Development management
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Undergraduate study in
Economics, Management,
Finance and the Social Sciences

This is an extract from a subject guide for an undergraduate course offered as part of the University of London International Programmes in Economics, Management, Finance and the Social Sciences. Materials for these programmes are developed by academics at the London School of Economics and Political Science (LSE).

For more information, see: www.londoninternational.ac.uk
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Introduction

Development management is a ‘300’ course offered on the Economics, Management, Finance and the Social Sciences (EMFSS) suite of programmes.

It is a subject which provides insights and understanding of the institutional drivers of economic and social development, as well as economic and social decomposition. It trains students to manage processes of change in the direction of increasing prosperity and freedom. Many students approach this course with the idea that development management is primarily about administering aid projects. Common misunderstandings are that countries develop as the direct result of international donor and NGO activities, and hence that by better administering the aid projects of such organisations, societies can become richer and more free. Such a view is rooted in a myth of charity which holds that people become more developed through the efforts and resources of others. This course will provide ample empirical and historical evidence to show that in fact societies develop as a result of deep changes in the way they organise key sets of rules by which they operate, such as the economy, government, and the system of justice. These sets of rules define their institutions, and hence development can be viewed as a process of transformation from less effective to more effective institutions. Outsiders, such as NGOs and international agencies, can play a crucial role in nudging societies towards such transformations, and advising national actors once change is under way. But the fundamental responsibility lies within developing societies. What you should take away from this course is an understanding of the role of institutions and organisations in developmental and anti-developmental processes, and strategies for fomenting the former and discouraging the latter.

It is a particularly relevant course for those of you who want to go on to careers in developing country governments, multilateral organisations such as the World Bank, United Nations, and regional development banks, development NGOs, CSOs and advocacy groups, and private firms working in developing countries, as the way it looks at development is central to the core tasks and problems that such organisations face. I teach a similar course at LSE, which is the core course of our MSc in Development Management. My particular interests are in decentralisation, local government effectiveness, the political economy of insurgency and violence, and the institutional roots of comparative development. My background is split between political science and economics, and hence my work tends to lie on the frontier between those two disciplines.

This course complements a number of other International Programmes courses, most obviously 26 International political economy, 96 Economic history in the twentieth century, 108 Political analysis and public choice, 44 Economics of development and 164 Economic geography. I hope that you enjoy studying this course.

Aims and objectives of the course

This course uses an institutional approach to examine the development process and analyse the roots of developmental and anti-developmental experiences in countries, regions and organisations. The approach draws on institutional theories from political science, sociology and the new institutional economics.
The objectives specifically include:
• to explain institutions and organisations as theoretical concepts
• to analyse the development implications of different organisational forms
• to examine coordination in the increasingly complex institutional systems that characterise the most advanced countries
• to explore how characteristics of this complex interdependence are related to the persistence of high and low states of development.

Learning outcomes
At the end of the course and having completed the essential reading and activities you should be able to:
• explain the role of incentives in political behaviour and economic performance
• map the links from different organisations and institutions to the incentives they put in place
• compare and contrast why certain organisations are better suited to certain types of services and/or environments than others
• map the links from incentive systems to micro and macro-level economic performance
• discuss what stable institutional constellations comprise, how they come about, and under which conditions they perish.

Syllabus

Part 1: Theoretical background
Institutional theories of development: Institutions, organisations and development management; the importance of managing the transformation from less to more effective institutions.

Part 2: Governance
Political Accountability and Public Action: The nature of democracy; voting as a means of achieving voice and exit; the roles of information and accountability; theoretical models of voting, and of their problems; empirical studies of government at the extremes of performance; a simple model of government that integrates economic structure, political party system, and the structure and dynamics of civic organisations.

Democracy and decentralisation: Fiscal architecture, hierarchical relations within government; government responsiveness; residual power; interest groups vs. civic groups; organisation, voice and political representation.

International aid and international governance: Aid, conditionality and national sovereignty; the concept and limitations of ‘global governance’; its effects on trade and aid flows; their ultimate effects on countries’ development prospects.

Part 3: Private provision: the market and beyond
Hierarchy, cooperation and incentives in private firms: Pure market exchange; the theoretical origins of firms; the role of hierarchy in efficiency and coordination.
Real firms, small firms: microentrepreneurs and the informal sector: Theory of the firm applied to real, third-world market conditions; the origins of the informal sector; prospects for its development.

Common resources and private solutions for collective action: The economic characteristics of common property resources; the pervasiveness of Tragedies of the Commons and environmental degradation in LDCs; implications for efficiency; possibilities for private solutions and collective action; empirical examples from LDCs

Part 4: Empirical studies of transformation and decomposition

Institutions vs. Geography vs. Values: Why are some countries rich and others poor? Competing theories of the determinants of development; empirical evidence for each.

Analytical narratives of development failure: Why do some countries ‘de-develop’? The cases of Venezuela, Zimbabwe and Pakistan; cross-country evidence of development failure.

Analytical narratives of development success: Why do some countries succeed? Can their success be replicated? The cases of China and Botswana; cross-country evidence of development success.

Towards a theory of development management: A synthesis of the theory of parts 1 and 2 with the evidence presented in part 3; the determinants of development success; successful management of the transition to a rapid development process.

How to use this subject guide

The aim of this subject guide is to help you to interpret the syllabus. It outlines what you are expected to know for each area of the syllabus, and suggests relevant readings to help you understand the material. There are four set textbooks which you must read for this course, but you will find that much of the information you need to learn and understand is contained in examples and activities within the subject guide itself. If you are to succeed in this course, it is important that you complete the essential readings; the adjective ‘essential’ is not accidental.

I would recommend that you work through the guide in chapter order, reading the essential texts beforehand. The activities provided will help to strengthen your understanding of key concepts, and to link them together. You may wish to supplement your studies by reading among the further references provided in each chapter.

Where appropriate, useful internet resources are provided which you may take advantage of. These provide data which you can use to explore particular topics further, case studies that illustrate specific points, or links to important organisations and research groups working on relevant issues.

It is important that you appreciate that different topics are not self-contained. There is a degree of overlap between them, and you are guided in this respect by the cross-referencing between different chapters. In terms of studying this subject, the chapters of this guide are designed as self-contained courses of study, but for examination purposes you need to have an understanding of the subject as a whole.

At the end of each chapter you will find a checklist of your learning outcomes, which is a list of the main points that you should understand, once you have covered the material in the guide and the associated readings.
Structure of the guide

Chapter 1 begins by asking: Why are some countries rich and others poor? Why are the citizens of some countries more free to realise their potential than others? Why are some organisations more effective and efficient at what they do than others? Development management is concerned first of all with analysing the role of institutions and organisations in the process of development. Development management also seeks to go beyond understanding and analysis, to the active management of organisational and institutional transformation, in ways that promote increased levels of growth, development, and freedom. To do this, we must first understand what institutions and organisations are, and what they are not. In North’s (1990) famous characterisation, institutions are the ‘rules of the game’, and organisations are the teams that operate within those rules. Institutions and organisations matter because they create incentives, and these incentives regulate human behaviour. Hence, institutional variation is not arbitrary, and its significance goes well beyond ‘local colour’. Understanding how institutions and organisations work requires a grasp of complexity. Institutions do not operate as islands, but overlap and interlink. And any given organisation, whether a firm, a government department, or a household, functions under a set of incentives created by multiple institutions, all of which affect their behaviours.

To become development managers, we must go beyond a static understanding of these relationships, to a dynamic understanding of how organisations and institutions change. Institutional change can occur through the gradual accretion of small changes over time, or via sudden exogenous shocks. Both kinds of change can be either positive or negative, leading to higher or lower levels of efficiency and effectiveness. Development management is about actively fomenting institutional and organisational changes that increase human freedom and wealth, and hence society’s level of development.

Chapters 2, 3 and 4 comprise a module on ‘Governance’. Although a country’s institutions are not limited to its government, the state does hold a privileged position in that it not only operates within the institutional context, but is also in many ways its shaper and guardian. We begin with the question of public order, exploring the origins and role of the states in historically-informed theoretical terms. But much more is required of modern states, and especially developmental states. Thus we explore the question of political accountability, and the role that voting and elections play in generating it. We then turn to the question of hierarchical relations within government, and the possibility of reform that increases government responsiveness to citizens’ needs. The most popular such reform worldwide is decentralisation, which we explore theoretically and empirically. The decentralisation literature is ambiguous about the likely effects of reform. We explore the sources of this ambiguity, and propose a theory of residual power that explains both why empirical results are not more clear-cut, and why decentralisation reforms are more often proclaimed than implemented. In Chapter 4 our gaze turns to the question of international aid and international governance. Foreign aid is often criticised for subverting national sovereignty. If so, it is quite likely that aid undermines government accountability to its citizens. We analyse the question of conditionality and aid effectiveness, both theoretically and empirically, and explore whether reforms to the aid architecture might improve countries’ development prospects.
Chapters 5, 6, and 7 comprise a module on ‘private provision’. The most common type of private provision of goods and services is by firms operating in the market. But why do we need firms? Why not just pure market exchange? This is an important question, as the answer has deep implications for organisational theory in general, and especially for the question of non-state provision. We rely on Coase, Alchian and Demsetz, and others to show that firms arise within the market in order to minimise transaction costs, and to solve the monitoring and efficiency problem. Hierarchies exist within the decentralised market mechanism because they are efficient. But taking this model of firms and markets to a developing-world context requires us to relax a number of assumptions about the institutional context. When an economy is marked by high levels of inequality, weak or unenforceable property rights, an untransparent and inefficient judiciary, and poor legislative oversight, economic activity will have strong incentives to ‘go underground’, and hence the informal economy will bloom. When the institutional context is distorted in these and other ways, informality emerges as an efficiency device for small and medium-sized firms for whom the costs of formality far outweigh the benefits. But the costs to society of informality are also significant, and include lower wages, lower health and safety standards, weak workers’ and consumers’ rights, low investment, and low levels of productivity. A number of reforms intended to reduce informality have been attempted in recent decades, and some of these have proved notably effective. We explore these measures, and suggest institutional reforms that can both reduce informality, and raise efficiency and productivity in the economy.

The implicit objects of our analytical gaze thus far are private and public goods. A third category not yet addressed is common property resources, which are both conflicting and non-excludable (e.g. a common pasture). For such goods, the market solution tends strongly towards degradation and resource collapse, while public provision is costly and very often ineffective, due to incentive incompatibility of the principal actors involved. But other private, non-market type of solutions are feasible. We explore a number of these which experience has proved successful, and derive broader theoretical implications for this class of goods.

Chapters 8, 9, and 10 comprise the last module, ‘Empirical studies of transformation and decomposition’. This module attempts to synthesise the key lessons learned so far regarding institutions, organisations, and the characteristics of state, market, and non-market private provision through a set of quantitative and qualitative empirical studies of development success and failure. We begin with broad approaches to the question of why some countries are rich and others poor. Competing theories centre on the role of institutions, geography, or culture/values in explaining development success and failure. We dissect such theories down to first principles, and explore their internal coherence and plausibility. We then test such theories with broad, cross-country empirical evidence. This evidence finds greater support for institutional approaches, and least support for culture, with geography playing a non-trivial mediating role. But to understand development, we must go beyond the correlates of development success and failure, to understand the dynamics of the developmental, and anti-developmental, processes themselves. Thus we turn to qualitative evidence, and to analytical narratives of development failure. The cases of Venezuela, Zimbabwe and Pakistan are three diverse, rich, and telling examples of development gone awry. In each case, favourable initial conditions and strong signs of early success turned into development tragedy, followed by economic and social decomposition. We explore the causes and dynamics of these failures, and attempt to draw
lessons from them. These lessons are tested against cross-country evidence. We then turn to analytical narratives of development success, and the cases of China and Botswana. As recently as 1970, the economic and social prospects of each country seemed bleak, and yet today each country has a strong claim to be a clear development success. We explore the causes and dynamics of these successes, and attempt to draw lessons from them as well. These lessons are also tested against cross-country evidence.

