

POLICY BRIEF No. 13

The Political Feasibility of Adjustment

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Introduction

In the history of adjustment, concern with the political aspects appeared only after long reflection. At the beginning of the 1980s, given the urgency of the financial crises afflicting many developing countries, the only thought was to restore macroeconomic balances, particularly the balance of payments, by means of short-term measures — budget cuts and tight monetary policy — and through devaluation. Adjustment was limited to a stabilization programme, the sole criterion being the reduction of the external deficit as rapidly as possible. It was soon realised, however, that stabilization is not an end in itself: reducing demand is not enough; it is also necessary to increase supply by improving resource allocation. Under the goading of the international organisations, stabilization measures were therefore supplemented by structural adjustment measures, such as reducing customs duties, deregulating financial markets and eliminating distortions in agricultural prices. This distinction between stabilization and structural adjustment is important from the political standpoint. In fact, a stabilization programme is a kind of emergency treatment and necessarily includes many unpopular measures: household incomes and consumption are sharply reduced through reductions in public-sector wages, subsidies and employment in the building industry. Structural adjustment measures, in contrast, can be spread over many years, and each measure creates at the same time both winners and losers, so that the government can easily rely on a coalition of beneficiaries to defend its policy.

Notwithstanding the economic successes obtained in certain countries through these stabilization programmes and structural reforms, the debate rapidly expanded to include criticism of the social consequences of adjustment. This new concern was symbolised by the publication in 1987 of Cornia, Jolly and Stewart's *Adjustment with a Human Face*. It was in order to make a scientific contribution to this debate that in 1987 the Development Centre launched a research programme on the social consequences of adjustment, the findings of which were presented in Policy Brief No. 1, *Adjustment and Equity*, published in 1992. This Policy Brief follows on from the first: to think that the sole aim of this research was to show how to avoid social unrest in case of adjustment would be to misinterpret our approach. It is clear that reconciling adjustment and

equity must be among a government's prime objectives, but it is entirely consistent with the scientific approach first to distinguish the problems and then to deal with them one at a time.

The way in which adjustment programmes were applied in dozens of countries during the 1980s shows that the political dimension of adjustment was generally neglected. Under the pressure of strikes, demonstrations and even riots, several governments were obliged to interrupt or severely truncate their programmes. This political constraint cannot simply be assimilated to the social problem referred to above. The social dimension of adjustment is, of course, obvious when the unrest is a desperate response by the poorest groups to stabilization measures which hit them directly, but in other cases opposition to adjustment does not come from the poor. For example, government employees or workers in public enterprises can block government action by striking in key sectors, and the heads of protected enterprises can slow trade liberalisation through lobbying. It therefore must be acknowledged that the economic success of adjustment depends on its political feasibility. A programme interrupted by strikes is a failure; a programme carried through at the price of repression which leads to hundreds of deaths is also a failure.

The political dimension of adjustment was a problem to which relatively little attention was paid until the beginning of the 1990s. Analysts had, of course, been building and testing politico-economic models for over 20 years, but these concerned the developed countries, where the political context is very different. Political commentators, for their part, had written monographs and qualitative comparative studies on developing countries, but, apart from a few exceptions, these studies had neither been integrated into a politico-economic framework, nor formalized, and nobody had carried out systematic analyses on the basis of quantitative data for several countries. It is only in the past few years that systematic research has been carried out on the relationship between the political context and economic growth. Alesina and Perotti (1994) made a critical survey of the literature: according to their study, it is clear that political instability has a negative impact on growth. It can therefore be assumed that, other things being equal, adjustment programmes which lead to violence slow growth more than other adjustment programmes do.

In 1990, these insufficiencies led the Development Centre to initiate a project on "The political feasibility of adjustment", which followed on from that on "Adjustment and equity". In this project, five in-depth case studies were carried out (for Ecuador, Venezuela, the Philippines, Côte d'Ivoire and Morocco), in which decision-making processes and the interactions between political and economic variables were analysed over a period of some ten years. In addition,

comparative analyses of adjustment were carried out, quantifying the political variables for seven Latin American and 23 African countries during the 1980s. Thanks to this corpus of studies, for the first time we now have precise estimates of the political risks of the different types of adjustment measure.

Our analysis in what follows is based on this broad sample of developing countries. It could have been extended to include the transition experiences of the eastern European countries: they have embarked on structural adjustment programmes (privatisation and market liberalisation) which have many points in common with structural adjustment in the countries that we have studied. Since we have attempted a political analysis, however, including the eastern European countries would involve a major risk: the history of these countries (a communist regime over a period of several decades) is very different from that of the countries studied, and as a result, the present *political* context is also different, even if certain *economic* reforms are comparable.

In Part 1 we present these results, after first proposing an analytical framework appropriate for analysing politico-economic interactions in developing countries. The recommendations in Part 2 for choosing a politically optimal adjustment programme are based on these empirical results. The definition of such a programme involves making a trade-off between the economic effectiveness of the measures and their political cost. It is clear that removing a subsidy on a product consumed only by poor families, for a minor budgetary gain, is a prime example of an inefficient measure. Conversely, a tight monetary policy, which effectively reduces overall demand without giving rise to unrest, is highly desirable. In order to classify stabilization measures according to these two criteria, we consider measures which have the same economic effect, for example the same reduction in the external deficit, since this is the prime objective of a stabilization programme. By classifying measures which have the same economic effect according to the different political risks which they entail, we obtain useful information for governments wishing to minimise the risk of unrest.

