

# Learning from the Logic of the Theoretical Literature

## Overview: Government failures as principal-agent problems

This chapter provides the conceptual framework of the report, drawing on the logic of the theoretical literature in economics. It defines the notion of government failure on the basis of economic theory, using the framework of “principal-agent” relationships between government officials who act as the agents of society or of citizens (who are the principals). Accountability problems in government are examined as a series of principal-agent problems, as follows: (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. Political engagement and transparency shape all three of these principal-agent relationships.

The next section examines how political engagement is the fundamental role that citizens can play in governance. Unhealthy political engagement, when leaders are selected and sanctioned on the basis of their provision of private benefits rather than public goods, arises as a result of conflict of interest among citizens. It leads to accountability failures in the functioning of a myriad within-government principal-agent relationships between leaders, public officials, and frontline providers. Some of these accountability failures can be examined as the “inversion” of principal-agent relationships. For example, vote buying and violence in elections involves political leaders holding voters accountable for political support. Public officials and frontline providers can be organized as powerful interest groups who control political leaders and thwart citizen action to monitor their performance. Such government failures can occur in both more and less democratic settings, and depend upon whether leaders who

wield power within government are held accountable for public goods or private rents.

A defining feature of principal-agent problems are informational asymmetries, which exist even when political engagement happens in healthy ways to select and sanction leaders on the basis of performance in providing public goods. Principals have imperfect information about the actions of agents and the consequences of these actions. Transparency, which provides such information, is therefore central to addressing principal-agent problems in government. The following section reviews the literature examining how transparency can improve the quality of political engagement, enabling citizens to hold leaders accountable for public goods and select better-quality leaders.

The last section examines how political engagement and transparency shape the beliefs and behavioral norms of citizens, political leaders, public officials, and frontline providers. These are topics on the research frontiers. One strand shows how political engagement and the leaders selected through it can shape norms of cooperation among citizens or in society. Another strand shows how the legitimacy of leaders matters for improving the functioning of public sector organizations and the behavior of public officials. The picture that emerges by putting together the dispersed pieces of theoretical research provides guidance for future work on how healthy political engagement, nourished by transparency, may contribute to strengthening norms and building legitimacy for effective public sector institutions.

### **Political engagement is the fundamental role that citizens play in the principal-agent problems of government**

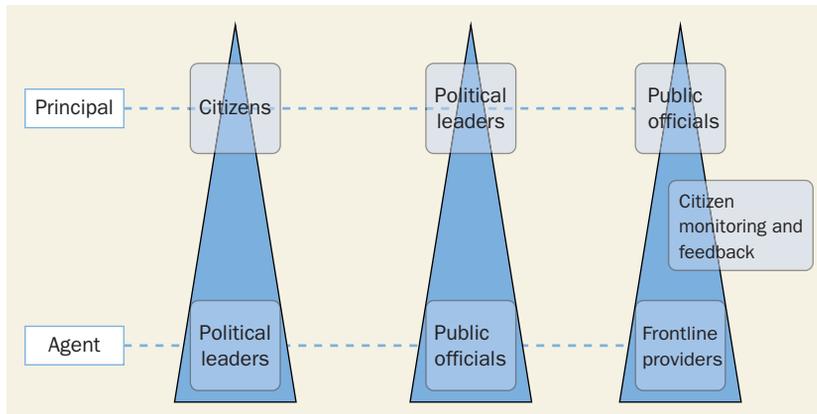
Political engagement directly shapes the relationship between citizens as principals and government leaders as the agents of citizens. Citizens play this role as principals in different ways across institutional contexts. For example, in countries with more democratic institutions, the power to select and sanction leaders is more dispersed among a large number of “ordinary” or non-elite citizens. In countries with less democratic or more autocratic institutions, the power is instead more concentrated among elites or well-organized citizens, such as political parties. However, even when formal electoral institutions are lacking, the threat of political

engagement by nonelite citizens through informal means, such as protests and revolutions, can serve as a constraint on leaders (Acemoglu and Robinson 2000, 2006a).

Political leaders, in turn, delegate tasks to public officials who manage a myriad of agencies within the government. Political leaders are therefore the principals of a variety of lower-level public officials within the government. These public officials who lead government agencies are, in turn, the principals of frontline providers who deliver public services. Figure 4.1 illustrates this series of principal-agent relationships in government. Most government systems around the world are a complex mix of power being shared between appointed and elected officials across multiple jurisdictions. For example, responsibilities over the management of public schools can be divided between locally elected governments or elected school boards, on the one hand, and appointed administrative officers on the other hand. Theoretical research has examined how different tasks of government should be assigned to an appointed public official or to an elected politician across these multiple jurisdictions, depending on the nature of the different principal-agent problems (Alesina and Tabellini 2007).

Non-political citizen engagement has become a prominent feature of policy efforts to improve government performance. Figure 4.1 also shows how these initiatives of non-political citizen engagement fit into the principal-agent problems of government. Officials who hold leadership positions in government can engage the help of citizens in making government agencies perform better. In the principal-agent setting, non-political ways of engaging citizens to solve accountability problems include

**Figure 4.1** The role of citizens in principal-agent relationships of government



using citizens to monitor lower-level government officials and providing feedback to higher-level leaders, which these leaders can then use to solve within-government accountability problems. 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. Non-political citizen engagement is thus part of the management practices within government.<sup>1</sup>

Citizens' political engagement shapes the incentives and characteristics of leaders who, in turn, select within-government management policies to address the principal-agent problem vis-à-vis public officials and providers. Leaders and public officials also determine whether to provide citizens with any powers of monitoring and feedback on frontline providers. Citizens' political behavior—what issues they consider when selecting and disciplining leaders, and their attitudes toward the public sector—underpins the functioning of all three principal-agent relationships. Political engagement thus indirectly influences all three principal-agent relationships through how it shapes the incentives and characteristics of leaders who exercise power within government.

