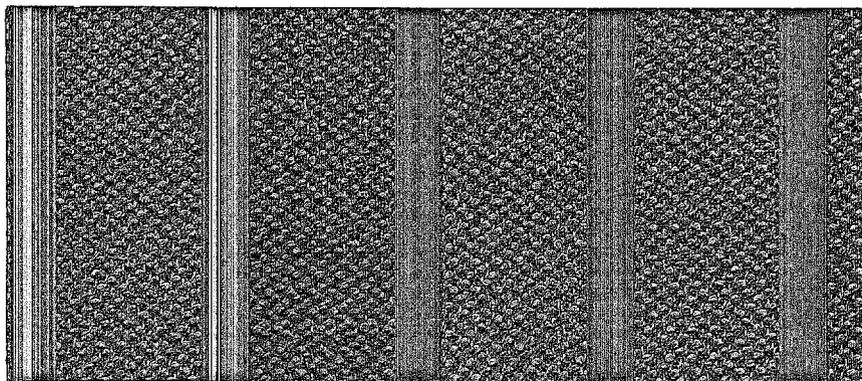


# DEMOCRATIZATION



# ECONOMIC REFORMS AND DEMOCRATIC TRANSITIONS

*Summary of a Workshop*

Christopher Sabatini, editor

Panel on Issues in Democratization  
Commission on Behavioral and Social Sciences and Education  
National Research Council

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## **BACKGROUND**

The need to better define and understand critical issues regarding the politics of economic reform has gained renewed urgency. Recent events in Eastern Europe, Latin America and the newly independent states of the former Soviet Union have emphasized the close relationship between economic reform and democratization. An unprecedented number of countries around the world are attempting to implement dramatic market-oriented reforms at the same time that they are consolidating fragile democratic systems. The relationship between these two processes is not always easy. The short-term effects of market-oriented reform programs often lead to the deterioration of material conditions in many sectors in society. In the longer term, reform policies may also threaten the effectiveness and accountability of democratic institutions and of the state itself. These possible consequences jeopardize not just the popularity of the government in power, but also the consolidation of democracy in many of these countries.

As part of its Democracy Initiative Program, the U.S. Agency for International Development (A.I.D.) requested the assistance of the Commission on Behavioral and Social Sciences and Education of the National Research Council's Panel on Issues in Democratization. In November 1992 the panel organized an expert meeting on the politics of structural adjustment. The meeting brought together a group of experts in the field of structural adjustment with senior A.I.D. and other U.S. Department of State managers and policy analysts. The Panel on Democratization asked the experts to report on recent research in this topic to identify and explore concepts and strategies that donor countries would find useful to assist governments to sustain both economic reform policies and democratization. The experts were also asked to identify new areas of research that could provide greater operational guidance for donors and for governments.

What follows is the summary of that meeting. The meeting agenda requested that each of the speakers address the same set of specific questions in regard to the topic, and this report divides the meeting into the themes covered by the participants. These topical summaries reflect both the expert presentations and the questions and discussions that developed on those subjects.

## **- STAGES AND PACING OF REFORMS**

Most of the workshop speakers opened their presentations with a discussion of the stages and pacing of economic reforms. The experts agreed that what they see emerging is a two-stage process of initiating and deepening economic reforms. There was less agreement, however, on the strategy for initiating those reforms.

### **Stages**

In her presentation, Joan Nelson emphasized that much of the early work on economic reforms focused on the launching and initial stages of stabilization and market-oriented policies. With the passage of time, however, there has been clear recognition that the process of sustaining and deepening these reforms, particularly in a democratic context, is a long-term process. Robert Kaufman referred to these two stages as the initiation and consolidation of reforms. Each stage involves different ways of organizing power. Most of the earlier research indicated the importance of the concentration of executive power for the initiation of reforms. The

consolidation of reforms, however, typically involves more actors and requires considerably more institutional change.

First-stage reforms usually include stabilization programs and such measures as the liberalization of prices, currency devaluation, tightening of monetary policy, and perhaps partial or substantial trade liberalization. Implementation of these measures typically involves only a small circle of actors within a government. Moises Naim referred to these early reform policies as “decree driven” reforms. Administratively, policies in this first stage are very easily set in motion: implementation usually requires only a cabinet meeting and the signing and printing of a decree. Moreover, research and experience indicate that centralized policy making within the executive branch may be necessary in the early stages of adjustment. The launching and maintenance of reforms often require some mechanisms to insulate executive power from interest groups and political forces. Governments often launch reform programs during the initial swell of popular approval following elections. The temporary support, and perhaps the success of early reform policies, may provide the government a short-term mandate to consolidate power in the executive branch, often at the expense of legislatures, interest groups, and local governments.

Second-stage reforms—the consolidation stage—differ in important respects from earlier tasks and often pose new challenges to the government. To sustain and deepen economic reform is often more complex technically than initiation, and second-stage reforms have different implications for power relations within a society. These reforms include financial sector reform, privatization or rationalization of state-owned enterprises, restructuring of social services, and, particularly in Latin America, Eastern Europe, and the former Soviet Union, opening up labor markets. These measures involve considerably more actors—not just in the design and the setting in motion of governmental policies, but also in how they impinge directly on affected groups. For example, the social programs in education and health targeted for large-scale reforms are often run by large employers with powerful unions that will tend to protest reform efforts. Consequently, consolidation of reforms involves broader forms of participation, cooperation, compensation to losers, mechanisms for bargaining, and often reductions in executive power—particularly in the personal authority of executive power.

