

What Is State Capacity?

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Abstract

Reform leaders who want to pursue technically sound policies are confronted with the problem of getting myriad government agencies, staffed by thousands of bureaucrats and state personnel, to deliver. This paper provides a framework for thinking about the problem as a series of interdependent principal-agent relationships in complex organizations, where one type of actor, the agent, takes actions on behalf of another, the principal. Using this framework to review and forge connections across a large literature, the paper shows how the crux of state capacity is the culture of bureaucracies—the incentives, beliefs and expectations, or norms, shared among state personnel about

how others are behaving. Although this characterization might apply generally to any complex organization, what distinguishes agencies of the state is the fundamental role of politics—the processes by which the leaders who exercise power over bureaucracies, starting from the lowest village levels, are selected and sanctioned. Politics shapes not only the incentives of state personnel, but perhaps more importantly, it coordinates their beliefs and expectations, and thereby the performance of government agencies. Recognizing these roles of politics, the paper offers insights for what reform leaders can do to strengthen state capacity for public goods.

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What Is State Capacity?

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Introduction

State capacity has come into prominence in research and international development policy dialogue from multiple perspectives. On the one hand, we have a broad macroeconomic view which finds that prosperous societies reside in states that establish peace, administer a compliant system for raising taxes, and enforce contracts and property rights (Besley and Persson, 2011). On the other, we have a variety of micro-analyses of “delivery units”, driven by the concern that the impact of anti-poverty and pro-growth policies and spending programs depends upon how well they are implemented or delivered by government bureaucracies (Barber, Kihn and Moffit, 2011). Across the left-to-right ideological spectrum, there is a shared recognition that states need to provide public goods, such as the rule of law and a level playing field, to enable markets to flourish, going beyond debates about the size of government or where it should intervene.² In international development the question is how funding and knowledge from external partners can build state capacity to deliver these public goods in places that are torn by conflict, or where property rights are insecure, or where abject poverty excludes people from competing in the marketplace.

Public policies are devised and implemented by myriad government agencies, staffed by thousands of bureaucrats and state personnel. This paper provides a framework for thinking about the capacity of these agencies using the economic theory of “principal-agent relationships” in complex organizations, where one type of actor, the agent, takes actions on behalf of another, the principal. Using this framework, the paper shows how the crux of state capacity is the *culture* of bureaucracies— the incentives, beliefs and expectations, or norms, shared among state personnel about how others are behaving.

Government organizations perform poorly when the multiple agents that work within them share expectations that low effort and performance are likely to go unpunished. Furthermore, organizations perform poorly when those who try to exert effort or exercise initiative to improve performance are perceived as a threat to those who extract rents from the status quo of poor performance. While this characterization might apply generally to any complex organization, what distinguishes organizations of the state is the fundamental role of politics--the processes by which the leaders who exercise power over bureaucracies, starting from the lowest village levels, are selected and sanctioned.

Politics fundamentally shapes the culture of bureaucracies all the way to the frontlines of service delivery. Processes or platforms of political contestation, and the leaders it produces, from those at humble local levels, such as in a village, to those occupying the national seats of power, have

² Fukuyama (2004) reviews the history of ideas over the decades of the 1980s and 1990s about the appropriate role of state intervention in markets. He draws a distinction between the debate over the *scope* of state activity from the consensus over the need for a *strong* state that is capable of implementing at least those minimum activities needed from a state even under limited government (such as, the rule of law). Acemoglu (2005) provides an economic framework for examining the tension between the need for “limited government” and yet “strong states”.

implications well beyond elections and politicians, through how they influence the incentives, beliefs and norms (or expectations of how others are behaving) of state personnel and thus, the day-to-day functioning of myriad agencies within the bureaucracy. When political contestation revolves around the extraction of private benefits from public resources, rather than around public goods whose benefits are widely shared, it creates and sustains a culture of low performance in the bureaucracy. When these political forces turn from private rent-seeking to delivering broader benefits from public resources, leaders have credible incentives and legitimacy to change management practices, instilling stronger incentives and professional norms among state personnel, which in turn improves performance.

I build these arguments by forging connections across disparate pieces of research and casting these into the framework of interactions among multiple types of agents in government bureaucracies. I provide international examples of how state capacity comes about, and review growing empirical evidence which supports the logical arguments from economic theory to substantiate this framework. Finally, I apply the framework to draw insights for how reform leaders in countries, and their external development partners might build state capacity for public goods.

Recognizing the different roles politics plays in shaping state capacity has new implications for how reform leaders and international development partners should approach the problem. The goal of this paper is to offer these new implications for policy dialogue and provide the conceptual framework for policy experiments to progressively learn and effectively build state capacity.

How have different countries built their capacity over time?

Consider the following examples in the literature of how state capacity came into being across countries as diverse as China, the United States and Brazil.

- In *How China Escaped the Poverty Trap*, Yuen Yuen Ang documents how higher-level authorities created effective incentives and motivation among different layers of the vast Chinese bureaucracy down to the cadres of local government, to implement national policy priorities (Ang 2016). China has a long history of strong state capacity—the ability to get bureaucrats in far-flung areas to follow orders, as well as exercise ingenuity and discretion to accomplishing national goals (Fukuyama, 2011 and 2014). This capacity led to devastatingly tragic outcomes under the Great Leap Forward and the Cultural Revolution because of the misguided national goals that bureaucrats were asked to pursue (Meng, Qian and Yared, 2015). But then the same capacity was turned around for an equally startling escape from poverty when national goals became those of market-style investments for economic growth (Ang, 2016). What Ang does not explain in her book is the origin of this Chinese bureaucratic culture, and the extent to which it may be unique, or shared primarily with other countries in East Asia. Fukuyama (2014) argues that the origins of Chinese state capacity lie in ancient history, going as far back as the third

century B.C., when Chinese emperors began investing in meritocratic recruitment of professional bureaucrats to administer state agencies. Dell, Lane, and Querubin (2018) provide evidence, drawing upon data from Vietnam, that a history of strong states in East Asia has persistent effects to present time, long after the disappearance of those historical institutions, through norms that support local cooperation in the provision of public goods. This literature on state capacity in East Asia thus highlights *norms* within state agencies as the key. But it raises the question: if strong bureaucracies in East Asia, whose effectiveness goes all the way down to village-levels, is due to inheritance of institutions and norms developed over centuries, how can countries in other regions replicate the success now, and urgently?

- Politics and bureaucracy in the United States in the 19th century looked very similar to conditions in many developing countries today. Bensel (2004) writes that for many men (women did not have the right to vote) at that time in the United States, “the act of voting was a social transaction in which they handed in a party ticket in return for a shot of whiskey, a pair of boots, or a small amount of money” (Bensel 2004, ix). Politics was dominated by clientelism and vote-buying; corruption was rife; state bureaucracies and city halls were captured by political leaders and their party machines (Fukuyama, 2018). Things began to change towards the turn into the 20th century, with a large literature examining the so-called Progressive Era in the United States during which bureaucracies were de-politicized. Rauch (1994) describes the reforms in this era that resulted in the professionalization of the bureaucracy in American cities, and the ensuing reduction in the political power to intervene in city management. Glaeser and Goldin (2006), Fukuyama (2018) and World Bank (2016) argue that the confluence of several conditions facilitated this era of bureaucratic reforms: rise in demand among elites for urban public goods, greater political engagement by non-elite citizens and their dissatisfaction with machine politics; and, greater transparency about corruption in politics through the emergence of a cheap and independent press. That is, favorable political conditions were fundamental to the establishment of professional, autonomous bureaucracies in the history of the United States.
- In Brazil, a series of reform-minded governors came into office in the state of Ceara, over 1987-1994, and confronted a situation of poverty recently made worse by a drought; some of the highest rates of infant mortality (102 deaths per 1,000) in the world; and no functioning public health system. Tendler and Freedheim (1994) provide a case study of how these reformers built state capacity to deliver health services and dramatically turned around health outcomes in the state within a span of a few years. Infant mortality fell by 36 percent and vaccination coverage increased from 25 to 90 percent. Perhaps even more importantly, the Ceara model was scaled-up across Brazil as the country’s Family Health Program (now called Family Health Strategy), relying on state-recruited community