### **Unhealthy political engagement can “invert” principal-agent relationships**

Unhealthy political engagement, when the leaders who wield power within government are selected and sanctioned on the basis of their provision of private benefits rather than public goods, arises out of conflict of interest among citizens. It exacerbates the accountability problem and can lead to “inversions” in each of the principal-agent relationships of government. Powerful elites with control over the coercive institutions of the state can subvert formal democratic and governance institutions. For example, the first principal-agent problem can become one in which leaders hold citizens accountable for providing political support by using violence and clientelist strategies such as vote buying (Acemoglu and Robinson 2006b; Stokes 2005).

Unhealthy political engagement can diminish accountability not only of elected leaders but also within the principal-agent relationships between leaders, public officials, and frontline providers. For example, if political norms allow vote buying and patronage to flourish in elections, those same norms would influence how leaders manage public officials and how public officials manage frontline providers. Leaders who can get away with poor

service delivery during their term in office by purchasing votes at election time also tend to provide jobs to public officials and to frontline providers as political patronage and *not* hold them accountable for service delivery. When frontline providers are patronage appointees, citizens do not expect that monitoring them or providing feedback on their performance will have any effect and therefore, do not engage to improve the third principal-agent problem. Citizens' expectations of how political power is exercised within government can maintain this vicious cycle, leading to citizens' demands for private benefits and the persistence of unhealthy political engagement.

Citizens' roles as monitors in the third type of principal-agent problem is also subject to free-riding problems, when each individual citizen contributes little to the public good of monitoring. An influential strand of the literature has focused on the free-rider problems that plague collective action and how group organization and cohesion play a role in outcomes.<sup>2</sup> Powerful local elites can also capture civil society and invert the role of citizens in the third principal-agent problem, again, through their control over local institutions of coercion or economic resources (Acemoglu, Reed, and Robinson 2014; Anderson, Francois, and Kotwal 2015). Rather than being engaged to hold public officials accountable, citizens can be engaged to deliver public services for themselves, letting leaders and public officials abdicate their responsibilities.

Even in contexts where power is more dispersed among citizens, rather than controlled by only a few elites, there can nevertheless be a conflict of interest among citizens with pernicious consequences for accountability for public goods. Citizens are heterogeneous in their beliefs about the role of government and what they demand from public policies and government leaders. Subsets of citizens organized as special interests can capture leaders and extract private rents from public policies (for example, as examined by Grossman and Helpman [2001]). Groups can form to engage in collective action with the objective of obtaining group-specific benefits that may come at the expense of public benefits that are shared with other citizens who are not organized (this is clearly conveyed, for instance, in Grossman and Helpman [1996]). Public officials and frontline providers can each organize as special interests (for example, teacher unions) that wield political power over leaders, thus inverting the second two principal-agent relationships within government. Social conflict leads to inefficient outcomes because those in power can choose policies to serve their interest and there is no outside agency with the capacity to control them (Acemoglu 2003).

A point emerging from this discussion is that group organization may deviate from, and reconfigure, the set of political rights agreed upon *ex ante* and expressed in constitutional arrangements. A crucial aspect of the political process is therefore the extent to which group pressures can be accommodated in a way that maintains balance among competing interests without causing serious distortions to commonly shared interests. The Virginia school, associated with the work of Buchanan and Tullock (1962), called attention to the potential inefficiencies that emerge from the *de facto* political process. The Chicago school, associated with the contributions of Becker (1983) and Wittman (1989) emphasized that the democratic process embodies a strong tendency to efficiency once competition and incentives for political entrepreneurship are taken into account.

An additional point emerging from the literature on collective action is that political parties can be a vehicle for organizing citizens in a way that makes rulers more responsive to citizen needs. But the way parties interact depends on electoral and representation institutions. For example, Persson, Roland, and Tabellini (2007) analyze the way in which, by affecting the accountability regime, presidential-congressional systems generate less spending and public goods provision than parliamentary systems (see also Persson and Tabellini [2004] and references therein). Although political parties are expected to play a large role in democracies, they may also play a surprisingly important role in some nondemocracies (Keefer 2011). The main body of this chapter largely abstracts from these themes to focus on arguments that can be made in more institution-neutral principal-agent models.

The specific characteristics of political engagement therefore matter in how it shapes the three principal-agent problems between citizens and leaders within each formal institutional context. These characteristics pertain to how active and organized different groups of citizens are, to what extent elite groups are in *de facto* control of state institutions, and to what are citizens' beliefs about public policies and demands from governments.

### **Even healthy political engagement is constrained by information asymmetries**

A large literature examines how, even if citizens have political power over leaders and want to hold them accountable for the delivery of public goods, they are constrained by a lack of information about the actions of leaders and the consequences of those actions. The transparency regime within

which each of the principal-agent relationships plays out determines what type of information is available to citizens and voters.