Chapter 11 synthesises the theory of modules 1 and 2 with the evidence and lessons presented in module 3, in an attempt to construct a theory of progressive institutional transformation, and hence a theory of development management. We bring together a knowledge of the determinants of development success provided above, with an understanding of the dynamics of institutional transition, to outline a theory of how development managers can catalyse rapid development processes in less-developed countries.

Essential reading

Detailed reading references in this subject guide refer to the editions of the set textbooks listed below. New editions of one or more of these textbooks may have been published by the time you study this course. You can use a more recent edition of any of the books; use the detailed chapter and section headings and the index to identify relevant readings. Also check the VLE regularly for updated guidance on readings.

You should purchase:


Each chapter of the subject guide starts by identifying the appropriate chapters from these textbooks. In instances where the textbooks are inadequate or simply do not cover a particular topic, additional readings are listed under both 'essential' and 'further' headings.

You are also required to read a number of articles which are available in the University of London Online Library. (See Online study resources below.)


You also need to read a number of papers or reports which are available online:

You may also be interested in the skypecast interview with DiJohn at: http://caracaschronicles.blogspot.com/2006/07/skypecast-jonathan-dijohn-casts-doubt.html.


Stern, N. *The Economics of Climate Change: The Stern Review*. (Cambridge: Cambridge University Press, 2006). Read Executive Summary (long version), available here: www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm


**Further reading**

Please note that as long as you read the Essential reading you are then free to read around the subject area in any text, paper or online resource. You will need to support your learning by reading as widely as possible and by thinking about how these principles apply in the real world. To help you read extensively, you have free access to the virtual learning environment (VLE) and University of London Online Library (see below).

Other useful texts for this course include:


**Online study resources**

In addition to the subject guide and the Essential reading, it is crucial that you take advantage of the study resources that are available online for this course, including the VLE and the Online Library.

You can access the VLE, the Online Library and your University of London email account via the Student Portal at:

http://my.londoninternational.ac.uk

You should receive your login details in your study pack. If you have not, or you have forgotten your login details, please email uolia.support@london.ac.uk quoting your student number.

**The VLE**

The VLE, which complements this subject guide, has been designed to enhance your learning experience, providing additional support and a sense of community. It forms an important part of your study experience with the University of London and you should access it regularly.

The VLE provides a range of resources for EMFSS courses:

- **Self-testing activities**: Doing these allows you to test your own understanding of subject material.
- **Electronic study materials**: The printed materials that you receive from
the University of London are available to download, including updated reading lists and references.

- Past examination papers and *Examiners’ commentaries*: These provide advice on how each examination question might best be answered.
- A student discussion forum: This is an open space for you to discuss interests and experiences, seek support from your peers, work collaboratively to solve problems and discuss subject material.
- Videos: There are recorded academic introductions to the subject, interviews and debates and, for some courses, audio-visual tutorials and conclusions.
- Recorded lectures: For some courses, where appropriate, the sessions from previous years' Study Weekends have been recorded and made available.
- Study skills: Expert advice on preparing for examinations and developing your digital literacy skills.
- Feedback forms.

Some of these resources are available for certain courses only, but we are expanding our provision all the time and you should check the VLE regularly for updates.

**Making use of the Online Library**

The Online Library contains a huge array of journal articles and other resources to help you read widely and extensively.

To access the majority of resources via the Online Library you will either need to use your University of London Student Portal login details, or you will be required to register and use an Athens login: http://tinyurl.com/ollathens

The easiest way to locate relevant content and journal articles in the Online Library is to use the Summon search engine.

If you are having trouble finding an article listed in a reading list, try removing any punctuation from the title, such as single quotation marks, question marks and colons.

For further advice, please see the online help pages: www.external.shl.lon.ac.uk/summon/about.php

**Journals**

There are a number of journals which will form the basis to lists of suggested readings and which provide useful up-to-date materials. They are:

- *American Economic Review*
- *American Political Science Review*
- *Development and Change*
- *Economics of Transition*
- *Journal of Development Economics*
- *Journal of Development Studies*
- *Journal of Economic Growth*
- *Journal of Economic Perspectives*
- *Journal of Public Economics*
- *Public Administration and Development*
- *World Development*
Other resources

Unless otherwise stated, all websites in this subject guide were accessed in May 2008. We cannot guarantee, however, that they will stay current and you may need to perform an internet search to find the relevant pages.

Angus Maddison’s database: www.ggdc.net/Maddison/
Centre for Global Development (CGD): www.cgdev.org/
Conference Board and Groningen Growth and Development Centre, Total Economy Database, November 2007: www.conference-board.org/economics/database.cfm
Development Studies Institute (DESTIN, LSE): www.lse.ac.uk/collections/DESTIN/
Roubini Global Economics Monitor: www.rgemonitor.com/
Suntory and Toyota International Centres for Economics and Related Disciplines (STICERD, LSE): sticerd.lse.ac.uk/
UK Department for International Development (DFID): www.dfid.gov.uk/
UNDP: www.undp.org
World Bank: www.worldbank.org/

Examination structure

Important: the information and advice given in the following section is based on the examination structure used at the time this guide was written. Please note that subject guides may be used for several years. Because of this we strongly advise you to check both the current Regulations for relevant information about the examination, and the VLE where you should be advised of any forthcoming changes. You should also carefully check the rubric/instructions on the paper you actually sit and follow those instructions.

Remember, it is important to check the VLE for:

- up-to-date information on examination and assessment arrangements for this course
- where available, past examination papers and Examiners’ commentaries for the course which give advice on how each question might best be answered.

The examination paper for this course is three hours in duration and you are expected to answer three questions, from a choice of 10. The Examiner attempts to ensure that all the topics covered in the syllabus and subject guide are examined. Some questions could cover more than one topic from the syllabus since the different topics are not self-contained. A sample examination paper appears as an appendix to this guide, along with guidance on answering the sample examination paper.

The Examiners’ commentaries, which are available on the VLE, contain valuable information about how to approach the examination, so you are strongly advised to read them carefully. Past examination papers and the associated commentaries are valuable resources in preparing for the examination.
Examination advice

When approaching an examination for this type of subject, the most important thing to remember is that even if you know and fully understand the material, you must clearly convey this to the examiner in order to do well. You need to be able to show that you have covered the syllabus and read widely, and that you can go beyond repeating the arguments you have read to construct your own.

Good practical advice for achieving this includes: write legibly and express yourself clearly. No matter how brilliant your answer may be, it is of no use if the examiner cannot read it. You should begin each examination by reading all the questions on the examination paper, and deciding which ones you will answer. Read each question carefully, and get a good sense of what the question is specifically asking for. Once you have decided which questions you will answer, write an outline of each answer before you begin the essay proper. A good rule of thumb for a three-hour examination is to spend 10–15 minutes on each outline, and 45 minutes writing each essay.

Think of your answers in terms of building an argument. Each answer should begin with definitions and first assumptions, and then build up an argument logically to conclusions that directly answer the question posed. Your answers should synthesise the ideas developed in the subject, and will often include evidence. ‘Evidence’ refers to examples, case studies, or statistical information gleaned from subject readings, or from other sources that you know about. Do not worry too much about bibliographical references in your answers. When dealing with major ideas or contributions from subject readings, it may be useful to cite relevant author(s). But you are not expected to know precise dates, and you are not expected to cite references for all the ideas you use in your essays. For example, when referring to ‘the invisible hand of the market’, you could reference ‘(Adam Smith)’ or just ‘(Smith)’.

Examination questions will require you to synthesise material across several chapters in order to provide complete answers. But in many cases, different combinations of material from different chapters can provide answers that are equally good and complete. For the most part, it will not be the case that a specific example question refers to a specific chapter.

Remember, it is important to check the VLE for:

- up-to-date information on examination and assessment arrangements for this course
- where available, past examination papers and Examiners’ commentaries for the course which give advice on how each question might best be answered.

List of abbreviations used in this subject guide

<table>
<thead>
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<th>Abbreviation</th>
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<tr>
<td>CSO</td>
<td>Civil Society Organisation</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>LSE</td>
<td>The London School of Economics and Political Science</td>
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<td>NGO</td>
<td>Non-Governmental Organisation</td>
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Chapter 1: Institutions, organisations and development management

Aim of the chapter

The aim of this chapter is to introduce you to institutions and organisations as theoretical concepts, and outline the overarching argument of this course: the problem of development implies a move from less effective to more effective institutions and organisations. The challenge of development management is to serve as a catalyst for institutional transformations of this nature.

Learning outcomes

By the end of this chapter and having completed the essential readings and activities, you should be able to:

• explain what institutions are, and give examples
• explain what organisations are, and give examples
• identify the main ways in which institutional and organisational change comes about
• discuss how institutional change can drive the development process.

Essential reading


Further reading


Works cited

Introduction

Why are some countries rich and others poor? Why are the citizens of some countries more free to realise their potential than others? Why are some organisations more efficient and effective at what they do than others? This subject develops a political economy approach to examining the institutional roots of developmental and anti-developmental processes. We begin with the basic theoretical tools of institutions and organisations, and analyse the implications of different organisational forms. We examine coordination in the increasingly complex, multilayered systems that characterise the most advanced countries. And we explore whether this complex interdependence is merely a correlate of development, or a cause, or both.

Activity 1.1

Consider Germany and Spain and Ghana and Sri Lanka. Why are the citizens of Germany and Spain richer and more free than those of Ghana and Sri Lanka? Is it because the former are more intelligent? Because they work harder? Because they are morally more just?

Write down what you think are the three most plausible causes of the different levels of development that these countries exhibit.

Consider the development transitions of the United Kingdom, the United States, Germany, the Netherlands, and Korea. Economic historians commonly estimate that the UK’s industrialisation process took about 150 years. The Industrial Revolution began in the UK, and so it is understandable that many mistakes, dead ends, and simple bad luck contributed to a longer process in the country that essentially invented industrialisation. The next country to follow, the US, learned from the UK’s many examples of both success and failure, and so was able to complete the transition in about half that time – some 80 years. Using very round numbers, Germany, the Netherlands, and other northern European economies took between 50 and 80 years to industrialise. The country that holds the world record for transition from a low productivity, largely agricultural economy, to a fully industrialised, sophisticated, high-technology, high-productivity economy, with high levels of fixed capital and a highly trained labour force, is South Korea. The Korean transition is commonly thought to have taken about 30 years, although some scholars put the number below 20 years. In the context of economic history, this is a miracle. The developmental processes put into place by South Korea from the 1960s onwards transformed its economy and society out of all recognition. They lifted an entire nation out of poverty and deprivation, and put South Koreans on the path to prosperity and freedom.

The goal of development management is to generate such miracles, not in isolated cases, but across the developing world. Our approach to development is premised on the notion that institutions are crucial to explaining not only development success but also development failure. Institutions are meta-phenomena; they are deeply set, and they have powerful effects on human incentives and hence human behaviour. But they are also susceptible to human action. Institutions can be changed. Learning to do so in the interest of accelerating development is the goal of development management.

