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The Political Impediments to Economic Reform: Political Risk and Enduring Gridlock

Barry R. Weingast

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The Political Impediments to Economic Reform: Political Risk and Enduring Gridlock

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Why do entrenched interests so often oppose economic reform? This phenomenon is especially vexing because successful reform increases prosperity, allowing all to be better off. This paper argues that the answer to the question is often *political risk*. This reflects the uncertainty that the prospective returns from reform will fail to materialize due to political factors, for example, due to corruption, technical or administrative incompetence, or political pressure that forces a policy reversal. When the political risks are too high, groups will fail to support reform plans with sound economic design. Analyzing the politics underlying economic reform is therefore complementary to analyzing the economics of reform. The approach is applied to topics such as agrarian reform in Africa and the former Soviet Union; the removal of exchange rate controls and patronage systems in Zambia; central political considerations underlying the rise of Korea and Taiwan; and sequencing considerations in China's successful economic reform.

The Political Impediments to Economic Reform: Political Risk and Enduring Gridlock

Barry R. Weingast

Executive Summary

Economic reform generates a striking paradox. For developing countries, economic reform holds the prospect of greater prosperity for all. Yet in surprising range of cases, political gridlock prevents reform, maintaining the status quo of low or no growth. Entrenched interests commonly attempt to block or sabotage reform and are often successful. Examples are ubiquitous: labor unions in Argentina; farmers in Africa, India, or Russia; managers of state-owned enterprises in the former Soviet Union; and urban workers receiving subsidized food in Africa. The paradox is that under successful reform, increased prosperity allows all to be better off. So why do many interests oppose reform? Moreover, is there anything that can be done about this problem?

The analysis in this paper demonstrates the importance of the political underpinnings of economic reform. It does so by focusing on the need of all governments to maintain sufficient political support to survive. This requires that regimes in the developing world evaluate the prospects for economic reform in political and well as economic terms: How will it affect their chances for survival? Reform programs that require a regime to attack its major support constituency without a concomitant gain in political support from other elements of society are on dubious grounds. As the case in Zambia of the mid-1980s shows, such reform is launched at the regime's peril. The consequence is either reversal of the reforms or failure of the regime.

For parallel reasons, economic groups will evaluate a reform plan in political as well as economic terms. The latter concern the potential benefits and costs from the plan as designed. But these alone do not determine the success of the reforms. To the extent that the reforms are easily reversed, economic actors cannot take the reform and its promises at face value. Attending any reform program is a degree of *political risk* that arises over and above any economic uncertainty: Will the reforms succeed? Will they be reversed because of political pressure? Or will the

gains be eroded via corruption? The uncertainty revealed by these questions suggests that an interest group's decision about whether to support the reforms is complex and depends on critical political questions as well as economic ones.

This perspective helps explain why political gridlock often prevents the introduction of meaningful reform. Under many circumstances, entrenched interests are reluctant to support reform despite the promise of large economic gains. To the extent that they believe that the promises of benefits are unlikely to be realized, they will oppose reform. If, for example, the group is outside the regime's constituency and thus without political leverage, it may rationally fear that the regime will not honor its promises. The consequence is either gridlock or reform failure.

Thus, the economic content and design of the reform package are of obvious importance; but they are not the sole determinant of its success. The political environment in which it is embedded matters as well. The analysis also suggests what types of measures make the reform package more credible and hence lower the political risk to the entrenched interest from supporting reforms rather than fighting to maintain political gridlock.

The principal conclusion of the analysis is this: Holding constant for the economic and technical aspects of a given reform, the ability of the government to commit credibly to the reforms is a critical variable in the reform's success. This implies that political development must accompany economic development. Political development is not something that automatically follows economic development. Successful development therefore requires that a country develop the appropriate political foundations for reform simultaneously with the adoption of the appropriate economic policies. Only the former have a hope of providing the secure foundation needed for long-run economic prosperity.

The approach is applied to topics such as agrarian reform in Africa and the former Soviet Union; the removal of exchange rate controls and patronage systems in Zambia; central political considerations underlying the rise of Korea and Taiwan; and sequencing considerations in China's successful economic reforms.

The Political Impediments to Economic Reform: Political Risk and Rational Gridlock

Barry R. Weingast*

1. Introduction.

Economic reform generates a striking paradox. Throughout the world, whether in developing nations like Argentina and Chad or the former socialist states such as Russia, economic reform holds the prospect for greater prosperity for all. Yet in surprising range of cases, political gridlock prevents reform, maintaining the status quo of low or no growth. Entrenched interests commonly attempt to block or sabotage reform, and often they succeed. Examples are ubiquitous: labor unions in Argentina; farmers in the United States, Europe, Russia, or Africa; managers of state-owned enterprises in the Russia; and urban workers receiving subsidized food in Africa. The paradox is that under successful reform, increased prosperity allows all to be better off. So why do many interests oppose reform? Moreover, is there anything that can be done about this problem?

The purpose of this paper is to develop a new approach to the political gridlock which often prevents the introduction of meaningful economic reform. The approach suggests why entrenched interests often prove so reluctant to participate in reform, despite the promise of large economic gains, choosing instead to perpetuate political gridlock.

An important insight into the problem of gridlock concerns *political risk*. Over and above any economic uncertainty associated with a particular public policy, political risk arises because political uncertainty surrounds any reform policy's future: Will the policy be implemented? Is it

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technically sound so that it has a chance of working if implemented correctly? And once implemented, will it be substantially altered or reversed? These questions suggest that a degree of political risk attends any program of economic reform. They further suggest that economic returns depend upon political events. To the extent that economic agents put their wealth at risk based on the reforms, they will be concerned about the reform's durability.

To see why gridlock so often proves hard to break, consider an entrenched interest that not only has the political power to block economic reform, but holds political privileges that impose considerable economic costs on the economy. In principle, the entrenched interest might be induced to give up its privileges and participate in reform, provided that the reform package compensates it for the losses associated with the removal of its privileges. From the entrenched interest's standpoint, the problem is that the potential compensation in welfare is not assured. The reform may fail for political reasons (e.g., due to corruption) or it may succeed but its benefits may be redistributed to others (e.g., due to a change in policy or a coup).

Thus, the entrenched interest cannot base its decision to participate in reform solely on the value of its promised benefits. Its decision must instead be based on a more complex calculation. First, the interest must discount the potential benefits of reform by the probability that the reform will succeed. Second, the prospective gains must then be weighed against the potential losses associated with giving up its privileges times the probability that reform will fail or that the benefits from reform will be redistributed to others. Even when reform has the appropriate economic design, the larger the political risk from corruption, coups, and redistribution, the less likely the interest will be willing to participate in reform. Economic actors may thus fail to support a well-designed economic reform because they deem the political risks too high.[1]

The problem of political risk comes down to the inability of the state to commit credibly to making the group better off. A *credible commitment* to reform requires that the state not only have the capacity to carry out the reforms, but that it is in the state's interests to do so. In contrast, a political "promise" to maintain the reforms differs from a commitment in that promises are easily broken. It is the absence of commitment that

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[1] Economic historian's argue that one of the factors associated with long-term economic growth is a set of political institutions that align the private and social returns to effort. See, e.g., Delong and Shleifer (1993), North (1981), Root (1993b), and Weingast (1993b).

generates political risk and the potential for a group losing rather than gaining if it decides to support reforms. The analysis emphasizes that political considerations are important in the success of economic reform. As North (1989) suggests, "Rulers can seldom afford efficient property rights since they would offend many of their constituents and hence become more insecure."

From the regime's point of view, if the reforms harm an important constituency, they must at least be capable of bringing in new constituencies. Several successful economic reform programs, for example, those of Chile, Korea, and Taiwan, have this feature. Reforms that do not counterbalance direct and immediate harms to important constituencies are likely to fail. As Bates and Krueger (1993,456-57) conclude, there usually exists a gap between the economic desirability of reform and the politically effective demand for it on the part of economic interests (see also Fernandez and Rodrik 1991). My paper is designed to provide a model of this process.

The analysis also suggests what types of measures make the reform package more credible and hence lower the political risk to the entrenched interest from supporting reforms rather than fighting to maintain political gridlock. The approach is applied to topics such as agrarian reform in Africa and the former Soviet Union; the removal of exchange rate controls and patronage systems in Zambia; central political considerations underlying the rise of Korea and Taiwan; and sequencing considerations in China's successful economic reforms.

