

DEMOCRATIC DECENTRALIZATION AND ECONOMIC DEVELOPMENT

by Roger B. Myerson, February 2014

<http://home.uchicago.edu/~rmyerson/research/decent.pdf>

Abstract. Decentralization and democracy may improve the chances for successful economic development. The importance of local government and democracy is evident in the history of many countries, but democratic local government has been less common in Africa than elsewhere. Democratic political competition can improve governance only if voters have a choice among qualified candidates who have good reputations for exercising power responsibly in public service. This essential supply of trusted democratic leadership can develop best in responsible institutions of local government, where successful local leaders can prove their qualifications to become strong competitive candidates for higher office. Thus, a federal constitutional structure that devolves substantial powers to autonomously elected local governments can increase the chances for successful democratic development. Foreign assistance can help to increase this vital supply of leaders with good reputations for spending public funds responsibly if some share of foreign-assistance funding is distributed directly to local governments and other local public service agencies.

1. Introduction

Great differences in the wealth of nations have a basis in their political systems, although the dependence of economic performance on political structures may be complex. Economic prosperity is generated by investment and trade, which depend on legal protection and public infrastructure that must be provided by government. The quality of government, in turn, is shaped by political leaders who compete for power according to the (explicit or implicit) constitutional rules of their society. So a theory of economic development is incomplete without a model of how effective states are built by political leaders.

I will argue here that a key to successful democratic development in a nation is to increase its supply of leaders with good reputations for using public funds responsibly. But it is not enough to focus only on national leaders; local leadership is also essential. Economic investments depend on local security and other public services from local agents of government, while profitable relationships of inter-regional and global trade rely on transportation networks and legal protection at the national level. Thus, economic development depends on both local and national politics, and a theory of economic development should include some analysis of the vital political relationships among local and national leaders.

Acemoglu and Robinson (2012) argue persuasively that successful economic development depends on inclusive political institutions, but they do not offer any recipe for building such institutions (p. 460). Lin and Monga (2012, p. 662) contend that "the social sciences literature does not provide an incentive-compatible mechanism for political leaders to improve governance and eliminate corruption." Following Joseph (2012), I want to argue that their conclusion is too pessimistic. Economic theories of competitive behavior and incentives in organizations can be applied to understand the competitive behavior of politicians and the incentives that they create for government agents (see Olken and Pande, 2012).

This paper outlines a general political theory based on leadership and trust and, from this theory, argues that the chances for successful economic development can be maximized by institutions of decentralized federal democracy. We begin in section 2 with a basic theoretical perspective on the foundations of the state, followed in section 3 by some historical perspectives on the role of local government in development. Then section 4 examines the role of leaders' reputations in constitutional change, and section 5 shows how local democracy can promote the competitive political leadership that is essential for successful democratic development. Section 6 concludes with suggestions of how political reform and development assistance can more effectively help poor nations to increase their increase their vital supply of leaders who have good reputations for using power responsibly in service to the public.

2. Theoretical perspectives on the foundations of the state

Governments are composed of people. In any society, the state is a network of agents who enforce laws that sustain property rights and reduce moral hazard in other organizations of society. Agents of the state could profit from abuse of their powers, and so they must be motivated by the expectation of greater long-term rewards for good service. But promised rewards for good service become a debt of the state which its leaders might subsequently prefer to deny. So the motivation of agents in the government itself is also a moral-hazard problem, which must be solved by political leaders who establish the government (Myerson, 2011).

The problem of creating political networks that can exercise power across a nation is solved anew in every generation by leaders who rise to positions of power in their society. Political leaders are the ultimate guarantors of incentives in government, and corruption in government agencies can be reduced only where leaders are willing to make appropriate efforts

for discipline. But any political leader needs a reputation for reliably rewarding the service of his active supporters and agents, without whom he could not gain power or apply it. So in any political system, the state must be expected at least to protect rights to promised rewards for the loyal supporters of the state's political leaders.

The critical question of political economy, then, is whether property rights are securely protected only for a small elite who actively support the national ruler, or does the circle of trust extend more broadly to include people throughout the nation. Members in the securely protected group require some legal and political power that could be used against a government official who failed to protect their rights. A broad distribution of such power to threaten the privileged status of government officials may naturally seem inconvenient to established national leaders, but people who have been admitted into this circle of political trust can invest securely in the state, increasing economic growth. A fundamental fact of modern economic growth is that it requires decentralized economic investment by many individuals who must feel secure in the protection of their right to profit from their investments. Thus, modern economic growth requires a wide distribution of political voice and power throughout the nation.

