

# Democracy, Public Expenditures and the Poor

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## Abstract

Countries vary systematically with respect to the incentives of politicians to provide broad public goods and to reduce poverty. Even in developing countries that are democracies, politicians often have incentives to divert resources to political rents and to private transfers that benefit a few citizens at the expense of many. These distortions can be traced to imperfections in political markets that are greater in some countries than in others. We review the theory and evidence on the impact of incomplete information of voters, the lack of credibility of political promises, and social polarization, on political incentives. We argue that the effects of these imperfections are large but insufficiently integrated into the design of policy reforms aimed at improving public good provision and reducing poverty.

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Governments can accelerate economic development through their decisions regarding public expenditures. Allocated appropriately, public expenditures can overcome market failures that exacerbate poverty, such as the inability of the poor to borrow for education, the lack of information among the poor about preventive health care, or externalities that exacerbate public health hazards to which the poor are most exposed. Unfortunately, inappropriate allocation is common. Public expenditures flow to wage bills for bulky state administrations, to farm subsidies absorbed by the wealthiest farmers, or to public works projects with limited public utility, all at the expense of quality public services. The Millennium Development Goals and many efforts around the world to “empower” the poor, whether through devolved decision making or through participatory budgeting, are all responses to these failures of government expenditure policies.

Misallocation has persisted despite a sea change in the way in which governments are selected and remain in office. From 1990 to 2000, the number of countries governed by officials elected in competitive elections rose from 60 to 100.<sup>1</sup> A large fraction of voters in many of these countries are low income. Democratization might be expected to benefit these voters. However, policy-makers in poor democracies regularly divert expenditures away from those areas that most benefit the poor, or fail to implement policies that improve those services from which the poor are known to benefit disproportionately.

In most countries, the distribution of income is skewed to the right – towards the higher end of the income spectrum. The median voter hypothesis (that the policy most preferred by the median voter can defeat any other policy proposal under majority rule) implies that when the income of the median voter is less than the average income of all

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<sup>1</sup>According to the number of countries reported in Beck, et al. (2002), *Database of Political Institutions* as having competitive elections for executive and legislative office (*EIEC* and *LIEC* equal to seven).

voters, government should be larger and social services should be correspondingly more extensive (Meltzer and Richard, 1981). This model evidently does not hold in many low-income countries, since in many countries where the poor are the median voters, social services are the most woeful. Moreover, there is little evidence that redistribution is greater in countries with greater income inequality (Knack and Keefer 1997). Political market imperfections, disrupting the translation of voter preferences into government policy, help to explain this puzzle. In this paper, we focus on three political market imperfections that we argue are particularly important in the context of government incentives to serve the poor: lack of information among voters about politician performance; social fragmentation among voters manifested as identity-based voting; and lack of credibility of political promises to citizens. We show that existing efforts to improve the quality of public policy towards the poor may fall far short of achieving their goals unless they are expanded to address them.

One difficult conclusion that we reach is that broad public services most important to the poor – health and education – are also the services most vulnerable to the three distortions. Political pressures to improve these services are therefore weakest. With respect to information, citizens cannot easily evaluate the quality and efficiency of these services. Even when they can, they cannot easily determine whether service providers, higher level ministry officials, or politicians are responsible for breakdowns or improvements. Similarly, politicians in many countries can make credible promises only to narrow groups of voters. It makes little sense for these politicians to promise reforms that benefit large numbers of voters when only a few voters believe these promises. Such politicians prefer to promise narrow targetable goods, such as infrastructure provision, rather than improvements in broad public services. Social polarization exacerbates these problems since it raises the

possibility that one group may oppose a broad reform that benefits another group, even if it also benefits from the reform.

We point in the next section to pervasive failures of social service provision and argue that low demand for social services on the part of the poor is an unlikely explanation for these failures. The impact, particularly on social service provision, of each of these imperfections in political markets – information constraints, social polarization, and problems of political credibility – is then assessed. The latter part of the paper demonstrates how the political market imperfections on which we focus help explain one of the more striking contrasts in government policy making, the famous cases of the states of Uttar Pradesh and Kerala in India. We argue that the lack of voter information, greater social polarization and the non-credibility of political party platforms in UP explains its failed social services relative to the well-performing services of Kerala. We conclude by exploring some implications of this political economy analysis for policy initiatives to improve the allocation of public resources.<sup>2</sup>

### **Politics and social services**

There is ample evidence that governments, particularly in poorer countries, prefer to spend on targeted programs, such as government jobs or infrastructure investment, rather than on improvements in broad social services. Feyzioglu, et al. (1998) find that foreign aid

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<sup>2</sup> Our focus on fundamental characteristics of electoral competition is complementary to another literature (reviewed by Persson and Tabellini, 2002) looking at the impact of electoral and political institutions on government decision making. It shows that whether countries exhibit presidential or parliamentary regimes or employ majoritarian or proportional electoral rules, for example, have significant effects on spending. Presidential regimes and majoritarian electoral systems spend less in total or less on public goods. In fact, preliminary work suggests that the magnitude of the institutional results varies significantly depending on the underlying electoral characteristics of countries that are the focus here. For example, in poorer or younger democracies, where voters are less likely to be informed and political competitors are less likely to be credible, the difference in government spending between presidential and parliamentary systems is less than half what it is in richer or older democracies. The analysis and review in this paper are therefore a logical first step in a full and comprehensive analysis of the political economy of government expenditures and the poor.

targeted at education is likely to be offset by reductions in own-government financing of education. When aid is used to support public infrastructure investment (transportation and communications), however, the opposite is true: governments are likely to maintain their own fiscal effort in the provision of these goods. Foster and Rosenzweig (2001) and Pande (2003) have shown that when disadvantaged groups in India – the landless poor and scheduled castes (respectively) – were newly able to elect their own representatives, more government resources flowed towards these disadvantaged groups. However, these increased flows largely took the form of increased access to government jobs and targeted welfare transfers. Enhanced political rights did not translate into improved education or access to other broad-based social services, though the resource cost of such improvements, relative to likely welfare gains, could have been much smaller.<sup>3</sup>

The preference of politicians for “pork barrel” or targetable spending is not the exclusive province of developing countries, and is widely documented in the United States (see, for example, Mayhew 1974). The problem for development is that many governments have exaggerated preferences for targeted expenditures. For example, a large and disproportionate fraction of expenditures in health and education typically flow to the salaries of teachers and health workers, yet rampant absenteeism and shirking by these service providers means that no services are effectively provided in many cases. Governments use these resources to provide (targetable) jobs rather than (less targetable) high quality services.<sup>4</sup> Service delivery falls far below the levels that even poorer countries

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<sup>3</sup> In their review of research on public spending and the poor, Van de Walle and Nead (1995) find that resources spent on basic health and education services (“broadly” targeted fiscal policies) have higher payoffs for the poor than finely targeted food subsidies or other redistribution schemes, in part because of the administrative costs and behavioral consequences of the targeted schemes.

<sup>4</sup> In India, recurrent expenditures on primary education accounts for 98 percent of total government expenditure on primary education; salaries account for 96 percent of recurrent expenditures, and teachers’

can afford, suggesting that the tradeoffs between targeted and non-targeted public expenditures are much steeper in these countries than in developed countries.

This is not simply a problem of “capture” by the “rich” of the levers of government policy making. Even when programs are explicitly “pro-poor”, they frequently take the form of targeted (and often unsustainable) redistribution programs, such as free food and temporary employment in public works, even when other, cheaper and broad-based programs to improve basic health and education services would have a bigger impact on welfare. At the same time, apparently broad-based programs benefit mainly special interests or the rich. Bates (1981) has shown for Africa that agricultural subsidies, such as price protection and subsidized electricity, disproportionately benefited middle and large farmers, who grew the protected crops and are more likely to engage in capital-intensive, power-driven private irrigation. India provides a wealth of examples, ranging from power subsidies to fertilizer subsidies, exhibiting the same characteristics. Once again, such biases are well-known in all democracies but are particularly extreme in many developing countries.

It is similarly unlikely that failures of social service provision are rooted in the lack of citizen demand for these services. A common finding of village studies and household surveys in India is that education is widely perceived by members of disadvantaged groups as the most promising chance for a better life for their children (Drèze and Sen, 1995). Farmers, landless laborers, and scheduled caste members therefore know the importance of education for their children. A thought experiment also makes clear that demand side considerations alone cannot explain why, even if fully informed about the value of education, the landless poor might still prefer targeted jobs.