health agents to deliver basic services targeted at poor households. Rochas and Soares (2010) estimate that this program has been successful in improving health outcomes in poor areas. How did Ceara, and subsequently Brazil as a whole, accomplish this? Tandler and Freedheim (1994) provide a detailed qualitative analysis of the various initiatives that began in Ceara that transformed the health system by creating a professional cadre of health service providers who were held accountable for delivery (eschewing the old system of patronage jobs and political hindrance in service delivery). The reformers followed a set of complementary “demand” and “supply-side” strategies. Even as they recruited a new cadre of public health workers, and trained them to deliver, they simultaneously took steps to ensure that these workers would not be captured by political patronage. They flooded radio broadcasts (the main news media at that time) with information about the value of public health, and the role of the newly recruited cadre of public health workers in delivering it. The public health workers told mothers that they should not vote for local politicians who would prevent the health workers from delivering vaccines to their children. In short, health was made politically salient, and health workers were instilled with a sense of professionalism and driven by peer pressure to perform.

Ceara has been in the limelight more recently with regard to its achievements in strengthening the education bureaucracy (Leahy, 2017). The story once again highlights the importance of municipal politics in shaping frontline service delivery. International teams regularly descend upon the municipality of Sobral in the state’s interior, and leave preaching the lesson that empowered teachers and school administrators, who take professional pride in doing their job, are “what works” in education. Why, then, is this not already happening? Martin Raiser notes: “*Sadly, many school principals are political appointees rather than education experts.*”³ Sobral’s mayor, the local politician, points out: “*One key recipe for success is to keep politicians out of schools.*” At the same time, from his own account, it seems the local politician in Sobral played a role in ensuring that qualified candidates would be appointed as school directors, and that teachers would be supported by the municipal government to focus on improving learning outcomes. Political support was thus extended to strengthening professional norms, replacing decades of political interference that destroys those norms.

The Ceara example resembles that of China and the United States in that the key to the emergence of state capacity, as described in the literature, is transformation in incentives and professional norms in the public sector. The Ceara example is different, and more relevant for contexts in the developing world of deep-rooted poverty, inequality, and patronage politics, in that it shows how capacity can be built quickly, by leveraging existing resources and political forces in developing countries.

³ See <https://www.brookings.edu/blog/future-development/2018/03/06/brazil-can-improve-education-by-copying-its-own-successes/> (accessed June 23, 2018).

In the following section, I provide a framework for analyzing the Ceara story, applying the logic of economic theory. But before that I anticipate the following question that might arise naturally in readers' minds: if the Ceara example has been around since the 1990s, why has this strategy—of a media blitz combined with public sector management reforms—not been tried elsewhere where primary health services are sorely needed? How is the Ceara example different from, say, the media campaigns to eradicate polio in India? I answer these questions as follows. The case of Ceara is different because the media campaigns were not primarily targeted to achieve *household* utilization of *one* health input (such as, the polio vaccine), but rather *municipal politicians'* support of the *professionalization of local public health systems*.

The reason the Ceara example has been sitting around on the shelf for so long is that reform leaders have not received these ideas from experts, until now. One, because policy-relevant questions of state capacity to deliver public goods have been falling through the cracks between disciplines. Economists have not taken sufficient account of politics when generating knowledge and giving policy advice. Political scientists have not examined equilibrium economic policy outcomes of political markets, and how transitions can happen from a low-level to a higher-level equilibrium. Two, international development partners fear political sensitivities when raising the role of politics in development. This inhibits policy dialogue on addressing political constraints in the problem of building state capacity. Three, my extended interpretation of the Ceara example is new, and motivated by advances in political economy research since the 1990s on the role of politics in shaping norms in the public sector. Applying the lessons from Ceara is not as simple as replicating it;⁴ rather, the Ceara case serves to support the following theoretical framework which links politics to bureaucratic productivity. Lessons can be tailored to other contexts using this theoretical framework to understand the problem of state capacity.

Understanding state capacity: A framework

Economic theory lends itself to a framework to understand state capacity within a series of interdependent “principal-agent” problems in which one type of actor, the agent, takes actions on behalf of, or at the behest of another, the principal.⁵ Public policies are selected⁶ and implemented by the state within the following principal-agent relationships illustrated in Figure

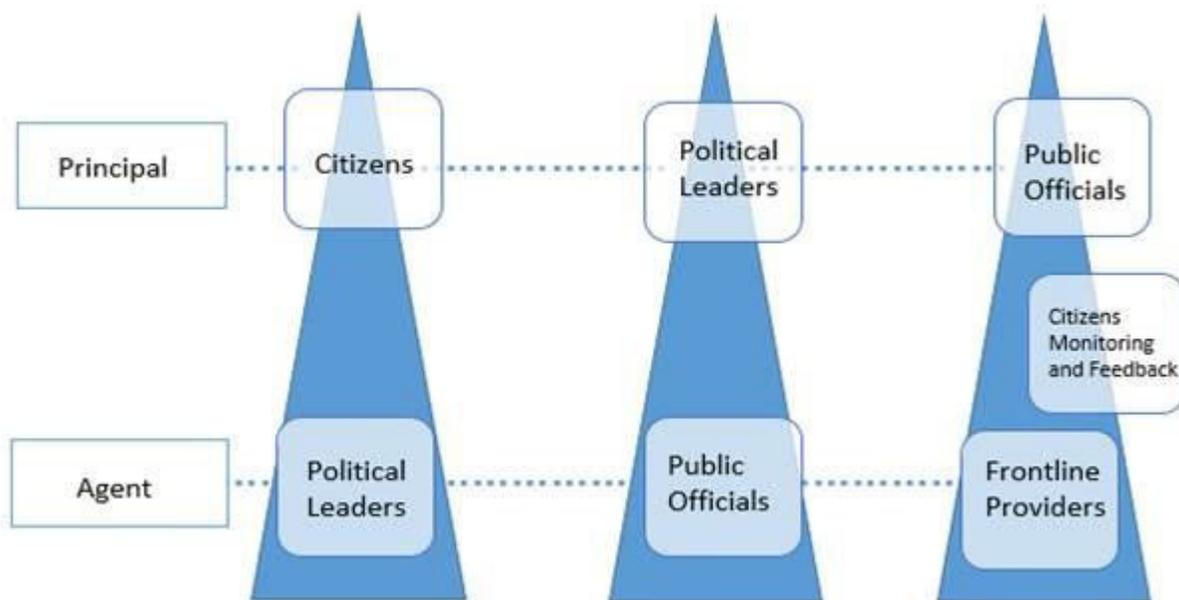
⁴ The success of the media strategy adopted by Ceara's reform leaders might be difficult to replicate. For example, in places where politics is polarized along party lines, information provided by senior political leaders might not be credible to all citizens. The following sections will break down the problem of how politics influences state capacity to derive lessons for different entry points across different contexts.

⁵ This framework was developed in the World Bank's Policy Research Report on governance (World Bank, 2016).

⁶ State capacity involves both take-up and implementation of policies. Part of the problem of state capacity is to foster a culture of policy-making on the basis of technical merit, accessing “experts” and debating options on the basis of the best available evidence.

1: (i) between citizens and political leaders, (ii) between political leaders and public officials who lead government agencies, and (iii) between public officials and frontline providers. This figure also shows how popular development initiatives of citizen engagement, to monitor frontline providers and participate in service delivery, fit into this framework.⁷

Figure 1: Principal-Agent Relationships of Government



Market failures and the need for public goods (to support competitive markets, at the very least) create the rationale for government intervention, and thus the need for state capacity, in both rich and poor countries. When governments intervene, principal-agent problems are created, as illustrated in Figure 1. When principal-agent problems are created, some amount of rents have to be given up by society to recruit agents and give them sufficient incentives to address problems of market failures and public goods (Acemoglu and Verdier, 2000).