Part 1: The Political Risks of Adjustment

The Analytical Framework

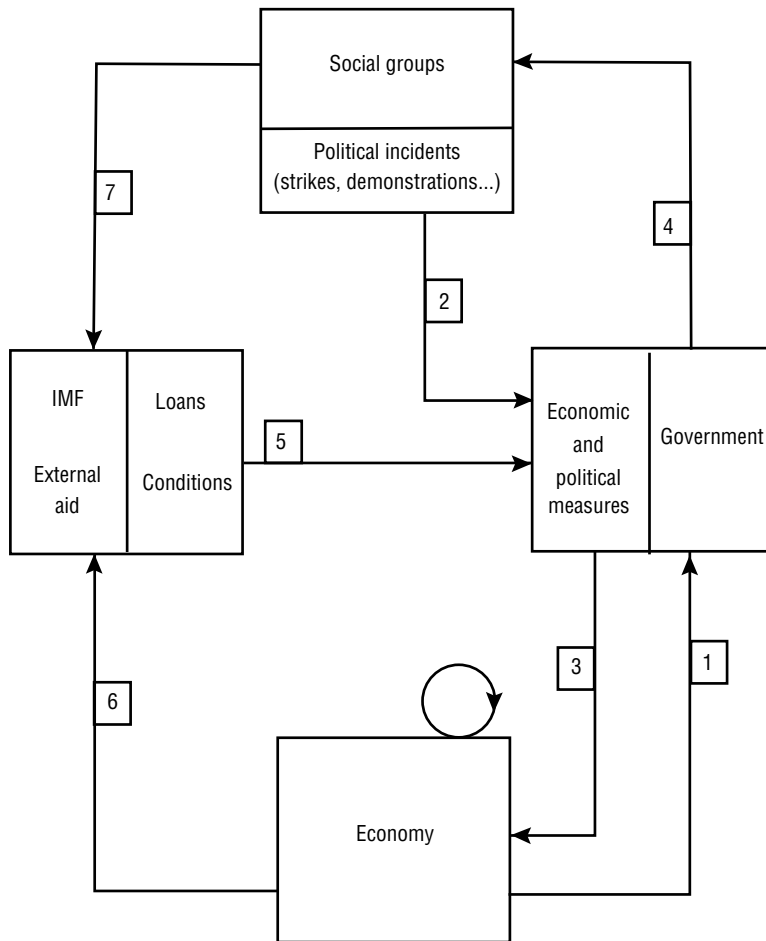
To grasp the principal politico-economic interactions of adjustment, a coherent framework is required. These interactions involve four categories of agents: the government, social groups, economic agents (as producers or consumers) and the outside world (international organisations and donor countries).

Even though a government may pursue various objectives, such as growth or international prestige, its prime objective is usually to remain in power, and the probability of its doing so depends both on the political support of the population and on repression. When the government makes budgetary choices, these affect two categories of expenditures: those which directly benefit certain groups and thus increase their political support, or those which contribute to the well-being of all in the long term, such as investment in infrastructures. In the case of adjustment, the international organisations demand a reduction in the first type of expenditure, thus reducing support for the government. The government can compensate for this fall in popularity by repression in the case of unrest, but this entails numerous costs (increased dependence on the military, negative reactions abroad). In the case of adjustment, therefore, the government is always caught between conflicting pressures: financial constraints and repression, on the one hand, and the disadvantages of this repression, on the other. Adjustment does not, however, consist solely of budget cuts; it also requires the restructuring of expenditure in favour of various groups or sectors. This does not necessarily lead to a fall in support: since this policy produces winners as well as losers, there may be some political compensation.

The different social groups can defend their interests in various ways: through the vote or negotiations, through strikes or demonstrations, or even through riots. In countries which tend to be autocratic the vote can scarcely be effective, so pressure on the government is exerted in other ways. Urban populations can initiate collective action more easily than those in rural areas.

Among the urban populations, certain workers have considerable negotiating power; if they are in key sectors such as energy or transportation, for example, they can block economic activity.

Figure 1



It is assumed that economic agents act in accordance with standard theory. Enterprises, for example, invest less if adjustment leads to higher interest rates. Lastly, if the country is in financial crisis, external agents intervene to help the country to comply with its commitments, by wholly or partly repaying its debts, while at the same time taking into account the country's own interests (a return to stable and durable growth).

Figure 1 summarises these relations schematically. A first block (arrows 3 and 4) shows the economic and political effects of measures implemented by the government or the outside agents. For example, a restrictive monetary policy slows activity (arrow 3) and the removal of a subsidy provokes unrest (arrow 4). The second block (arrows 1, 2 and 5), shows how the government reacts to political events or economic conditions. With arrow 1, for example, we see how a large external deficit obliges the government to stabilize. Unrest leads to repression (arrow 2). Lastly, "conditionality" shows the influence of the IMF on government policy (arrow 5). The last block (arrows 6 and 7) shows relations with the outside world, which reacts to the country's financial crisis (arrow 6) or the political situation (arrow 7), for example by expressing disapproval of very harsh repression.

