FOREIGN AID AND THE POLITICS OF PARTICIPATION IN ECONOMIC POLICY REFORM

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ABSTRACT
Research suggests that borrower ‘ownership’ of reforms is highly correlated with the success of reforms in developing countries. One of the most important components of ownership is the nature of public–private relations and consultation with interest groups. Yet participatory reform must overcome several political dilemmas, including problems of credibility, collective action, and distributive (in)justice. The characteristics of reforms also affect the possibilities for participation. Democratic governments interested in making policy reform more participatory and presumably more sustainable can draw on several strategies, including the selective use of incentives and compensation, public education and communications, capacity building in society, institutional mechanisms for consultation, and political sequencing of reforms. These strategies have implications for the foreign aid agencies who often fund reforms. They suggest that donors need to recognize the political rationality behind cross-payments and spending to maintain important constituencies; that political sustainability may require reform sequences that are out of step with current orthodoxy; that policies ought to create winners before creating losers; that democratic consultation will require much more time in achieving consensus; and that outside actors need to refrain from intervening too directly in the political process by throwing their support behind particular interests. Copyright © 2000 John Wiley & Sons, Ltd.

INTRODUCTION
Newly democratic governments in developing countries face pressures for more participation in economic policy making from below, by their people, and from above, by aid donors. Yet allowing broad scope for participation in economic policy creates a set of dilemmas for democratic governments and donors. Coalitions of various interests are critical for supplying the support democratic leaders need to get their reforms through the legislative process and to maintain reforms during implementation. Yet narrow constituency demands may derail reforms that would be in the long-run public interest. Interest groups frequently possess the technical knowledge required to make some kinds of reform feasible. Yet government–interest group relationships that are too close create the danger of ‘capture’ where agencies begin to identify more closely with their clients than with the public interest. Interest groups articulate the needs of important societal groups and provide channels for negotiation and mediation between their constituencies and government. But they can also ‘radicalize and promote conflict’ (Nelson, 1994, p. 150).

Growth may be critical for sustaining democracy in poorer nations. Recent research by Limongi and Przeworski (1997, pp. 167–169) showed that, over time, poor countries with growing economies were more likely to remain democratic than poor or even middle-income countries suffering economic decline. How are newly democratic governments to reconcile the dilemmas of participation while consolidating their democracies and producing growth? And what is the role of external funding agencies in supporting this process?

This article explores the current state of knowledge about the role of interest groups and constituencies in economic policy reform. It begins by examining the different kinds of reforms and the different kinds of interests, and how they interact. The next section presents some of the typical political problems presented.

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by reforms, while the following section analyzes the experience of managing reforms with greater participation. The final section addresses the challenges for foreign aid in this process.

**REFORMS AND STAKEHOLDERS**

Economic reforms vary on a number of dimensions: purpose, ease of implementation, and phasing. Some policy changes can be done through ‘a stroke of the pen’: devaluation, raising interest rates, or decontrolling fixed prices. Others require much more complex negotiations and institutional changes. For example, privatization may require legislation to clarify and secure private property rights, capital markets, a methodology for assessing enterprise assets and liabilities, provisions for worker retraining, and so on. Reforms also have decision phases, and implementation phases, and the political management of each phase may differ for good reasons.

In much of the world, the first generation of reforms—stabilization—was focused more on the less complex if still highly politicized decisions necessary to achieve macro-economic stability in the wake of the debt crisis. These reforms generally included devaluation, improved control over the fiscal deficit and money supply, and liberalization of trade, interest rates, and most prices. The second generation of reforms involves more micro-economic and institutional restructuring as well as additional liberalization: financial sector deregulation, tax reform, reforms of labour relations, export promotion measures, and social security reforms. Although many governments and their advisers resist the delays and possible dilution that accompany participation in first-generation (stabilization) reforms, consultation and negotiation over things like public and private sector wages can in many cases improve the sustainability of fiscal and monetary discipline. Second-generation reforms frequently require greater technical capacity, feedback and inputs from stakeholders for their successful implementation.

Stakeholders and potential coalition members include those outside of the government: organized labour, the urban ‘popular’ sector; the middle class; professionals like lawyers or physicians; business; farmers; the intelligentsia (including students); and the poor. These groups differ tremendously in their access to information, their capacity, and the resources they can draw on to support participation. Important stakeholders are also located within the government: policy elites or technocrats, public enterprise managers, and the military. International aid agencies clearly also become stakeholders as they join the policy circle with their own agendas, resources of funds and information, and practices of political and economic conditionality. No group holds exclusive ‘veto power’ in economic reform, as there are many cases of governments reforming, or not reforming, despite pressures from multiple powerful stakeholders.