As Wilson (1989: 375-76) describes in his classic analysis of the American bureaucracy, some of the problems of public sector agencies are inherent to the tasks they are required to perform. He writes: *“All complex organizations display bureaucratic problems of confusion, red tape, and the avoidance of responsibility. Those problems are much greater in government bureaucracies*

⁷ Citizen engagement in monitoring service delivery, providing feedback and expressing grievances, has become a prominent feature of policy efforts to improve government performance. Officials who hold leadership positions in government can engage the help of citizens to pressure service delivery cadres to perform better. For example, a District Executive Officer with formal powers over teachers, health workers, agricultural extension workers, road works contractors, and so on, can engage civil society organizations and request feedback from beneficiaries as an input into internal management practices.

because government itself is the institutionalization of confusion (arising out of the need to moderate competing demands); of red tape (arising out of the need to satisfy demands that cannot be moderated); and of avoided responsibility (arising out of the desire to retain power by minimizing criticism)...The greatest mistake citizens can make when they complain of “the bureaucracy” is to suppose that their frustrations arise simply out of management problems; they do not—they arise out of governance problems.”

Developed and developing countries each face the inherent challenge of managing principal-agent relationships-- recruiting or selecting the appropriate agents for the job and providing sufficient incentives and motivation for performance.⁸ One set of solutions consists of using technologies to reduce reliance on agents altogether, such as by establishing secure payment infrastructure and funds flow for delivering welfare benefits (Muralidharan, Niehaus and Sukhtankar, 2016; Banerjee, Duflo, Imbens, Mathew and Pande, 2017). Technology can also be used to reduce monitoring and management costs (Dodge, Pande et al, 2017). This slew of research projects has used complex data and statistical models to show that technology *can* be tailored to suit the needs of program delivery in developing countries, focusing on the largest welfare program in the world, the National Rural Employment Guarantee Scheme (NREGS) in India. Scaling-up technological solutions is challenging even for advanced economies such as the United States, as was demonstrated by the roll out of the Affordable Care Act, commonly known as Obamacare. Muralidharan, Niehaus and Sukhtankar (2014) write that it took 15 years for the United States to migrate Social Security payments from paper checks to electronic payments.

When technology cannot be used to bypass agents, or when agents are responsible for undertaking multiple complex tasks that are difficult to monitor, a large literature uses the logic of economic theory to derive insights that apply equally to rich and poor countries for how to manage these principal-agent relationships.⁹ Public sector agencies are typically tasked with producing *public goods*, which are precisely those for which incentives, as generated by markets, tend to fail. For example, the task of serving the children of poor families, whose parents' capacity is limited by budget and credit constraints, in addition to any behavioral constraints imposed by poverty, lack of education, and social deprivation. Another example is the challenge of regulating private markets for the broader public interest when consumers are unable to discipline those markets on their own. Furthermore, the structure of principal-agent relationships

⁸ Of course, an even more basic challenge that is common across rich and poor countries is that of raising taxes to resource government agencies. Some recent work has described the problem of state capacity in poor countries as a problem of under-staffing and under-resourcing (for example, Kapur, Mehta and Vaishnav, 2017, for India). While such descriptions are useful, they do not answer the more interesting questions of why; whether greater public resource allocation to addressing these resource constraints (such as, hiring more staff) will improve state capacity; and what are “optimal” levels of resource allocation to state capacity. The debate in the richest country in the world, the United States, with potentially the largest resource base to allocate to state capacity, has revolved around the question of how large should government agencies be, with the consequence that government agencies are under constant pressure to justify their existence and fight for their resources (Wilson, 1989).

⁹ Following are some of the pioneering contributions: Tirole, 1994; Dewatripont et al., 1999; Francois, 2000; Dixit, 2002; Besley and Ghatak, 2005; Acemoglu et al., 2008; Alesina and Tabellini, 2007, 2008.

in the public sector, namely, the presence of multiple principals with conflicting interests, is also quite different from those in other complex organizations outside government (Dixit, 2002). For example, consider the case of health service delivery by district governments in a typical country in Africa (Habyarimana, Khemani and Scot, 2018). Frontline health workers are answerable to several different appointed and elected leaders such as, district health officers, district chief administrative officers, and directly elected councilors, as well as to citizen committees (such as the Health Users Management Committees in Uganda).

Two insights emerge from the literature about how to structure principal-agent relationships in government bureaucracies when tasks are multiple and complex (and thus technological solutions are less applicable):

1. Reduced role of high-powered incentives and greater role for recruiting intrinsically motivated agents
2. Reduced role for top-down hierarchical monitoring and greater role for autonomy and peer-to-peer professional norms

In practice, bureaucracies across the world tend to use flat and above-market wages, presumably to attract public service motivated and talented workers (Finan, Olken and Pande, 2015). In many striking cases, these arrangements also “work”. For example, the success of one of the highest performing education systems in the world, the Finnish public education system, has been attributed to the meritocratic recruitment of highly trained teachers, imbued with strong professional norms, and autonomy in their classrooms (World Bank, 2018). Incentives are also strong in that teacher salaries are high to be able to attract highly competent individuals into the profession, and teachers can be let go by school administrators (who also exercise autonomy in how they manage schools).¹⁰ But incentives are not *high powered* in that salary structures are flat rather than consisting of bonus components contingent on test scores of students. The Republic of Korea’s high-performing education system shares with Finland these characteristics of the management of public school teachers (World Bank, 2018).¹¹ Greater autonomy in public agencies is also found to be robustly associated with better outcomes in the delivery of public investment projects in developing countries (Rasul and Rogger, 2017).

At the same time, however, critics of bureaucracies in the United States argue that federal workers are overpaid and underworked (Johnson and Libecap, 1994). These arguments are difficult to assess because the studies are not able to address the counterfactual of what outcomes would be in the absence of an overpaid and underworked bureaucracy. The value or economic contribution of these bureaucracies to keeping markets well-functioning may justify above-

¹⁰ Teachers in Finland are strongly unionized, and yet enforce professional norms among their cadres (Box 10.1.1 in WDR 2018).

¹¹ Even though the Korean and Finnish systems diverge in their pedagogical approach, they are strikingly similar when it comes to management of teachers in public education bureaucracies.

market wages and below-market working hours. Evans and Rauch (1999), for example, find a robust cross-country correlation between indicators of meritocratic bureaucracy and economic growth. Yet, if there is scope to make bureaucracies more efficient, or find management systems that work better in improving the quality of public goods and policies delivered by those bureaucracies, there is little known about it from the research literature even for the United States. Most of the available work on American bureaucracies is qualitative. The classic work by Wilson (1989) makes the point that well-functioning public agencies, be they schools, prisons, or armies, are characterized by having good quality leaders who are able to create a sense of “mission” in the organization to perform at high levels. But beyond these general attributes which resonate with the two insights listed above from economic theory, there is no blueprint about the formal structure of state agencies that would promote the sense of mission, professionalism and leadership that Wilson describes.

The crucial difference between developed and developing countries that comes out in the literature is that state personnel in the former tend to have stronger professional norms and basic incentives (for example, to show-up to work) compared to state personnel in poor countries. In developing countries, the organization of public sector agencies has allowed private rent-seeking and lacked sanctions, both formal and informal, against poor performance. One study finds that the same doctor performs worse in the public sector clinic than in his own private practice (Das et al., 2016); another finds rampant absenteeism among public sector teachers and health workers (Chaudhury et al., 2006); yet another finds that those who cheat in a lab game are more likely to express interest in a public sector career (Hanna and Wang, 2014); and many others document widespread corruption and bribe-taking behavior. Furthermore, several randomized control trials (RCTs) of implementing high-powered incentives in the public sector find that these incentives work—performance improves significantly (Muralidharan and Sundararaman, 2011; Mohanan et al., 2016; Singh and Masters, 2017)—which might appear contrary to the lessons from theory described above.