Before continuing, it is important to establish what this subject is not. This is not a subject which teaches students hands-on, practical tools that they are likely to use immediately upon completion, in their work as
development professionals. This subject will not teach students how to
draw up logical frameworks, calculate an internal rate of return, estimate
project timelines, or budget project costs, to name just a few. It does
not familiarise students with software packages that they are likely to
use in the professional world, nor does it make much effort to acquaint
students with practical jargon, acronyms, and other professional minutia
of the development field. A number of courses at other universities do
these things, and some of those are available through external study.
Such practical, vocational training has a useful place in the educational
spectrum.

Many people consider development management to be mainly
about administering aid projects. They assume that the study of
development management should primarily train students to work in
NGOs or multilateral agencies. Such views are rooted in a common
misunderstanding that countries develop as the direct result of
international donor and NGO activities, and hence that by better
administering the aid projects of such organisations, societies can become
richer and more free. Such a view is rooted in a myth of charity which
holds that people become more developed through the efforts and
resources of others. This is not a view that we espouse in this subject
guide, for reasons that are developed in the chapters that follow.

Before moving deeper into development management, we must first define
‘development’. There are a number of definitions, with some of which you
are no doubt familiar. For many, development is more or less synonymous
with GDP per capita. For others, development implies industrialisation,
especially the growth of manufacturing and heavy industries. Still others
use the word development to refer to individual freedoms, and extensive
civil and political liberties. Arguments over the definition of development
are often rich and interesting. But it is important to realise that, strictly
speaking, they cannot be resolved. The meaning of the word ‘development’
is essentially a value judgment, and thus something about which well-
informed people can legitimately differ.

In this subject, we will by-and-large adopt the definition of Amartya
Sen, who defines development as that which increases human freedom.
Freedom to do what? In Sen’s formulation, the object of freedom is to
maximise individual potential. Hence, increasing income is developmental
because greater resources provide the means for an individual to reach
her human potential. More wealth can make you more free. But freedom
has many other dimensions as well, which are only indirectly related
to income and wealth: spiritual and religious freedom, for example;
freedom of speech; human security; freedom of association; and many
others. Income often serves as a convenient shorthand for measuring
development, as it is an input for many of the things that help people to
realise their potential: food, shelter, education, etc. Hence income (and
wealth) can serve as a proxy for development. But it is important to note
that income and development are not substantively the same.

Institutions and organisations

Institutions

The concept of institutions is at the centre of this subject, and hence it
is important that we understand what is meant by the term ‘institution’
before continuing. The academic literature on institutions is deep and
rich, covering sociology, economics, political science, and anthropology, amongst other things. We draw on all of these traditions in this subject, but root ourselves most strongly in the political economy tradition, especially the New Institutional Economics. The New Institutional Economics is, according to Clague (1997a):

...a kind of “expanded economics”. Like standard economics, it focuses on the choices people make in their lives. But it enriches the simple rational choice model by allowing for the pervasiveness of information problems and human limitations on processing information, the evolution of norms, and the willingness of people to form bonds of trust. The NIE seeks to explain not only individuals’ choices with a given set of institutions but, more important, the way that individuals’ beliefs and choices affect the evolution of the institutions themselves.¹

We follow Clague (1997a) and Olson and Kahkonen (2000) in construing the NIE broadly to include the economics of transaction costs, institutional innovation and efficiency, property rights, collective action, and the evolution of cooperation and norms.² Note that some of the foremost exponents of some of these subjects might well disagree with so broad a definition (see North (1990) and Williamson (1995a)). Our purpose here is not to give a comprehensive account of the NIE, but rather to highlight useful concepts in a framework which can be employed to analyse local government.

According to Williamson (1995a), the NIE insists on realistic, commonly verifiable instead of analytically convenient, behavioral assumptions: (i) opportunism, and (ii) bounded rationality. Opportunism does not assume that all people are always dishonest, but rather that ‘some individuals are opportunistic some of the time and that it is costly to ascertain differential trustworthiness ex ante.’³ Opportunism thus prompts agents to seek credible commitments before executing transactions. The concept of bounded rationality was proposed by Simon (1957) as behaviour that is ‘intendedly rational, but only limitedly so’.⁴ It arises because people are limited in the information they possess and in the computational skills they bring to bear in making choices. ‘The capacity of the human mind for formulating and solving complex problems is very small compared with the size of the problems whose solution is required for objectively rational behavior in the real world.’⁵ Bounded rationality makes the mind itself a scarce resource.

Closely related to bounded rationality is what Douglass North (1990) calls imperfect subjective mental models. This relates to the implicit behavioural assumption of the rational choice and neoclassical economics schools that:

actors possess cognitive systems that provide true models of the worlds about which they make choices or, at the very least, that the actors receive information that leads to convergence of divergent initial models. This is patently wrong for most of the interesting problems with which we are concerned. Individuals make choices based on subjectively derived models that diverge among individuals and the information the actors receive is so incomplete that in most cases these divergent subjective models show no tendency to converge.⁶

Imperfect mental models interact with and reinforce the bounded nature of human rationality to create significant obstacles to efficiency in transactions.

¹ p.16.
³ p.190.
⁵ Ibid., p.179.
⁶ p.17.
Bounded rationality and imperfect mental models, combined with uncertainty, imply that ‘all complex contracts are unavoidably incomplete’. Modern complex contracts are both multidimensional and extend over time. Agents’ limited mental abilities imply that parties to a contract will be unable to specify all possible future contingencies. Parties will thus deliberately leave possible unknowns unspecified, rendering contracts incomplete. Instead they delegate the resolution of disputes which may arise to some third party, which accounts for the rise of certain institutions, to which we turn presently.

A fifth idea central to the NIE is costly transactions, pioneered among others by Coase (1937). North expands on this theme:

> The costliness of information is the key to the costs of transacting, which consists of the costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements. […] Commodities, services, and the performance of agents have numerous attributes and their levels vary from one specimen or agent to another.

Ascertaining the level of these attributes, protecting rights, and policing and enforcing agreements makes transactions costly.

With these tools in hand, we can now turn to the structural characteristics of society. Consider first institutions and organisations.

**Activity 1.2**

Define ‘institution’. Write down your definition.

Write down five examples of institutions that you know of.

What is an institution? North (1990) defines institutions pithily as the ‘rules of the game’. He uses a football analogy, where the game of football is the institution (i.e. the rules of football), and teams of players are the organisations that compete within this institutional context. These definitions are compelling, and you should keep them in mind. In this subject guide we use a different definition, which is quite similar in spirit, but slightly more comprehensive. Institutions are systems of rights and obligations in the form of recognised, formal or informal, but enforceable rules that enable individuals to cooperate to achieve common purposes by creating regularised role relationships. Examples of institutions are: the US Constitution, the global market economy, Islam, football, marriage, and the Mafia.

**Organisations**

**Activity 1.3**

Define ‘organisation’. Write down your definition.

Write down five examples of organisations with which you are familiar.

Organisations are the teams of people operating within the rules set by institutions to achieve particular goals. They are agencies that facilitate cooperation among individuals in the name of these goals, on the basis of rules, authority, and incentives. Examples of organisations are: the Democratic Party, Toyota Motor Corporation, a mosque, Manchester United (a football team), and a gang.

Institutions and organisations involve implicit contracts between agencies and recipients, in which the former supply services in exchange for
appropriate awards. The terms on which these are supplied (the balance of powers between service provider and recipients) determine the political social and economic impact of any system of institutional arrangements. Institutions can be more or less formal, conscious and visible. Formalisation tends to increase with development. Institutional contexts may change significantly over time, but formal and informal, new and old, institutions will continue to exist.

**Activity 1.4**

Your answers to the previous two learning activities were your ‘naïve views’. Now that you are properly equipped, repeat both exercises. Write down your answers. These are your theoretically informed views. Remember them.

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**Complexity**

There is no clear, linear progression from nation to institutions to organisations. Institutions and organisations overlap to an extent that North’s football analogy somewhat obscures. If institutions are the ‘rules of the game’, and organisations are the ‘teams’ that operate within those rules, then it is important to note that most ‘teams’ that we can think of operate and are significantly affected by different coherent sets of rules, and hence different institutions. For example a family – a particular kind of organisational unit – will operate under the institutions of marriage, the constitution, property rights, the market, etc. The same is true of a firm or NGO.

Furthermore, within any category, or sector, organisations engaged in substantively similar activities may have very different structures and levels of efficiency and effectiveness. The garment manufacturing sector, for example, is populated by a large number of firms. Some of these are huge, multinational concerns, and others are small and highly local. Some invest heavily in research and product development and are capital intensive, while others mainly copy external designs and are labour-intensive. Hence institutional systems are characterised by complexity.

**Why they matter: incentives**

Institutions and organisations are important because they generate incentives that govern human behaviour. But what are ‘incentives’? Incentives are rewards and punishments that accrue to individuals (or groups of people) due to certain actions or behaviours. A salary is an incentive, as is the possibility of promotion, or of gaining the favour of a superior. These are all positive incentives. Negative incentives include fines, the possibility of losing one’s job, loss of reputation, and physical punishment, amongst others.

Different institutions create different incentives. This, in turn, means that variations in institutions and organisations are not arbitrary, and their significance goes well beyond ‘local colour’. The particular institutions and organisations that society is endowed with critically affect the incentives that permeate that society, and hence what sorts of activity are promoted or encouraged. The way organisations are structured, and the way they operate, directly affect how well they achieve their organisational goals, and with what levels of efficiency.

**Activity 1.5**

Consider two identical twins separated at birth. Both have grown up to become inventors. One lives in a country with a private market economy populated by firms and individual
agents. The other lives in a country with a collectivised, socialist economy composed entirely of cooperatives.

Which twin has stronger incentives to invent and innovate? To engage in research and development activities? To pursue ideas? To be curious?

Keep in mind that the question is not which twin will invent more in any given period, but rather which faces stronger external (i.e. to herself) incentives to invent.

For example, in the 1950s and 60s rocket scientists in the United States and Soviet Union faced similarly strong incentives to develop more and more powerful rocket engines, and to do so quickly. But although they had similar effects, these incentives took very different shapes in the two countries, and were embedded in radically different organisational structures and institutional contexts. The Soviet space programme operated as a silo, physically and institutionally disconnected from the rest of the economy. By contrast, the American space programme was deeply connected with its leading universities, and with private sector aerospace firms. As a result, the brilliant technical advances of the Soviet space programme remained mostly isolated from the rest of the economy, which in fact was starved of resources and expertise for the sake of the space effort. The American space programme, by contrast, benefited from the dynamic efficiencies generated elsewhere in the economy. As a result, more scientific and engineering know-how filtered back into private sector aerospace and manufacturing firms.

Organisational and institutional change

Organisations change over time. They change because they learn to execute core functions more efficiently, or with greater precision or quality, because they invent new technologies of production, they develop new products or services, or they learn to organise themselves better. Hence automobile manufacturers may learn to build cars with fewer raw materials or fewer workers, they may learn to build cars with fewer defects, they may develop machines which save materials or labour in the production process, they may invent a new kind of engine that gives their cars a competitive advantage, or they may reorganise their supply chains or distribution networks in ways that save money. Alternatively, organisations and organisational performance can deteriorate in any or all of these ways as well.

Likewise, institutions become more (or less) efficient and effective as the rules that comprise them are modified or replaced in ways that promote greater (or less) human productivity and freedom. Increasing levels of public education in the West, for example, were often portrayed at the time as a question of human rights, or a moral imperative. But a more educated population also increased levels of human capital in the labour force, boosting productivity, innovation, and facilitating the development of a more sophisticated, higher value-added economy. Such institutional changes are often prodded by changes in the organisations that operate under institutions, or broader social or cultural changes, whose proponents gain sufficient political power to ‘institute’ changes beneficial to themselves. Hence the extension of civic and political rights down the social ladder in late medieval Europe was at least partly prompted by outbreaks of plague, which decimated the population, increasing the value of rural and urban labour. Amongst the peasant masses, those who survived found themselves in a much better bargaining position, and so able to extract concessions from landowners, lords, princes and priests.
Conclusion: the meaning of development management

Development management is about actively fomenting institutional and organisational changes that increase human freedom and wealth, and hence the level of development. It is the opposite of a laissez-faire approach, which waits for change to happen autonomously, with no attempt at coordination or catalysis. It is, instead, the deliberate, conscious and informed attempt to move institutions and organisations towards higher levels of efficiency and effectiveness in a way which is faster than their autonomous rate of progressive change, and – to the extent that this is possible – more coordinated.

