

State-Building, Leadership, and Local Democracy

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Overview

Great differences in the wealth of nations can be derived from basic differences in their political systems.

Investment is protected locally, but trade must be protected nationally, so development depends on both local and national politics.

A theory of development should be based a general model of how effective states are built by political leaders.

The state is a network of agents who enforce laws that sustain property rights and reduce moral hazard in other organizations of society.

Motivation of agents in the state itself is also a moral-hazard problem, which must be solved by political leaders who establish the state.

Outline:

- Historical examples of how political structures affect development
- Sketch of an agency/leadership theory of state-building
- Some implications for development assistance

What has caused such great differences in wealth of nations?

To understand development, Schultz argued, we should study history.

"In England, a lease for life of forty shillings a-year value is a freehold, and entitles the lessee to vote for a member of parliament.

As a great part of the yeomanry have such freeholds, the whole order becomes respectable to their landlords, on account of the political consideration which this gives them.

There is nowhere except in England, any instance of a tenant building upon the land of which he had no lease, and trusting that the honour of his landlord would take no advantage of so important an improvement.

Those law and customs, so favorable to the yeomanry, have perhaps contributed more to the present grandeur of England, than all their boasted regulations of commerce taken together."

Adam Smith, *Wealth of Nations* (1776).

Economic development depends on allocation of local political power, which is vital for enforcement of property rights and contracts.

Feudal roots of underdevelopment

When first establishing rule in India (& after Mutiny), the British granted local power and privileges to local agents called zamindars. Holding local power as a permanent property right, zamindars became a class of local leaders with a vested interest in the regime. The effectiveness of their feudal power proved remarkably durable. Long after independence, Banerjee-Iyer (2005) find lower agricultural productivity and higher infant mortality in zamindar regions.

Feudalism can help to establish a stable political regime, but it can also have serious long-term economics costs. How much of global underdevelopment has resulted from such strategies of traditional and colonial state-building? Analysis of economic development is incomplete without considering local political leadership.

Balancing local protection of investment, national protection of trade

In 1700s, turnpike trusts built toll roads that gave England the world's best transportation, setting the stage for the industrial revolution.

These toll roads were managed by local leaders but had to be nationally regulated as part of a national transportation network.

The national government's dependence on local elites in Parliament made such local investments secure against central expropriation.

With representation, English towns could become secure open markets to attract elastic investment (compare Poland, Spain).

In late 1800s China, provincial governors sponsored new corporations for modern shipping, telegraphs, and railroads. (Feuerwerker, 1958)

Kang-i looted their accumulated profits for the central treasury in 1899.

Expropriation of provincial railroads caused Qing dynasty's fall in 1911.

Today China's central leadership cannot violate profit-sharing deals with local governments, but can reduce local protectionism.

Market preserving federalism (Weingast, 1995).

What comes first in constitutional state-building: laws or leaders?

Bremer (2003): no elections in occupied Iraq without a constitution;

Al-Sistani: a constitution must be written by elected leaders.

The chicken-&-egg question of constitutional democracy!

Thesis: Political institutions are established by recognized leaders who can motivate a faction of active supporters.

A leader needs a reputation for reliably distributing patronage benefits to his loyal supporters (*fundamental political law*).

To establish a state, political factions must develop networks of patronage and power that reach into every community.

A democratic state needs leaders with good democratic reputations.

Bremer's theory of the primacy of written constitutions would make it difficult to understand how they ever evolved in the first place.

A complex system can be spontaneously self-organizing when it has many opportunities to start locally and then grow larger.

True of leader-follower networks, but not of constitutional law.

Political leaders as guarantors of social incentive systems

Alchian-Demsetz ('72): Agents' incentives in an organization depend on supervisors reliably judging and rewarding performance; top supervisor's incentive to do so depends on ownership of profits.

Agents in a firm might look to state courts for contract enforcement, but not in a political faction that acts to take state power itself.

Political leaders are highest guarantors of social incentive systems.

The state is a network of agents with broad powers who could profit from abusing power, and so must expect greater long-term rewards from good service (*moral-hazard rents*). Candidates would pay for such offices.

