantly an enabling environment within development institutions. Several multilateral and bilateral organizations are exploring ways the development community can implement internal reforms, with the aim of having more agile, flexible and adaptive projects. Partnerships such as the Global Delivery Initiative also look at the methodologies and approaches available for development practitioners to work more adaptively through citizen engagement tools and feedback mechanisms, information and communication technologies (ICT), and real-time practitioner exchanges in order to overcome complex problems, such as those faced during governance projects.

Look beyond traditional aid modalities

9.49 The declining role of overseas development assistance relative to other forms of capital

and the inherent limitations of the traditional foreign aid model to many of today's challenges call for a broader approach to achievement of the Sustainable Development Goals. As discussed in this chapter, the increasingly complex and interconnected realm of transnational rules, agreements, and regulations driven by both public and private actors has significant influence on domestic governance and the achievement of development outcomes. International actors should enhance efforts to engage on "the two-level game"—using transnational coordination and commitment devices backed by promotion of incentives, preferences, and contestability in the domestic policy arena to help achieve security, growth, and equity goals.

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Spotlight 11 Illicit financial flows

S9.1 In early spring 2016, the leak of a set of 11.5 million confidential documents from a Panamanian law firm was breaking news worldwide. These documents, referred to as the Panama Papers, contained information on the assets held in offshore companies by wealthy individuals, including policymakers, in more than 40 countries around the world. While holding assets in a tax haven may not be illegal, the prevailing sentiment expressed in newspaper articles, and reaction from the public, has mainly been that of condemnation and criticism of a practice interpreted as powerful economic and political elites concealing taxable income from domestic fiscal authorities, with the assistance of the financial systems of many developed countries.

What are IFFs?

S9.2 These secret accounts are one of the manifestations of what has come to be known as illicit financial flows (IFFs). There are varying definitions of IFFs and two leading interpretations of what makes these financial flows illicit.¹ The normative interpretation suggests that financial flows become illicit “not only because they hinder development, but also because they are deemed illegitimate from the perspective of an existing consensus about the social (developmental) good” (Blankenburg and Khan 2012: 32). The legal interpretation, upon which the empirical literature on IFFs is predominantly built, suggests that IFFs refer to money that is earned, transferred, or used in contravention to existing law. In some cases, this could mean money that is legally earned, but is transferred out of the country illegally to evade taxes or currency controls. There are many different sources of illegally earned IFFs, ranging from drug trafficking to embezzlement. The types of IFFs can be classified based on whether the actors involved are criminal organizations, individuals, or corporations (Jaský 2013). Table S9.1 presents a few examples.

Table S9.1 Different actions generating Illicit Financial Flows

		Source of earnings	
		Money legally earned	Money illegally earned
Actors involved	Criminal organizations		<ul style="list-style-type: none"> • Drug trafficking • Human smuggling
	Individuals	<ul style="list-style-type: none"> • Tax evasion • Evasion of currency controls 	<ul style="list-style-type: none"> • Corruption • Embezzlement
	Corporations	<ul style="list-style-type: none"> • Tax evasion • Profit shifting 	<ul style="list-style-type: none"> • Violation of intellectual property rights • Illegal exploitation of natural resources

Source: WDR2017 team.

S9.3 Although estimates of the size of IFFs are controversial (UN 2015), there is consensus among development scholars and practitioners that IFF outflows on average actually exceed official development assistance in developing countries (Herkenrath 2014).

¹ See Epstein (2005: 7). For a recent review of the different definitions found in the literature, see Tropina (2016).

Rethinking our approach to IFFs

S9.4 IFFs deprive developing countries of resources that could be at least partially used for redistribution, to finance public goods, and to foster private investments in local businesses. In doing so, IFFs support existing inequalities and are particularly detrimental to the poor. IFFs are also deeply connected to the governance process. Corruption and embezzlement thrive in environments of low accountability to citizens, and, in turn, weaken trust in state institutions. Tax evasion—a manifestation of a lack of cooperation in society—is fuelled by a lack of commitment of the state to use resources for the delivery of public goods, and, in turn, undermines the outcome legitimacy of the state, which is based on the delivery of public services. Criminality also flourishes in environments where trust is low and where the state fails to provide the means for large population groups to effectively participate in the legitimate economy.

S9.5 The WDR 2017 framework can help to shed light on how to think about approaching reforms to combat IFFs.

Think not only about the form of institutions, but about their functions

S9.6 As discussed in chapter 1, importing forms is not enough to change the facts. Kenya is often cited as a major destination for the proceeds from piracy in the Indian Ocean and a key transit point for terrorist funds to neighboring Somalia. With the aim of fighting illicit financial activities, especially money laundering and terrorism financing, Kenya established the Financial Reporting Centre (FRC) in 2012. While creating this Centre enabled the country to get off the Financial Action Task Force's (FATF) list of countries that might be sanctioned for noncompliance, little seems to have changed.^{2,3} There is substantial evidence of high-level corruption in the government of that time, yet no cases have been brought against senior officials as a result of violations of the money laundering regulations. To make the Centre meaningful, the administration would have had to pursue many of its own senior members.