The primary domestic stakeholders are often lumped together as ‘business’ and ‘labour’ but this may obscure the very real differences within as well as between these groups. For example, workers in the formal sector have an interest in maintaining restrictive hiring practices, while those in the informal sector would benefit from the increase in overall employment that would likely result from greater flexibility. Likewise, business interests can easily be divided along several axes: those oriented toward commerce and those toward import-substitution industrialization, or those relying on liquid assets (finance and banking) and those relying on fixed assets (Frieden, 1991). Reforms are likely to affect these interests differently, as in the case of devaluation or the raising of interest rates.

Typically, traditional chambers of commerce and industry associations have been dominated by interests opposed to economic liberalization: large-scale farmers that benefit from tractor service and fertilizer subsidies, and import-substitution industrialists opposed to reductions in protection. Yet in many cases, business associations wary of many aspects of liberalization are nonetheless supportive of stabilization, with its promise of greater predictability, lower inflation and more secure access to foreign exchange. For example, MAN, the Manufacturers Association of Nigeria, has consistently supported stabilization plans, but has generally fought trade liberalization. Their participation in Nigeria’s home-grown adjustment programme led to a highly selective trade ‘liberalization’ that lowered tariffs overall, but imposed a record number of new import bans.

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POLITICS AND POLICY REFORM: WHAT DO WE THINK WE KNOW?

Economic policy reform is a highly political process, affected by state capacity, international pressures, domestic interests, and the institutional legacies of previous choices. Policy makers must walk a fine line between insulation/autonomy and participation. Reform choices involve trade-offs: suppressing high inflation ultimately benefits almost everyone but speculators, yet the instruments used almost inevitably provoke recessions, with widespread lay-offs and bankruptcies. Trade liberalization benefits exporters and consumers, but since trade taxes are generally among the easiest to collect, trade liberalization often worsens fiscal deficits. Many of the political problems associated with reforms can be grouped into three categories: credibility problems, collective action problems, and distributive justice problems (Haggard, 1994; Bates and Krueger, 1993).

Credibility

Voters have few instruments for ensuring that politicians carry out election promises. Donors have relatively more (including successive tranches of funds, conditional on actual implementation). Yet politicians in election campaigns and in donor negotiations routinely promise more than they can deliver, back-tracking about reforms and, as a recent study by Killick (1998) demonstrates, facing few sanctions from the donor community. Promising without delivering creates intense credibility problems. If economic actors don't believe in the credibility of reforms, they are likely to wait and see, or to focus their efforts on the quick profits available in commerce, real estate, or speculation. Lack of political credibility is strongly associated with weak long-term growth (Brunetti and Weder, 1994), and new democracies have to overcome this problem in order to resume the growth that their democratic consolidation may in fact require.

Collective Action Problems

Collective action problems centre on the difficulties of getting individuals to join in co-operative action for the public good. If most individuals act on the strong incentive to be a 'free rider', actions that would benefit the group as a whole won't be taken. This set of problems also arises because winners and losers have different incentives for collective action. Losers from reforms have clear incentives to struggle to maintain or return to the status quo, even when society as a whole would be better off under reforms. Conversely, the costs of reform come immediately, while benefits are slow to emerge. This makes it difficult for potential winners to have the incentive to organize to support reforms.

Distributive (In)justice

Policy change intentionally redistributes income and resources from some groups (losers) to others (winners). Distributive problems are exacerbated by the tendency of many kinds of reform to produce increases in inequality. This tendency has many possible sources. One is the fact that devaluation drives down the relative value of labour while higher interest rates raise the return to capital. New taxes and subsidy cuts introduced for fiscal balance tend to be regressive: value-added taxes, reductions in food subsidies, and public transport fare hikes take a relatively bigger percentage of the earnings of low-income, urban people, even if removing or reducing taxes on exports may be progressive for rural smallholders.\(^1\) Partial reforms create gaps quickly filled by a temporary set of winners, who may then obstruct the completion of the reforms, as in the Soviet Union's privatizations (Hellman, 1998). Many Nigerian speculators became very rich very quickly when the government liberalized the banking system, but kept the exchange rate tightly controlled and highly over-valued (Lewis and Stein, 1996). Finally, in most instances the first risk-takers to respond to successful reforms face little competition and can earn a high rate of very visible profits. Growing inequality can create

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\(^1\)I thank an anonymous reviewer for the latter point.
economic as well as political problems. Alesina and Perotti (1996) show a strong relationship between higher levels of inequality and lower rates of growth, which suggests that overcoming distributive problems may also be critical for maintaining the growth that democratic consolidation needs.