In any society, leaders can govern effectively only when there is broad public recognition of their authority, and this in turn can depend on their complying with generally recognized constitutional rules that characterize the nation's political system. Political systems can differ on at least two major dimensions that fundamentally affect the distribution of power in a society: democracy and decentralization. Democratic political systems distribute political voice more broadly in a nation by making leadership of government dependent on free expressions of popular approval from a large fraction of the nation's citizens. Decentralized political systems distribute power more widely to autonomous provincial and local units of government.

Power can be applied throughout a nation only by a political network that spans the nation, reaching into every community. Relationships between local and national political leaders are vital elements in the structure of any state. In any political system, national leaders can wield their power only with trust and support of local officials throughout the nation, and local leaders in turn rely on national leaders to affirm their privileged positions of local power. But under different constitutional systems, the primary leaders of local government may be agents appointed by the national leadership, or they may earn their positions by autonomous local politics. This distinction between centralized and decentralized states should be seen as

one of the primary dimensions on which states vary, potentially as important as the distinction between democratic and authoritarian states. Decentralized federal democracy and centralized unitary democracy may have significantly different implications for economic development.

3. Historical perspectives on local government and development

For a historical perspective on the roots of successful economic development in early modern England, we may start with the remarkable observation of Adam Smith (1776):

"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; and as a great part of the yeomanry have freeholds of this kind, the whole order becomes respectable to their landlords on account of the political consideration which this gives them. There is, I believe, nowhere in Europe, except in England, any instance of the 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 laws and customs so favourable to the yeomanry have perhaps contributed more to the present grandeur of England than all their boasted regulations of commerce taken together." (Wealth of Nations, Book III, Chapter 2, p. 415)

The central focus of the economics profession since Adam Smith has been on regulations of commerce that can encourage greater economic growth. But in this passage, Smith tells us that basic political and legal rights for small farmers, which enabled them to invest in improving their land without fear that the benefits of such improvements would be expropriated by a landlord increasing the rent, may have been the most important factor in the prosperity of England in his time. He indicates that this empowerment of poor tenant farmers was a result of particular legal and political institutions of England, including the participation of small farmers in local parliamentary elections. Political developments in England that gave political voice to a great mass of small farmers in turn enabled them to invest securely in economic improvements which marked the start of modern economic development.

Mass local political participation was also cultivated after 1620 in the British colonies of North America (the future United States), where institutions of local self-government were granted to encourage English settlers to come to America and to offer loyal service in local militias. But colonial governments were very different elsewhere in the world. Important

insights into the problems of development can be found in a study of comparative local government in colonial India by Banerjee and Iyer (2005).

When the British were first establishing their rule in India in the eighteenth century, they regularly granted local power and privileges to local agents called zamindars, who had primary responsibility for collecting local land taxes. Holding local power as a permanent property right, the zamindars became a class of local leaders with a vested interest in British rule. The people who were initially recruited to serve as local zamindar lords for their communities may have already had some traditional political support in those communities. But the demands of subservience to foreign domination may have been resisted by many of those who would have been the strongest contenders for local leadership under traditional pre-colonial forms of local politics. In many cases, surely the colonial administrators must have instead promoted some secondary candidate for local leadership who could not have hoped to rise so high in his community without the foreigners' support. Thereafter, these zamindars and their local adherents would have enjoyed privileges that were dependent on their reliably collecting local taxes and maintaining local order in their domains. Thus, the system of local political authority was transformed in wide areas of India to create a network of local feudal agents who could be counted on to maintain the British imperial dominion. In return, the higher administration of the British Empire in India was constrained to maintain the system of local privileges for the zamindars on whom the Empire relied.

In the early nineteenth century, reformers argued that the large rents taken by these feudal zamindars were a costly political expense depleting the wealth of India and the empire. Then areas that subsequently came under direct British rule were given other forms of local administration, with responsibility for the collection of local land taxes being given either to local village councils or to provincial administrators. After the 1857 Mutiny challenged British rule in India, however, the British returned to apply the zamindar system in new additions to their colonial territory.

