

Executive Summary

Experiences from many countries indicate that successful implementation of economic reforms, to a large extent, is determined by the political and social environments in which reforms are introduced and their evolution over time.

- (ii) Consolidation of reforms is less a matter of specific measures than of changes in the attitude and behaviour of economic actors. Successful market reforms are possible if they generate incentives for firms and workers to direct effort to efficient production rather than winning concessions from governments. An important ingredient of such a process is the assumption that the new rules of the economic game are not likely to be reversed or radically changed. Economic actors must also increasingly come to accept the uncertainty inherent in the system, namely, that market economies provide only the rules and procedures to be followed, but do not guarantee outcomes to specific actors.
- (iii) The successive oil price shocks of the 1970s and associated debt accumulation, together with high world interest rates, slackening demand and declining commodity prices in the early 1980s were the origins of recent economic policy reforms. Growing external and internal imbalances were compounded by tightening capital markets. Starved of private capital and faced with growing disequilibrium, developing countries turned to the Bretton Woods Institutions (BWI) – the World Bank and the International Monetary Fund (IMF) – for assistance, which increasingly was offered only on the basis of structural adjustment conditionality, incorporated in the specific policy reform packages known as Structural Adjustment Programmes (SAPs).
- (iv) The implementation of structural adjustment policies have been very slow. SAPs have usually involved stabilisation efforts in the first instance, followed by structural reforms directed at the private/public sector boundary of economic activity. The stabilisation policies comprise fiscal, monetary and exchange rate reforms, while structural adjustments have involved changing legal and institutional frameworks as well as attempts to alter the general structure of the productive economy. Thus, in the civil service, for example, there were redeployment and retrenchment of workers to trim the structure of the service and to cut down the public wage bill. Other attempts to reduce the size of government included privatisation and divestiture of state-owned enterprises. In most cases the financial sector was also reformed.
- (v) The bulk of typically implemented reform was not only administratively simple but had relatively more manageable political costs which, moreover, could be handled within existing institutional arrangements. In cases where ownership of the reform programme rests with the domestic economy, local capacity has been available to implement the programme.
- (vi) Evaluations of the experience with SAPs have produced mixed results. Most of the success achieved so far has been in regard to reducing inflation and restoring economic growth. SAPs have been almost always favourable to the external account.

- (vii) Reform programmes usually present obstacles in terms of both design and implementation. These obstacles include the politics of balancing the interests of various groups, the nature of the political environments, information asymmetry, the competence and capacity of the bureaucracy to manage reform programmes, and donor influence. In addition, the reform policies themselves present their own difficulties. For cash-strapped developing economies fiscal reform which calls for further tightening of government spending may squeeze out the social sectors and thus further impoverish their people. Moreover, financial sector weaknesses have never made monetary reforms easier for developing countries. And in a situation where there is no proper understanding between the political authorities and the reform implementing agencies such as the central bank, economic reform becomes difficult. It has been argued that central bank independence, for example, lowers inflation and promotes growth; but central bank independence has proved to be elusive to many.
- (viii) The global economy also presents difficulties to reforming developing countries. In the global economy, anything can be made anywhere and sold everywhere. In present post-Cold War circumstances, this means performing each economic activity where it can be most cheaply done and selling the resulting products wherever profits are highest. With the end of the communist threat, sentimental attachment to some geographical parts of the world is increasingly no longer an acceptable alternative.
- (ix) The world's financial markets can now move so much money around the world so quickly that monetary policies have to be adjusted to their dictates and not to the domestic needs of the economy. In order to keep from being hit by capital outflows, governments are forced to raise interest rates when slack domestic demand and unemployed productive resources would call for precisely the opposite.
- (x) In spite of all the problems faced by an adjusting country it is clear that without adjustment most economies will sooner or later collapse. The political and economic changes that have come with reform have essentially disrupted the established ways that governments have conducted business and have also proved to be incompatible with existing institutions. The ills of adjustment can be minimised, however, if a country can improve the political and strategic capacity of its economic managers to organise the means of co-operation and efficiently manage the distributive effects of uncertain outcomes, to compensate or neutralise losers from the choices that are made, to expand constituencies and build support and consensus among broader segments of the society.

Conclusions and Recommendations

- (xi) Economic reforms, regardless of their aggregate effects, have distributive consequences creating benefits for some while imposing hardships and loss on others. Whether reforms succeed and are sustained can therefore hinge on the ability of the government to mobilise political support for the reform process and to manage the opposition.
- (xii) Bureaucrats, businessmen and other interest groups attempt to capture or thwart policy initiatives that are perceived by them as not being in their self-interest. For this and other reasons, it is politically difficult to implement reforms or change the regulatory environment. It is extremely naive to assume that enunciating a desired outcome is by itself sufficient to achieve it.

- (xiii) The importance of political obstacles to economic reform has led to the examination of the scope for de-politicisation of decision-making. Central Bank independence is widely accepted as one credible mechanism. There are, however, some serious reservations about how to reconcile the exercise of so much power by unelected bureaucrats with the principles of democratic rule.
- (xiv) But while politics matters, institutions are also important. Under the right institutional conditions, astute political leaders can build new coalitions of winners that crowd out those with an interest in the status quo. The evidence also points to the fact that the effects of institutions depends on the level of commitment. For example, the applicability of the rule of law is essential to the efficacy of budgetary institutions. When, as in developing countries, adherence to the rule of law is weak, liberalised financial markets have been found to be useful in exacting the necessary commitment and discipline.
- (xv) Technological breakthroughs underpinning the globalisation process, place severe limitations on the options available to reforming countries. Successful reform must consequently not only take due cognisance of the domestic political economy but also the international environment. Adjustment asymmetries between strong (surplus) countries and weak (deficit) ones make adjustment take longer and more painful. This survey of the recent reform experience and specifically the political process and reform leads us to recommend that an adjusting country should consider the following:
- ❖ Radically reorganise its state apparatus by overhauling and modernising its processes.
 - ❖ Political stability is a sine qua non to effective adjustment and economic growth. Unstable political environments make for volatile policies and short-lived management teams. Governments and political leaders will increasingly have to recognise the need to agree to protect crucial public agencies from the ravages of partisan politics and political clientelism.
 - ❖ There should be a new definition of the role of the state. Sustaining and deepening the reform process will require states to increase their technical and managerial capacities far beyond present levels. The process of privatisation and divestiture must accelerate to get the state out of functions better suited for the private sector, in order to focus more keenly on the discharge of 'core public functions': reforming the judicial system, introducing efficient government, alleviating poverty and providing efficient social security systems.
 - ❖ Governments will have to move beyond the maintenance of macroeconomic stability and move to build the organisational infrastructure of the state to deal with any potentially explosive social situation. Governments will have to move swiftly to overhaul the financing, production, and distribution of public services in many areas: education, health care, transport, justice, personal safety etc. Tax collection, banking supervision, regulation of privatised and other monopolies, social security, labour practices, export promotion, the Civil Service, the judiciary and a plethora of other areas are in dire need of more and better governmental attention.