My analysis proceeds as follows. I first develop a simple model that shows the role of political risk in the calculus of interest group decisionmaking. This is done in two parts. Section 2 discusses the problem from the government or regime's point of view, emphasizing the political considerations attending the problem of remaining in power. Section 3 defines the problem from point of view of an entrenched interest, demonstrating the importance of political risk in its calculus about whether to participate in reform or to maintain gridlock. Several applications from the developing world and the transition from socialism follow. Section 4 looks at the problem of agricultural reform in Africa, asking why a continent of farmers cannot feed itself. Section 5 examines the political mechanisms of shared growth in Korea and Taiwan. Section 6 provides a series of additional illustrations of these principles and extensions to new principles. My conclusions follow.

2. The Regime's Political Survival.

In order to study the conditions fostering the inception of meaningful economic reform, we need to understand how such policies interact with the regime's ability to remain in power. This, in turn, requires an appreciation of the political logic underlying the relationship between various constituent groups in the polity/economy and the regime's survival. In what follows, we assume that regimes seek to remain in power and that to do so they need a basis of support among the polity. For democratic regimes this assumption is straightforward. The on-going support of a majority of the electorate is necessary for continued power. But non-democratic regimes also need support to remain in power, though the necessary degree of support is typically less than a majority. As is revealed again and again in the literature, even repressive regimes need support constituencies to remain in power.[2]

The central political problem of the regime is to remain in power, not to maximize its citizens' welfare. Often, remaining in power depends on policies with large economic costs; such policies are maintained because they to critical supporters of the regime. In contrast to neoclassical economics, we do not assume that the state is benevolent. Nor, however, do we assume that it is malevolent, that is, one that responds solely to rent-seeking, corruption, and plunder. The degree to which the state plays one role or the other depends on the nature of its constituencies.

To understand the regime's ability to remain in power, it is useful to divide citizens into four relevant types of constituencies. Among the regime's supporters are its *core constituency*, those groups whose support is necessary for the regime's survival under most circumstances. Because losing the support of these groups threatens the viability of the regime, the latter will pay close attention to their interests in major policy decisions affecting that group.

Often the core constituency is large enough to provide the sufficient support for the regime to remain in power. More typically, the regime needs support beyond this group, and it gains this support by courting other groups who become their *marginal constituency*, for instance, groups that provide sufficient support for the regime beyond the latter's core constituency so that it can remain in power. Because the support of the

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[2] Alesina et. al. (1992), Ames (1987), and Londregan and Poole (1992) provides the most systematic evidence of this. See also Bates and Krueger (1993), Bienen and Gersovitz (1985), Haggard and Kaufman (1989), and Nelson (1989).

marginal constituency is necessary for the regime to remain in power, this group is typically in a strong bargaining position. Their power is weakened, however, to the extent that several potential constituencies may serve this role equally well.

A third type of group is the regime's *inframarginal supporters*, those groups who support the regime but whose support is not necessary for the regime to remain in power. Groups in this category are in a weak bargaining position with respect to the regime. Because their support is not necessary, the regime need pay less attention to — or even ignore — their interests.

The final type involves those groups who are not part of the regime's constituency. Usually such groups are *opponents* of the regime. Because the regime does not need their support to survive, it typically treats them as groups to be taxed rather than showered with benefits.[3] There is no assumption that the different groups who oppose the regime are themselves politically united. In many cases, the regime maintains its power because its many opponents are divided and cannot overcome the free-rider problem to form an effective opposition.

Implications for economic reform

This simple perspective on the regime's need to remain in power yields important implications for the initiation of meaningful economic reform. In considering whether to undertake such a change in policy, the regime needs to evaluate the effects of reform on the various constituencies. Because economic reform will affect them differentially, these constituencies will worry about how the reform affects their welfare. These concerns have two aspects. Most obviously, groups care about the content of the economic reform, that is, the direct implications of the reform package for the economy. Equally important, however, are the reform package's *political* implications, for example, whether it holds the potential to alter the regime's constituencies. In the typical non-liberal state of the developing world, a group's principal source of political power derives from its role in the regime's survival. Only those groups that are necessary for the regime's survival have political power to protect their interests. This implies that groups will evaluate the reforms from the standpoint of how they expect the reforms to alter their political

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[3] The degree to which this can be accomplished in practice varies. Liberal regimes, for example, provide considerable protection of individual rights, thus limiting the degree to which those in power can extract wealth from their opponents.

relationship to the regime. Marginal supporters, for example, will be concerned about whether reform holds the potential to alter their position. Once a group becomes infra-marginal, it looses the ability to protect itself. Thus, economic reform may induce a degree of political risk.

The regime's concerns parallel those of interest groups. Because of its need to maintain support, it will choose to initiate meaningful reform only under certain conditions. First, reform cannot make today's core constituents worse off in the long-run. If it does, these groups will use their power over the regime to block reform. To succeed, therefore, reform must somehow compensate the core group for any losses entailed from reform. As we will see in the next section, this is not a straightforward task, for promises of compensation alone are insufficient.

Second, the success of economic reform often depends upon actions by economic agents who are opponents of the regime. Because these groups hold no political power over the regime, they remain in a weak political position, for they have no recourse in the event that the regime seeks to alter any of the reform's promise of benefits. These interests will therefore be especially wary of participating in the reform, unless the reform package also holds the potential to make them part of the regime's support constituency. But that raises another type of political problem.

To the extent that the reform package potentially transforms current opponents into supporters of the regime, some subset of current supporters may be concerned that they will lose out. For example, a group currently among the regime's marginal constituency may fear that reform will transform it into an inframarginal constituency, one whose interests may be ignored.

Let me conclude this section with the observation that this view differs from the standard emphasis on interest groups in that not all interest groups matter equally. In our view, the influence of a particular group depends upon whether it is part of the regime's consistency.[4] This explains an asymmetry commonly observed in the literature about the power of interest groups. Bates and Krueger (1993), for example, show that interest groups cannot explain what policies are initiated but can explain what policies persist, once adopted. This asymmetry follows from our perspective. When we ignore whether a group is within the support constituency of the regime or not, we cannot predict whether their interests will be served. Ignoring this in effect introduces a random component into the relationship

[4] Put another way, this analysis differs that emphasizing interest groups alone by, in Skocpol's terms, "bringing the state back in" (Skocpol 1985).

of observed policy choice and interest groups. In contrast, observing what policies can be protected *selects* for exactly those groups who are constituents of the regime. As constituents of the regime, the perspective predicts them to be powerful. Thus, Bates and Krueger's findings provide some support for our view.

3. The theory of political risk and economic reform.

Consider a developing country with the following three common characteristics: First, the regime or government has a particular interest group among its core constituency. Second, this interest group plays a fundamental economic role in the society. Third, the exchange cementing this group's support for the regime is a set of special privileges which have a negative impact on economic growth. Examples of these circumstances are ubiquitous: The interest group may be a labor union with favorable legislation that maintains high wages or that penalizes firms for terminating workers; a firm with monopoly privileges, protection from imports, or state subsidies; or farmers with substantial price supports. In many of these cases, meaningful economic reform requires that these privileges be removed. As long as the regime maintains them, economic growth will be limited or non-existent. Given that the interest group has the political power to retain its privileges, facilitating economic reform in developing countries requires taking this problem into account.

Suppose that the government seeks to embark down the path of economic reform, necessitating the removal of the interest group's special privileges. What are the political conditions necessary for it to succeed? The political relationship of the interest group to the regime implies that these privileges cannot be revoked outright without threatening the regime's future. The regime must therefore coax or persuade the interest group to participate in reform. And here lies the promise of reform: The potential growth implies that, in principle, a deal can be struck in which the gains from growth can be used to compensate the interest group for giving up its privileges. Such an agreement seems to be pareto optimal because economic growth allows the regime to make both the interest group better off and all others as well.

The neoclassical economic analysis economic reform ends at this point. The assumption of the benevolent state combines with the opportunity for pareto improvements to realize the potential benefits. This view assumes away the possibility that political impediments will snag the reform process. It therefore provides an inadequate understanding of the politics of economic reform in many developing economies. One major reason is that it ignores the problem of how such political agreements are enforced. What is needed is an approach that provides an understanding of the potential impediments to agreements that hold the prospect of making all members of a society better off.