The effectiveness of the zamindars' power proved remarkably durable, with consequences for Indian society even after the feudal system was formally abolished at the end of the colonial period. More than half a century after independence, Banerjee and Iyer (2005) found evidence of lower agricultural productivity and higher infant mortality in the regions of India that endured local rule by feudal zamindars. Indian peasants in these regions clearly lacked the kind of legal

and political rights that Adam Smith saw as so important for English yeomen. The lesson seems clear: Feudalism can help to establish a stable political regime, but the feudal redistribution of local political power can also have serious long-term economic costs. We should ask, how much of global poverty and underdevelopment has resulted from such feudal strategies of traditional and colonial state-building?

Systems of local political authority in Africa were fundamentally transformed by colonial rule, even when colonial rulers claimed to respect the traditional rights of local chiefs. In traditional political rhetoric, a chief could claim absolute authority as the rightful heir of his predecessors; but the realities of local politics would generally allow competitive rivals to challenge such claims if a chief failed to maintain a network of loyal supporters throughout his domain (see Comaroff, 1978, for example). Such local political competition was rendered ineffective when colonial magistrates registered the legitimate chief in each area, as the chiefs' authority could then be effectively based on the recognition of a colonial magistrate, rather than the support of his constituents. Thus released by the colonial regime from any need for broad political support, a chief would have more incentive to assert the privileges of his position and less incentive to maintain the traditional obligations of leadership in his society.

The system of local government in a country can have economic implications not only for the security of investments by small farmers and tradesmen, but also for larger investments in industry and public infrastructure. Here, again, it is worth considering some lessons from the England on the verge of the industrial revolution.

In the eighteenth century, turnpike trusts built toll roads that gave England the world's best land transportation system, which set the stage for the industrial revolution (Albert, 2007). These toll roads were managed by local county leaders, who retained profits from tolls on well-maintained roads, but the tolls had to be nationally regulated as part of a national transportation network. The national government's dependence on local elites through their representatives in Parliament made such local investments secure against central expropriation. Thus, the development of the world's first modern land transportation network depended essentially on England's constitutional system, which made the national government responsible to locally elected representatives. (The development of standardized macadam road-building technology in this period facilitated the subsequent development of modern roads elsewhere in the world.)

A stark contrast may be seen in the frustration of early industrial development in late

imperial China, as described by Feuerwerker (1958). In China during the late nineteenth century, provincial governors sponsored new corporations for modern shipping, telegraphs, and railroads. But any reinvested profits from these corporations would be vulnerable to expropriation by the national government of the Qing imperial dynasty. Most prominently, the imperial Grand Secretary Kang-i made a tour of China's more developed regions to loot the accumulated profits of industrial corporations for the imperial treasury in 1899. This expropriation was at the expense of China's early industrialists and the provincial governors who sponsored them, and the result was to discourage further industrial investment outside the areas under foreign extraterritorial control. The expropriation of provincial railroads in 1911 (which might have seemed economically justifiable by network externalities) cost the imperial government the trust of provincial leaders throughout China and precipitated the final collapse of the Qing dynasty.

Today, even without Western-style democracy, the government of China has a federal constitutional structure, which can guarantee that profits of corporate investments sponsored by local government officials can be retained locally. The result has been a spectacular economic growth with industrial entrepreneurship sponsored by local officials throughout China. Thus, China's economic development in the past forty years has depended on the development of a federal political system in which the national government is strong enough to prevent local governments from creating monopolistic restraints on inter-regional trade but is also weak enough to be credibly held to profit-sharing agreements with local leaders. Weingast (1995) has called this *market-preserving federalism*.

Although Acemoglu and Robinson (2012, pp 455-460) say that they have no recipe for building inclusive political institutions, they offer the political transformation of Brazil since 1970 as a recent example of such institutions successfully taking root. It is striking that their summary of this transformation focuses on political groups that first held power in elected municipal governments during a transitional period when the military still controlled the national government. The Workers' Party, which has successfully supplied presidents for Brazil since 2002, proved its ability to exercise power responsibly in dozens of municipal governments before the first (1989) presidential election since the military coup. In this sequencing of local democracy before national democracy, Brazil's recent transformation notably resembles the revolutionary transition of the United States after 1776. The United States government was

established by thirteen autonomous provincial assemblies whose members had been locally elected for over a century before the first election to choose a national president in America.

Africans under colonial rule had direct contact with the bureaucratic national agencies of imperialist governments but not with the decentralized subnational levels of domestic politics on which these imperialist governments were based. So it is not surprising that, after independence, post-colonial political elites in Africa might view centralized national bureaucracy as a more "modern" way to integrate national power than the traditional institutions of local politics that were dominated by traditional chiefs.

