# The Political Economy of Reform

## *Designing, Initiating, and Sustaining Public Sector Reform in Developing Countries*

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This article, in two parts, examines the nature of the public sector reform process in developing countries, drawing primarily on the experience of countries in the Asia-Pacific region, particularly the two rather different cases of Papua New Guinea and Bangladesh. In discussing key issues, the academic debate has been summarized but the focus has been on reviewing its implications for policymakers in the developing countries. First part is published today.

ONLY in the past two decades has the term "reform program" achieved its current ubiquitous status in the developing world, having become a common feature in virtually every nation's economic policy statements. Developing countries are constantly exhorted to "reform" their economies and their state institutions and improve the quality of "governance". The implication is that they remain underdeveloped due to weaknesses in their economic organization and shortcomings in the operation of the institutions of the State. The further implication is that whereas in the developed world the role and institutional structure of the State have successfully evolved over time to meet the changing needs and challenges of the modern world, developing countries have lagged behind in the recasting of policies and institutions. The relatively slower rate of institutional adaptation to change in developing countries may reflect a number of factors.

the existence of powerful interest groups that may prevent the "spontaneous forces for change" noted above from operating.

civil services that are not geared to efficient management of change processes, lacking the training or incentive structures to ensure the effective implementation and management of reform programs;

the absence of strong political leadership in favour of the reform process. This should not be construed as an argument for discarding the checks and balances of democratic processes : it should be remembered that in some countries there may be strong leadership that firmly opposes change; and

a relatively weak "civil society". In the developed countries "civil society" has been a major vehicle for articulating the need for change and ensuring that the forces for change coalesce in an effective manner, but its growth elsewhere has been constrained by poverty, low levels of education and poor access to the media.

In the discussion that follows the term "public sector reform" will encompass the entire range of policy actions being undertaken to:

a) enhance the effectiveness and efficiency of the institutions of the State in meeting the needs of its citizens, particularly in terms of the provision of public goods;

b) improve transparency and accountability in government;

c) reorient the State to provide an enabling economic environment for the private sector, which is envisaged as the "primary engine" of economic growth.

d) shift the focus of the State towards "core" functions, and away from activities that could be more efficiently performed by the private sector, and

e) decentralize the provision of public services (strengthen local government institutions) and move to alternative service delivery mechanisms, enhancing the role of the private sector and Non Governmental Organizations (NGOs), where appropriate.

f) reform principal-agent relationships, incentive structures and administrative processes that govern the activities of the civil service, to improve its efficiency in the implementation of Government policies and its ability to effectively manage the reform process.

What then are the forces that are currently spurring reform and specifically public sector reform in the developing countries? Generalizations across the disparate range of countries that constitute the developing world are always difficult, but although the importance of individual factors may vary considerably across countries some common themes may be identified.

First, there are the pressures of globalization and the need to compete effectively in global markets. Unless a nation chooses autarky, the dynamics of international communications, trade and labor and financial mobility may demand changes in the organization of domestic institutions to enable them to interact effectively with their foreign counterparts. In this context it is important to stress the role of international capital markets which generally favor countries with well-functioning public sector institutions.

Second, there are the economic and business interests that have been benefited by the first wave of economic liberalization policies, and which have gained the strength to press for further reforms.

Third, there is the role of "civil society", which encompasses various private associations and non-government organizations (NGOs). The latter have emerged as a potent force for change in a number of poorer developing countries that are otherwise regarded as poor in terms of social capital.

Fourth, there are the extensive interventions of the bilateral and multilateral donors, both groups facing pressures to use taxpayer resources effectively in their aid programs. Despite much talk of "ownership" of reform programs by the recipient country, it is well-recognized that donors have become a major factor in the design, timing and sequencing of reforms in many countries, leading to concerns about the encroachment of national sovereignty and the sustainability of externally imposed reforms.

A fifth factor is the existence of "agents of reform" within the public sector. Even in the most poorly performing of public sectors, there are likely to be pockets of excellence or at least competence. It is important to identify these areas, support the forces in favor of reform and, attempt to replicate the lessons of success.

Lastly, policymakers may take heed of the experience of countries which have been forced by crises to reform in a manner and at a speed that may exacerbate the social costs of the reform process. Rather than have reform "imposed" upon them, countries may choose to take pre-emptive action to forestall economic crises engendered by governance failures, and decide to strengthen management of the public sector to support faster economic growth.

The remainder of this paper examines some of the problems encountered in fostering and sustaining specific public sector reforms and good governance in developing countries in the context of the forces enumerated above. The area of public sector reform is an extensive one and no attempt will be made in this paper to present a magisterial view of the subject. We will focus on some of the main objectives of reform (notably, the enhancement of transparency and accountability), aspects of civil service reform (a central issue given that the civil service must implement the broader reform programs), the role of donors in the reform process, and the development of effective coalitions of interests to support and sustain the reform process.