The accountability problem in principal-agent relationships arises because agents pursue objectives different from that of the principal and have access to private information that the principals lack. In the absence of these factors—if agents shared the objectives of principals, or if principals had full information—there would be no principal-agent problem. Leaders, public officials, and frontline providers undertake tasks to maximize their own payoffs comprising policy interests, reelection concerns, rent extraction, and so on. The ability of voters to decide whether political leaders have delivered the right policies and, as a result, whether those politicians should be reelected, depends on what information voters have about what policy was implemented, what level of welfare they perceive, and if policy is observed, whether circumstances warranted that particular policy choice. Similarly, voters may obtain information about the quality of political leaders themselves via disclosure rules (for example, individual assets) or through the media. An important question is what types of information are beneficial to citizens and when, both to better discipline officials and to sort good ones from bad ones.

Information problems are also acute in the within-government principal-agent problems between political leaders and public officials, and between public officials and frontline providers. Government agencies typically operate in areas where markets fail, which has profound implications for accountability. Market-based indicators of performance, such as profits, which discipline firms, cannot be used to discipline agents in government. This is one of the key conditions giving rise to bureaucracy, which instead disciplines agents by keeping track of inputs and imposing procedural constraints (Downs 1965; Wilson 1989). Procedural constraints (that is, red tape) then also become a potential source of misgovernance. Because relying on market forces is infeasible, red tape may be used not just to control agents, but also to screen clients—another potential source of misgovernance (Banerjee 1997).

Within firms, more complete incentive contracts can be written that reward agents for performance. Within government, good metrics of performance may be unavailable, making incentive contracts impractical. Multitasking distortions, which occur when agents shift effort away from valuable tasks in which their performance is difficult to measure in favor of those tasks where performance is more easily measured, are more common in government. These characteristics of principal-agent problems within

government mean that even well-intentioned leaders will face the challenge of designing appropriate institutions to influence incentives for some tasks, but also to shape professional norms of behavior for others where incentives alone will be insufficient (Dixit 2002).

Information is a special good. It is a public good whose use is nonrival, hence it will typically be underprovided by the market system. Government intervention can help address this market failure and help information to be provided at more satisfactory levels in markets. A problem arises when the information that must be generated is about the government itself. Information is a crucial ingredient for solving principal-agent problems of the kind discussed above that particularly plague government agencies. Like any other industry, the government may have perverse incentives to aggravate the market failures that arise in the provision of information. But unlike any other industry, the government also has the means to do so. Against this backdrop, as will be discussed in greater detail further below in this chapter, third-party actors such as the media are critical to accountability relationships because they can provide information about the government that the government may prefer remain undisclosed.

### **Transparency can strengthen political engagement to improve incentives of and select better-quality leaders**

The theoretical literature on the role of transparency focuses on institutional contexts in which citizens can exercise electoral power to select and discipline political leaders. The first contribution on electoral discipline as a constraint on shirking and rent extraction is by Barro (1973), although this work did not include an informational advantage for the politician. Ferejohn (1986) expanded the analysis to consider a politician who has greater knowledge than do voters about economic circumstances. This asymmetric knowledge allows politicians to gain higher rents from office. In this model, policy amounts to the choice of an effort level by the politician, that is, policy is vertical, and more is always better for the citizen. As a result, information is good for the voter because it allows him or her to fine-tune the use of elections as a source of discipline. Voters do not observe actions, but only the consequences of those actions as evident in resulting welfare. This result parallels that in Holmström (1979), in which information about the agent can never hurt the principal as long as an optimal contract can always be improved to exploit that information.

In politics, however, the “contracting” environment is very limited, and electorates often face other objectives in addition to providing incentives for pure effort.

***Ambiguous effects of transparency: Details matter***

Unfortunately, the basic lesson that more information is always better does not generalize over many relevant political settings. A case in point arises in models in which policy can be differentiated in a horizontal rather than vertical fashion (for example, left versus right, well adapted to circumstances versus not) and voters can only choose to retain an agent or not. When politicians have “career concerns,” they may want to pick policy with an eye toward generating a favorable image of themselves. An early example of this phenomenon is in models of biased advisors (Morris 2001). Harrington (1993) makes the point that when voters have strong views about what policy ought to be picked and politicians have strong office motivation, pandering will result. In other words, politicians will do what voters demand even when politicians have better private information than voters that suggests an alternative policy would be better.

Canes-Wrone, Herron, and Shotts (2001) prove this pandering tendency is present even when politicians are benevolent rather than directly office-minded, but desire to be perceived as competent so they can continue to have the chance to set good policy. Maskin and Tirole (2004) allow for office motivation but consider politicians who do not want to project competence but, instead, congruence with the electorate’s tastes. In both of the last two models, pandering is eliminated if the probability that voters will observe the consequences of actions is high enough. The key distortion is that certain policy actions, which are observable, are *a priori* tied to certain types of politician (competent or congruent) who are more desirable. It is the voters’ desire to use information to weed out bad incumbents that creates a cost in the form of forgone discipline.

Prat (2005) studies a situation in which the politician does not have superior information about his or her level of expertise but is concerned with the perception of competence. The politician shows that transparency about actions can distort incentives when the politician wants to increase the voters’ perception of his or her competence. The key condition is that a sufficiently strong correlation be present between a certain type of politician and the actions the voters tend to consider appropriate. An ancillary yet interesting aspect of models à la Prat is that if the principal could

observe the same signal that the agent observed, the agent's incentives to manipulate his or her actions would disappear. In other words, the negative effect of information on actions stems both from opacity of consequences as well as of "process." An additional distinction is between transparency of revenues versus transparency of expenditures (Gavazza and Lizzeri 2007b). Transparency of revenues may have negative effects if expenditures are not fully transparent.