In these cases, the power accumulated during the first stage may need to be scaled down or reoriented. Centralized executive power in the initiation stage is no guarantee that reforms will be successful. On the contrary, it can lead to abuse and dangerous long-term trends of isolated authority. In the consolidation phase, executive power can isolate the government politically and become a liability. The initial series of decree-driven reforms may create the illusion in the executive branch that a government can implement reform without dealing with the messy dynamics of legislatures or constituencies, the judiciary, or local governments. In the consolidation phase, however, the government will find that it will have to enter into processes of negotiation and compromise and consensus building. This often occurs at the same time that the political context for reform is changing. New elections may approach. The temporary wave of popularity may have passed, and groups that oppose the reforms may have had time to organize and build support.

Consolidation reforms are also less technically clear-cut. Initial macroeconomic reforms usually are guided by some fairly well-defined and accepted ideas about macroeconomic management. Later stage reforms are different and in many ways more complex. There is a weaker theoretical foundation for these reforms, and, consequently, policy prescriptions are not as clear. How does a state go about rationalizing or privatizing state enterprises? What ought to be done about social services? For many of these issues, there is no single economic blueprint.

Despite these difficulties in the consolidation of reforms, the experts agreed that recent

experiences in many countries may also ease the tasks of sustaining and deepening structural adjustment. Most of these countries have experienced profound economic crises prior to the initiation of reforms, and many have previously launched reforms. For many of these countries, economic adjustment is not a new phenomena. The experiences and the lessons learned from past events will shape and influence the course of future efforts. Moreover, the broad trend over the past decade has been toward a growing awareness of some of the problems of state-led, inward-oriented models. In some cases, such as Argentina, which experienced severe hyperinflation, there has been a recognition of the need for dramatic change. The depth of the economic crises in some of these countries may promote the implementation of reforms as the population recognizes that adjustment demands dramatic change and reform. Nevertheless, Nelson advised that one should not exaggerate this trend; in particular, that one must recognize that it leaves immense scope for intense disagreement on the timing, phasing, and design of particular policies.

Market-oriented reforms can initially hurt more groups than they help. Support among groups that stand to benefit depends on their confidence that reforms will be carried through and the knowledge of how they will benefit. In some cases, beneficiaries may not even be aware of who they are. Nelson explained that public reactions to reforms are influenced by their perceptions of several factors: the need for far-reaching economic reform; whether the government has a plausible game plan; whether the government seems to have a longer run strategy for the country's future (which is not the same thing as a structural adjustment program); and fairness—whether the rich are escaping their share of the burden or not. All of these factors have policy implications (see below).

### **Pacing**

John Waterbury began his presentation with a summary of a recent debate over the economic reforms in Russia. The discussion focused on the strategy of implementing and consolidating economic reforms. The debate and discussion suggest that experience has not led to an understanding of what sustains economic reform efforts. Waterbury outlined two types of strategies or approaches. The first is the *blitzkrieg* or radical program. The radical program justifies its approach on three assumptions: first, much of the pain of adjustment has already been experienced by those that have to go through it; second, it will be easier to finish the pain of adjustment as quickly as possible, swallowing reform measures as a bitter pill; third, politically, by initiating reforms quickly, economic agents will not be able to anticipate or vitiate the reform measures.

Waterbury said that following the recent events in the former Soviet Union and Eastern Europe, the radical approach has been fully discredited. There is not one country that has engaged in this strategy that has been able to sustain it and bring about thorough-going structural adjustment. The radical program may launch countries into the initial phase of economic reform, but it is very hard or impossible to sustain this approach through the consolidation phase.

Waterbury noted that most reform packages tend to erode or eliminate entitlements that are politically crucial to sustaining incumbent political powers. Consequently, radical reform is most feasible for challengers, opposition groups, or leadership teams that have not been included in the original distribution of entitlements. These outside actors can come to power either through quasi-legal or illegal means (typically a coup d'état—for example Pinochet in Chile or the military in Turkey) or, occasionally, through elections (for example, in Sri Lanka,

Philippines, or, more recently, Peru.) These outsiders are groups that have not benefitted directly from existing distributive entitlements and they therefore have a much freer hand, at least initially, to shake up patterns of resource allocation. For this reason, outside challengers have greater liberty to consider shock therapy or *blitzkrieg* tactics. Shock therapy, in these cases, may have an economic as well as a political logic to it: not only might reforms produce economic benefits, but they also destroy the political base of the groups that these challengers are trying to displace.

Waterbury stressed that a more gradual strategy is usually pursued by leadership groups within the system. Because economic and political bases of support for these groups may depend on the existing system of resource allocation, issues of sequencing economic reforms and trying to estimate their political consequences is crucial. Inevitably, these incumbent governments try to maintain to some extent the entitlements and support of groups that have built their claims over a long period of time and have brought them to power.

Naim took exception to Waterbury's assertion that radical reform strategies are completely discredited. He noted that in many countries the option of pursuing a reform policy gradually does not exist. In order to initiate and sustain reform, there must be a state that is capable of fine-tuning and making complex adjustments. The gradual implementation of complex reforms demands that organizations have a capacity to coordinate, communicate, gather information, and link information to decisions. At the same time, states embarking on a program of gradual reform must neutralize the efforts of those in opposition. For many states, however, this is simply not possible. Most of the states undertaking reform have lost even the capacity to perform such simple tasks as collecting money from toll roads. They surely lack the strength and the management and technical capacities necessary to carry out gradual economic reform. Thus, Naim warned, one has to be careful of recommending a gradual approach when it may not be an available option.

Naim also advised that analysts abandon the dichotomy—even if he is using it for the sake of brevity—of gradual versus shock approaches. Characterizing the strategies as polar opposites and referring to them with such broad labels masks understanding more than it helps. In fact, most economists still have not clearly defined what elements of reform constitute a shock approach. One needs to begin by dissecting what is meant by “reforms” and understanding that reforms imply a whole set of policy changes: each reform has its own political economy, its own technical conditions, and its own administrative preconditions. Lumping all of the policy changes under the umbrella of reforms blurs any analysis.