**Interest Groups and Economic Reform**

Are interest groups ‘good’ or ‘bad’ for sustainable economic reform? Seen from a pluralist perspective, interest groups are part of the fundamental core of democratic practice, the bedrock of civil society. Exercising ‘voice’ and forming alliances with other compatible organizations, interest group competition leads to sustainable policies that reflect the core concerns of a nation’s citizens. From another perspective, interest groups create a politics of rent seeking. Interest group pressure at its worst produces disastrous policies like the United States’ Smoot-Hawley tariff of 1930 and may lead to ‘gridlock’ in legislative decision making.

Some of the earlier research on political and economic interactions in economic reform found that economic policy-makers needed to be protected from interest group pressures (Bates and Krueger, 1993; Williamson, 1993). One extensive study found that ‘in every successful reform effort, politicians delegated decision making authority to units within the government who were insulated from routine bureaucratic processes, from legislative and interest group pressures, and even from executive pressures’ (Haggard and Webb, 1994, p. 13). Researchers also pointed out that East Asia’s phenomenal growth primarily took place during a long and repressive authoritarian period.

Yet much of this research took place in countries that had not yet experienced the ‘third wave’ of democratizations. Non-transparent and exclusionary policy making may make it difficult to consolidate the economic reforms and the democracy. A more inclusionary approach involving consultation with affected groups may very well improve the design and implementation of growth-supporting policies. Insulation may be useful to get reforms under way, but the consolidation of reforms may require consultation and negotiations (Nelson, 1993, p. 438). In Latin America, J. Frieden’s research suggests that leaving important interest groups out of negotiations about reform simply ensures that they will ‘disrupt the implementation of whatever decisions were made’ (Frieden, 1991, p. 252). A non-transparent reform process also short-circuits the important learning process that new reformers typically experience. In newly democratic Bolivia, a highly centralized reform process may have been ‘initially expedient’, as one researcher found, but ‘it also resulted in the loss of the “pedagogical value” of congressional discussions and helped frustrate the public’s expectation of more transparency and participation’ (Morales, 1996, p. 16). It may ultimately have caused Bolivia’s adjustment to lose steam and high-level political support, as few understood the issues or the continued necessity of adjustment measures. While the World Bank waited somewhat impatiently, Mauritius spent more than four years building a consensus among sugar workers, small and large cane farmers and sugar factories before going ahead with major legislation and a World Bank-funded programme to restructure the sugar sector. On the other hand, technocrats in Mexico City designed Mexico’s major reforms of the ejido land tenure system with almost no consultation with the rural poor whose lives were about to be profoundly changed. They provided their feedback less formally, in the 1994 Chiapas uprising.

The literature on social democracies in Europe reinforces the idea that good reforms may require consultation with and inputs from important stakeholders. Europe’s small social democracies—Denmark, Switzerland, Belgium, The Netherlands, Sweden and Austria—have better records than many large industrial states in maintaining both economic openness and harmonious labour relations. Katzenstein (1986) has argued that the system rests on the strength of economic interest groups, particularly unions, and their formal (corporatist) inclusion as partners in the coordination of broad areas of economic policy. While the reasons for the success of democratic corporatism in Europe may be historically specific, other cases also suggest a pattern where strong unions linked to strong ruling parties are better able to implement economic adjustment policies, presumably because strong unions can better guarantee their members’ compliance with agreements, and because strong party ties make for mutual interest in fairness and stability, ultimately
generating greater trust (Bates, 1993, p. 33). A recent International Labour Organization study of changes in labour flexibility in 20 European and developing countries also reports that the ‘coordinated collective bargaining’ that is the norm in systems of organized tripartite negotiations may lead to higher economic performance than decentralized and uncoordinated collective bargaining (Ozaki, 1999).

