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Governance and Development

CRED WP 2010/07

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January 2009

*Written as a chapter in the Handbook of Development Economics, edited by Dani Rodrik and Mark Rosenzweig to be published by North Holland. We are grateful to Frederico Finan and Robert Putnam for providing us with their data to María Angélica Bautista for her research assistance and Dani Rodrik for his detailed comments on an earlier draft.

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Abstract

In this paper we discuss whether or not ‘governance’ is an important source of variation in development experiences. We draw four main conclusions. First, governance is best thought of a sub-set of ‘institutions’ and as such emphasis on governance is consistent with much recent academic work. Nevertheless, governance is a quite vague rubric which it is difficult to unbundle. Second, the governance of a society is the outcome of a political process and as such is closely related to the literature on the political economy of development. Third, improving governance necessitates understanding the nature of the entire political equilibrium. Finally, an important research frontier is understanding the forces that create or impeded endogenous changes in governance.

1. Introduction

Like it or not there are fashions in social science and in beliefs about which paradigm is the correct one for understanding the world. Such fashions are highly prevalent in the study of economic development. When Max Plank famously remarked that “science advances one funeral at a time” he seriously underestimated the creativity of the scholars, policymakers and practitioners in this field and their willingness to accept new ideas. A current paradigm puts issues of “governance” at the heart of an understanding of development. Poor countries are poor because they have bad governance and countries that grow or are rich are those that improved their governance. Such a view of development is now enshrined as a key mission of the World Bank whose former President Paul Wolfowitz (2006) summed up this conventional wisdom in the following way during a speech in Indonesia

“In the last half-century we have developed a better understanding of what helps governments function effectively and achieve economic progress. In the development community, we have a phrase for it. We call it good governance. It is essentially the combination of transparent and accountable institutions, strong skills and competence, and a fundamental willingness to do the right thing. Those are the things that enable a government to deliver services to its people efficiently . . . An independent judiciary, a free press, and a vibrant civil society and important components of good governance. They balance the power of governments, and they hold them accountable for delivering better services, creating jobs, and improving living standards.”

In practice bad governance is often associated with corruption and reflecting this President Wolfowitz continued

“Today one of the biggest threats to development in many countries, including I think here, is corruption. It weakens fundamental systems, it distorts markets, and it encourages people to apply their skills and energies in nonproductive ways. In the end, governments and citizens

will pay a price, a price in lower incomes, in lower investment, and in more volatile economic fluctuations.”

One can easily find a plethora of examples from the development experience of the past 50 years which loosely support the notion that bad governance is the root of underdevelopment. The locus classicus of how poor governance derailed development in Africa is Tony Killick’s *Development Economics in Action*. Killick reports in detail the sad litany of governance failures in Ghana in the 1960s. A startling example is the construction of a fruit canning factory “for the production of mango products, for which there was recognized to be no local market, [and] which was said to exceed by some multiple the total world trade in such items” (Killick, 1978, p.229). The government’s own report on this factory is worth quoting at some length (Killick, 1978, p. 233)

“*Project A* factory is to be erected at Wenchi, Brong Ahafo, to produce 7,000 tons of mangoes and 5,300 tons of tomatoes per annum. If average yields of crops in that area will be 5 tons per acre per annum for mangoes and 5 tons per acre for tomatoes, there should be 1,400 acres of mangoes and 1,060 acres of tomatoes in the field to supply the factory.

The Problem The present supply of mangoes in the area is from a few trees scattered in the bush and tomatoes are not grown on commercial scale, and so the production of these crops will have to start from scratch. Mangoes take 5-7 years from planting to start fruiting. How to obtain sufficient planting materials and to organize production of raw materials quickly become the major problems of this project.”

Killick’s acerbic comment is that “it is difficult to imagine a more damning commentary on the efficiency of project planning” stated a whole year before the factory was constructed. This is certainly an example of dreadful governance leading to a huge misallocation of resources and helping to perpetuate the poverty of Ghana. Nevertheless, there is a big jump from examples of bad governance like

this to an explanation for comparative development and useful policy advice. For one thing, one needs to explain why on earth this happened. For another, one needs to carefully establish the causal effect of bad governance in circumstances where governance is endogenous and there are many omitted variables.

In this chapter we aim to assess the state of knowledge about the role of governance in development. Of course not all scholars agree with the view that poor development is caused by poor governance and there are many approaches to comparative development. Some scholars dismiss governance out of hand, for instance Sachs et al. (2004) assert that poor countries cannot afford good governance and after regressing various measures of governance on GDP per-capita use the residuals to assert that many African countries have surprisingly good governance! Others, such as Hausmann, Rodrik and Velasco (2008) recognize that governance may be an issue, but list it as only one among many other factors which may be the ‘binding constraint’ on growth in any particular society.

Still others would criticize the emphasis of Paul Wolfowitz on ‘public governance’ and the role of the state. Most of the governance literature considers how society is governed in isolation from how it is organized. To apply an old-fashioned distinction, most attention is devoted to *the superstructure* of society, very little to *the base* of the economy. Governance, however, is not only about those who govern, but also about those who are governed. The basic habits of those who are governed are essential in determining public governance. All this was clearly seen by Alexis de Toqueville. After his nine months visit to America in 1830 he wrote:

“Among the new objects that attracted my attention during my stay in the United States none struck my eye more vividly than the equality of conditions. I discovered without difficulty the enormous influence that this primary fact exerts on the course of society; it gives a certain direction to public spirit, a certain turn to the laws, new maxims to those who govern, and particular habits to the governed.”
(2000, p 3)

Though most of the work on governance and development ignores these issues there are many who would argue that forms of ‘private governance’ are crucial for

comparative development. An example of this work might be the work of La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998) on corporate governance and its relation to legal systems. While the importance of the legal system for explaining development (and even corporate governance) is moot (Acemoglu, Johnson and Robinson, 2001, Acemoglu, and Johnson, 2005, Lamoreux and Rosenthal, 2005) there is no doubt that many aspects of private governance differ across countries (see Bloom and van Reenan, 2007, for important evidence) and that this may be an important source of variation in development experiences. Though one may ultimately be able to treat many aspects of private governance as related to the state,¹ this may not be true of other aspects of the form of organizations and private governance, such as what Kreps called ‘corporate culture’ (Kreps, 1986). This notion relates more basically to the nature of social equilibria which generate trust or cooperation and which may differ radically across societies (as emphasized by Platteau, 2000, Dixit, 2004, Fafchamps, 2004 or Greif, 2006). Though we regard the issue of ‘private governance’ as important and we introduce some elements of it into our discussion, for example in our discussion of social capital, de facto political power, and the Scandinavian experience, the many potential dimensions of this issue mean that it is beyond the scope of our essay. Following de Toqueville we therefore introduce aspects of private governance to the extent that they influence the nature of public governance.

We draw the following conclusions. First, the literature on governance is most usefully thought of as part of the larger literature on the relationship between institutions and economic development. Following in the footsteps of North and Thomas (1973) a recent empirical literature, particularly the papers of Hall and Jones (1999) and Acemoglu, Johnson and Robinson (2001, 2002, 2005b), has tried to estimate the causal effect of economic institutions on development. They find that the preponderance of income differences between poor and rich countries can be explained by differences in these institutions.² Though this empirical

¹See Roe (2003) and Gourevitch and Shinn (2005) on the importance of state politics in explaining corporate governance.

²Though it is somewhat controversial we include economic policies along with economic institutions. Policies, like institutions, are chosen by those with political power and they have

literature emphasizes security of property rights, not governance, as being the most crucial institution, it also recognizes that what matters for development is a ‘cluster of institutions’. The right way to think about governance is as a potentially important part of this cluster of institutions. So far governance has not been ‘unbundled’ (to use the terminology of Acemoglu and Johnson, 2005), so we do not have definitive evidence for the importance of governance, but there is evidence that some parts of what people mean by this is surely important for development. We note, however, that since governance is really a vague rhetoric it may be intrinsically impossible to unbundle it.

Second, to understand governance and why it varies one has to study the political economy of development. Poor governance is not exogenously assigned and is the outcome of political decisions and as a result will reflect the political institutions and sources of power in society which mould the political process. Nevertheless, there is still a great deal of uncertainty about what political institutions or circumstances lead to good policies and institutions. Some variables, such as measures of constraints on the executive and measures of checks and balances are robustly correlated with development (Acemoglu, Johnson and Robinson, 2005a, Henisz, 2000). But such measures are often equilibrium outcomes, rather than related to more specific institutions such as the form of the constitution. Focusing on these we know that there is little evidence that the form of the constitution, such as whether the system is presidential or parliamentary, matters for growth, and other aspects of the form of government, such as whether or not it is democratic, do not seem to be correlated with development either. As yet, we do not have a satisfactory characterization of the circumstances which lead to a political equilibrium which is conducive to economic growth in a society and it appears that there are many ways in which property rights security, for example, can be achieved. We emphasize these issues by examining the political economy of the ‘Scandinavian model’ of governance and development. If the nature of the political forces that generate stable property rights in early 21st century China are very different from those that do so in the United States, so the economic institutions and patterns

large impacts on the incentive structure of society so for the purposes of the discussion it is not important to distinguish between them.

of governance which generated such rapid growth in Scandinavia during the 20th century are likewise very dissimilar from those of the United States.

Third, from a policy point of view, the key issue is to understand the entire political equilibrium. Governance reform is unlikely to be successful unless we understand the political forces that generate bad governance in the first place. In lieu of such an understanding, policy reforms to improve governance will often be ineffective. We suggest that to be effective reform has to change the political equilibrium of a society. Though it is possible that small changes may do this, it is more likely that reform has to take place simultaneously in many dimensions.

Finally, a research priority is to try to understand salient cases of endogenous transitions from bad to good governance (or vice versa, though this is much less common) to identify some generalizations about the factors or circumstances that lead to improved institutions, and by implication, better governance.

The chapter proceeds as follows. In the next section we ask what is governance? Section 3 then asks how governance can be measured. Section 4 discusses what theoretical mechanisms might link governance with development and illustrates the political economy of bad governance with an extended case study of Sierra Leone. In section 5 we then discuss the correlates of governance and evidence which suggests that governance has a causal effect on economic development. We include here a discussion of the ‘first stage’ or what causes variation in governance. In section 6 we move to discussing how to improve governance. We here emphasize that the political economy approach to governance suggests that there will be many pitfalls in attempts to reform governance. Section 7 then examines some successful instances of institutional and governance reform and draws some lessons. In this section we particularly focus on a great success story of the endogenous emergence of good governance - the Scandinavian model. Section 8 concludes.

2. What is Governance?

The first thing is to decide what governance is. The Oxford English dictionary defines governance as “government, control, or authority” or alternatively as “the

action, manner, or system of governing”. The organizers of the World Bank’s governance project and website define governance to be,

“the traditions and institutions by which authority in a country is exercised. This includes (1) the process by which governments are selected, monitored and replaced, (2) the capacity of the government to effectively formulate and implement sound policies, and (3) the respect of citizens and the state for the institutions that govern economic and social interactions amongst them.” Kaufman, Kraay and Zoido-Lobaton (1999, p. 1)

These definitions of governance, as with that proposed by Wolfowitz, are obviously very broad and include not just an emphasis on state capacity and the ability of the government to implement autonomous decisions, which many associate with governance, but also on the form of political institutions which determine who governs and presumably what choices they make. For example, both definitions also stress that accountability is a part of governance. Wolfowitz stresses this directly, while Kaufman, Kraay and Zoido-Lobaton do so indirectly through their first criterion.

These definitions of governance are so broad that they encompass nearly all aspects of the political institutions of a society in addition to the structure and capacity of the state. Indeed, the only thing they don’t directly refer to are the objectives of the government, though ex-President Wolfowitz mentions a “fundamental willingness to do the right thing”.

In this chapter by the governance of a society we shall mean two things. First, the nexus of political institutions in society construed broadly. We therefore mean not only things such as the form of the constitution and electoral system, whether or not there is democracy, whether the state is federal, and the system of political parties. But also other factors which influence the political power of different groups and individuals in society, such as whether or not they can solve the collective action problem, exert influence, exploit connections, and maybe even fire guns. Such institutions determine the aggregation of preferences in society and thus what institutions and policies arise in equilibrium. Second, governance also

refers to the implementation of such collective choices once made. This includes such issues as state capacity and the ability of the state to coherently and efficiently implement policies and the extent and impact of corruption.

It should be clear that with respect to the first meaning, the organization of the economy and perhaps the nature of society more broadly, ‘private governance,’ will be important even if they do not in themselves have a causal effect on development outcomes.

3. Measurement

3.1. Political Institutions

We cannot aspire here to overview the available sources of information on political institutions. Most of these, such as those compiled by Freedom House, the Polity Project, or the book by Persson and Tabellini (2003), are well known and we discuss these when they come up in our analysis. There are other sources of political power of course, such as the ability of groups to solve the collective action problem, and whether or not the central state has a monopoly of violence. These have been much less systematically measured, but they may be just as important in poor countries for the nature of the political equilibrium.

3.2. State Capacity and Effectiveness

There are several sources for cross-country comparisons of this aspect of governance. The main one, or at least the main one which uses this terminology, is the World Bank’s Governance project. For the past decade or so they have been collecting information on many institutional variables which are closely related to different notions of governance. These are, (1) Voice and Accountability, (2) Political Stability and Absence of Violence, (3) Government Effectiveness, (4) Regulatory Quality, (5) Rule of Law, and (6) Control of Corruption. Table 1 reports data from the last four of these variables for a variety of countries which pertain to the second sense in which governance is defined in the previous section. We use the latest data we have from the World Bank, which is 2005, and in the

first four columns show the bottom decile of the distribution of countries. All the series are normalized to lie between 2.5 and -2.5, with -2.5 being the lowest possible score.

Table 1 shows that there is a fair amount of agreement amongst these different dimensions of governance about which countries in the world have the worst governance. The usual suspects include Somalia, Haiti, Sudan, North Korea, the Democratic Republic of the Congo and Myanmar (Burma). Needless to say, these same countries would also be right at the bottom of any ranking of countries based on voice and accountability or political stability and absence of violence.

The World Bank defines government effectiveness as “the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies.” Regulatory quality is defined as “the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.” Rule of law is defined as “the extent to which agents have confidence in and abide by the rules of society, and in particular of contract enforcement, the policy, and the courts, as well as the likelihood of crime and violence.” Finally, control of corruption is “the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as “capture” of the state by elites and private interests” (World Bank, 2006, pp. 2-3).

These indices are constructed by unobserved components from 31 different datasets collected by 25 different entities (see World Bank, 2006, p. 17). Some of these datasets are surveys, while some of them represent the perceptions of experts in different areas. Data based on expert perceptions has been much used in the recent literature, for example the influential data on the security of property rights constructed by Political Risk Services. Obviously data based on perceptions are problematic, in the absence of a valid instrument, in that one tends to see low corruption in a country that is doing well and vice versa. For instance, Kang (2002) specifically argues that the notion that corruption fell in South Korea in the 1960s is false and he claims that the growth of the economy simply led people to believe that corruption must have been lower. Information can be based on

the perceptions of only a small number of informants. It may also be true that a free press, by denouncing more regularly corrupt practices, may give the image of more corruption, while the actual amount is or becomes smaller. In addition, to the extent that this data represents data about a country that is relevant to international businessmen (the usual market for the firms collecting this data) there may also be an issue of whether governance for international investors is the same as for domestic investors.

Nevertheless, one should be not overly skeptical about this data. Every source of data has problems and many different and independent strategies for measuring governance come up with similar rankings of countries and it seems unlikely that a country in which foreign investors had to deal with corruption would be one where its own citizens did not have to also deal with corruption, or that countries use one bureaucracy for foreigners and another one for their domestic residents. Though it may be true that President Mobutu's Zairianization program was focused on expropriating the assets of foreign nationals (Turner and Young, 1985, Chapter 11), the assets of Zairians were not safe either.

An example of one of the surveys used in constructing the World Bank's governance indicators in the BEEPS II Interactive Dataset: Enterprise Survey in Transition, 2002.³ This is based on surveys of firms in transition economies and asks a series of questions about governance and corruption. For instance it asks "When firms in your industry do business with the government, how much of the contract value would be typically paid in additional or unofficial payments/gifts to secure the contract?" Other important surveys which the World Bank uses for its governance indices include the Latin Barometer⁴ which, for example, asks respondents to report actual percentages of corrupt officials or actual number of times they witnessed acts of corruption, and the Afrobarometer which also has questions about governance and corruption.

Another important source of information on corruption comes from Transparency International. Their corruption perceptions index is widely used in empirical work (for instance Treisman, 2000, and Persson, Tabellini and Trebbi,

³<http://info.worldbank.org/governance/beeps2002/>

⁴<http://www.latinobarometro.org>

2003) and the final column of Table 1 shows the most corrupt countries in the world according to Transparency International. Transparency International also have a bribes index where they survey firms and ask them about bribing.⁵

There are however other sources of information about governance and corruption. One of the most important and influential studies of governance is that of Putnam (1993). He focused on the factors that determined the comparative performance of government in Italian regions. To do this he collected original data on twelve measures of governance and tried to explain why these varied so much within Italy. Several of the series he collected are very interesting and are worth understanding in detail. One measure, which he called ‘budget promptness’ was the average delay in approving the state budget over the period 1979-1985. The date at which this happened was on average January 27 in Friuli-Venezia Giulia to August 7 in Calabria. Another measure very relevant for state capacity is whether or not the state had created any statistical or information facilities. Six regions, Abruzzi, Calabria, Campania, Marche, Molise, Puglia and Sicily had none. Other regions, such as Emilia-Romagna and Lombardia were well equipped with such services. Putnam (1993) also collected information on legislative innovation. To do this he examined twelve different areas on which similar laws appeared in different regions, for example air and water pollution, consumer protection, strip mining regulation, etc. He then coded which regions led in implementing these laws measuring on average across the twelve domains how soon after the first appearance was the law implemented in a particular region. The pioneering region was given a score of 100 with a region that never adopted being given a 0. This data was aggregated into an index of legislative innovation. A final index of interest was that which attempted to measure bureaucratic responsiveness. To construct this, in January 1983, researchers contacted regional bureaucracies requesting information on various issues, for instance the agricultural department was asked, on behalf of a “farmer friend” for information about loans and subsidies for experimental crops. The initial requests were by mail, and replies were

⁵Another source of data on corruption and governance comes from Business International now incorporated into the Economist Intelligence Unit which was first used by Mauro (1995) and also Treisman (2000).

evaluated for their promptness, clarity and comprehensiveness. If no reply came then follow up telephone calls were tried and even personal visits. From all this information Putnam constructed an index of bureaucratic responsiveness. Fascinatingly, while in Emilia-Romagna and Valle d'Aosta two of the three requests received detailed replies within one week in Calabria, Campania and Sardinia none of the mailed requests received a reply at all.

With respect to data on corruption, an important study by Ferraz and Finan (2008) used data on a random corruption audit of municipal governments carried out by the central government in Brazil. They construct an index of corruption which is simply the number of violations that mayors are found to have done. Another innovative study is by Olken (2007) who used audit data on 600 road projects in Indonesia to investigate the misallocation of funds.