This set of interactions can also be interpreted from a dynamic standpoint, which brings to light a politico-economic cycle specific to adjustment. Let us suppose that, because of a serious balance-of-payments deficit, a government introduces unpopular stabilization measures (arrow 1); these measures provoke strikes and demonstrations (arrow 4), which force it to use repression (arrow 2). Usually, however, this repression does not last long in democracies or autocracies (unlike in dictatorships). After a certain time, the government introduces political liberalisation measures (arrow 4). If external aid has given the government some room for manoeuvre, it can now introduce popular economic measures which stimulate the economy and increase support for its policy (arrows 3 and 4). Unfortunately, if the macroeconomic balances have not been properly restored in the meantime, this return to a more laxist policy may bring the country back to its starting point. In this case, conditionality can be seen as a protection against this cyclical process.

The Political Risks of a Stabilization Programme

Our two samples, comprising numerous African and Latin American countries, confirm the risks of such a programme. We see a close link, with a delay of three to six months, between the announcement of stabilization measures and unrest, strikes or demonstrations. This delay is interesting, since it proves that,

contrary to the theory of rational expectations, political reactions appear at the time when measures are actually applied, rather than when they are announced. This can be explained by the technical nature of adjustment: when the government announces a programme and outlines it in broad terms, most of the people concerned are unable to form any clear idea of its consequences for them, or think that it will mainly affect others.

Reactions vary greatly according to the type of measure introduced. Those which most often give rise to demonstrations are those which affect the whole population, i.e. price increases, whatever the cause (reduced subsidies, increased indirect taxes or devaluation). In Zambia, for example, the doubling of flour and maize prices in December 1984, due to the removal of subsidies, provoked a wave of riots and repression resulting in 15 deaths; because of these reactions, the government subsequently cancelled the measure. Similarly, when the price of paraffin oil, bought mainly by poor households, was increased in Nigeria in 1988 (again because the government removed the subsidy), this measure provoked riots leading to the death of six demonstrators.

Such increases lead less often to strikes, which is scarcely surprising because in many countries most of the urban population is employed in small enterprises or the informal sector, where people cannot strike without losing their jobs. What is more, strikes are sectional movements by nature, which explains the correlation between budgetary restrictions affecting public employees and strikes: such restrictions frequently lead to wage cuts and even redundancies in the administration and public enterprises; since these workers are organised and often in secure employment, they can strike. This was the case in the Congo in 1990, where, in the context of an agreement with the IMF, the government reduced the number of civil servants and cut public-sector wages: this led to a wave of strikes until these measures were suspended. In Burkina Faso, a 15 per cent wage cut in 1982 led to a strike by government employees; when, in 1984, the government withheld 25 per cent of their wages, teachers again reacted by striking. However, other measures, such as cuts in public investment or operating expenditure (excluding wages), do not lead to unrest. Statistics from dozens of countries observed over ten years thus prove that the political risks are very different from one measure to another. This finding is important, because it means that programmes having the same economic impact may entail very different levels of risk, and that there is thus a politically optimal programme, i.e. one that minimises the risks.

Governments' reactions to unrest vary according to the case. The harshest forms of repression are reserved for demonstrations, which is explained by the autocratic nature of many regimes. Since demonstrations are considered a threat

to the regime, the latter defends itself by all possible means, including summary executions or firing on demonstrators. Thus, in January 1984, a doubling of bread and semolina prices in Tunisia provoked serious riots in the south of the country: these were immediately repressed at the price of scores of deaths. Strikes may also be repressed, but less severely; there may be arrests, for example, censorship may be imposed, or schools and universities may be closed if teachers go on strike.

For the Latin American countries, comparing democratic regimes like Colombia, Ecuador and Peru with military regimes, such as Argentina and Chile in 1981-82, shows that unrest is less frequent in a military regime; furthermore, it is different in kind, since there are more strikes than demonstrations. Comparing the two experiences of Argentina under a military regime (in 1981) and under democracy (1987) is revealing: the level of protest was three times as great in 1987 and there were many more demonstrations. This is easily explained by the greater risks for demonstrators under a military regime. Nevertheless, this type of regime is not necessarily less fragile: changes of government as a result of unrest are more frequent with such regimes and, beyond a certain threshold, social unrest rapidly snowballs to the point of threatening the regime, which is not the case in democracies.

The autocratic, but not dictatorial, nature of many regimes is shown by the correlation between repression and political liberalisation; in fact, it is characteristic of a dictatorship that it never introduces many or durable liberalisation measures: lost freedoms are lost for ever. On the other hand, we must not confuse authority with autocracy. It is entirely natural that, even in the most democratic countries, certain personalities exert a dominant influence of a purely moral nature which is in no way counter to democratic principles, whereas all autocratic regimes trample on these principles. Among the 23 African countries studied over 11 years, we often see this policy of liberalisation a few months after the repression: prisoners are freed, banned newspapers reappear and closed schools are reopened. Harsh and lasting repression — as was the case in Guinea under the regime of Sékou Touré (this country is not in our sample) — is not possible for several reasons: the cost of the repressive apparatus, the government's dependence on the army and the police, and above all the external impact. Donor countries may react by cutting aid or even severing all trade and technical links. Only countries like Guinea, which at the time benefited from the unconditional support of the Soviet Union, were not exposed to this risk.