How do we know what sorts of institutions development managers should work towards? Five criteria are commonly used to differentiate better from worse institutions:

1. Efficiency and growth. Better institutions are more complex, larger scale, cost minimising, and tend to increase growth. Efficiency stems from institutions that maximise rational planning and the role of science by encouraging free experimentation and merit-based selection, and eliminating inherited monopoly power.

2. Autonomy and freedom. Better institutions allow people the ‘freedom to choose’ by basing control over resources on competition and free discussion, rather than a monopoly on physical or moral coercion. This requires institutions that create formal equality of access (democratic states, free-market economies, gender equality, religious and ethnic tolerance), rather than those based on dictatorship, command planning, patriarchy, or ethnic or religious discrimination.

3. Diversity and pluralism. Better institutional systems use different kinds of agency to provide political, economic, or social services, and to meet the needs of people with different cultural dispositions and different levels of skill and social capital. This increases complexity and choice.

4. Equity and justice. Better institutions create equality of opportunity, ensure that rewards are directly tied to performance, and minimise exclusion and insecurity. Development requires systems that create incentives that tie rewards to performance, and use accountability mechanisms that enable recipients to exercise effective leverage over those who provide them with their services.

5. Connectedness and voluntary cooperation. Better institutions increase the range of autonomous interdependence, and therefore our capacity to cooperate freely with each other. This requires systems that are based on reciprocity and interdependence. No one should be able to use their personal power to exploit anyone else – to extract resources from them without providing an adequate return.

We know that progressive institutional transformation can be done, because it has been done in a number of countries. More often it has failed. But where it has succeeded, good development management has transformed people’s lives, and lifted entire nations out of poverty in as little as one lifetime. The difficulties development managers face are enormous, and the risk of failure is high. But the benefits to society of success are even greater, and all the more worth the risk because the alternatives are not good.
A reminder of your learning outcomes

Having completed this chapter, as well as the essential reading and activities, you should be able to:

• explain what institutions are, and give examples
• explain what organisations are, and give examples
• identify the main ways in which institutional and organisational change comes about
• discuss how institutional change can drive the development process.

Sample examination questions

1. Define ‘institution’. Define ‘organisation’. Why does each matter for development?
2. Why are some institutions better than others?
3. Provide an example of an institution that you consider dysfunctional. Explain its dysfunctionality in terms of the incentives it creates, and the outcomes these lead to.
Part 2: Governance
Notes
Chapter 2: Political accountability and public action

Introduction and aims of the chapter

The first chapter in this module on governance is about political accountability, and the extent to which it exists or not in a democracy. In modern times we have grown used to thinking reflexively that democracy implies ‘government of the people, by the people, and for the people’. But at the same time, we have grown used to thinking that politicians are corrupt, governments inefficient, and public services inflexible and unresponsive. The difference between these plainly contradictory beliefs is in part the difference of theory versus practice – the difference between what democracy should be, and its real-world realisation in far too many countries.

But part of the problem is an uncritical, undifferentiated view of what democracy is, and how it works, that is generally held by the majority of citizens in many, if not most democracies. We accept that democracy is ‘good’, but do not question why it is good, what are the necessary preconditions for it to function in a way leading to good outcomes, nor the distortions, inefficiencies, and even oppressions that can result when these preconditions are not met.

This chapter examines democracy from first principles, asking under what conditions and to what extent it can make government accountable to the governed. We begin with the single most important characteristic of democracy, voting, examine what it can and cannot do, and then move on to a broader view of democracy that sets voting, campaigning, and political competition in a broader social and economic context. We motivate the latter part of this exploration with specific empirical examples from Latin America.

Learning outcomes

By the end of this chapter and having completed the essential reading and activities, you should be able to:

• define ‘accountability’
• explain the roles of information and accountability in making governments responsive to citizens
• explain the role of voting in revealing and transmitting information to politicians
• summarise how voting interacts with other aspects of democratic government, such as lobbying, campaigning, and the activities of civic organisations
• analyse the strengths and limitations of democracy for providing government that is accountable to its citizens.

Essential reading


Faguet, J-P ‘Governance From Below: A Theory of Local Government With
Further reading


Works cited


Democracy and voting

Does voting make governments act in the interests of the governed? It is self-evident that two conditions must be met for government to be responsive to society:

1. Information. A mechanism exists by which citizens’ policy preferences are revealed to government officials. This typically occurs either through the selection of politicians with majority-preferred platforms, or the communication of the majority’s preferences to elected officials.

2. Accountability. A mechanism exists by which elected officials are held responsible to voters for acting upon this information. By placing power over officials in the hands of voters, the former are given incentives to act in the interests of the latter.

Activity 2.1

What is accountability? Why would we say that person A is accountable to person B? In what sense does he give her account? Of what? Write down your answers.

What is this ‘accountability’? The Oxford English Dictionary defines the term as:

Being bound to give account, to explain.

My old Random House College Dictionary defines the term as:

Subject to the obligation to report, explain, or justify some thing; responsible; answerable.

If we think in pure abstract terms, accountability must involve a minimum of two people (although it can involve many more). Person A will be
accountable to person B if he must answer to B for his actions. This gives B significant influence over the actions of A. Where accountability is complete, B can make A do what she wants. In a similar sense, we say that government is accountable to voters when it does what they want it to do.

Let us begin with the first of the two conditions. Do elections reveal information about voters' preferences? Do they transmit such information to elected politicians? If so, how do these processes work?

Two of the earliest technical approaches to these questions were Hotelling (1929) and Black (1948). Their contributions showed that majority voting can bring about an equilibrium in single-dimensional space given single-peaked preferences.

Activity 2.2
What does the term ‘dimension’ mean in geometry? What might it mean in a political economy context?

What is the political economy meaning of the term ‘dimension’?

Dimension: A domain within which quantities are comparable (e.g. voters’ preferences for education spending, or for health spending; not for education+health spending).

A good illustration of their insight is known as the ‘Hotelling beach game’. The motivating story is as follows: imagine a beach that is naturally bounded at either end, beyond which sunbathers cannot go. Imagine also that the beach has no width, making it a one-dimensional beach. Assume sunbathers are equally distributed along the length of the beach. A refreshments vendor encounters such a beach – the question is, where on the beach will she choose to locate?

The Hotelling beach game can be depicted graphically as in the figures below, where the black circles are the natural endpoints, the horizontal line is the beach, and the small vertical lines are players. Hotelling points out that the vendor's problem is: which position on the beach will maximise her market share, in the sense of attracting the most customers? It is easy to see that for a single vendor, the solution is in the middle of the beach (Figure 2.1). For this first case, the vendor competes not with other vendors, but with the implied transaction costs borne by customers of traversing the beach some distance to the vendor's position. The further away the vendor is from a particular customer, the lower are the chances that he will get up off the beach and walk to the vendor to purchase a drink. Hence when there is only one vendor on the beach, she will locate at the midpoint, because this minimises the distance that the average customer will have to walk to her stall. This is a stable equilibrium in the sense that the vendor has no incentive to defect, meaning no incentive to change her position.

Figure 2.1: The Hotelling beach game with one player

Now analyse the game for two vendors. Assume, further, that the vendors and their wares are identical in every way, such that customers will not prefer one to the other for any reason other than how far they have to walk to their stalls. Where will the two vendors locate on the beach? Many students are tempted to say about one-third and two-thirds of the length of the beach, as in Figure 2.2(i) below. But this is wrong. To understand why, consider the initial
payoffs and accompanying incentives faced by each vendor, if the two begin the game at those locations. At the outset, the leftmost player will capture all the sunbathers to his left, and half the sunbathers between him and the other vendor. The rightmost vendor will capture all the sunbathers to her right, and, likewise, half the sunbathers between her and the other vendor. The halfway point is marked with a dotted line in the figure below. But the leftmost player can increase his market share by moving to the right. This is because he will not lose any sunbathers to the left of him, and can steal away some of the other vendor's market by moving closer to her. But the rightmost vendor faces equal and symmetric incentives, hence the two vendors will converge at the midpoint (see Figure 2.2(ii) below). Neither has any incentive to deviate from the midpoint, because neither can increase her market share by moving to any other location. The fact that neither player has any incentive to deviate is what makes this a stable equilibrium. It is possible, however, that one of the vendors is more intelligent than the other, and locates at the midpoint from the start, while the other locates elsewhere on the line. In this case, a process of trial and error will reveal to the less intelligent vendor his mistake, and he, and if necessary the other vendor also, will adjust their positions over time until both once again converge at the centre.

![Figure 2.2: The Hotelling beach game with two players](image)

Now consider the Hotelling beach game with three players. Does this game have a solution? For any initial distribution of vendors along the beach, the players will tend to converge on the midpoint, as in Figure 2.3 below, for the same sorts of reasons analyzed above. But once all three players have reached the middle of the beach, they will not be able to find a stable equilibrium. This is because the player that ends up in the middle loses his entire market share to the two outer players. Hence he will relocate to a position just to the left or the right of one of the two players surrounding him. But this will leave another player stuck in the middle, who will then behave likewise. In an abstract game such as this, with no relocation costs, this sort of competitive churning will go on forever, until the end of time, and no stable solution will ever be found. Any stable solution for the three player game would entail one of the players accepting zero market share, which none of the three will do.

![Figure 2.3: The hotelling beach game with three players](image)
Lest you think there are no solutions for more than two players, consider the six-player game depicted below. This game has a solution that is unambiguous and stable at the positions depicted in Figure 2.4 below. At these positions, the outermost players will capture the entire market between them and the endpoints, and the four interior players will split the remaining market between them, where each interior player catches the line segment between himself and the nearest dotted line (which are, again, the midpoints of the two interior line segments). This solution is somewhat counterintuitive, but is stable.

**Activity 2.3**

Convince yourself that Figure 2.4 is indeed the solution to the six-player hotelling game, and then work out solutions for four and five players. Do solutions exist for these cases? Are your proposed solutions stable equilibria?

![Figure 2.4: The Hotelling beach game with six players](image)

The Hotelling beach model has been applied frequently to the analysis of party positions in political ‘space’, where the beach becomes an ideological continuum varying between left-wing and right-wing positions. In particular, the two and three player games have been used to explain why third parties, and third-party candidates, fare so badly in countries like the US and UK, with entrenched two-party systems. There is no ideological space for a third party to occupy such a system, the Hotelling model implies. When a third party forms in such a system, the existing two parties will manoeuvre to take away its market share, in this case potential voters, by relocating so as to surround it on both sides. Such dynamics also explain why two-party systems always battle for the political centre. Neither the left nor the right-leaning political party will actually locate on the left or right of the ideological spectrum. Both will locate firmly in the middle, because the middle ground is where elections are won. Only in political systems with more than three parties do you find parties with reliably left wing ideologies and left-wing platforms, or right-wing ideologies and platforms.