4. Theoretical Mechanisms

Given the different ways that one can think of good governance, there are obviously a huge number of different potential theoretical mechanisms linking governance to development. Indeed, given that we shall emphasize the political roots of governance, this topic encompasses almost the entire literature on political economy and we cannot hope to survey this literature here. In this section therefore we do the following, we first emphasize a few key ideas and present what we feel is a basic approach to thinking about governance and the politics of governance. We then illustrate the political forces that lead to bad governance with an in depth case study of Sierra Leone since the political economy of decline here is very representative of the political economy of governance in much of Sub-Saharan Africa.⁶

Development is caused by a society adopting institutions and policies that create incentives for its citizens to save, invest and innovate. Though institutions such as secure property rights create huge potential Pareto improvements in society, in general, growth enhancing institutions have important distributional effects. To refer to an obvious example, though the insecurity of human and prop-

⁶This discussion presumes that the distribution of political power matters for the efficiency of institutions and policies (see Acemoglu, 2003, 2006).

erty rights in Darfur is a disaster for economic incentives, it is in the interests of the current Sudanese government in Khartoum. These interests may not be immediately economic, but can also be political. In the Sudanese case the policy of the government towards Darfur is focused on maintaining power. Going back to Table 1, this approach implies that while the rule of law, for example, may be poor in Sudan, and even though this is costly for growth, the governing elite in Khartoum is better off without the rule of law (at least if that is the only way they can retain their rents).⁷

Economic institutions and policies are endogenous and are determined as collective choices of the society. Governance refers both to these choices, such as whether to build an effective bureaucracy or establish the rule of law, and also refers to parts of the institutional nexus which lead to these choices by influencing who has power and how it can be exercised. Clearly, there is no guarantee that all individuals and groups will prefer the same set of economic institutions because, as noted above, different economic institutions and policies lead to different distributions of incomes and power. Consequently, there will be a conflict of interest over the choice of economic institutions. In such a situation it will be the inherited distribution of political power in society that determines what institution are chosen. The group with more political power will tend to secure the set of economic institutions and policies that it prefers.

The distribution of political power in society is also endogenous, however. Following Acemoglu and Robinson (2006) we distinguish between two components of political power: *de jure* and *de facto* political power. Here *de jure* political power refers to all types of power that originates from the political institutions in society. Political institutions determine the constraints on and the incentives of key actors in the political sphere. Examples of political institutions include the form of government, for example, democracy vs. dictatorship or autocracy, and the extent of constraints on politicians and political elites. However, a group of individuals, even if they are not allocated power by political institutions, for example as specified in the constitution, may nonetheless possess political power.

⁷On the nature and behavior of the elite in the Sudan see Seekers of Truth and Justice (2000) and Cobham (2005).

Namely, they can engage in collective action, revolt, use arms, hire mercenaries, or use economically costly but largely peaceful protests in order to impose their wishes on society. We refer to this type of political power as *de facto* political power.

It will be this composition of *de facto* and *de jure* power in society that determines the actual power of a group or set of interests and this will determine which economic institutions and policies arise. This vision emphasizes that those with power today take decisions not just to maximize their income today, but also to maintain their grip on power. These goals are often in contradiction. This can be for the simple reason that economic policies which increase even the incomes of elites today may increase the incomes of opponents even more, thus influencing the future distribution of *de facto* power. It may also be that, as pointed out in the seminal study by Bates (1981), good economic policies are often not good politics. In particular though providing public goods may increase the incomes of the elite, staying in power may be better achieved by using redistributive instruments which can be targeted at supporters and withheld from opponents.

How does governance fit into this scheme of things? Used in the first sense, of the nexus of political institutions, governance plays an important role in determining the distribution of *de jure* power in society. This matters for the aggregation of preferences. For example if we consider the Glorious Revolution of 1688 in England, we would identify the change in political institutions which endowed Parliament with more power (see North and Weingast, 1989) as an improvement of governance. It had important implications for the types of policies and economic institutions that arose because it changed the distribution of *de jure* power in the direction of those who had an interest in socially more desirable policies. The Glorious Revolution was a change in governance not just because it changed political institutions, but also because it led to a revolution in the nature of the state and how it functioned. For instance, Brewer (1988) studied the creation of the excise tax bureaucracy in 18th century England. Brewer (1988, Chapter 4) shows how a fiscal-military state emerged after 1688 which needed a strengthened revenue base. Despite the fact that many positions in the bureaucracy were venal and there was a lot of corruption, both Whig and Tory governments built

a highly efficient and meritocratic excise bureaucracy because they needed new taxes to fund naval expansion. Figure 1 shows the excise rounds of Supervisor George Cowperthwaite between the 12th of June and the 5th of July 1710. Brewer records that during this trip Supervisor Cowperthwaite travelled 290 miles, visited 263 victuallers, 71 maltsters, 20 chandlers and one common brewer. In all he took 81 different measurements of production and checked the work of 9 different excisemen who worked for him. The government stopped corruption by collecting a huge amount of information, creating incentives and punishments and also regularly rotated excise officials in order to stop them colluding with local employers.⁸ So the Glorious Revolution led to changes in both senses of governance we discussed above.⁹

Our theoretical approach to governance is not the approach of many studies. For instance, much of the work on corruption sees it as an inevitable by-product of bureaucracy and the principal agent problems inherent in having a state (see for example, Bertrand, Djankov, Hanna, Mullainathan, 2007). This literature often focuses on the way corruption can be mitigated or eliminated, as well as its' consequences for private incentives and resource allocation.¹⁰ Our emphasis instead is on the political equilibrium of which corruption may be one consequence. Though corruption in bureaucracies may be the inevitable result of principal agent problems, and no doubt takes place in every country of the world, we are dubious that variation in this type of corruption is sufficient to account for first-order patterns of development. The type of corruption that one sees in countries such as Sierra Leone, which we examine next, may be sufficient, but as we shall argue this corruption has to be seen as part of a vector of governance pathologies which stemmed from the political strategy of the government of Sierra Leone.

⁸Interestingly, though it was possible to purchase commissions in the British army until the 1870s this was never possible in the (much more important) navy.

⁹There now a small but important theoretical literature on the political economy of state capacity, see Acemoglu (2005b), Acemoglu, Ticchi and Vindigni (2006) and Besley and Persson (2007).

¹⁰Important studies in this enormous literature include Lui (1985), Shleifer and Vishny (1992), Besley and McLaren (1993), Mookherjee and Png (1995), Banerjee (1997), Acemoglu and Verdier (1998, 2000) and Chand and Moene (1999), see Bardhan (1997), Rose-Ackerman (1999), Aidt (2003) and Svensson (2005) for useful overviews of the literature on corruption.

4.1. The Political Economy of Governance in Sierra Leone

In 2002 Sierra Leone emerged from a 9 year civil war as possibly the poorest country in the World in terms of per-capita income and ranked last in terms of the United Nation's Human Development Index. The political and economy history of the country since independence in 1961 can be easily summarized. After the early governments of Sir Milton Margai and his brother Sir Albert Margai, successive leaders of the Sierra Leone People's Party (SLPP), the country was ruled from 1967 by the All People's Congress Party (APC) until it was ejected from power by a military coup in 1992. During this period, under the presidencies of Siaka Stevens until 1985 and subsequently Joseph Momoh, the economy declined almost monotonically and state institutions collapsed. The coup, led by a group of young officers who formed the National Provisional Ruling Council (NPRC), was in response to the widening civil war which began with the first incursion across the border from Liberia of the Revolutionary United Front (RUF) in March 1991.

It is clear that Sierra Leone is a poor country because it has had terrible governance. Though the civil war which blighted the country between 1991 and 2002 caused further economic hardship and distress, the main reason that Sierra Leone emerged from war as the world's poorest country, is that it entered the war with that status in 1991.¹¹ Sierra Leone is not intrinsically poor, it has diamonds and great agricultural potential and is close to European markets. Had governance been better Sierra Leone may not have become South Korea or Taiwan, but at worst it would have become Botswana.

The British colonial administration seems to have had little interest in developing the country and even appears to have actively undermined business interests of Krios (the descendents of freed slaves who formed something of an elite during the colonial period) from Freetown, for example by promoting Lebanese commercial interests. The British also designed political institutions in the 1950s to guarantee that the more educated Krios would not dominate the politics of a newly independent Sierra Leone. Since independence, a sequence of politicians has had

¹¹There is total consensus in the academic literature on this see Davies (2007) for a recent authoritative view, also Luke and Riley (1989) and Kallon (2004).

no interest or incentive in providing the most elementary things which can lead a society to prosper. The main reason for this is that post-independent politicians ruled the country using the political strategy of patrimonialism, and the general unaccountability of the political class led to a high degree of kleptocracy.¹²

Patrimonialism, also called ‘neo-patrimonialism’, ‘personal rule’ or more simply ‘clientelism’, is a style of governance where politicians control power through a system of personal relationships where policies/favors are distributed in exchange for political support. There are several reasons that this is disastrous for economic policy and performance and they hinge mostly on how the exchange is structured in order to maximize the control and bargaining power of those running such regimes.

First, the form in which patrimonial or clientelistic exchanges have to take place is highly inefficient. For instance, patrons will find it politically desirable to use private goods which can be targeted to supporters and withheld from opponents. Public goods are not politically attractive ways to generate support and are thus generically under-supplied under patrimonialism.

Second, patrimonial rulers need to make people reliant on them for their future success or failure. To do this they create insecurity and uncertainty which only they can resolve. To quote a famous example, Rafael Trujillo, who ruled the Dominican Republic for 31 years forced all politicians to write a resignation letter which he kept in his desk. One parliamentarian was served with his resignation during his own speech in parliament (Turits, 2003, for this story). One robust consequence of patrimonialism is that property rights are insecure. People only have property because patrons allow them to have it, but such rights are always conditional and can be withdrawn. This creates terrible incentives to invest in assets. Moreover, laws are selectively applied with no concept of the rule of law or equality before the law which of course are completely inconsistent with how clientelism is dispensed. In a patrimonial regime you have rights if you are a client of the patron and otherwise you do not. The application of uniform rules or criteria to allocate resources impedes the ability of patrons to use discretion.

¹²See Cartwright (1970) and Clapham (1976) for the politics of the early independence period.

Third, as Bates (1981) first pointed out, patrimonial regimes create distortions in market prices to create rents which can then be politically allocated. When supply is not equal to demand, something is in short supply and this is a great political resource to those who can allocate it. This creates massive economic distortions, but it can be good politics.

Finally, patrimonialism undermines the coherence of the bureaucracy. This is because the bureaucracy represents a potential source of political opposition to patrons, and a consequence is that bureaucrats are continually “shuffled” so that they cannot conspire against rulers - a rather different type of shuffling from that experienced by 18th century British excise tax collectors. Another reason seems to be that bureaucrats in patrimonial regimes are even encouraged to be corrupt and steal, perhaps because this gives patrons more leverage over them. As Mobutu Sésé Seko famously said in this context

“If you want to steal, steal a little in a nice way. But if you steal too much to become rich overnight, you’ll be caught” quoted in Gould (1980 , p. 485)

This strategy of patrimonialism makes it very difficult for a central state to really establish and institutionalize its’ capacity and control over its’ territory. At some level, as we shall shortly discuss, patrimonialism is an attempt to create a national political order, but it does so not by eliminating alternative sources of authority in society, but by co-opting them. It does so not by trying to create a national identity, but by attempting to disarticulate potential sources of opposition or alternative identities. This leaves many sources of potential challenges to patrimonial rule simmering close to the surface and is why many of them break down. This problem is exacerbated by the fact that civilian control of the military seems to be inconsistent with patrimonialism, possibly because the regimes lack legitimacy and also because by their nature highly personalized regimes are very easy for even small groups of dissident soldiers to overthrow.¹³ The reaction to

¹³For example, the 100 year rule of the True Whig Party in Liberia was overthrown in 1980 by just 18 men led by Master Sergeant Samuel Doe.

this is that patrimonial regimes tend to keep the military very weak so as not to mount a credible threat. Instead, they often privatize security with presidents having bodyguards, often consisting of foreign nationals.

This somewhat stylized vision of how a patrimonial regime functions seems to fit quite well with accounts of how Stevens and Momoh ran the country. They used the control and discretion that this gave them to loot the nation's wealth. This description also seems to help understand the utter lack of provision of public services and the increasing inability of the central state to impose its writ on the country. The characterization fits right down to the decision by Stevens shortly after assuming power to cut the army to 1,000 men since it was initially a coup that had stopped him assuming power in 1967. Stevens also privatized violence creating a private security force initially named the Internal Security Unit (the ISU - which was apparently referred to by his long-suffering people as 'I Shoot U') and afterwards the Special Security Division (SSD - or 'Siaka Steven's Dogs', Jackson, 2004, p. 63, Keen, 2005, p. 17 on these acronyms). In the end it was a group of only 30 soldiers led by Captain Valentine Strasser which pitched the APC regime from power on April 30, 1992.

The APC came to power on the basis of strong support in the North of the country, particularly from the Temne and Limba ethnic groups. Patrimonialism was perfected to a fine art by Stevens, who was known as 'Pa Siakie' (father of the nation - Kpundeh, 1995, p. 23). Though Stevens built his patrimonialism on the social networks of the APC and much of the academic literature on this topic emphasizes the importance of informal relations, the strategy was greatly facilitated by changes in political institutions which began soon after he assumed power. Importantly, these involved making himself president and concentrating power in the executive, suspending democracy and creating a one-party state, first *de facto* in 1973 and then *de jure* in 1977. Stevens also seriously manipulated traditional political institutions such as Chiefship, buying support through the distribution of patronage and jobs, privatizing and personalizing state finances and looting the diamond wealth of the country (Barrows, 1976, Tangri, 1978,

Reno, 1995).¹⁴ Violence and the coercion of political opponents, if not on the scale of Omar Al Bashir, Idi Amin, Samuel Doe, Mengistu Haile Miriam or Charles Taylor, was a regular feature of life and criticism was not tolerated. A notorious example being the murder in 1980 by defenestration from a top floor office window of Sam Bangura, the governor of the central bank (Reno, 1995, pp. 137-141). This was ‘politics of the belly’ writ large (Bayart, 1993). The regime also featured the dominance of Freetown over the rest of the country and an urban bias (Lipton, 1979, Bates, 1981) which involved the reversal of decentralization and the abolition of district councils in 1972.

Casual empiricism suggests that barely any public goods were provided in the country in the 40 years prior to the end of the civil war and re-democratization in 2002. After coming to power in 1967, Stevens, a man who apparently without irony used to enjoy quoting the Krio aphorism “the cow eats where it is tethered”,¹⁵ famously pulled up the railway to Bo, Kenema and Pendembu and sold off all the track and rolling stock to make the change as irreversible as possible. Though interpretations of this event differ, a salient one is that he did this to isolate Mendeland which was the area which most strongly supported the SLPP (for instance Abraham and Sesay, 1993, p. 120, Richards, 1996, pp. 42-43, Davies, 2007, pp. 684-685). The roads fell to pieces and schools disintegrated. National television broadcasts stopped in 1987 when the transmitter was sold by the Minister of Information and in 1989 a radio tower which relayed radio signals outside Freetown fell down ending transmissions outside the capital (Reno, 2003, p. 48 for these stories). Other aspects of economic policy also fit very well with the classical analyses of patrimonial regimes. For example, the Sierra Leone Produce Marketing Board, inherited from the British, had a monopsony over all export crops, and paid farmers very low prices (Bates, 1981) as low as 40% of the world level (Davies, 2007). The exchange rate was massively over-valued creating a black market and a scarce resource which Stevens’ allocated through what Reno (1995) dubbed the ‘shadow economy’. According to Maddison’s data, GDP

¹⁴Stevens was not of course the first to interfere with chiefship. The British colonial state had done this as did early SLPP governments (see Kilson, 1966).

¹⁵In Krio “who sai dem tie cow nar day e go eat” quoted in Stevens, 1984, p. 35.

per-capita fell almost monotonically from the early 1970s onwards and declined to about 40% of the level recorded at independence by the end of the civil war. As if to add insult to injury, Stevens (1984) left a highly disingenuous autobiography!

There is a simple lesson from this section. Most of the things that people refer to as ‘bad governance’ are the consequences of a particular strategy of rule or power consolidation. They are not an inevitable outcome of principal agent problems. No doubt there was bureaucratic corruption in Sierra Leone along the lines studied in much of the literature on corruption, but this was second order compared to the institutionalized bad governance emanating from the state itself.

5. Consequences and Causes of Variation in Governance

5.1. Correlates of Governance

There are several well established facts about the correlations between measures of governance and corruption and various socioeconomic and institutional outcomes. We produce some of these in a few figures. Figures 2-5 shows the correlation between the World Bank’s four main measures of governance we discussed above and GDP per-capita. Figure 6 shows the relationship between average income and the Transparency International corruption index. It is clear that these measures of governance are all highly correlated with income, and also obviously highly correlated with each other. Generally, one does not find a country with good rule of law and endemic corruption. Though these indices of governance heavily use subjective ratings by experts, the association between income and governance is real. This is clear from Putnam’s data on Italy where his measures of governance are highly correlated with regional income per-capita (see Putnam, 1993, Figure 4.2, p. 85) and from Figure 7 which shows the correlation from Ferraz and Finan (2008) between the number of corrupt violations per-municipality in Brazil and the income per-capita of the municipality. Clearly, more prosperous municipalities have fewer corruption violations.

Obviously, however, these figures say nothing about any type of causal relationship. One simple strategy to examine this might be to use panel data and

country fixed effects. To think about what this approach might yield Figures 8 and 9 plot the change in the World Bank's measures of government effectiveness and control of corruption 1996-2003 against the change in the log of GDP per-capita of the country over the same period. These changes are uncorrelated in the case of control of corruption even though in quite a few cases the value of the index changes quite a lot. On the other hand Figure 8 shows that there is some evidence of a positive association between changes in income per-capita and government effectiveness over this period.¹⁶

Our perspective in this paper, however, is that one should think of governance as something intimately related to the wider literature on institutions and growth. From this perspective, one can interpret the evidence in Hall and Jones (1999) and Acemoglu, Johnson and Robinson (2001, 2002) as demonstrating that governance has a causal effect on economic growth. Nevertheless, one should perhaps be cautious about this. First, these papers propose an instrument for economic institutions and though the argument behind the instrument in Acemoglu, Johnson and Robinson involves elements of governance, they do not directly test a hypothesis about governance. Other work, such as that of Mauro (1995) which attempted to develop an instrument for corruption, is not very successful. Mauro suggested that ethnolinguistic fragmentation influences growth only via its impact on corruption, which seems rather unlikely (see Acemoglu, 2005a for a discussion of this issue). Other attempts to instrument measures of governance by variables such as settler mortality (e.g., Kaufman and Kraay, 2002) have exclusion restrictions which are equally as implausible.

We would conclude therefore that while there is evidence that a 'cluster of institutions' does have a causal effect on economic development and it is plausible that governance is connected to this, as yet governance has not been unbundled. This is not very surprising since the word is used in many different ways and quite imprecisely at that.

¹⁶The fact that the within variation does not suggest that the change in income per-capita and control of corruption are correlated may suggest, along the lines of Acemoglu, Johnson, Robinson and Yared (2008), that the correlation between the levels is due to the effects of an omitted variable.

5.2. The First-Stage

One of the most important aspects of the empirical approach of Hall and Jones (1999) and Acemoglu, Johnson and Robinson (2001, 2002) and the more historical agenda developed by Engerman and Sokoloff (1997) was the focus on the sources of variation of institutions.¹⁷ Acemoglu, Johnson and Robinson used variation in institutions within former European colonies arguing that historical mortality faced by Europeans and density of indigenous population were important sources of variation in the types of institutions that emerged. Acemoglu, Johnson, Robinson and Yared (2008) shows that these same historical variables also predict long-run democracy not just economic growth.