Once a government embarks upon this political liberalisation, it has more difficulty in maintaining tight policies and, fairly often, a return to laxism occurs: subsidies are reintroduced, public expenditure starts growing again, monetary policy is eased. After the riots of January 1984 in Tunisia, for example, the Minister

of the Interior responsible for the repression was forced to resign, the state of emergency was lifted and at the same time the policy of true prices was abandoned: the subsidies on bread and semolina were reintroduced and the rent freeze was maintained. Such decisions result partly from political liberalisation: as opposition to adjustment can be articulated anew, the government is inclined to change economic policy, all the more so when the stabilization programme has already been applied for some time. A government in this position hopes that this will be sufficient and relaxes its policies. Experience thus confirms the hypothesis of a politico-economic cycle of adjustment.

The existence of such a cycle justifies the conditionality imposed by the IMF, however, because frequently the macroeconomic balances have not been re-established and this return to laxism leads to another loss of control. This being said, conditionality is no panacea. The Philippines under Marcos failed several times during the 1980s to meet its commitments to the IMF, while in the same period, Indonesia and Malaysia managed to complete stabilization programmes without IMF aid.

The five in-depth case studies carried out under the Development Centre research programme complement the information provided by the two samples of African and Latin American countries, and permit us to refine these results. A major advantage of these studies is to show us how a government, by choosing an appropriate strategy, can avoid this politico-economic cycle and successfully apply a stabilization programme.

Unpopular Measures, Unrest and Repression

The sequence “stabilization measures - unrest - repression - cancellation of the measures” certainly exists. The most significant example is that of Ecuador. In October 1982, a package of strict measures was introduced: increase of 120 per cent in the price of gasoline; removal of the subsidy on flour; increases in the taxes on cigarettes, beer, cars and capital gains on property; and an increase of 25 per cent in urban transport fares. The reactions were immediate and violent: ministers taken hostage, strikes in transport, education and other sectors, and serious riots. In October, the government had to give in on several points: wage rises were granted to compensate for the price increases and the price of gasoline was reduced. The same reactions recurred several times. In 1985, the government increased the gasoline price by 67 per cent and bus fares by 50 per cent in order to reduce the fiscal deficit. The biggest union called a two-day general strike, which degenerated into violence and the death of seven people. Two months later there was a new wave of strikes and demonstrations. Thanks

to the support of the military, however, President Cordero was able to stand up to Congress, which wanted a sharp increase of the minimum wage. In 1989, a further increase in the gasoline price and in taxes on vehicles triggered a national strike of truck and bus drivers. President Borja called in the military to operate public transport. Later on, in November 1989, an increase in bus fares provoked violent student demonstrations.

The case of Venezuela shows that there is no link between social violence and a country's level of development: despite a relatively high per capita income, this is the country where the disturbances were the most violent. In February 1989, the government ordered a 100 per cent increase in the prices of gasoline and of goods and services produced by parapublic enterprises, including urban transport. These decisions triggered riots followed by looting; repression by the army caused 300 deaths, according to the official figures. Despite this crisis, followed in May by a general strike, the government continued with the application of its programme. It nevertheless introduced certain compensatory measures in favour of the poor, which cancelled out three-quarters of the impact of the price increases as from 1990.

The same phenomenon is found in the sample of 23 African countries. It was in Gabon, which has one of the highest per capita incomes in Africa, that serious rioting broke out in January 1990, following strikes in the public sector resulting from cuts in wages and employment in the administration and in public enterprises. In the repression of these riots, some 50 people were injured and 250 arrested.

Lastly, in Côte d'Ivoire, the disturbances of 1990 interrupted the stabilization programme. The government had decided to impose a 10 per cent levy on private-sector wages and to cut civil servants' wages by 15 to 40 per cent. The news triggered student demonstrations followed by looting, then by strikes in education, the health professions and banks. A demonstration of support for President Houphouët-Boigny degenerated into a riot (one demonstrator was killed). The government therefore had to postpone the application of these measures, but even so, there was a subsequent general strike which endangered the stability of the regime, because soldiers and police took part in the demonstrations.

These examples confirm our analyses based on the large samples: price increases for basic goods and services, and cuts in net wages (after taxation), frequently provoke serious unrest resulting in a cycle of strikes and demonstrations.

Good Management of Price Increases

There are examples of success, however, where a government manages to avoid this risk, as in Morocco in 1983-85. In July-September 1983 the Moroccan government increased the prices of lump sugar, oil and high-quality flour by 10 to 20 per cent (as the result of cutting subsidies), the prices of tobacco and cigarettes by 8 to 26 per cent, and the prices of oil products by 6 per cent. The prices of these products were then not raised again until September 1985, and again only moderately.

These two series of price increases did not provoke any marked reactions. Admittedly, there was serious unrest in the north in January 1984, but this was due to local factors. This political success is explained by two factors: prudence and a good communication strategy.