In an analogous manner, scholars now argue that East Asia’s phenomenal growth was based not on authoritarian governments isolated from their societies, but rather depended on feedback, interaction and exchanges between government technocrats and business interests in structured ‘deliberation councils’ (World Bank, 1993). In this view, the strong, meritocratic bureaucracies in East Asia were ‘embedded in a concrete set of social ties’ that provided ‘institutionalized channels for the continual negotiation and renegotiation of goals and policies’ (Evans, 1995, p. 12). Korea’s authoritarian President Park instituted and ‘religiously attended’ regular National Export Promotion Meetings including ministers, business association representatives, bureaucrats, and firm executives, to strategize about export policy, hear the problems of firms, and get their feedback on policy initiatives (Haggard, 1990, p. 71). Labour was denied equivalent access, a fact that probably helped build the high degree of intransigent militancy among unions in Korea. The internal cohesion of the bureaucracies enabled them to avoid ‘capture’ and enabled them to use these ties to make more informed policy decisions. During the recent economic crisis, pundits declared that ties between government and business in East Asia were actually more akin to the ‘crony capitalism’ of the Marcos era in the Philippines. Yet out of the East Asian debacle may come a long-term perspective that privileges communication and consultation. In early 1998, South Korea’s newly elected president Kim Dae Jung emphasized consultation with the unions affected by austerity measures, while the post-Suharto governments in Indonesia have given civil society much more space to voice their concerns.

Greater participation by affected social groups in policy formation and implementation is likely to boost ownership as well as credibility. A team of researchers at the World Bank found that ‘borrower ownership’ strongly influenced whether or not the structural adjustment reforms supported by the Bank would actually be adopted and sustained (Johnson and Wasty, 1993). The degree of consultation between the public and private sectors, and the political influence of interest groups, were the most important factors making up borrower ownership. Reforms backed by broad political consensus have a better chance of becoming institutionalized (Killick, 1998). Ownership, sustainability, and credibility may all be boosted by a more participatory process of reform. Recently, World Bank president James Wolfensohn has reflected these findings in speeches and proposals that give new legitimacy to consultation and stakeholder involvement.2

Finally, as an interest group, donors have influence and leverage, but frequently less than either they, or their critics, like to acknowledge. Killick’s (1998) finely detailed study of policy conditionality establishes quite convincingly that conditionality rarely works to force changes that governments are unwilling to implement. Yet governments are often divided, and a reformist leader may ‘use’ donor pressure as a way to convince other stakeholders in and outside of the government that there is no other option than undertaking difficult reforms. Donors are also often divided between supporting a more consultative process (consultative group meetings to discuss a country’s entire aid package have become increasingly open to civil society stakeholders) and hewing to the tried and true, and more efficient (from their perspective) practice of holding consultative group meetings in Paris, which poses significant barriers to participation by all but the most well-funded stakeholders. Differences of opinion among donors regarding optimal policy changes are not uncommon, and well-prepared governments can use these as leverage to postpone or avoid policy reforms. Political conditionality to force democratization, as in the case of Kenya, may backfire when, by withholding economic aid, donors contribute to a deterioration in the government’s fiscal position, while forcing multiparty elections which are often accompanied by unsustainable election year spending by the incumbent government (Grosh and Orvis, 1996/1997). Finally, donors using political conditionality to promote democ-

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2 In a speech that became the foundation for the World Bank’s new Comprehensive Development Framework (CDF), Wolfensohn (1998) emphasized that “the people must be consulted and involved”. The proposed CDF itself endorses the principle of ‘strong partnerships among governments, donors, civil society, the private sector, and other development actors’ (World Bank, 1999).
racy may find that a more liberalized political environment can actually reduce participation in economic policy reform, as in Zambia, where corporatist consultation institutionalized under a previous regime was abandoned in a newly pluralistic environment (Rakner, 1998). All of these factors make participatory policy reforms more challenging for all concerned than an authoritarian approach, despite the accumulating evidence that participation may be both useful, and necessary for sustainability.

MANAGING PARTICIPATORY POLICY REFORM

Building and maintaining the coalitions and consensus necessary to support economic policy reform under democratic governance are likely to entail a mixture of incentives and compensation, education, capacity building, channels for communication, and political sequencing. How has this worked in practice?

Incentives and Compensation

John Waterbury (1989) has argued that leaders use three kinds of rewards to manage their relations with their constituencies: incentives directed at winners to boost their ability to accelerate the resumption of growth; compensation for losers, to ameliorate their pain and protests; and the ‘rents’ and ‘pork’ necessary to maintain the support of voters and patrons. He observes that ‘Donors, creditors, and economic advisors approve of the first, do not always understand the logic of the second, and condemn the third. It is in fact the design and disbursement of compensatory payments that is crucial to transitional periods in coalition management’ (Waterbury, 1989, p. 41).