In summary, the theoretical literature yields a few key insights. First, information about policy actions may distort incentives and discipline when agents want to be perceived as competent or congruent with principals. This situation happens when information about policy consequences is poor. In those circumstances, somewhat paradoxically, transparency about actions may be counterproductive. When that happens, accountability leads to a form of "excess responsiveness" in which informed agents disregard valuable information and take actions to please their uninformed principals. In contrast, information about policy consequences (as opposed to actions) is typically beneficial. Finally, direct "information on information," that is, about the agent's signal, eliminates the bad effects of information on actions, suggesting that giving citizens information about the policy-making process is beneficial.

### *Discipline effects versus selection and sorting effects of transparency*

Papers in the Downsian tradition of economic analysis of political markets (Downs 1957) typically take the set of candidates and the set of voters as given and show how the preferences of voters, as well as the competitive nature of elections, shape policy outcomes. The typical question is whether convergence to the median voter's preferred policy occurs.

The citizen-candidate tradition (Besley and Coate 1997; Osborne and Slivinski 1996) considers endogenous entry. The nature of the electorate, the costs of running, and competition are key determinants of who runs and subsequently what policies are implemented. In other words, the rules of the democratic game affect who gets elected to office. Although it is tacit, a clear message in this work is that the composition of the electorate is important. Therefore, citizens' political engagement as voters matters directly for policy outcomes.

To the extent that partisanship and other politician characteristics have a bearing on policy, candidate self-selection and screening by voters are also relevant to outcomes. Political engagement matters for outcomes through

leader selection even in strong institutional environments because leader characteristics play a role in policy selection and implementation. That is, elections do not only serve to choose between competing policies but also in the selection of the “quality” of leaders. A theoretical literature has examined the effect of various factors on political selection, for example, compensation on the quality and integrity of politicians (for example, Caselli and Morelli 2004; Messner and Polborn 2004). Other papers have considered whether candidates with good “character” are likely to arise endogenously (and be elected). Callander (2008) shows that candidates who care about policy and not just office will in equilibrium come forward and signal their genuine interest in policy by diverging from the median.<sup>3</sup> Myerson (2006) shows how federal electoral institutions can enable local leaders, who have built reputations for responsibly managing public resources at local levels, to emerge as credible contenders in national politics.

Abstracting from selection, Alesina and Spear (1988), Harrington (1993), and Keefer (2011) discuss the role of political parties in disciplining politicians. The key idea is that opportunistic deviations trigger some punishment of the politician. One important question is whether institutions that discipline politicians—be they parties or forms of accountability—in office can have effects on what type of politician reaches office. It has been argued that in polities in which policy makers face coercive pressures, the presence of political parties as protection or insurance devices can improve outcomes and attract better candidates (Dal Bó and Di Tella 2003).

Besley (2004) integrates the analysis of disciplining and selection effects. The key tension is that when reelection incentives lead noncongruent politicians to choose policies voters want, voters lose the ability to distinguish between congruent and noncongruent politicians. Knowledge of the politician’s type is directly valuable because it allows the weeding out of noncongruent types. However, a higher rate of direct revelations about the politician’s type can backfire because it weakens the incentives of a noncongruent type to mimic the policy choices of a congruent type. For example, the politicians might think, “If the media will reveal I am a crook, I might as well behave like one.” The idea that more precise information about the agent’s type can weaken discipline goes back to Dewatripont, Jewitt, and Tirole (1999) and Holmström (1979).

In summary, theoretical models of the role of transparency and political engagement in the selection of leaders have three main predictions. First, citizen engagement matters through citizens’ direct participation

as candidates, and in many contexts, the personal qualities of those who participate will translate into policy outcomes. Second, the compensation, the expected impact on policy, and the conditions surrounding policy making (for example, the protections afforded to policy makers) will affect political selection. Third, information about the (bad) quality of politicians has counteracting effects: although it may help the electorate weed out noncongruent politicians, it can also weaken discipline.

### *Role of the media and consequences of media slant*

The media can reveal information about the effort of politicians, which is valuable because it provides incentives for politicians to exert effort that benefits citizens (as in the model in Besley and Burgess 2002), thereby mitigating the principal-agent problem between citizens and politicians. The media can also reveal information about the politician's type. This information will help the electorate weed out incumbents with preferences that are not congruent with those of voters, but will also decrease the ability of the electorate to discipline bad incumbents. If bad incumbents know they will be seen as such, they will lose the incentive to mimic the policies of more congruent types (Besley 2004). This outcome will be an acceptable trade-off for an electorate that is primarily concerned with weeding out bad incumbents (Besley and Prat 2006).

Some papers have analyzed the special properties of information in models in which voters must seek out that information (for example, Martinelli 2006). The basic lesson is that, although costly, information is acquired in a way that permits information aggregation and the correct collective decision to be made.

Another strand of papers on voting and elections incorporates the media and the possibility that media are biased in a way that affects political outcomes. The predictions for voter welfare from adding profit-oriented media are at variance with each other. For example, Bernhardt, Krasa, and Polborn (2008) consider a model in which for-profit media may suppress information to cater to partisan voters and increase profits. The result of information suppression is potentially inefficient political outcomes. Chan and Suen (2008) analyze a model in which media seeking to maximize their audience by partially informing voters leads parties to be more likely to select platforms that cater to the median voter. Prat and Strömberg (2013) synthesize approaches considering for-profit media, politicians that seek rents from office, and voters interested in selecting and disciplining politicians.<sup>4</sup>

A prediction of their model is that groups that are larger and have more potential as advertising markets will see more coverage of the issues in which they are interested and be able to attract more public policy efforts by officials. This finding qualifies the discoveries in Besley and Burgess (2002): officials will exert more effort to protect the vulnerable if there is media coverage of the issues pertinent to that population. But this is a big “if.” On the contrary, if a profit-seeking member of the media caters to either the numerous or the elite, public policy will also. This result raises the question of how to level the playing field in issue coverage for more vulnerable sectors of the population.