It is impressive that such a simple, parsimonious model can shed light on such complex real-world phenomena as the number of parties that survive in different political systems, and the ideological positions they take up. But does Hotelling’s model shed light on our two conditions for responsive government above? Unfortunately, both uni-dimensionality and ‘single peaked-ness’, key assumptions of the Hotelling model, are implausible if votes are to transmit useful information to politicians. With respect to voting, uni-dimensionality implies that voters can only care about a single domain of their lives, such as education, transport, or defence. But they may not care about any of the three domains, let alone more. Given that voters do care about more than a single domain, and then elections must transmit information across a number of domains if they are to make politicians accountable to voters, uni-dimensionality is simply unrealistic. And given multi-dimensional tastes, single peaked preferences are implausible, for reasons that we will not go into detail about here.
More recent scholars, including notably Downs (1957), and Besley and Coate (1995), have devised a variety of models of voting. But voting equilibria are problematic for deep reasons first recognised over two centuries ago by the Marquis de Condorcet – the possibility that voting in multi-dimensional space will lead to cycling. To understand the logic behind this, consider the following experiment. After a long night of revelry, three Development Management students crave ice cream. They find themselves in the last ice-cream selling venue still open in London, and with only enough money between them for one tub of ice cream. The vendor offers them Chocolate (C), Strawberry (S) or Vanilla (V). The students are named 1, 2, and 3. They vote for which flavour to buy. Figure 2.5 depicts the order of their individual preferences over the three flavours:

\[
\begin{array}{ccc}
\text{C} & \text{S} & \text{V} \\
\text{S} & \text{C} & \text{V} \\
\text{V} & \text{S} & \text{C}
\end{array}
\]

**Figure 2.5: Three students’ ice-cream preferences**

**Activity 2.4**

Is there a stable equilibrium in this situation? Carry out the voting experiment for this situation. What would the vote count be for each flavour?

There is a stable equilibrium in this situation, and a simple vote reveals that chocolate is preferred to vanilla by a majority of two votes to one.

Now assume the students’ preferences are instead as in Figure 2.6:

\[
\begin{array}{ccc}
\text{C} & \text{S} & \text{V} \\
\text{S} & \text{V} & \text{C} \\
\text{V} & \text{C} & \text{S}
\end{array}
\]

**Figure 2.6: Condorcet cycling**

Is there a stable equilibrium with preferences that look like this?

**Activity 2.5**

Repeat the vote counting exercise for Figure 2.6 above. Which flavour do the students choose?

There is no stable equilibrium for this situation. None of the three flavours is preferred by a majority, and no stable equilibrium will form around any particular flavour. To understand why, imagine a hypothetical election. The shopkeeper calls out ‘chocolate’, and student 1 raises her hand. Then the shopkeeper calls out ‘strawberry’, and student 2 raises his hand. When the shopkeeper calls out ‘vanilla’, student 3 raises her hand. The prospect of getting chocolate, which is student 2’s least favourite flavour, leads him to propose a vanilla alliance with student 3, which student 3 accepts. But student 1 likes vanilla least, so she approaches student 2 and suggests a strawberry alliance. At this point, student 2 breaks the vanilla alliance, and joins the strawberry alliance, which flavour he prefers. But strawberry is the flavour student 3 likes least… and so on. In the absence of frictions and transaction costs, meaning in practical terms that the students have nothing else to do, and do not die of hunger, these broken-coalition elections can go on and on and on until the end of time without ever a stable equilibrium being reached.
There are two distinct problems in this situation. One is the impossibility of the existence of a stable equilibrium in multidimensional space. The other is about instrumentality, (i.e. of the voting mechanisms we commonly use as a means for bringing about such an equilibrium.) A number of scholars have tried to solve one or the other of these problems, by proposing increasingly restrictive assumptions about the sorts of preferences voters are allowed to have, or by positing probabilistic voting mechanisms, which remove the mechanical link between voters’ beliefs and/or preferences, and their voting behaviour. Although some progress has been made, none of these contributions has managed to solve either problem in a way that is approximately realistic, and allows our two conditions – information and accountability – to be met. We do not have the space to consider such issues further here. Students who want to pursue this further, and who are prepared for a discussion that becomes very technical very quickly, are strongly encouraged to consult Dennis Mueller’s Public Choice Three.

The overarching lessons of these theoretical models would appear to be uniformly negative. Democracy can produce stable equilibria – that is to say, clear results of some sort – only in the simplest models, and under highly unrealistic assumptions, that make the transfer of information from voters to politicians impossible. Relax the assumptions of these models even a little, to allow for – say – three dimensions, and even the equilibria disappear, and the models have no solution. In other words, our conditions of information and accountability cannot even be asked in a Condorcet-type model, where as few as three people voting over three dimensions are incapable of even producing an outcome.

Do these results imply that democracy is a sham? Do they imply that democracy is an elaborate show, a Roman circus meant to distract the people while fundamentally different means are used to govern them? Such conclusions, sometimes put forward by democracy’s critics, are too harsh on two counts. First of all, real world elections are generally one-dimensional. We cast a vote for one party or another, or for one candidate or another, rather than expressing detailed preferences across a menu of policy options. The latter exercise would much better inform our leaders as to what we want them to do. But real-world voting mechanisms by and large do not work that way. Hence it is not necessarily our models of voting that are limited, but rather our real voting systems, which the models in some fundamental respects try faithfully to represent.

A second objection to the gloomy view is that voting is not everything. What about interest groups, pressure groups, and civil society? What about campaigns, polling, and individual encounters between voters and politicians? When we model democracy by focusing on voting, we miss more than half the action. So our task consists of building a more realistic model of governance that includes civic groups, along with producer and consumer lobbies, and other actors or interests in society who lobby, express preferences, and otherwise participate in policy-making.

An empirical study: local government at the extremes

Rather than continue with abstract theoretical models, we turn instead to a close, deep, detailed empirical analysis of government in two very different kinds of cases: one very good quality, the other very bad. In doing so, we hope not only to understand what caused the quality of governance to vary so much between these two localities – though we will do that – but rather to derive a general model of governance that identifies its structure and necessary preconditions, and maps shortfalls or distortions of these
into specific types of policy failure. This model of governance will go beyond elections, to contemplate broader interactions in the economy and society, and how these combine with political movements and dynamics to produce the level of governance that a specific society achieves.

But first let us consider Viacha and Charagua. Both are municipalities, in Bolivia as it happens, during the period immediately following decentralisation (see Chapter 3), when previously ignored and often non-existent local governments received a sudden shock of immense new resources, and significant new power and political authority over public services. What we see in Bolivia, as one might expect, is a significant variation in the way that different municipalities responded to this shock. Amongst the large majority with little or no experience of local self-government, some municipalities were able to manage their affairs with probity and transparency, while others were marred by corruption and poor government effectiveness, and a third group remained ‘caught in the headlights’, seemingly incapable of doing anything at all. Of our two case studies, Viacha was at the lower extreme of terrible government performance, while Charagua resided at the upper extreme of high quality governance. We consider each in turn, before attempting to theorise. Our evidence is based on six months of fieldwork, and scores of interviews.

Viacha

Viacha is located on the Altiplano, about an hour’s drive south of the capital, La Paz, on the highway to Oruro. It is an industrial town, boasting the Bolivian National Brewery’s bottling plant, and a large cement factory. The municipality is headed by the town of Viacha, and includes a large rural catchment area that reaches up to the Peruvian border. Local government in Viacha was unresponsive, violent and corrupt. There was abundant evidence that the mayor short-circuited public accountability by sabotaging the institutions of government. This left him with little effective oversight, freeing him to engage in corrupt deeds. These he pursued with vigour and relish according to many knowledgeable sources, including even his direct political superior within the party he represented.

Evidence for the bad quality of government in Viacha includes:

- Local government expanded its payroll by more than 100 per cent, without significantly increasing administrative ability or technical skills.
- The sewerage refurbishment project, awarded to a political supporter of the mayor, replaced underground pipes with new pipes that were too small and structurally weak, leading them to explode and project sewage up through large holes onto the city streets.
- The most prominent public project, the Municipal Coliseum, was unfinished and over-budget long past its completion date.
- The ‘Park of the Americas’ had become a rubbish tip, and one of its main attractions, a 15-foot high children’s slide, was missing several of its main steel panels, making it dangerous or even deadly for any children who might attempt to slide down.
- Public officials, municipal councillors, and even the mayor’s political boss testified to the mayor’s corruption, and
- A national audit of municipal accounts charged the mayor with malfeasance.

1 CBN, in Spanish, a privately held company, unlike what the name suggests.
Box 1: Project identification in Viacha

In Santa Ana de Machaqa
The mayor comes along brightly to ask us what projects we want, but then does nothing about it….The municipality isn’t like the Plan Internacional [an NGO active in the area], which does come through for us. […] We spend money making trips to Viacha to make formal requests for projects, but nothing comes of it.
The municipality did build a schoolhouse and public urinals in Santa Ana, but local residents were not consulted about project design, and were not told the value of their counterparts. The community’s request to change the urinals to an additional classroom was rejected. Then they were overcharged for their lime supplies, and discovered that the wood the municipality had provided was rotten.

from Faguet (2002)

Box 1 provides a flavour of the sort of testimony given again and again in Viacha.

The proximate causes of poor government in Viacha included a corrupt and corrupting mayor, an ineffective municipal council who demanded to know in interviews precisely what their duties and powers were, and a neutered, corrupted oversight committee which was meant to represent civil society before the local administration, but in practice operated as a servant and plaything of the mayor.

These proximate causes are correct as far as they go, and are undoubtedly connected to the phenomenon of bad government. But they are not very useful, indeed, they are akin to explaining that in order to become wealthy, one needs to acquire a lot of money. To understand the causes of corrupt, ineffective government in Viacha, we need to go much deeper – to structural factors. Consider structural factors in three categories: the economy, the political party system, and civil society.

The Viachan economy was dominated by the bottling plant of the CBN brewery, whose influence on the local political system was even greater than its economic weight, since the other big firm – a cement factory – had effectively withdrawn from politics a few years earlier. The national owner of the CBN also headed the UCS (Unión Cívica de Solidaridad) political party, which he had founded as a personal vehicle, and which had become one of the main political parties in the country. Hence the director of the bottling plant, Juan Carlos Blanco, was also the head of the local branch of the UCS.

To first build up, and then maintain, the UCS’s dominant position in Viachan elections, Blanco placed the assets of the bottling plant at the service of the party, and acted with fiercely partisan aggression to dominate the political party system. His twin strategy was to capture votes and to promote the UCS/CBN brand. Hence he funded campaign rallies with dual-branded banners and signs, staffed by workers from the bottling plant, where beer was given away free initially, but subsequently sold. His delivery trucks, often the only regular contact from the city experienced by small, rural communities, also distributed political pamphlets and other propaganda. He provided the local branch of the UCS with all the support and resources it could possibly need.

And he became the monopolistic provider of political finance not just to his party, but to all political parties. Rival parties confided that he contributed to their campaign funds on condition of being allowed to veto, or occasionally choose, candidates for their electoral lists. In effect, Blanco paid opposition parties to not compete. With this system in place, the
UCS won a succession of local elections. But voter turnout fell sharply, as citizens sensed little real political competition, and hence no substantive political choice.

The third pillar, civil society, might have been a counterweight to this confluence of politics and economics. But unhappily, in Viacha civil society was doubly divided against itself: once between the ‘white’ city dwellers, self-described descendents of Europeans, modern and rational, versus the pre-modern indigenous countryside; and a second time between the Machaquas region, guardians of pre-Columbian cultural traditions and self-governing institutional forms, versus the rest of the countryside, permeated by the peasant unions that the 1952–53 Revolution established. Hence there was widespread distrust between town and countryside, and additional distrust between different parts of the countryside, with episodic outbreaks of violence, and low social cohesion.