In diagnosing the disappointing failures of economic growth in Africa in the generation after independence, van de Walle (2001) and Bates (2008) depict the African states as administratively weak in their ability to implement economic policies, but as politically strong in their ability to suppress challenges to the national leaders' positions. This combination of weakness and strength perhaps should not be so surprising, as the political strength may itself be an explanation of administrative weakness. If a small group in the capital can hold recognized national power without much support from local leaders throughout the nation, then national leaders will have an incentive to concentrate the benefits of power among the small elite whose support they actually need to get and hold national power. Thus, we should not be surprised to find the pattern of postcolonial political development described by Bates (2008, chapters 3 and 4) in which national leaders progressively narrowed the range of those entitled to benefits of state power until rural farmers were heard to say "Independence isn't for us; it's only for city people" (Dumont, 1966, p 17). This political narrowness can become a particularly acute problem in a centralized political system where the national president has the power to appoint governors and mayors, as these powerful local officials may understand that their privileged positions depend primarily on their loyal service to the president, not on any efforts to earn the local population's trust or approval.

Such minimal winning coalitions could retain stable control until the 1990s, when authoritarian governments suddenly lost the ability to get international financial support in exchange for aligning with one side or the other of the Cold War (Bates, 2008). Then as international donors and domestic populations demanded more accountable governments, democracy spread widely in Africa after 1990. But as Bates (2008, p. 137) observes, the spread of democracy was at best a mixed blessing. On the one hand, it was the ability of authoritarian

leaders to govern with a narrow base of support that laid the foundations for state failure. On the other hand, the political insecurity of competitive democracy could increase the motivation of a ruling faction to use its power to loot the nation for short-term benefits, instead of making investments for long-term national economic growth. In many African nations, the transition to constitutional democracy has seemed somehow misdirected or incomplete. Apparently there may be something more that we need to understand about constitutional change and the conditions for successful democracy.

4. Constitutional change and leaders' reputations

A constitution may promise a system of rights for citizens and constraints on government officials, but any constitutional document is just a collection of words and cannot itself constrain anyone's behavior unless other people are expected to behave according to its stipulated rules. Whether such a constitution is effective or not, then, is game-theoretically a question of multiple equilibria, subject to the focal-point effect described by Schelling (1960). If history or tradition makes enough people believe that the constitution is an effective political law, then it is so; but otherwise it is just another mass of words.

The key is that constitutional laws must be affirmed by recognized political leaders. But in a constitutional democracy, laws must be issued by political leaders who have been elected under the law, which raises a chicken-and-egg question: Which comes first in building a constitutional democracy, the constitutional laws or the democratically elected leaders? This theoretical question had practical importance in Iraq after the American invasion of 2003, where the American viceroy L. Paul Bremer insisted that a constitution had to be written before any elections in occupied Iraq, while Grand Ayatollah Ali Al-Sistani insisted that a legitimate constitution for Iraq could only be written by elected leaders.

Bremer's (2006) 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, which is true of leader-follower networks, but not of constitutional law. In fact, the United States after the American Revolution began its independent political existence with a large supply of leaders who had been locally elected under British colonial rule long before the federal constitution was written. Indeed, the adoption of the United States constitution depended substantially on the

longstanding personal political reputations of its authors.

Under any political system, political leaders can compete for power only if they can motivate active supporters by promises of future political patronage. Thus, I have argued (Myerson, 2008), the need to maintain a reputation for reliably rewarding the service of their active supporters is the fundamental political law for political leaders everywhere. The standards of behavior that active political supporters collectively expect of their leader, if he is to keep their trust, become a primary constraint on the leader's actions and may be viewed as an informal personal constitution for him. The establishment of formal constitutional structures in a state may depend critically on their compatibility with such personal constitutions for the leaders who hold high offices. The initial leaders under any new constitutional system will generally have established personal relationships with the supporters who helped them to win their positions in the new regime, and these leaders cannot be expected to act according to any constitutional provisions that would be taken by their supporters as a violation of trust. Constitutional rules can be enforced on the top leaders of national government only when the rules are consistent with the expectations of the top leaders' active political supporters. This is, of course, generally true in established democracies but may not be true in new democracies.