Most of the political entry models (for example, citizen-candidate models) pertain to ideological selection. But the point has been made that transparency about politicians may affect equilibrium selection along a valence dimension, that is, pertaining to the competence of politicians. Caselli and Morelli (2004) show that more precise information about politicians’ types leads to higher-quality politicians. This effect acts through candidates’ decisions to run and is additional to the effect highlighted by Besley (2004) of voters being able to select better types among a given set of incumbents. Counterintuitive results have been found, however, wherein more transparency (meaning better information about individual talent being available to the private sector) lowers the quality of politicians, because talented individuals are more likely to move into the private sector and select out of political entrepreneurship (Mattozzi and Merlo 2007).

Prat and Strömberg (2013) derive predictions of media coverage of issues relevant to a group for the expected competence of representatives along those issues. Groups whose issues are covered more can expect to see not only more effort directed to their issues but also higher competence.

There are strong theoretical links between political selection and capture of media by powerful or special interests. Dal Bó, Dal Bó, and Di Tella (2006) derive results emphasizing negative effects on politician quality when honest policy makers are subjected to coercive pressures that the judiciary cannot neutralize, and that the captured media may be used to amplify through targeted press operations. If much of what is good in public policy occurs as the result of benevolent political entrepreneurs, this adverse selection of politicians is a first-order problem since higher media capture will diminish the availability of those benevolent political entrepreneurs. This result has the effect of harming policy and reducing the quality of politicians.

Rather obviously, bad incumbents prefer an opaque regime in which their types are not revealed directly; their actions, when related to rent extraction, are not observed; and the negative consequences of their actions are not known. Governments may then have incentives to suppress information. A key lesson in Besley and Prat (2006) is that a more numerous and diverse media industry, that is, more plural media, raises the costs for the government to suppress information, leading to better ability to weed out bad incumbents. Apart from government, special interest groups can also capture media in the pursuit of their group interests (Grossman and Helpman 2001). When a society faces hurdles in diversifying its internal press sources, international partners may have a potential role in helping remove the hurdles on the path toward plural media, with healthy competition among diverse sources and low risk of capture by the state or special interests.

In summary, theory predicts positive effects of transparency on effort, although in a multigroup society with for-profit media, the discipline effects may be biased in favor of specific groups for reasons other than merit. In addition, most theories predict positive effects of free media and transparency in particular, and “clean” politics (in which unhealthy practices such as violence, intimidation, and vote buying do not invert the principal-agent relationship) in general, on selection. The theoretical work on the link between transparency and selection is scarce, but the empirical work is even scarcer, suggesting the need for studies on the topic.

### *Importance of citizen capacity and modes of engagement in using transparency*

A key question is what citizens do with information they obtain as a result of transparency, beyond individual actions of complaining or optimally choosing what part of the bureaucracy to engage with. In most of the models already reviewed, citizens use information to vote politicians in or out of office. However, a lot of the effective control takes place through civil society activities such as petitioning, lobbying, and challenging official decisions in court. Examples of this are the actions of consumer advocate organizations, unions, and business associations. As mentioned in the context of the logic of collective action, group activity may pursue particularistic objectives rather than the general interest. A good system will maintain a balance between competing special interests, and more transparency is likely to aid all groups in mutually checking each other.

Political scientists have advanced the view that transparency and accountability can be created by design in the regulation of agencies, guaranteeing a level playing field for various interests to engage with the rule-making process (McCubbins, Noll, and Weingast 1987). In this view, citizens can be empowered via the design of administrative procedures to act as monitors (in the third type of principal-agent relationship) and as principals themselves. Certain aspects of administrative procedure are directly linked to transparency, such as freedom of information acts. Another relevant concept in the United States is the Government in the Sunshine Act (1976), which limits what parts of the policy-making process can remain opaque.

Citizens' capacity to influence bureaucratic processes is unequally distributed. As stated by McCubbins, Noll, and Weingast 1987, 261), "the resources available for representation in the administrative process vary systematically and predictably among interests." This motivates the question of how groups organize and what institutions and initiatives facilitate pluralistic citizen organization along healthy lines. This question is important because, according to the Olsonian logic of collective action, endeavors that might be costly when undertaken individually may become affordable when undertaken collectively (Olson 1965). This "cost savings" is especially true for actions that resemble public goods, like generating and using information to hold leaders accountable, challenging official decisions in court, and counterbalancing another interest group.

Transparency can have ambiguous effects even with citizens as monitors. Gavazza and Lizzeri (2007a) study cases in which publicizing the best bureaus permits more efficient queuing, but may dampen the incentives of the better bureaucrats to invest in lowering waiting times.

Another mode of citizen engagement is through complaint. Prendergast (2003) studies how complaints may yield value to the management of the bureaucracy. A central government may rely on elections at the local level or even permit rioting as an additional way to monitor the performance of local governments.