Political risk in the interest group's calculus. Consider the problem from the interest group's standpoint. Its position as a core constituent of the regime affords it two choices: to go along with the change or to maintain the no-growth gridlock by vetoing the change in policy. If growth occurs and if the interest group is among the beneficiaries, the interest group will be compensated for giving up its privileges. The problem, however, is that a series of events may prevent the group from benefitting once it has given up its privileges. First, growth is not assured. Corruption, for example, may dissipate the potential gains from the new policies so that there are no net gains from which to compensate the group. Second, even if growth does occur, nothing assures the interest group that it will benefit. A coup might occur in the middle of the process that reverses the reform without reinstating the group's privileges. Alternatively, though growth continues, the new regime may redistribute the net gains to its supporters instead of to the group. In either case, giving up its privileges makes the interest group worse off. Because a variety of events may yield this possibility, the reform process generates political risk that promises made to a group will not be honored.

The existence of political risk yields the following conclusion. Giving up an interest group's privileges may be a *necessary condition* for growth, but it is not a *sufficient condition*.

A simple expected utility model of the interest group's calculus

To develop a more precise view of these effects, we turn to a simple expected utility model that demonstrates the logic of the above claims. We again begin with an interest group from the regime's core constituency. The payoffs to the interest group from the different alternatives are as follows: G from growth in which it shares; C under the corruption scenario; M under the military coup scenario; and Q under the status quo. We assume that the following relationships hold among the payoffs:

$$G > Q > M = C.$$ [5]

If the government is stable and can commit to policies generating growth, then the interest group is assured of both growth and its share of the gains. In this case, it will give up its privileges and participate in growth as long as $G > C$. Since this holds by assumption, there is nothing problematic the interest group's participation in economic reform.[6]

The problem becomes more complex, however, in the absence of governmental commitment. When the regime lacks the ability to make credible commitments, the interest group needs to worry about political risk.

To simply the calculus, observe that because the interest group is indifferent between dissipation of the gains from growth via corruption and the redistribution of the gains of growth to others via a coup (i.e., that $M = C$), we let $B = M = C$. B represents the set of "bad" scenarios under which the interest group gives up its privileges but is worse off. From the interest group's standpoint, the relationship among the three outcomes is thus, $G > Q > B$. If the interest group chooses to maintain gridlock, the status quo, Q is retained. If instead it chooses to support reform, then the two outcomes, G and B, occur with probabilities p and 1-p respectively.[7]

The interest group's expected payoff from agreeing to give up its privileges is now the probability of growth from which it benefits times those benefits plus the probability it does not benefit times its payoffs, that is, $pG + (1-p)B$. For the interest group to participate in growth, the expected payoff from agreeing must exceed the utility of the status quo, that is, $pG + (1-p)B > Q$. Solving for p, this yields:

$$p > (Q-B)/(G-B). \quad (1)$$

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[5] Clearly, M need not equal C. We have assumed equality for simplicity. As will be clear, this restriction is not needed in what follows; it is retained so that the basic insights remain transparent.

[6] We also observe that, because the neoclassical model implicitly assumes away all commitment problems, its predictions closely parallel those of when the regime has no commitment problems.

[7] All the following calculations assume that the interest group is risk neutral. If, instead, its members were risk averse — as is commonly assumed — then the conditions derived below will over-predict reform.

Thus, without commitment, $G > Q$ is no longer sufficient to induce the interest group to give up its privileges.[8] Instead, a stronger condition must hold. Inequality (1) implies that the probability of the interest group capturing the gains from growth must not only be positive, but "large enough" in a specific sense. For example, suppose that from the group's perspective the gains from successful reform equal the costs if the reforms fail, that is, $G - Q = Q - B$. Then the probability of success must be over 50% for the group's expected benefits of reform to exceed the benefits of remaining at the status quo. If the probability of success is below this, then, despite the fact that $G > B$, the group will not risk giving up its privileges. The demonstrates the main conclusion: Under some conditions, political risk deters the interest group from participating in economic reform even if the latter is economically sound.

If, as in Africa or Latin America, corruption is rampant and coups are common, then the probability of either a coup or corruption exceeds the probability of successful reform. This, in turn, implies that $p < 1/3$. In this case, the model yields further implications. Observing that G-B can be rewritten as (G-Q) + (Q-B), inequality (1) yields:

$$G - Q > [(1-p)/p](Q-B). \qquad (2)$$

If p exactly equals one-third, (2) implies that G-Q must not only be positive, but twice (Q-B). When p is lower that this, for example, 1/4 or 1/5, then G-Q must be three or four times (Q-B), respectively. Under these circumstances, the most likely outcome from giving up its privileges is that the interest group is worse off: The promised compensation is unlikely to materialize and yet the group has lost its privileges. Under these conditions, the interest group accept the risk only if the potential gains are really large.

A implication follows from this analysis. Suppose that the group's entire wealth is at stake, that is, that a new or corrupt regime might not only take away potential gains from growth, but it will confiscate the group's wealth. In this scenario, Q-B is large. In combination with (1) and (2), this implies that the return accruing to the group — if the reform works well — must be enormous for it to agree to participate. Specifically, the return under reform must several times (i.e., [(1-p)/p]) the value of the group's assets at risk. Because political risk may yield bad

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[8] It remains necessary, however. $G < Q$ implies that inequality (2) will never hold, even if $p = 1$.

outcomes, the private economic returns accruing to the group if all goes well must be large in order to compensate it for the potential losses. If the returns from participating in reform reflect only "normal" profits, then substantial political risk implies that the group will simply not risk giving up its privileges and hence gridlock, not growth, is the outcome.

These calculations are simple. They nonetheless demonstrate the role of political risk. The greater the likelihood of political change that prevents the interest group from capturing the promised benefits of economic reform, the less likely is the group to participate in reform. Gridlock is both rational and stable.

Risks to opponents of the regime. In many circumstances, opponents of the regime must play a critical role in economic reform by virtue of their economic position in society. For example, reform might require that certain sectors make specific investments. The problem here is that, by virtue of being opponents of the regime, these interests hold no political power over the regime. To the extent that the reforms induce them to support the regime, their support remains infra-marginal. The regime can thus risk losing their support and remain in power.

From the standpoint of opponents or infra-marginal supporters of the regime, the potential gains from participating are at risk to confiscation by the regime. Again, political risk drives a wedge between the private returns from this group's participation and social returns. The latter are, by assumption, positive. But, because the private returns depend on the regime's future policies, the private returns to a particular group become negative when they are redistributed to the regime's support constituency or to members of the regime itself via corruption. When this type of risk is anticipated and is sufficiently large, these groups have a strong incentive not to participate.

4. Gridlock in Africa: Reform in the Agriculture Sector.[9]

One of the most perplexing developmental problems in Sub-Saharan Africa concerns the problem of why a continent of farmers is unable to feed itself. Obviously, a range of factors contributes to this outcome. The lack of appropriate economic policies, the lack of technically trained individuals in the society, capital shortages, under-developed markets, etc. The

[9] The results reported in this section are based on Bates (1981).

approach of this paper emphasizes that one of the primary reasons for this failure is the political foundations of the regime's policy choice.

Regardless of its ideological character, most regimes in Sub-Saharan Africa tend to subsidize food for its urban constituents (Bates 1981). This generates excess demand for food which can be addressed only through some combination of importing food on the world market and rationing. The regime must therefore dedicate considerable resources to import food rather than to promote growth and development.

The particular problem of concern in this section is why farmers seem unwilling to adopt more advanced farming techniques that hold the promise of greater productivity. For years, proponents a "green revolution" have promised dramatic increases in agricultural productivity in Africa. Large increases in output — whether truly revolutionary or not — would go a long way toward solving this problem. And yet the persistent reluctance of farmers in Sub-Saharan Africa to adopt new techniques seems striking.