In many countries of Africa, popular movements for democracy have established the principle that a national political leader can retain general acceptance of his position only by submitting to regular competitive elections. Then we may hope that the need to compete for popular approval should motivate democratic political leaders to offer better benefits of government for voters than authoritarian rulers would provide, just as competition in any economic market should motivate suppliers to offer better values for their customers than would be provided by a profit-maximizing monopolist. This is the basic argument for democracy. Even a benevolent autocrat may find it difficult to resist his courtiers' urge for greater privileges if further exploitation of the public would entail no more risk of losing power.

But unfortunately, as Bates has observed, the benefits of democracy have often seemed scarce. To understand why, we need to think more carefully about the nature of democratic political competition. We need a model that can help us to understand how democratic competition can fail to provide political incentives for leaders to provide better public service.

5. The vital role of decentralization for success of democracy

Even with free elections, a corrupt political faction could maintain a grip on power if the voters believed that other candidates would not be any better. Successful democracy requires more than just elections; it requires alternative candidates who have good democratic reputations for using power responsibly to benefit the public at large, and not merely to reward a small circle of supporters. In a nation with a long tradition of democracy, there are typically many politicians who have such good democratic reputations. But in a new democracy, politicians with good democratic reputations are typically lacking. Aspiring politicians who have no real power can make fine speeches about better government, but they cannot demonstrate any ability to allocate public funds and patronage in a way that provides public goods and services for the population. Voters may be reasonably skeptical of candidates' promises when they have no evidence of good public service in the past. Then voters would have no incentive to turn a corrupt incumbent out of office, if the alternative candidates were expected to be just as bad or worse. But if blatant corruption would not reduce the leader's chances of re-election, then he should have no incentive to prevent his supporters from enjoying corrupt benefits of power.

In a simple game-theoretic model, I have shown (Myerson, 2006) how such failure of democracy can be a rational equilibrium for a centralized unitary state, but this bad equilibrium can be eliminated by decentralizing a share of power to independently elected local and provincial governments. The key is that local governments create independent opportunities for local leaders to begin cultivating good democratic reputations. Then, if political leaders at all levels of government were expected to be uniformly corrupt, a local leader who offered better public service could establish a good reputation with the voters that could make him a serious contender for power at higher levels of government.

Thus, devolving some share of power and public budgetary responsibility to separately elected local and provincial governments can make national democratic competition more effective for the voters, as politicians can prove their qualifications for higher office by responsible service at lower levels of government. When the effectiveness of democratic competition is limited by a lack of competitors with good reputations for spending public funds responsibly, we should see local and provincial democracy as providing more opportunities for such reputations to develop.

This argument for decentralized democracy can also be derived from the basic economic

concept of barriers to entry. A successful system of democratic competition should reduce political leaders' ability to take corrupt profits from their positions as suppliers of government services. Economists understand, however, that the expected amount of profit-taking in a competitive market equilibrium may depend on barriers against the entry of new competitors. By enabling more local politicians to prove their abilities to govern responsibly, federal decentralization and local democracy can reduce barriers against new entrants into the national political arena, and so can make national politics more competitive, thus sharpening the incentive for elected national leaders to provide better public services. In the United States, for example, many candidates for president have served previously as governor of a state (province).

The interactions between local and national politics can go both ways. I have argued that local democracy strengthens national democratic competition as successful local leaders can become candidates for higher offices. But national democracy can also strengthen local democratic competition, as national parties can support alternatives to established local bosses. The risk of local government being dominated by an unpopular local autocrat can be countered by the participation of competitive national political parties in local elections. Local political bosses should know that, if they lose popular support, they could face serious challengers supported by a rival national party. Competitive national political parties played an important role in the successful introduction of local democracy in Bolivia as described by Faguet (2012). Crook and Manor (1998), Enikolopov and Zhuravskaya (2007), and Ponce-Rodriquez et al. (2012) find cross-national evidence that the benefits of political decentralization can depend on strong competitive political parties at the national level.

The potential of autonomous subnational governments to become sources of new competition for national power is, however, an important reason why established national leaders might not want to share power with locally elected governors and mayors. Thus, we have reason to expect that political decentralization may often be undersupplied, relative to what would be best for the general population, as it runs against the vested interests of those who hold power at the national level. In Pakistan, elected politicians of national and provincial government have three times dissolved institutions of local democracy that had been created by military rulers (Cheema, Khan, and Myerson, 2010). In Egypt, the new constitution of 2014 (like the previous constitutions of 2012 and 1971) promises an eventual devolution of power to locally elected councils but then allows current national leaders to postpone such decentralization and continue

the centralized appointment of local governors and administrators.