Although reference will be made to the devolution of non-core functions to the private sector, this topic will be dealt with in the context of the other reform issues indicated above. In each of the reform areas noted above the arguments in favor are generally well known and will not be presented at length here. The so-called "Washington Consensus" on governance and public sector reform, referring to the position taken by the World Bank and the IMF, is rarely even questioned these days. It suggests that markets generally function better that governments and that public sector reforms are needed to reorient government towards "core functions" and the provision of an enabling environment for the private sector. One could argue that the unquestioning acceptance of the primacy of markets may have led to an excessive pullback by governments from many functions the private sector cannot or should not perform. Moreover, the ease of establishing effective regulatory frameworks has been grossly underestimated, so that the transfer of functions to the private sector has not always resulted in the expected gains in efficiency. While accepting that the private sector must be the main engine of economic growth, we would argue that it is not possible to bypass governments (through the private sector or NGO's) and that major reforms in the public sector are needed to improve economic performance. The focus of the present paper will be on examining why progress on public sector reforms has been so difficult to achieve despite all the persuasive academic arguments marshaled in their favor.

**"The consequences of reform are often measured using quantifiable yardsticks, such as national income, exports, or inflation. But an equally important aspect of reform is whether it succeeds in reshaping the values and norms of the state and the state's relationship to the economy. It is this transformation that ultimately legitimates reforms in the public eye." World Bank, World Development Report 1997, P. 155.**

### Initiating Public Sector Reform

In this section we will examine the reasons for the reluctance of many governments to reform the public sector. At the very outset it should be remembered that an incumbent government may find it difficult to openly identify or even acknowledge existing problems, which may involve acceptance of at least partial responsibility for failures in public sector management. However, even when there is agreement on the nature of these shortcomings, there appears to be little urgency to take corrective action.

The main factors behind this apparent inertia of governments faced with pressures to reform the public sector include:

* an unwillingness to risk the stability of the government through reforms which may have unforeseen consequences such as engendering dissension in the civil service, or creating new political threats to the regime;

* the absence of institutional structures capable of managing the change process;

* the "hidden" barriers to reform whose existence is often difficult to openly acknowledge such as corrupt practices which may be;

* a recognition that reforms may need to involve long-term programs (beyond the time horizon of political governments) and that reform costs are often paid quickly, while its benefits accrue only in the medium-term;

* the lack of a popular mandate which would allow them to push through difficult changes;

* the unstable dynamics of coalition governments. The latter forces the more reformist elements in a coalition to limit the pace of change to one that is acceptable to the most conservative of their partners in government

* an unwillingness to take on painful reforms to deal with longstanding problems which represent a drag on the economy but hardly a catastrophic political threat.

We focus here on two of the above factors: the hidden costs of reform and some of the likely scenarios under which rapid progress in reform is most likely, and conclude by pointing to some possible actions to engender change.

In undertaking major changes in the public sector, one must keep in mind the simple fact that throughout the reform process the business of government must go on. Although there will of necessity be some disruption of processes and even activities, there is a need to draw a fine balance here in effecting change while ensuring that existing structures do not grind to a halt before the revamped institutions become fully operational. This is particularly true for the civil service, which must manage the broader reform process and at the same time undergo major changes that may increase uncertainty and lower morale in the transition period. In many countries the civil service unions are powerful and effective and are vociferous in their opposition to the vision of a leaner public sector. The role of the civil service in the reform process has been discussed at greater length in an another section of this paper.

The proponents of public sector reform in the developing countries donors, elements of the business community and "civil society" present their arguments for reform openly and effectively. Without wishing to caricature their position, they would represent the issue as one of consulting with all the "stakeholders" in the reform process and then designing schemes to compensate the "losers" from reform on the basis of the larger gains of those who benefit. They would argue that there are clear overall benefits from the reforms they advocate (notably privatization, reorienting the State towards core functions, civil service reform and decentralization) on the basis of an assessment of losses and gains. The opponents of reform often do not present direct arguments against these proposals, but are likely to a different tack, suggesting a different sequencing of reforms, delays to accommodate adjustments by those adversely affected and revisions in the design of the reform plans. This helps slow down reforms and in some cases the delays may be sufficient to ensure the would-be-reformers complete their terms without having made irreversible changes.

A common miscalculation of the proponents of reform is to limit the analysis of losses and benefits to those identified as "legitimate". The main stakeholders in a program to privatize a state-owned-enterprise, for example, may be identified as the management, workers and consumers of the enterprise's output. However, management and labor leaders may derive many times their official remuneration from rent-seeking behavior and corruption. Moreover, there may be other groups that currently derive benefits from the enterprise, such as the political leadership and civil servants in the controlling ministry. The inability to take account of these factors in most privatization programs undertaken under the aegis of the World Bank is a serious shortcoming that may explain their failure in many cases. One reason for this may be the apparent intractability of the problem it would be morally wrong and, indeed, impractical to attempt to fully compensate those earning large illegitimate incomes from the operations of state enterprise. One method used to overcome such resistance is to provide substantial equity stakes for existing management and workers, but even this is rarely sufficient to overcome opposition to privatization given the value of controlling an enterprise with virtually unlimited recourse to government-guaranteed financing.