It is unsurprising though perhaps encouraging that a well-implemented RCT that changes incentives yields improvements in performance in contexts where incentives are weak to start with. However, even when incentives are shown to “work” in an RCT, scaling-up and sustaining those incentives requires considerable resources and “political will” (Muralidharan and Sundararaman, 2011). Banerjee, Duflo and Glennerster (2008) discuss how such reforms are sabotaged and repealed. Dhaliwal and Hanna (2014) discuss possible inadvertent side-effects of incentive interventions, displacing rent-seeking to other areas, and the lethargy within the bureaucracy to implement reforms. At the same time, support for the role of non-pecuniary or intrinsic motivation has begun to emerge from studies undertaken in other countries: Finan et al. (2015) review the evidence. For example: using rich data on variation across project implementation within Nigeria, Rasul and Rogger (2017) find that bureaucratic organizations with greater autonomy, rather than high-powered incentives, perform better. Donato et al. (2017) find evidence in India that impact of incentive interventions is sensitive to behavioral traits of

health workers, suggesting the need for further research to understand the relative roles of intrinsic and extrinsic motivation. Ashraf et al (2015) find evidence in Zambia that selection of different types of agents into the public sector matters beyond incentives.

The key difference that explains perverse incentives and lack of motivation in bureaucracies in poor versus rich countries is the nature of politics. For example, Mathew and Moore (2011) provide an account of “deliberate disinvestment” in state capacity in Bihar by leaders who use caste identity as their core political strategy. Beteille (2009) finds that politically connected teachers in India are more likely to be absent from the job. Similarly, in Pakistan, doctors with connections to political leaders are more likely to be absent from public health clinics, and the public officials who manage these doctors are more likely to report political interference when trying to apply sanctions (Callen et al., 2016). Habyarimana, Khemani and Scot (2018) find that the quality of local politicians in Uganda is one of the most robust correlates of bureaucratic productivity in delivering health services in Uganda (along with the presence of local media and voter attachment to national political parties). The politics of vote buying that is widespread in the Philippines is found to be substantially correlated with worse health service delivery and a higher proportion of malnourished children (Khemani, 2015). Conversely, more effective enfranchisement of the poor in Brazil, which was accomplished through electronic voting reforms that reduced the number of invalid votes cast by the poor, is associated with greater public spending on health and improved child health (Fujiwara, 2015). Mobarak et al. (2011) also report evidence of the influence of local politics on health service delivery in Brazil. Political party turnover in Brazil leads to greater replacement of headmasters and teachers, lowering of test scores among children in municipal schools (Akhtari, Moreira and Trucco, 2017).

As discussed in the example at the outset of this paper, politics in a country like the United States in the 19th century was very similar to present-day prevalence of clientelism and patronage in developing countries, and similarly impeded the capacity of the state to deliver public goods. When I presented this example at the start, I argued that changes in political contestation, spurred by mass participation and proliferation of cheap media, were fundamental to the strengthening of state capacity. At the same time, accounts of the Progressive Era suggest that many changes were simultaneously occurring in society, beyond politics. This was also an era which strengthened the notion of a “profession”, beyond occupation and employment, characterized by a moral authority stemming from expertise (Hofstadter, 1985; Miller, 1952). Professionalism spread throughout the economy, and not just the civil service.

The time seems to have passed for a similar social movement in developing countries today, since professionalism is no longer a new idea. The distinctive feature of developing countries today appears to be the unprecedented scale of political participation by non-elite, relatively unorganized and poor citizens, through the spread of local elections within countries across the political spectrum (World Bank, 2016). Politics in the developing world is typically characterized by weakly organized political parties, and yet vigorous political contestation in the

form of large numbers of candidates contesting for leadership at local government levels. Mayoral politics in Ceara, Brazil, the other example I started with, has these characteristics. Transformation of state capacity for health and education service delivery in Brazil has come from local political leaders who undertook deliberate steps to shift the platforms of political contestation to service delivery performance. Future research on building state capacity in developing countries needs to examine the role of local political leaders in shaping the incentives and norms of frontline state personnel. Below I examine what lessons can be drawn from the research that is already available.

Drawing lessons from available literature on how politics influences the bureaucracy

Forging connections within the available literature, I argue that politics influences the bureaucracy through three channels:

- (i) **Incentives:** by shaping the incentives of leaders--both elected politicians and appointed bureaucrats-- who wield power within state agencies
- (ii) **Selection:** by shaping who selects to become a leader—the intrinsic motivation and capability of leaders
- (iii) **Norms:** by providing focal points for citizens, both ordinary and office-bearing, to coordinate their expectations, and evolve norms of behavior.

An example for channel (i), the incentive channel, comes from research in Pakistan, cited earlier as well, which found that doctors who are politically connected are more likely to be absent from public health clinics, and the supervising bureaucrats who manage these doctors are more likely to report political interference when trying to impose sanctions (Callen et al, 2016). At the same time, the researchers found that where political incentives were stronger, such as in more competitive constituencies, supervising bureaucrats were more likely to take-up an innovative technology (using smartphones) for monitoring doctors. A larger body of research on political incentives finds more generally that when greater shares of poor and previously marginalized citizens become effectively enfranchised, politicians can get bureaucracies to deliver more public services like health from which these newly enfranchised citizens benefit. Fujiwara (2015) finds this in the case of Brazil, with public health spending and outcomes improving after the introduction of electronic voting machines which reduced the errors in voting by poor citizens. Miller (2008) finds this in the case of the history of the United States after suffrage was extended to women, which spurred legislators to increase public health spending, as a consequence of which child mortality declined.

Empirical evidence on channel (ii)-- through the selection of different *types* of agents, going beyond their incentives--is difficult to gather because of the challenges involved with measuring traits like altruism, public service motivation and integrity, which theory predicts as important determinants of productivity in public bureaucracies (Francois, 2000; Dixit, 2002; Besley and

Ghatak, 2005). Nevertheless, new results are emerging. For example, Habyarimana, Khemani and Scot (2018) find that district bureaucracies in Uganda perform better at delivering public health services in places where locally elected politicians have higher integrity, measured using survey modules developed in psychology to assess moral disengagement. Case studies of Ugandan districts suggest that locally elected politicians can play both negative and positive roles in the delivery of services--interfering to obstruct versus monitoring to facilitate better services. The integrity of local politicians can be expected to matter in whether they obstruct or support technical officers in delivering services within the complex organization of local government. For example, if local politicians are colluding with health service providers to extract rents from the health facility, they may obstruct disciplinary action by district management. This is consistent with the Pakistan results cited just above, that doctors with connections to political leaders are more likely to be absent, and the public officials who manage these doctors are more likely to report political interference in their management.

Large sample, econometric evidence on channel (iii)--how politics shapes norms of behavior in bureaucracies--is even harder to gather because of problems with measuring norms, especially when it comes to norms of low-effort and low-motivation which respondents would not want to admit. Nevertheless, both empirical and theoretical research on this channel is also growing. For example, Pandey (2010) provides direct evidence linking historical institutions that shape norms to current political behavior and the delivery (or lack thereof) of public services. She takes advantage of historical variation across districts in India in colonial land revenue institutions which concentrated power among elite landlords. Landlord districts had more oppressive revenue systems that gave greater power to elite landlords rather than to peasants. In districts with non-landlord control, village bodies that were more representative of peasants were responsible for collecting revenue. The results show that in ex-landlord-control districts, elections in contemporary times are more likely to be won by leaders belonging to high-caste groups, who are the social elite. These high-caste groups are less likely to send their children to the public schools in the villages compared with low-caste groups. Lower-caste children are overrepresented and high- and middle-caste children underrepresented in enrollment rates in public schools relative to their respective populations. Teacher effort is significantly lower in villages in ex-landlord districts. When results are analyzed by teacher caste, the difference in teacher effort between ex-landlord and ex-nonlandlord districts is significant for high- or mid-caste teachers who would be considered elites (based on their caste status). For low-caste teachers, the difference in effort between ex-landlord and ex-nonlandlord areas is not significant. Finally, student test scores and school infrastructure are significantly worse in villages belonging to ex-landlord districts.