The workshop discussion on the issue of the pacing of economic reforms showed that the debate between radical and gradual reform strategies has not been settled. Various countries have had different outcomes, depending on the economic conditions before the initiation of reform, the institutional structure of the reforming country, strategies of the leaders in power, and popular public reactions. As a result, no clear conclusion concerning the pacing of reform has been reached by either analysts or managers.

## **ECONOMIC REFORMS AND THE STATE**

One topic that arose several times during the presentations and discussions was the relationship between the state and economic reforms. There was a consensus among the experts that there is a need to view the politics of economic reforms in the broader context of the crisis of the state. Fiscal and political crises have reduced normal governmental operations to ineffectiveness in many countries, and, in some cases, to the point of corruption and decay. This

condition tremendously complicates the introduction of new responsibilities and the carrying out of necessary functions and changes.

The speakers agreed that one issue under this topic is the problem of reforming public-sector unions. An important component in the consolidation of reforms is often the opening up of labor markets. The state's relationship to unions however, frequently hinders state actions in these reforms. Although the initiation of reforms often generates resistance, organized opposition does not effectively emerge until the consolidation stage. The time span between initial implementation and the second stage of reform allows opposition to the government to strengthen and organize. This organized opposition limits the government's discretion and power when it seeks to open labor markets. The state finds itself significantly weaker as it attempts to take on a reform that may be politically explosive. If the state does take on the issue of labor markets, the government often finds it easier to tackle private labor markets than public-sector labor markets. As a result, public-sector labor laws and rules are left basically untouched. What results is a situation in which public workers have instant tenure, bargaining is poorly regulated, labor taxes are extremely high, dismissal costs are enormous, labor mobility is rarely restricted, and wages are essentially not linked to productivity.

Leaving public-sector unions untouched confines the government in its pursuit of other reforms in the public sector within a framework of highly rigid and nonfunctional labor conditions and labor laws. In most developing countries, two of the largest employers are the ministries of health and of education. They are usually highly unionized labor institutions and therefore highly politicized, and their bargaining power vis-à-vis the government is enormous. This power hampers the state's ability to provide social services and makes it more difficult to build safety nets to ease the implementation of reforms. One way around this is to develop compensatory programs outside of the institutional structure of the state (see below, "Compensatory Programs").

A second issue related to fiscal reforms for the state is what Naim called the "paradox of the forgotten price." The slogan of reforms among politicians is often to get prices "right." The goal is to establish realistic foreign exchange rates, interest rates, etc. But the salaries of high-level managerial positions in the public sector are never commensurate with those in the private sector; public-sector wages for managers always lag behind private sector wages. Reforms have the effect of liberating managerial markets in the private sector: the demand for managers increases, driving up the wages and creating more opportunities for managers in the private sector. At the same time, austerity policies in the public sector create a ceiling for the salaries of public-sector managers. It becomes very difficult for the state to attract and maintain the kind of human resources that are needed to implement the complex programs in economic reform policies.

Naim also raised the issue of crime and public order during periods of economic reform. Increases in crime rates are often the result of poverty and unemployment and the deterioration of the law enforcement and judicial systems in many countries. This problem of public order is having serious political consequences in many countries, frustrating the economic reform process and threatening the survival of democracy. If people associate free markets with increased crime and corruption, they may oppose the implementation of further economic reforms. And if a regime cannot maintain public order, citizens may opt for security over democracy.

According to Nelson, much of the crime problem flows from the disintegration of a variety of state functions. In the "lost decade" of the 1980s, for example, many Latin American states lost the capacity to provide effective police and judicial services. This occurred when many people had been displaced by structural adjustment policies and so economic inequalities appeared greater. Citizens who find legal economic opportunities closed down may find

criminal activity more attractive. The threat of punishment for potential criminals decreases with weakened, corrupt police forces, ineffective judicial systems, and overcrowded jails. At the same time, police forces themselves have become threats to public law and order. The corruption of police forces in many developing countries has made it difficult for them to maintain a police force that is any more credible than the criminals. Dramatic decreases in the wages of civil servants during economic reforms have provided police with a tremendous incentive, given the available opportunities, to engage in extortion and other illegal activities. As a result, the police in many developing countries have become a predatory force. Although most of the workshop participants agreed that police violence and corruption threaten the legitimacy of a fragile democracy, Waterbury reminded participants that these features have been a common characteristic of democracy in India, and they seem not to have seriously undermined the democratic system.

All participants agreed that in most cases market-oriented reforms mean that the states cannot deliver many basic services. In many reforming countries, the provision of services has slowed down or ended because the states are out of money. Kaufman referred to this situation as the conflict between the exigencies of stabilization and fiscal adjustment and the exigencies of keeping the state alive to deliver the services that it must. Within this struggle to reform state fiscal excesses and still provide necessary public services, there are certain actions that states and the aid community can take. States can develop mechanisms for systematically setting priorities for expenditures. This may prove very difficult since setting priorities will touch on political issues, but it may be the most effective method of ensuring that some of the most important services reach the public. For the aid community, these kinds of areas—police, education, health, poverty alleviation—may be those for which short-term monetary relief can help to alleviate some of the fiscal pressures and improve the capacity of a state to deliver needed services. Both democracy and the economic reforms process can be strengthened if citizens perceive that the state can effectively provide these basic public services.