The perspective developed above provides considerable insight into the political impediments preventing this critical step in economic development. To begin, consider the neoclassical economic interpretation of this problem using supply and demand diagrams. In this country, the subsidized price of food for urban constituents, p_s, is set below the market clearing price (for simplicity we assume the latter equals the world price of food, p_w — see figure 1). At the subsidized price, the quantity produced is q_s, far less than the quantity demanded, q_d, so $(q_d - q_s)$ is the excess demand. The government chooses to ration and import food, importing an amount $I = (q_i - q_s)$ for a total expenditure of $p_w * (q_i - q_s)$ (indicated as the shaded region in figure 1). The total amount of food available from domestic and international sources is then rationed by some method, about which we say more below.

Suppose that farmers could, in principle, undertake an investment that would increase productivity and thus push the supply curve to the right. Will they do so? The answer to this question depends on how we model the decisionmaking of the government and the farmers. In what follows, we compare two approaches, the standard neoclassical model, with its assumption of a benevolent state, and a variant of the political model developed above.

The neoclassical approach. In the neoclassical approach, farmers are readily induced to make the investment. To the extent that this investment requires farmers to make direct expenses, the "benevolent government" can induce them to do so by a variety of policy choices. It might provide farmers with the funds for the investment. It might subsidize inputs or promise some other attractive privilege or inducement, for example, a tax benefit. And finally, it might promise to raise prices so that the amount received by farmers goes up.

The investment, by assumption, pushes the supply curve out to the right, from S to S′ (see figure 2). This increases domestic production, allowing a dramatic decline in the country's food imports. Since the domestic quantity produced has risen from q_s to q_t, the government now needs to import only q_j-q_t. The total cost to the regime has fallen dramatically, represented by the shaded region in the figure. The net savings to the regime is $s = p_w*(q_t-q_s)$. By assumption, some portion of s must go to farmers in order to subsidize the new investment. The remainder is available for other purposes, for example, promoting economic development.

In this scenario, all parties are at least as well off as before. Urban consumers are better off — the price remains at the subsidized level but the excess demand has fallen sufficiently so that much less need be rationed. Fewer people are hungry. Farmers are also better off by virtue of their subsidies or privileges. Finally, the government is also better off since its total expenditures on food has been markedly reduced. This in turn will allow it to lower taxes or to use the funds for economic development.

The political approach. The problem with the neoclassical approach is its assumption of a benevolent government, a government that attempts to make all citizens better off. No structural or technical impediments prevent the reforms from succeeding. This approach therefore has no explanatory power. It clearly cannot explain the regime's persistent failure to induce farmers to make the relevant investments.

In contrast, the political perspective developed in this paper suggests that the government cares about the welfare of its support constituencies, but not of its opponents. Most regimes of Sub-Saharan Africa do not include farmers among their constituents (Bates 1981). Farmers are heavily taxed so as to provide the regime with resources for its marginal constituents, especially urban workers. When agricultural productivity rises under these political circumstances, the amount that can be extracted also rises.

The stability of these regimes is typically problematic, so they are constantly concerned about losing power. An increase in resources allows them to reduce their risk by increasing benefits to marginal constituents. This increases the latter's support, lowering the risk of losing power.

Under these assumptions, the government behaves much differently than that predicted by the neoclassical model. Because farmers are not necessary for the regime's survival, an increase in farmer productivity allows the regime to increase taxes and other exactions on farmers. The regime will transfer the fruits of farmer investment to its marginal supporters, urban workers.

This argument is best illustrated in terms of the supply and demand diagrams. By assumption the increase in agricultural productivity pushes out the supply curve from S to S′ (see figure 3). The regime then lowers the subsidized price from p_s to p_t. At the new, lower price, the realized increase in output is far less than that predicted by the neoclassical model, only to q_t instead of q_n. The surplus transferred to the marginal constituency now rises by the amount of $(p_s-p_t)*q_t$. Paradoxically, an increase in farmer productivity has not altered the regime's need to purchase food on the world market.

But all this can be anticipated in advance. Farmers have strong reasons to believe that the government will not honor its promises of compensation. The political circumstances of such a regime prevent it from making the relevant credible promises. And if farmers cannot believe the regime will abide by its promises of compensatory benefits sufficient to induce investment, they will not make them.

In the neoclassical approach such promises are automatic because there is no reason that a benevolent governments would not honor a promise that led to an increase in welfare. But politically motivated regimes, concerned about retaining their power, face a different set of incentives. Because these states are *politically underdeveloped* as well as economically underdeveloped, they lack the political institutions necessary to allow them to honor their promises, that is, to honor restrictions or limits on their own future behavior.

Not being constituents of the regime, farmers can do little to punish it if it fails to honor its promises. The loss of farmer support is not critical to the regime. Farmers simply have no leverage in this situation.

This implies that a promise by the regime to make the farmers better off is not credible because it is not in the regime's interests to honor it. And because farmers understand this in advance, they will simply refuse to undertake the relevant investments. Lower productivity is rational from the farmer's stand point even though it is not from the society's.

By way of summary, this case illustrates that government behavior often radically differs from that studied in neoclassical economics. Regimes need to worry about the need to survive and hence about their support constituencies. In the case of Sub-Saharan Africa, the political logic of regime survival induces a stability to low productivity in agriculture. Farmers remain outside the support groups of the regime, opposed by the urban consumers who are far more threatening to the government. Under these circumstances, the government has little opportunity to adopt the long-run policies that would allow farmers to make the investments necessary for long-term productivity growth. This in turn underpins a political equilibrium in which a continent of farmers cannot feed itself (Bates 1981).

5. Building a Reform Coalition: Shared Growth in South Korea and Taiwan.

The last section examined the political circumstances weighing against the success of economic reform. This naturally begs the question, what does work? The varied set of political circumstances throughout the developing world implies that no comprehensive guide can be offered. Nonetheless, a few suggestions can be made about strategies used by certain countries. What follows discusses a particular strategy upon which a widely divergent set of economies have relied.

At its simplest, the idea is that benefits from reform cannot be concentrated among a select few. They must instead be shared among a wide group of individuals, potentially cutting across many elements in society. Stated in terms of the framework developed above, the notion is this: By providing a credible means of sharing the economic gains of reform, the regime can increase the support for reform.[10] These factors allow a transformation in the political coalition supporting the regime to take place simultaneously with the economic transformation brought about by the reforms.

The high performance Asian economies (HPAEs) such as Korea and Taiwan provide good illustrations.[11] Prior to their high growth stage, these economies were often compared with states in Africa or Latin America. Importantly from our perspectives, their political situations did not bode well for inducing economic success, namely military dictatorships with a narrow basis of political support and legitimacy. Such regimes consistently have problems maintaining sufficient support to remain in power. They therefore have short time horizons and rarely choose policies that foster long-term economic growth.

A large number of critical factors underlies the high performance of the Korean and Taiwanese economies (Campos and Root 1994; Haggard

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[10] Observations paralleling this principle have been noted by others, e.g., Bates and Krueger (1993), Campos and Root (1994), Nelson (1989,1990), Waterbury (1989).

[11] Much of what follows also holds for other HPAEs such as Japan, Hong Kong, Thailand, Indonesia and Singapore (see Campos and Root, 1994).

1990, Wade 1990, and World Bank 1993), including the following. First, early on they rejected the then prevailing wisdom emphasizing import substitution in favor policies promoting export-led growth. Second, they rejected a system of politics based on patronage and, in its place, established and maintained a technocratic system of policymaking insulated from the standard demands of interest group politics. Third, each began with land reform, violently imposed, that marginalized the rural elites who had previously dominated the society. Finally, the threat of communism also played an important role in motivating the regime and its citizens, helping foster the notion of security through economic power.[12]

From the perspective of this paper, another element proved an important factor, namely, an explicit attempt to build widespread support for economic reform and growth by providing a series of mechanisms for widely sharing the fruits of economic growth. These included a series of elements:

(1) The first element is nation-wide access to education. The reform programs did not create a privileged group or exacerbate the urban-rural cleavages that often plague developing states (Bates 1981, Lipton 1976). The possibility of upward mobility into the "modern" sectors was extended to all. This mitigated the potential for inducing political cleavages based on those who participate in the modern economy and those who do not.

On the economic side, this policy helped improve the skills of the labor pool, directly contributing to growth, as many studies indicate (e.g., Barro 1993). It also produced a direct impact on the income of large numbers of individuals, the most visible indicator of sharing and regime success.