Promises of back-loaded rewards become a debt owed by the state, which leaders could be tempted to repudiate and re-sell the office.

Political leaders must guarantee the state's allocation of moral-hazard rents, but who can bind a leader who wields sovereign power of the state?

His trusted agents together have such power.

The foundations of the state, and the leader's position in it, depend on the leader's reputation for reliably rewarding his supporters' loyal service.

Basic unit of political mobilization: the leader with his faction

Any political leader needs support to compete for power.

Supporters' efforts must be motivated by promises of rewards if win.

So a successful leader must have a reputation for reliably rewarding the loyal supporters in his faction (captains).

My *APSR* '08: In equilibria of competition for power, a leader cannot get any support unless he can assure his supporters that he would risk losing power if he cheated any of them.

Political debts are converted into moral-hazard rents by appointing key supporters to high office. (captains to governors)

Then key supporters join a high council that monitors the leader's distribution of rewards and offices when he wins power.

The norms of behavior that a faction expects of their leader are his fundamental political law or personal constitution.

The state's constitutional rules can be enforced on its top leaders when the rules are consistent with the leaders' personal constitutions.

Key constitutional question: how are governors chosen

A strong state needs networks of political trust that reach from the capital into every community.

Provincial governors are vital links between national and local leaders, and as powerful officials they must get substantial moral-hazard rents.

A key point of any political system is how are governors are chosen: by central appointment, or by decentralized local election.

When local elites have no role, national leaders can use these appointed offices as rewards for central supporters, instead of locally trusted leaders.

Such centralization of local-government agency rents weakens the state outside the capital. (Bates, *When things fell apart*, 2008.)

(Inefficient taxation can prevent Coasean bargains for better local gov't.)

Remedy: constitutional requirements to share power with autonomous local leaders (decentralized democracy or feudalism).

Democratic decentralization gives more people the political standing to invest securely in the state. (Adam Smith's yeomen.)

In a federal system, national leaders' reputations for respecting local privileges become essential for building strong political coalitions.

To build a democracy, democratic leaders are needed

We see leaders' political reputations as social capital of state-building. A democratic state needs candidates with good democratic reputations for using public funds responsibly in the public interest, not merely to reward loyal supporters.

Voters would not reject a corrupt incumbent unless they could expect better from another candidate.

Federal decentralization creates more opportunities for politicians to begin developing good democratic reputations.

(My *QJPS* '06: small transition costs, uncertain virtue; frustration of democracy is equilibrium in a unitary state but not a federal state.)

Autonomous local governments can reduce barriers against new political entry into national democratic competition, which established national leaders may naturally resist (Pakistan).

Summary: What are essentials for democratic development?

Democracy has many forms. What is essential for its success is not just elections, but competition in the public interest.

The key to democratic development is to increase the supply of leaders with reputations for using public funds to provide public services, and not just to give jobs to their supporters.

Strong foundations for democracy should be both national and local:

Local democracy strengthens national democratic competition:

Successful local leaders can become candidates for higher offices.

National democracy strengthens local democratic competition:

National parties can support alternatives to established local bosses.

In a federal state, national leaders' reputations for working within the constitutional division of powers become essential political assets.

A finance ministry that distributes funds accountably across levels of government can be vital for decentralization (Ghani-Lockhart, '08).

3 pillars of democratic state-building: *multi-party national assembly, elected local councils, and an effective finance ministry.*

Policy implications for foreign financial assistance

For political development, the essential measure of a project's success is how it enhances reputations of the political leaders who direct it.

Outputs of public goods count only towards this political end.

All public services should be directed by indigenous leaders, but they should include both national and autonomous local leaders.

To cultivate leadership at all levels, assistance should be distributed to national and local governments (perhaps also to minority parties).

Largest share of assistance funds should go to national government, but conditioned on some decentralization also to local public service agencies (Collier, 2007).

Foreign donors should require transparent public accounting for all funds, both by the donors and by the national finance ministry.

This accounting should be to the local population, so they can learn what their leaders have spent, and what this spending has achieved.

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