What the above example shows is that behavior varies a great deal across and within villages (between teachers of different castes) sharing the same formal political institutions of local democracy, as well as generally similar economic conditions. Furthermore, variation in these behaviors can be traced to historical institutions of colonial revenue administration and even

older institutions of caste networks, suggesting that these behaviors are shaped over time and can thus be described as long-standing norms. The distinction between norms and incentives is important because long-standing norms among thousands of state personnel limit the ability of reform leaders to change incentives in the short-run by changing the formal rules of the game. For example, as cited earlier, Banerjee, Duflo and Glennerster (2008) and Dhaliwal and Hanna (2014) provide evidence from India that reformers who tried to use new technology to monitor frontline health workers and strengthen their incentives ultimately failed to implement or sustain these reforms.

Theoretical models suggest that initial sets of beliefs and expectations about how others are behaving can underpin the type of equilibrium into which society settles—whether one of high expectations and performance or its converse, low expectations, that support rampant corruption, for example, and inhibit even well-intentioned reform leaders from bringing about change. Frisell (2009) shows how reforms can be suspiciously viewed by voters when corruption is widespread. Leon (2013) shows how the presence of bad quality politicians as contenders in the wings can lead to paralysis among incumbent leaders.

Political norms of behavior — what citizens demand from the state, and how they expect others to be acting in the public sector — can explain why well-intentioned reformers, in powerful political positions, find it difficult to institute change. To illustrate the argument, prevalent political norms can be characterized as follows. Rational expectation among “ordinary” (*i.e.*, non-office-bearing) citizens is that other citizens will vote for politicians who share their identity or ideology, and who provide targeted private benefits, even though, in equilibrium, the consequences are harmful for everybody (since voting on the basis of identity and private benefits weakens political incentives to provide public goods). Of these ordinary citizens, among those who have leadership or entrepreneurial qualities, who become contenders for political power (starting from the village level, as local elections spread within countries across the political spectrum), the rational expectation is that other contenders are entering the fray to seek private rents from public resources. Among office-bearing citizens, or state personnel, all the way from high- and mid-level bureaucrats to frontline providers, the rational expectation is that their peers do not care about doing their jobs well because there are few formal or informal (sanctions) rewards for (bad) good performance. The service delivery organizations of the state thus lack both incentives and non-pecuniary sources of motivation (such as peer pressure and professional norms). When a reform leader tries suddenly to strengthen incentives in this low-performance setting, those reforms are resisted and thwarted by well-organized interest groups, such as unions of teachers and doctors, or other politicians who seek rents from the status quo.

Where even dynamic and motivated leaders find it hard to bring reforms is where success is difficult to deliver using their executive powers alone, and therefore, also harder for them to take credit for and return to office. These difficult areas are human-resource intensive and require sustained change in the day-to-day behavior of a large number of frontline personnel. It is also precisely in these human-personnel-intensive sectors of delivery that leaders face a particularly

difficult political trade-off— win elections by extending the patronage of government jobs and deploying ideological instruments (such as by exploiting social animus between groups on the basis of religion or ethnicity) versus strengthening bureaucratic institutions so that service providers are professionally motivated and routinely held accountable without need for political intervention. Thachil (2011) and Chidambaram (2012), for example, find that political parties with religious ideologies respond to citizen demand for health and education by providing services through their party organizations outside of the state bureaucracy, in order to win citizens’ gratitude and their vote; but, these parties do not appear to have sufficient incentives once in office to institutionalize service delivery by de-linking it from patronage or ideological politics.

In the language of game theory, persistent and systemic problems of low effort and low performance in government agencies can be understood as the non-cooperative equilibrium of a Prisoner’s Dilemma, supported by low expectations for cooperation (that is, non-cooperative norms) among large numbers of players. Dixit (2018) describes this problem in the context of widespread corruption. Although it would be beneficial for society as a whole to reduce corruption, society is instead stuck at high corruption levels because individuals believe that engaging in corruption is the best they can do given how others are behaving. For example, bureaucrats ask for bribes in order to provide public services, and citizens pay these bribes because they believe that most others engage in bribery; if you refuse to pay the bribe, you will get nothing, or worse, you may suffer retribution. Combatting corruption when it is entrenched and pervasive requires collective action and coordinated effort to escape the Prisoner’s Dilemma.

Dixit (2018) provides examples from the history of different countries of how such collective action has come about through different pathways and policy choices. The main contrast offered is between the top-down processes followed by powerful national leaders to create professional and accountable bureaucracies, as in the case of Hong Kong SAR, China, and Singapore; and the bottom-up process by which civil society groups organize a social movement, as in the case of the *addiopizzo* in Italy to resist extortion by the Sicilian Mafia. I argue below that the “top-down” versus “bottom-up” approach is a false distinction. In the vast majority of cases around the world, political leaders at both national and, importantly, at local levels, and processes of political contestation through which these leaders emerged, played the key role in transitioning from a non-cooperative to a cooperative equilibrium.

Politics is key to transitioning from a non-cooperative to a cooperative norm

Some of the examples in Dixit (2018)—such as the creation of professional bureaucracies by the King in Denmark in the 17th century and a Prime Minister in Singapore in the 20th century—consist of powerful national leaders taking authoritarian steps to set-up the institutions needed to change incentives to engage in corruption. However, when other countries tried to emulate Singapore and established similar anti-corruption agencies (ACAs) which would monitor and

prosecute the “askers” of bribes among politicians and bureaucrats in government, the results have been described as quite unlike Singapore’s. By many accounts, ACAs in other countries have largely been failures (Meagher, 2005; Doig et al, 2006; Recanatini, 2011; Heeks and Mathison, 2012; Mungiu-Pippidi, 2015).¹² Furthermore, the literature on corruption makes a distinction between “grand” corruption and “petty” corruption in East Asia (Rose-Ackerman, 2007). The argument is that while countries in the region were able to establish well-functioning and professional bureaucracies, uprooting bribery and petty corruption down the ranks of civil service cadres, the elites continued to capture rents at higher levels through political connections with large corporations.

There are two points I want to make in this section, partly through reference to the literature on the East Asian experience: one, authoritarianism as a way of building state capacity is the wrong lesson to draw for replication in other countries; and two, the right lesson to draw is about the importance of norms in the public sector as the crux of state capacity. Further, I show in this section how the literature supports the argument that norms are determined by historical political institutions. This re-enforces the first conclusion that countries without a history of successful autocracy cannot replicate the East Asian path to building state capacity through authoritarian diktat.

On the first point, a large body of research comparing economic performance across countries with more and less democratic institutions, suggests that, on average, democracies enjoy better outcomes (Acemoglu et al, 2014; World Bank, 2016). Yet, clear examples can be pointed to where autocracies outperform democracies (Besley and Kudamatsu, 2008; World Bank, 2016). Research examining these differences suggests that the key question that applies to both autocracies and democracies is whether leaders are selected and sanctioned on the basis of performance in delivering public goods (World Bank, 2016; Khemani, 2017). The argument here is not that greater political contestation *per se* would result in strengthening incentives and norms in government agencies, but rather it is the quality of that contestation which matters—whether contestation revolves around extracting private benefits or providing more public goods. In fact, growing evidence drawing upon variation *within* democratic countries suggests that sometimes, politicians respond to greater electoral competition by choosing strategies such as vote buying that come at the expense of broader public goods needed for development (Khemani, 2015; Cruz, Keefer and Labonne, 2017).