First, the price increases were planned with care. Basic foodstuffs (the flour known as “national” and the granular sugar consumed by the poor) were not affected, the price increase on oil products was very slight and those on other goods remained moderate. The increases decided in 1985 were equally modest and well timed, coming after a long delay and at a time when the economic situation was improving. This prudence had a financial cost, however: the food subsidies per inhabitant were maintained at the same level, in real terms, between 1983 and 1986.

Second, the government was able to influence public opinion at the right times. In August 1983, it embarked on a price-control campaign, and the newspapers published lists of prices and the names of shopkeepers who had been sentenced for failure to comply with the regulations, together with the amount of the fine. In November 1983, the formation of a “government of national action” and the freeing of trade unionists who had been arrested in 1981 defused the political climate. Lastly, in December, the king proclaimed that the poor should be protected against the adverse effects of adjustment and that a survey was to be carried out on their situation to guide government action in their favour. Articles in the pro-government press explained that the adjustment was to be made slowly and that there would be no sudden removal of food subsidies, as had been the case in Tunisia, where this policy had triggered serious unrest. In autumn 1985, when the prices of basic products were increased, the king made a speech on the theme “Yes to austerity, no to pauperisation”. Thus, during each sensitive period, the authorities skilfully took action to reassure public opinion and demonstrate their concern for the poor.

Measures Involving Little Danger

The five country studies by the Development Centre confirm that certain stabilization measures are politically easy to implement: a restrictive monetary policy, sharp cuts in public investment or a reduction in operating expenditures entail no risk for a government. This does not mean that these measures have no negative economic or social consequences: slashing public investment slows growth for the years to come and immediately puts thousands of building workers out of work, without any unemployment benefits. Here, however, we are arguing in terms of only one criterion: minimising the risk of unrest. There is of course no reason to neglect other criteria and, for example, a donor country which has given money to finance public investment in a rural area for the benefit of small farmers would be quite right to maintain the expenditure that the government has been obliged to cut because of the crisis.

To be sure, any stabilization measure arouses opposition from one quarter or another. For example, employers react to tight monetary policy: in Morocco, in November 1983, they approached the authorities because of the cash-flow difficulties of many enterprises; the same thing happened in Ecuador, where the interest-rate hike caused many bankruptcies. This kind of reaction, however, does not worry a government very much.

Cuts in investment budgets rarely trigger any reaction, even when they are very severe: -40 per cent in Morocco in three years, -40 per cent in Côte d'Ivoire in two years, -66 per cent in Venezuela between 1982 and 1985, and -60 per cent in the Philippines in two years. In Morocco, the opposition parties certainly criticised this measure, pointing out that it prevented job creation and compromised long-term growth. Building enterprises do indeed suffer greatly from such cuts, which lead to many bankruptcies and redundancies, but this sector, composed mainly of small and medium-sized enterprises, has virtually no political weight.

Cuts in operating expenditure, always more modest, do not generally provoke reactions either, although there was an exception to this rule in Ecuador, where civil servants went on strike and occupied government buildings. Governments can even obtain the support of public opinion if they proceed shrewdly. In Morocco, for example, when expenditure for administrative vehicles was frozen, the government and the press presented this decision as an equity measure: at a time when sacrifices are requested from the entire population, civil servants should accept them as well.

Lastly, the experience of the five countries shows that the political success of a stabilization programme depends on two political factors: the support of a favourable coalition and institutional stability.

The Political Factors of Success

It is scarcely possible for a government to stabilize against the wishes of the whole population. It must contrive to have the support of part of the population, if necessary penalising certain groups more than others. In this sense, a programme which affected all groups equally (i.e. one which would be neutral from the social standpoint) would be more difficult to apply than a discriminatory programme, which makes certain groups carry the cost of adjustment while others are spared so that they will support the government.

In Morocco, the stabilization programme of 1983 systematically favoured the farmers who traditionally support the regime. In addition, the government introduced targeted measures in favour of the poor in order to isolate the hardest-hit group, workers in the modern sector. In Côte d'Ivoire, the first two stabilization programmes (1981 and 1985) were relatively beneficial for the planters, so that President Houphouët-Boigny was once again able to rely on this group, as in the years following independence; while modern-sector employees, notably those in public enterprises and the civil service, who had been given favoured treatment by the regime during the 1970s, were the main ones to suffer the effects of the adjustment.

In some cases, however, governments are unable to juggle with the different groups in this way. This is the case in Ecuador, where governments have had the greatest difficulty in applying programmes because they have constantly been in a position of weakness. The President never has a stable majority in Congress and terms of office are very short (four years, non-renewable, for the President, two years for the Congress), whereas all the interest groups are well organised in unions or trade associations. Every time an attempt at adjustment has been made, the President has therefore come up against a strong front of opponents.

In the case of real confrontation, the exceptional political weight of a head of state can be a decisive factor for the success of the adjustment. Governments always have a real capacity for resistance, of course, thanks to the police and the military. In several cases, including that of Ecuador, they did not yield when faced with riots. When unrest is such as to threaten the regime, however, the authority of the head of state is a very important factor. This was the case in Morocco, Côte d'Ivoire and Venezuela, where the President had this authority in 1990 because the same party controlled the presidency, the parliament and the biggest union.