The general picture of institutional variation developed in these papers is that the institutional organization of society has a strong tendency to persist. It is implicit in the discussion so far that there are large forces which generate persistence in the political economy equilibrium. If a certain group is empowered by the existing structure of political power then they will choose economic institutions that favor them. This will increase their wealth and be one channel through which their de facto power will persist or increase. Moreover, those who hold power today will not only be able to determine economic institutions today. They will also be able to determine political institutions in the future which tends to cement the de jure power of such a group. Hence the distribution of political power and thus economic institutions is naturally highly persistent over time.

The tendency for institutions and patterns of governance to persist can also be illustrated by returning to the observations of de Toqueville we quoted in the introduction. Let us use “inequality” as a catch-all word for a wide range of economic and social disparities. What Toqueville hinted at can then be visualized as a political and economic system where (A) initial inequality affects individual and organizational behaviors— the selection of preferences of those who govern, and the possibility to implement different policies towards those who are governed; (B) the selected behaviors and policies affect the outcome and the social and economic inequality which form the initial conditions (A’) for a new round of

¹⁷See also La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1999).

political and economic behavior. The dynamics of the system loosely described by (A)–(B)–(A') can clearly be path dependent. While a high level of inequality can generate policies and governance that induce or maintain inequality, a more egalitarian starting point can generate policies and governance that maintain this low inequality. The system is in a long run equilibrium whenever initial inequalities are reproduced.

Nevertheless, institutions and governance can change. There may be intrinsic dynamics or shocks to the system that lead to redistributions of power and thus changes in economic institutions. It may also be the case that the incentives of those in power are changed, perhaps because of technical innovation or new market opportunities, and this may change economic institutions we well.

This perspective suggests however that while small changes may cumulate into systemic changes in institutions, the more usual case seems to be that at large 'critical junctures' the institutions of society are moulded and after that tend to be highly inertial. This was why the current institutions of Latin America, for example, look so different from those of North America. It was the apparent importance of such critical junctures which led Acemoglu, Johnson and Robinson (2001) to focus on the institutional consequences of European colonialism.

An interesting way to see the importance of the emphasis on critical junctures is to consider more broadly the consequences of factor endowments for development. Engerman and Sokoloff (1997) and Acemoglu, Johnson and Robinson (2001) show how factor endowments at the time of colonization had large effects of institutions. But what about the impact of subsequent changes in factor endowments, such as the role of oil in the 20th century? Some authors, such as Sachs and Warner (1995) blame bad economic performance on the abundance of such resources. Nevertheless, as Mehlum, Moene and Torvik (2006) show, that what matters is the combination of resource abundance and institutional quality. The growth effect of resource abundance varies with institutional quality. In countries with good institutions, resource abundance attracts entrepreneurs into production. In countries with weak institutions, however, entrepreneurs are diverted away from production and into rent appropriation. The historically determined institutional path that a society is on therefore subsequently conditions what happens when

shocks, such as the discovery of oil, arise.¹⁸

There are many potential sources of institutional variation in the world and to understand why Western Europe became so successful economically compared to Eastern or Southern Europe one would need to appeal to very different historical events. Scholars who have focused on the emergence of capitalist institutions in Western Europe, have focused on such systematic factors as the rise of the mercantile economy (Pirenne, 1937), the differential response of institutions to the population collapse of the Black Death (Postan, 1944), different patterns of social conflict (Brenner, 1976), the great shock of 1492 and the expansion of European powers into the world (Williams, 1944, Pomeranz, 2000, Acemoglu, Johnson and Robinson, 2005), or the French Revolution (Acemoglu, Cantoni, Johnson and Robinson, 2008). Institutions may also evolve in ways which depend on technology, as emphasized by White (1962), or even because of religious conversion (Pirenne, 1939).

So understanding institutional variation necessitates an explicitly historical approach. Two good examples of this come from the work by Putnam (1993) and Evans and Rauch (1998, 1999). Putnam (1993) famously proposed that what determined the measures of government performance discussed above was the relative amount of social capital of different Italian regions. In Figures 10 and 11 use his data on the number of inhabitants per cultural or recreational association in 1985. These associations include choral societies, hiking clubs and bird watching groups. We plot this data against two of the variables we introduced above. Figure 10 shows the density of associational life to be negatively associated with the mean budget delay while Figure 11 shows it to be positively associated with the quality of interaction with the bureaucracy.

Why does social capital vary? Here Putnam argued that this had deep historical roots related to the imposition of feudalism in the south of Italy in the 11th and 12th centuries after it was invaded by the Normans compared to the development of self-governing communes in the north as the power of the Holy Roman Empire declined (see Guiso, Sapienza and Zingales, 2008, for an attempt

¹⁸See Haber and Menaldo (2007) who similarly find no effect of oil on the political regime.

to test this idea).

Another important example both of measurement and the historical evolution of institutions comes from the research of Evans and Rauch (1998, 1999). They conducted a survey of experts to collect information of the structure of the bureaucracy in 35 countries. This project was an attempt to measure the extent to which the bureaucracy was ‘weberian.’ Figure 12 plots the data they collected on how meritocratic the bureaucracy was against the World Bank’s government effectiveness index. This shows that the greater the extent to which meritocratic procedures are used, the more effective is the government. The variable was constructed by averaging the replies to the following two questions: (Evans and Rauch, 1998, pp. 55-56) “Approximately what proportion of the higher officials in these agencies enter the civil service via a formal examination system?” and “Of those that do not enter via examinations, what proportion have university or post-graduate degrees?” Figure 13 instead plots against government effectiveness an index of how ‘weberian’ the state is from Evans and Rauch (1999) which uses information from 10 different questions. Again the weberianess of the state is positively correlated with the effectiveness of the government.

Why is it that some countries have weberian states while others so not? Evans (1995) suggests that this is the outcome of deep historical processes. For instance he argued that the capable bureaucracy in South Korea was related to the historical organization of the bureaucracy and examination system.

Our emphasis here is not on the path dependence of particular institutions, though we would not deny this can be important, but rather on the path dependence and historical roots of the entire political equilibrium of which bureaucratic capacity and governance more generally are two parts. In Sierra Leone, for example, we emphasized that the poor performance of the bureaucracy was closely tied to the ‘strategy of rule’ adopted after independence. More generally there is a close relationship between clientelism and bureaucratic capacity. Indeed, the connection between clientelism and poor governance emerges from Putnam’s data. In Figure 14 we give one example. Here we plot the incidence of innovative laws, discussed above, against the % of preference votes cast as a % of total possible preference votes in the 1976 Italian national election. Voters in Italian elections

at that time voted for a single national party list with seats being allocated in the legislature by proportional representation. However, if people wished, they could also indicate a preference for a particular candidate on that list. Such preference voting is associated with clientelistic exchanges. Figure 14 shows that clientelism thus measured is inversely related with legislative innovativeness.

5.3. Origins of Bad Governance in Sierra Leone

5.3.1. General Ideas about Patrimonialism

We now return to the Sierra Leone experience and ask: what do we know about what causes patrimonialism? We first do this at a more general level and in the next sub-section focus on how these general arguments apply in Sierra Leone. There are two sides to this question, the supply of patrimonialism and the demand. Almost the entire academic literature focuses on the supply side, namely the circumstances under which patrimonialism is an attractive strategy for politicians to use to stay in power. The demand side, the circumstances under which citizens demand patronage instead of, say, public goods, is neglected though may be important.

There are some basic ideas about what causes the supply of patrimonialism. First, it seems to be attractive in circumstances where national identities are lacking and there is no a settled social contract or legitimate structure of authority in the country. This was obviously quite a common circumstance in Africa after independence where countries inherited the arbitrary boundaries created by European colonialism.¹⁹ Though we do not have good analytical models of this, Zolberg's (1966) insights about 'creating political order' still seem germane today. Patrimonialism may have great social costs but it is a very effective way of governing in a fissiparous nation.

Second, patrimonialism seems to be encouraged by heterogeneity of identities. There seem to be a few reasons for this. One is that patrimonialism heavily uses various forms of divide and rule and this strategy appears to be much more feasi-

¹⁹As Englebert (2000) has shown the arbitrariness of a country's boundaries in Africa are correlated with poor development outcomes.

ble in societies have distinct ascriptive identities (Padró-i-Miquel, 2007). Another, stems from the demand side. In a very heterogeneous society there may be much less demand for public goods, which reduces the opportunity cost of the massive under-supply of public goods which is the natural by-product of patrimonialism. Another facilitating factor on the demand side may stem from the fact that in a society divided by ascriptive differences it is easy to conceive of a polarization between different groups which may lead people to be disposed to reject the application of universal rules, so undermining principles which would impede the creation of patrimonialism. Heterogeneity of identities also seems to make it more difficult to establish civilian control of the military. When the military cannot be relied on it becomes very difficult to establish such key state functions as monopolizing violence and this again makes patrimonialism more attractive as a method of political control (see Horowitz, 1985, on how civilian control of the military is fraught in ethnically divided societies).

The third potent source of patrimonialism seems to be a type of path dependence from the institutional structure and operation of the colonial state. A large amount of recent empirical and historical work has emphasized the path dependent influence of colonial institutions (e.g. Engerman and Sokoloff, 1997, Acemoglu, Johnson and Robinson, 2001), and this work resonates with arguments made by Africanists. Cooper (2002), for example, coins the term ‘gate-keeper state’ to refer to the institutions the Europeans created. They built governing centers on the coasts and constructed infrastructure and institutions only to the extent that this was needed to extract valuable resources or provide the thinnest veneer of order. Cooper’s argument suggests that center-periphery relations in post-independent African states were heavily influenced by the structure of the colonial state. Young (1994) specifically argues that the political strategies adopted by post-colonial African regimes were directly modelled on the way that colonial states functioned. For example, indirect rule practiced in British colonies precipitated indirect rule by post independent governments.²⁰

²⁰Many other types of arguments appear in the literature, for example patrimonialism is linked to central traits of African indigenous political systems or maybe African political culture (see Carlson, 1999). Another set of arguments involve the claim that patrimonialism is more

It is also possible to make path dependent arguments about the creation of state institutions more generally. The institution on indirect rule was the antithesis of the construction of effective central state institutions and the development of what Mann (1986) calls ‘infrastructural power’. Indirect rule was not a strategy for building state institutions, rather it was a minimum cost way of creating order which gave up the desire of ‘penetrating’ society so as to provide public goods or structure public life, in order to focus on resource extraction. As Fanthorpe (2005, p. 4) points out in the case of Sierra Leone,

“even today, the vast majority of rural Sierra Leoneans obtain primary rights of residence, land use, and political/legal representation as ‘natives’ of chiefdoms rather than as citizens of the state.”

Here the academic literature builds firmly on the work of those like Hintze (1975) and Tilly (1975, 1990) who studied the development of central state institutions in Europe. These scholars emphasized how fiscal and tax institutions, bureaucracy and political institutions such as parliaments evolved out of the desire of states to raise resources to fight inter-state wars. Herbst (2000) and Bates (2001) specifically attribute the poor capacity of African states to the absence of the historical factors that led to them in Europe. To these scholars, as to Max Weber, patrimonialism was the natural state of affairs before the creation of states and “rational-legal authority” and it sees no natural tendency for patrimonialism to change without external challenges.²¹

Though the deep roots of the phenomenon are therefore complex, what is clear is that the strategy is complementary to certain types of political institutions. Throughout Africa, the creation of patrimonial rule went hand in hand with changes in political institutions. This involved a strengthening of the executive

attractive when countries are ‘resource dependent.’ Unfortunately, resource dependence is hard to measure in an objective way since economic decline will naturally lead a country to become resource dependent, at least if measured by the share of natural resources in GDP or exports (see Robinson, Torvik and Verdier, 2006, for this point).

²¹Herbst (2000) and Bates (2001) tend to emphasize ‘fundamentals’ such as population density and resource endowments as the main reason for the lack of incentives to build states, rather than the institutional inheritance of colonialism.

which was achieved by a move away from parliamentary to presidential constitutions. One can think of several reasons why being a president was more attractive than being a prime minister for politicians such as Stevens, but there seems to be a natural affinity between presidentialism and patrimonialism. It also involved a reduction in accountability which was implemented by the suspension of democracy. During the consolidation of patrimonialism power was also concentrated in the central state and capital city.

5.3.2. The Sierra Leonean Context

Some of these ideas obviously apply to Sierra Leone. Like most Sub-Saharan African countries Sierra Leone was 'arbitrary' and, the Western Areas aside, made up of a patchwork of different pre-colonial states and polities with different languages, histories and cultures. At independence, there was probably little notion of a national identity or agreed rules for structuring the contest for power and this no doubt led different groups to perceive that the stakes were very high.

Sierra Leone also seems to fit well with ideas of the gate-keeper state' centered on Freetown and of course the Protectorate was ruled indirectly through a system of chiefs institutionalized by the British in the 1890s.²²

Civilian control of the military was also highly problematic and Sierra Leone even appears as a case study in Horowitz (1985) of a society where the colonial military recruitment policies gave post-independent civilian governments severe problems. For instance the British recruited primarily from the South of the country and this is one of the reasons why the Mende dominated officer corps opposed the election of the APC in 1967 and mounted a coup to block the transfer of power. Though Stevens quickly moved to replace Mende officers with northerners, his primary strategy was to emasculate the military, something which proved a disaster when the RUF invaded.

This being said, the intensity of patrimonialism in Sierra Leone might not have been anticipated in 1961. For one, unlike most Sub-saharan African countries it actually had a national language, Krio, something which is associated

²²See Migdal (1988) for an analysis of indirect rule and its' consequences in Sierra Leone.

with political stability in Tanzania, or with very good development outcomes in Botswana.²³ Second, though there were distinct ethnicities in Sierra Leone, these were not based on the type of socioeconomic differences seen in Rwanda or Burundi and at no point does the civil war seem to have degenerated into anything approximating an ‘ethnic conflict.’²⁴ Herbst (2000) even classifies Sierra Leone into one of the rare African countries with ‘easy’ political geography based on its’ small size and distribution of population.

Despite these advantages there seem to have been some other factors that may have exacerbated the intensity of patrimonialism in the country. Most commonly cited is not the extent of natural resources but the *form*. It is widely observed that the alluvial nature of diamonds and their wide spread across the country makes it very difficult for the state to control diamond mining. This breeds illegality, smuggling and evasion and as Clapham (2003, p. 12) puts it

“a situation highly uncondusive to the maintenance of legal norms and bureaucratic state structures”.

It seems quite likely that the failure of the British colonial state and post-independence governments to bring the diamond mining economy under the control of formal state institutions helped to stimulate different ways to control it and extract wealth from it. The contrast with the deep mined capital intensive diamonds of Botswana is interesting.²⁵

Another factor often quoted in favor of Sierra Leonean distinctiveness is an undertow of socioeconomic and political conflicts possibly missing in most African

²³Though of course there is Somalia and Rwanda as well.

²⁴Indeed though Humphreys and Weinstein’s (2008) data shows that being Mende does predict membership in the RUF, this effect comes only from those who were coerced into joining the movement. This effect almost certainly stems from the fact that the RUF began in the south of the country, which is more explained by the location of Liberia and Charles Taylor than anything else.

²⁵Mentioning Botswana, one might ask why the factors we have discussed here did not lead to patrimonialism in Botswana, and one salient success story in Sub-Saharan Africa. As Parsons and Robinson (2006) discuss, the historical pattern of institutional creation and governance in Botswana was rather unique both before, during and after the colonial experience. They show how the economic success of Botswana can be explained by the absence of the forces here we suggest lead to patrimonialism.

countries. For example, Richards (1996), Sawyer (2004) and Fanthorpe (2005) see historical roots of the civil war stemming from inegalitarian patterns of access to land and resources and many have written about the extent of ‘gerontocracy’ in Sierra Leone and the grievances this created amongst young men. It is possible that the existence of a large strata of disillusioned young men also facilitated the creation of patrimonialism since excluded from local resources, they may have valued very highly what rents were on offer from the political patrons in Freetown.

It may also have been that an added incentive to undermine the bureaucracy and create a shadow state’ in the post independence period came from the fact that the state inherited from the colonial powers was dominated by Krios, while politics was dominated by people and interests from the former protectorate (Clapham, 2003, p. 12).

Finally, one could also argue that the fact that the Mende and the Temne, each with about 30% of the population, formed the basis of the two main political parties gave politics a type of ‘polarized structure’ in the sense of Esteban and Ray (1994) which may have been very conducive to conflict.

6. Improving Governance

Our discussion in this paper has embedded the discussion of governance into the political economy of institutions and development. Our basic argument is that bad governance arises because it distributes income and or political power in particular ways. To improve governance we need to understand the political forces that lead to bad governance in the first place and we also need to understand how and why governance improves. These questions are closely related to more general ones about the processes that lead to institutional persistence and change. Institutions persist when the incentives and structures of power that led to them also persist. It is clear that even though there is a great deal of persistence of institutions in the world, institutions do change. The approach we have taken in this chapter suggests that this will happen when the political equilibrium changes.

Nevertheless, at present we do not have a satisfactory understanding of the circumstances under which dysfunctional political equilibria arise and sustain them-

selves. A natural idea would be to focus on specific political institutions such as democracy. Yet we know that democracy per se is not necessarily associated with better development outcomes and we all know the famous examples of ‘developmental dictatorships’ such as in South Korea or Taiwan. However, as yet, we do not understand why some dictatorships are developmental and others not or why, for instance, there has never been a developmental dictatorship in Sub-Saharan Africa or Latin America.

Though we cannot yet say under what circumstances political equilibria which lead to economic growth will arise, we can illustrate the utility of the ideas we have developed by examining the issue of governance and institutional reform. If governance is poor then a natural approach is to directly try to reform governance. If there is corruption, then promote an anti-corruption law, set up an anti-corruption agency, make aid conditional on eliminating corruption. The potential problems facing such an approach highlight the first set of *pitfalls of reform*. Our perspective emphasizes that one should not try to understand or manipulate governance without thinking about the political forces that created the particular patterns of governance that we observe.

Indeed, we shall argue that direct governance reform in itself is unlikely to be effective and that instead it might be more useful to focus on understanding and reforming the forces that make governance bad. It is therefore important to focus on political institutions and the distribution of political power in thinking about reform. This raises the second potential pitfall of governance reform; while we have recognized the importance of political institutions, we are still at the beginning of understanding the complex relationship between political institutions and the political equilibrium and thus governance. Sometimes changing political institutions may be insufficient, or even counterproductive, in leading to better economic outcomes.

The pitfalls of reform are related to the fact that patterns of relative economic performance are very persistent. Examining the pitfalls of reform is one way of approaching this issue. We then move to examining successful change.

We begin our discussion by focusing at more length on whether reforming governance without thinking about politics is likely to be effective. We argue

that such reforms may not work if they do not change the political equilibrium. We then examine if these pitfalls of reform can be solved by reforming political institutions (thus altering the distribution of de jure power in society). We argue that this may not work either because de facto power may persist and may override the effects of reforms to political institutions. From this it might seem to follow that a successful reform necessitates changes in both de jure and de facto power. We show that simultaneously changing both may not achieve real reform either because the political equilibrium may be path dependent.

6.1. Persistence of Power and Incentives—The Seesaw Effect

Many poor growth experiences are accompanied by a system of dysfunctional laws and regulations and other aspects of governance. An obvious idea might be to directly intervene in these components of governance and promote change in laws and regulations. This was the sort of reasoning that led to the famous Washington consensus some of whose components, for example, privatization of state enterprises, deregulation, and legal security for property rights all seem related to governance.