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salaries account for 97 percent of all salaries in education spending (Tilak, 1993, p. 60). Yet, field investigations in rural areas of Indian states, particularly in the north, reveal that teacher absenteeism is endemic, with almost two-thirds of the teachers employed in the sample schools absent at the time of the

Suppose that a village must choose between demanding a single job for some, randomly chosen individual in the village, or the presence of a teacher from outside the village. Suppose the village has thirty families and that the teacher would instruct one child from each family. Further, assume that literacy raises the present value of each child's lifetime income by 30 percent, that literacy takes five years of education to achieve, and that the present value of each child's income, absent education, would be the same on average as that of the average wage earner in any of their families. Then the total value to all 30 families from having the teacher (assuming the teacher is guaranteed to stay for five years) would be  $0.3 * 30 * (\text{the present value of the average wage earner's lifetime income})$ .

To match this wealth effect, and even assuming that the job offered in lieu of a teacher was guaranteed for the life of the recipient, the job would still have to pay ten times the average wage to make the expected value of the job to the village the same as the expected value of the teacher. The demand for education would therefore have to be extraordinarily low to explain the apparent preference of the poor in many developing countries for jobs and subsidies over schools and clinics.<sup>5</sup> However, because we observe the poor making large sacrifices to educate their children despite imperfect credit markets and discount rates that are not particularly low, it makes sense to look beyond demand-side issues in asking why voters in some countries do not pressure politicians to provide high quality education.

### **Why does political competition fail to induce the optimal provision of public goods?**

It is easy to show conditions under which, in a simple median voter model with no political market imperfections, governments always provide the optimal level of public

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investigators' unannounced visits (Drèze and Gazdar, 1996; Weiner, 1991; Prasad, 1987).

<sup>5</sup> Demand might be low returns to education are low, discount rates are high, or severe credit market

goods. In the real world, where such imperfections are endemic, political incentives to provide public goods fall far below the optimum. The appendix to this paper presents several simple models that drive this point home. One key imperfection that upsets the relationship between citizen preferences and politician decision making is that citizens cannot easily observe the contribution specific politicians make to policy, nor the connection between policy and their own welfare. Imperfect information makes it difficult for citizens to assign credit or blame. Politicians therefore have heightened incentives to seek rents rather than to provide public goods.

A second imperfection is that citizens are heterogeneous, with respect to income, ideology, religious belief, language, or the value they attach to different public goods, occupation and location. These affect citizen preferences for government policies and public goods. Moreover, if citizens prefer politicians from particular ethnic groups at all costs, they are less likely to oppose their preferred politicians when they perform poorly.

The lack of credibility of political competitors is the final major disruption in the relationship between citizens and government. In the worst case, when political challengers cannot make credible promises to any voters, the threat of political competition imposes practically no constraint on incumbent politicians. Incumbents know that voters do not believe challenger promises that they will do a better job; incumbents therefore feel freer to underperform and seek rents.

These imperfections—information asymmetries, social polarization, and non-credibility of political promises—undermine the role that elections can play in guaranteeing accountable and responsive government. Each is explored in greater detail in the sections that follow. Substantial evidence suggests that all are important sources of distortion in

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constraints block access to complementary inputs (books, foregone child labor).

political markets. Reform efforts designed to improve the access of the poor to quality social services need to address them explicitly in order to be successful.

***The impact of imperfect information on the provision of social services to the poor***

Informational constraints adversely impact the provision of social services to the poor by reducing the ability of citizens to hold politicians accountable, and by encouraging politicians to cater to special interests. Even if the poor participate actively in the political process, imperfect information about politician contributions to social service improvements can distort government incentives to provide basic social services. Broad sections of the poor population might be particularly disadvantaged in accessing information, because of illiteracy, limited mobility, and underdeveloped media for mass communications, creating space for organized and informed special interests to purchase narrowly targeted policies at the expense of broad services.

Social services have several characteristics that pose substantial informational challenges to citizens attempting to assess politician contributions, and to structure punishments and rewards based upon the quality of services available to them. Because of these information problems, politicians prefer to expend resources in constructing and staffing schools and clinics that remain empty and unused, as they get some credit for the easy to observe building activity and the provision of public employment, but little or no credit for the quality of services available.<sup>6</sup>

First, the *quality* of services such as health and education, which actually impacts citizen welfare, depends critically on day-to-day provider behavior rather than easily observable actions of remotely located politicians. Although policy decisions taken by

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<sup>6</sup> Mani and Mukand (2002) show that if elections serve the purpose of voters choosing amongst candidates to select the most competent one, then resource allocation will be biased against those public goods whose outcomes are more noisy and harder to use to assess politician ability, as politicians will have the incentive

politicians, such as in teacher management or preventive health care initiatives, can have large impact on provider incentives and behavior, citizens need specific and substantial information to deduce which policies have contributed to better quality services. Second, measurable benefits (or costs) may simply not emerge until several years after the policy action has been taken, which makes it difficult for voters to reward (or punish) political agents within a particular electoral cycle. The effects of education reforms, for example, are typically difficult to verify until a cohort of students has been exposed to them for a sufficient period of time.

Third, the provision of service provider jobs to constituents is precisely the sort of activity for which politicians in low-information societies can easily take credit. Like roads and buildings, jobs are easily targeted and highly visible. Unfortunately, it is politically more rewarding to give jobs to unqualified job recipients, who have fewer outside opportunities and therefore owe a greater debt to politicians than do high quality recipients. Gazdar (2000) and the World Bank (1998, 2001) make it clear that non-professional qualifications are key factors in the placement of teachers in Pakistan. Similar reports from the Dominican Republic suggest that posting of teachers is highly discretionary and not clearly related to educational concerns (Keefer 2002a).

If the poor are particularly uninformed participants in the political process, then broad social services can also suffer because politicians make policy concessions to organized and informed special interests. Rather than being influenced by independent evaluations of the performance records of competing candidates, uninformed voters may be swayed by political campaigns and advertisements. Special interests – single firms, groups of manufacturers, farmers, public sector employees, or subsidized retail store owners –

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to provide other goods that are better signals of high ability.

purchase narrowly targeted policies by providing campaign finance (Baron, 1994, and Grossman and Helpman, 1996). They need not be rich, but they are, by definition, informed.<sup>7</sup>

There is little direct evidence on information available to and used by voters that are poor. Nevertheless, disparate pieces of indirect evidence demonstrate the general importance of information for political accountability. One piece of evidence comes from the impact of exogenous shocks on voter behavior. Voters everywhere find it difficult to disentangle the contribution that politicians make to their welfare from the contribution of other influences, such as weather. Voters regularly punish politicians excessively when these exogenous conditions are unfavorable and reward them unnecessarily when they are favorable. In India, state governments tend to lose elections in years of poor rainfall. Wolfers (2002) finds that voters in oil-producing states in the US tend to re-elect incumbent governors during global oil price rises and vote them out of office when the oil price drops.<sup>8</sup> The fact that unobservable, or difficult-to-observe shocks disrupt the connection between electoral success and government performance undermines government incentives to perform at a high level.

A second strand of evidence for the importance of information comes from the literature on electoral cycles in monetary and fiscal policies. Large and systematic electoral cycles in policies are more likely to occur when voters are ill-informed about politician competence and contributions to their welfare.<sup>9</sup> Cross-country evidence indicates that

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<sup>7</sup> Alderman (1988) describes protests in Pakistan by retailers of government subsidized wheat and flour when their livelihood was placed at risk because of amendments in the subsidies program.

<sup>8</sup> Filtering out performance from noisy signals in outcomes is a pervasive issue in principal-agent problems, and not somehow restricted to or especially intractable for the citizen-politician agency problem. Bertrand and Mullainathan (2001, p. 1) find, for example, that CEO pay “responds about as much to a lucky dollar as to a general [earned] dollar”.

<sup>9</sup> The most persuasive theoretical explanation for electoral cycles emerge from rational expectations

electoral cycles in monetary and fiscal policy are significantly larger in developing countries (Shi and Svensson, 2002; Block, 2002; Schuknecht, 2000). Shi and Svensson (2002) establish a direct link between electoral budget cycles and limited information available to voters, showing that some of the difference in the size of political budget cycles across countries is due to variation in access to free media – the greater is access, the smaller are the observed budget cycles. Evidence of election cycles in the *composition* of public spending within a long-standing democracy in the developing world, India, is also suggestive of the impact of informational constraints on service delivery. Khemani (2003) finds that as elections draw near, state governments in India increase expenditures on easily observable public investment projects and away from more broad-based categories of spending on public services. In addition, prior to elections, state governments in India increase targeted tax breaks to narrow groups of producers that may be precisely intended to elicit special interest contributions to campaign financing.