In many cases, the losses from reform would be highly concentrated in a relatively small group whereas the benefits might be dispersed throughout the society. This presents the difficult (although not insurmountable challenge) of forming a broad coalition of interests that would benefit from reforms. Educating the public about the benefits of reform through the media might help support the formation of such a coalition but this would necessarily be a slow process. In countries where there is widespread cynicism about virtually every institution of government, the motivation of those advocating some reforms (such as privatization in Russia for example) may itself be questioned.

Decentralization is another area where opposition from interests at the center is very likely. Even when decentralization presents the prospect of clear benefits in terms of improving accountability and the delivery of public services, real devolution of power and resources is often slow to take place. This is not surprising given that it is the legislators at the center with the most to lose, given the creation of often competing sources of electoral power in their areas who will control the speed and nature of decentralization. This resistance can be overcome as in Bangladesh under the present government where there is strong leadership in favor of decentralization due to a perception that it represents a popular program that would be an electoral asset. In Papua New Guinea, on the other hand, lawmakers from the national government have become provincial governors, eliminating the problem of competing sets of elected officials at the center and in the provinces. It should be noted the decentralization that took place in Papua New Guinea during the 1990s has had mixed reviews in terms of its impact on the quality of service provision.

It has been argued that "....an external threat or an economic crisis real or perceived may override resistance to change." It should be noted that an economic crisis is no guarantee of change, however, as Japan continues to demonstrate. On the other hand economic crisis was a major factor in stimulating reform in Indonesia (1961-64), Fiji (1988) and Peru (1990). Papua New Guinea undertook a number of major reforms (notably in liberalizing labor markets) in the wake of the economic crisis in the wake of the Bougainville mine closure, and important public sector reforms have taken place in South Korea and Thailand following the 1987 Asian economic crisis.

Adding to the likelihood of reform in such crisis periods is the role of the IMF and the World Bank in providing financial assistance. Given the weak external reserves position of many countries during economic crisis (and the difficulty of borrowing from commercial sources) governments have little choice but to accept stiff reform conditionalities. Not surprisingly, these two institutions regard economic crisis in developing countries as opportunities rather than calamities. Even the most earnest domestic proponents of reform would ever want to see a situation where external agencies gained such control over their countries' policies. Clearly, if a country is to maintain control over the pace and content of its reform agenda it must ensure that its external reserves are sufficient to absorb short-term shocks.

If reform is not to be driven by crises, then how is it to be initiated? First, there are examples of countries where major reforms took place in the absence of a crisis, such as Australia (1983) and New Zealand (1980s). Second, just a change in government may provide the opportunities to chart a new set of policies for the public sector. Third, is the possibility that successful reform in a few carefully selected areas may create support for broader reforms. The initial choice of reforms is very important here ideally the activities/sectors chosen should have the broadest and most direct interface with the public. Examples would be public transport, health facilities, the passport office and (in some countries) the airports. Finally, we would note the arguments to seek social and cultural change to support the reform process, by operating on the "deep structures" of society. This is likely to be effective, but would by its very nature involve long-term processes. In the respect one must question its appeal to key groups such as the bureaucracies of donor agencies, the nature of whose jobs demand quick, easily discernable (and preferably quantifiable) results.

*(Tomorrow: Second part)*

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# Excerpts from the main report of Hamoodur Rahman Commission of Inquiry as declassified by Government of Pakistan

## POLITICAL BACKGROUND: XI

From Dacca the President came to Karachi and on 17th January, 1971, went to Larkana to pay a visit to Mr Bhutto. Accompanying him were also General Hamid and General Pirzada. It has been said that General Hamid went there only because of a shooting trip and General Pirzada's presence of course is understandable as General Yahya's Principal Staff Officer. The allegation has therefore been made and denied that this was a sinister meeting between the army top brass and Mr Bhutto who were conspiring to do Mujib out of the fruit of his favourable election results. We do not really see that there is much in this. It may well be that General Hamid was in fact going for a shooting trip and it may equally well be that it might have been mere politics to avoid his presence. A meeting between Mr Bhutto and General Yahya at this time would seem to be politically as necessary as one between the latter and Sheikh Mujibur Rahman and whether General Yahya was accompanied by only General Pirzada or seven other Generals would seem to make little difference. In any case, Mr Bhutto was meeting the Army's top brass.