The first pitfall of reform is that directly reforming specific institutions, policies or aspects of governance may not be sufficient, and may even backfire. The reason why such reforms may be ineffective is that it is usually not a coincidence that some aspect of governance is bad. Bad governance is probably fulfilling some political objective. But there are many different ways and a multitude of instruments to achieve a specific goal. Taking away one instrument without altering the balance of power in society or the basic political equilibrium can simply lead to the replacement of one instrument by another with little net effect of the ultimate goal - economic performance. This phenomena was dubbed the *See-Saw Effect* by Acemoglu, Johnson, Robinson and Thaicharoen (2003).

6.1.1. Case Study: Central Bank Independence

Acemoglu, Johnson, Querubín and Robinson (2008) use the case of central bank independence (CBI) to illustrate these ideas about reform. CBI is a canonical

example of a reform in governance which was proposed as a way to improve monetary policy. It is a particularly interesting type of reform to study empirically since it has a clearly delineated target - *inflation* - and one can thus judge the success of CBI by investigating whether or not it has reduced inflation. Acemoglu et al. (2008), in the spirit of the argument above, argue that the impact of reform will be conditional on the initial political equilibrium that generated the need for reform. For example, only policy reforms that the groups with political power cannot easily over-ride, circumvent or ignore are likely to achieve their objectives. In consequence, in many countries, such as those in Sub-Saharan Africa, where there are only few constraints and checks on politicians and on politically powerful groups, policy reform is unlikely to be very effective. Case study evidence for this is presented in van de Walle (2001, see also his 1993 paper) who illustrates that for African politicians (2001, p. 13)

“restoring economic stability and growth has often taken a back seat in government motivations to preserving political power.”

In the context of structural adjustment he argues (2001, p. 76)

“Often, the policies have changed on paper, but in practice, something resembling the status quo ante continues to prevail. In some cases, the old policies were reinstated under a new name or with some new policy objective ... In other cases, governments ignore the spirit of their own liberalization efforts by continuing to interfere in officially deregulated markets.”

Put starkly, who would expect policy reform to have significant effects in Zimbabwe as long as Robert Mugabe is in power? As an illustration of this Figure 15 plots the inflation rate in Zimbabwe and plots a vertical line in 1995 when the central bank’s act was modified in order to grant the Reserve Bank of Zimbabwe more independence. Clearly, the independence of the Central Bank in Zimbabwe did little to restraint the subsequent monetary policy of the government. Therefore, a major reason why policy reform will often fail is because of the absence of

a functioning accountability system and lack of constraints and checks on politicians.

Acemoglu et al. (2008) point out, however that this does not imply that better political institutions and transparency always increase the impact of reforms. In particular, we would not expect societies with a functioning system of accountability and with checks on politicians to be those pursuing such highly distortionary policies. For example, inflation was already low in the United Kingdom in the 1990s, before the central bank became independent in 1998 and in consequence the potential for a large effect from CBI reform is limited.

The arguments in the previous two paragraphs suggest that once we take a political economy perspective, there should be a non-monotonic relationship between the extent of constraints on politicians and the impact of policy reform. Acemoglu et al. (2008) then test these ideas using cross-national panel data. They find that CBI has little effect on inflation in countries with either high or low values of constraints on the executive, but it does significantly reduce inflation in countries with intermediate values of constraints. However, they also hypothesize that if policy reform does not change the political equilibrium, reform in one dimension can lead to simultaneous disreform in another dimension. They test this idea by examining whether or not CBI leads to a deterioration in fiscal policy. They indeed find some evidence that while in countries with high or low constraints on the executive CBI has no impact on fiscal policy, for countries with intermediate levels of constraints it tends to increase the size of the government relative to GDP. This is a precise instance of the *see-saw effect*. We illustrate this idea in Figure 16 with two figures from their paper which plot for Argentina and Colombia inflation and government expenditure as a % of GDP. Again the introduction of CBI is indicated by a vertical line. The figures suggest that while CBI reduced inflation, it also coincided with a large expansion in the size of the government relative to the economy.

6.1.2. General Lessons

Making or imposing specific reforms may have little impact on the general structure of governance or performance if they leave untouched the underlying political equilibrium. Of course, it is possible that a reform in governance may induce a change in power and ultimately in the broader political equilibrium. Nevertheless, as the above example make clear, this is far from certain.

Despite all of the Washington consensus reforms that took place in Argentina, for example, there was little change in the way politics worked. The political genius of Menem and the Peronist party after 1989 was to recognize that the policies of the Washington consensus could be bent to function as ‘politics as usual’. In consequence there was little change in the underlying political equilibrium though the instruments which the Peronists used after 1989 were different. Though it is possible that such reforms could change the political equilibrium, it did not happen and this is why the Washington Consensus led to such disappointing results.

6.2. Persistence of De Facto Power

The last section illustrated that reforming particular parts of governance without perturbing the underlying political equilibrium may not lead to improved economic performance. Moreover, we shall now argue that even reforming de jure power (for instance enfranchising former slaves) or introducing democracy may not be sufficient to induce broader institutional change. The reason why changes in de jure power may not be sufficient to trigger a change in the political equilibrium is that the political and economic system is kept in place by a combination of de jure and de facto political power. An external or internal reform of de jure institutions may still leave the sources of de facto power intact, and groups that have lost their de jure power may use their de facto power in order to re-create a system similar to the one that has departed (Acemoglu and Robinson, 2008a). The new system may be as inefficient as the old one.

This is not to argue that reform of de jure institutions is not possible or that it is irrelevant. For example, democratization in many European societies in the 19th century appears to have significantly changed economic institutions, for example

leading to sustained expansions of educational systems (Acemoglu and Robinson, 2000, Lindert, 2004). It is to argue however that reform comes with pitfalls and as yet we have an incomplete understanding of the circumstances under which such reforms will succeed.

An excellent illustration of these ideas is the evolution of institutions in the US South after the Civil War. Our discussion follows Acemoglu and Robinson (2008b).

6.2.1. Case Study: The US South before and after the Civil War

An important example which illustrates our perspective is the continuation of the economic system based on labor repression, plantation and low-wage uneducated labor in the U.S. South before and after the significant changes in institutions brought about by the Civil War. Most obviously these changes in de jure power included the enfranchisement of the freed slaves.

Before the Civil War, the South was significantly poorer than the U.S. average income at about 70% of GDP per-capita. The South lacked industry (Wright, 1986, Table 2.4, p. 27) and in 1860 the total manufacturing output of the South was less than that of either Pennsylvania, New York or Massachusetts (Cobb, 1984, p. 6). The South had very low rates of urbanization (around 9% as opposed to 35% in the Northeast) and relatively little investment in infrastructure. For example, the density of railroads (miles of track divided by land area) was three times higher in the North than in Southern states. The situation with respect to canal mileage was similar (Wright, Table 2.1, p. 21). Perhaps more importantly, especially in the context of the potential for future economic growth and industrialization, the South was not even innovative for the sectors in which it specialized. The relatively backwardness of the South was due the plantation economy and slavery.

In the aftermath of the Civil War, the income per-capita of the South fell to about 50% of the U.S. average. If the organization of the slave economy had been the reason why the South had been relatively backward in 1865, one might have imagined that the abolition of slavery in 1865 would have removed this blockage to Southern prosperity. The evidence and historical interpretations show that the

abolition of slavery had a surprisingly small effect on the Southern economy. Out of the ashes of the Civil War emerged a low wage labor intensive economy based on labor repression. Cut off from the rest of the United States, income per-capita remained at about half the average until the 1940s when it finally began slowly to converge. Just as before the Civil War, there was systematic underinvestment in education (Margo, 1990).

So why did the economic system of the South change so little following the Civil War, especially given the significant changes in political institutions? At first, this persistence appears at odds with the significant changes in the distribution of *de jure* power that took place after the Civil War, for example, with the enfranchisement of the freed slaves, and the repeal of the Missouri compromise, which had previously cemented the political power of the South in the federal government.

We argue that this persistence is due to the exercise of *de facto* political power by the Southern landed elites to compensate for the loss of their *de jure* political power. There was considerable persistence in the identity and power of these elites. For example, Wiener (1978) studied the persistence of the planter elite in 5 counties of the black belt of western Alabama. Tracking families from the U.S. census and considering those with at least \$10,000 of real estate, he found that (p. 9) “of the 236 members of the planter elite in 1850, 101 remained in the elite in 1870.” Interestingly, this rate of persistence was very similar to that experienced in the antebellum period; “of the 236 wealthiest planters families of 1850, only 110 remained in the elite a decade later” (p. 9). Nevertheless, “of the 25 planters with the largest landholdings in 1870, 18 (72%) had been in the elite families in 1860; 16 had been in the 1850 elite group.”

After the end of the Civil War, more or less the same group of planter elites controlled the land and used various instruments to re-exert their control over the labor force. Though the specific economic institution of slavery did not persist, the evidence shows a clear line of persistence in the economic system of the South based on plantation-type agriculture with cheap labor. This economic system was maintained through a variety of channels, including both control of local politics and exercise of potentially violent *de facto* power. As a consequence, in the words

of W.E.B. Du Bois (1903, p. 88), the South became “simply an armed camp for intimidating black folk.”

A key to the persistence of the antebellum system after the Civil War was the continued control over land. For example, in the debate over the redistribution of 40 acres of land to the freedmen (vetoed by President Andrew Johnson in 1865), Congressman George Washington Julian argued (quoted in Wiener, 1978, p. 6):

“Of what avail would be an act of congress totally abolishing slavery ...
if the old agricultural basis of aristocratic power shall remain?”

Southern elites were able to disenfranchise blacks after 1877 and a whole gamut of segregationist legislation—the so-called Jim Crow laws—was enacted (Woodward, 1955, for the classic analysis). These laws turned the postbellum South into an effective “apartheid” society where blacks and whites lived different lives. As in South Africa, these laws were aimed at controlling the black population and its labor supply. Consequently, the South entered the 20th century as a primarily rural society. “It remained an agrarian society with a backward technology that still employed hand labor and mule power virtually unassisted by mechanical implements” Ransom and Sutch (2001 pp. 175-176). In 1900, the South’s urbanization rate was 13.5%, as compared to 60% in the Northeast (Cobb, 1984, p. 25).

Ransom and Sutch’s (2001, p. 186) assessment of the implications of this economic and political system in the South for economic progress is representative of the consensus view: “Southerners erected an economic system that failed to reward individual initiative on the part of blacks and was therefore ill-suited to their economic advancement. As a result, the inequities originally inherited from slavery persisted. But there was a by-product of this effort at racial repression, the system tended to cripple all economic growth”:

All in all, the Southern equilibrium, based on the exercise of de facto power by the landed elite, plantation agriculture and low-wage, uneducated labor, persisted well into the 20th century, and only started to crumble after World War II. Interestingly, it was only after the demise of this Southern equilibrium, that the South started its process of rapid convergence to the North.

6.2.2. General Lessons

Just as reforming governance or economic institutions without changing the political equilibrium may not improve economic performance, so changing de jure power, while leaving the sources of de facto power intact, may have little impact. In the US South, the same economic system based on the repression of labor got reinstated after Reconstruction. Even though the enfranchisement of the freed slaves meant that there had been a change in de jure power, and after the Civil War blacks exercised this power and voted in large numbers, southern elites were able to use their de facto power to re-assert control over labor and eventually by the 1890s disenfranchise the blacks. The persistence of de facto power was facilitated by the fact that white elites had kept hold of the land after the Civil War, and because these elites had avoided being killed during the Civil War and still had a huge comparative advantage over blacks in the ability to engage in collective action. Control was exercised via coercion, lynching and the Ku Klux Klan and other extra-legal methods and eventually institutionalized via control of state legislatures.

The general lesson seems to be that change in institutions which affects the distribution of de jure political power, needs to be complemented by changes in the sources of de facto political power of the elite and reductions in the benefits that political incumbents have in intensifying their use of de facto political power.

6.3. The Iron Law of Oligarchy

The conclusion from the last section seems to be that to change the political equilibrium there needs to be changes in both de jure and de facto power. For instance, if there is an elite which is structuring institutions to its benefit with adverse aggregate effects, then to engineer a transition to a better equilibrium both their de jure and de facto power must be simultaneously reformed.

Unfortunately, things are not quite so simple as this. This is because even if de jure and de facto power changes, those who acquire the power in the new political equilibrium may not have the correct incentives either. More importantly, their incentives to use their power and the institutions they find it optimal to create

may be fundamentally shaped by the status quo they replace - they may be path dependent. If an elite with power is initially structuring economic institutions or the nature of governance to extract rents from society, then the very fact that it is doing this may induce a new elite to do likewise. The replacement of one elite by another may therefore do little to improve economic performance. This pitfall is reminiscent of the classic idea in sociology of an *Iron Law of Oligarchy* going back to the work of Michels (1962), Mosca (1939) and Pareto (1968). This hypothesis states that it is never possible to have real change in society because when new groups mobilize or are created in the process of socioeconomic change they simply replace pre-existing elites and groups and behave in qualitatively similar ways. There seem to be many circumstances in which ‘Iron Law’ type behavior may occur and there are quite possibly many mechanisms that can generate behavior like this. We now present a case study of this phenomenon in action drawn from Acemoglu and Robinson (2007).

6.3.1. Case Study: The Bolivian Revolution

Bolivia features centrally in accounts of comparative development in the Americas. It was at the heart of the Inca Empire with a high density of indigenous peoples and during the colonial period economic institutions designed to extract rents – the *encomienda*, *repartamiento*, the Potosí *mita* (forced labor draft for the silver mines) - were all central. Although the *mita* was abolished at independence a highly inegalitarian and authoritarian society persisted. In 1950, for example, 6 % of landowners owned 92% of all lands and the smallest 60% of landowners owned 0.2% and the tin mines which formed the basis of the export economy were owned by three families. A mere 31% of the adult population was literate and only 4% of labor force was employed in industry. Indians still subject to unpaid *pongueaje* (personal services) for the landowners whose lands they worked (Klein, 1992, for an overview of this evidence).

The remains of this system were swept away by the Bolivian revolution of 1952 which was masterminded by the MNR (Movimiento Nacionalista Revolucionario), a political party which had formed in urban areas in the 1940s to contest the power

of the traditional elite. Following the Revolution, the MNR formed a government which implemented land reform, expropriated large estates and redistributed them to the labor force and Indian communities. It also introduced universal suffrage by abolishing literacy requirement on voting and nationalized the mines of the tin barons.

These appear to be huge, radical institutional changes. In particular there was a shift in the distribution of both *de jure* and *de facto* power. Surely Bolivia was launched on a new path of institutional and economic development. At the very least one would have anticipated a sustained fall in inequality. Unfortunately none of these good outcomes occurred. Following the Revolution the 1950s saw a failed attempt by MNR to create a one-party state and in the process they re-built the military which had been disarmed in 1952. They were also able to use clientelism to gain the support of the indigenous majority. Indeed, there are striking comparisons between the traditional clientelism which had existed before 1952 and that which emerged during the regime of the MNR afterwards. In a seminal study, Heath (1972), showed that although the identity of the patrons were different and the instruments of clientelism had changed following the institutional changes brought by 1952, there were very strong similarities in the basic structure of the political equilibrium. Kelley and Klein (1981) estimated that 10 years after the Revolution, inequality had returned to 1952 levels.

How can we understand an outcome like this? We believe that there are mechanisms that can generate persistence in the political equilibrium even when *de jure* and *de facto* power changes and can produce an Iron law of Oligarchy. The idea is quite simple. Initially in Bolivia institutions were structured to the benefit of traditional elites. A new elite emerged, spearheaded by the MNR. The MNR needed to win support of the campesinos and other urban groups. To do this they had to develop a political strategy, but the form that strategy took was highly influenced by the strategies being used by the traditional elite. The traditional elite were clientelistic, so it was optimal to use clientelism to compete with them. Similarly, the traditional elite ran a political system with few checks and balances. Would the MNR find it optimal to create a political system with checks and balances? Not necessarily. After all, though this might have appealed

to citizens and garnered more support, it would also have been disadvantageous to them once they were in power. Hence there is a well defined trade-off. Indeed, the MNR were able to attain power and create highly imperfect political institutions which they were then able to undermine.

6.3.2. General Lessons

One might conclude from our discussion of the US South that the real problem was the persistence of the elite and their resources. If only the North had implemented land reform and given the freed slaves their 50 acres and a mule, as they had been promised, everything would have been different. The example of the Bolivian Revolution shows that the situation is more complex than this. In Bolivia the previous elite were expropriated and their power taken away, yet the new elite that emerged (the MNR) used strategies that were very similar to the old elite and which had the same impact on economic institutions. Thus there can be huge path dependence in political equilibria, even when de jure and de facto power changes hands from one group to another. This implies that, for reformers, a policy of changing political institutions and trying to simultaneously undermine the de facto power of incumbents may not work. Instead, reformers must change the incentives of new elites and de-couple their choices from those of the previous elites.

6.4. Successful Reform

Though so far we have emphasized the problems of reform which result for the political nature of poor governance, nevertheless there are many cases of improvements in governance. To give a tangible example of the forces leading to institutional change let us return to the US South. Starting in the 1940s the income per-capita of the US South began to converge very rapidly to the US average. This period saw the end of the isolation of the labor market. It saw the abolition of institutionalized racial discrimination in labor markets and social life and the re-enfranchisement of blacks culminating in the Voting Rights Act of 1965 (see Wright, 1999, for an overview).

These changes were driven by a number of interacting forces which both changed the ability of Southern elites to maintain the previous system and their incentives to do so. The ability of whites to continue with the institutions which had been in effect since the late 19th century was severely undermined by the fact that blacks in South finally solved the collective action problem (McAdam, 1983). The civil rights movement made much of the previous system unenforceable. Black collective action was facilitated by the intervention of the federal government. At the same time there was a much smaller ability and incentive for the whites to continue to repress labor. Starting in the 1940s there had been a huge out-migration of blacks from the South which could no longer be controlled. At the same time technological change, particularly the mechanization of cotton picking (Heinicke, 1994) made it far less important to repress labor.

There was real change therefore in the political equilibrium in the South which led to much better governance and economic institutions. The old economy based on extracting rents from the blacks crumbled, along with all the negative externalities that it had for other parts of the economy. No new elite arose to carry on repressing black labor using different instruments and the situation did not turn on its head with blacks extracting rents from whites. This may have been because of the technological changes that took place at the same time, but more likely it was because the South is embedded in a larger economy with well functioning institutions. This latter feature of the South may have considerably raised the opportunity cost of having bad economic institutions and is something which obviously differentiates it from Bolivia or the Congo.

Improved governance can therefore come about when changes in state variables or structural parameters influence the costs and benefits of different sets of institutions, and thus change interests, or there is a change in the distribution of political power. These changes are often endogenous to the system though often in response to shocks. Nevertheless, policy interventions promoted by economists and by external entities such as the World Bank can lead to sustained reform by working on any of these margins. An obvious example of this are the institutional and governance reforms precipitated in Eastern Europe by the carrot of accession to the European Union. This created enormous financial incentives to reform.

6.5. Governance and Equity—The Scandinavian Model

Though better governance may have arisen in Britain in the 17th century as the consequence of a political revolution (Pincus, 2009), in the US South governance improved as the joint outcome both of economic and political changes. Though people certainly refer to the ‘Civil Rights Revolution’ in the US, one does not need a revolution to change the political equilibrium and indeed, as the Iron Law of Oligarchy emphasizes, revolutions may simply replace one dysfunctional equilibria with another. It is possible that just changes in the economic environment, in technology or in the organization of markets can permanently change the political equilibrium and this is no doubt what Karl Marx had in mind when he observed that “the windmill gives you society with the feudal lord; the steam mill, society with the industrial capitalist” (see also White, 1962). We illustrate this possibility with an in depth case study of the emergence and persistence of the Scandinavian model of capitalism.