(2) These policies provided access to jobs in the commercial and industrialized sector for a growing number of individuals with rising wage rates. The industrial sector grew rapidly, allowing a wider range of individuals to have jobs in the modern sector, and with growing incomes.

(3) Various mechanisms were used to help rural incomes keep pace with urban ones. In contrast to African nations, farmers were allowed a relatively high proportion of the value of their produce. The role played by subsidies to farmers in the HPAE systems appears to be different than that in other developing states. In the latter, these subsidies are too often

[12] Still others make a virtue of the authoritarian nature of these regimes, emphasizing that democratic governments have trouble insulating politics from standard pressures to compromise policies that promote growth. The problem with this view, as Campos and Root (1994) observe, is that it fails to explain why these authoritarian regimes acted in this way when most act more like the kleptocracy of Idi Amin's Uganda. The authoritarian nature of the East Asian regimes cannot explain this divergence.

allocated on the basis of privilege and patronage. In the former, they are a component of social insurance that assures that rural interests participate in the growth. This extends the promise of sharing to rural areas and avoids the rural-urban political cleavages.

(4) In contrast to the nearly standard system of politics and bureaucratic decisionmaking in developing nations based on patronage and privileged access, Korea and Taiwan based their political systems on principles of universality and transparency (Campos and Root 1994). Universality means that laws and regulations apply to all individuals in the same way; individuals are not privileged by virtue of having bribed the appropriate person or by being a client and supporter of the appropriate politician. Transparency means that the laws and regulations are known in advance and all have access to the laws. In the typical developing country, regulations are frequently not written, and a firm seeking to do business must often bribe bureaucrats to get information, and that information often comes one step at a time. Thus, a firm might spend six months to get authorization for an activity only to find out it must then obtain a license.

(5) A final factor involves the emphasis on objective economic indicators of performance in the allocation of state support and subsidies. In Korea, credit is tightly constrained, with its allocation depending upon past performance with respect to exports. Firms gain subsidies, not through political relationships or bribes, but through increasing their market share in the world economy. This system does not maximize net domestic surplus, and is thus biased. But its bias is politically valued because it increases firm size. In political terms, this implies that employment is larger than it would otherwise be. This enhances the visible success of the regime in promoting development — more citizens become a part of the modern sector.

These regimes have produced economic development with a striking degree of equity. As Campos and Root (1994) demonstrate, Korea and Taiwan are among the most egalitarian states in the world. Thus, not only have these regimes promised widespread sharing, they have made good on that promise. Moreover, Campos and Root also show that this sharing began at the same time as did growth, in other words, that the gains began to be shared immediately.

Regime credibility. But what makes the regime's promise of sharing credible? Answering this question requires that it be split into two separate parts. First, why does the regime honor its promise to share the gains? Why not capture economic surplus for other purposes, whether private wealth accumulation or for enriching particular interest groups? Second, how have these regimes been able to avoid the standard interest group pressure to provide special privilege and advantages, so common to the developing world, that would prevent growth? These are addressed in turn.

The main consideration underlying the credibility of the policy of sharing is that the regime's future depends on it. The purpose of widespread sharing is to enhance the regime's legitimacy and to obtain widespread support for a military dictatorship. Shared growth also induces citizens to participate in the types of activities needed to make the economy grow, for example, hard work, savings, and investment (e.g., in human capital). Were the regime to renege on these promises, it would lose this widespread support and jeopardize its long-term survival.

Reneging would have a second consequence, also debilitating to growth. To see this, we turn to the second question about how these regimes have been able to avoid the standard politics of interest group influence and rent-seeking. After all, most developing countries would also like to adopt more efficacious policies and rid themselves of debilitating patronage systems, only to find that interest group pressure requires them to maintain the system of special benefits. What allows the HPAEs to insulate themselves from this pressure? Part of the answer is, again, sharing. The political advantage of sharing is that it fosters widespread support for the regime. Large numbers of individuals give their support when they become rich. And it is this support, in turn, that allows the regime to remain above interest group politics. The support of special interests is thus traded for support from a widespread group.

This second factor also has implications for reneging on the promise of sharing. Were the regime to renege and lose its widespread support, it would then be vulnerable to interest group pressure. In order to have a chance at survival, it would have to respond to interest groups, and that would compromise the nexus of economic policies fostering growth.

A third factor also plays a central role for the HPAEs, and that is security. This is most easily seen for the case of Taiwan. In order to support an army sufficiently large to hold off the Communists from the Peoples Republic, the mainlanders of Republic of China needed to gain the support of the indigenous population. Their violent take-over of the Island was an obvious barrier to building that support. The policy of widespread sharing played a central role in developing support for the regime in two senses. First, it helped improve the regime's legitimacy with the indigenous population. Second, and perhaps more importantly, it provided benefits to precisely those groups most likely to support the communists, namely the poorest one-quarter or one-third of the population.

To summarize, this approach emphasizes that both Korea and Taiwan developed the necessary political support for their reform programs. These states not only chose appropriate economic policies; they provided the basis for generating widespread support for the reforms.

6. Extensions and Further Illustrations.

This section provides further illustrations and extensions of the principles discussed above.

A. Reforming Collectivist Agriculture in the Russia

A variant on the African agricultural problem is found in the former Soviet Union and its successor states, particularly Russia. Here, the government has attempted agrarian reform and privatization. Its efforts have, by and large, failed. The perspective developed above suggests that political risk may play a role.

The sources of political risk to farmers are twofold. First, neither the Gorbachev nor the Yeltsin regime could commit its own government to sustaining such a policy. Indeed, as Litwack's (1991) work on tax policy demonstrates, Gorbachev's effort to provide a stable tax regime over a five year period failed immediately. Yeltsin's reforms have similarly vacillated on a variety of issues, and, as of this writing, the entire reform process remains in considerable jeopardy. There are no reasons to believe that the regime's behavior with respect to agrarian reform would be more secure. Second, the regime's future remains in doubt. As events proved, the Gorbachev Government could not ensure that it remained in power. The fate of Yeltsin's Government has yet to be determined but, as today's events indicate, this too remains uncertain.

From the perspective of agricultural workers, both sources of political uncertainty generate considerable risk. Consider the problem of the durability of a policy initiating privatization in agriculture. Suppose one of the promised inducements to privatization concerns market clearing prices for crops. To the extent that the decision of farmers to participate in privatization depends upon *receiving* these prices, they will worry about the likelihood that this policy can be sustained. That in turn depends upon several factors. First, the promise might not be sustainable on its face, for example, because urban consumers will never pay such prices. Second, the ability to compensate farmers critically depends on other pieces of the reform succeeding, for example, increased employment and rising wages in urban areas so that consumers' willingness to pay market clearing prices increases. Further, if the regime promises subsidies to farmers for the difference between market clearing prices and the prices charged for goods, then the credibility of the promise depends, in part, on the future fiscal health of the regime.

This suggests that a variety of circumstances may force the regime to renege on its promise of market clearing prices due to political and economic considerations beyond the control of farmers. In the first scenario, the regime's ability to compensate farmers depends not only on the success of agricultural privatization, but on the success of reform in the urban areas. In the second scenario involving direct compensation, the ability of the government to honor its promise directly depends on its fiscal health, which, again, will reflect risks from many other factors. In particular, as McKinnon (1991) argues, unexpected revenue shortfalls will necessarily lead to "reinterventions," that is, to compromises in the reform promises. This too puts the promised compensation to farmers at risk. Farmers may well deem these joint-risks to be too high.

The second source of political risk — regime stability — is perhaps more severe in Russia. Memories are long among peasants in the former Soviet Union. Millions lost their lives during Stalin's collectivization in the 1930s. Today's peasants hardly want to expose themselves to a similar risk. The possibility of Yeltsin being replaced by a reactionary regime that would attack the newly "reformed" agricultural sector is hardly unthinkable. And under such circumstances those peasants who bet their futures on privatization stand to be big losers. Like the entrepreneurs prior to Stalin's collectivization, their survival is potentially at stake.

In the face of these two sets of political risk, it is not surprising that most peasants vehemently resist privatization. Without the ability of the state to provide a degree of durability to its policies — let alone to its own future — success in agricultural reform is likely to prove difficult in the former Soviet Union.