Reforms have sharp, short- and medium-term costs for many people, and they may express their ‘voice’ in demonstrations, strikes and riots. At the most vulnerable level are the urban, low-income people who have only sporadic employment or who survive off of the small margins of informal sector trade. Others with low-paid, formal sector jobs frequently support entire extended families. Those near the bottom understandably oppose price hikes, devaluation, and recession, and the short- and medium-term increases in inequality that frequently accompany reforms. Targeted compensation and protections can help keep the peace while also easing the often rough entry of a formerly protected economy into the global economy. In European social democracies, higher levels of worker protection enable lower levels of trade protection (Bates et al., 1991). Rather than guaranteeing jobs, programmes in these countries offer unemployment insurance, worker relocation and retraining mechanisms to ease adjustment. In Bolivia, an innovative and decentralized safety net programme may have helped strengthen the new democracy, building support for the system from people in remote villages who were often getting their first state benefits (Graham, 1994).

While the costs of reform hit almost immediately, the benefits are uncertain and slow in coming, making it hard for winners to know who they are, or to organize in support of reforms. This makes it all the more important to design and sequence reforms so that winners are more clearly aware of their benefits. Highly visible improvements in public transport, roads, or electricity may buy time for slower reforms to work (Nelson, 1994). This tactic appears to have helped Zambia’s President Chiluba win the 1996 elections, which followed five years of maintaining difficult macro-economic reforms.3 Winners can be created. Privatization may provide funds that can be used to fund packages to compensate those losing their jobs and benefits. Foreign aid can help here. In Mauritius’s successful adjustment, loans from the World Bank enabled the government to compensate losers and accelerate gains to winners. With export-led growth as the goal, the government offered loans to small farmers to encourage exports of tea, cut flowers, and other agricultural products. New graduates, who might have demanded government jobs, could qualify instead for unsecured loans to start small export businesses in the Export Processing Zones (Bräutigam, 1997).

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Public Education and Communication

Efforts by governments, political parties, and interest groups to educate and inform constituencies may also ease the course of reform (Frischtk and Atiyan, 1996). Radio programmes, street theatre, town meetings, and so on can educate the public about the issues and the long-term stakes. When Italy faced difficult restructuring after the first oil shock in the 1970s, the Italian Communist Party marched a million workers to evening economic literacy classes, aimed at explaining why Italy needed austerity (Bressler Pereira et al., 1993, p. 12, n. 9). Skilful use of the media to give public explanations and communicate the reasons for reforms creates transparency, is low cost, and may make reforms more sustainable. Peru removed subsidies from gasoline only after the finance minister used the media extensively to explain why the price had to be raised. Even after the price rose 3000%, there were no strikes or riots (Graham, 1994, pp. 7–8). Poland’s popular Minister of Labour guided Polish citizens through the rationale for each step of their reforms during frequent television appearances and ‘fireside chats’ (Sullivan, 1990).

The extra legitimacy of a democratic government may be necessary for explanations and public education to work. For example, in the mid-1990s, the former military government in Nigeria mounted an extensive campaign to educate the public about the costs of maintaining subsidized fuel prices (then at a few pence per litre), but when the subsidies were consequently reduced strong protests made it clear that the public distrusted the military government’s ability to channel the gains of higher prices toward the public good. Although the implication of education and communication is somewhat ‘one way’ (the government informs, and the people listen), these meetings provide opportunities for feedback in the other direction as well, and ultimately assist in building the capacity of both state officials and societal groups to better understand the reasons for reform and to make their participation more informed, and thus more effective.

Capacity Building

The past decade has seen much discussion of the need for greater capacity in the public sector, but in order for consensus building and persuasion to move beyond legislative debates and public education conducted through the media, stakeholder groups also need to develop technical and analytical capacity. Frequently, few groups outside of the finance ministry have a strong understanding of the reasons why economic reform is necessary. Weak understanding of economics limits the ability of interest groups to analyse reforms proactively and present constructive critiques or alternative approaches. Legislatures typically lack the same access to technocratic analysis enjoyed by the executive branch. Reports and editors in the media rarely have an economic background, which can limit the media’s effectiveness as a forum for debate, even with press freedom. Shifting to an issues-based politics requires stronger internal ability to analyse policy issues, supplemented by access to think tanks and university institutes. How can the capacity of these independent voices be enhanced?