6.5.1. The Rise of the Scandinavian Model

Social Democratic governments came to power in Sweden and Norway in the midst of the Great Depression committed to reducing unemployment and alleviating poverty. The main slogan of the social democrats in the thirties was employment for everybody. Both governments increased spending on policies such as unemployment benefits, public housing and agricultural price supports. In retrospect, the key innovation was not the crisis policies that were adopted in the 1930s, but the institutional response to the problem that threatened the recovery program (Moene and Wallerstein, 2006): What would keep the increased government spending from raising the wages of insiders in the labor market, rather than increasing employment?

The problem came to a head in both countries in the construction industry. Construction workers in Sweden and Norway were highly paid, militant and sheltered from foreign competition. When foreign demand collapsed in the 1930s, workers in the export sectors such as metal workers accepted large wage reductions in order to stem the decline of employment. Construction workers came

under no such pressure, in large part because of increased government spending on housing. Since construction workers were employed in the export sector as well as in home construction, higher construction wages raised labor costs in the export sector, which threatened the jobs of metalworkers. When construction unions called a strike in support of higher wages, the national confederation of unions intervened to force the strike to an early and from the construction workers' point of view, unsuccessful conclusion.

The intervention of the national union confederation to end the strikes in construction was the initial step in a process of centralization of authority within the union movement in both Norway and Sweden, a process that was encouraged and supported by employers. "Basic agreements" between the national associations of unions and employers establishing rules for collective bargaining at the industry-level were reached in 1935 in Norway and 1938 in Sweden. In the 1950s, (1956 in Sweden, 1958 in Norway), bargaining at the industry level was replaced by direct negotiations over pay by the national associations of unions and employers. As white-collar and professional union confederations joined the centralized negotiations, the coverage of the central agreements expanded to include most of the working population in the private sector.

The central agreements were necessarily general. The details of how the agreement were to be implemented was decided by subsequent bargaining at the industry and local level. Once the central agreement was signed, however, work stoppages were illegal. Wage increases at the local level were limited to what could be obtained without the threat of a strike. The centralized system of wage setting, which reached its zenith in the 1970s, had three important consequences. The first was the virtual elimination of industrial conflict. From the countries with the highest levels of strikes and lockouts in the world in the inter-war year, Norway and Sweden became countries with some of the lowest levels of industrial conflict in the postwar period.

The second consequence was to allow conditions in the export industries to determine the growth of wages throughout the economy. This implied wage moderation. In practice, the centralized system of wage bargaining tied wage growth throughout the economy to the growth of wages in the export sector, since the

unions in the export sector, the metal workers in particular, were the largest and most influential unions within the national confederations.

The third consequence of centralized wage setting was a gradual process of wage compression that, over time, generated the most egalitarian distribution of wages and salaries in the capitalist world. In the 1950s, wage compression was adopted as an explicit goal of the unions in both Norway and Sweden under the title of “solidaristic bargaining.”

Solidaristic bargaining was defended more in terms of efficiency than in terms of equity. In the 1950s, two Swedish trade union economists, Gösta Rehn and Rudolf Meidner (Rehn, 1952), argued that equalizing wages across Swedish firms and industries would promote economic development by forcing wages up in low-productivity firms or industries and keeping wages down in high-productivity firms or industries. By reducing profits in low-productivity firms and increasing profits in high-productivity firms, labor and capital would be induced (or coerced) to move from low productive to high productive activities, increasing aggregate efficiency as well as improving equality (Moene and Wallerstein 1997, Agell and Lommerud, 1993).

Whatever the benefits of solidaristic bargaining in terms of efficiency, the cumulative impact on the distribution of wages and salaries was large. In Sweden between 1970, when comprehensive wage data on individuals began to be collected, and 1983, when the system of centralized bargaining temporarily collapsed, the variance of the log of hourly wages among private sector blue-collar workers declined by over 50 per cent (Hibbs and Locking, 2000). That dramatic decrease does not include the equally prominent reduction of the wage differential between blue-collar and white-collar workers. Hibbs and Locking (2000) estimate that a similar decline occurred during the 1960s as well, implying that the variance of log hourly wages in 1983 was only one quarter of what it was in 1960. In 2003, the ratio of the wage for a worker at the 90th percentile of the wage distribution to the wage for a worker at the 10th percentile was about 2 to 1 in Sweden, Norway and Denmark, the lowest ratios of any country in the OECD. In contrast, the 90-10 ratio was above 5 to 1 in the US in 2003.

To keep highly productive employers from undermining the policy of wage re-

straint by offering workers generous benefits (which were harder than wages to monitor at the central level), the Swedish employers' confederation lobbied the government to nationalize the provision of health care and pensions (Swenson, 2002). Moene and Wallerstein (2001) show that expenditures on social insurance against the loss of income due to unemployment, disability, sickness and occupational injury rises as wage inequality declines. If insurance is a normal good, a policy that raises the income of the majority of workers with below average incomes increases the political demand for social insurance policies. The compression of wage differentials, in sum, had far-reaching economic and political consequences, one of which, was to increase the pace of economic development. It introduced a system of governance and incentives that led private businesses to act in socially desirable ways without altering property rights.

6.5.2. How Equality Multiplies

Today the societal model of the Scandinavian countries is still distinguished by a large welfare state, encompassing unions and employers associations, and a governance system of routine consultation among government and representatives for interest organizations. In terms of policy it is characterized by the provision of basic goods for everybody as a right of citizenship; a government committed to full employment; and wage leveling through "solidaristic bargaining" (Moene and Wallerstein, 1993).

From a governance point of view it is important to notice that these institutional arrangements are complementary. The impact of one of them tends to strengthen the impact of others. Governance is easier and more efficient whenever institutions and policies fit together in this manner. A policy for full employment, for instance, requires wage moderation by the unions. For union members to accept that their union bosses negotiate wage moderation, they must face credible promises of a full employment policy. Thus the unions rely on a government commitment to full employment in their wage moderation policies as much as the government relies on union wage moderation in its policy for full employment.

The complementarity between social spending and wage setting is a related

aspect of the mutual dependence politics and markets. Barth and Moene (2008) demonstrate how economic and social equality multiplies due to the complementarity between wage determination and welfare spending. Returning once more to the mechanism that Toqueville hinted at, we have that (A) a more equal wage distribution fuels welfare generosity via political competition, while (B) a more generous welfare state fuels wage equality further via its support to weak groups in the labor market.

Together the equality magnifying effect (A) and the wage equalizing effect (B) generate a cumulative process that adds up to a sizable social multiplier. Using data on 18 OECD countries over the period 1976-2002, Barth and Moene (2008) are able to identify an equality multiplier of more than 50 per cent. Any exogenous change in either welfare spending or wage setting is thus magnified by 50 per cent by endogenous forces caused by social complementarity. This equality multiplier helps explain why almost equally rich countries differ so much in the economic and social equality that they offer their citizens: With only one third of the pre-tax inequality of the US, the Scandinavian countries of Denmark, Norway, and Sweden have twice as generous welfare spending as the US.

These calculations are based on a political economic equilibrium approach that incorporates the mutual dependence between the governance of labor markets and the governance of social policies. While social welfare spending depends on the wage dispersion in the labor market, it also feeds back to the determination of this wage dispersion. The political economic equilibrium outcome is a wage dispersion and a level of welfare spending that are consistent taking the mutual feed-backs into account. Hence, the new political economic equilibrium gives “new maxims to those who govern and particular habits to the governed,” as Toqueville said.

These are examples of how certain policies, institutions and governance systems fit together and strengthen each other. In the long run, the outcomes may look as if societal arrangements come in packages with different social and economic organization.

6.5.3. How the Political Equilibrium Changed

The Scandinavian model was not the result of intelligent design, but rather of social, economic and political evolution. One of the central groups who supported solidaristic bargaining were the employers (Swenson 1989, 1991). While the Nordic countries are well known the strength of unions, employers also achieved an extraordinary level of organization. Employers much preferred to bargain with the “sensible” leadership of the union confederations, rather than with the militant leadership of the shop floor union bodies.

The other important group that supported the policy of wage compression was the leadership of unions of low-wage workers. Since the union movement was encompassing, both low and high wage earners had influence in union policy. While the policy of wage compression was controversial in unions of high-wage workers, it was enthusiastically supported by unions of low-wage workers. Thus, the political coalition that prevailed in the 1950s and established the pattern of centralized and solidaristic bargaining that was to last until the 1980s was comprised of the low-wage unions and employers.

High-wage unions were prevented from leaving the centralized negotiations by the threat of lockouts. It is unlikely that the low-wage unions and the leadership of the union confederation would have been able to force the high-wage unions to accept an egalitarian wage policy without the backing of employers and the threat of lockouts against recalcitrant unions.

Many critics would claim that Scandinavian model is only possible in consensual, homogeneous and affluent societies with an extraordinary commitment to equality. The most common explanations for the Scandinavian experience thus circle around variations of Scandinavian exceptionalism, emphasizing the importance of social homogeneity (Alesina, Glaeser and Sacerdote 2002), a Nordic commitment to equality (Therborn 1986), a consensual model of decision-making (Wilensky 2002) and affluence. In third world countries that are conflict-ridden, heterogeneous and poor, the model is deemed infeasible. But conditions in Norway and Sweden in the period preceding the social democratic ascent to power were anything but consensual, egalitarian and affluent.

In the 1920s and early 1930s, Norway and Sweden experienced the highest levels of industrial conflict in the world. In Norway the number of working days lost in strikes and lockouts in one year—1931—was three times larger than the total number of working days lost in industrial conflict the 25-year period 1945 to 1970. Nowhere else were employers as ready as employers were in Norway and Sweden to fight the unions with lockouts.

The consensus between employers and unions that characterized social democracy after the war was nowhere to be seen when the Social Democrats entered government in the 1930s. While the Nordic countries were relatively homogeneous in terms of religion and language, the working population was far from homogenous in terms of living conditions. In particular, the social and economic cleavages between rural and urban residents were striking. Measured by income per capita, the gap between the poorest and richest rural municipalities was 1 to 14. (Falk and Tovmo, 2000).

Scandinavian social democrats came to power in societies no less economically divided than many poor countries of today. As in developing countries today, there was significant underutilization of labor. Surplus labor in the form of open unemployment was most evident. In addition, there was disguised unemployment in the countryside that may have been as significant as open unemployment in the cities. Around half of the population lived in sparsely populated areas where most made a living from farming and fishing.

Finally, the economies that the social democrats inherited in the 1930s were far from affluent. The real per capita GDP of Sweden and Norway when the social democrats entered government was far below the current real per capita GDP of middle-income countries like Brazil or South Africa. The majority of citizens in Scandinavia became rich under the Scandinavian model of governance, not before.

Consensus, homogeneity, and affluence are products of the Scandinavian governance, not prerequisites. Nevertheless, skeptics have from the beginning doubted the long-run feasibility of a governance structure that combines market efficiency with social equality. In 1899 Rosa Luxemburg characterized it as “a sort of a labor of Sisyphus” (1970, p. 43) in which social victories would be continually eroded by market forces. More recently, conservative critics have made the re-

verse argument that market forces are steadily eroded by social reform with bad consequences for economic performance (Lundberg, 1985). Neither view is proven correct. Social equality and worker security have persisted in the Scandinavian countries and economic growth has been at par with the US.

6.5.4. General Lessons

The Scandinavian experience is interesting for several reasons. First, it is an interesting example of an endogenous change in the political equilibrium. Though the background to this is no doubt the spread of democracy around the time of the First World War, the proximate cause was the shock of the Great Depression. It was certainly not a general phenomenon that this shock led to better political equilibria in the world. In much of Latin America, for example, it led nascent democratic governments to be overthrown and to the emergence of an inward looking authoritarian development strategy that probably significantly retarded economic growth during the second half of the 20th century. In Scandinavia, however, the shock precipitated a very different reaction. This response changed dramatically the way that the labor market worked and fed back into the entire political equilibrium. While the gap between Scandinavia and the rest of the World in 1930 was no doubt much smaller than that between Sierra Leone and the US today, the evidence really suggests that these changes did alter the political equilibrium in a way that generated the societies we see today. Scandinavia was not always ‘different’ and if preferences between people in those countries differ today, this is more likely to be an outcome of institutional differences rather than a cause.

Second, this examples suggests again the complex way in which good institutions and good governance are created. The Scandinavian model generated rapid economic growth and rising living standards. But it did it with very different labor market institutions and welfare policies that at the same time promoted a radically egalitarian distribution of income. Growth occurred for the standard reasons, there were incentives to accumulate and save and the state provided public goods, but many of these incentives were generated in the context of quite

distinct specific economic institutions (a theme of the literature on the ‘varieties of capitalism’ see Hall and Soskice, 2001, and Rodrik, 2008).

6.6. Promoting Reform

So far we have discussed two examples, from the US South and Scandinavia, of endogenous reforms. We conclude this section by returning to Sierra Leone and asking what have we learned that might help us promote reform there or whether reform is likely to come endogenously. We first observe that the See-Saw Effect has been powerfully in operation in Sierra Leone (this is one of the sad lessons of the previous experience of structural adjustment in the country which Herbst (1990), Griffiths (2003), Reno (1995, 1998) and made so much of). The experience of Sierra Leone has been precisely that attempted reform in one dimension has led to disreform in another. How then might one push the political equilibrium in Sierra Leone in the direction of better outcomes? One idea comes from our earlier discussion about the construction of patrimonialism in the country. At some deep level it is difficult to change the attractiveness of patrimonialism as a political strategy. It is obviously an incredibly effective way of binding your supporters to you and disarticulating your opponents. Things of course may have changed. First, Sierra Leone may be more of a nation state now and there may be more of a sense of national identity than there was in the 1960s or 1970s, the lack of which we have argued makes patrimonial rule attractive. Second, people’s preferences (We hesitate to use the word ‘values’) may have changed in a way which makes the ‘patrimonial exchange’ more difficult to consummate. In essence citizens may be less happy with patronage now, they want development. The evidence on this seems to be very mixed however. So the structural underpinnings of patrimonial rule may have changed, but they probably have not have changed much. We don’t think the World Bank or international institutions and governments can do much about this in any case. What they can do is to focus more on how institutions were changed to facilitate patrimonialism.

Leaving the social structure aside, it is clear from the facts about Stevens’ rule and from the wider African evidence that certain sorts of political institutions

facilitate patrimonialism (Robinson and Torvik, 2008). Stevens didn't just suspend democracy, he also made himself president and concentrated power in the executive. He also accumulated power in Freetown. The international community clearly recognized this when they pushed for decentralization after 2002 and the re-introduction of district councils and more generally of course the support for multi-party democracy in the country. Trying to decentralize power and resources out of Freetown was surely an excellent idea. But this view which underpinned this policy was not taken to its' logical conclusion. In itself, just establishing elected district councils has not done much to undermine executive dominance or strengthen the system of checks and balances which are so crucial to a successful democracy, it is only a small part of reforms in political institutions which might be potentially useful.

The obvious conclusion from the discussion so far is that other reforms of political institutions are needed which would further unwind the legacy of patrimonialism. The most important aspect of this is the power of the executive, particularly relative to parliament. This is an obvious conclusion from the experience of Sierra Leone and Africa more generally. We reiterate however that we are still far from having a convincing framework which will help us understand how to change the political economy equilibrium of a society and few changes, not even reducing the power of the president or even reversing presidentialism, have such a large impact as the potential ability to join the European Union.

7. Conclusions

Returning in conclusion to Killick's mango canning factory discussed in the introduction we can ask was this example of bad governance, and many others like it, the reason for such poor economic performance in Ghana? Our argument suggests that such projects were part of the channel via which the political equilibrium created poor performance. Such projects were driven by the patrimonial logic underlying Nkrumah's political strategy and good governance in the sense of choosing rational public sector investments was inconsistent with Nkrumah's goal of consolidating his political power (Robinson and Torvik, 2005). So bad

governance in the sense of an ineffective state was economically costly but was nevertheless politically attractive or perhaps expedient. This was because these projects allowed Nkrumah to employ his supporters or generate rents for contractors in parts of the country where he needed to consolidate his support. Bad governance in this sense was a consequence of bad governance in the other sense, of the nexus of political institutions which determine the political equilibrium. By the time the mango canning factory was built, Nkrumah had suspended democracy and made himself president so there was little accountability and little chance for the immiserated citizens of Ghana to contest this economically costly decision.

It is possible then to attribute important consequences for development to governance. Nevertheless, we have argued in this chapter that the literature on governance is really part of the more general literature on the political economy of institutions and development and so far the proponents of governance have not made a strong case that there is something called ‘governance’ which is conceptually distinct and which is causally related to development. As yet governance has not been unbundled and indeed appears too vague to be unbundled. This being the case, though we have attempted here to enter into the spirit of the literature on governance, we are ultimately quite sceptical about what the term, as currently wielded by its proponents, adds to our understanding of development.