## **COALITION BUILDING**

### **Who Supports Reform?**

Questions about the sustainability and consolidation of reforms leads to discussions of who supports the reform process. Irrespective of whether the implementing government is authoritarian or democratic, successful consolidation of economic reforms requires some bases of political support. The discussions on this topic focused on how to analyze how groups will react to particular reforms and on how the groups and coalitions that may support economic reforms can be developed or strengthened.

Kaufman noted that economic interests are not a very good short- or medium-term predictor of an actor's responses to economic reform. Although some literature uses this basis for analysis, Kaufman said his research indicates that responses to reform measures depend on more than an actor's role in the process of production and distribution. Obviously, these interests play some role, but there are other factors that influence responses. First, the effects of reform are often ambiguous. This ambiguity affects how individuals weigh the potential costs and future gains of economic reforms, regardless of immediate short-term economic impact. If citizens are confident that reforms will be carried out and will improve their standard of living, they will value future consumption as much as present consumption. If, however, they lack faith

that the reform process will be successful or will produce results, they may place a higher value on present consumption (see Przeworski, 1991). Second, the way in which actors define their interests often depends on their institutional environment: whether the actors are organized, the way in which they are organized, and how they are linked to the political system. For business groups and labor groups, a great deal depends on the organizational framework in which they operate and the way in which they are linked to the party system.

For labor unions, their role depends on whether and how they are linked to the governmental authority. This linkage will often affect a union's perceptions of return over the long term and therefore its willingness to accept or cooperate with economic reform policies. As examples, Kaufman cited the cases of Mexico, Argentina, and Brazil: the responses of labor unions to the stabilization and adjustment programs in these countries were extremely different, and a large part of the difference had to do with the relationships of the unions to the governing party. Mexican labor suffered economically during the reform programs of the 1980s, yet the unions remained in a relatively cooperative position vis-à-vis the government's program. In Argentina and Brazil, in contrast, labor took a very hostile, confrontational stance through much of the 1980s to similar kinds of programs and policies. The economic interests of the actors may account for some of this difference, but much of it reflects the linkages in Mexico between the labor unions and the governing party, the PRI (Partido Revolucionario Institucional, Institutional Revolutionary Party). These links have helped to create long-term understandings that provided greater incentives for union leaders to cooperate. Conversely, in Brazil, where there are no systematic linkages of consultation or cooptation, there is no institutional guarantee that cooperation in the short term—wage restraint, etc.—will lead to long-term benefits.

Kaufman also added that in the business sector, many businesses in Latin America are multisectoral conglomerates. Because of the size and scope of these conglomerates, sectoral position is not a very reliable predictor of their reaction to trade reform. Opposition or support for trade liberalization may not split strictly along lines of whether firms are exporters or importers; many of the larger conglomerates may contain firms that engage in both activities. In these cases, in order to understand responses to trade reform, it is more useful to look at firm organization and size, rather than sectoral base.

These two cases of labor and business demonstrate rational behavior, but it is a behavior structured around organizational and institutional matrixes rather than strictly economic interests. During economic reforms, the degree of cooperation hinges on the confidence of the actors in future outcomes. How actors weigh present costs and potential future benefits often rests on the opportunities and resources available to the organization rather than its economic position.

All of the participants agreed that who supports the reform process initially depends on the depth of the crisis that precedes a reform effort. It is a bitter irony that to push forward reform, there is a certain desirability to having a profound crisis. It is sometimes hard to launch and sustain the process if the crisis has been marginal. Varying degrees of crisis set the stage for degrees of support and differing mixtures of groups and interests that will support or oppose the reform process. Periods of hyperinflation, no growth, high unemployment, and the inability of the government to deliver services—when they occur together—will initially tend to disarm or neutralize opponents and will provide a period of time before they can regroup. It will also tend to shift popular opinion in the direction of more profound, far-reaching reform. This window of opportunity can allow governments to pursue a reform agenda.

Despite this temporary window of opportunity, however, there may be little organized support for a reform process. Behind the push to reform the economy are often rather isolated leadership groups, generally with the support of the international donor community and international finance. Internally, there is usually little organized support. Consequently,

governments may need to provide economic and political support to certain groups in order to encourage the coordination of new forces and interests. Compensatory programs (such as those discussed by Carol Graham, below) have been used in some countries to hold “entitled” groups in line and to build new constituents for reform. All of the participants also emphasized the importance of developing an effective communication strategy on the part of the government to explain reforms to the public (see below).

Understanding how different reform policies affect economic and social groups influences how governments approach building coalitions and bases of support for adjustment programs. Some groups will tend to benefit from the reform program in general; others will benefit from particular reforms while suffering from others. Drawing from his research, Waterbury highlighted several groups that will often gain economically from some reforms and may support the reform process:

- to the extent that reforms encourage exports, exporters may provide support;
- devaluations will assist migrant workers who repatriate their earnings;
- small-business credit and deregulation will assist the informal sector;
- middle-class consumers will enjoy the benefits of cheaper, better quality products; and
- in some cases, commercial agriculture will benefit.

Many of these groups are often politically unorganized. Economic and political support will begin to provide them some ability to coalesce and express their interests, increasing their political weight in the society. Waterbury noted, however, that much will depend on the response of the economy to the reform measures. Reforms have to produce real growth in the economy fairly quickly in order to provide the government with resources to generate political support. One problem with this approach is that in at least some countries, the economic supply response is going to be slow—particularly in the least developed countries.

### **Role of Communication**

There was a consensus among the workshop participants on the importance of perception and communication during reforms. Participants agreed that how citizens perceive economic reform measures and their effects, how strategies and policies of reforms are communicated to interest groups and the public, and the level of communication and dialogue between interest groups and government affect expectations and reactions to an adjustment program. These factors have a significant impact on the support-building processes that accompany market-based reforms.