Charagua

The contrast with Charagua was immense. Charagua’s government was participative and responsive, led by strong organisations of government that produced high-quality policy outputs. Evidence for this includes:

- The mayor of Charagua topped a departmental ranking of municipal mayors.
- Operating costs were kept to four per cent of the total, in a period when the municipal budget grew 6,500 per cent.
- National government audits concurred that local government was well-organised and transparently administered.
- Local testimony overwhelmingly concurred.

Indeed, this last point is perhaps the most impressive. In scores of interviews across all areas, political tendencies, and social levels of Charaguan society, not a single respondent criticised the honesty or good intentions of the municipal administration. Many took issue with specific budget items, or disagreed with general priorities. But no one disputed that the municipality was led by a high-quality administration.

The proximate causes of Charagua’s honest, effective government were an honest, hard-working mayor; a representative, responsive, well-informed municipal council; and a vigilant, independent oversight committee. Once again, these proximate explanations are fine as far as they go, but they do not go far enough.

Box 2: Project identification in Charagua

Communities throughout the large municipality of Charagua were well informed about the costs, schedules, and counterpart contributions of projects being implemented locally. In Kapiwasuti, the entire community discussed and agreed plans for an irrigation project for local farmers, and then approved the design drawn up by a local NGO. And villagers mobilised themselves to provide collective services. Thus Acae boasted three production teams which planned, organised and worked communal lands for the benefit of all. And this was not limited to more prosperous areas. Even the poorest communities such as El Espino and Taputami, where respondents were shirtless and scarcity was evident, had village presidents, community officers and production teams. These organisations permitted villages to coordinate relatively large and complex projects. Thus Taputami was able to design and build a 100 meter bridge over a local stream entirely on its own.

_from Faguet (2002)_
The structural causes of high-quality local government in Charagua are far more telling. First, Charagua benefited from a competitive local economy led by relatively pluralistic cattle ranchers. Charagua’s agricultural economy was traditionally dominated by cattlemen, and the remainder consisted of a large number of subsistence farms owned by impoverished members of Bolivia’s third-largest ethnic group, the Guaraní. But a group of cattlemen, even in a small community like Charagua, and despite high levels of intermarriage, is nevertheless a collection of independent businessman. It is not a single, monolithic firm marshalling its resources under a unified command, as was the case in Viacha. Hence at campaign time, Charagua’s cattle ranchers supported parties across the political spectrum, even if they and their families voted mostly for centre and right-wing parties. This generally took the form of ranchers donating a cow, which a party would barbecue for its supporters at a political rally. In this way, individual ranchers did not alienate the opposition, should they win. This more competitive, less monolithic economy contributed to an open, competitive political system. Politics in Charagua was open to new entrants, a point proven when the left-wing MIR party, which had never exceeded five per cent of the vote in Charagua, made an offer to Guarani civic leaders that transformed local politics and won them control of the municipality. The MIR invited the dominant Guaraní organisation to choose the person who would lead the MIR’s electoral list in Charagua, and to negotiate a political platform jointly. The MIR’s only condition was that the Guaraníes work to get out their rural vote. The parties agreed, and their strategy proved an unprecedented success, as the MIR took over local government under the leadership of a Guaraní-selected leader. This is a clear example of how an open, competitive political system foments political entrepreneurialism, and hence the broad representation of different social groups and political interests in government policy-making.

The third structural cause of good government in Charagua was a highly organised, coherent civil society. Bolivia’s Guaraní-speakers were enjoying a cultural renaissance during this period, after nearly dying out at the turn of the twentieth century, after which they lived for decades in the shadows of national public life. Their ‘peak association’, the Guaraní People’s Assembly (APG in Spanish), existed to give its members voice, help them organise collective action, and represent their interests and culture more broadly. Its roots lay deep in Guaraní village traditions, which had survived a century of neglect unscathed, and which provided the APG immense legitimacy and convocatory power amongst Guaraní villagers. Hence civil society in Charagua benefited from characteristics that were the polar opposite of civil society in Viacha: high degrees of organisation, trust, legitimacy, and a proven ability to solve the collective action problem. Hence when decentralisation opened up a new sphere of public life in Charagua – the local sphere – the APG simply took it over and made it its own through the straightforward expedient of winning an election in which it represented three quarters of voters. Local government in Charagua changed decisively for the better.

**A simple model of government**

The experiences of government success and failure in Charagua and Viacha suggest the following model of government, which has sufficiently general properties as to apply to both local and national contexts. Politicians need to win power if they are to control the institutions of government, so consider first elections. Politicians and political parties make policy promises to individual voters in exchange for votes. This is
'quasi-market 1', in which political ideas and influence are traded at the retail level. But political parties do not run on ideas or intentions alone. Parties require resources, if only to run campaigns. Hence they must engage in a separate market, 'quasi-market 2', in which they trade blocs of policies, and longer-term influence over policy, in exchange for money at the wholesale level. Such trades occur with organisations that have money, and are interested in influencing policy. These, for the most part, are firms and economic interests, although we need not limit this group in any particular way.

The combination of these two quasi-markets, and also the way in which they interact with each other, is the electoral exercise, in which one political team wins and the other loses, and the winners take control of the institutions of government. Once the new government is formed, it enters into a very different sort of organisational dynamic with the intermediating organisations that comprise 'civil society'. Here, civic groups provide government with information on social preferences, feedback on the efficacy and desirability of previous interventions, and community counterparts and participation, in exchange for public goods and services. Note that the same citizens appear in two separate boxes in this model. In the upper left-hand box, citizens are conceptualised as individual voters exercising the secret ballot. In the bottom-middle box, citizens are construed as members of intermediating organisations that aggregate their interests and preferences, and organise their collective action, according to a rich set of cross-cutting cleavages and identities into which society spontaneously organises itself.

Figure 2.7: A simple model of government

A comparison of the two quasi-markets is revealing. Quasi-market 1 is both powerful and compelling because it is the only means by which inadequate governments can be removed from office. This would seem to place an inordinate amount of power in the hands of ordinary citizens. But quasi-market 1 is infrequent and discontinuous in the temporal aspect, and thus plays a supporting role through most of the electoral cycle to quasi-market 2, where the influencing of politicians is continuous, and a much smaller number of individuals take much bigger decisions. These advantages of timing and aggregation are more or less counteracted by the
organisational dynamic into which politicians and civic organisations enter once the former assume power. Here, contacts between politicians and civil society are much more continuous, and at a higher level of aggregation, than in the electoral sphere. These characteristics magnify the incentives that civic organisations provide to politicians, to the point where they can broadly rival those wielded by firms and economic interests.

This, then, is an account of the structure of government, and the main dynamics that define its operation. Government will tend to be effective when the two quasi-markets and the organisational dynamic are in rough balance. Where one dominates the others, systemic and predictable distortions of policymaking will occur. For example, where quasi-market 2 is dominant, policymaking will reflect the preferences of one or a small number of economic interests. Politicians will not be accountable to ordinary voters, nor will they respond to the demands of civil society from below. This, in essence, is the story of Viacha. Where the market for policies/votes is weak or missing, government will tend to be undemocratic. Where the market for political influence is weak, under-funded parties may be unable to canvass voter opinion effectively, and government may be insensitive to economic conditions. And where society's civic organisations are weak, government will be lacking in information, oversight and accountability.

By contrast, a competitive local economy will tend to lead to competition in politics, as we saw in Charagua. Where local politics benefits from an open and transparent electoral system, as well as a competitive party regime, the natural dynamics of political competition will tend strongly towards a substantive focus on local issues and local people. The latter arises endogenously, via the sorts of political entrepreneurship described above.

But in order to work well, the system requires civil society to be well-structured and vigorous. Civil society is crucial to government effectiveness through its informational and coordinating roles. A well-ordered civil society will have the following characteristics:

1. the ability to communicate
2. minimum levels of human capital amongst civic leaders
3. minimum resources and
4. norms of trust and responsibility, both within communities and amongst them, as well as across time.

Where such conditions obtain in the economy, politics, and civil society, and there is a stable tension between the three, the markets and dynamics of power and influence that swirl within government will tend to counterbalance each other, leading to governance that is open, inclusive, and responsive to the various constituencies and interest groups. The fundamental conditions of information and accountability that we defined at the outset, implicit in different ways in both quasi-markets and the organisational dynamic, will be met. In such circumstances, government will be accountable to the governed, and democracy will be achieved.

A reminder of your learning outcomes

Having completed this chapter, as well as the essential reading and activities, you should be able to:

• define ‘accountability’
• explain the roles of information and accountability in making governments responsive to citizens
• explain the role of voting in revealing and transmitting information to politicians
• summarise how voting interacts with other aspects of democratic government, such as lobbying, campaigning, and the activities of civic organisations
• analyse the strengths and limitations of democracy for providing government that is accountable to its citizens.

Sample examination questions

1. Democratic elections provide a façade of accountability where really there is none. Discuss.

2. What stable equilibria exist for 1, 2, 3, 5 and 6 player combinations on a Hotelling beach? What does the concept of ‘stable equilibrium’ mean in such a context? Why might this model be inappropriate for analysing real-world issues?

3. After a hard night of post-examination revelry, three Development Management students crave ice cream. They find themselves in the last ice-cream selling venue still open in London, and with only enough money between them for one tub of ice cream. The vendor offers them Chocolate, Strawberry or Vanilla. The students are named 1, 2, and 3. They vote for which flavour to buy. Figure A depicts their individual preferences:

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**Figure A**

Is there a stable equilibrium? If so, what is the majority-preferred preference ordering of the three flavours? If there is no stable equilibrium, describe how temporary equilibria break down.

Now assume their preferences are as in figure B:

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**Figure B**

Is there a stable equilibrium? If so, what is the majority-preferred preference ordering of the three flavours? If there is no stable equilibrium, describe how temporary equilibria break down.

In one or two sentences, what does this model imply about real-world elections?
Chapter 3: Democracy and decentralisation

Aims of the chapter

The second chapter in this course is concerned with one of the most widespread, and potentially powerful, reforms in the world today, designed to improve the quality of governance that a country achieves, thereby both accelerating and deepening its development. This is the question of decentralisation. Over the past two decades, decentralisation has become one of the broadest movements, and one of the most debated policy issues in the world of development. It is at the centre of reform throughout Latin America, Asia, and Africa. Indeed, under the guises of subsidiarity, devolution, and federalism, is at the centre of the policy debate in the EU, UK, and US as well. The World Bank estimates that between 80 per cent and 100 per cent of the world's countries are experimenting with one or another version of decentralisation. It is therefore curious, if not bizarre, that the empirical literature is so ambivalent about the effects of decentralisation on a number of important policy variables. Does decentralisation improve service delivery for the poor? Does it increase or decrease the unit cost of health, education, irrigation and roads? Does it increase or decrease economic growth? Does it increase or decrease corruption? We simply do not have clear answers to these or many other important questions. Even in cases where theory unambiguously predicts a certain direction of effect, attempts to establish such effects empirically have produced contradictory results.

Why is this the case? There are several good reasons, which we explore further below. The most important ones are the lack of a good, clear definition of decentralisation in the empirical literature, which in turn leads researchers to compare cases that are not strictly comparable, because the specific actions they have taken in the name of 'decentralisation' are fundamentally different from one another.

How, then, can we learn more about decentralisation's effects on poverty, growth, efficiency, and development? This chapter provides a way in to these questions by first defining decentralisation clearly. We then discuss the predictions of theory about what decentralisation of this type might achieve. Lastly, we empirically examine the experiences of two countries where decentralisation of this type was vigorously implemented, to try to establish what its systematic effects across hundreds of municipalities are.