As the primary agent of state power in his province, a governor occupies a powerful office with substantial opportunities for profiting from corrupt abuse of power. In a centralized state where governors are appointed by the national leader, these offices can be among the most prized positions that the national leader can use to reward loyal supporters. But then, if local people have no political role, the national leader may not be inclined to object when a governor uses his power to enrich himself instead of trying to build trust with the local population. Of course, the national leader might also be concerned about the adverse impact of a governor's corruption on the local tax base. In a nation without efficient mechanisms for domestic taxation, however, the economic loss of the local tax base may be worth less to the national leader than the political value of allowing corrupt profits from the province to be taken as his promised reward for a key supporter. From this perspective, we can readily understand much of the narrowness and decline of state capacity outside the capital that Bates (2008) has described. Unfortunately, this argument can apply even in a centralized democratic system, at least in provinces that are considered unlikely to provide many votes that the national leader will need for reelection.

This tendency to weaken the state in politically peripheral provinces can be countered by constitutional requirements to share power with autonomous local leaders who are products of local politics. Once established, an accepted federal division of power can become self-sustaining, as national leaders' reputations for respecting local constitutional privileges become essential for their ability to build strong political coalitions that include established local leaders.

A finance ministry that distributes funds accountably across levels of government can be vital for decentralization (Ghani and Lockhart, 2008). Different offices of government are always in some competition for public resources under any system, but this competition is intensified when different levels of government are controlled by rival parties in a federal democracy. Thus, political decentralization increases the need for a central finance ministry that can reliably and transparently distribute public funds to different levels of government. In this sense, the decentralized distribution of autonomous budgetary power to local governments may depend on effective administrative controls against moral hazard in the central government. (In the early development of English government from the twelfth century, the first key institution was the Exchequer, which regulated financial relations between national and provincial governments; see Fitznigel, 1189, and Warren, 1973.) So a democratic federal state may stand

on three institutional pillars: a multi-party national assembly, elected local councils, and an effective finance ministry with clear rules for allocating federal revenues between these bodies.

Political decentralization has been applied less in Africa than in other parts of the world. In a 2007 survey of 82 selected countries around the world (UCLG, 2007), the average share of national GDP spent by local governments was about 6.6%, but the average in sub-Saharan Africa was only 1.8%, with all African countries substantially below the global average.

Nigeria has had imperfectly competitive elections at both the national and provincial levels since 1999. Our theory of federalism reducing entry barriers into national politics suggests that we should expect to see some governors who have provided superior public services in their provinces becoming popular candidates for national leadership, as voters around the nation should want such successful governors to provide similar benefits for the whole nation. In fact, a few governors seem to have earned reputations for providing better local government, but their ability to offer themselves as candidates for president has apparently been limited by inter-regional suspicions in Nigeria. A governor who has provided superior public service for the people of his province might not appeal to voters elsewhere if they thought that he would use presidential power only to benefit people in his old province. So regionally divided political identities may reduce the competitive benefits of federal democracy.

Elected local councils at the district or municipal level were also introduced in some regions of Nigeria during the last decade of colonial rule, but these institutions of local democracy were suppressed by elected regional leaders in the first few years of independence (Vaughan, 2000). In contrast, the first elected national leaders of Botswana acted to create locally elected district councils shortly after independence (Vaughan, 2003).

Fortmann (1983) argued persuasively for the importance of such local political institutions for rural development in Botswana, which has had the best record of economic growth in post-colonial Africa. A poor community can mobilize its resources for public investments that are essential for its economic development only when members of the community are coordinated by local leaders whom they can trust to appropriately reward contributors and discipline free-riders. Such trust can be expected only from leaders whose authority is based in local politics. Local officials whose positions depend on national political patronage are inevitably less concerned about developing trust among the residents of a small poor community. Thus, integrated efforts to achieve economic development throughout a nation

may depend on a political system in which admits autonomously elected local leaders into the national network of power.

6. Implications for political reform and development assistance

The key to successful democratic development is to increase the supply of leaders who have reputations for using public funds responsibly to provide public services, and not just to give patronage jobs to their supporters. This proposition is the main conclusion of the arguments in this paper. I have argued that substantial political change must be embodied in the personal reputations of political leaders, and that effective democratic competition depends on voters having an ample supply of trusted candidates with proven records of good public service. Decentralized democracy maximizes opportunities for increasing this vital supply of good democratic reputations.