Naim discussed the role of the media in the process of economic reforms. Central to popular support for adjustment is the public perception of fairness in the execution of reforms. The public must perceive that the government is both honest and competent in order to agree to withstand the pain associated with the transition. Those expectations and opinions are shaped to a large degree by the media. On the part of the media, however, there are a variety of forces that affect the way they report. One force is the interests of the companies and the conglomerates who own the media: the media may sometimes serve as an instrument for owners to pursue their own political or business aims. Another force is the interests of journalists. Market-oriented reforms often affect journalists as a class; consequently, journalists are often antagonistic to market-oriented reforms. In addition, some journalists are unable to digest and communicate the new concepts, acronyms, and ideas that are often introduced with economic reforms. In this

situation, journalists may be reflecting a state's problem: with the flood of new concepts and technical jargon, governments themselves are often unable to communicate the theory, intent, and expected results behind adjustment policies. Normally, governments recruit technocrats well versed in econometrics and technical ideas, but these technocrats often lack the ability to communicate the concepts behind reform policies in ways that will make them accessible to the larger public. Citizens find themselves in a situation of extreme flux with little basis for understanding the technical rationale or the long-term benefits of economic adjustment. As a result, opposition groups have a greater opportunity to shape popular attitudes and opinions regarding economic reform.

Participants cited the examples of two countries as successful cases of government communication during economic reform. In Zambia, the Chiluba government campaigned on its reform agenda and won on a pro-reform ticket. Once in power, the government made a special effort to articulate to the public the economic measures it was pursuing and explain the expected consequences of policies. Because of this effort, the government was able to implement dramatic adjustment measures without popular unrest. In Turkey, as part of a media blitz, the Turkish government focused on a broad appeal to Turks as consumers rather than as producers. It has worked. If you think of yourself as a worker in Turkey you are doing terribly: your real wages have been going down and inflation is nibbling away at your life. But as a consumer, you can say the country has a better telephone system and better public transport; we've invested in our municipal infrastructure; certain prices have gone down; and with lower tariffs new consumer goods are available at low prices. By selling the reforms in this way, the government has been able to play a role in shaping how citizens perceive reforms.

### **Compensatory Programs**

The issues of the deterioration of state services and of building constituencies for reform both touch on compensatory programs. In spite of a reform process that pares back activities, there develops a greater need for the states to perform critical, basic functions effectively. Services such as health care and poverty alleviation programs can help cushion the shock and disequilibria of reforms. If they are implemented on a parallel track with economic reforms, they can also be used to hold entitled groups from developing opposition to reforms and to build new constituencies for reforms.

Carol Graham discussed the results of her research on the creation and implementation of safety-net programs during adjustment. She drew from case studies of four countries, Bolivia, Senegal, Zambia, and Chile, to discuss the lessons learned from each case.

#### **Bolivia**

Bolivia's Emergency Social Fund (ESF) was the first social fund of its kind. Its success has meant that it has been duplicated both throughout the region and in other regions. The Bolivian government developed the ESF as a demand-based program. Local communities bid for and implemented projects, rather than a central fund dictating programs from above. One of the direct benefits of this structure was that it prevented any one political actor from monopolizing the fund at election time. The program therefore managed to avoid becoming entangled in partisan politics.

By working in a predictable, open and nonpartisan manner with local governments and

nongovernment organizations of all political stripes, the ESF resulted in unprecedented collaboration efforts between nongovernment organizations and the state. These collaborations allowed the fund to reach the poor in remote communities that had rarely seen the state follow through on promises. Bringing these new groups into the system became important for the government. New support for adjustment, or at least for the government that was implementing adjustment, was created among these groups in society that had traditionally been marginalized from state benefits. As the government effectively extended services to reach these groups, it also succeeded in building new coalitions of support. Moreover, the ESF's policy of providing local governments with funds independent of the central government also enhanced local government capacity.

Graham noted that one of the inherent drawbacks of a demand-driven program is its inability to target the poorest sectors. If you look at the breakdown of beneficiaries under the ESF program in Bolivia, most of the beneficiaries were not in the poorest two income deciles. This is one of the problems with what is a very appealing structure for poverty reduction. Demand-based compensatory programs are limited in which groups they can target, particularly the poorest.

## **Senegal**

The Senegalese government made an initial attempt in 1987 to create a program to compensate middle-class sectors affected by adjustment. The program, named DIRE, failed, suffering from corruption and inefficiency. In 1988, in response to massive civil unrest after the February 1988 elections, the Senegalese government made a second attempt to compensate the losers of adjustment and established the Agetip program. Agetip was patterned after Bolivia's ESF as a demand-based program. Like the ESF, it was set up as an independent agency outside the ministerial structure. (The government's experience with the DIRE program demonstrated the importance of administering a program by a private-sector manager outside of state institutions.) The program was widely considered a success in terms of its efficiency and the number of projects implemented. However, also like Bolivia's ESF program, Agetip's demand-based program structure was not able to reach the poorest sectors of Senegalese society. For a variety of reasons, unfortunately, Agetip also missed several of the beneficial effects of the ESF as well: no cooperative relationship between the government and nongovernment organizations developed; the program only dealt with members of the governing party; and because it was operated from a monopolized structure, Agetip did little to develop local institutions and local organizations. As a result, Agetip failed to build any kind of support coalition among the poor.

## **Zambia**

In Zambia, the Chiluba government had campaigned on a pro-market program while also pledging to make a priority of reaching the poor and most vulnerable groups in society. In order to accomplish the latter, when it took office the Chiluba government expanded an existing program. The program funded small projects that helped community organizations revamp existing state infrastructure. Like the ESF program in Bolivia, the Zambian program responded to proposals from communities. It required a 25 percent contribution on the part of beneficiaries in cash or in kind in order to receive government funds.