In mitigating information problems, the evidence suggests that improving accountability does not require that all voters be deeply informed, only that most voters share some information about political responsibility for key policy outcomes. Studies in the US have shown that voters adopt simple voting criteria based on very limited information about politics and public policies (various articles in Ferejohn and Kuklinski 1990). Fiorina (1990) emphasizes that the information people use to vote comes from the ordinary performance of social and economic roles, and is therefore “free”. Motivated by these findings, Fiorina and Shepsle (1990) and Chappell and Keech (1990) argue that citizens can employ voting rules requiring very little information and still motivate politicians to pursue

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models in which asymmetric information and shocks to politician competence over time create conditions under which it is rational for voters to focus on performance closer to elections (Rogoff, 1990; Persson and Tabellini, 2000).

policies in their interest. Ferejohn (1990, pp 8-9) paraphrases this process as follows: “find a way to get the electorate to commit itself to act as though it is a simple principal with a one-dimensional set of rewards. In this way, incumbents will be prevented from taking advantage of the conflicting interests in the electorate”. This suggests potential for citizens to coordinate information about particular policies and thereby coordinate voter responses for greater political accountability.

Coordination problems emerge when that information diverges greatly across the population or is simply unavailable. The content of “free” information can vary widely over the electorate depending on the differentiation of occupations in the economy and the variability of social settings. Divergence is also likely due to the extent of development and reach of mass media, if the poor listen to state-controlled radio and the rich read private newspapers, for example. Only when a large enough fraction of citizens is exposed to the same information is there a threat of coordinated voter action in response to under-performing incumbent governments (Ferejohn 1990, Iyengar 1990, Ottati and Wyer 1990).

There is some evidence for the role of mass media in spreading and coordinating information amongst the electorate and thereby improving political accountability. Strömberg (2001) finds that between 1933 and 1935 in the US federal assistance to low-income households was greater in those counties where more households had radios and were thus more likely to be informed about government policies and programs. The spread of the radio particularly improved information access for rural voters and accounted for as much as 20 percent greater allocation of social assistance funds to a rural county as compared to an identical urban county. Besley and Burgess (2003) show that state governments in India are more responsive to declines in food production and crop flood

damage via public food distribution and calamity relief expenditure when newspaper circulation, particularly in local languages, is greater.

Although such evidence does confirm that when voters are informed about particular policies they are able to extract greater resources and better performance from political agents, it does not tell us that an increase in media access improves government incentives either to target the “neediest” citizens with transfers or to invest in public goods benefiting large segments of the population. It could be the case that the mass media better enable politicians to take credit for targeted payoffs to particular constituencies, leading them to reduce expenditures on public goods or on broad-based social programs. In countries where media reach is limited and difficult transportation and communications systems divide the electorate, coordination is less likely. The information base of poor, rural citizens of developing countries might therefore be skewed in a way that detracts from their ability to hold elected officials accountable for the quality of public services.

Given this evidence, it is clear that reforms to solve information problems should include loosening restrictions on the media, including dependency on government advertising, and reducing barriers to entry for new private entrants into different media. However, promoting competitive conditions in the media industry may not be sufficient to ensure media coverage of government performance with regard to service delivery—journalists might provide inadequate information, or none at all if the market they serve consists largely of the “rich” who do not consume public services. A competitive media industry might also not solve the problem of voter coordination, as differentiated products providing different types of information might appear when barriers to entry are low.<sup>10</sup>

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<sup>10</sup> Evidence concerning the role of the media naturally gives rise to the question: under what conditions is free (or low cost) media informative? Several authors have begun to examine the conditions of competition in political and economic markets and the resulting incentives for the kind and quantity of information

Given potential imperfections in media markets, particularly in poorer countries, external interventions may be useful in promoting diffusion of the information needed for political accountability. These are likely to include journalist training, subsidized information transmission, or “information campaigns” by civic society organizations.

There are numerous examples of particular experiences from around the globe of how “information campaigns” regarding public services have succeeded, though we have no rigorous evidence for what kinds of information dissemination strategies significantly and systematically alter the nature of political competition.<sup>11</sup> We can, however, speculate on some features of the type of information and dissemination strategy that would make a difference in terms of improving political incentives. Information about broad public sector performance aggregates, whether based on surveys, budget studies, or report-cards on sector-wide service provision, is likely to be politically relevant only if it provides individual voters with a sense of how their specific representatives in government hurt or help them. It is even more likely to promote reform when the information providers show evidence of being able to coordinate voter responses to poor service provision. This suggests that they are more effective to the extent that they transcend the role of simple information collectors or survey firms and take a more aggressive stance themselves with regard to political accountability. Finally, information campaigns are most helpful when they tell citizens not just how bad services are, and which are worse than others, information that citizens tend to have already, but also how bad the services are in their

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disseminated by the media industry (Strömberg, 2002; Djankov et al, 2002; Mullainathan and Shliefer, 2002).

<sup>11</sup> The most important and well-established is the Public Affairs Centre in Bangalore, India ([www.pacindia.org](http://www.pacindia.org)), which developed the technique of giving public services “report cards” and of exhorting political competitors to endorse service improvements that would be tracked by successive report cards.

neighborhood relative to others, who or what processes are responsible for this, and whether services have improved as a result of specific policy reforms pursued by political representatives.

Finally, and related to themes discussed below, the information burden on voters is reduced if political parties are key actors, rather than individual politicians. It is difficult for voters in a single electoral district to hold their elected officials responsible for problems in social service delivery that afflict the entire country. The role the individual legislator plays in the overall construction of government policy is difficult to unearth, on the one hand, and on the other, voters know in any case that their individual representatives are likely to have little influence over these services. Where parties are institutionalized, however, and exercise substantial control over their elected officials, voters can more easily assign responsibility for non-performance. A party, controlling many elected officials, can more clearly prevent deterioration in social services than can an individual official.

### **Social polarization and provision of services to the poor**

The provision of high quality social services to the poor also suffers when societies exhibit deep polarization, an acute problem in many developing countries. Studies of electoral politics in India show that identity characteristics along ethnic, linguistic and religious lines dominate political behavior (Weiner and Field, 1974). Similarly, in Nigeria, social cleavages along the lines of religion and ethnicity play a prominent role in determining political behavior. In socially polarized and/or ethnically fragmented societies, voters therefore tend to vote for those candidates they most closely identify with, irrespective of public performance and policy records; political competition between parties thus also concentrates on identity issues, and candidates are nominated from constituencies largely on the basis of demographic calculations of ethnicity and religion. Like uninformed voters,

polarized voters are therefore also less able to hold politicians accountable for their performance in office. Public good provision should suffer most under these conditions, since politicians in polarized societies rarely internalize the society-wide costs and benefits of their policy decisions.

Compelling evidence demonstrates a significant impact of social polarization on public good provision. In a cross-country setting, Easterly and Levine (1997) find that ethnic diversity is negatively correlated with the provision of public goods such as the percentage of roads that are paved, efficiency of the electricity network, and years of schooling of the population. For cities in the US, Alesina, Baqir and Easterly (1999) show that shares of public spending on productive public goods – education, roads, sewers, and trash pick-up – are inversely related to the city’s ethnic fragmentation. Miguel (2001) concludes that higher levels of local ethnic diversity in Kenya are associated with sharply lower contributions to primary school funding and worse school facilities.

The effects of identity politics are especially dramatic when minority identities lack political power. In India, Betancourt and Gleason (2000) find that districts with a higher proportion of traditionally disadvantaged groups with respect to caste and religion – the scheduled castes and Muslims – have lower public inputs in health and education. Similarly, Banerjee and Somanathan (2001) find that districts with a higher share of scheduled tribes in population receive significantly fewer “desirable” public goods. They also find some evidence that links the relationship between ethnic heterogeneity and public good delivery to underlying political incentives—districts that are ethnically fragmented are also likely to be politically fragmented, in that elections in these districts are characterized by a larger number of contestants and a smaller vote share for the winning party.

There is also substantial anthropological and anecdotal evidence in India that disadvantaged groups are systematically excluded from using public goods within their own villages by social processes of discrimination. Micro-level case studies and survey evidence from India show that within-village inequality in education access and achievement is significant, with the privileged castes in the village enjoying near-universal adult literacy for several decades while literacy rates are still close to zero among disadvantaged castes in the same village (Drèze and Sen, 1996).

Adverse policy effects do not emerge in all of the countries with profound caste, religious, tribal, racial or other differences. The affinity-based voting patterns observed in India or Nigeria are not evident in the US or Western Europe. On the contrary, surveys of voting behavior in the US in the 1950s and 1960s (Campbell et al, 1966) show that an overwhelming determinant of voting behavior is the ideological identification of voters with political parties. In this case, though, ideology has significant policy roots in citizen identification with the perceived position of political parties on a wide range of social and economic issues.