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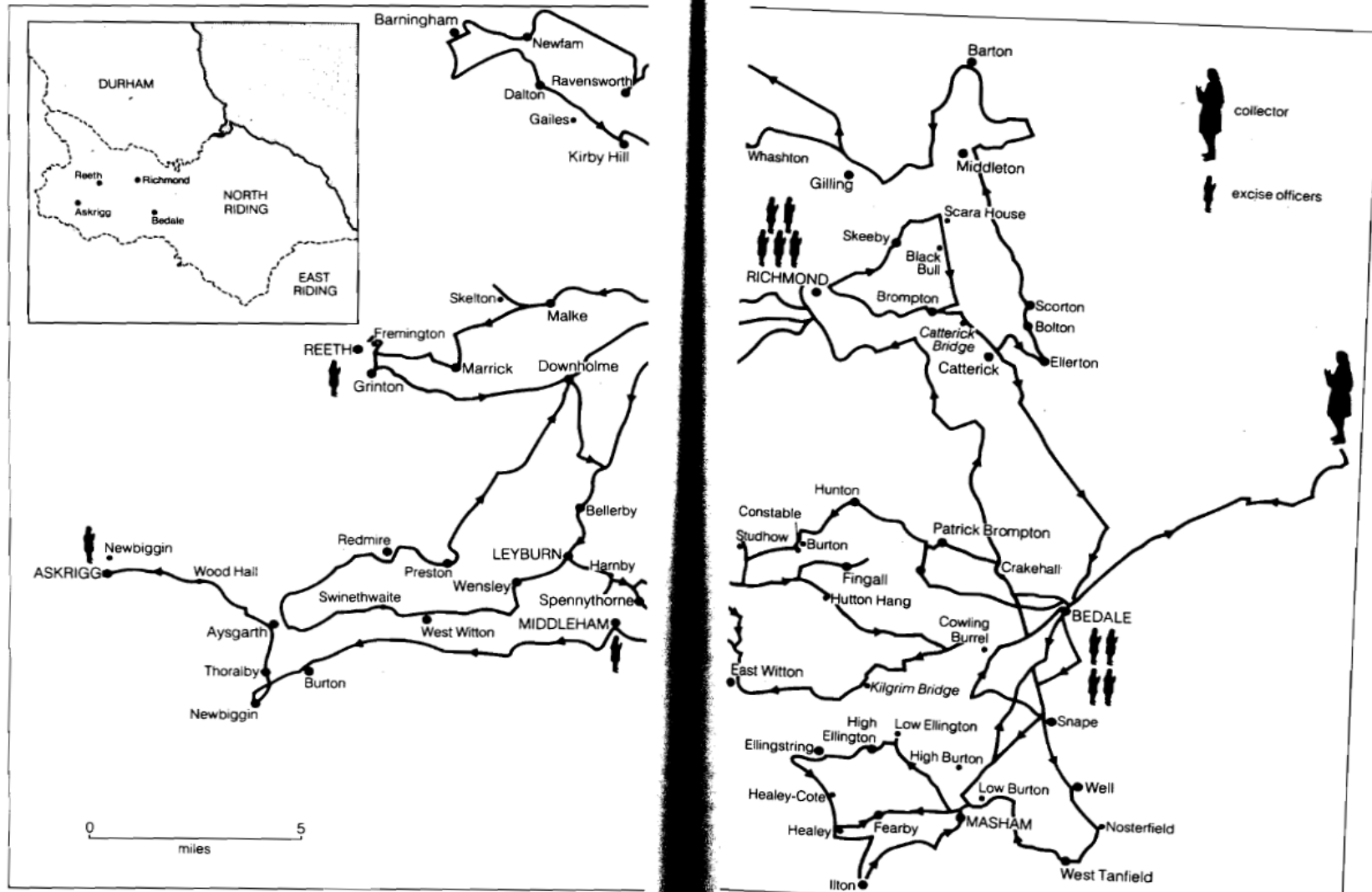
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Table 1: The World's Most Poorly Governed Countries

Country	Government Effectiveness 2005	Country	Regulatory Quality 2005	Country	Rule of Law 2005	Country	Control of Corruption 2005	Country	Corruption Perception Index 2006
Somalia	-2.21	Somalia	-2.35	Somalia	-2.36	Equatorial Guinea	-1.79	Haiti	1.8
North Korea	-1.82	North Korea	-2.31	Iraq	-1.81	Somalia	-1.74	Guinea	1.9
Congo, Dem. Rep.	-1.64	Zimbabwe	-2.2	Congo, Dem. Rep.	-1.76	Haiti	-1.45	Myanmar	1.9
Iraq	-1.64	Myanmar	-2.19	Afghanistan	-1.68	Myanmar	-1.44	Iraq	1.9
Comoros	-1.63	Turkmenistan	-1.95	Haiti	-1.62	Sudan	-1.4	Chad	2
Myanmar	-1.61	Eritrea	-1.84	Liberia	-1.6	Afghanistan	-1.37	Bangladesh	2
Turkmenistan	-1.57	Cuba	-1.75	Myanmar	-1.56	Congo, Dem. Rep.	-1.34	Sudan	2
Central African Republic	-1.47	Uzbekistan	-1.71	Sudan	-1.48	North Korea	-1.32	Congo, Dem. Rep.	2
Guinea-Bissau	-1.46	Liberia	-1.7	Cote d'Ivoire	-1.47	Turkmenistan	-1.3	Equatorial Guinea	2.1
Zimbabwe	-1.42	Congo, Dem. Rep.	-1.66	Zimbabwe	-1.47	Tonga	-1.28	Cote d'Ivoire	2.1
Equatorial Guinea	-1.42	Afghanistan	-1.63	Congo, Rep of	-1.42	Iraq	-1.27	Cambodia	2.1
Haiti	-1.39	Comoros	-1.63	Turkmenistan	-1.41	Zimbabwe	-1.24	Uzbekistan	2.1
Togo	-1.38	Iraq	-1.61	Nigeria	-1.38	Cote d'Ivoire	-1.23	Belarus	2.1
Cote d'Ivoire	-1.38	Belarus	-1.53	Guinea-Bissau	-1.33	Nigeria	-1.22	Kenya	2.2
Liberia	-1.36	Iran	-1.49	Equatorial Guinea	-1.33	Chad	-1.22	Kyrgyzstan	2.2
Burundi	-1.34	Libya	-1.44	Uzbekistan	-1.31	Paraguay	-1.19	Nigeria	2.2
Congo, Rep. of	-1.31	Equatorial Guinea	-1.31	Central African Republic	-1.29	Bangladesh	-1.18		
Sudan	-1.3	Sudan	-1.29	Angola	-1.28	Cameroon	-1.15		
Syria	-1.23	Angola	-1.24	Chad	-1.23	Cambodia	-1.12		
Afghanistan	-1.2	Central African Republic	-1.23	Venezuela	-1.22	Laos	-1.1		

Figure 1: Supervisor Cowperthwaite's excise round, 12 June to 5 July 1710, Richmond, Yorkshire.



Source: Brewer, John (1988) *The Sinews of Power: War, Money and the English State, 1688-1783*, Cambridge; Harvard University Press, pp. 106-107.