Reactions to Structural Adjustment Measures

The political problems posed by structural adjustment measures are very different from those raised by a stabilization programme. In the first place, structural reforms take time and their consequences are not felt until after a certain delay. These reforms therefore do not have a “shock effect” like that of a 50 per cent increase in food prices. Furthermore, the majority of these reforms hit certain groups but benefit others, so that a government can always obtain the support of the coalition of winner groups against the losers.

Trade liberalisation — a measure strongly recommended by the World Bank — illustrates these opposing reactions which the government can turn to its advantage. There is, of course, always a fairly large and powerful protectionist front, but it is heterogeneous. It includes heads of enterprises in protected sectors (and their employees), senior officials who wish to retain their power (to say nothing of the opportunities for corruption associated with the granting of import licences), the unions and leftist parties (the Marxists being the most opposed), and, in certain countries, nationalist parties for whom the importation of certain goods is synonymous with westernisation. The government is supported, however, by those who benefit from liberalisation: entrepreneurs in export industries, farmers, artisans who can obtain their supplies more easily and cheaply, and consumers.

The history of trade liberalisation confirms the resistance of the groups mentioned but shows that they are not dangerous to the point of compromising the policy of opening up the economy. Thus, in the Philippines, the leftist parties and the Ministry of Trade and Industry (which represented the protected manufacturers) were hostile. President Cory Aquino supported the liberalisation policy and the quotas on consumer goods were removed, although President Aquino abandoned the idea of liberalising imports of intermediate goods.

In Venezuela, the biggest union was opposed to liberalisation in sectors dominated by small and medium-sized enterprises, which account for most jobs. At first the employers’ association supported opening up, but it later changed its attitude; about half of the employers, those who suffered from this policy, became hostile, but this did not make the government back down.

In Morocco, the protectionist lobby was very powerful, including senior officials, some employers, the unions, the leftist parties and press, and also the traditionalist party. Nevertheless, liberalisation was rapidly and successfully implemented, thanks to a well-judged liberalisation strategy.

The only failure among the five countries studied, in Côte d'Ivoire, was due not to political opposition, but to the economic situation (fall in the dollar) and the rigid structure of the franc zone: an appreciation of 50 per cent in the real exchange rate made the reduction of protection intolerable in sectors which had to compete with imports.

Another policy which does not arouse very strong political opposition is that of internal liberalisation for agriculture or the financial sector. Of course, there is always a certain amount of discontent: in Venezuela, the employers were favourable to financial liberalisation, but became critical when their financial costs sharply increased. The same reaction to this increase was seen in Morocco, but it did not deter the government.

It was in the Philippines that the control of agricultural markets had the most scandalous consequences. President Marcos conceded monopolies for the marketing of each product to his *protégés*, enabling them to make fortunes. The elimination of all these monopolies by President Cory Aquino brought a considerable increase in the average income of the small farmers and in agricultural wages, and was very popular in rural areas. Morocco abolished the monopolies on the supply of inputs and the collection and export of products. The unions and the Marxist newspaper *Al Bayane* protested against the abolition of the Office de commercialisation et d'exportation and the dismissal of its staff, but the farmers were well satisfied and they supported the government.

The problem of the reform of public enterprises, through restructuring or privatisation, arises in many countries and always gives rise to strong opposition because it runs counter to a number of vested interests: those of the managers who have government connections, those of senior officials who hope one day to have a well-paid position in one of these enterprises and those of the employees who have the combined advantages of the public sector (security) and the private sector (higher wages than in the public service). This coalition of interests is all the more powerful where the public sector is very large and controls most key activities (transport, energy, mining, etc.). An aggravating factor is that while the losers are highly motivated in the defence of their advantages, the winners cannot be mobilised, because the gains from this reform appear only after some years and are diffuse.

In many countries, a considerable proportion of the fiscal deficit results from the deficits of these enterprises, which must be financed by the state, but any attempt to reform them leads to a trial of strength, with long strikes which paralyse economic activity. If this confrontation coincides with unrest triggered by a stabilization programme, the political situation becomes very dangerous for

the government; otherwise, the outcome is uncertain. In certain countries of our sample the government had to abandon the reform, but in Côte d'Ivoire, President Houphouët-Boigny managed in 1961 to restructure 29 state enterprises out of 36, with the support of his traditional political base, the planters. The obstacles encountered by Ghana in trying to implement the same policy in its 1983 structural adjustment programme confirm that the more extensive the parapublic sector, the more difficult it is politically to implement this reform. In certain cases, however, governments have managed to implement restructuring plans which would be rejected in developed countries. In Bolivia, for example, President Paz introduced extremely harsh measures in 1987: two-thirds of the workforce of the state tin-mining company were dismissed because this enterprise was responsible for one-third of the total fiscal deficit. This decision triggered a series of strikes and demonstrations, but the government held firm against the miners and remained in power for another three years.

Part 2: How Can Political Risks Be Avoided?