The program was very important in reviving a community of self-help spirit, in reaching

areas not previously reached by the state, and in creating a base of support among previously marginalized but large groups of poor people. It also encouraged previously marginalized groups to exercise their political voice. The program succeeded in building new coalitions of support among new groups by assisting them economically while also enfranchising them in the political system.

## Chile

Unlike the other programs, the Chilean program was not demand based. When the Pinochet government came to power, it revamped the entire social welfare system and targeted social spending to the poorest groups. This approach was accompanied by large-scale employment programs between 1975 and 1987. At the height of the unemployment crisis in 1982, these employment programs in Chile employed up to 13 percent of the work force. However, these programs had several flaws. The most important was the authoritarian manner in which they were implemented. But this method also had its benefits: although centrally selecting which groups to target precluded beneficiary participation, because of its insulation the Chilean program was able to target the poorest groups rather than the most politically expedient sectors. Even the program's harshest critics agree that the scale and duration of the programs in Chile reduced the potential for social explosion at a time of unprecedented unemployment during economic adjustment.

Graham noted that there have been several lessons learned regarding the implementation of safety-net programs:

- Openness and predictability of programs is very important. The public has to perceive that compensatory measures are honest. For this reason it is necessary to make it publicly evident who the measures are benefiting and why, so that people are not suspicious and think that others are benefiting at their expense.
  - Involving the poor in the design and implementation of programs is very important, both for sustainability of programs and in enhancing political voice among new groups.
  - Compensatory measures have to be implemented as an integral part of the reform program, for two reasons. First, initiating compensatory programs that are parallel to reforms ensures that governments and donors have a stake in the poverty alleviation programs—which is usually not the case. Second, compensatory programs give beneficiaries the perception that they have an interest in the ongoing process of reform. In the Zambian case, adjustment reforms and compensatory programs were sold at the same time, as one package. This mattered for the beneficiaries who saw the government's community development efforts tied to the success of reform.
  - Political context makes an enormous difference in the possibilities of redirecting resources to the poor. Attempts to buy off vocal opponents of adjustment tend to be expensive, and they have a relatively poor track record. Such groups are likely to remain opposed to adjustment regardless of compensation.
  - Less open political systems give entrenched interest groups much greater opportunities for protecting their positions and allow fewer opportunities to compensate poorer groups and build new coalitions in favor of reform.

On the issue of what groups governments should target for compensatory programs, Graham suggested that targeting the poor is the most effective for three reasons. First, in

developing countries in which poor and marginalized people are in the majority, it makes sense ethically and economically to target them. Second, it is too general a conclusion to assume that the poor are untouched by economic reforms or that they automatically benefit from them. In many African countries, price increases generated by reform policies negatively affected the urban poor. In Latin America, there is a large mass of urban poor people who very strongly feel the negative effects of adjustment. In Peru, for example, structural adjustment policies have wreaked havoc with the living standards of the urban poor. Third, from the standpoint of political sustainability in Latin America and Africa, where the poor are a big majority and the privileged and powerful are a minority, targeting the privileged and powerful is unlikely to be the most effective strategy. The privileged minority will not enjoy the same status under the new system; consequently, it will be very difficult to buy them onto the reform game. Meanwhile, the poor majority has everything to gain and nothing to lose from reform. Focusing on that majority, and at the same time trying to bring them in to the political system by providing them with an effective political voice, may accomplish more in terms of political sustainability.

Later discussion made a distinction between the poorest of the poor and the poor groups directly affected by economic reforms. Even if one accepts that targeting the poor is the most effective route, there are still questions of who are the poor and which poor. Reaching the poorest people in rural areas takes more time and resources than reaching other groups. By definition, resources during times of reforms will be too scarce to build broad-based support. If a safety-net program is to be used for the purpose of building political support, then it must target select groups of poor. This selection will often be politically determined. A majority of the participants agreed that it would be more effective and efficient to target the affected poor rather than the poorest groups. In this sense, there may be a tradeoff between political concerns and welfare concerns.

Naim noted that another possible group for compensatory programs is the military middle class. In discussion of the sectors affected by economic reforms and austerity measures, the military middle class is usually neglected. When governments trim military budgets under fiscal austerity measures, food and other services for soldiers and others in the military usually suffer the largest share of the reductions. The middle ranks of the military often have a difficult time weathering these fiscal cuts under adjustment. Naim said that this is an important issue for governments and donors to think about in compensating for the effects of reform.

### **New Constituencies for Reform**

The lack of organized support for economic reforms in developing countries raises the question how to build coalitions that support reforms. Waterbury described the efforts of the Salinas government in Mexico and the military government in Turkey to build bases of support for their economic program.

For 12 years the military and civilian governments in Turkey have tried to shift to a new coalition of interests. To accomplish this, the government has used compensatory or redistributory resources in a highly targeted way to try to organize these interests. The government has had some success: its efforts have prevented the reform process from breaking down, but there has been little payoff in electoral terms. From the outset, it has been a gradual process that has been sustainable and has brought into the political arena with considerable weight actors who did not play much of a role in the 1960s and 1970s. The coalition is a large conglomerate of exporting and manufacturing groups. In addition, the government has managed

to maintain in the coalition small-scale entrepreneurial groups that produce for the Turkish market by providing them with a small degree of compensation and protection from trade liberalization.

In Mexico, Salinas sought to maintain parts of a broad-based coalition, such as the unions, while moving the coalition in the direction of reform. At the same time, Salinas also reached out to new constituencies, some of them based on a number of organizations that sprang up in the wake of the 1985 earthquake. Salinas recognized these new neighborhood and peasant groups as an opportunity, and through Mexico's social fund brought the groups into the system in an openly political way. This approach has broadened his political base of support for reforms.