In order to devise interventions that can soften the social divides in a country, one must therefore first ask why these divides drive politics in some countries but not in others. One possibility is simply that members of the same ethnic, religious or social group value each others' welfare much more than the welfare of members from other groups. Historic antipathy between groups may even be such that reductions in welfare for one group improve welfare for others. In the end, such arguments simply say that group preferences are buried in the utility functions of citizens. To the extent that this is the case, the design of appropriate interventions is best guided by psychological and sociological

insights as to what sorts of information about and interactions between different groups best soften the animosity that divides them.

A second explanation is the focus of the next section of the paper and is likely to be the most relevant. Where political competitors are generally not credible, voters can often believe only the promises of those competitors with whom they have personal connections. In the US, parties have established credible positions on certain issues. These together comprise a package that attracts particular voters, who then appear to be “ideologically” committed to the party when they are simply committed to the policy positions with which those parties are credibly associated. In India and Nigeria, though, the problem is the reverse. Voters only believe promises from political candidates within their own ethnic or religious groups; those promises are therefore, necessarily, narrow and targeted to members of the respective ethnic group. Political promises for broad-based public services that cut across social groups are not credible.

In fact, if one looks at the effects of increasing the political power of minority groups, it appears that both animus and credibility may explain the role of social polarization in political competition. India, for example, instituted political reservations for scheduled castes and tribes in the national and state legislative assemblies. Pande (2002) finds that mandated reservations in state legislatures resulted in increased public sector job quotas for scheduled castes in the public sector, but significantly lower resources allocated to education. The antagonism of the majority towards the scheduled castes and tribes explains why the greater political influence of the latter led to a change in benefits. However, because the newly emergent representatives of the disadvantaged groups could make credible appeals only to their ethnic groups, they favored targeted rather than broad public goods, even when the benefits to their groups would have been higher, per rupee expended, from the latter.

### **Credibility and the provision of social services**

Politicians may be unable to make credible promises to citizens about social services, or anything else, for two different reasons. The first is imperfect citizen information and has already been discussed. When citizens cannot easily verify whether quality public goods have been provided or not, politicians have an incentive to under-provide relative to what they have promised. The argument above is that promises regarding social service provision are particularly difficult to verify. Knowing this, citizens disregard promises to improve social services, and politicians stop making these promises. The second reason is simply the absence of a penalty if politicians renege on their promises. In particular, citizens do not believe the promises of a political competitor who confronts no reputational loss from renegeing, such as a political competitor who is not expected to seek office in the future or who has no history of fulfilling promises.

When pre-electoral promises are not credible, elections become less effective devices for holding politicians accountable. In the best case, when voters can coordinate on *ex post* performance standards, turning out incumbents who fail to meet them, public goods are still underprovided, targeted transfers are not provided at all, and rent-seeking is high (Persson and Tabellini 2000). In the worst case, if voters cannot coordinate, elections are useless and rent-seeking prevails (Robinson and Verdier 2002).<sup>12</sup>

This work predicts that in low credibility environments elections have little meaning and politicians never authorize narrow, targeted expenditures. However, politicians in countries lacking established political parties with clear policy reputations typically feel threatened by elections and are deeply concerned about their ability to deliver targeted transfers to constituents. Keefer (2002b) suggests that these outcomes emerge when

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<sup>12</sup> See the Appendix for additional details.

politicians can only make credible promises to those voters with whom they have built up a personal reputation. Such ties most clearly emerge in the context of “patron-client” relationships that a large literature identifies with the politics of developing countries. Credible politicians are, for example, locally influential people who have helped families with loans or jobs or assistance with legal or bureaucratic difficulties. In the absence of well-developed political parties or national party leaders who are more broadly credible to voters, the promises of such influential people are all that voters can rely on in making electoral choices.

Patrons have relatively weak incentives to provide public goods, since these benefit both clients and non-clients alike. Promises of buildings and government jobs become the currency of political competition at the expense of universal access to high quality education and health care. The former can be targeted to individuals and small groups of voters and therefore are clearly seen as evidence of political patrons fulfilling their promises to clients – recalling that only clients believe promises in the first place. Universal access is by definition not easily targeted. Improvements in quality are also difficult to target, both because they tend to involve managerial improvements that spread throughout the system, and because they are difficult for voters to attribute to politicians.<sup>13</sup>

Evidence supports the notion that clientelist governments have a stronger than average preference for targeted infrastructure provision, are more corrupt than average, and under-provide education. For example, Keefer (2000b) argues that political competitors, especially parties, in young democracies are less likely to have built up reputations through repeated electoral cycles. Political competitors in young democracies are therefore less likely

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<sup>13</sup> Voters cannot distinguish whether the quality or attendance of teachers has improved because of their own pressure on the teacher, because the teachers themselves decided to do a better job, because of a generalized reform in teacher quality that is affecting all teachers and education beneficiaries, or because of

to be able to make credible promises to all voters and are more likely to rely on clientelist promises. In fact, targeted spending – public investment – is higher in young democracies than in old, secondary school enrollment is lower and corruption is higher.

Qualitative evidence from Pakistan supports this logic. Competitive elections were a regular feature of the political landscape of Pakistan during the 1990s, but credible promises by political parties or political leaders to voters were supported largely by clientelist relationships and related to targeted transfers rather than broad public policies. There is little evidence of political competition on the basis of broad policy promises, nor of distinctions among the major parties regarding their stances on broad policy issues. One would expect the provision of broad-based public goods in such an environment to be low and the provision of targeted goods to be emphasized.

In fact, compared to countries with similar incomes per capita and demographic characteristics (age and proportion rural), access to potable water in Pakistan in 2000 was 25 percentage points higher than expected. Investments in potable water, particularly in rural areas where they consist largely of well-drilling, are particularly easy to target and their benefits are immediately accessible and observable. Primary school enrollment, though, was 20 percentage points less than one would have expected, controlling for the same variables (World Bank 2002).<sup>14</sup>

The Pakistan case illustrates the importance of a long horizon in ensuring the credibility of political promises. During the 1990s, no elected government completed its term and voters and elected officials had short horizons. Political competitors with short

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the targeted intervention of a particular politician.

<sup>14</sup> Another, complementary explanation taken up in just the next section is political instability. For decades Pakistan has been marked by considerable political instability. The tenure of incumbent leaders was frequently cut short (three times in the 1990s). This would also have generated a marked preference for the provision by government of goods that generate benefits immediately and would not be dependent

horizons are unable to credibly promise to implement projects that require a longer time period to bear fruit. This matters little if the promises concern jobs or public works projects, which, in principle, can be fulfilled with little delay after an election and whose benefits can be quickly realized and recognized by voters. However, shortened political horizons render other government services, such as education, considerably less useful.

Education must be received for a certain minimum period of time before recipients realize any benefits from them. This is particularly true in the early years: schooling yields few benefits until students achieve literacy and numeracy, but this may not occur before the fourth grade. In Spain, returns to education are low prior to 10<sup>th</sup> grade, but there is a spike in returns to education precisely upon completion of the fourth grade (Sanmartín 2001). Glewwe and Jacoby, in examining the determinants of student achievement in Ghana, gave subjects a basic reading and mathematics test. Performance by those who had not advanced beyond grade school was so poor that they were excluded from the sample and the authors focused on middle school achievers only. To the extent that education also serves a signaling function, the horizon problem worsens: receipt of the credential generates a discrete jump in the returns of the previous years of schooling, but the credential can only be received after a certain number of years of schooling.<sup>15</sup>

The horizon problem can have a significant impact on voter decision making. The earlier example of 30 families, each with a school age child, makes this clear. These families can choose between a politician who promises to provide a job and one who promises to staff the empty school with a qualified teacher unrelated to the 30 families. Prior to the election, they do not know which family will get the job, so the expected value to each family

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on the decisions of future governments.

<sup>15</sup> The magnitude of the signaling effect is contentious, particularly for primary and secondary education. Layard and Psacharopoulos (1974) strongly dispute it, but Hungerford and Solon (1987) claim to find

of the job is  $1/30$  of the salary. If they know that the teacher will stay for five years, so that each child becomes numerate and literate, raising expected lifetime income by 30 percent. Otherwise, there is no benefit to education. These families prefer the politician who promises the teacher only if the promise is credible over the entire five year period.