Why are some settings, within both autocracies and democracies, successful in selecting and sanctioning leaders on the basis of competence and performance in providing public goods, and others disastrous at it? There is some research available on the experience of electoral competition over time to guide us on this question, which I turn to in the next section, but much less on whether messy democracies can eschew elections, however flawed they may be, and become well-functioning autocracies. For example, Kenya is (in)famous for typifying identity politics and ethnic violence during elections, with negative consequences for the delivery of

¹² Olken and Pande (2012) point out, however, that since no randomized control trial of ACAs has been conducted, we do not have sufficiently rigorous evidence on whether they reduced corruption.

public goods to support economic growth. However, one study finds that ethnic favoritism led to distortions in public resource allocation even under authoritarian regimes in Kenya, and that periods of transition to multiparty electoral competition were in fact associated with *reductions* in these ethnicity-based policy distortions (Burgess et al. 2015).

On the second point, starting with Weber (1968) a large literature on East Asian “miracle” economies has argued that countries in this part of the world entered their era of industrialization with pre-existing conditions of professional bureaucracy (Ang, 2018, provides a review). More recent research by Dell, Lane and Querubin (2018) exploits a natural experiment within one country in the region--Vietnam--to provide evidence of persistence of norms of state administration and civic cooperation that were developed over centuries of history. Local administration within modern Vietnam in villages that were part of the erstwhile Chinese state during the first millennium CE, exhibits more cooperative norms today compared to neighboring villages that were part of the Khmer empire of South East Asia. The authors attribute these present-day differences in the quality of village administration within Vietnam to long-standing norms of behavior that were developed over time under the strong bureaucratic traditions of the Chinese state compared to the patron-client relationships of the Khmer.

This new research on the sources of state capacity in East Asia joins another body of deep evidence from an altogether different part of the world—Italy—to illustrate the role of history and path dependency through the channel of norms. Regional differences in the quality of government within Italy, between the center-north and the south, ultimately attribute better performance to stronger norms of cooperation; and these differences in norms are in turn attributed to earlier experience with participatory democracy, dating back to the twelfth century (Putnam, Leonardi, and Nanetti 1993; Guiso, Sapienza, and Zingales 2006; Alesina and Giuliano 2015). The inclusiveness of political institutions in “free cities”—a formal institution in the twelfth century—triggered a set of cultural traits (civic and cooperative behavior) whose effects persist today (runs the argument in this literature). Regions that were not free cities in the twelfth century but that currently have institutions of local political engagement are argued to suffer from “uncivic” voting, which allows corruption by political leaders to go unpunished (Nannicini et al. 2013). The earlier experience with democratic institutions, and greater accumulation of such experience over time, is thus credited as the underlying source of differences in governance within Italy today.

Similarly, Acemoglu and Robinson (2012) argue that early experience with inclusive or egalitarian political institutions in the history of nations is the source of variation in subsequent paths of economic development. Sokoloff and Engerman (2000) further argue that historically unequal economic institutions in Latin America compared with those in the United States and Canada were responsible for the delay in adoption of inclusive political institutions, and this delay is associated with subsequent weak institutions and persistently worse economic outcomes. The authors provide evidence that exogenous variation in the climate to produce sugar led to variation across countries within the Americas in the timing of adoption of egalitarian political institutions (democracy with universal adult suffrage) and social policies (education for universal literacy).

Although this body of work shows that early adoption of participatory political institutions is important, the mechanisms behind why early adoption matters and has persistent effects is not clarified or made explicit. Why are countries not able to change outcomes within short time spans by instituting elections with universal adult suffrage and spending on public education? And, conversely, why is it that reform leaders cannot bring about lasting or effective change through authoritarian rules? The answer offered in World Bank (2016 and 2017) is that norms are important in shaping the functioning of formal institutions and take time to change; and second, that norms can vary within the same formal institutions, and thereby explain different outcomes within places sharing the same political institutions. Historical institutions of inequality in present-day developing countries, such as examined by Sokoloff and Engerman (2000), Acemoglu, Reed and Robinson (2014), Anderson, Francois, and Kotwal (2015), Banerjee, Iyer, and Somanathan (2005), contributed to unhealthy political norms such as those that sustain clientelist forms of political competition where political support is won on the basis of providing targeted private benefits (such as a secure government job) rather than broad public goods (such as accountability for service delivery in that government job).

In places where unhealthy political norms are the starting point of the problem of state capacity (through the three channels of weak incentives, selecting poor quality agents, and sustaining low-effort norms), transitioning to a better equilibrium (of strong incentives, selection of good quality agents, and high-effort norms) necessarily goes through politics and cannot bypass it. For example, international development partners have tried to support so-called “social accountability” institutions, such as village-level organizations of citizens, as a way of building norms of collective action, without directly engaging with political institutions.¹³ A large body of research on social accountability, and other initiatives to foster local collective action, has found no evidence that it builds state capacity (for example, Casey et al, 2012).¹⁴

Theoretical analysis of how changes in norms come about points to a triggering role for political contestation, and the leaders selected through it. Leaders can play this role as “prominent agents” who signal a shift in beliefs among society at large (Acemoglu and Jackson, 2015). Growing experience with political engagement and the learning that comes from it, such as through frustration and indignation with bad outcomes, can create fertile conditions for change in political norms (Bidner and Francois, 2013). Recent theoretical developments on the management of complex organizations generally, both in the private and public sectors, is also pointing to the role of leaders in shaping organizational culture. For example, Akerlof (2015, 2017) defines the concept of “legitimacy” of leaders in getting lower level personnel to follow

¹³ The framework of accountability relationships in the World Development Report 2004 (World Bank, 2003) contributed to popularizing the idea that politics can be bypassed when it is a problem. One of the authors of the WDR 2004 has acknowledged that research developments since the publication of that report call for amending its framework (Devarajan, 2014). The framework was indeed amended in World Bank (2016) and is the basis of this paper.

¹⁴ Even the most prominent proponents of community-driven-development (CDD) programs have acknowledged that these approaches are not intended to substitute for state capacity, and not designed to address problems in complex bureaucracies above the community (Wong and Guggenheim, 2018).

the organization's objectives of their own accord, through peer-to-peer interaction, without incentive payments and monitoring from the top.

In each of these theories of how changes in norms come about, information and communication that shift expectations about how others are behaving is the necessary element that brings about change. In some models, the information is communicated through the types of leaders that are selected (Acemoglu and Jackson, 2015). In others, information is gathered and shared over time among citizens through the experience of political participation (Bidner and Francois, 2013). In any problem where norms support a less than desirable outcome, shifting to a new norm requires information sharing and communication among the actors to update their beliefs about how others are behaving. The role of political leaders and processes of political participation as *the* channels for sharing information that shifts norms in public sector agencies, is consistent with classic work on norms for collective action (Ostrom, 2000).

Can political norms be changed in the short run by reform leaders?

The literature on the persistent effects of historical institutions, long after the formal institutions have disappeared and been replaced by others, is useful in supporting the argument that norms matter, and that changing norms need not involve changing formal institutions. For example, as discussed above in the context of the literature examining differences in economic performance across democracies and autocracies (Besley and Kudamatsu, 2008; World Bank, 2016). Shifting norms need not involve large changes in formal political institutions, such as introducing elections into authoritarian regimes; or vice versa, removing elections or changing electoral rules in democracies. The growing evidence of significant variation in economic outcomes within countries, across places sharing the same formal political institutions, shows how the *functioning* of political contestation is what matters. To illustrate what this means, it may be worth repeating an example cited earlier—in places where the currency of political contestation is, literally, to buy votes, municipal governments under-invest in public health services and a larger proportion of children are recorded in health facilities as being severely undernourished (Khemani, 2015). Vigorous electoral contestation can strengthen incentives, but for the “wrong” strategies, at odds with technical evidence on the types of public policies that governments should pursue (Finan and Mazzocco, 2016).