The arguments here have been theoretical. Indeed, our main proposition may seem hard to test or refute empirically, as we could hardly expect to find many politicians with reputations for good public service in a nation where democracy has failed to provide much benefit for the mass of citizens. But our theory suggests that the chances for successful development can be improved by reforms and policies that create opportunities and incentives for local leaders to begin building such reputations for spending public funds responsibly. Thus, the argument here has testable policy implications for development assistance and political reform.

When authority over substantial public budgets is distributed across two or more separately elected levels of government, officials at the lower local level have opportunities to develop a reputation for spending public funds effectively, and the possibility of winning election to higher office can motivate their efforts to earn such a reputation. Thus, the possibility of democratic advancement in decentralized federal democracy can provide an incentive-compatible mechanism for increasing the supply of trusted political leaders who can improve governance and eliminate corruption.

This mechanism relies, however, on both democracy and decentralization, together with a clear constitutional distribution of power and budgetary authority to each level of government. Those who would encourage beneficial political reforms should understand that this mechanism would not function as well in a centralized presidential democracy where responsible executive authority is concentrated in the hands of one elected national leader, who then has little incentive

to raise popular expectations. Indeed, one might find more opportunities for independent political development of reputations for responsible public service in a decentralized federal system without multi-party democracy, as in China today.

Up to a point, the effect of encouraging more competitive political entry could be increased by having more elected sub-national governments in smaller districts, thus creating more opportunities for more politicians to demonstrate their ability to serve the public. (Concerns about regional separatism could also be a reason to limit political decentralization to local councils for small districts that are too small to stand alone against the rest of the nation.) But our argument imposes one important constraint: The districts must be large enough, and the responsibilities of public administration in each district must be substantial enough, so that a politician's good performance in one locally elected office can be taken by the voters as evidence of qualifications for service in a higher level of government. From this perspective, an ideal system of federal democracy would have several levels of sub-national governments, with elected offices at different levels together forming a ladder of democratic political advancement that effective leaders can climb from local politics to provincial and national politics.

Competitive political entry can also be strengthened by foreign economic assistance when foreign-assistance funds are used to create more opportunities for national and local leaders to demonstrate their ability to use public funds responsibly in the public interest. When economic development depends on political development, the essential measure of success for a development project may be, not in how many schools or roads it builds, but in how the project enhances the reputations of the political leaders who spend the project's funds. This reputational effect requires that development projects should be clearly directed and controlled by national or local leaders, not by foreign aid administrators. The largest share of assistance funds may normally be given to projects that are directed by the national government; but, as Collier (2007) has argued, such aid should be conditioned on the right of donors also to fund projects also for other local public service agencies. Even if the national leadership might view some of these groups as potential political rivals, an essential goal should be to help citizens find more trusted options for leadership at both national and local levels. Thus, donors could help to increase the nation's supply of leaders with good reputations by distributing some share of development-assistance funds to autonomous leaders of provincial and local governments. Donors could even consider funding some development projects for minority parties in the national assembly.

For this reputational goal, and to clearly distinguish foreign development assistance from covert efforts to achieve political influence, donors must also insist on transparent public accounting for all funds that are spent by political leaders at all levels. The essential accounting here must be to the local population, however, not just to foreign donors who provided the funds. Local people must be able to learn what funds were spent by their leaders and must be able to monitor what public services were provided by these funds.

Doubtless, many will be seen to have wasted money on graft and corruption. But if the national government cannot achieve public benefits commensurate with the assistance funds that it has received, then other local leaders who are seen to do better with their assistance funds may be recognized as the new leadership that the nation needs. Such a mechanism may seem inconvenient to established national leaders, but it would provide an incentive for them to improve governance and eliminate corruption.

REFERENCES:

- Daron Acemoglu and James A. Robinson, *Why Nations Fail* (Crown Business, 2012).
- William Albert, *The Turnpike Road System in England: 1663-1840* (Cambridge U. Press, 2007).
- Abhijit Banerjee and Lakshmi Iyer, "History, institutions, and economic performance," *American Economic Review* 95(4):1190-1213 (2005).
- Robert Bates, *When Things Fell Apart* (Cambridge U. Press, 2008).
- L. Paul Bremer and Malcolm McConnell, *My Year in Iraq* (Threshold, 2006).
- Ali Cheema, Adnan Q. Khan, and Roger Myerson, "Breaking the countercyclical pattern of local democracy in Pakistan," <http://home.uchicago.edu/~rmyerson/research/pakdemoc.pdf> (2010). To appear in *Is Decentralization Good for Development: Perspectives from Academics and Policy Makers*, edited by Jean-Paul Faguet and Caroline Pöschl.
- Paul Collier, *The Bottom Billion* (Oxford U. Press, 2007).
- John L. Comaroff, "Rules and rulers: political processes in a Tswana chiefdom," *Man* 13:1-20 (1978).
- Richard C. Crook and James Manor, *Democracy and Decentralization in South Asia and West Africa* (Cambridge U. Press, 1998).
- Rene Dumont, *False Start in Africa* (Praeger, 1966).
- Ruben Enikolopov and Ekaterina Zhuravskaya, "Decentralization and political institutions,"