Figure 2: Income and Government Effectiveness

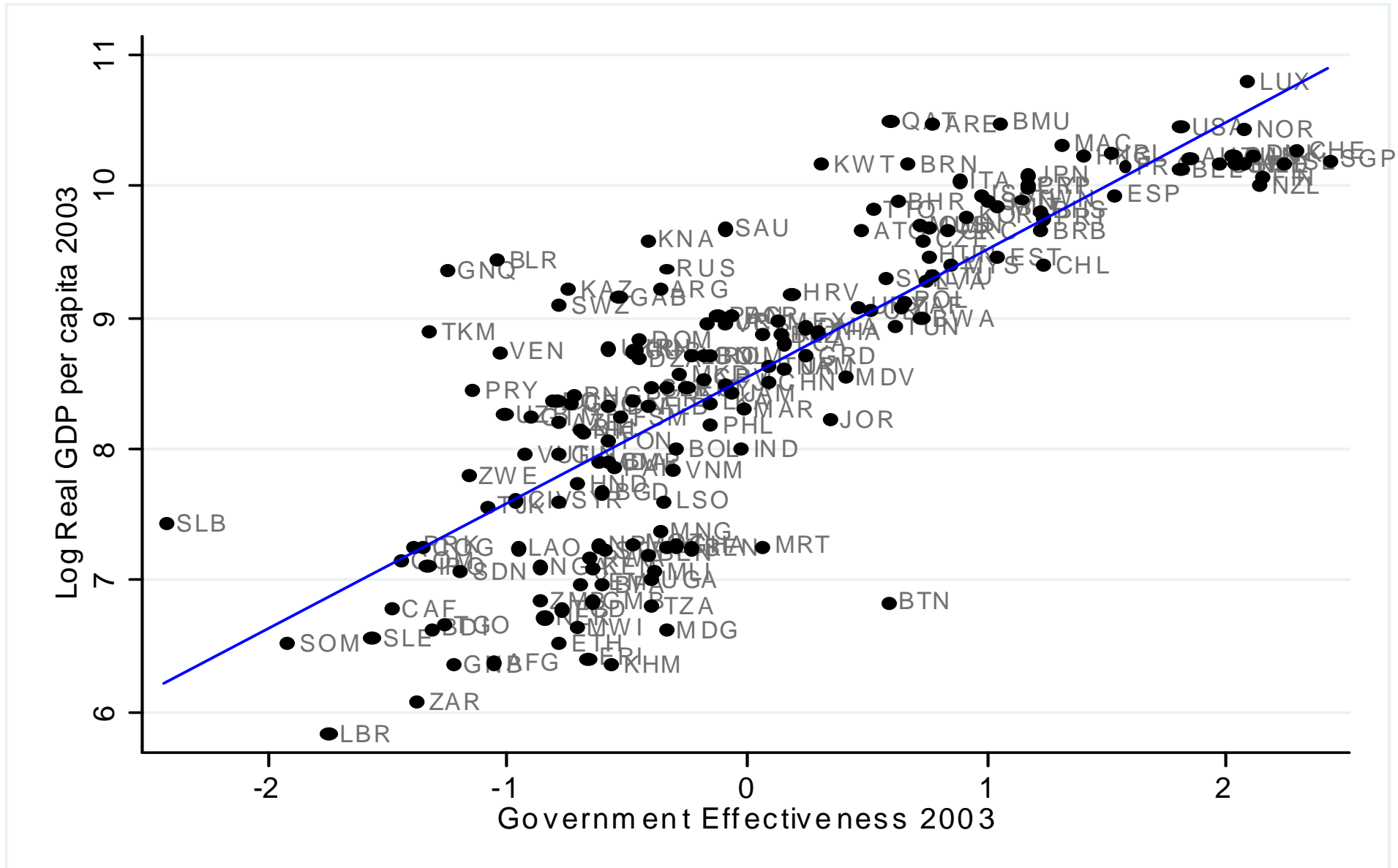


Figure 3: Income and Regulatory Quality

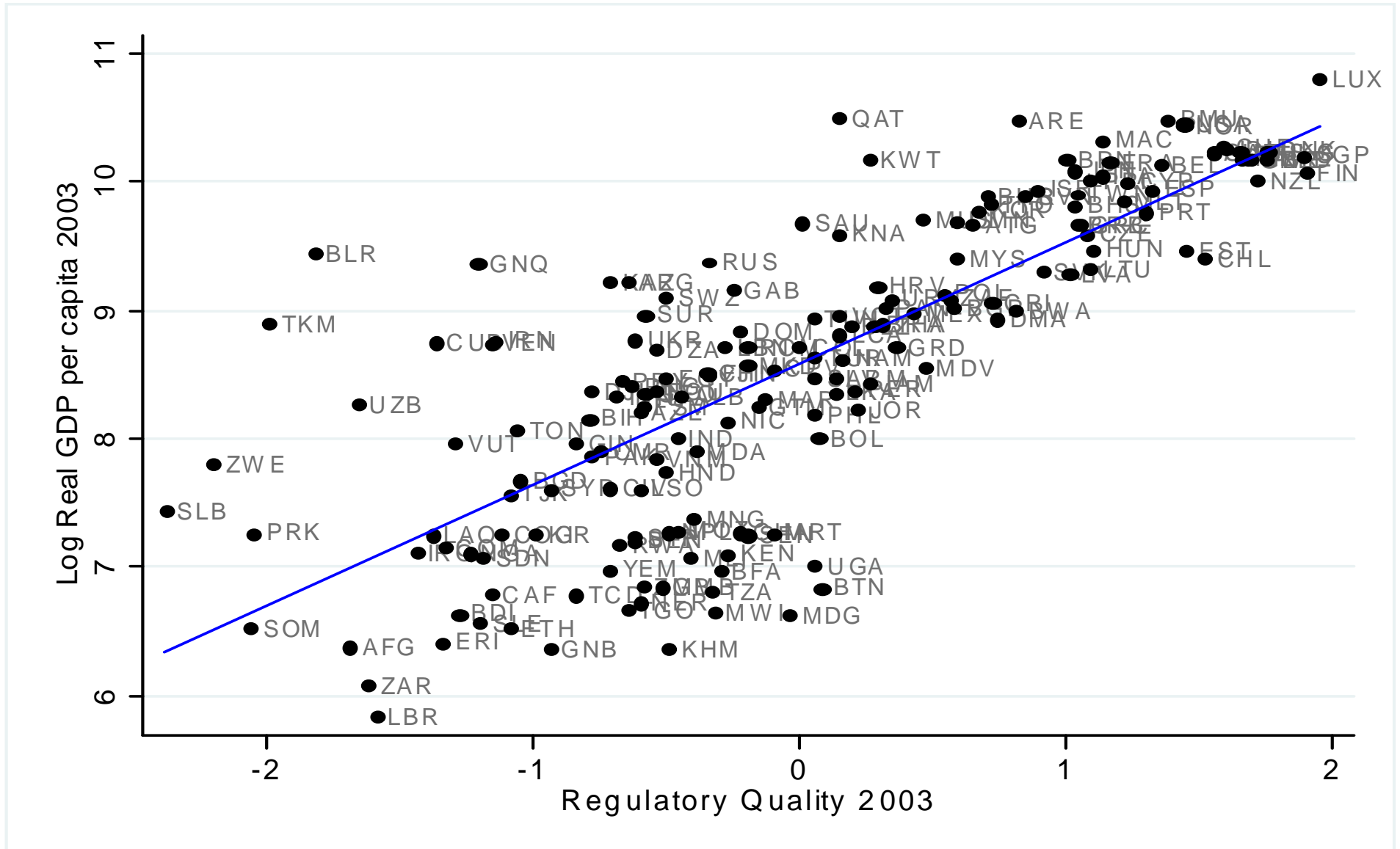


Figure 5: Income and Control of Corruption

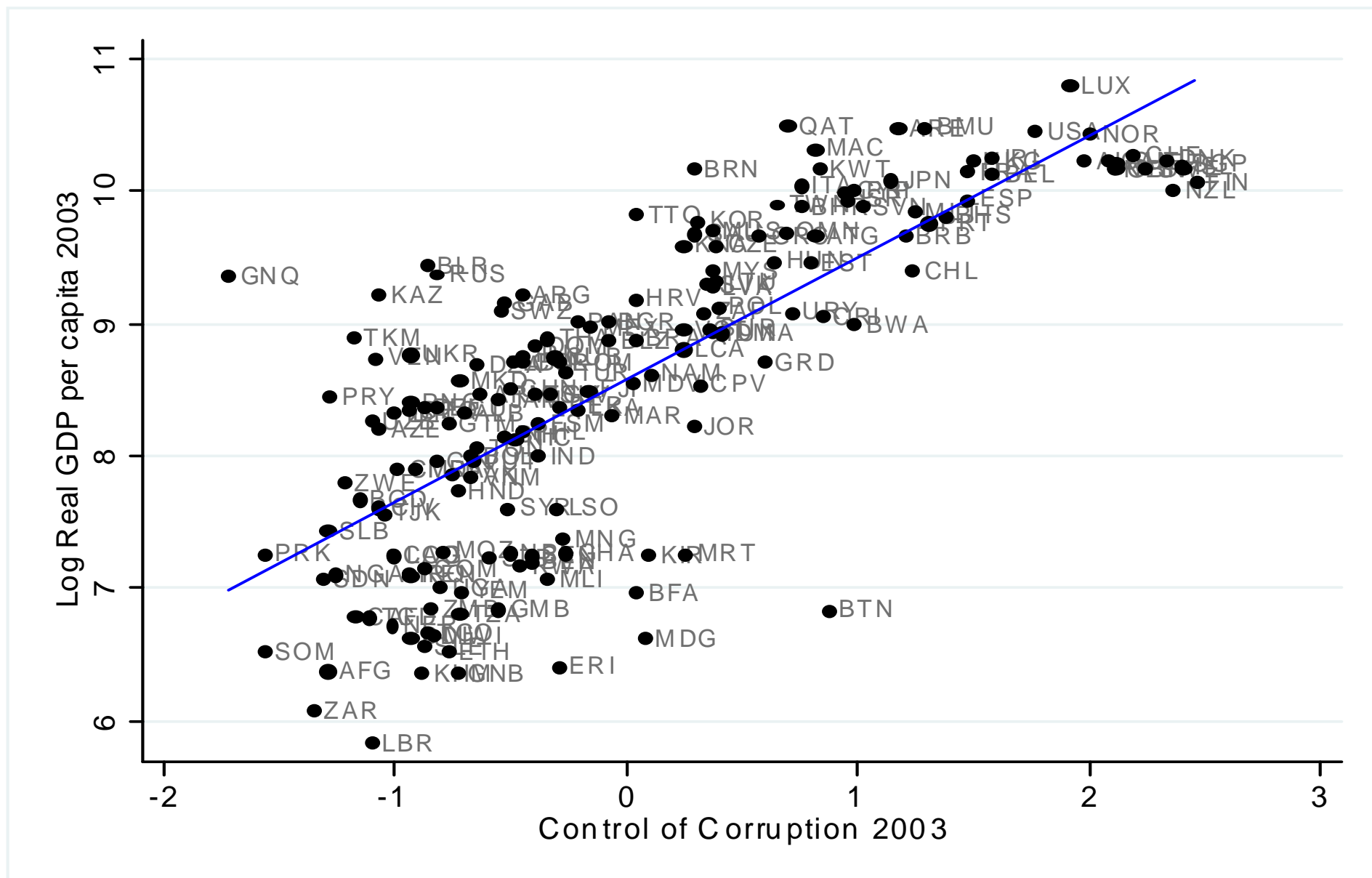


Figure 6: Income and Corruption Perceptions

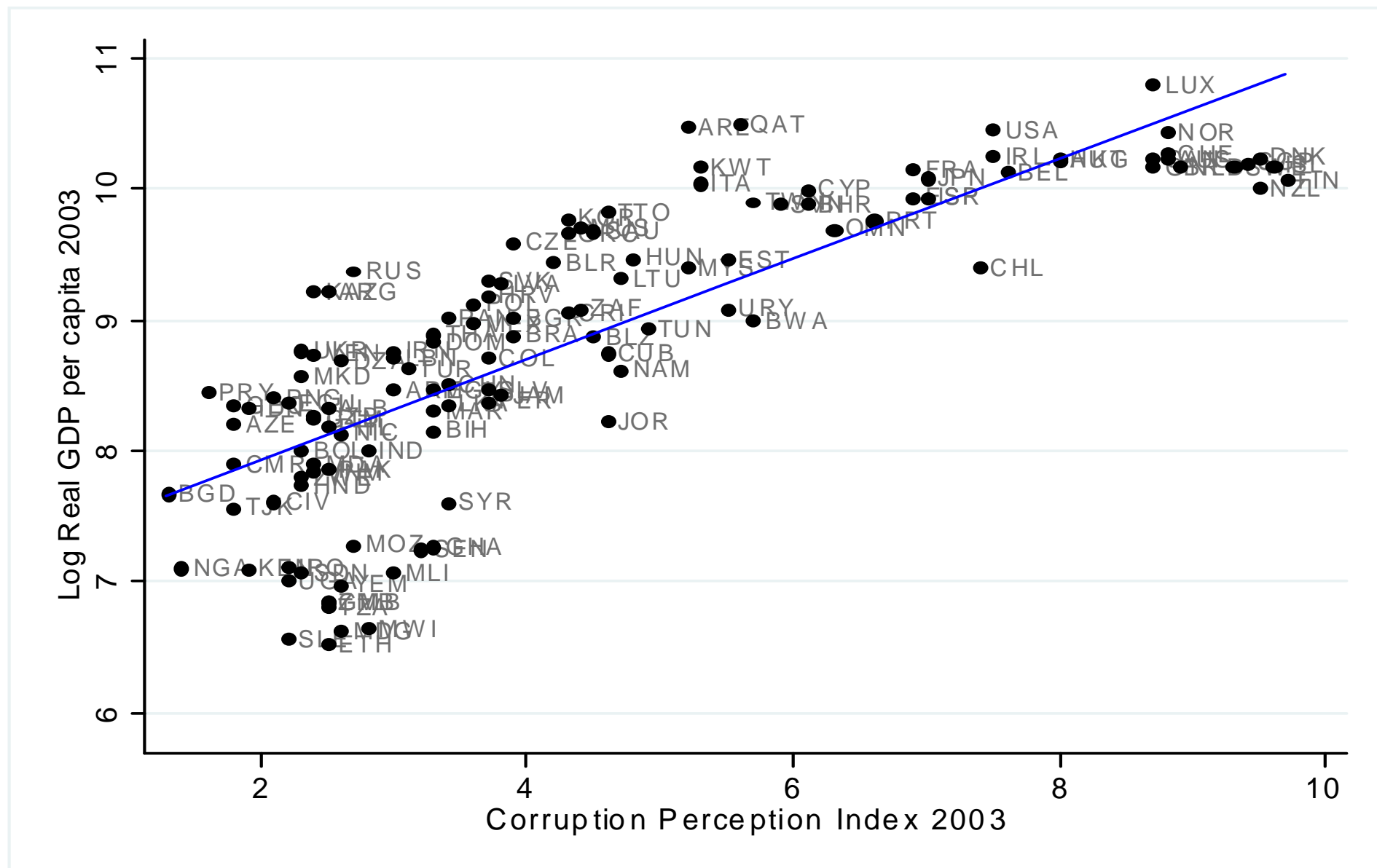


Figure 7: Corruption and Income across Brazilian Municipalities

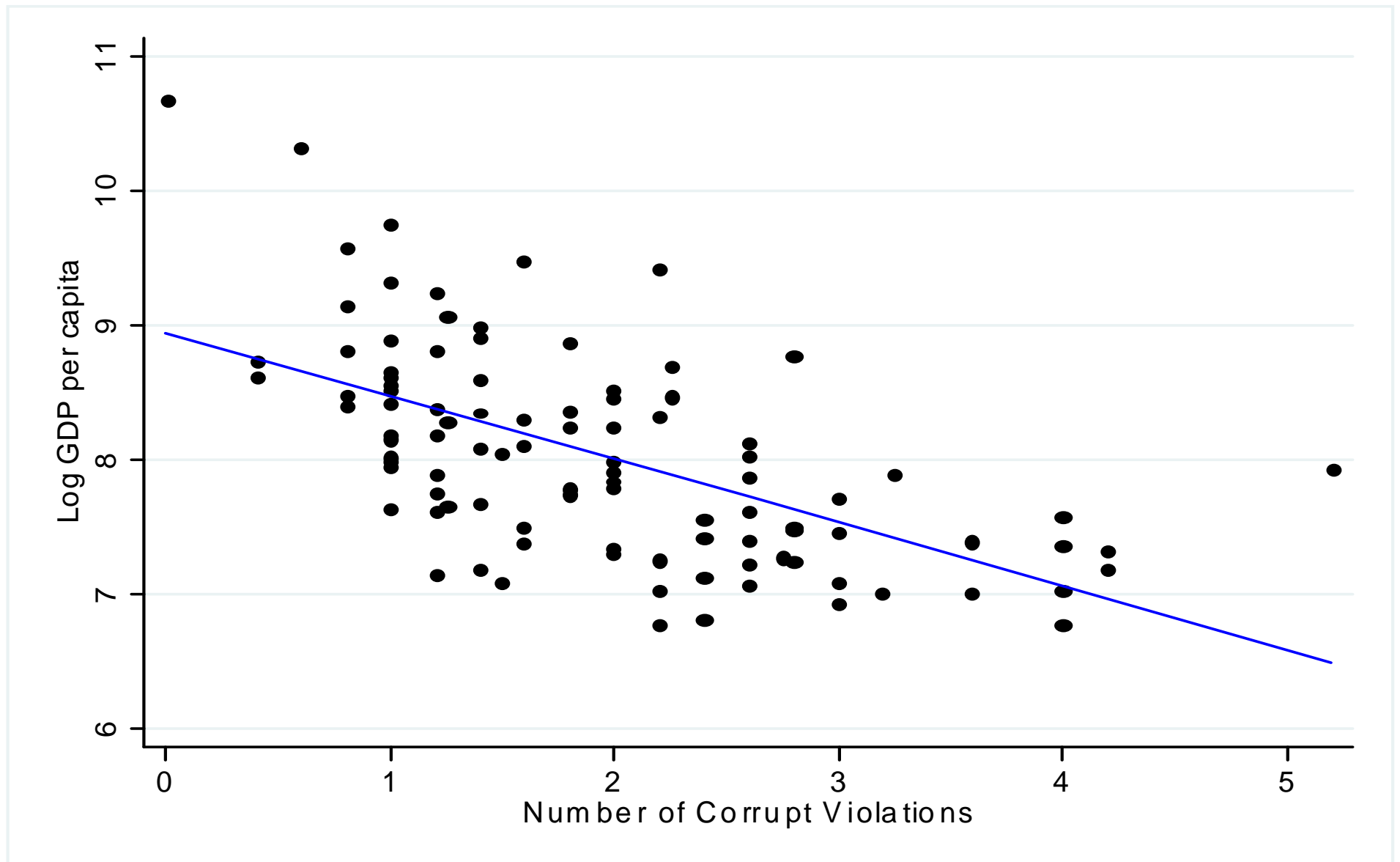


Figure 8: The 'Within Variation' – Government Effectiveness

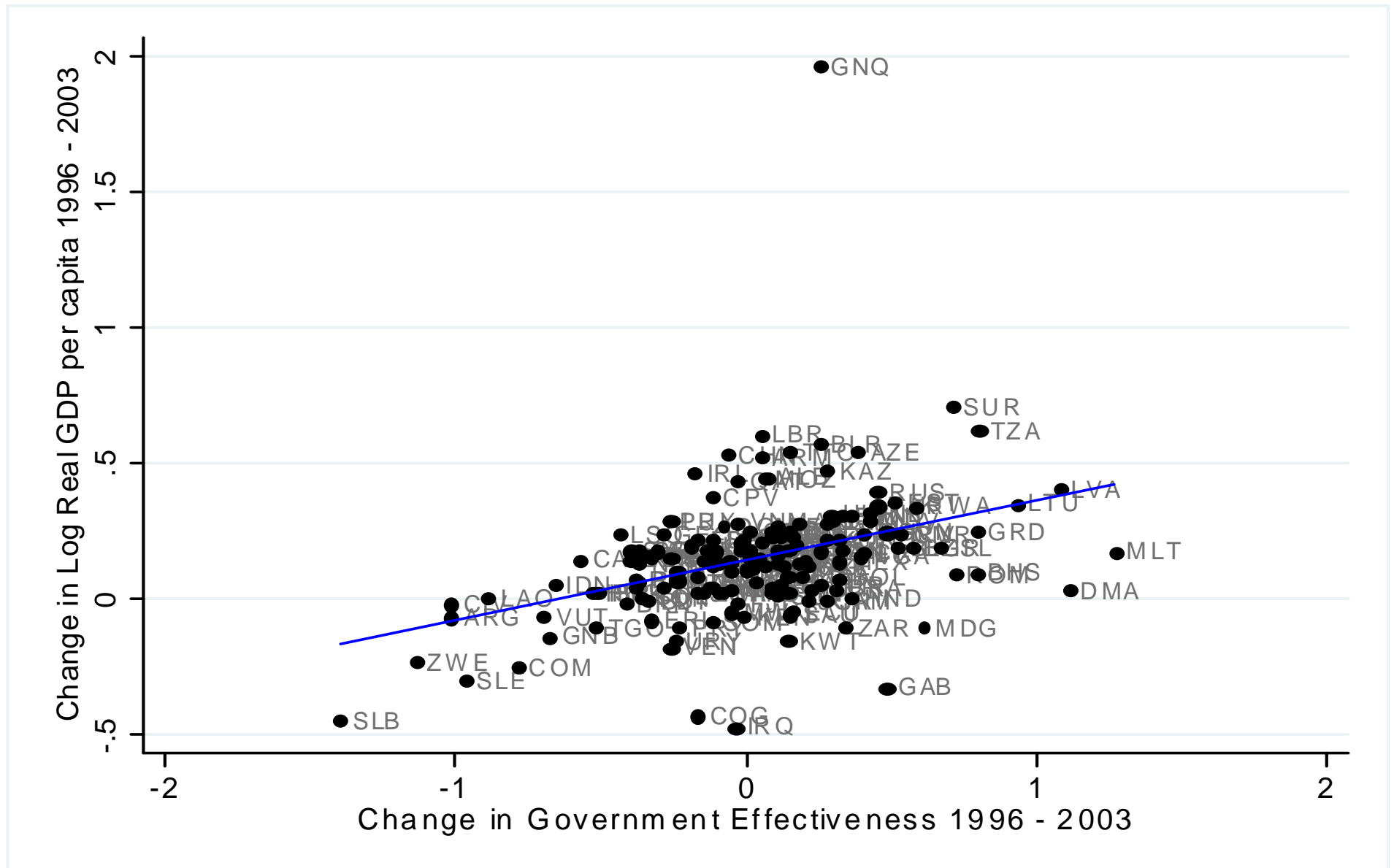


Figure 9: 'The Within Variation' – Control of Corruption

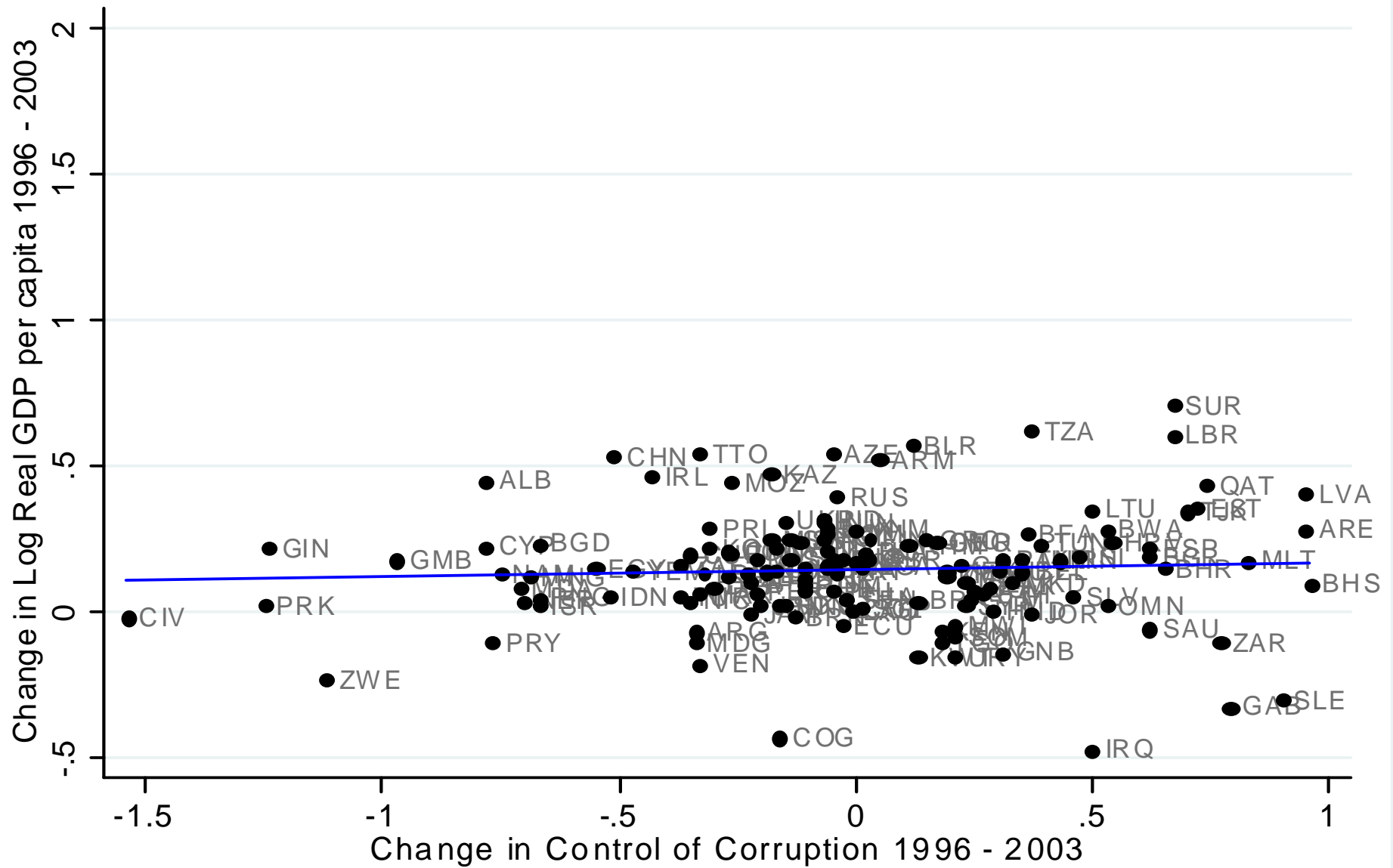


Figure 10: Social Capital and Budget Delay in Italy

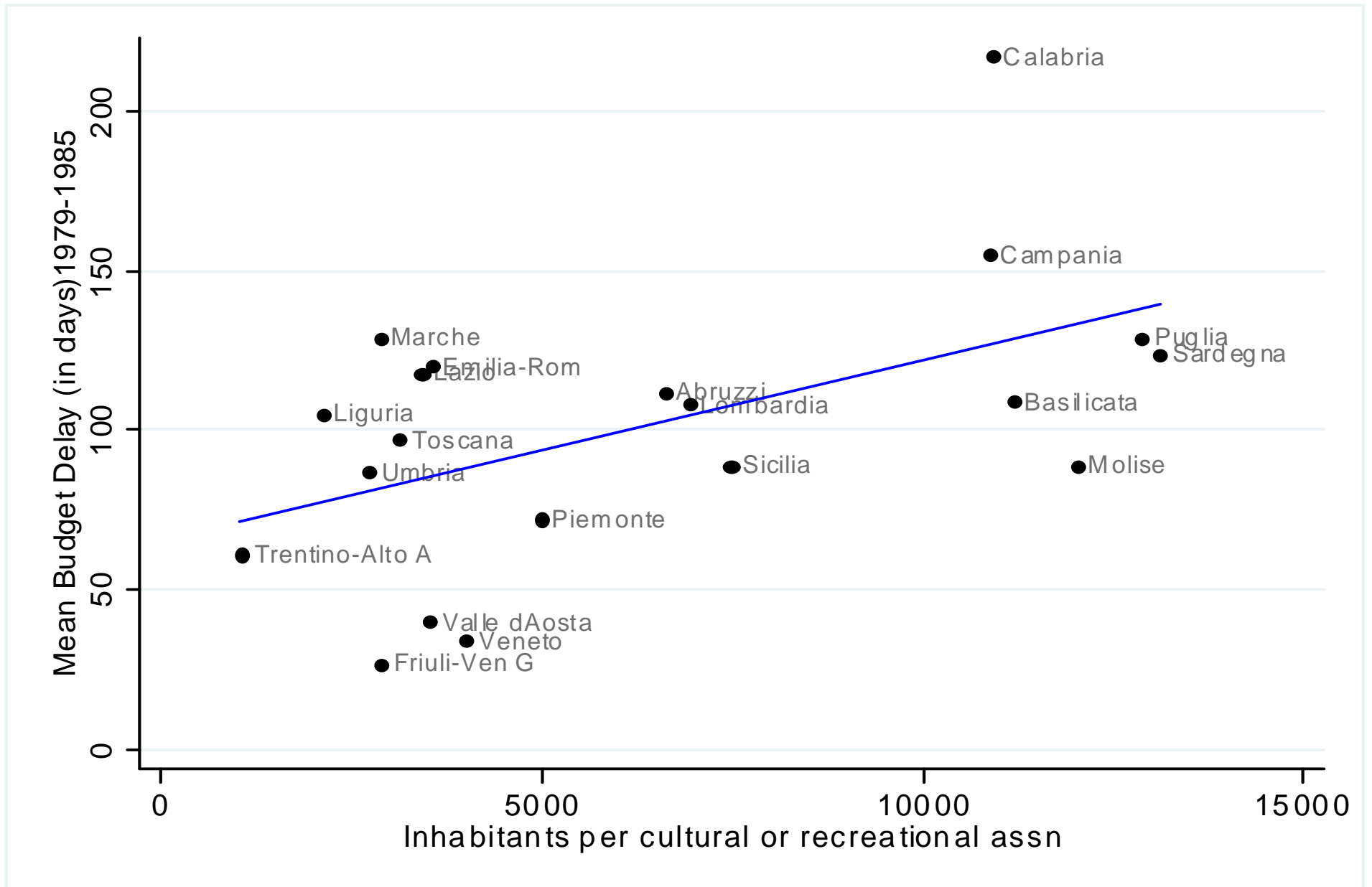


Figure 11: Social Capital and Bureaucratic Quality in Italy

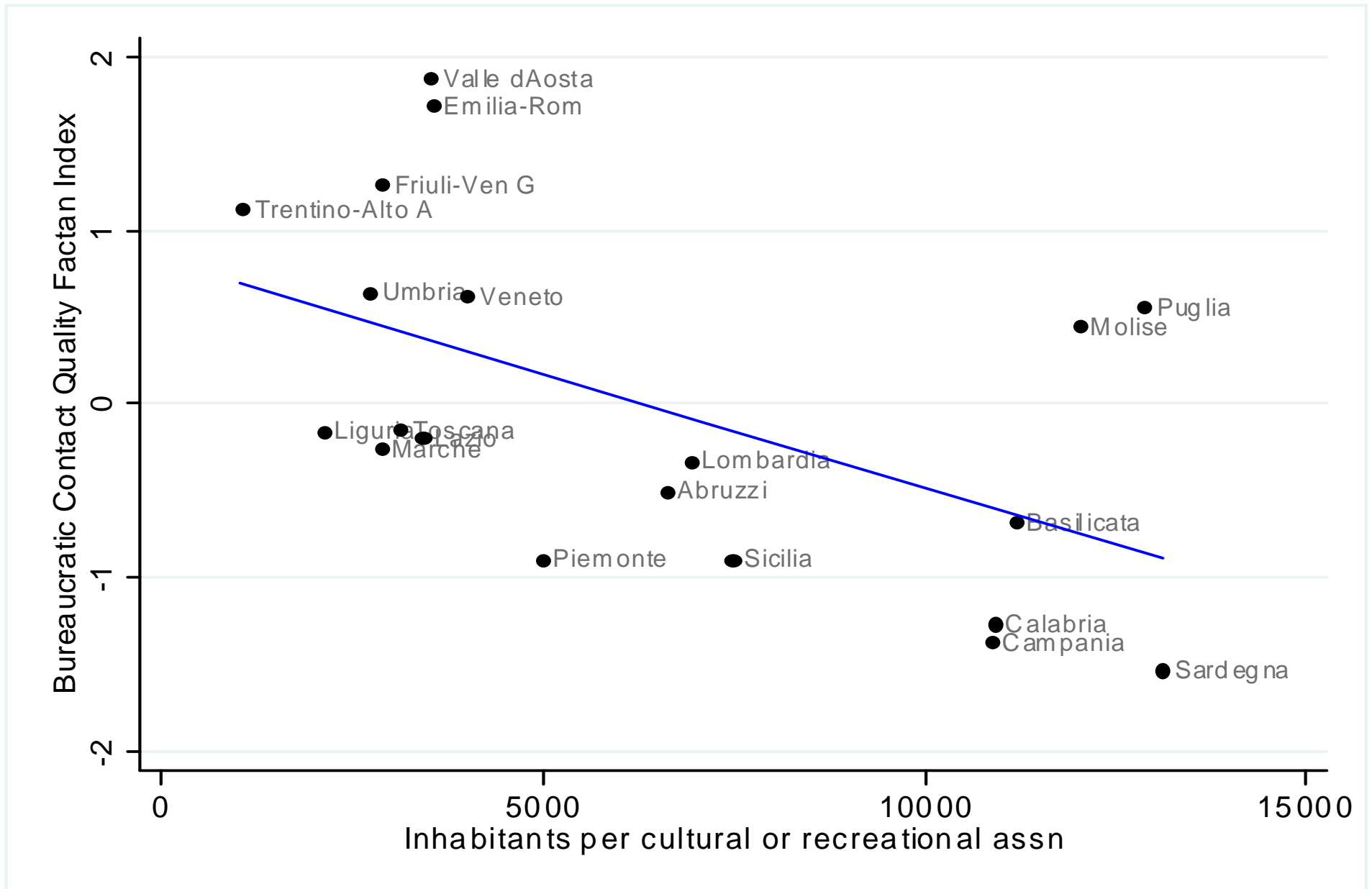


Figure 12:

Meritocratic Recruitment and Government Effectiveness

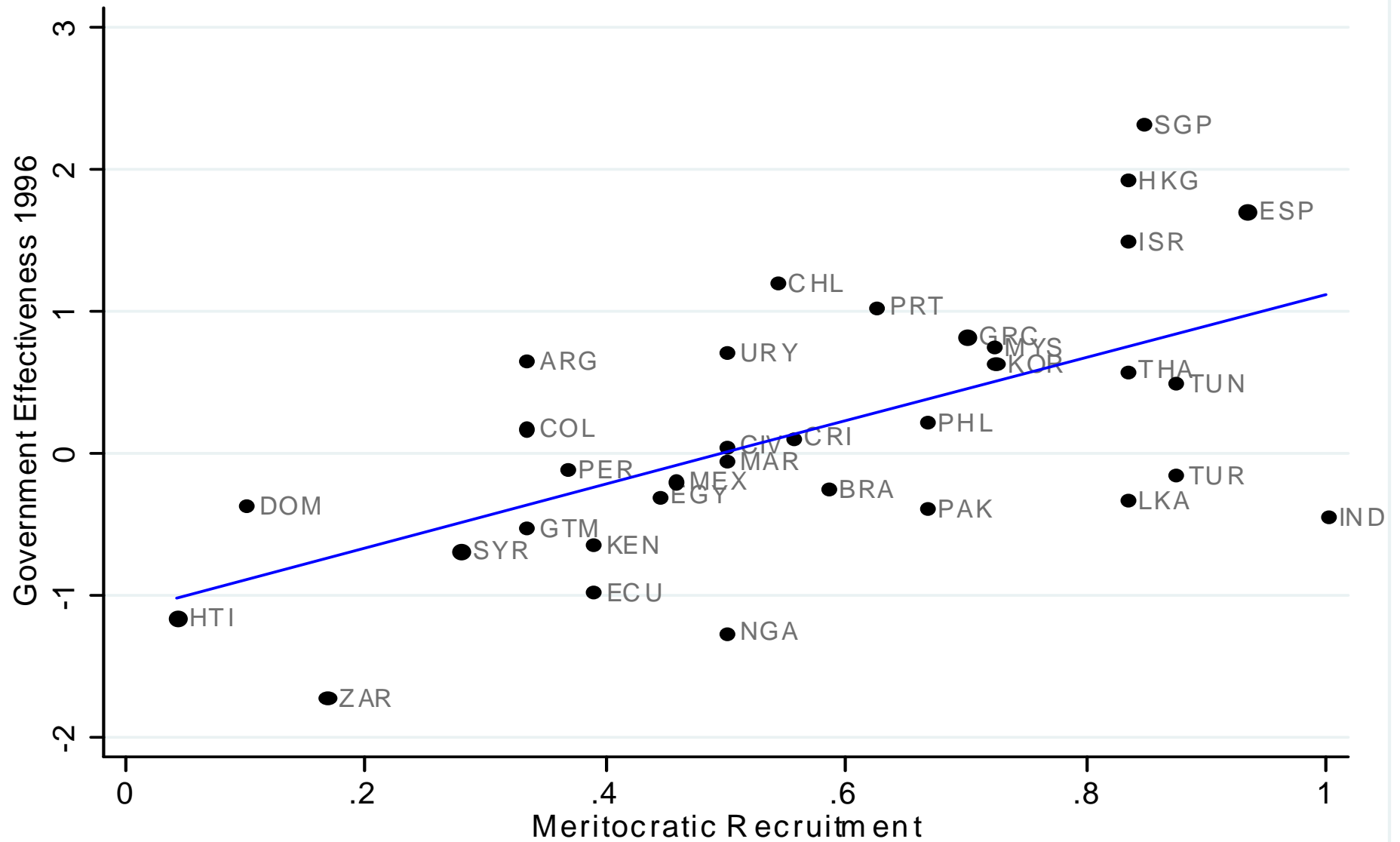


Figure 13: 'Weberianness' and Government Effectiveness

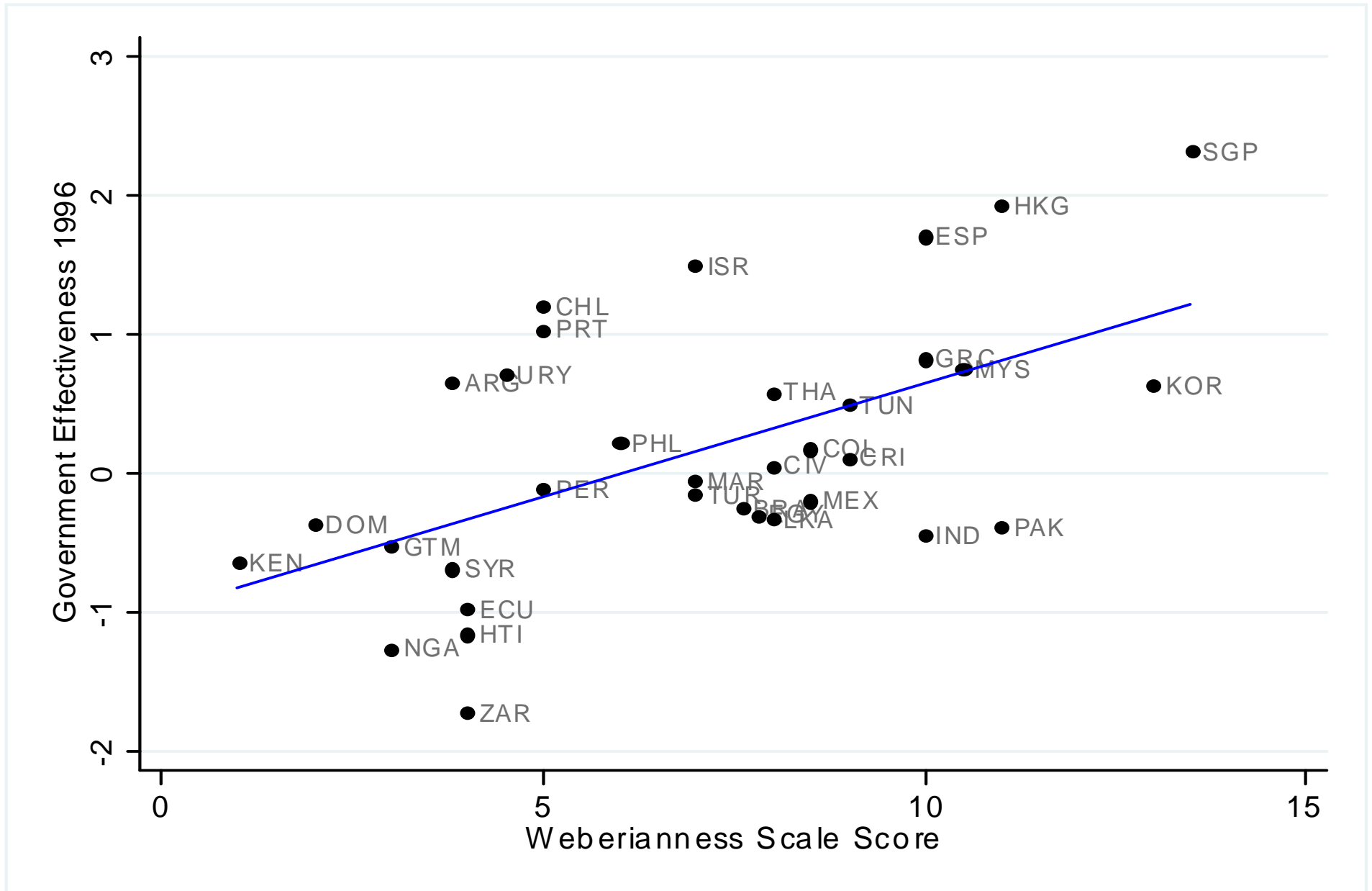


Figure 14: Clientelism and Innovative Laws in Italy

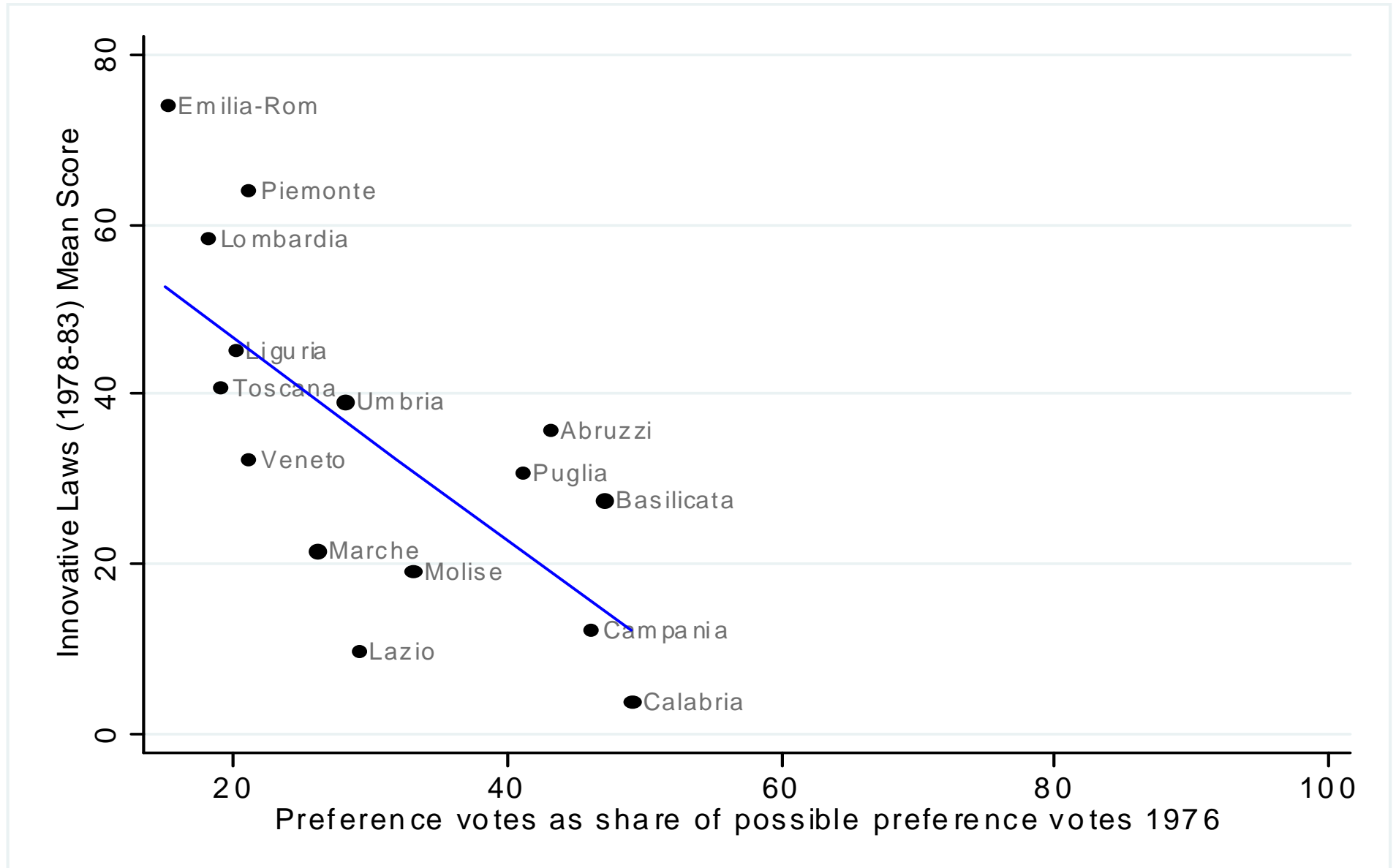
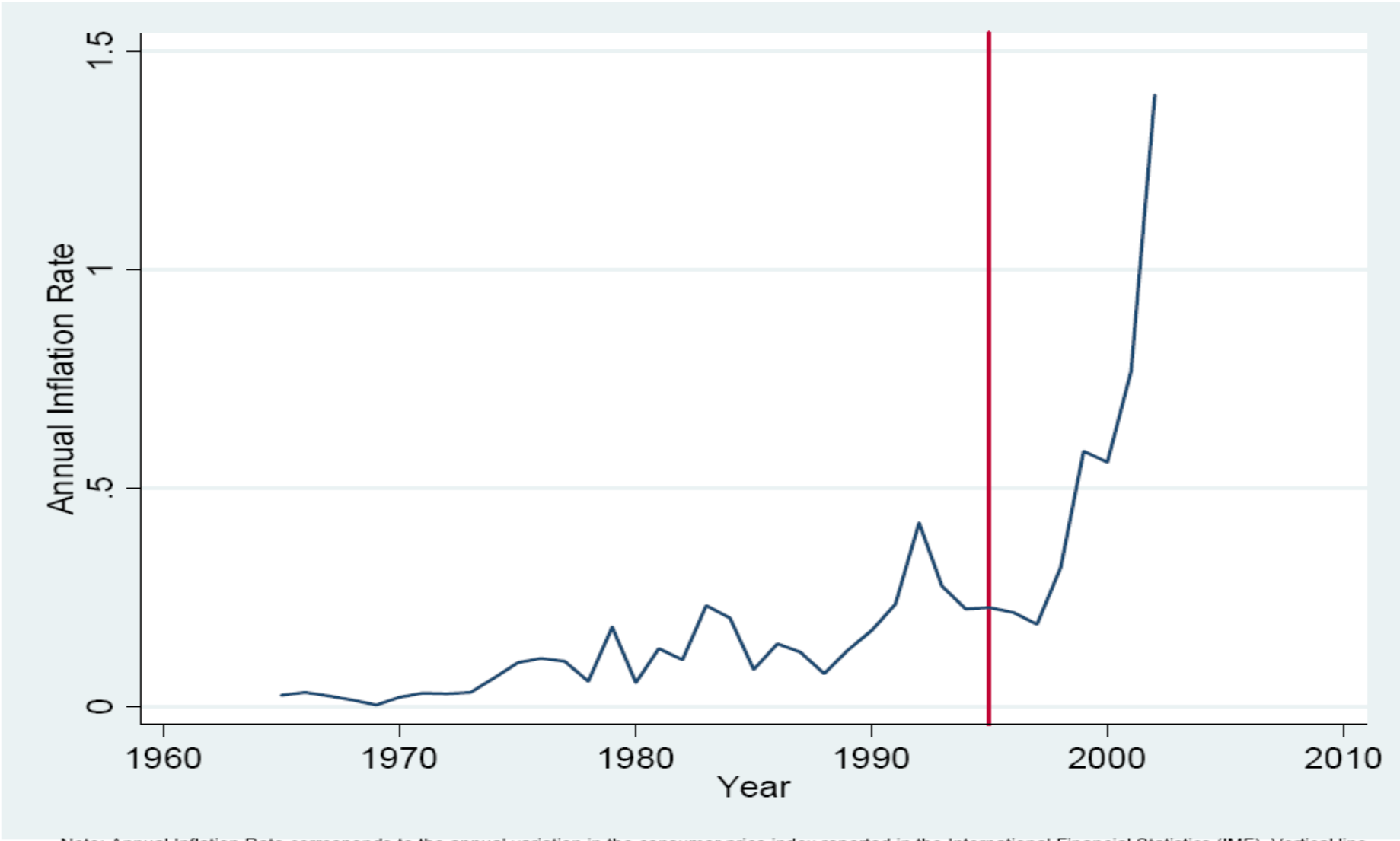
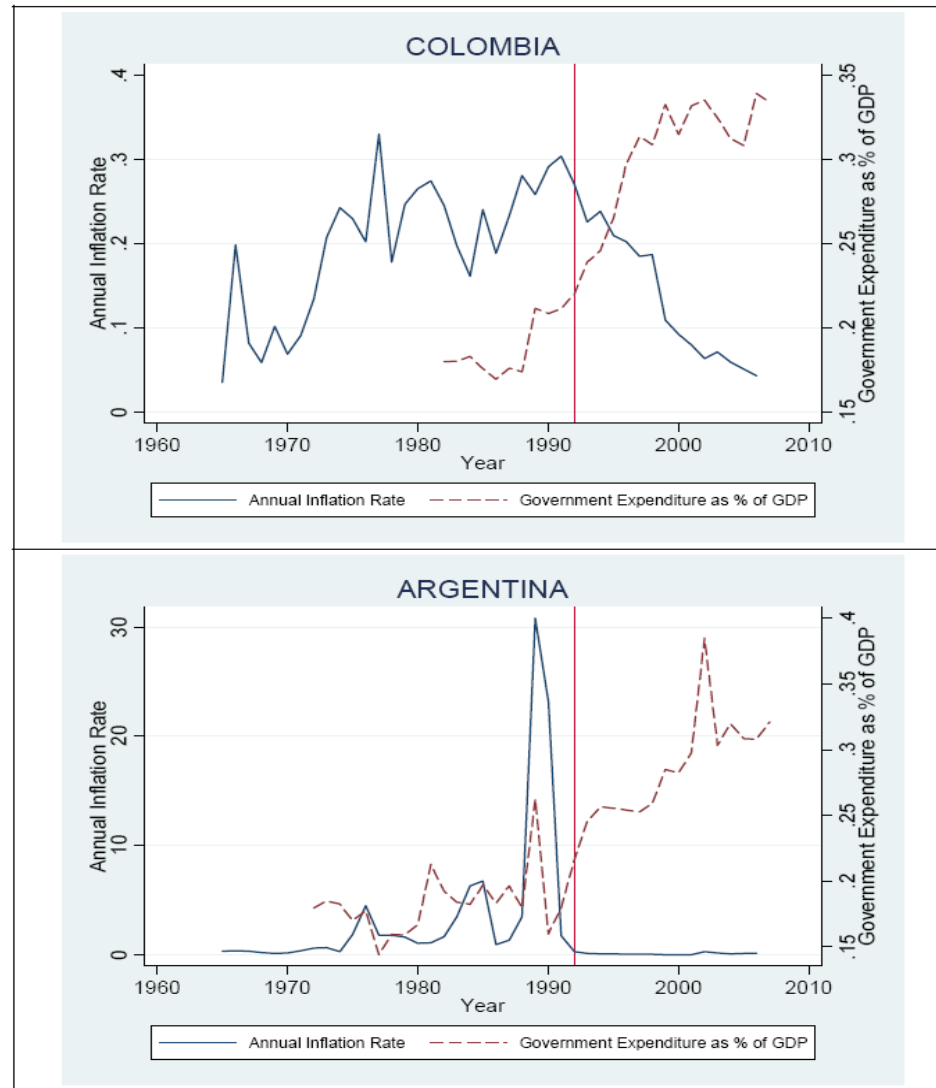


Figure 15: Central Bank Independence and Inflation in Zimbabwe



Note: Annual Inflation Rate corresponds to the annual variation in the consumer price index reported in the International Financial Statistics (IMF). Vertical line shows the year of Central Bank reform taken from Polillo and Guillen (2005).

Figure 16: The See-Saw Effect in Colombia and Argentina



Note: Annual Inflation Rate (scale on the left vertical axis) corresponds to the annual variation in the consumer price index reported in the International Financial Statistics (IMF). Government expenditure data (scale on the right vertical axis) are from World Economic Outlook (IMF). Vertical line shows the year of major Central Bank reform taken from Jácome and Vasquez (2005).