The easy part of politics is the strengthening of incentives of political leaders to devise strategies to defeat opponents and gain and remain in office. The difficult part is to change political norms of thousands of ordinary citizens, and of mid-level bureaucrats, and frontline providers, so that winning strategies move away from things like vote-buying and exploiting ideological divisions among voters, to pursuing broader public goods. Prevalent political norms explain why, despite intense electoral competition, and powerful leaders who emerge from it to speak the language of reforms, these leaders find it hard to get frontline service providers, such as teachers and community health workers to deliver (eg. Callen et al, 2016). Even though reform leaders wield formal power over the humble workers on the frontlines of the state, leaders can be thwarted in their attempts to exact accountability from them (Eg. Banerjee et al, 2008; Dhaliwal and Hanna,

2014). Effective reform in this context is not the passage of a new law or act. Such high-level reforms may look good on paper and in policy dialogue with development partners, but may not, in fact, deliver results. The reform that matters in this context is in the minds of the thousands of human personnel that run state bureaucracies and implement public policies.

At the same time, the evidence of persistent effects of history and path dependency raises the question of historical determinism. Are countries doomed to run the long course of history and evolve norms over time, or, can a variety of policy actors do anything in the short run to change norms? In this section I argue that yes, reform leaders can attempt to change political norms in the short run by approaching it as a mechanism design problem. The framework offered in this paper shows how by raising three questions: 1. What is the goal, or the outcome the state hopes to achieve? 2. Who are the agents whose actions will collectively shape that outcome? 3. What resources and incentives do each of those agents have?

Let's return to the Ceara example to illustrate how this mechanism design approach can work for reform leaders to bring about dramatic change in the short run. The goal of a series of reformist governors of Ceara was to effectively deliver public health services, such as vaccination, which can be characterized as a classic public good. The agents whose actions would collectively shape whether vaccinations are effectively delivered are the frontline health workers, as well as the locally elected mayors and the nurses these mayors hire who have supervisory powers over frontline workers. Apart from physical resources—such as vaccines and cold chain and other equipment—needed to accomplish the goal, the governors confronted the lack of incentives and professional norms among nurses and existing health workers because of local patronage politics. A new cadre of health workers were meritocratically recruited by the governors' office, trained, and given credible signals that their career trajectory would depend upon their performance. Credibility came from broadcasting information about the hiring of these workers, the goals they were expected to pursue, the welfare gains that would come from that, and communicating what people could do if they did not see these workers performing. Those candidates who did not get the job under the new recruitment drive effectively became monitors of those who did. Radio broadcasts about the new cadre of workers made public health services politically salient, thereby changing the incentives of mayors. Mayors began to compete on the basis of facilitating health workers to deliver rather than distributing government jobs as patronage.

Yet, replicating the specific initiatives undertaken by the governors of Ceara is far from guaranteed to work in other places. Incumbent political parties in other places may not have the credibility to be effective by producing the media broadcasts themselves; or may not enjoy the fiscal and political space for meritocratic recruitment of a new cadre of workers. Mayoral politics at the local level in other places may be more entrenchedly clientelistic and resistant to change even after a media blitz.

However, the framework I offer in this paper is consistent with the general approach to the problem of state capacity adopted by the reformers in Ceara, Brazil-- as a problem of incentives and norms that is rooted in politics. Approaching the problem in this way would require understanding the platforms of political contestation in any context, from the lowest level

jurisdictions up, and examining how it shapes incentives and norms across different types of state agencies. Any policy reform to how state personnel are recruited and managed within a particular department—such as in the case of health workers in the Ceara example—would have to be accompanied by communication campaigns to shift expectations. Such communication campaigns, targeted at existing problems of weak incentives and norms, are a necessary complement to technical reforms, even if a particular campaign fails to produce improved results. Failure means going back to the drawing board and re-thinking how to change the communication strategy and re-test a different design.¹⁵ As a reminder of the discussion earlier, communication is the necessary complement to bring about change in low-effort norms, because shifting norms requires updating beliefs about how others are behaving. Identifying the role of communication as a complement to other technical reforms requires equal scientific investigation, and careful design based on better understanding how principal-agent problems function in public agencies.

Effective communication campaigns that shift political norms could also make the difference for which management models work better than others. High-powered incentive contracts, for example, where a community health worker's wages are dependent upon how many pregnant women she brings to deliver in clinics, may work better in an RCT compared to giving flat wages, when the local political context sustains a low-effort norm. However, flat wages *plus* a communication campaign that shifts the local political equilibrium may, in theory, out-perform the high-powered incentive contract. Future research-policy collaboration should test such interactions between communication and management reforms to identify more efficient ways of building state capacity.

To summarize: one set of new ideas offered here is a role for information and mass media in shifting norms. This role is very different from prior work on information campaigns for

¹⁵ The argument in this paper that communication campaigns are necessary to build state capacity would naturally raise the question: what is the evidence on the impact of information and communication interventions? World Bank (2016) was tasked with taking stock of the evidence and concluded that both citizens and politicians in developing countries are highly responsive to information, within a variety of institutional contexts. The evidence is consistent with the theory of principal-agent problems—information asymmetries are inherent parts of the problem, and provision of greater information typically leads to changes in the actions undertaken by politicians and citizens. That is, the report concluded that the appropriate question to ask is what information, communicated how, to whom, can help solve principal-agent problems in the public sector; **not**, does information work? The net result, in terms of development outcomes, of any specific information provision initiative depends upon what actions were taken in response by both politicians and citizens. The net result also depends upon whether the information provided was relevant to the actors whose behavior was targeted, and on the quality of information (whether fake or true news). Post publication of this World Bank stock-taking report, a group of political scientists have coordinated studies across multiple contexts to pull together meta-evidence on whether vote shares in developing countries change as a result of giving information to voters (<http://egap.org/metaketa/metaketa-information-and-accountability>). The informal word (at the time of writing this draft of the paper) is that this project is finding precisely estimated zero results—that is, vote shares accruing to different political parties and candidates do not shift after the provision of information to voters. This suggests that the design of information provided in these campaigns was either not salient to voters and politicians, or that each took actions that resulted in net zero results. For example, knowing that voters were going to receive information that would change their behavior in certain directions, politicians might have incorporated it into their electoral strategies (Humphreys and Weinstein, 2013).

strengthening incentives and accountability. In addition to targeting transparency to enable ordinary citizens to hold leaders accountable, the diagnostic of political norms also suggests policy ideas for how to use transparency among peers to strengthen professional norms in the bureaucracy. Furthermore, the diagnostic here suggests that information and communication can be targeted to shifting citizens' own political norms and preferences, increasing demand for more public rather than private goods.

The other set of new ideas have to do with the structure of principal-agent relationships within government—who is tasked with doing what—given the tendency of political norms to veer towards private rent extraction rather than public goods. This paper identifies a new complementarity between transparency and other management reforms. Furthermore, it shows why the mechanism design approach to management reforms of public bureaucracies needs to start by defining the nature of tasks that agents would be required to perform, in order to apply economic theory on how to structure contracts (depending upon the extent to which the tasks create a role for intrinsic motivation, autonomy, and peer pressure). There is considerable scope for policy experimentation by reform leaders, combining media campaigns, communication within peer groups, and design of principal-agent contracts using economic theory, to strengthen state capacity for public goods.¹⁶

What are the implications for the role of external partners in building state capacity?

External development partners bring financing and global knowledge to the table to offer to developing countries. However, critics have argued that the impact of external partnerships can be weak, or worse, counter-productive, if the design of how financing and knowledge are packaged and delivered, is not carefully thought through and based on scientific evidence of what works and what does not.¹⁷ This critique applies forcefully to the role of external partnerships for building state capacity. In influential work, Pritchett, Woolcock and Andrews (2013) have characterized capacity building activities by external partners as “isomorphic mimicry”—trying to make government agencies in developing countries look like agencies in the developed world. They argue that the evidence shows such mimicry does not work to build effective state capacity in poor countries. I go a step further in this paper and argue that even rich countries do not have sufficient scientific knowledge about how to build state capacity to address problems of market failures and public goods. When government intervention is needed, all countries grapple with the consequent principal-agent problems of delegation of tasks to politicians, bureaucrats and frontline state personnel.