Learning outcomes

By the end of this chapter and having completed the essential reading and activities, you should be able to:

- define 'decentralisation'
- explain the major benefits and costs associated with decentralisation
- explain why the empirical literature on decentralisation is characterised by contradictory conclusions and recommendations
- give a detailed account of the underlying trade-offs involved in moving from a highly centralised to a decentralised form of government.
- explain the major effects of decentralisation in Bolivia and Colombia.
Essential reading


Further reading


Works cited


Introduction

Two small anecdotes hinted at the growing enthusiasm with which decentralisation is viewed in policy circles. In 1997, Professor James Manor gave a lecture in Rome in which he called decentralisation ‘a quiet fashion of our time’. Four years later, Tim Campbell published a book about decentralisation in Latin America called The Quiet Revolution (2003). In this book, Campbell shows that it is not just the number of countries decentralising that impresses, but the scope of authority and resources that have been devolved to sub-national governments: ‘From Guatemala to Argentina, local governments began spending 10 per cent to 50 per cent of central government revenues’.

Decentralisation is thus an important reform affecting most, if not all, of the world’s countries; and the scale of the changes it can bring about in how countries are governed is potentially significant. It is odd, then, to look at the empirical literature and find so few clear answers concerning decentralisation’s effects in the countries where it has been tried. This is all the more so because the decentralisation literature is itself vast. Empirical studies have tended to come in waves. The first was in the mid-1960s to early 1970s, the second in the early 1980s, and a third beginning in the mid-to-late 1990s. Taken as a whole, this literature is often frustrating, and broadly indeterminate. This is not to say that it is uniformly of poor quality. It contains many excellent studies, and individual pieces of evidence that are compelling. But any particular conclusion about any aspect of decentralisation is contradicted by at least one opposite finding of apparently equal weight. This has led scholars in the past to despair about our ability to conclude anything about the impact of decentralisation...
on the things that we care about, such as poverty, economic growth, the responsiveness of government, and development more broadly.

I myself recently conducted a review of decentralisation studies published in *World Development* for a paper just published in that same journal. More than 50 studies have been published in recent decades. Of the 24 articles published since 1997, 11 reported broadly positive results from decentralisation, and 13 were broadly negative. The following lists some of the most interesting of these results:

**Positive**

- Fiszbein (1997): decentralisation can spur capacity building in local government in Colombia.
- de Oliveira (2002): decentralisation boosted the creation and administration of protected areas (Bahia, Brazil).
- Parry (1997): decentralisation improved educational outcomes (Chile).
- Andersson (2004), Larson (2002), McCarthy (2004) and Nygren (2005) are more cautious; decentralisation is a complex, problematic phenomenon that may ultimately be good for local welfare.

**Negative**

- Ellis, Kutengule & Nyasulu (2003), Ellis & Mdoe (2003), and Ellis & Bahiigwa (2003): Decentralisation probably depresses growth and rural livelihoods by facilitating the creation of new business licenses and taxes that stifle private enterprise (Malawi), and propagates rent-seeking behaviour down to the district and lower levels, so becoming ‘part of the problem of rural poverty, not part of the solution’ (Tanzania and Uganda).
- Bahiigwa, Rigby & Woodhouse (2005) and Francis & James (2003): decentralisation in Uganda did not lead to independent, accountable local governments, but rather local governments captured by local elites, and hence little poverty reduction.
- Porter (2002) agrees with the previous point for Sub-Saharan Africa more generally.
- Woodhouse (2003): decentralisation will fail to improve access of the poor to natural resources, or reduce ecological damage.
- Casson and Obidzinski (2002): decentralisation in Indonesia has spurred depredatory logging by creating bureaucratic actors with a stake in its proliferation.
- Martinez-Vazquez & McNab (2003): cross-country evidence doesn’t show whether decentralisation affects growth directly or indirectly; there are no clear theoretical grounds for predicting a relationship either way.
- De Mello’s (2000) study of 30 countries: failures of intergovernmental fiscal coordination will lead to chronic deficits and, eventually, macroeconomic instability.
- Sundar (2001), Thun (2004) and Wiggins, Marfo & Anchirinah (2004) provide cautious arguments that are on the whole sceptical about the possibility of beneficial change through decentralisation.
These results are reviewed in more detail in Faguet and Sánchez (2008). The lack of clear conclusions reflected in these results is echoed in the broadest international surveys of the literature. Rondinelli, Cheema and Nellis (1983) find that decentralisation has seldom if ever, lived up to expectations. Most developing countries experimenting with decentralisation experienced a series of administrative problems, with limited success in some countries, and little or none in others. Fifteen years later, surveys by Piriou-Sall (1998), Manor (1999) and Smoke (2001) are slightly more positive about decentralisation, but with many caveats about the strength of the evidence in its favour. Manor notes that decentralisation is no panacea, and evidence about it is incomplete, but it has many virtues and is worth pursuing. Smoke, on the other hand, finds the evidence mixed and anecdotal, and asks whether there is empirical justification for pursuing decentralisation at all. More recently, a survey by Shah, Thompson and Zou (2004) reviews 56 studies published since the late 1990s. They find that decentralisation in some cases improved, and in others worsened, service delivery, corruption, macroeconomic stability, and growth across a large range of countries. Hence we find ourselves in an absurd situation. After 50 years of policy experimentation, and hundreds of studies, and at a time when most or all of the world’s countries are decentralising, we still know very little about decentralisation’s empirical effects, and whether it is likely to accelerate or hold back development. On what is so much enthusiasm based? How can we know so little?

Activity 3.1

What does ‘decentralisation’ mean? Write down the best definition you can think of.

A large part of the problem is about concepts and definitions. Many of the studies surveyed by Rondinelli and others compare decentralisation in a handful of countries, such as (for example) Mexico, India and Thailand, or China and Russia. Despite high initial expectations, the results they find range between indifferent and inconclusive. This, in turn, is at least in part due to the very different nature of reforms pursued in each country. This, in turn, is largely due to the way decentralisation has been defined in the literature. One influential taxonomy of the various types of decentralisation is the following:

1. **Deconcentration** moves some administrative authority to lower levels within central government agencies. It gives limited discretion to field agents (to plan and implement programs and projects, or to adjust central directives to local conditions within the guidelines set by the higher level of government).

2. **Delegation** transfers managerial responsibility for specifically defined functions to organisations outside the regular bureaucratic structure, and only indirectly controlled by the central government. But the sovereign authority retains ultimate responsibility for public service provision.

3. **Devolution** creates or strengthens sub-national units of government, the activities of which are substantially outside the control of central government. Local governments are independent, autonomous, and usually have exclusive authority over explicitly reserved functions.

4. **Privatisation** is the auto-divestiture by governments of functions that are either transferred to voluntary organisations or left to the private sector. (Rondinelli, et al., 1984)
Although each of these measures is an interesting and important phenomenon in its own right, the four of them do not belong under a single rubric called ‘decentralisation’. In fact, no two of them belong under the same rubric, as if they were similar phenomena, or minor variations on a theme. Each of these four reforms belongs to a different category, because each sets up distinct incentives that will promote particular behaviours distinct from the rest. Hence the incentives faced by a public service providers under deconcentration are fundamentally different from those faced by public service providers under devolution. In the former, lines of authority and accountability go upwards to ministerial authorities and the capital; in the latter, lines of authority and accountability go downwards to local voters. When we treat these reforms as closely connected, and compare countries implementing different ones, we are, in effect, comparing beans with bananas. It is not surprising that the comparison yields little fruit.

Hence the first step in analysing decentralisation rigorously is to choose a clear, unambiguous definition. I suggest the following:

Decentralisation is the devolution by central (i.e. national) government of specific functions, with all of the administrative, political and economic attributes that these entail, to democratic local (i.e. municipal) governments that are independent of the centre within a legally delimited geographic and functional domain. (Faguet 2004)

Activity 3.2

Which of the definitions of decentralisation (i–iv) listed above do you consider best? Why?

Arguments for and against decentralisation

With that definition in mind, we can now consider the underlying theoretical arguments for and against decentralisation. The first of these is that reform can bring government ‘closer to the people’. This is the popular expression of a deeper set of arguments that we must unpack in order to analyze them. The first component of ‘bringing government closer to the people’ is that decentralisation can provide government with more and/or better information on local conditions and local needs. This will allow government to take better decisions about what sorts of public services to offer in each locality, and thus improve the efficiency and responsiveness of the state. Secondly, the argument refers to increased voice and participation in public affairs. By locating public authority and resources closer to citizens, the latter will more easily make their voices heard, and more fully and more frequently participate in public decisions. A third interpretation of ‘bringing government closer to the people’ is that decentralisation can improve the accountability of public officials to citizens by putting the fate of the former in the hands of the latter via regular elections, lobbying, and all of the usual accoutrements of (local) democracy.

A second argument in favour is that decentralisation will deepen democracy by providing a fuller and more intimate version of it for citizens far from the main cities, where national politics tend to be focused. This argument is in essence a reformulation of the first argument, but focusing more on politics and the value of participation per se, and less on technocratic notions like information, voice, and responsiveness.
A third argument in favour of decentralisation is that it can ‘cut through’ bureaucracy and improve the efficiency of the state. In this view, the problem of a bureaucratic, inefficient state is that it consists of too many layers, arranged in a centralised administration that is distant and wasteful. Decentralisation can solve these problems by relocating power and resources related to local services in small government units that will tend to be less bureaucratic and less wasteful than central government.

A fourth argument in favour is that decentralisation can reduce public spending. This is a claim frequently made by those promoting decentralisation in a specific country. The argument is frankly a red herring, and is frequently used by national elites who seek to reduce fiscal deficits by devolving responsibility for service provision to local governments without providing adequate resources. In these cases, decentralisation can be a rallying cry designed to obscure a series of unfunded mandates, and a relocation of political responsibility to local politicians whose efforts are systematically underfunded.

In theory, by contrast, there is no strong reason for thinking that decentralised government will be cheaper or more expensive than centralised government. In other words, theoretical arguments go both ways, and so are indeterminate. There are solid reasons for thinking that local governments will enjoy lower unit costs in the production of public services, as the markets in which they operate typically feature lower prices than those of large cities. This is in large part a function of lower property prices in towns and villages, which feed through to lower product prices and lower wages. But on the other hand, a decentralised system of government will be expected to have higher overhead costs, as economies of scale in administration are lost by locating elected governments and their administrative apparati in localities throughout the country, instead of centralizing them in the capital. The question of which affect will dominate – higher overheads or lower unit costs – cannot be resolved theoretically, and is the proper subject of empirical research.

Activity 3.3

Will decentralisation tend to make governments more corrupt or less? Why?

The principal argument against decentralisation is that it will abet elite capture. This is because local elites (landowners, businessmen, or other notables) are small compared to national government, but can be very large compared to local government. In the latter case, local elites can capture the local policy-making process, and systematically distort policy to favour it themselves and their interests, and not those of the majority.

A second argument against decentralisation is that it will tend to generalise graft and corruption. An advantage of centralisation is that it limits the number of people with discretion over public authority and the public purse. Decentralisation, by contrast, allows far more people to ‘put their hands in the pot’, and will thus exert a corrupting influence on the state and the nation. Local government is ‘naturally’ corrupt, claim some, and hence the last thing reformers should do is to put more power and resources at its disposal. A curious footnote to this argument is that the president of Bolivia, when announcing his decentralisation programme, turned this argument on its head. If the only thing achieved is that more people steal public funds, he claimed, at least that will be preferable to the current situation, where a few steal everything, and much of the money leaves the country.
A final argument against decentralisation is that it will undermine macroeconomic stability. This is because local politics is less transparent than national politics, which allows local governments to run large deficits and become highly indebted. Although central governments may proclaim their determination to not bail out local governments, in practice this will be extremely difficult politically, especially around election time, when local fiscal crises can lead to economic and social displacements. In this way, decentralisation can destabilise the central government’s accounts, and lead to macroeconomic instability.

