

Discussion of Akerlof; Rijkers et al; Bluhm and Thomsson

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Three quite different papers, linked by governance

- Legitimacy of leaders and the structure of organizations
- Leaders that capture the state for private rent-seeking
- Role of ethnicity or identity-based groups in governance

On Akerlof (2015):

- Agent has two actions: effort (standard) + dutifully follow orders
- Information problem: actual output is hard to measure; agents can exert effort that increases measured output but not the actual output that the principal cares about (unproductive effort—extension to counterproductive?)
 - A bit unusual? Does the principal ever observe actual output? Is this model particularly applicable to tasks for which actual output is never observed (too hard to measure)?
 - Eg. Management of international bureaucracies—incentives to push out loans, which may come at the cost of sustainable domestic institutions that favor development
 - Eg. Citizens as principals of government leaders—link to Andrea Prat’s work distinguishing transparency about actions of “expert” agents versus the consequences of action (when the principals are not experts)

On Akerlof (2015):

- Principal faces trade-off between giving a bonus for higher measured output (which increases effort in the unproductive task) versus investing in building legitimacy to be able to give higher-value direct orders to put effort into the productive task
 - Principal wants to pay a fixed wage (regardless of measured output) and give higher value orders (constrained by AM and by the outside option, which in a sense gives us a social valuation of the output produced through effort for this principal's profits)
 - One or the other: invest in AM (give higher-value orders) or pay a bonus for high measured outcome, but not both

On Akerlof (2015):

- Market relationship is inefficient—information problem as a traditional source of market failure. Higher λ —greater market failure.
- Solution to market failure is novel: build organizations where leaders have legitimacy to give the socially optimal order
- Suggests a particularly fruitful direction of future work extending this framework:
 - how are leaders selected for tasks that have this particular market failure (observed output is always a noisy signal of actual effort)?
 - Can legitimacy be endogenized/modeled as leader selection?

On Akerlof (2015):

- Model focuses on leaders' own costly actions to bolster legitimacy
- If a little bit of bolstering can be done cheaply, $k'(0)$ is small, there exists a region where leaders will choose to bolster their authority to reach closer to first-best effort
- Efficient level of bolstering depends upon cost of bolstering, and the size of the exogenously given level of legitimacy to begin with
- λ only determines which regime we are in: whether to give an order or not, and how high-value that order is. It does not have implications for investing in bolstering—the cost of bolstering is not linked to λ

On Akerlof (2015):

- In the example of above-market wages, the principal pays above market wages to bolster legitimacy: again, inefficiency
- Description of bureaucracy seems very different from the intuition of the model—bureaucracy stifles innovation and creativity by relying on orders from leaders or based on rules. But the extension of the model to the bureaucracy actually assumes that order-giving is optimal because the leader with lower legitimacy has better information, and should be giving orders

On Akerlof (2015):

- What if you have a problem of very low initial legitimacy L_0 , and very high λ (very high information problem about the true output): no order is given, and the agent exerts unproductive effort. But the model does not yield an implication for bolstering given the fact that λ is so high, since bolstering is modeled only based on the costs of bolstering
- Will society be more likely to choose institutions/organizational structures that address this problem?
 - Incentives in international development agencies to increase lending volumes? Versus flat wages that don't depend on lending, and orders to do what tasks ???
 - how are leaders selected for tasks that have this particular market failure (observed output is always a noisy signal of actual effort)?
 - Can legitimacy be endogenized/modeled as leader selection?

On Rijkers, Freund and Nucifora (2015)

- Remarkable forensic evidence on the political capture of state instruments
- Value-added of regression analysis is less clear
 - *Lots of variation described by the paper in the performance of the 214 Ben Ali firms: 100 firms report no labor; only half of remaining 114 post a positive profit;*
 - *regression analysis then compares these 114 to thousands of unconnected firms— why run a regression at all?*
- Suggests that political elites can use multiple instruments for rent extraction
 - Importance of barriers to entry is less clear: restricted to the 3 large connected firms in the telecommunications sector?
 - (BTW: why so many presidential decrees? Why not a blanket licensing requirement for all firms? What's the evidence/understanding of political capture of bureaucrats— Ben Ali could presumably get bureaucrats to implement whatever he wanted?)

On Rijkers, Freund and Nucifora (2015)

- Give us more forensic evidence?
 - The 3 firms in the telecommunications sector
 - The 5 firms that are in media markets. What does their market share there look like? Political capture of media to maintain autocratic institutions?
- Efficiency/economic costs of rent-seeking? Is it (relatively) efficient rent-seeking that explains the longevity of the regime?
 - For example, Khwaja and Mian (2005) estimate significant GDP losses (0.3-1.9%) due to political capture in Pakistan

On Bluhm and Thomsson (2015):

- 58 episodes of “slumps” are measured, with longer durations disproportionately drawn from Africa
- Too little variation in this data to rule-out the “Africa effect”, despite authors’ awareness that this is a problem
 - Africa stands out in the world as having the highest levels of ethnic heterogeneity, and political organization around ethnic network
 - Two together explain why the authors find remarkably robust correlation between their selected X and Y variables
 - But, unclear what this teaches us about *why* political organization around ethnic networks is correlated with poor economic outcomes (as established in prior literature)?

On Bluhm and Thomsson (2015):

- Does the theory in the paper address that question (mechanisms through which ethnic politics matters)?:
 - Key ingredient in model: ethnic groups fail to cooperate to adopt the policies that are needed for economic recovery because of uncertainty about the post-recovery distribution of income (and power)
 - Post-recovery random shock that impacts probability of expropriation
- Unclear why this particular theory is compelling:
 - one, it seems more intuitive that slumps could directly affect groups unequally (as opposed to the same, as in the model in the paper) and change the balance of power, or prompt executive appropriation.
 - two, model is not clear about what policy characteristics are needed for economic recovery out of a slump, and how ethnic politics delays the adoption of those policies?

On Bluhm and Thomsson (2015):

- What policy characteristics are needed for economic recovery out of a slump, and how does ethnic politics delay the adoption of those policies?
 - In previous literature, delays driven by different policy preferences between political groups about the size and role of government
 - What policy instruments exist in poor economies to come out of slumps? Are slumps and recovery in these economies largely driven by what happens in external, global markets, including international aid flows?
 - Ethnic politics may play no role in delays, but recovery from slumps in economies that have low public goods and poor resources may be delayed because these are poor economies to begin with that find it much harder to deal with economic shocks

Intersection of these papers: questions for overcoming governance impediments to development

- Where do leaders who have legitimacy specifically for the purpose of pursuing development come from?
 - Incentives of leaders
 - Selection of leaders
- How can leaders of public bureaucracies build legitimacy in the shadow of unhealthy political contestation for leadership?
- How/do ethnic or identity-based networks contribute to unhealthy political contestation? If so, how can it be overcome?
- Policy research report on the role of transparency and political engagement in addressing these questions