B. Economic reform and the importance of safety nets.

The cases of Korea and Taiwan illustrate the principle of extending the political constituency as a means of generating support for the reform, allowing the regime to resist political pressure from those seeking to protect the status quo. By providing mass constituencies with a large stake in the reform's success and by generating results, this support counterbalances that for the opponents of reform. This principle can be seen in operation again and again in the reform process and through a surprisingly variety set of mechanisms (Bates and Krueger 1993, Nelson

1989, Waterbury 1989). This subsection discusses three variants on the general theme.

The first concerns a paradox raised by Bates and Krueger about political reform in Chile. In its move from protectionism to openness, the Pinochet government introduced an expanded program of social insurance. According to Bates and Krueger (1993, p. 461), "It has long puzzled students of Chile as to why an authoritarian government, with a record so strongly anti-labor, should have introduced programs generally associated with the welfare state." They contend that the answer is that this program represents a direct attempt by the government to generate support for the reform package, to mitigate the cost born by those negatively affected by the change in policies, and thus to mitigate the political support for the opponents of the regime who favor protectionism.

Several scholars provide a similar explanation for the extensive social programs underlying the small, economically successful trading states of Europe (e.g., Austria, Belgium, Denmark, Netherlands, Sweden and Switzerland; see, e.g., Bates and Krueger 1993, Katzenstein 1985, and Rogowski 1987,1989). These states combine a social system that protects a small set of economic activities in the trading sector from political plundering, and yet provides extensive redistribution to share the economic gains across all elements of society and to provide insulation and insurance to those who are directly affected by the variability of that sector's economic fortunes. These social programs are designed, at least in part, to enable the government to resist demands for protectionism and thus to protect the long-run economic security of the nation.

A third variant of this principle is found in the innovative experimental program of vouchers designed by the new Czech republic. These vouchers serve a potentially important role in the political underpinnings of economic reform. First, they give large numbers of individuals a direct stake in the success of the reforms, and hence increase the potential support constituency for reform.[13] Second, given the immediate financial exigencies, these may prove a good substitute for the more elaborate but expensive social welfare programs that the republic seems yet able to afford.

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[13] Notice that this will hold even with extensive voucher trading, presuming that some meaningful portion of the public retains their shares, e.g., ten percent.

C. Failed Public Sector Reform in Zambia.

One of the principal lessons of the framework developed above is that reform is on tenuous political foundation if it requires a direct assault by the regime on an essential support constituency. All too often in developing countries, public sector employees are a principal constituency of the regime. As Kahler (1990) and Nelson (1989) have observed, this leads to a paradox in which the very public employees who are creating a problem are called upon to administer the reforms.

When the administrative bureaucracy functions as a patronage system, bureaucrats and public managers often have extensive private holdings obtained via their use (and abuse) of political discretion. Major reform of such a system — such as converting a system of political discretion over licenses to transparent, universal, and objective criteria — requires the cooperation of these bureaus to implement. This conflict of interest may render implementation impossible, and the regime attempts it at its own peril.

It is precisely such an attempt that caused the collapse of Zambian President Kenneth Kaunda's reform effort in 1987 (Bates and Collier 1993, Nelson 1989). The reforms were initiated by the President and his technocrats under the advice of external agencies. They were designed to eliminate exchange rate controls, and with it, elaborate mechanisms of patronage and domestic price controls. These efforts were opposed by the major systems of patronage in the country, including most of the government and the reigning Party which enjoyed a monopoly on political control (the United National Independence Party). Major interest groups benefitting from these systems of patronage (for example, for scare foreign exchange: public sector employees) and price controls (for example, on food for urban dwellers) also opposed the reforms.

The reforms removed these systems immediately, causing a burst of price increases, in large part due to the lifting of price and exchange rate controls. As a consequence, the reforms were blamed for a series of problems. No visible benefits appeared to counter the immediate and visible costs. Clients of the patronage system, urban dwellers, and public sector employees were all worse off, at least in the short-run.

Zambia nonetheless contained the potential for developing a constituency for the reforms. The problem was that these groups were not important constituents of the Party. Instead, the economic interests politically most relevant were urban consumers. According to Bates and Collier (1993,430):

> There existed political forces in Zambia that welcomed the market and that benefitted from it: farmers, businessmen, and those who drew incomes from employment in their enterprises. But these productive forces of Zambia's economy stood at the margins of the polity. They were not lodged in the Party, which constituted the system's core. And they therefore could not provide a political defense for this experiment with the introduction of the market.

The "result was a political bias that defended immediate consumption at the expense of long-run growth" (1993,429). Opposition to reforms spread quickly, and soon the president caved into his erstwhile supporters.

D. Political implications of reform sequencing.

An important question concerning economic reform is whether it should be of the "big bang" type, that is, all at once, or whether it should be sequenced through a series of stages. Economists who study this issue typically focus on the economic implications of sequencing (Edwards 1984, McKinnon 1991, Lipton and Sachs 1990; an exception is Dewatripont and Roland 1993). In what follows, I focus on the political implications of sequencing. This discussion is not intended as a criticism of the economic logic. Rather, it complements that analysis by suggesting that additional, political constraints ought to be taken into account.

Most regimes in the developing world do not have comfortable margins of political support. This is especially true of those facing an economic crisis. Not only does this induce a short time horizon and the attendant biases for economic choice (Ames 1987, Barro 1993, Root 1993a), but it also creates a problem revealed by the political logic underlying the support for the regime. Because reform usually means taking away the privileges or benefits accruing to certain support constituencies, this usually implies that the regime must search for alternative sources of support. This, in turn, raises a number of problems concerning credibility mentioned above, for example, technical uncertainty about the efficacy of the reforms, the ability of the regime to implement the reforms, and the risks associated with corruption and coups. To the extent that reforms raise these uncertainties, citizens face significant risk about the future under reform. Hence they may be rationally reluctant to embrace the reforms.

In this case, "demonstration effects" can be critical, for they can greatly reduce the uncertainty that underlies the rational hesitancy (Dewatripont and Roland 1992). Successful reforms in particular sectors or industries can serve to demonstrate the technical capacity to succeed and the lack of political problems such as corruption that might prevent their successful implementation. If targeted correctly, their success can also induce new support for the regime and the reform effort.

In terms of the model above, political risk may be sufficiently large that it is not possible to engineer the political coalition necessary for massive, big-bang type reform.[14] Even if optimal economically, the latter may be politically infeasible. If so, then the sequenced approach may well be preferred for political reasons.

From the standpoint of a regime concerned about maintaining sufficient political support to remain in power, sequencing can prove politically attractive. The logical first step under these circumstances seems to be an area with two characteristics: first, where there is modest support for the reforms — or at least not too much opposition — among the regime's supporters; and second where demonstrable gains can be realized in a reasonable time. Success under these circumstances can change the expectations in society. In particular, by realizing gains, the regime demonstrates not only that the plan is sound but that the gains will not be lost due to corruption. This, in turn, lowers the perceived risk of supporting the regime and its program of reform.[15]

Sequencing of reform in China. This lesson has proved an essential component of the Chinese economic reforms. These began as experiments in agriculture. When those proved successful, they were extended in scope and in coverage across regions. Continued success with these extensions increased the confidence both in the regime's dedication to economic reform and markets — despite its socialist roots — and to the possibilities of created by the prospect of reform.

In later phases, local governments (from the provincial through the township levels) gained political control over their local economy. This led to a series of experiments as different jurisdictions used this power in different ways. Some opted for markets and openness. Others choose the opposite path. Over time, as the results of these different strategies became apparent, and more and more have opted to foster markets and open economies in order to emulate the success of those who initially adopted them (Montinola, Qian, and Weingast 1993). For example, in the Northeastern Heilongjaing province, those vowing to demonstrate the value of the old state-run system increased the standard set of subsidies to

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[14] This has long been the standard wisdom in the political science literature on this topic, e.g., Huntington (1968,ch 6).

[15] As Nelson (1989,13) concludes, "[s]hrewd phasing" is an "important element of coalition management. The key is to avoid alienating too many groups at once and to keep potential opposition groups isolated from each other."

citizens. A short time later, it was revealed that, at the same time, Guangdong, the home of the market activity in south China, had freed prices on the same basket of goods. In the latter case, new markets had arisen and prices had fallen to levels at least comparable to those in Heilongjaing. Officials in the latter drew the obvious conclusion: Guangdong had accomplished precisely the same goal via market reform but without extensive fiscal commitments and drain on the provincial treasury.