Foreign aid has played an important role in building the capacity of groups to engage in constructive consultations over economic policy. In Ghana, the donor-supported Institute of Economic Affairs (IEA), an independent think tank and advocacy group, provides analysis of economic policy reforms pending before the legislature, focusing in particular on how the proposed reforms would affect business. The IEA’s efforts have apparently raised the quality of discussion and served to better inform a wide range of stakeholders (Scribner, 1997, p. 35). Uganda’s Presidential Forum for Strategic Management (National Forum), established in 1992 to create a mechanism for dialogue among politicians, senior government officials and representatives from the organized private sector, was supported by the United States Agency for International Development (USAID), which provided training and funds to enable the business sector to establish four sectoral working groups on investment and exports, finance, human resources and capacity, and tax policy. These groups discussed and debated policies in their areas, and their recommendations and feedback were given to the cabinet-level Economic Council (Crosby, 1996, p. 1409). Finally, the donor-supported SAPRI (Structural Adjustment Participatory Review Initiative) research programme also involves a simultaneous process of building up the capacity of civil society groups in eight countries to undertake
research on the impact of structural adjustment, while also bringing government, the World Bank, and civil society groups together to negotiate the design of the research programme and discuss each stage of its implementation.\(^4\)

In supporting capacity building in civil society, donors need to be careful to support local groups’ control of their own advocacy agendas, as in the approach taken by the donor-sponsored West Africa Enterprise Network. The facilitators working with the Network consciously refrained from suggesting which policies Network members should work on, limiting their involvement to the provision of tools and training (Crosby, 1996, 1413; Orsini et al., 1996, p. 1464). Approaches that have proven particularly useful in building capacity while supporting ownership include action-planning workshops and process consultation, where facilitators assist advocacy groups to identify their own capacity needs and develop their own plans for action to meet those needs (Joy, 2000). Twinning, or the creation of sustained partnerships between organizations in high-income and low-income countries, may also be well suited for upgrading technical and professional skills of civil society groups, particularly if it is reoriented away from formal training courses toward ‘learning by doing’ while encouraging critical reflections by both partners on their shared experience (Jones and Blunt, 1999). Finally, capacity building for interest and advocacy groups may require prior legislative changes protecting freedoms of association and of speech. Without these basic protections, groups will find that their ability to participate is dependent on the whim of the political leadership.

**Mechanisms for Consultation**

Many mechanisms exist for formalizing communication and consultation in new democracies: regular meetings of tripartite commissions of labour, capital and government, task forces that bring experts from government and society together to make recommendations about policy issues, government attendance at associations’ annual meetings and conferences, public hearings, action-planning workshops, even focus groups and town meetings. No matter what the forum, non-governmental participants need free access to economic information in order to make their participation meaningful. Countries that have been democratic for longer tend to have more well-developed mechanisms for openly bringing dissenting views into the decision-making process. Botswana regularly uses traditional community meetings called ‘kgotlas’ as opportunities for public consultation, although not generally on matters of economic policy. More recently, the government has invited the Botswanan Chamber of Commerce, Industry, and Mines (BOCCIM) to join the High-level Consultative Committee, chaired by the President, and tasked with review and discussion of major policy issues.\(^5\) In democratic Costa Rica, under fiscal pressure to lift subsidies on agricultural inputs and make other major changes, but facing a politically aware rural electorate, the government decided to establish six commissions on aspects of agricultural policy so that all interested parties could be informed and have input into the proposed changes (Nelson, 1990, p. 209). Mauritius uses annual pre-Budget consultations with civil society groups as an important way to consult stakeholders, and regular tripartite negotiations over minimum wages and other aspects of labour policy are also well institutionalized.

In many parts of Africa, bilateral consultations between chambers of commerce and other business groups and government are becoming more institutionalized, although labour unions typically have less access. One exception to this is the experience in South Africa, where business and labour joined government in a corporatist National Economic Forum, later superseded by the National Development and Labour Council (NEDLAC), established ostensibly to give business, labour, and a select number of nationwide community organizations (such as the National Women’s Coalition and the Federal Council for the Disabled) a significant role in policy formation (Nattrass and Seekings, 1998, p. 223). In practice, NEDLAC’s con-

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\(^5\) Terry Carroll, personal communication, 4 January 2000.
tributions have been limited to labour policy and several small agreements on business policy and training. Nattrass and Seekings point out that NEDLAC's constituency is the urban working class and middle class, not the poor, an issue that is likely to arise in any traditional tripartite forum in countries with high unemployment.