One important problem in citizens' ability to hold powerful leaders accountable is the phenomena of clientelism, vote buying, and elite control over coercive state institutions. Some early contributions to the vote-buying literature expanded principal-agent models to cases wherein a special interest (a principal) sought to provide incentives to legislators, seen as agents (Groseclose and Snyder 1996; Snyder 1991). A highly stripped-down model of vote buying that aids in the understanding of influence

over both committees and general electorates is analyzed in E. Dal Bó (2007), where again principals can direct payments to voters who act as agents. The analysis shows that when voters care about the outcome (rather than just about how they vote), each voter exerts a “voting externality” over the others, which causes inefficiencies to arise. This is the fundamental difference between a market for typical goods and a market for votes.

Because the market for government policies is very different from the market for goods, establishing protections for the independence of the vote can be valuable. E. Dal Bó (2007) introduces analysis of the secrecy of the ballot when vote buying is a concern and finds that secret ballots can help when voters care about the outcome (as in general elections), but may hurt when voters care about their vote per se (as with legislators voting under monitoring by their constituencies, suggesting that voting in legislatures should be public, but ballots in general elections should be secret).<sup>5</sup>

Dekel, Jackson, and Wolinsky (2008) consider a dynamic setup in which principals can compete for votes. They show that voters tend to be better off when vote buyers cannot directly buy votes up front, but can only make promises contingent on winning (that is, campaign promises), a result that would also recommend secret ballots. Note that secret ballots are a constraint on transparency, but may help maintain citizens as principals in the political game rather than agents. Baland and Robinson (2008) study a model in which landowners sell the votes of their workers and, in turn, offer them contracts that leave rents but stipulate their political behavior. The authors examine the introduction of the secret ballot in Chile in 1958 and show how it decreased the vote for the right wing more where there were more rural workers who were dependent on landowner contracts, suggesting that the secret ballot increased the independence of the vote.

Powerful leaders, whether landowning patrons or political leaders, may offer compensation other than direct cash. To provide two examples from the vast literature on clientelism and electoral particularism, Anderson, Francois, and Kotwal (2015) consider the exchange of insurance for votes in rural India. Lizzeri and Persico (2001, 2004) consider political elites who compete using two instruments: particularistic transfers (as in Myerson [1993]) and public goods with diffuse benefits. Conditional on the cost of producing public goods, transfers confer an advantage at courting voters because transfers can be targeted more narrowly. These papers study factors that can mitigate the underprovision of public goods. Lizzeri and Persico (2001) compare the advantages of proportional representation

versus winner-take-all systems, and Lizzeri and Persico (2004) examine the extension of the franchise as an inducement toward less particularism. Lizzeri and Persico (2004) show that when voters can be courted in these ways, more political competition (a higher number of parties) can exacerbate the incentives to cultivate narrow constituencies, leading to less efficient outcomes.

## Political engagement and transparency shape beliefs and behavioral norms

The analysis of norms and, in particular, of what might create informal authority and legitimacy are difficult topics in the research frontier. However, several approaches yield valuable insights. To begin with, citizen beliefs can matter to political accountability in several natural ways. In models of electoral discipline, citizen expectations about officials' performance can drive equilibria to display high or low performance (Barro 1973; Myerson 2006). But central aspects of the institutional architecture, such as federalism, can contribute to pinning down beliefs, thereby ruling out systematic bad equilibria (Myerson 2006). This implies that institutions and norms can interact, with certain types of institutions preventing "bad-norm equilibria." The beliefs of citizens can also be important in driving outcomes in settings where pandering, rather than shirking, is a possibility. Frisell (2009) studies how widespread beliefs about the corruptibility of officials make idiosyncratic policy choices seem suspect, thereby providing honest politicians with incentives to pander ("populism").<sup>6</sup>

Citizen norms can also affect how a particular institution (for example, unemployment benefits) affects outcomes. For example, if living off of benefits is deemed acceptable, moral hazard will be acute and taxpayers will desire low welfare benefits in political equilibrium (Lindbeck, Nyberg, and Weibull 1999). In a more abstract environment, P. Dal Bó (2007) shows that under community enforcement, beliefs can support not only cooperative equilibria, as typically characterized by folk theorems pertaining to bilateral games, but also highly unequal and "discriminatory" equilibria. These equilibria include "royal" equilibria in which one actor always defects to take an action with social cost on others, but enjoys cooperative behavior by all others, and a "caste" equilibrium in which each higher caste takes an action that imposes a cost on lower castes but enjoys cooperation from them. Thus, citizen beliefs can undergird social

structures that shape basic patterns of social interaction. Can these patterns be improved? Expectations about mutual behavior do much to determine what is perceived as legitimate behavior. This situation, however, only begs the question of what exactly legitimate behavior might be and what could enhance it.

Dal Bó, Foster, and Putterman (2010) offer an experimental design that enables a view of legitimacy and legitimate behavior as what arises when people choose their own rules of the game. In their experiment, subjects can vote for a policy (or institutional) reform that will transform a prisoners' dilemma game into a coordination game. Subjects may then find themselves in the new game either as a result of their own votes (an endogenous, "organic," reform), or as a result of an arbitrary, random decision of the computer (an exogenous reform). Subjects coordinate in the good equilibrium significantly more often when they access the coordination game because of their own decision rather than the computer's, even if the information about the vote is held constant, suggesting a buy-in or legitimating effect, of the reform bestowed by the democratic process. If homegrown policies and institutions will be more effective at improving behavior, it would be important to enable healthy political engagement wherever possible to select both policies and new institutions.