Waterbury stressed, however, that because resources are so scarce, these coalitions are always going to be fairly narrow. The governments lack the resources to develop very broad-based coalitions. Part of the strategy, then, is also neutralizing other elements in society to ensure that they do not shift into open opposition. Although these strategies have proven effective for host countries in sustaining reforms, most of the participants cautioned that external efforts to build coalitions in support of reform would appear as meddling or interventionist. The role for outside actors in this field is very limited. Nelson recounted the recent efforts of President Menem in Argentina to reform labor markets. Through a series of negotiations and bargains, Menem was able to neutralize union opposition to labor and social security reforms. The lesson, according to Nelson, was that there was little that any outside organization could have done in the situation. The factors that make coalition building possible are often internal to the country. It may be useful for A.I.D. and other donor agencies to understand these processes, and at times there may be an opportunity to assist reform-minded governments. But Nelson noted that she was uneasy with the idea of A.I.D. attempting to engineer or contribute to coalition building.

Graham made a distinction between the two types of coalitions being discussed and the roles of external actors in each. The first are those at the grass-roots level, where people establish the capacity to assist themselves economically and become involved in the political system. She cited her examples of compensatory programs and Waterbury's example of Salinas in Mexico. These are not central-level coalitions, but they are coalitions of support. Such bases of support can be a neutralizing factor, and they may be important in countries in which there are regular elections to prevent broad electoral swings away from reform. A donor organization like A.I.D. could become involved in this type of activity without the accusations of meddling in politics. Second, in the instances of larger coalition formation, A.I.D. could play a role by explaining the tactics and policies of other countries to interested governments and groups. That, too, would be an effective and nonpolitical way to become involved.

Echoing this point, Kaufman related a story about Mexico. Many of the economists in Mexico in 1988 had been involved in networks of conferences and think tanks prior to and during the country's economic reform program. The contacts the economists gained through these organizations allowed them to draw extensively from the experiences of other countries for Mexico. Kaufman suggested that this concept could be broadened to include not only economists, but also political scientists and politicians. Such an approach would allow one country's officials to observe and study the experiences of other countries. This in fact may be better than outsiders' saying what coalitions should form.

## PERFORMANCE BUDGETING AND INSTITUTIONS

### Performance Budgeting

For the aid community, support for democratization and economic reform raises questions of tying foreign assistance to a country's policies in these areas. Most of the participants noted that the occasional tensions between economic reform and democracy may complicate any effort to condition assistance on the basis of these two criteria. Several different opinions and suggestions emerged on this topic. Discussion focused on the merits of conditioning aid and how to best measure the political sustainability of reform.

Kaufman noted that foreign assistance conditioned on democracy may be effective for setting the context of reform. But he cautioned against linking aid to specific steps a government should take, such as the promise of more aid if a government decentralizes. The purpose of conditioning aid should be to raise the cost of repression. If donors express to governments that there will be a cost if they engage in certain types of repression, it will enter into their calculations of how to treat their populations. However, donors also have to recognize that in the context of structural adjustment, selective repression may have some benefits. In the case of Bolivia, the state of siege and the arrest of union leaders in 1985 gave the government a freer hand to push the reform process along. In these instances, Kaufman suggested, what may be important is that the government undertook the measures within democratic institutions, seeking legislative approval for its actions.

For A.I.D., however, the primary issue is often not conditionality of assistance: the amount of money that A.I.D. provides to countries often does not constitute enough to work as an effective carrot or stick. Instead, a more relevant issue is how to measure the sustainability of reforms for the allocation of aid. The U.S. Office of Management and Budget (OMB) is requiring A.I.D. to identify characteristics of countries that indicate the effectiveness with which they implement and pursue economic reforms. Within that effort, the question becomes whether there is a method by which A.I.D. can measure the political sustainability of reforms.

Nelson responded that developing and applying such an index would not be advisable. First, the effectiveness measure implied by the OMB index indicates that the goal of A.I.D. is economic development, when, in fact, A.I.D. has a variety of goals—chief among them is U.S. foreign policy objectives. Second, Nelson doubted that there are indicators that can forecast, even for the short run, if a very promising program is going to collapse or if a currently difficult situation is going to clear up. Relying on a rather simple formula is going to lead to a lot of mistakes.

Most of the participants agreed on this point. Nonetheless, Kaufman outlined four criteria that could be used to develop a system of indicators to measure the political sustainability of reforms. First is quality of data: how good is the quality of political and economic information available to the government? Second is the existence of communication channels with affected groups. In the case of dictatorships this may mean the business groups, but at the very least the government should be getting feedback from the private sector. Third is the degree to which recruitment into the decision-making bureaucracy is meritocratic: are there some kinds of standards for promotion and are those followed? Finally, to what extent does this program rely on the systematic application of coercive mechanisms? A highly repressive government probably will not last.

## Institutions

Over the course of the workshop, several participants touched on institutions: issues of the degree of openness of institutions and institutional design were brought up in several of the presentations and during group discussion.

Kaufman summarized the current debates in political science about constitutional design. Some of the current interests in the field include the debate between the merits of presidential versus parliamentary systems, the extent of presidential versus legislative power, and the relationship between a central government and local units of government. Most of these debates center on the balance of power in government. One of the hypotheses that is emerging from the debates is that excessive centralization of the executive reduces the incentives for compromise and consensus building needed for democracy and for consolidation of reforms. Another hypothesis asserts that a high concentration of power in the central government can increase the stakes of political conflict that may destabilize democratic consolidation. In this case, devolution of power to local and municipal governments may provide a more constructive context for compromise and consensus building. Kaufman cautioned that many of these hypotheses about centralization have specific implications for reform, and one needs to be aware of them. Kaufman cited the cases of decentralization during the 1980s in Argentina and Brazil: in these countries, institutional changes designed to provide greater control for provincial and municipal governments over budgets later impeded fiscal reform and control efforts by the central government. Democratic reorganization and rules may have positive effects at some steps of the reform process and negative effects at other steps. There are also going to be tradeoffs in the institutional choices made from the perspective of democratic reform and structural adjustment programs. Policy makers need to be aware of how these factors interact.