Another exception has been Zimbabwe, where in the early 1990s the Mugabe government established an Industrial Review Committee (IRC) to make recommendations on a liberalization strategy (Skålnes, 1995). The Chamber of Zimbabwe Industries, the Chamber of Commerce and the Zimbabwe Congress of Trade Unions were all represented on the IRC, along with government technocrats, and the country's first major adjustment programme closely resembled the proposals submitted by the IRC. With the success of the IRC, the interest groups pushed for a permanent mechanism for participation, and a Tripartite Negotiating Forum was established as a permanent forum, bringing labour, business and government together regularly to debate and discuss the parameters of economic policy. In 1995, Tor Skålnes judged the government–interest group cooperation that resulted from the Forum as 'essential to the success of economic reform' (Skålnes, 1995, p. 145). Later, a National Economic Consultative Form with a broader civil society membership was also established. As of early 2000, both were still in existence, although the Zimbabwe Congress of Trade Unions had pulled out of the Tripartite Negotiating Forum, in part as a protest because of a temporary ban on strikes. Unfortunately, by then the government had lost its earlier enthusiasm for reform, and the adjustment programme had deteriorated badly, suggesting that participation may be ineffective in pushing for reform in the absence of a committed political leadership.

The experience of the Uganda National Forum suggests some of the limits as well as the possibilities for effective participation. USAID worked primarily with the Uganda Manufacturing Association to create the Forum. In its early years, the Forum working groups each had targets for activities they wanted to achieve, including policy recommendations. The annual National Forum, chaired by the President of Uganda, would be used to hear reports from the working groups. In the words of one participant, this 'generated a lot of good will and beneficial exchange among participants and a sense of ownership of the policy formulation process by all stakeholders'.7 After four years, however, other interest groups had gained strength and cohesion and were no longer willing to have the UMA represent the interests of business by itself. At the same time, other donors began supporting other federations of business and civil society and assisting them to express their views. The National Forum was abandoned as civil society became more vigorous and less unified. Currently, the UMA retains a seat on the Economic Council advising the President. A new UNDP project brings together different sectors in Sector Consultative Groups, while the World Bank is supporting the Private Sector Foundation, a forum of all the private sector business promotion organizations.8 While pluralism is certainly democratic, Uganda’s plurality of business federations may have helped dilute the voice of the organized private sector in negotiations with the government over policy reform.

**Political Sequencing**

Finally, reforms need to be designed and implemented with specific attention to political, not just economic, sustainability. Sequencing reforms to take into account the problem of building constituency support may dictate different sequencing than might economic theory. For example, lowering import tariffs and quotas before export industries have become strong means that governments must attack the interests of import-substituting industrialists. At the same time, they are likely to find that a decline in tariff revenues hurts their fiscal balance, while liberalizing trade before exports have expanded puts pressure on the balance of payments. The East Asian model provides some lessons here. Taiwan and Korea made policy and institutional changes

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7 Personal communication, Director of Information Services, Manufacturers Association of Uganda, 7 May 1999.
8 Personal communications, President of the Central Bank of Uganda, 13 May 1999 and Director of Information, Uganda Manufacturing Association official, 7 May 1999.
that promoted exports before they put broad trade liberalizations in place. Mauritius, following the East Asian model, likewise promoted textile exports that gradually absorbed much of the excess rural labour force, before allowing the rural sugar industry to gradually implement much-needed restructuring. These strategies created strong vested interests in new policies, and give potential losers a transition period in which they might also take advantage of new incentives for efficiency.

Likewise, it is widely recognized that simultaneous political and economic liberalization creates much greater pressure than either pursued alone. Competitive elections create pressure for election year spending in both old and new democracies, and in new democracies undergoing economic reform incumbent governments find it nearly impossible to stick to austerity programmes. The politics of election cycles have recently destabilized economies in Africa (Kenya, Ghana), Latin America (Ecuador, Mexico) and Asia (Thailand) as the 'political business cycle' tempts governments to abandon good economic policy, boosting spending, printing money and generating inflation. Some researchers argue that donors might best separate their political and economic conditions, and keep in mind that unstable economies are unlikely to prove supportive of stable democracies (Grosh and Orvis, 1996/1997).