How do we resolve this set of claims and counterclaims, some of which are theoretical, others empirical, and which span a variety of disciplines and demand different methodologies if they are to be answered? Rather than approaching them head-on at a high level of generality, we opt instead for a deeper, more contextual analysis, examining what were decentralisation’s effects in two particular countries, where a number of political, economic, social and cultural factors can be explicitly accounted for. The characteristics of our two country case studies are particularly well-suited to an exploration of this nature, and the data available for each is a surprisingly good quality. The countries in question are Bolivia and Colombia, two Latin American countries of almost identical size that decentralised in the mid-1990s.

**Decentralisation in Bolivia and Colombia**

We begin with the pre-decentralisation political and economic context in both countries, then describe the main elements of the decentralisation reforms that each country undertook, before turning to an analysis of the effects of decentralisation in each.

Bolivia’s modern political history divides neatly into the long period before the 1952–53 nationalist revolution, and afterwards. Pre-1952 Bolivia was a poor, backward country with extreme levels of inequality, presided over by a ‘typical racist state in which the non-Spanish speaking indigenous peasantry was controlled by a small, Spanish speaking white elite, [their power] based ultimately on violence more than consensus or any social pact’ (Klein 1993, 237). The nationalist revolution embarked upon a state-led modernization strategy of breaking down provincial fiefdoms and transforming social relations (Dunkerley 1984). Their main tool was a highly centralised state. The revolutionaries organised state power into a cascading chain of authority that originated with the President. The President named his ministers and prefects, who in turn named regional and local authorities beneath them directly, a dedo. For the most part, the legal and political instruments of local government did not exist in Bolivia. Hence beyond some 30-odd cities, local government existed in Bolivia only in name, as a ceremonial institution devoid of administrative capability or funds.

Colombia was similarly a highly-centralised country, where governors and mayors were named directly by the executive branch, albeit without Bolivia’s extreme levels of inequality and discrimination in modern times. Indeed, Colombia had seen the ascendancy of a Liberal party dedicated to progressive social policies, the extension of suffrage, and the separation of church and state from the nineteenth century onwards. These progressive instincts implied little desire to devolve power away from the centre, but they did imply a country where the poor and working classes had many more opportunities than their Bolivian brothers.
The Bolivian decentralisation programme

Decentralisation was announced in Bolivia in January of 1994, and implemented on July 1, 1994, as a radical ‘shock therapy’ treatment. The program had four main components:

1. **Resource allocation.** Transfers to municipalities doubled to 20 per cent of all national revenues. The allocation of these funds amongst municipalities switched from an unsystematic, highly political criteria to a strict per capita basis. The difference this made to municipal finances in the majority of Bolivia’s districts was immense: before decentralisation, 86 per cent of all devolved funds went to the three biggest cities; after decentralisation, these three cities garnered only 27 per cent of devolved funds, in accordance with their population.

2. **Responsibility for public services.** Ownership of local infrastructure in education, health, irrigation, roads, sports and culture was given to municipalities, along with the responsibility to maintain, equip and administer facilities, and invest in new ones.

3. **Oversight committees (Comités de Vigilancia)** were established to provide an alternative channel for representing popular demand in the policy-making process. Composed of representatives from local, grass-roots groups, these bodies propose projects and oversee municipal expenditure. Their ability to have disbursements of ‘popular participation funds’ suspended if they find funds are being misused or stolen can paralyse local government, and gives them real power.

4. **Municipalisation.** Municipalities were expanded to include suburbs and rural catchment areas. One hundred and ninety-eight new municipalities (out of 311 in all) were created in law and in fact.

The Colombian decentralisation programme

Decentralisation in Colombia was a much more gradual, measured, consensual affair, carried out over several decades.

**Phase 1** began in the late 1970s, and consisted mostly of fiscal measures aimed at strengthening municipal finances. The most important of these were Law 14 of 1983 and Law 12 of 1986, which increased municipal tax collection powers and regulated their investment.

**Phase 2** runs from the mid-1980s to 1991. This phase was primarily concerned with deepening democracy. It established the popular election of mayors and governors, and sought to promote popular participation in local public decision-making via local administrative committees, and other similar bodies. The 1991 constitutional reform established citizens’ initiatives, municipal planning councils, open *cabildos*, mayoral revocation, referenda, and popular consultations.

**Phase 3** consisted of laws to regulate the new constitution, and other fiscal and administrative reforms. It promoted greater municipal responsibility for the provision of public services and social investment. It also provided additional resources by increasing central government transfers to local governments. Automatic transfers to regional governments rose from about 20 per cent to over 40 per cent of total government spending. In this way, Colombia moved to first in the region amongst unitary states, and third overall behind the two big federal countries, Brazil and Argentina, in terms of total sub-national spending (Alesina et al., 2000).
What were the results? Four stylised facts about Bolivia and Colombia

What were the results of decentralisation in Bolivia and Colombia? We compare investment flows before and after decentralisation in each country, in order to get a sense of what, if any, where decentralisation's effects. Consider first how central versus local governments in Bolivia invested resources across sectors, (i.e. across the various uses to which resources can be put.) Figure 3.1 shows central government investment during the final three years before decentralisation, compared with local government investments during the first three years after decentralisation. We see that central government invested most in transport, followed by energy, and ‘multisectoral’ (a collection of odds and ends difficult to characterise). Local government, by contrast, invests in education, followed by urban development, and then water and sanitation. Hence central government preferred infrastructure and economic production, whereas local government preferred primary services and human capital formation.2

Figure 3.1: Central vs. local government investment (Bolivia)

Source: National Secretariat of Public Investment and External Finance; original calculations.

A second way in which we can compare centralised versus decentralised government is to see how each regime invested its resources across space. In Figure 3.2, each black point represents investment in one municipality. Each graph shows investment in bolivianos3 per capita, again summed over the last three years before, and the first three years after, the decentralisation reform. The most unequal allocation of resources across space that one can imagine would show a single municipality receiving all national investment, and all the other municipalities aligned in a row at zero investment. The first graph in Figure 3.2 is not quite this unequal, but it looks fairly close. The extremely high top few observations, reaching over 50,000 bolivianos per head, distort the vertical axis, so we drop the highest 12 observations in order to expand this axis and look for more variation. The second graph shows that there is indeed more variation, but if we count all the black dots on the horizontal axis, we see that half of all Bolivian municipalities received exactly nothing during the final three years of centralised rule. The third graph in Figure 3.2, which shows local government investment per capita between 1994–96, demonstrates a much less unequal distribution of investment across space, with two-thirds of all municipalities located in a band between Bs. 100 and 300 per capita.

2 Much ‘urban development’ investment constituted of new municipalities building or refurbishing office space in localities that had never had a local government, and where necessary physical infrastructure did not exist.

3 The average boliviano exchange rate for this period was Bs. 5 per US dollar.
Lastly, Figure 3.3 shows scatter plots of central government investment (left-hand side graphs) vs. local government investment (right-hand side graphs) in education. Again, the graphs plot central government investment during the last three years before decentralisation vs. local government investment during the first three years after decentralisation, against objective indicators of real local need in each municipality. Each graph includes a regression line summarising the overall relationship. The first comparison shows that central education investment fell as the
illiteracy rate rose, meaning central government chose to concentrate education resources where literacy was higher. This is the opposite of what we would expect if central government were investing in areas of greatest need. After decentralisation, by contrast, local governments invested progressively more where illiteracy was higher. Both regression lines are statistically significant – at the 5 per cent and 0.1 per cent levels respectively. Note how many municipalities received no education investment at all under centralised rule. These graphs imply that decentralisation increased government responsiveness to real local needs.

A graph of central versus local government investment in Colombia (Figure 3.4) shows a similar pattern to that described above for Bolivia, albeit not quite as dramatic. Colombia’s central government invested most in infrastructure, followed by health and education. Under decentralisation, local governments invested more in health, followed by education, with infrastructure a distant third. But Figure 3.5 reveals a more interesting pattern still. Here, school enrolment is normalised to one in the year 1994, and the graph shows its evolution over the following decade, with total enrolment divided into its public and private shares. The graph shows that total enrolment rises in Colombia after 1997, and finishes the period some 20 per cent higher than at the outset. But public school enrolment rises more strongly still, to some 130 per cent of its 1994 level. Whereas private school enrolment, which does initially rise, falls back after 1999 to below its initial level. Education was perhaps the
most important sector over which central government devolved control and resources to municipal governments. Figure 3.5 implies that decentralisation coincided with an increase in total school enrolment, and that this increase was disproportionate in those schools that local governments controlled. In fact, there appears to be a substitution effect, where parents who initially withdrew their children from public schools in 1997–99, put them back into public schools after 1999, presumably because public education under local government was a more attractive option. The reader should note that Colombia’s recession in this period came in 1997, and by 1999 the economy had returned to strong growth. Hence public school enrolments are not simply varying with economic cycle.

Sophisticated regression analysis establishes two more stylised facts for Bolivia and Colombia. In Bolivia, centralised investment was economically regressive, concentrating public investment in richer municipalities and ignoring poorer ones. Decentralisation, by contrast, shifted resources towards poorer districts; after 1994, public investment rose in municipalities where indicators of wealth and income are lower. And in Colombia, in municipalities where decentralisation had progressed further, implying more local control over investment resources and less central intervention in local policymaking, student enrolments went up strongly. By contrast, where education investment was more firmly tied by central government, implying central priorities and criteria intervening in local decision-making, student enrolment
actually declined. The findings are robust to a number of different estimation
techniques and strategies, and significant at the 1 per cent level of confidence.
We can summarise our findings from these two country cases of
decentralisation as follows:

**Bolivian styled facts**

Decentralisation:

1. shifted public investment into social services and human capital formation,
at the expense of economic production and infrastructure
2. distributed investment more equally across space
3. made investment more responsive to local needs
4. shifted investment towards poorer districts.

**Colombian styled facts**

Decentralisation:

1. shifted public investment into social services and human capital formation,
at the expense of infrastructure.
2. improved enrolment rates in public schools. In districts where educational
finance and policy making were most free of central influence, enrolment
increased. In districts where educational finance was still based on
centrally-controlled criteria, enrolment fell.

In both countries, these changes were driven by the smallest, poorest
municipalities investing devolved funds in their highest-priority projects.
This contradicts common claims in the literature that local government is too
corrupt, institutionally weak, or prone to interest-group capture to improve
upon central government. At least for Bolivia and Colombia it is not the case
that local governments administered public resources with less ability or
sensitivity than the centre had done before them. Rather, in both countries
local governments performed better, and in Colombia local governments
obtained demonstrably superior results.

**A reminder of your learning outcomes**

Having completed this chapter, as well as the essential reading and activities,
you should be able to:

• define ‘decentralisation’
• explain the major benefits and costs associated with decentralisation
• explain why the empirical literature on decentralisation is characterised by
contradictory conclusions and recommendations
• give a detailed account of the underlying trade-offs involved in moving
from a highly centralised to a decentralised form of government.
• explain the major effects of decentralisation in Bolivia and Colombia.

**Sample examination questions**

1. Provide three distinct definitions of ‘decentralisation’. Which one do you
think is best? Why?

2. Decentralisation takes power away from insensitive national bureaucrats
and places it in the hands of local politicians who are, on the whole,
dumber, less educated and more vicious. Hence it is to be avoided. Discuss.

3. It is consistent to have a strong normative bias in favour of democracy and
oppose decentralisation. Discuss.
Notes