There is no direct evidence of the horizon effect on social service delivery, but there is documentation related to other long-term promises of governments. For example, Clague, et al. (1996) consider the security of property rights, which is clearly sensitive to the horizons over which government actors can make credible promises. They make the argument that the longer is a regime (the years a country is democratic or that an autocrat is in power), the longer is the horizon of the political decision makers. The evidence they present suggests that the security of property rights is higher in both older democracies and older dictatorships. Keefer and Knack (2002) find as well that productive public investment – the payoffs to which are largely in the future—fall when property rights are weak, while unproductive public investment – corruption and rent-seeking – rise. These results are suggestive, at least, that in the area of social service provision, particularly education is likely to suffer when the horizons over which government officials can make credible promises are short.

Unfortunately, as the problem of political horizons indicates, there is nothing inevitable about the formation of policy reputations. Although young democracies are less likely to exhibit institutionalized political parties, institutionalization is far from an inevitable development as democracies age. For example, though political parties could gain by attempting to build strong policy reputations, there are also strong political incentives in the opposite direction. In socially polarized countries, for example, there are also political

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convincing evidence of it.

rewards to developing a reputation for favoring one group at the expense of another. As Glaeser and Shleifer (2002) have shown in the case of the city of Boston, as the experience of Zimbabwe makes self-evident, and has been the case throughout history, politicians can often gain political advantage by fanning ethnic divisions. In the limit, as in Boston or Zimbabwe, electoral advantage is cemented by simply pushing the out-of-power ethnic group out of the jurisdiction.

The difficulties of developing party reputation are more general than this, however. In an environment where no party is credible, the most successful parties are those with leaders who are personally credible and have a national reputation. If those leaders build up the party's apparatus and reputation, distinct from their own reputation, they cement their party's hold on power, but at the same time loosen their personal hold. Once the party is institutionalized, the barriers to entry confronting competitors for party leadership fall. Competitors no longer need the national profile that is required for success in the absence of institutionalized political parties. Given this tradeoff, it is not surprising that so many parties, for example in Pakistan or Bangladesh, have failed to institutionalize.

Finally, reputation can develop for the "wrong" policies when there is uncertainty about the most effective instruments to achieve particular public objectives. The history of political competition may lead to a "bad" equilibrium where only certain promises, for inefficient policies, are credible. New democracies established in poor, agricultural economies have historically adopted poverty reduction strategies focusing on subsidies for consumption and agricultural production, at the expense of broad public services that may perhaps have higher returns in terms of poverty impact and economic growth. Once political reputations are established for particular policies, even if these policies are sub-optimal they will receive greater public resources than if all political promises were credible.

Given the obstacles to reputation-building, interventions to strengthen the credibility of pre-electoral promises of political competitors are difficult to devise. Many organizations seek to improve the professionalism of political parties. This can be important, as long as it advances the policy basis of the party. Professionalization can also enhance the development of party machines, however. This is not entirely bad: relative to a personalized political system, a patronage-based party is likely to have a longer horizon and is more likely to provide public goods. However, competition between credible, policy-based parties that engage in some patronage is almost certainly better for public policy than competition between more purely machine-based parties.

### **The dynamics of political competition and provision of social services: Uttar Pradesh versus Kerala**

Some of the most striking contrasts in basic health and education outcomes exist between neighboring countries with comparable levels of economic development, and between regions within the same country – between Sri Lanka, Thailand, and the southern states of India on the one hand, and Pakistan, Bangladesh, and the northern states of India on the other. One such contrast, between the northern state of Uttar Pradesh (UP) and the southern state of Kerala in India, has been explored in depth by Drèze and Sen (1995, 1996). These two states exhibit almost identical levels of per capita income and poverty, but dramatically different outcomes in health and education. Table 1 (based on data presented in Drèze and Sen, 1996) summarizes this contrast. Human development outcomes in Kerala are comparable to some of the richest nations of the world, but those in UP to the poorest.

Drèze and Sen attribute these stark differences to the divergent nature of public action in these respective states. We reinterpret their example to emphasize the differences in political incentives of policy-makers across the two states to provide social services to all.

Public policy is clearly different across the two states. Figure 1 demonstrates striking differences in real per capita public expenditures on health and education in the two states. Over four decades from the 1960s to the 1990s, average real *per capita* spending in each decade in Kerala has been more than double that in UP.

**Table 1: Contrasting Experience in Social Services**

	<i>India</i>	<i>Uttar Pradesh (UP)</i>	<i>Kerala</i>
Per capita income at current prices 1991-92 (in Indian rupees)	5583	4012	4618
Poverty headcount ratio, 1987-88 (%)	44.9	47.7	44
Real (1992 Rs) per capita public spending on education, 1985-92	228	147	309
Real (1992 Rs) per capita public spending on health, 1985-92	70	49	82
Literacy rate, age 7+, 1991 (%)			
Female	39.3	25.3	86.2
Male	64.1	55.7	93.6
Percentage of rural children aged 12-14 who have never been enrolled in a school, 1986-87			
Female	51	68	1.8
Male	26	27	0.4
Proportion of persons aged 6 and above who have completed primary education, 1992-93			
Female	28.1	21.4	60.5
Male	48.6	47.3	65.8
Proportion of children aged 12-23 months who have not received any vaccination, 1992-93	30	43	11
Proportion of recent births preceded by an antenatal check-up, 1992-93	49	30	97
Infant mortality rate per 1000 live births, 1990-92	80	98	17
Proportion of villages with medical facilities, 1981	14	10	96
<i>Source: Drèze and Sen (1995, 1996); Public spending numbers from annual publications of the Reserve Bank of India Bulletin on state finances in India; India-wide numbers on public spending only for 15 major states</i>			

Figures 2a and 2b demonstrate differences across the two states in spending on targetable items relative to education and health. Kerala's public resources were

overwhelmingly allocated to education and health services in the early decades of democracy, constituting 45 percent of total expenditures, with correspondingly fewer resources (less than 30 percent) spent on state administration (largely, jobs going to non-service providers). In UP, during this same period, expenditures were concentrated in state administration, comprising almost 50 percent of the total, while health and education received less than 25 percent of public resources.<sup>16</sup>

The quality of public services is indisputably harder to target and here the evidence is clear: the quality and effectiveness of public spending are higher in Kerala. Drèze and Sen review extensive evidence that public schools and health clinics in Kerala have high teacher and physician attendance, are well supplied, adequately maintained, and widely utilized; similar facilities in UP simply lie abandoned.

These differences raise two questions. Why did they emerge? And why do they persist? Why, that is, can a village school in UP be non-functional for as long as ten years due to teacher absenteeism and shirking, without any collective protest being organized (as Drèze and Gazdar 1996 observe), while Mencher (1980) finds that if a primary health center in Kerala is unmanned for a few days, there are massive demonstrations at the nearest district office. The formal political and legal institutions in the two states are the same and both states lie within a single sovereign nation. Both have had regular elections to their legislative assemblies since the 1950s, monitored by the Election Commission of India and in accordance with constitutional procedures. Hence the answer cannot lie in differences

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<sup>16</sup> The circumstances in Kerala distinguished it as well from most Indian states, since on average the major Indian states spent approximately 30 percent of total spending on health and education and over 40 percent on state administration. Largely because of the growing debt burden in both states which increased the share of resources going towards interest payments (included under state administrative spending), they have converged to similar levels of spending, in proportional terms, in recent years. In sum, if spending on health and education is less easy to target than other types of spending, as seems to be the case, then the allocation differences across the two states reflect stronger preferences in UP for targeted spending.

between political institutions *per se*, but in the dynamics of political competition. We argue that the explanation lies in the differences between the two states along the dimensions of information, social polarization and credibility of political promises—both in the past and currently, Kerala’s voters are better informed and less polarized on non-policy dimensions than voters in UP, and its political parties compete on credible platforms for delivering broad social services, as compared to clientelist platforms in UP.

Kerala entered the era of democratic elections with a politically active electorate with literacy rates of approximately 40 percent. In contrast, the state of UP entered the new era of democracy with a population of largely illiterate voters (less than 18 percent even in 1961) with limited access to widely published information. Active institutions of social discrimination effectively prevented the so-called “backward castes” from accessing public services and even from participating in political processes. Although caste issues also existed in Kerala, poor and socially disadvantaged voters were more likely to participate in political processes to influence policy issues affecting their welfare (Nossiter, 1982; Chander, 1986). These differences affected political party competition and the likelihood that credible political competitors would emerge to contest elections.

The other key political variable is that following independence from British colonial rule, the Congress Party was the dominant party in India. It had the widest national presence, the most solid reputation based on its association with the fight for independence, and the longest presence as a political party. Congress espoused a common socialist platform throughout India, focusing on state-led development and redistribution to the poor. However, at the state level there was substantial variation in the perception of the Congress Party by voters, the extent and nature of competition confronting the Congress

Party, and the types of credible promises to voters that the party could or had to make to be successful.