**POLICY IMPLICATIONS: THE ROLE OF FOREIGN AID**

‘If success means resuming growth under democratic conditions’, a 1993 study argued, ‘the evidence for successful recipes turns out to be much thinner than for disasters’ (Bresser Pereira et al., 1993, p. 200). Under democratic governance, policy reform is a continual, iterative process of decisions implemented, reversed, reconsidered, and reimplemented. Given the highly political nature of economic reform, and the uncertainty about the direct growth implications of many liberalization recommendations, funding agencies need to maintain a certain modesty and caution in their interventions. With that caveat, this final section considers some of the implications for foreign aid programming.

**Economic reformers need to be able to communicate with and (often) compensate losers.** When governments take time to communicate with affected populations, explain the need for reforms and offer temporary assistance with adjustment, even difficult reforms can be tolerated with surprising forbearance. Democratically elected governments, particularly in their early ‘honeymoon’ period, are likely to enjoy higher legitimacy, which may create greater confidence in the population. However, it is also widely recognized now that reform is a long-term process that creates many losers along the way, and that social programmes and safety nets are important for reform sustainability. Safety nets serve a political purpose by compensating losers, but they also buffer the impact of rising inequality, a dangerous trend that threatens both democracy and growth. And although donors don’t like it, governments need to have some degree of ‘pork’, patronage, rents, and spoils to maintain political support for their initiatives. Patronage politics and compensatory cross-payments are not (necessarily) the same as corruption, and need to be better understood and designed in order to maintain twin goals of economic reform and political stability.

**Political sustainability may dictate less orthodox reform sequences.** Economic efficiency and political feasibility are both important in the design of reforms. Investors value predictability in their business environment, particularly when committing their capital to a long-term investment. Maintaining a stable policy environment may be more important for investment and thus growth than the pursuit of the ideal economic framework, particularly when the optimal policies are unlikely to be politically sustainable. The high-performing East Asian economies grew most rapidly between 1965 and 1985, under a regime of highly controlled interest and exchange rates, state-owned enterprises, and protection. Premature liberalization of the capital account clearly contributed to the East Asian crisis of the late 1990s. Donors should probably exercise more modesty and caution regarding the content and specifics of economic reforms, once macro-economic stability is achieved. This is particularly important to keep in mind as donors contemplate increased selectivity.

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Whenever possible, create winners before creating losers, and deliberately accelerate the gains to lower- and middle-income winners. China’s leaders decided 20 years ago to ‘open the door’ to foreign investment, encourage domestic entrepreneurship, and promote export-oriented industries in enclaves along the coast. Today, as China prepares to join the WTO, trade liberalization is just beginning, and the government only began to openly discuss privatizing China’s still substantial sector of state-owned industries in the late 1990s. Creating winners first means that millions of people now have a stake in a market-oriented system. Likewise, introducing competition into an economy by building incentives for import-substituting firms to shift capital into exports rather than allowing across-the-board trade liberalization, the strategy followed in Mauritius, creates constituents who are more likely to support later liberalization efforts.

Democratic ‘embeddedness’ and consultation are more time consuming and require deliberate capacity building and construction of mechanisms of interaction. Donors who sought to work with teams of technocrats in an insulated enclave of the executive branch now face a policy-making process that has been widened to include all kinds of stakeholders. Many have formally embraced this challenge. Although messier and more time consuming, an approach that brings key stakeholders together in negotiating reforms keeps decision makers in touch with the needs, expectations, and likely objections of the actors whose behaviour they hope to influence through policy reform. Donors can assist in speeding this social learning process through helping groups gain exposure to ‘best practice’ in other countries, and through helping build their ability to analyse the costs and benefits and feasibility of various alternative policies. For the long-term strength of democracy it is particularly important not to continue to exclude labour representatives from the learning and consensus building that goes on in these broader policy circles.

Outsiders should exercise caution when tempted to throw their support behind particular constituencies or coalitions. External funding agencies face a dilemma in the fact that certain stakeholders are friendlier to their positions on policy reform that others. The temptation is to act to empower those stakeholders. This can backfire. As Tony Killick (1989, p. 64) once warned, ‘The danger is that donors will use their muscle in ways which have political consequences which they are not in a position to anticipate and whose risks will have to be borne by others’. A more neutral stance, offering general capacity building, information, education, and informed analysis, may be critical for success, as well as for supporting local ownership of reforms.

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