The results presented in Part 1 clearly show that the interactions between the economy and politics play a vital role in the adjustment process. Once we know the nature of the relationships involved, it is obviously very desirable to derive recommendations. Knowing, for example, that different stabilization measures having the same impact on the external deficit involve very different risks of giving rise to riots, one can classify these measures according to their political riskiness, so that governments can choose the stabilization programme which is easiest to apply politically, i.e. the least risky.

While such information is very useful, it is necessary to stress its limitations. The economist may be able to calculate with some precision the impact of a stabilization measure on the fiscal deficit or the external deficit; he may, though it is more difficult, evaluate by means of a macro-micro model the impact of such a measure on the number of poor (cf. Morrisson, 1992). On the other hand, when he has to deal with the political aspects, the economist can reason only in terms of probability, and then only very approximately. Let us assume that one stabilization measure increases the probability of strikes from 5 per cent to over 10 per cent, and another measure increases it from 5 per cent to over 50 per cent; this is useful information for the adjustment policy makers, but it concerns only probabilities: a prudent government may choose the first measure and still suffer a strike, while one choosing the second may not. Strike action, like a demonstration, results from the combination of many factors (many of which are not economic). As a result, a stabilization measure increases the risk of unrest to a greater or lesser extent, but there is no mechanical link between this measure and a political event. This means that all the recommendations that we present below must be treated with caution, since their foundations can never be absolutely solid.

Second, it should be recalled that any adjustment is a risky operation in political terms. The government inevitably has to introduce unpopular measures, whereas the policy pursued previously will have been all the more popular the more laxist it was. Opposition parties obviously leap on this occasion to mobilise public opinion against the government, deriving support from a coalition of the groups always hostile to the government and those particularly affected by the

adjustment measures (the latter may appear among the former, but need not necessarily). On the one hand, the opposition will impute all the costs of adjustment to the government, even if exogenous factors are partly responsible for the macroeconomic imbalances; while on the other, if the government waits for a financial crisis before adjusting, through fear of the opposition, it will have much less room for manoeuvre in a political crisis. At the extreme, it can in principle make no more concessions once it has made commitments to the IMF in order to obtain its help. In fact, such a decision may actually help a government, since it can then say to its critics that the agreement reached with the IMF was imposed on it, like it or not.

For any government, adjustment is thus not only a technically difficult economic and financial operation (as in the case of an international organisation), it is also a political fight to be fought from a position of weakness, one where no holds are barred (the opposition may violently attack measures for which it is really responsible because of the laxist policy it pursued when in power), because the main objective of certain political parties is not to restore the economy to health, but to win power, and this at a time when the economy is very fragile. This type of confrontation obviously occurs in all countries where changes in government can occur as the result of regular elections. These cases are relatively rare in Africa, but not in Latin America or in certain Asian countries. Furthermore, the study of authoritarian regimes in Latin America reveals that even these experience serious unrest and changes of government in periods of adjustment. It would thus appear that under an authoritarian regime political confrontation exists, even if it is different in nature, and that irregular changes of government are possible, this type of regime being more dependent on the reactions of public opinion than might be expected.

We now consider in turn what precautions a government can take before the adjustment, then what stabilization measures, or what structural reforms, are the least dangerous politically.

The Best Political Strategy Before a Crisis Appears

Even before being confronted with serious macroeconomic imbalances, any government has an interest in taking measures to make the adjustment process less risky politically. Two types of action appear desirable: one against inequality, the other against interest groups. Experience shows that often the greater the inequality of incomes, the more difficult it is politically to implement a stabilization programme. Thus, the countries of South-East Asia having moderate concentration

of incomes have generally reacted fairly rapidly to imbalances, while Latin American countries with a comparable, but more inegalitarian, per capita income have waited for a crisis to develop before introducing adjustment measures. By reducing inequalities, a society gains in flexibility and in its capacity to adapt to constraints such as stabilization measures. In addition, as pointed out by Alesina and Perotti (1994) and Bardhan (1996), the risk of unrest is reduced, because income inequality favours the mobilisation of the urban poor for violent demonstrations.

The Dangers of Corporatism

The other obstacle is connected with interest groups: the more powerful and well-organised interest groups there are, the more restricted the government's room for manoeuvre. The government will be incapable of taking essential measures, even if it has a parliamentary majority in a democratic regime and is trying to adjust before a financial crisis occurs. The recent history of developed countries like France and Italy shows in fact that the developing countries do not have a monopoly of corporatism. This problem arises above all in parapublic enterprises, where the government often wants to eliminate subsidies in order to reduce the fiscal deficit. This measure inevitably brings wage cuts and sometimes redundancies as well. If the enterprises concerned are in key sectors (energy, transport or mining, where mining exports are the prime source of foreign currency) and if the workers in these enterprises are well organised, they can provide effective opposition to the government decision. Numbers are not what matters here, because even minority groups within the enterprise can completely halt its activity if they control strategic departments.

Any policy which weakens this type of corporatism is desirable: from the economic standpoint, this would eliminate obstacles to growth, while from the political standpoint, the government would gain a certain freedom of action which could be important to it in a period of adjustment. It can be objected that this policy will arouse opposition, but it is better for the government to fight this battle when the economic situation is satisfactory than in a time of crisis, when it is weakened. Such a policy can take diverse forms: guarantee of minimum service, training of additional skilled workers, privatisation or splitting into several competing enterprises, where this is possible.