Think not only about capacity building, but about power asymmetries

S9.7 The lack of capacity of developing countries in managing complex laws and regulations is often stressed as the cause for difficulties in curbing IFFs. Some developing countries do not have any transfer pricing rules, thus ensuring that the multinational corporation operating in its jurisdiction can transfer as much of its profits elsewhere as it wishes. Multinational corporations are often the initiating actors in these matters.⁴ Nevertheless, the basis of low capacity is often a power issue: it is in the interest of someone to keep the capacity low because it allows them to extract some rents (Leite 2012). Lack of political will has indeed been recognized as more difficult

²The Financial Action Task Force (FATF) is an intergovernmental body established in 1989 by the ministers of its member jurisdictions to set standards and promote effective implementation of legal, regulatory, and operational measures for combating money laundering, terrorist financing, and other related threats to the integrity of the international financial system. Currently it comprises 35 member jurisdictions and 2 regional organisations (the European Commission and the Gulf Co-operation Council).

³For example, Findley, Nielson and Sharman (2014) find that Kenya is the single country in the world where it is easier to open an anonymous shell company, one of criminals' preferred devices to transfer money internationally. Moreover, FRC's website does not seem to have been updated after 2013, and it does not provide any information on its current or past activity, as none of the reports are downloadable.

⁴See, for example, Global Witness (2006).

to overcome than any legal, institutional, or operational issues in this context (Stephenson and others 2011).

Think not only about the rule of law, but about the role of law

S9.8 Incumbents can seemingly promote compliance with international laws and regulation to gain legitimacy, while continuing to do business as usual. One important requirement of the FATF Anti-Money Laundering (AML) regime is to facilitate requests for information and cooperation from other nations pursuing money laundering cases involving the country's nationals (Recommendations 35–40). Most nations have adopted statutes and regulations that conform to the FATF rules. However, in many developing nations, authorities have a long record of dragging out the process of cooperation so long that in fact the laws are effectively nullified: for example, on requests from countries where the illicit funds are hidden for Mutual Legal Assistance (MLA) (Chêne 2006). On the other hand, using delay to deny politically motivated requests from developing countries for MLA may be fair in systems that are essentially corrupt (Terracol 2015).

A way forward

S9.9 Fighting the illicit flow of capital abroad is an important development concern. The money returned in 2009 to Peru from Switzerland and belonging to the accounts of Vladimiro Montesinos, the de facto chief of intelligence and main advisor of former Peruvian President Alberto Fujimori (1990–2000), amounted to \$US93 million. In 2004, the Philippines Treasury recovered \$US683 million from the Swiss accounts of Ferdinand and Imelda Marcos, president and first lady of the Philippines (1965–86). In both cases, the money recovered would have been enough to fill at least 25 percent of the nations' poverty gaps in the same year.⁵

S9.10 In the aftermath of the Panama Papers revelation, the top five European economies (France, Germany, Italy, Spain, and the United Kingdom) announced actions to improve information sharing to fight tax evasion and money laundering. The United Kingdom has a particularly sensitive role in this respect as a number of its dependencies, such as the British Virgin Islands and Jersey, derive a substantial share of their GDP from providing financial secrecy services. Panama itself, according to a statement of the OECD secretary general, seems to have decided to adopt international tax reporting standards. Also, a group of 300 prominent economists around the world directed a letter to country leaders as well as international organizations, including the World Bank, urging them to take concrete measures to bring to an end fiscal havens deemed responsible for worsening global inequality by benefitting some rich individuals and multinational corporations (Oxfam 2016). Fundamental reforms that seemed fantasies just ten years ago are now being discussed as active proposals by powerful bodies such as the G7, G20, and OECD. These include country-by-country reporting of corporate profits, which facilitates detection of transfer pricing abuses and other methods of shifting profits to low-tax jurisdictions, and the creation of public lists of beneficial ownership to prevent concealment through shell corporations.⁶

S9.11 However, the generation of each type of IFF featured in table S9.1 involves a different and complex network of actors, including domestic and foreign state institutions, corrupt domestic and

⁵ WDR2017 team estimates on the STAR (Stolen Asset Recovery Initiative) database and World Development Indicators.

⁶ For a summary of the measures currently adopted and been discussed within OECD and G20, see OECD (2016).

foreign public officials, and foreign financial institutions; influenced by different factors for moving the money abroad and using different channels (e.g. bulk cash smuggling, shell corporations, informal value transfer systems and trade based money laundering). Failure to take into account the mutually sustainable relations of incentives among all the actors involved in IFFs, and to disaggregate the different types of IFFs risks generating ineffective reforms (Reuter, 2016). In particular, attempts to solve the issue should not concentrate only on the countries of origin, but also on the countries receiving IFFs.

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