In particular, in states such as UP, Congress did not confront vigorous competition from credible and well-organized parties. In others, credible challenges to the Congress were mounted by regional parties and newly emerging communist parties. In Kerala, the communist parties were particularly active and invested substantially in mobilizing the poorest voters, and by repeatedly interacting with these voters, developed the ability to make credible promises to them (Chander, 1986; Nossiter, 1982). This was not inevitable. First, the ability of the communist parties to mobilize large numbers of activists to establish personalized contact with voters is unusual. Absent this asset, they would have been less able to establish their credibility in competition with the Congress Party. Second, the leaders of the communist parties could have chosen to use these personalized contacts to focus on jobs and targeted services to core constituencies, or to strengthen the personal positions of the leaders of the communist parties. These were certainly a part of the message to voters, but they also used activists to establish the policy credentials of the party.

Competition in Kerala was therefore between two credible political parties, the Congress and communist parties, both able to make promises to broad segments of society and both driven by elections to make promises that would best serve the needs of broad segments of the population – such as high quality social services. This diminished the importance of patron-client relationships to an extent that was unparalleled in any other state. In UP, on the other hand, the development of such competition was severely handicapped.

Moreover, credibility was reinforced as promises were kept. The first two decades of elected state government in Kerala saw dramatic improvements in human development

indicators. Infant mortality declined about 43 percent, for instance, between 1956 and 1966 (Krishnan, 1991). This decline has largely been attributed to high female literacy (which was also expanding through state programs in education) but was clearly facilitated by access to public primary health care, and state-sponsored programs of infant and child immunization (Zachariah, 1992). In UP, on the other hand, absenteeism and other indications of widespread shortfalls in service delivery have persisted since the beginning, suggesting few political pressures to use resources for purposes other than political patronage.

The Congress Party in UP confronted only opposition from personalized rather than more institutionalized parties. Since opposing parties were not broadly credible, the Congress Party in UP could win elections with exceedingly modest promises. In fact, the Congress Party won on average more than 70 percent of the seats in the state assembly (numbers based on data provided in Butler, Lahiri, and Roy, 1995). At the same time, massive voter illiteracy suggests that voters were also poorly informed about the connection between political decision making and their well-being. This undermined the ability of any party to make credible promises to voters, since reputation with voters is difficult to establish if voters are poorly informed. Finally, in conditions of visible and often coercive social discrimination, organization of the victims of discrimination was highly costly.

Perhaps as a reflection of more informed voting along policy dimensions in Kerala, and greater credibility of political parties, voter turnout in the state has been historically higher than in any other state, averaging over 75 percent even in the first few state elections. In contrast, turnout in UP in the first few elections averaged 55 percent, which is suggestive of greater voter apathy to policy issues, because of the combination of lack of information, greater social polarization, and lack of credibility of political parties.

UP is not immune to the fact that it is only one state in a country with well-developed democratic institutions. Literacy has slowly climbed and democratic institutions have penetrated the social landscape bit by bit over the past fifty years, especially through the political mobilization of traditionally repressed lower castes. However, consistent with the earlier discussion of the obstacles to building reputation, more competitive elections, the emergence of new parties, the increased integrity of elections and the representation of lower castes have not led to social service improvements. New parties have instead either been personal vehicles for party leaders or have built themselves up as vehicles for representing narrow segments of the population. In either case, political incentives to improve broad based access to quality social services remain weak.

Ethnic or caste-based parties are a particularly important new development in UP. In an otherwise non-credible environment, there is political advantage in mobilizing voters along caste or ethnic lines, since the credibility of intra-caste promises is greater. Among the three main parties competing in the state today, the Bharatiya Janata Party (BJP) appeals to upper caste Hindus, the Bahujan Samaj Party (BSP) to so-called backward castes, scheduled castes and tribes, and minority religion groups (hence the complementary set to upper caste Hindus), and the Samajwadi Party (SP) to similarly marginalized groups along the lines of religion and caste. These parties compete explicitly clientelist platforms. The BSP party platform, for example, simply does not print any election manifesto to explain its platform. It does, however, publicize the ethnic profile of its candidate list to demonstrate commitment to its single point program of proportional representation for every ethnic group in the bureaucratic institutions of the state (Chandra, 1999).

The contrast between Kerala and UP demonstrates that the same formal institutions of democracy can sustain very different forms of electoral competition with substantial

impact on the quality of public services supported by the state. It also demonstrates that the sheer endurance of democracy is no guarantee that political market imperfections will disappear. In fact, path dependency in public policies or persistence of differences in the nature of electoral competition is exactly what would be expected when there are credibility problems in political markets. The analysis undertaken here suggests that external interventions to break this path dependency, change the process of political competition, and hence impact the quality of social services, should focus on the information processing capacity of voters, social fragmentation, and the capacity of politicians to make credible commitments. Further research is needed to evaluate the impact of ongoing political and institutional reforms in the developing world, and to draw lessons from the existing variation in institutions across countries. Where poor voters are already active in political processes the real issue is that of bolstering the credibility of political candidates to provide broad social services, with a corresponding reduction in existing political pressures to pursue clientelist policies.

### **Conclusion: Policy Implications and Further Research**

The Millennium Development Goals imply a dramatic improvement in the condition of the poor. A large literature suggests that institutions are likely to “matter” in this endeavor. How they matter is the subject of this paper. We argue that the specific circumstances of electoral competition and political decision making have a large effect on social service outcomes to the poor. Information gaps, social polarization and the absence of credible political competitors lead to the underprovision of government services to the least informed, to the most polarized and to the vast majority who do not have personal connections with a powerful patron.

There are many significant examples of reforms intended to improve the ability of the poor to secure their own interests in government decision making (to “empower” them), including decentralization, legislative reservations for minority groups in India, decentralization in Pakistan, and participatory budgeting in Brazil. These are all most effective to the extent that they overcome the underlying political market imperfections that notably impair government services to the poor. However, as the earlier discussion of the effects of reservations in India suggests, the improvements wrought by these reforms may be only partial to the extent that they leave unchanged many aspects of the political marketplace.

Two types of decentralization, in particular, are often seen as responses to inadequate central government attention to social service delivery: decentralization of responsibilities for the provision of local public goods to locally elected village and municipal governments; and greater autonomy of decision-making for service providers such as schools and clinics, combined with greater participation of citizens through community-based organizations such as parent-teacher associations and health committees. The political economy analysis here has implications for both

Decentralization is likely to have a positive impact on social services if it allows voters to be better informed about political responsibilities for local public good provision; if local public good provision is more salient in local elections than in central government elections; and if promises by political competitors in local elections are more credible than in central government elections.<sup>17</sup> This type of decentralization may not succeed if local voters are apathetic to local elections and have little or no information about the resource

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<sup>17</sup> If issues are “salient”, votes are more heavily conditioned by candidate performance on them than if they are “non-salient”.

availability and capability of local governments; if social polarization is more intense at more local levels; or if clientelist promises to a few voters are easier to make and fulfill due to closer social relations between the elected representatives and their clients (see Keefer, Narayan and Vishwanath, 2003, for a more extensive discussion of these issues).

Decentralization of authority to service providers and communities can solve both credibility and information problems, though again not necessarily. Remotely located political agents are not able to credibly promise to improve quality of services in such transactions-intensive sectors as health and education, since they are unable to closely monitor provider actions. By shifting the monitoring of service providers to communities, this form of decentralization reduces the information voters need to hold politicians accountable: they need only verify whether political agents have made resources available for schools and clinics.<sup>18</sup> However, such policies are difficult to enforce as they require politicians to compromise their claim on public employment as political patronage. Additional and complementary efforts to generate and widely disseminate information about the impact of policy changes on social services would be needed to make it easier for politicians to take credit for successful policies that increase benefits to broad sections of the population, and therefore reduce the need for targeted patronage.

Reforms other than decentralization can also mitigate political market distortions due to information. Such reforms would provide independent validation about the quality of public goods and the scope of accomplishment and failure of individual political decision makers. They would provide voters a vehicle to coordinate by clearly communicating to citizens that the information is widely shared. Not only can the press provide this type of

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<sup>18</sup> This solution is limited to the extent that central government intervention is needed either to remedy disparities in performance or funding across jurisdictions, however.

validation and coordination, so also can external agencies and civic groups or “civil society.” Survey instruments, such as citizen report cards that consolidate public feedback on the state of government services, are potentially powerful vehicles for mobilizing voters around the issue of quality of public services.

Credibility, like information, is particularly likely to be problematic in developing countries. Reforms designed to improve social service delivery directly can improve credibility by making it easy for politicians to *take credit* for public good improvements. If they help politicians build a reputation for broad-based service delivery, as was the case in Kerala, social service reforms become more sustainable. This is challenging, however. It means specifically that aid be provided for education and health especially in those cases where politicians have made emphatic, public and verifiable promises regarding health and education. This is not common in many developing democracies.