- Journal of Public Economics* 91:2261-2290 (2007).
- Jean-Paul Faguet, *Decentralization and Popular Democracy: Governance from below in Bolivia*, (U. Michigan Press, 2012).
- Albert Feuerwerker, *China's Early Industrialization: Sheng Hsuan-huai and Mandarin Enterprise* (Harvard U. Press, 1958).
- Louise Fortmann, "The Role of Local Institutions in Communal Area Development," (Gaborone, Botswana: Applied Research Unit, Ministry of Local Government and Lands, 1983), http://pdf.usaid.gov/pdf_docs/PNAAT392.pdf (accessed Feb 2013).
- Richard FitzNigel, *Dialogus de Scaccario* (c. 1189); translated as *Dialogue of the Exchequer* by Charles Johnson (Oxford U. Press, 1983).
- Ashraf Ghani and Clare Lockhart, *Fixing Failed States* (Oxford U. Press, 2008).
- Richard Joseph, "Industrial policies and contemporary Africa: the transition from prebendal to developmental governance," Northwestern University working paper (2012).
- Justin Yifu Lin and Celestin Monga, "Solving the mystery of African governance," *New Political Economy* 17(5):559-666 (2012).
- Roger Myerson, "Federalism and incentives for success of democracy," *Quarterly Journal of Political Science* 1(1):3-23 (2006).
- Roger Myerson, "The autocrat's credibility problem and foundations of the constitutional state," *American Political Science Review* 102:125-139 (2008).
- Roger Myerson, "Toward a theory of leadership and state building," *Proceedings of the National Academy of Sciences USA* 108(supplement 4):21297-21301 (2011).
- Benjamin Olken and Rohini Pande, "Corruption in developing countries," *Annual Review of Economics* 4:479-505 (2012).
- Raul A. Ponce-Rodriguez, Charles A. Hankla, Jorge Martinez-Vazquez, and Eunice Heredia-Ortiz, "Rethinking the political economy of decentralization: how elections and parties shape the provision of local public goods," working paper 12-32, International Center for Public Policy, Andrew Young School, Georgia State University (2012). http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1903106
- Thomas C. Schelling, *The Strategy of Conflict* (Harvard U. Press, 1960).
- Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776; reprinted by U. Chicago Press, 1976).

United Cities and Local Governments, *Local Governments in the World: Basic Facts on 82 Selected Countries* (2007).

http://www.cities-localgovernments.org/gold/upload/pocketbook_complete.pdf

Nicolas van de Walle, *African Economies and the Politics of Permanent Crisis: 1979-1999* (Cambridge, 2001).

Olufemi Vaughan, *Nigerian Chiefs: Traditional Power in Modern Politics, 1890s-1990s* (U. Rochester Press, 2000).

Olufemi Vaughan, *Chiefs, Power, and Social Change: Chiefship and Modern Politics in Botswana, 1880s-1990s* (Africa World Press, 2003).

W. L. Warren, *Henry II* (U. California Press, 1973).

Barry Weingast, "The economic role of political institutions: market-preserving federalism and economic development," *Journal of Law Economics & Organization* 11:1-31 (1995).

AUTHOR'S ADDRESS: Roger Myerson, Economics dept, U. of Chicago, 1126 East 59th St, Chicago, IL 60637 USA.

Phone: +1-773-834-9071. Fax: +1-773-702-8490. Email: myerson@uchicago.edu

Web site: <http://home.uchicago.edu/~rmyerson/>

This paper: <http://home.uchicago.edu/~rmyerson/research/decent.pdf>

[*current version: Feb 27, 2014*]

The final version of this paper has been published as Chapter 41 in *Oxford Handbook of Africa and Economics Volume 1: Context and Concepts*, edited by Justin Yifu Lin and Celestin Monga, (Oxford University Press, 2015) pages 756-769.