At this meeting the Chairman of the Pakistan People's party is said to have pointed out to the General the necessity of giving him some time to parley with Sheikh Mujibur Rahman for otherwise a meeting of the House, with Mujib bent upon his Six Point programme and supported by a clear majority, would surely be able to go through with the Constitution which meant the end of one Pakistan. He also wanted time to prepare public opinion to enable his party to go as far as possible to meet the substance of Six Points on the condition that nothing should jeopardise the unity of Pakistan Mr. Bhutto at this meeting with General Yahya did not suggest a specific date for the calling of the Assembly but he wanted sufficient time and indicated that he would be ready be about the end of March. General yahya appeared to be more or less in agreement and Mr.Bhutto then went with some other members of his party to Dacca where he met the Sheikh on the 27th of January, 1971.

As to the talks that were then held we have the evidence only of Mr Bhutto and some of his associates and are necessarily without the advantage of the evidence of Shaikh Mujibur Rahman or the other members of his party. The Pakistan People's party chairman has deposed that in his talks Mujibur Rahman was somewhat harsh in his attitude and refused entirely to shift from the Six Points. No amount of persuasion had any effect on him. He was set upon a meeting of the National Assembly on the 15th of February as we have already stated, and the Pakistan People's Party pointed out to him that even for enabling the party to accept the Six Points in substance with some concession which would ensure the continued existence of Pakistan, it would be necessary to canvass public opinion in the West. The Shaikh understood the difficulties of the party but was entirely unamenable to the request that he should agree to a date for the National Assembly later than the 15th of February. Mr Bhutto, therefore, returned from Dacca really having failed in his mission, but did not say so publicly contenting himself with a non-committal account of his talks at Dacca.

He then met General Yahya at Rawalpindi on the 11th February, and reported to him the result of the discussions. Mr Bhutto felt that between the conflicting demands of the Pakistan People's Party for postponement and that of Shaikh Mujibur Rahman for a very early session the President could steer a middle course and satisfy both sides by making an announcement of a date sufficiently distance to allow the Pakistan People's Party the time it wanted. Mr Bhutto maintains that he left General Yahya with the clear impression that the latter agreed with him and would convene the Assembly on some date during the end of March 1971. However, General Yahya chose the 3rd of March and announced that the Assembly would meet on that date.

In the meantime agitation had been mounting in East Pakistan for the early summoning of the National Assembly, an agitation which could well go completely out of hand. In some measures the effect of non-interference with the election campaign of the Awami League had already emboldened the masses. By about the time that General Yahya announced the date, the 13th of February, a feeling that an impasse had been reached, was clearly there.

A few days after the Assembly had been summoned for the 3rd of March, that is, 15th of February, Mr Bhutto called a press conference at Peshawar. The announcement of 3rd March had come as complete surprise to him for only two days earlier he had met General Yahya and was given the impression that the National Assembly would be summoned to meet in the end of March 1971. At the conference he stated his party's position along the lines that we have stated above and announced that his party would not participate in the National Assembly session on the 3rd of March, unless their point of view would be heard and, if found to be reasonable, accepted by the Awami League. He maintained before us that neither then nor later did he say that it meant to boycott the National Assembly session. All that he wanted was an assurance that there would be reciprocity from the Awami League for adjustment in the Six Points. Judging from the conversation between the Awami League and General Yahya on the 7th of January, 1971, a conversation which was confirmed by General Yahya, and the broadcast months later on the 28th of June, 1971, we might have thought that such an assurance would not have been difficult to obtain from the Awami League. Be that as it may, from the 15th February onwards the Pakistan People's Party continued to say that they wanted accommodation to hold dialogue with the Awami League and that, unless this was assured, it would not be possible for them to attend the session on the 3rd of March. On the 21st February, a convention of the party took an oath to abide by the party decision not to attend the Assembly on the 3rd of March.

Finally, on the 28th of February, 1971, Mr Bhutto not knowing that the decision to postpone the National Assembly meeting had already been taken by General Yahya Khan on the 22nd of February, and was being conveyed to Mujib on the 28th, addressed his famous mammoth public meeting at Lahore. He declared that neither his party would attend the Assembly Session at Dacca not would it allow anybody else from West Pakistan to do so. He warned the other parties that if any of their member decided to go, they should do so on a one-way ticket as they would not be allowed to return to West Pakistan, that their "legs would be broken," and that "the country would be set ablaze from Khyber to Karachi." It is true that at this very meeting the chairman of the Peoples Party had put forward the alternative suggestion that the time limit of 120 days set for Constitution-making in the LFO be waived, but he knew fully well that this General Yahya Khan was not going to accept. Mr Bhutto's attitude is best summed up by a statement he made at a press conference on the 19th of February, 1971: "We have gone a mile to accommodate the Six Points. We request our East Pakistani friends to move at least an inch to accommodate our view point."

Tomorrow: POLITICAL BACKGROUND-XII