Finally, social polarization can have harmful effects on social service provision, just as on other aspects of civic life. One response that should always be considered in the design of outside intervention is to insist that criteria other than those related to social cleavages determine access to resources. This may not always be practical. For example, if one group is poorer than the other, redistributive transfers on the basis of income will always favor that group.

When social cleavages are purely “taste-based” (a preference for one particular ethnic group or tribe and a dislike for others), a two-pronged, obviously long-term approach is necessary: educational responses to moderate these tendencies and strong signals from the center about the inappropriateness of such behavior or preferences. Ample experience suggests that this can, over time, soften such cleavages. However, polarization is often due to tremendous imperfections in political and economic markets. People retreat into the

groups with which they have the strongest personal links and the greatest hope of accessing resources. In this case, the appropriate response is to assist in reforms that remove those imperfections.

Only recently have we begun to understand the profound role that political market imperfections play in development. It is no surprise that more research and practical experiments are needed to discover how best to alleviate these imperfections. Decentralization reforms, which are just now taking root in a variety of contexts and with significant institutional variation, provide an important opportunity to evaluate one strategy for addressing them. Similarly, systematic research on the particular experiences from around the globe of how information campaigns regarding public services have succeeded is likely to be feasible and promising. Further research would be valuable on the nature of information availability and processing by poor voters, and how information provision mechanisms can be institutionalized to enable these voters to provide stronger incentives for politicians to improve performance of public services. Finally, more, innovative research is required on credibility in politics. Under what conditions do politicians shift their promises from only targeted transfers to broad and continuous improvements in service quality? The rewards to such admittedly difficult research are likely to be enormous, since it would vastly improve our understanding of distressingly vast differences in government performance around the world.

### Appendix: the impact of market imperfections on the median voter model

A few simple models make clear how imperfections in political markets can undermine the incentives of political decision makers to provide optimal government services to citizens. These results stand in contrast to those in a “benchmark” society, in which all political promises are credible, politicians cannot make targeted transfers (transfers to some voters but not others), voters are identical, and voters can observe at no cost the contribution that politicians make to their welfare. Under these ideal conditions, the public good preferences of voters *always* translate into actual government policy.

In the benchmark society, there are  $N$  identical voters whose individual welfare  $W$  is given by  $c + V(g)$ , where  $g$  is the amount spent on public goods,  $c$  is private consumption and  $V(g)$  is the utility each individual receives from spending on public goods;  $c = y(1 - \tau)$ , or income net of a uniform tax  $\tau$ , and  $g = \tau Ny$ . The welfare of the average or median voter (the same in this case, since all voters are identical) is therefore maximized by public good provision  $g^*$  such that  $V_g(g^*) = -1/Ny$ .<sup>19</sup> This is precisely the level of public good provision that maximizes total social welfare (taken to be the sum of the welfare of all  $N$  voters), as any text in public finance makes clear. Any candidate who deviates from the policy promise  $g^*$  and  $\tau = g^*/Ny$  is defeated by any candidate who offers this optimal policy package, since all voters prefer  $g^*$  to any other  $g$ .

One key assumption in the benchmark model is that voters can costlessly observe the contribution of politicians to policy changes and the connection between government policy and their own welfare. Politicians therefore always get credit or blame for the actions they take or fail to take on behalf of voters. Imperfect voter information makes it difficult

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<sup>19</sup> Rewrite welfare in terms of  $g$  and maximize with respect to  $g$ .

for voters to assign credit or blame, and therefore increases political incentives and scope for rent-seeking.<sup>20</sup> In the limit, if voters are utterly ignorant about politician responsibility for government policy or about the contribution of policy to their own welfare, the results from the benchmark model entirely reverse and no public goods at all are provided.

Voters are also assumed to be identical in the benchmark model. In reality, voters differ on a host of margins, including income, ideology, religious belief, language, the value they attach to different public goods, occupation and location. All of these can affect their preferences for government policies and public goods. If voters have strong preferences for or against specific candidates or parties, independent of the policy choices of these parties, social service provision can suffer significantly.

It is easy to show the potentially devastating impact of ideological preferences on outcomes in the ideal world. Imagine that there are only two political parties competing for votes. Some voters derive utility from the election of party  $A$  and disutility from the election of party  $B$ , and the remaining voters derive utility from party  $A$  and disutility from party  $B$ . For simplicity, voters who prefer party  $A$  are identical in their preference for party  $A$ , as are the voters who prefer party  $B$ . Further, the disutility that voters get when their non-preferred party is elected is exactly equal to the utility they get if their preferred party is elected, and the amounts of utility and disutility for each group of voters are the same. That is, for all voters, the utility they get if their preferred party is elected is  $\varepsilon$ , and the disutility they get if their non-preferred party is elected is  $-\varepsilon$ . As before, politicians representing each party make promises regarding public goods and elections are held. When ideological

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<sup>20</sup> Persson and Tabellini (2000) argue that the larger the density of citizens who are uninformed and therefore vote randomly (that is, with complete disregard for policy promises and outcomes), the greater is political rent extraction in equilibrium.

polarization is severe enough, however, politician promises regarding public goods are irrelevant.

Consider, for example, a situation in which half of all voters prefer party  $A$  and half prefer party  $B$ . If party  $A$  is elected, voters who prefer party  $A$  receive  $W_A = c + V(g_A) + \varepsilon$  and voters who prefer party  $B$  receive  $W_B = c + V(g_A) - \varepsilon$ , where  $g_A$  is the level of public goods promised by party  $A$ . Conversely, if party  $B$  is elected, welfare outcomes for each group of voters are given by  $W_A = c + V(g_B) - \varepsilon$  and voters who prefer party  $B$  receive  $W_B = c + V(g_B) + \varepsilon$ . If ideological preferences are zero,  $\varepsilon = 0$ , the two parties both promise  $g^*$ . However, as  $\varepsilon$  grows, voters become more willing to vote for their preferred party even if that party promises fewer public goods than the non-preferred party. If social polarization is sufficiently high and  $\varepsilon$  sufficiently large so that  $V(g^*) + y(1 - g^*/y) - \varepsilon < V(g) + y(1 - g/y) + \varepsilon$  for all  $g$ , or  $V(g^*) - V(g) + g - g^* < 2\varepsilon$ , there is nothing that the non-preferred party can promise prior to the election that will convince the supporters of the other party to switch their allegiance. The welfare that the supporters of the other party receive from electing their own party, even if their own party provides no public goods at all, is greater than the welfare that they receive if the other party is elected and provides the optimal level of public goods.<sup>21</sup>

The third key assumption of policy making in the ideal world is that pre-electoral promises are binding on the election winners. This is clearly counterfactual: electoral promises are not legally enforceable anywhere. Instead, the credibility of campaign promises depends on the reputation of either the individual candidate making the promises or of the

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<sup>21</sup> Governments cannot extract rents in the ideal world – if they could, they would be easier to extract in a polarized world, where voters prefer parties regardless of their policy performance or rent-seeking.

political party to which candidates belong. If, as in Robinson and Verdier (2002), no promises are credible, politicians have no incentive at all to pursue the public interest except to the extent that it directly improves their own private welfare. For example, incumbents might approve public expenditures on roads as long as the roads pass by their privately-owned factories. In this limiting case, non-credible politicians set the tax rate  $\tau$  to maximize the rents that they can extract from the economy during their expected time in office and provide no public goods whatsoever. Elections are almost meaningless in this context.

However, we frequently observe that voters remove non-performing incumbents from office, even when challengers are not credible. Ferejohn (1974) explains this as a consequence of voters implicitly coordinating to establish some threshold of performance that the incumbents must meet if they are to be re-elected. Such a threshold provides only weak voter control over incumbents, since incumbents always have the opportunity of “looting” – taking all of the rents possible in a given period and foregoing any chance for re-election.<sup>22</sup> Keefer (2002) explains policy formation in low-credibility states as the consequence of competition between patrons – politicians who are able to make promises to narrow groups of voters only (e.g., their “clients”), but not to the wider population.

The benchmark model finally assumes that governments can only provide public goods. However, in every country the ability to make targeted transfers (such as “pork barrel” projects) is a key weapon in the political arsenal and almost always directly conflicts with the goal of providing efficient public services to those who most benefit from them.