A majority of the participants raised the issue of the long-term danger of centralized authority. Although some degree of insulation and autonomy may be necessary to initiate reforms, the consolidation of reform requires more communication and consensus building. Failure to make this transition may threaten the success of reforms. Rigidity may set into a political system during the course of economic adjustments. In these cases, the focus should be to discourage rigidity while not undermining the reform program. For example, efforts to privatize businesses in Argentina in the initial phases were terribly corrupt. Encouraging openness in this case might have prevented some of the problems that arose later. The goal should be to try to find methods by which governments can carry out activities in ways that are not be manifestly corrupt or lead to an excessive personalization of authority.

Regarding the insulation of central banks, Kaufman noted that in theory this may be attractive. History also demonstrates, however, that when there is no broad support or political consensus about their desirability, strong financial institutions are not likely to survive. Simply making the central bank autonomous will not guarantee its effectiveness or longevity. The nationalization of the once strong Peruvian central bank in the 1980s is a prominent example. Institutional reforms at that level are important, but there has to be some political consensus if they are going to last.

One of the future directions for research in this area will be on the design of institutions. What is the role of designing institutions for choice and structuring incentives for reform? More specifically, what institutional frameworks can optimize opportunities for governments to innovate and to engage in corrections and also encourage democratic competition that is not polarized and that moves towards general conciliation?

## CONCLUSION

All of the workshop participants agreed that recent experience and research demonstrate that the reform process is a long-term effort. As noted throughout the workshop, the implementation of market-oriented reforms can be thought of as a two-stage process of initiation and consolidation. Each of these stages contains a separate set of reforms. Second-stage reforms are often more technically complex, involve greater institutional change, and require different mechanisms for their design and management. One of the most difficult dilemmas facing governments as they seek to consolidate economic reforms will be that of balancing the need for insulation and strength with increasing demands for participation and negotiation. Tackling pressing reforms, such as labor market deregulation, requires government autonomy from interest groups and opposition pressures. But in many of the reforming countries the political environment for reform has changed, popular support for reform has faded, and new opposition groups have emerged. Many of the reforms that lie ahead for these governments will involve a wider set of actors and interests. These conditions demand that governments now engage in consulting, bargaining, and cooperating with outside groups. Inevitably, these processes will limit the power of a reforming government.

Although no consensus emerged among the participants regarding the pacing of reforms, the participants did agree that a more important issue is the strategy of governments in seeking political support for reforms. Whether undertaken radically or gradually, reforms will fail unless governments make a concentrated effort to seek or attempt to construct constituencies that actively support the reform policies.

The pace and character of reforms also affects the possibility of redirecting resources to previously marginalized groups. Rapid and dramatic political change, as in the case of Zambia, provides opportunities to redirect resources to previously marginalized groups. Slowed or stalled adjustment efforts allow privileged groups more opportunities to protect their monopoly of state resources.

All of the participants spoke of structural adjustment and reform in the broader context of the crisis of the state. This crisis involves several obstacles that states face in reforming institutions, maintaining an effective civil service, and delivering basic public goods. The paradox in structural adjustment policies is that typically weak states must perform tasks that require a high degree of autonomy and effectiveness. And this task is being undertaken in many states in the face of budgetary constraints that have resulted from austerity measures. One expert proposed that for donors, providing brief monetary assistance in such areas as education, health, law enforcement, and poverty alleviation will improve the ability of states to deliver these services.

A large part of the presentations and discussions focused on the building of coalitions for reform and the role of external donors in that process. The meeting emphasized three methods of building or assisting coalitions in support of reform. First, groups and sectors that support reform policies and emerging political interests need to be encouraged and given greater weight in the political system. Second, compensatory programs can serve as a political tool during times of reform to ensure that previously marginalized groups have a stake in the reform process. Programs of this nature can achieve the greatest political effect by targeting the poor directly affected by economic adjustment, rather than the affected middle classes or the poorest groups who often live in rural areas.

Third, all of the participants raised the significance of perception and communication during the reform process. How the public perceives reforms will be critical to their success. Whether it is the media or the implementing government that help shape these opinions becomes

a key issue. Participants noted the examples of Turkey and Zambia as instances where the governments successfully played a role in defining how citizens understood and received reforms. The participants noted, however, that given the nature of economic reforms, coalitions in support of adjustment will always be quite narrow. Ultimately, the capacity of a government to build and maintain coalitions of support will depend on how quickly the reforms produce results.

On the role of donors in building coalitions, discussion centered around the issue of neutrality. For an outside actor to become involved in the internal processes of political coalition building risks accusations of meddling. Given these considerations, the meeting highlighted three points in the reform process at which donors can play a role. First, donors can assist in the creation of grass-roots support for reforms through compensatory programs. Such programs will both cushion the shock of adjustment measures and bring new groups that support economic reform into the political system. Second, donors can encourage the communication of experience and information to interested actors, for example, to policy makers and journalists. Understanding the accumulated experience and knowledge of other countries in implementing and sustaining reforms can assist new governments in designing policies and strategies in their countries. Third, external groups can also play a role through mediation or conflict resolution efforts by bringing groups together in the reforming country and encouraging communication.

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