The importance of this sequence of reform and results in China is that it has changed perceptions about the ability of the reforms to provide widespread benefits, even in areas that seemed dedicated to the older system. The growing evidence for the success of reform has thus increased the spirit and scope of reform across China.

E. The Role of political institutions.

Development is not solely an economic process but also a political one. One way that political institutions play an important role is by providing credibility to the policy commitments of the regime.[16] Because the rules of the economic game are chosen in the political system, the content of these rules alone is not sufficient for economic success. They must be lodged in the political system in a way that they can be preserved over the long-run. Without that protection markets are vulnerable to various forms of predation and rent-seeking, and they are unlikely to survive for long periods.

No systematic theory exists as to the appropriate institutional boundaries of the state. However, a few systemic lessons have been provided. We discussed above the role of social insurance in small European trading states. As Rogowski (1987,1989) emphasizes, there is an important institutional component to the success of these arrangements. He argues that these state's reliance on proportional representation (PR) is critical to the long-run economic health of these societies. The reason is that PR systems typically allow for smaller swings in policy across elections than do first-past-the-post (also known as winner-take-all) systems used by the United States and Great Britain. This, in turn, raises the costs to groups seeking to extract gains from the trading sector.

[16] A host of scholars have analyzed this relationship. Delong and Shleifer (1993), North (1981, 1991), North and Weingast (1989), Persson and Tabellini (1991), Riker and Weimer (1993), Rogowski (1989) Root (1993b), Weingast (1993a).

A second institutional basis for economic reform is readily seen as underpinning the economic success of Chinese economic reform. Specifically, a major question in the literature concerns the question of whether the reforms remain at the discretion of the central state, and hence whether the latter might simply choose to reverse the reforms at some point in the future. I argue elsewhere (Montinola, Qian, and Weingast 1993 and Weingast 1993a) that part of China's success is precisely that it has provided some institutional durability underpinning the reforms. This has been accomplished by systematically altering the political and fiscal relationships between the central and local governments. These alterations yield several results. First, they have made many local governments fiscally independent of the central government, especially those areas with the greatest economic success. The new fiscal arrangements have induced local governments to care far more about their own local economic health and prosperity than about the central governments' interests. Second, they have changed the nature of the communist party hierarchy. No longer is promotion into the central government so desirable. Large numbers of members are communist in name only and want to retain their positions and grow rich along with their local governments.

These arrangements have changed the relative bargaining power between the central and local governments in ways that have made the arrangement more durable. Recentralization is not impossible, especially since the central government still controls the army. But the price it must pay has risen considerably. For example, the central government no longer has the fiscal capacity to take on the commitments associated with recentralization. Although it might attempt to make up for this through confiscatory measures on the lower governments and successful enterprises, this would immediately dampen economic activity and increase the regime's social responsibilities (due,for example, to the unemployment it would generate). Strong doubts as to the central government's ability to meet these responsibilities raises the specter of the fate of the former Soviet Union, something that the Communist Party of China clearly seeks to avoid.

Two events following Tiananmen square reveal the durability of the reforms. First, shortly after crushing the democracy movement, Li Peng, China's premier, moved to recentralize control over the economy. Led by the governor of Guangdong, the provinces successfully forced him to back down (Shirk 1993, p **). Despite large provincial differences, the new decentralization and fiscal incentives appear to have united them on protecting their new powers.

Second, this was perhaps the most propitious moment for a successful curtailment of the reform process, as conservatives were on the political ascendancy. The economic retrenchment begun about this time lowered the central government's support for reform. The retrenchment failed, however, in part because of an economic downturn mixing falling revenues with increasing commitments, a disastrous combination. The official moment at which the retrenchment ended, Deng Xiaoping's "Southern tour" in early 1992, returned reform to favor.

These two events, at the apex of the conservatives' power, suggest that the power of those seeking to preserve China's decentralization is substantial. The revelation of the conservative's failure, in turn, greatly increased the perceived political security of the reforms. Economic growth soon skyrocketed well into the double-digits for the rest of 1992.[17]

7. Conclusions.

Economists and economic advisors are often reluctant to discuss the internal politics of states. This does not reflect a denial that history, culture, and politics matter; rather that economics has little to say about these factors. Its rationale for ignoring these factors is the presumption that those countries which adopt the "prescribed policies" will succeed, regardless of their culture or circumstances. My argument suggests that this claim is false. Adopting the appropriate policies alone may be necessary for economic growth, but it is not sufficient. These policies must also have the appropriate political foundations. Reform that is not credible or durable will not be taken seriously and may well backfire.

The analysis in this paper thus demonstrates the importance of the political underpinnings of economic reform. It does so by focusing on the need of all governments to maintain sufficient political support to survive. This requires that regimes in the developing world evaluate the prospects for economic reform in political and well as economic terms: How will it affect their chances for survival? Reform programs that require a regime to attack its major support constituency without a concomitant gain in political support from other elements of society rests on a dubious political

[17] In closing this section, let me observe that precisely this type of political institutionalization underpinned the economic growth of the West (North 1981, Root 1993a, Weingast 1993a). For example, as I argue (Weingast 1993b), this type of political underpinning served to create the common market that underlaid the developing economy and its enormous growth in the early history of the United States.

foundation. As the case in Zambia of the mid-1980s shows, such reform is launched at the regime's peril. The consequence is either reversal of the reforms or failure of the regime. Alternatively, as Fernandez and Rodrik (1991) argue, reform programs often fail to gain the relevant support because of a critical political asymmetry: The losers are known in advance but the potential beneficiaries have yet to be identified and hence do not generate sufficient political support to allow the regime to carry out its program.

For parallel reasons, economic groups will evaluate a reform plan in political as well as economic terms. The latter suggest the nature of the potential benefits and costs from the plan as designed. But these alone do not determine the success of the reforms. To the extent that the reforms are easily reversed, economic actors cannot take the reform and its promises at face value. Attending any reform program, therefore, is a degree of *political risk* that arises over and above any economic uncertainty: Will the reforms succeed? Will they be reversed because of political pressure? Or will the gains be eroded via corruption? The uncertainty revealed by these questions suggests that an interest group's decision about whether to support the reforms is complex and depends on critical political questions as well as economic ones.

This perspective helps explain why political gridlock often prevents the introduction of meaningful reform. Under many circumstances, entrenched interests will be reluctant to support reform despite the promise of large economic gains. To the extent that they think the promised benefits are unlikely to be realized, they are likely to block reform. Prospects of a coup or corruption will also lower the expected benefits. Alternatively, if the group is outside the regime's constituency and thus without political leverage, it may rationally fear that the regime will not honor its promises. The consequence in either case is gridlock or reform failure.

The case of agricultural reform illustrates these principles. Farmers are rationally concerned about the political durability of the promises made in any reform program. Their decision to support reform must not only be predicated on the economic consequences of the program, but on assessments of the ability of the regime to maintain its promises, for example, to assure farmers that they will receive near market clearing prices for their products. In the former Soviet Union — and now Russia — maintaining such promises depended on a variety of highly uncertain circumstances, for example, the political inclinations of urban dwellers to pay those prices. Alternatively, to the extent that subsidies might have been involved to make up the difference between prices charged consumers and prices given to farmers, the regime's ability to make good on these promises directly depended on its fiscal health. Because this uncertainty can be anticipated by farmers in advance, they were unlikely to put themselves at such risks. Hence they failed to cooperate with developing reform in either the Gorbachev or Yeltsin governments.

In the case of Sub-Saharan Africa, the political logic of regime survival has also induced a stable pattern of low productivity in agriculture. Farmers remain outside the support groups of most regimes, opposed by the urban consumers who are far more important and threatening to the government. Under these circumstances, farmers have no means of protecting themselves after the fact, and the regime will take advantage of them if it needs to. This reflects the inability of the government to adopt and maintain the long-run policies that would induce farmers to make the investments necessary for long-term productivity growth. The pattern of political forces thus underpins a political equilibrium in which a continent of farmers cannot feed itself (Bates 1981).