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<sup>22</sup> Persson and Tabellini (Chapter 8, 2000) refine the Ferejohn model, introducing the possibility that politicians can make targeted transfers as well as provide public goods. They show that if, for example, politicians need to attract the votes of 51 percent of the electorate in order to be elected, incumbents provide public goods as if only 51 percent of voters benefited from them rather than all voters. An attempt by any majority of voters to demand a higher level of public goods would be undercut, because the incumbent could always offer targeted transfers to a few voters that offer greater welfare than the extra public good but are cheaper for the incumbent to provide. However, since all voters would like to receive

Benefits are targeted according to political calculations that need not and often do not coincide with technocratic notions of targeting, which emphasize targeting according to other criteria, such as need. Political and program targeting criteria need not and usually do not coincide, undermining adequate social delivery.

To see the implications of political targeting, one can assume  $N$  identical voters, as before, and allow individual voter welfare  $W$  to be given by  $c + V(g) + m_i$ , where  $m_i$  is a transfer from the government to voter  $i$ . As before,  $c$  is  $y(1 - \tau)$ , but  $\tau Ny = g + \sum m_i$ . For even the slightest deadweight loss from taxation,  $m$  should be zero since the utility gain of transfers to any voter is offset by an equal utility loss borne by other voters. However, there are many possible scenarios under which politicians would prefer to provide  $m$  exclusively. These relate to the earlier market imperfections. For example, if voters are imperfectly informed such that they can only verify promises related to the direct provision of targeted goods (e.g., a job), but not of broad public goods (e.g., efforts to improve school quality), politicians have an incentive to provide *only* transfers to voters.<sup>23</sup> If most voters are ideologically polarized, but some are not, politicians would compete by making promises only to the ideologically uncommitted. If this group were small enough, its members would prefer all tax revenue to be used to provide them with targeted transfers than with public goods that would benefit all citizens.<sup>24</sup> Finally, if politicians can only make credible pre-

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such transfers, they bid them down to zero.

<sup>23</sup> In the absence of additional structure, there is no equilibrium policy outcome in the simple model of targeted transfers. There is no offer of transfers and public goods that is invulnerable to defeat by some other offer. Transfers to each voter each constitute a different policy dimension and Plott (1967) shows that majority rule with a multi-dimensional policy space is unlikely. Many of the political institutions discussed in this paper solve this problem. For example, most political systems grant agenda setting authority to some elected officials but not to others. Those officials can make take-it-or-leave-it offers to other policy makers, thus offering an institutional solution to the problem of policy instability introduced by politically targeted transfers. Such institutional innovations tend to give rise to their own distortions.

<sup>24</sup> That is, for any amount of tax revenue, a small group of  $k$  swing voters would prefer transfers to public


electoral promises to narrow groups of voters, they might prefer to make promises that benefit these voters exclusively.

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good provision as long as  $V_g < 1/k$ , where  $1/k$  is the marginal utility gain for members of this group of an additional unit of transfers to them.

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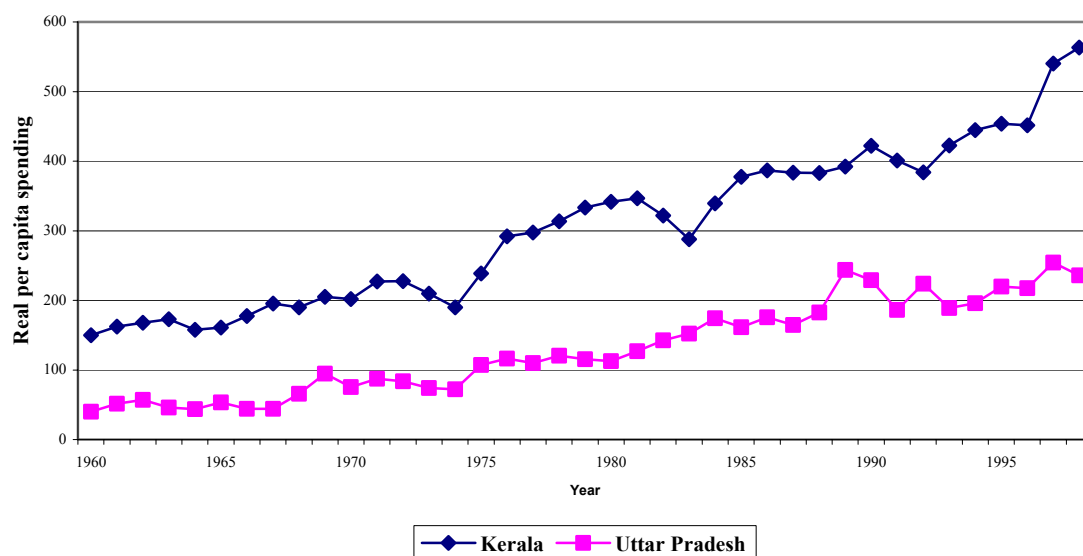
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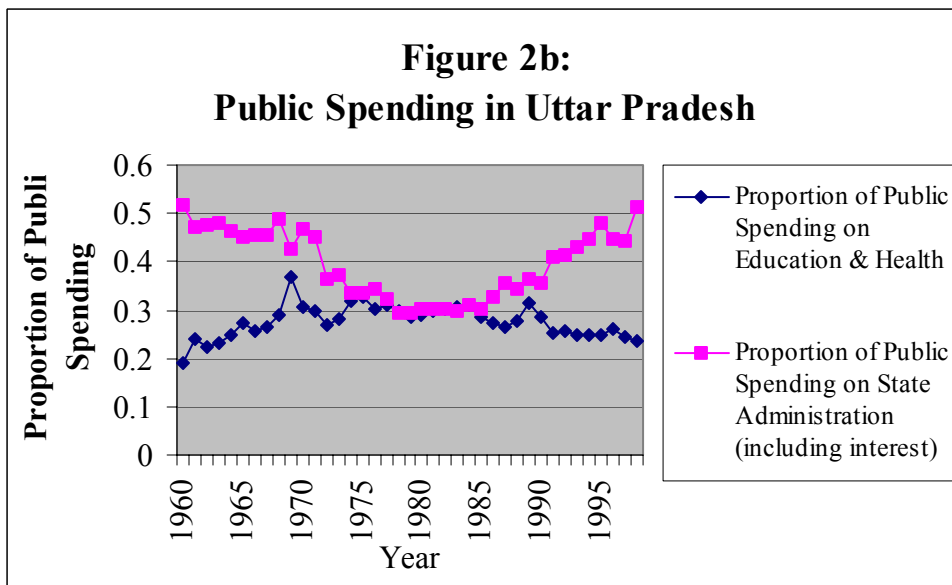
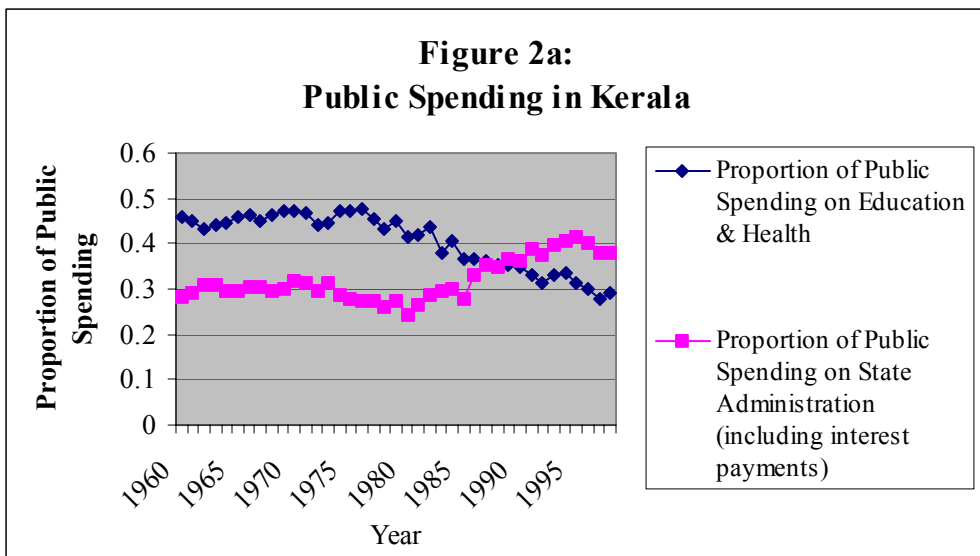
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Figure 1: Public Spending on Health & Education (Per Capita 1992 Rs)



Source: For nominal public expenditures, Reserve Bank of India Bulletin, various issues. Public spending data refers to spending on the current account, the largest category of state government expenditures which includes the bulk of spending on health and education. Price deflator and population from World Bank India Poverty Database (Ozler et al, 1996).



*Source: Reserve Bank of India Bulletin, various issues. Public spending data refers to spending on the current account, the largest category of state government expenditures which includes the bulk of spending on health and education.*