At the same time, I argue that what we *do* know, that also applies to every country, rich and

¹⁶For example, an old paper by Kandel and Lazear (1992) discusses how principal-agent contracts in Japanese and American firms differ, based on the role of peer pressure and team-work norms in the former. The theoretical ideas in such papers can be applied to the reform of public sector organizations.

¹⁷ Reviewing the huge literature on aid effectiveness is outside the scope of this paper. Clemens et al (2011) is a recent contribution, reviewing the prior literature on aid's impact on economic growth. The general conclusion of independent agencies like the Center for Global Development is that the design of aid programs needs to be based on and guided by better quality evidence.

poor, is that characteristics of political contestation play a fundamental role in shaping incentives and norms within government agencies; and that these incentives and norms are the key to state capacity.¹⁸ This “result” that stems from a review of economic theory and evidence then has logical implications for the role of external partners.

With regard to knowledge, since research on state capacity is nascent, external partners do not have credible, scientific, off-the-shelf ready solutions to offer. More humility is warranted among external partners about whether they know which reforms should be instituted. Rather than treating “windows of opportunity” with reform leaders as windows to push through some known technical reforms to build capacity, these opportunities should be used for joint learning through policy experimentation.

Second, these opportunities should be used to enlarge the window beyond reform leaders, by leveraging information and communication to strengthen political incentives to build state capacity more generally. World Bank (2016) reviews the literature on the impact of transparency on political incentives and concludes that external partners have a comparative advantage in producing credibly non-partisan, ideologically free, technically rigorous information. Box 7.3 in World Bank (2016) discusses the political prohibition in the Articles of Agreement of the World Bank, and how this prohibition lends credibility and space to produce such knowledge. Using windows of opportunity to leverage this comparative advantage, by targeting information and communication to improving the quality of political contestation, can make it more likely that reforms will be sustained across successive governments, rather than hinging upon the continuation of a reform partner in office.

Contrast the above outlined Ceara-like approach with one where external experts court government leaders to allow them to “crawl the design space” to identify precisely which technical interventions work to get improved health outcomes, or education outcomes, or some other type of service delivery or policy implementation, through what has become a famous acronym (PDIA, for “problem-driven-iterative-adaptation” in Andrews, Pritchett, Woolcock, 2013). The analysis in this paper suggests that the PDIA approach does not sufficiently take politics into account, thereby hampering the search for technical solutions to the problem of state capacity (politics is part of the “technical” when it comes to state capacity). The PDIA approach typically involves finding political and bureaucratic leaders who are willing to bring-in the experts and willing to implement and learn from a variety of new ideas the experts are bringing. This approach does not ignore politics but navigates politics in a personalistic and partisan way rather than as an institution. Success not only hinges on whether the experts have brought in good ideas that work but also on whether the specific leaders, belonging to specific political parties or coalitions, remain in office to support the “crawling”. Furthermore, if the thousands of

¹⁸Other disciplines, such as sociology and political science, contain research arguing that culture and norms play a significant role in shaping the performance of public bureaucracies (for example, Mangla, 2015, provides a review). This paper’s comparative advantage is to leverage economic theory to examine multiple equilibria that can arise depending upon the distribution of initial beliefs and expectations among thousands of actors, and how transition comes about from worse to better equilibria. Emerging economic theories on such transitions are pointing to the role of political contestation and the leaders who emerge from political processes

state personnel who would be implementing the PDIA approach think this is a new scheme of the incumbent party, rather than a real change in the way things are done that would be supported by *all* political parties, then this approach is unlikely to change long-standing habits and norms (not because of irrational mind-sets, but rather, rationally grounded mind-sets which are acutely aware of how things *really* work, as new schemes, and the experts who propose them, come and go).

Here's an example. The Aam Aadmi Party in Delhi state in India came into office on a platform of improving governance and service delivery. In 2016 they invited Pratham, an internationally renowned charitable trust working to improve education, to help the party transform teacher motivation in public schools and improve learning outcomes in demonstrable ways so the party could deliver upon its electoral promises. Pratham crawled the design space with the state's education department and provided multi-dimensional inputs and expert advice. A scathing critique of this program was published in an op-ed in a leading newspaper by the state head of a rival political party, the Indian National Congress.¹⁹ This pattern suggests that the technical initiatives were viewed as a special scheme pursued by a political party rather than a non-partisan shift in strengthening the capacity of state personnel. Independent research into how such programs have been performing, such as one with the education department in the state of Bihar in India, yields the following lessons (Aiyar, Dongre and Davis, 2015): teachers are not doing things sufficiently differently in their day-to-day activities in the classroom, and the program loses traction once the reform champion moves out. The researchers explain this as the persistence of old norms, and the challenge of shifting to a new way of doing things.

What about the financing provided by external partners? The arguments about incentives and norms in this paper are entirely consistent with the value of additional financing and resources to build state capacity. Having greater resources to pay frontline public service providers a steady wage, for example, is needed if the evidence shows those providers will effectively deliver public goods needed for growth and development. However, if the financing is provided in contexts of low-effort norms, without accompanying efforts to shift those norms, then impact is likely to be weak. In a worse case scenario, external financing might seriously undermine political accountability in recipient countries, allowing rent-seeking incumbent leaders to remain in office despite poor performance (Deaton, 2013). External financing that does not pay attention to its effects on political accountability and norms can thus end-up hindering the development of state capacity. Also, conceptually, if external financing comes bundled with poor quality technical advice, and countries who want the money cannot say no to the conditions that come attached with that money, then that financing would pursue ineffective or sub-optimal reforms. Devarajan and Khemani (2018) provide a brief history of development assistance and conclude that bundling financing and knowledge into a canonical "project" is not an efficient way to provide either; unbundling knowledge from financing, and targeting knowledge to strengthen political accountability, would make external partnerships more effective in achieving

¹⁹ <https://indianexpress.com/article/opinion/columns/aap-arvind-kejriwal-punjab-gujarat-go-polls-delhi-education-why-aam-aadmi-party-needs-to-go-back-to-school-2989321/>

development outcomes.

In conclusion, the binding constraints to state capacity identified through this paper's framework are the incentives and norms among state personnel. When state agencies are persistently under-performing in delivering public spending programs and implementing policies, the reason is not that they lack knowledge (or access to knowledge) but rather that they are stuck in a non-cooperative equilibrium in game-theoretic terms. In plain-speak, state personnel are stuck with perverse expectations of each other. Not only do people think that there is little systematic punishment for bad behavior, but that punishment, ostracism or suspicion may, perversely, be more likely when someone tries to exert greater effort, take more initiative or exercise ingenuity. Processes of political contestation that have spread across and within countries are key to shifting incentives and norms among state personnel.²⁰ Recognizing the centrality of politics in building state capacity has transformational implications for how external partners should approach development assistance, and for how leaders should approach management reforms of public bureaucracies.

²⁰ To avoid misunderstanding, it is worth repeating that the argument is **not** that greater political competition, such as through closely fought elections, would result in strengthening incentives and norms. In fact, growing evidence suggests that greater electoral competition can, under some circumstances, have weak or even negative effects on the optimal allocation of public resources to achieve public good objectives (Habyarimana, Khemani, and Scot, 2018). And, some authoritarian regimes which restrict political contestation can achieve better economic outcomes than messy democracies (Besley and Kudamatsu, 2008). Rather, the argument is that when political contestation is producing perverse outcomes, there is no bypassing it; the solution needs to take political incentives into account and design a mechanism to address the problem.

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