The approach also reveals how Korea and Taiwan worked to develop political support for their reform programs. These states not only chose appropriate economic policies, for example, by replacing an emphasis on important substitution with policies fostering export-led growth; they provided the basis to generate widespread support for the reforms. Based on a policy of extensive sharing the gains the economic growth, these regimes gained the support necessary to withstand political pressure from interest groups which supported patronage systems benefiting themselves.[18]

This paper's perspective relies on the interaction of the regime and interest groups. But unlike most approaches utilizing interest groups, that in this paper does imply that interest groups are the sole determinant of economic policymaking. Instead, the political institutions of the state matter as well. Those groups that are critical supporters of the regime are likely to gain via the regime's policy choices. But opposing groups are not. A second difference arises between my perspective on interest groups and the conventional one. In the latter, the economic consequences interest group influence are almost always negative, as if the absence of interest group politics would yield a pure market system meeting the specifications of neoclassical economics. My perspective, in contrast, implies that interest groups and public support are required for all policy choices, including those which foster long-term economic growth. Previous

[18] Similar principles seem at work to some extent with the social welfare policies of Chile and in the small European trading states (Bates and Krueger, 1993).

approaches may provide considerable insights into the increasing intervention in the economies of the developed West over this century, but they fail to account for why a prosperous market ever came into being in the first place. The perspective in this paper not only holds the potential for that explanation (see, e.g., Weingast 1993a,b), but provides considerable practical insights into the political problems of modern economic reform in the developing world.

By way of summary, let me restate one of the principal conclusions of the analysis. *Holding constant for the economic and technical aspects of a given reform, the ability of the government to commit credibly to the reforms is a critical variable in the reform's success.* This implies that political development must accompany economic development. Political development is not something that automatically follows economic development. Rather, successful development requires that a country develop the appropriate political foundations for reform *simultaneously* with the adoption of the appropriate economic policies. Only the former have a hope of providing the secure foundation needed for long-run economic prosperity.

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Figure 1: Excess Demand for Food in Africa

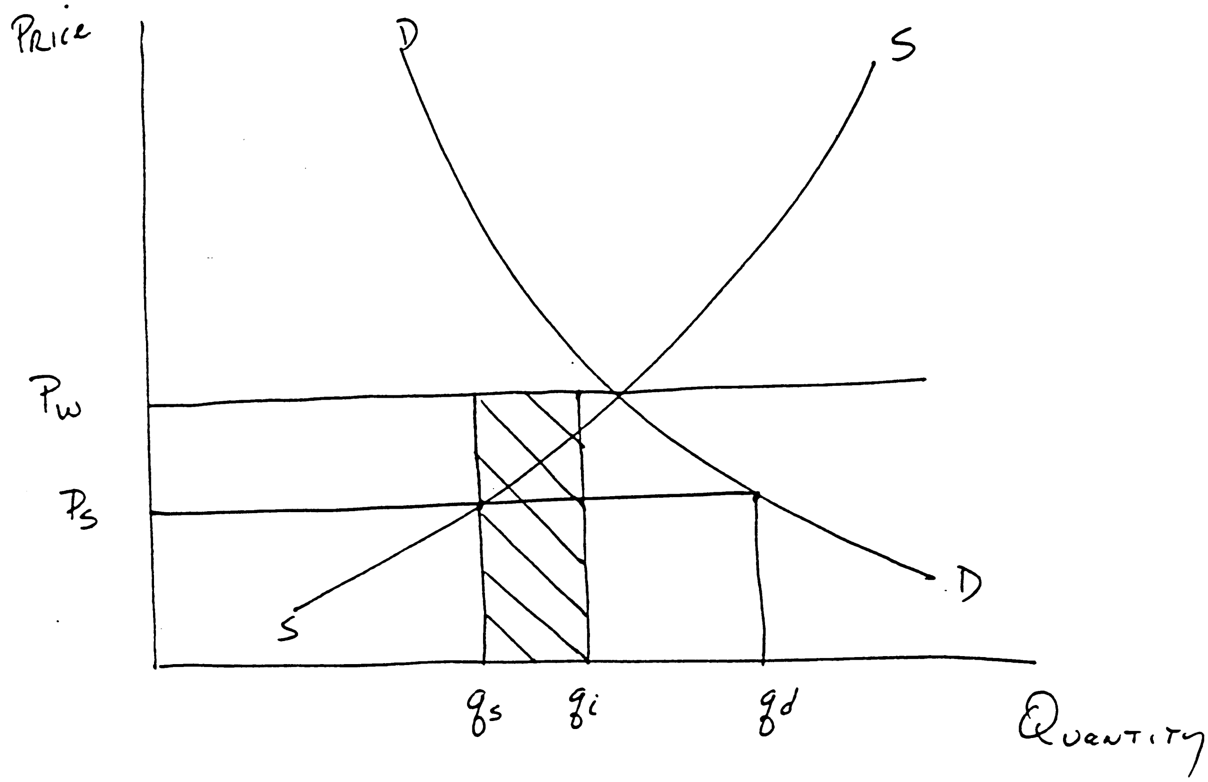

Figure 2: Neoclassical Analysis of Improved Farming Techniques

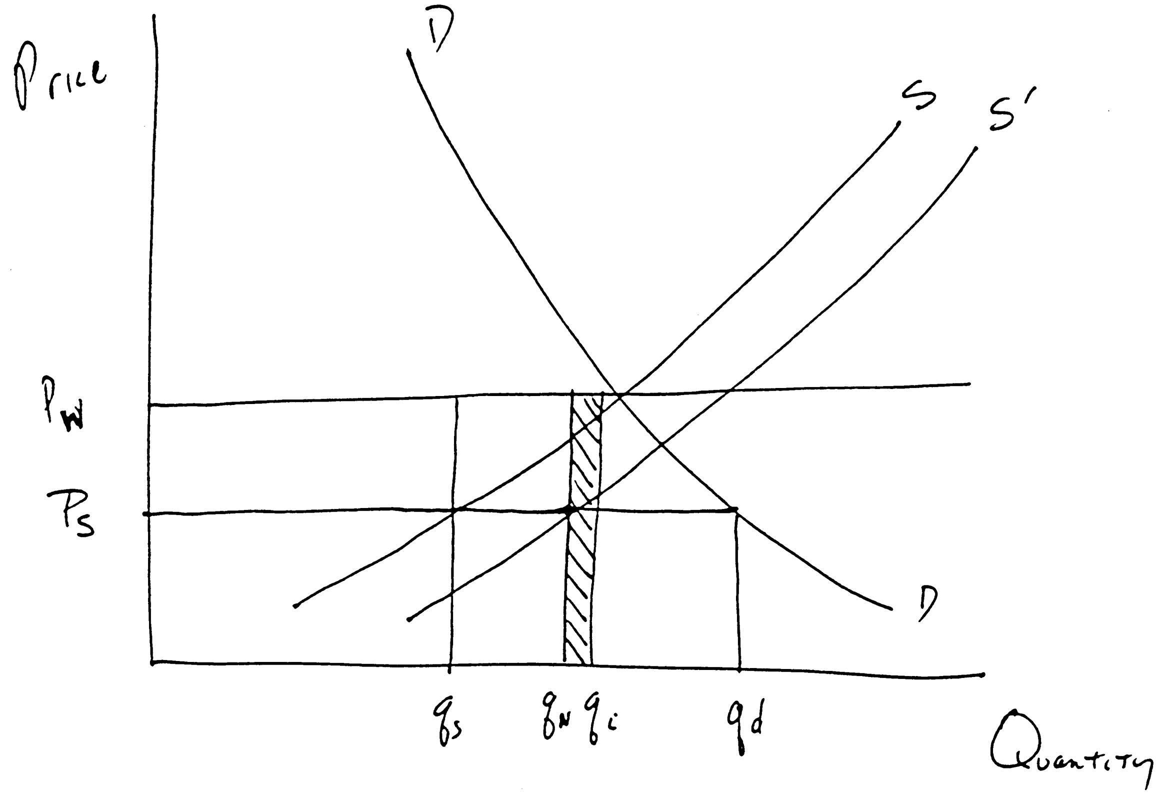

Figure 3: Political Analysis of Improved Farming Techniques