Akerlof (2015) offers a model of legitimacy-based authority, that is, the level of orders that a principal can give that will be carried out by the agent because following orders is a "duty." The model can be applied to gain an understanding of performance and behavioral norms in complex public bureaucracies. Akerlof shows how the model is operationally equivalent to agents monitoring each other to ensure compliance with orders when leaders have greater legitimacy. If legitimacy is lacking, however, the agent will reject that there is a duty and revert to considering the incentives to comply, as in standard principal-agent models with moral hazard.

However, the origins of legitimacy are not modeled in Akerlof (2015). Bolstering legitimacy is treated as an investment decision of leaders. The notion of legitimacy of leadership links with the previously mentioned work on how legitimacy for cooperative behavior can arise from democratic processes (Dal Bó, Foster, and Putterman 2010).

A way to improve interactions both among people and between people and officials might be to have leaders that exemplify certain types of behavior. Hermalin (1998) provides an early analysis of how an informed leader may promote efforts by others through his or her own effort, thereby signaling the worth of a task (see also Komai et al. [2007]). The behavior

of leaders can also shift political norms under which citizens feel indignant about bad performance and act to hold leaders accountable (Bidner and Francois 2013). Acemoglu and Jackson (2015) also offer a theory in which the behavior of leaders (actors whose actions are visible to all) affects norms (citizen beliefs about mutual behavior). In the last three papers, leaders can take actions that subsequently lead to citizens' adopting cooperative social or political norms.

Taken together, this body of work suggests a pathway from political changes to the strengthening of bureaucratic institutions for service delivery. If "clean" politics can bolster the legitimacy of leaders for delivering public goods and the reverse is true when politics is "dirty," cleaning up politics can be an avenue for larger changes in how bureaucratic institutions function. Bolstered legitimacy of political leaders for delivering public goods and leaders' roles in signaling a shift in behavioral norms, might translate into improvements to the culture of performance in bureaucracies. In environments in which politics is becoming cleaner, public officials and frontline service providers may be more inclined to monitor each other to comply with rules rather than bend them for private gain.

The theme of legitimacy is also raised in Basu (2015), who is motivated by the question of the interplay of laws and norms. He argues that behavioral traits as well as citizen beliefs can result in a change in the incentives of enforcers and generate multiple equilibria. In that context, the law may have an expressive component that acts as an equilibrium-selection device. Acemoglu and Jackson (2015) analyze the interplay between laws and norms through a model in which private parties choose complementary levels of a behavior before being matched with each other. The law stipulates a threshold beyond which behavior is illegal. Multiple equilibria arise; aside from actions being complementary, detection of illegality by enforcers depends on whistleblowing by the parties, which leads to mutual expectations of behavior relevant to expectations of law enforcement. In this context, tighter laws affect the prevalence of law breaking, as well as the level choices of law breakers and law abiders, in relation to prevalent mutual expectations. Thus, the effectiveness of the law at shaping behavior (and setting future norms) depends on initially prevalent norms.

### ***Emergence of citizens' demands for public goods***

The very experience of political engagement and the outcomes it produces for quality of government and service delivery, can lead to evolution

in political behavior toward the larger public interest. The previously mentioned work of Bidner and Francois (2013) has this flavor, whereby citizens become frustrated with corruption and increasingly intolerant of transgressions by leaders. This situation leads to a shift in political norms toward punishing corruption. Establishing anticorruption norms among citizens is also the idea in Dixit (2015), who examines the role of the business community in reducing the supply of bribes to government officials in the award of licenses and contracts.

A rise in demand among the elite for public goods has been linked to historical episodes of institutional reform. Lizzeri and Persico (2004) explain the extension of suffrage by English elites in the mid- to late-1800s as arising from an increase in the value of urban public goods following the industrial revolution (public health infrastructure such as sewerage, waterworks, and paved roads). A majority of the franchised elite pushed for reforms to extend the suffrage so that political parties would have stronger incentives to deliver these public goods. Consistent with their explanation, the authors document that following suffrage reforms, spending by municipal corporations on public health infrastructure increased substantially.

Demand for common-interest public goods and inclusive political institutions are highlighted by Besley and Persson (2009) as part of the explanation for the origins of state capacity. The building of legal and fiscal institutions of the state, which are needed to support markets, protect property rights, and provide public goods, are linked in their model to conditions that enable citizens to come together for a common purpose.

If citizen beliefs and demands are important because of how they interact with institutions and with politicians, one avenue to improving outcomes would be to foster interventions that affect those beliefs and demands for common-interest public goods. The literature on persuasion offers guidance on how to approach that agenda<sup>7</sup> and is part of the review of empirical evidence in chapter 6. An important question is whether transparency may affect beliefs, and thereby change how citizens engage with institutions, leading to an interaction between transparency and modes of engagement. Transparency can increase the value of specific modes of engagement and do so in ways that increase the value of transparency.<sup>8</sup> Elections and mass media are two institutional elements through which transparency and citizen engagement can potentially interact as strategic complements. Both elections and media have the potential to coordinate citizen action. Fearon (2011) offers a theory in which elections coordinate voters' beliefs about compliance by the ruler and thus also coordinate their readiness to

revolt when incumbents ignore the electoral calendar or results. A similar role is played by royal courts in the model by Myerson (2008), wherein a common venue allows the nobles to learn how the king is treating each of them. Yanagizawa-Drott (2014) offers a model in which media play a similar role as a coordination device. Although the effects of media in politics have been studied, disentangling pure coordinating effects from other, more direct, encouragement effects is difficult. The evidence in Yanagizawa-Drott (2014) shows that media can be used to manipulate citizens and coordinate actions, and even do so in negative directions, as in the role of radio in promoting participation in the Rwandan genocide.

This issue links back to the discussion of how media can affect political selection and incentives depending upon the nature of its programming content—whether it reflects capture by political leaders or by special interests, or whether more diverse and plural media flourish to reveal information that is relevant for accountability. Empirical advances discussed in chapter 6 suggest that the role of media is a challenging yet crucial area for governance policy. The challenges arise from how even plural media that are independent of state control can sometimes work to reduce political engagement and polarize the electorate.

Previous sections deal with the fact that politicians may gain from opacity and media slant, and may prevent all valuable information from reaching voters. The chapter also covers the fact that voters may face collective-action issues in acting on the information they do have. Problems with clientelism notwithstanding, voting is a low-cost activity and could be relied upon more when it comes to engaging citizens in decision making. But voter capacity issues arise—voters may lack the capacity to keep track of all relevant issues and metrics. A literature on political behavior<sup>9</sup> studies the ability of voters to compose a “political picture” by relying on partisan cues and other information-economizing heuristics. But as Caplan (2007) shows, substantial gaps remain between the policy opinions of experts and average voters. Bartels (1996) argues that voter information gaps can have large political consequences. Several voter biases have been characterized, such as antimarket and antiforeign biases. However, little is known about structural characteristics that may lead voters to error. This situation is intriguing given that the possibility of voter error is an assumption in the pandering models reviewed previously.

Dal Bó, Dal Bó, and Eyster (2013) propose a conceptual framework based on the idea that voters may underappreciate equilibrium effects, leading to a demand on their part for inefficient policies and institutions,

and show experimental evidence to support this idea. According to the evidence, voters fail to democratically solve social dilemmas (such as getting out of the tragedy of the commons) because they perceive the direct effects of policy on payoffs, but not its indirect effects through the induced changes in the behavior of other players. Voters reject Pigovian taxes that help internalize externalities and improve equilibrium payoffs because their immediate, visible effect, being a tax, is to lower payoffs. The evidence suggests that experience with all policy options, or at least voter education on the relevant options, is a necessary condition for overcoming this type of voting failure. Understanding the way in which civil society can expand voter capacity is a pending assignment for future research.

This chapter has cast governance problems as a sequence of principal-agent problems, as follows: (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. Political engagement and transparency shape all three of these principal-agent relationships in fundamental ways.

Citizen engagement matters to governance outcomes. Engagement involves various dimensions: whether citizens act as principals or agents, citizen beliefs and expectations, and citizens' empowerment to act on information. When citizens are engaged as agents rather than principals, for example, as a result of vote buying, this typically leads to inefficiency. This outcome is true even when candidates compete for votes, because competition may push candidates to target narrow majorities via particularistic benefits, eschewing public goods. This situation is typical of clientelist systems. The ability of different groups to engage, cooperate with each other, and achieve tighter accountability varies, sometimes with socioeconomic characteristics, but also with aspects of the design of the policy process and institutions, such as democratic mechanisms and federalism. If citizen collective action is an important component of engagement, a crucial question is how best to promote pluralistic citizen organization.

The chapter shows how disciplining leaders and selecting different types of leaders matters for governance and development outcomes. Transparency about both policy actions and policy consequences is essential. When information about policy consequences is lacking, transparency

about policy actions may be counterproductive, leading to pandering and populism by politicians seeking to please uninformed citizens. In contrast, information about policy consequences can strengthen the ability of citizens to hold leaders accountable for outcomes.

Citizen beliefs about politicians, the political process, and public policies are relevant. Political norms that ingrain expectations of low performance perpetuate underperformance, be it corruption, shirking, or pandering. In addition, pandering is more likely when politicians are not trusted, which would occur when corruption is high. Thus, corruption, by creating a culture of distrust, has the indirect effect of fostering pandering. Political engagement, and the leaders selected through it, can help shift political beliefs and norms of political behavior among citizens, potentially enabling societies to escape low-performance traps to improve governance in the public sector.

## Notes

1. Direct citizen participation in providing public goods is separate from this principal-agent setting because it consists of citizens directly contributing their labor and monetary resources to the maintenance of local public goods and the management of funds that are devolved to community-based organizations. Citizen engagement by public officials to provide technical inputs into the formulation of public policies, such as, for example, regulatory agencies seeking feedback from businesses in rule-making, is also separate from this principal-agent setting. These forms of direct citizen participation in the provision of public goods and in the crafting of public policies and regulations, are not within the scope of this report.
2. See, for example, the seminal work by Olson (1965).
3. On the issue of candidate character, see also Kartik and McAfee (2007) and Bernheim and Kartik (2014).
4. Their treatment draws on Strömberg (2004a, 2004b).
5. Levy (2007) considers transparency in committees where members are not targeted by vote buyers but where members care about their reputation. She shows that transparency in committees, by allowing a tighter attribution of a collective decision to individual inputs, may make committees less “conformist” and more likely to pass reforms.
6. On populism, see also Acemoglu, Egorov, and Sonin (2013).
7. See DellaVigna and Gentzkow (2010) for a review of the literature.
8. A different example of the interaction between transparency and modes of engagement is provided earlier in the chapter, in the context of information about different government bureaus that can lead to actions (queuing) that lower the value of transparency (Gavazza and Lizzeri 2007a).
9. See Bartels (2012) for a review.

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