Other interest groups, in the liberal professions, for example, can also put a brake on adjustment. This recommendation thus has general validity: a government which wants to increase its room for manoeuvre and make a society more flexible would be well advised first to weaken all the interest groups, which

by their very nature constitute obstacles to adjustment measures. It is clear, however, that only a democratically elected government has the legitimacy needed to take such action.

When a government is confronted with macroeconomic imbalances, what is the best strategy to adopt? All analyses of the adjustment timetable come to the same conclusion: the best way of minimising the economic and social costs of the adjustment — and hence the political risks — is to adjust *before* there is a financial crisis. This implies both economic and political perspicacity.

Methods of Anticipating the Crisis

Economic perspicacity depends on the aptitude of the political authorities to understand economic problems. Owing to their short-term horizon, political leaders have difficulty in anticipating the consequences of growing indebtedness. They do not realise that this can only lead to a dead end, and that if they refuse to apply unpopular measures today, they will soon have to resort to much more costly and hence even more unpopular measures. To adjust before a crisis appears, it is necessary to possess two qualities: courage and a sound grasp of economic mechanisms. In Ecuador, for example, President Hurtado, as director of a research centre, had realised the necessity of adjustment before even taking office. In Malaysia and Indonesia, the decision to adjust before the crisis is partly explained by the economic competence of the ministers' closest advisors. More generally, the fact that there are many qualified economists and that they take part in the public debates on economic policy creates a favourable environment.

Political perspicacity is essential for being able to act rapidly and effectively. If a government comes to power at a time when macroeconomic imbalances are developing, it enjoys a short honeymoon period (four to six months), during which it has the support of public opinion and can blame the need for unpopular adjustment measures on its predecessor. Thanks to this support, interest groups are temporarily weakened and the government can stir up public opinion against its adversaries. After the honeymoon period, this possibility has gone: the new government has to carry all the political costs of the adjustment policy, for it is now considered to be solely responsible for the situation. It is therefore in its own interest to apply a stabilization programme immediately, while blaming the difficulties on its adversaries. This implies a good communication strategy, which is an important weapon in political combat. It is necessary on coming to power to stress, even to exaggerate, the seriousness of the imbalances, highlighting the responsibility of the previous government and the role of unfavourable exogenous factors, instead of talking optimistically and merely postponing the moment of

truth. Conversely, once the stabilization programme has been implemented, the government should start talking more optimistically to restore confidence, a positive factor for recovery, while at the same time taking credit for the first benefits of the adjustment.

It is also desirable that the government rapidly constitute a coalition of interests to form a counterweight to the opposition. This is the essential complement to the government's communication strategy and the only way to ensure lasting support. Adjustment brings benefits for farmers, entrepreneurs and workers in export industries. Well-targeted accompanying social measures can benefit certain poor urban households. In addition, if the wages of civil servants are reduced, strategic sectors (the army or the police, for example) can be exempted. The government must make every effort to unite these different groups in a coalition in favour of adjustment. The opposition will inevitably take advantage of the situation to build up a vast movement of malcontents — a stabilization programme cannot be implemented without going against the interests of workers in the public and parapublic sectors, urban consumers, and modern-sector employers and employees — but it is necessary to prevent this movement from extending to the entire urban population. This can be done by means of discriminatory measures in favour of different groups, so as to form a coalition in support of the government. It is desirable, for example, to limit wage cuts to civilian government employees only, and to grant well-targeted aid to poor families. This strategy makes it possible to win supporters without losing any, since many civilian functionaries would have been hostile to the adjustment in any event.

The Best Stabilization Strategy in the Case of Crisis

Let us suppose that the stabilization programme has been postponed for one reason or another, so that it must be applied under the constraint of a crisis. It will be necessary to introduce measures which are more strict, and hence more dangerous politically. This is yet another reason for choosing the package of stabilization measures which minimises the risk of unrest, though this is also desirable of course when the adjustment is implemented before any crisis appears.

Let us first recapitulate these risks of unrest in the developing countries. The risk of demonstrations is always greater here than in the developed countries and, unfortunately, the chances of their ending in bloodshed are also much greater. This does not mean that the developed countries are immune from big demonstrations sometimes accompanied by violence (looting or fire-raising, for

example), but riots with tens or hundreds of injuries and deaths are most exceptional in these countries, whereas they are frequent in developing countries in connection with adjustment. The fact is that in many countries there are masses of poor or destitute people who are always inclined to demonstrate, even when the economic situation is normal, and whom the opposition can easily mobilise against austerity measures. These are the inhabitants of the shantytowns or the poor districts, most of them working in the informal sector or unemployed. Sometimes they do not even have access to basic public services (primary education, health services, roads, sewers or water supply). Many of these people feel frustrated and excluded in comparison with the rest of the urban population. Vandalising and looting shops in the more prosperous districts thus enables them to vent their feelings. If a stabilization measure — a cut in subsidies, for example — causes a sharp increase in the prices of basic foodstuffs, these populations will react violently in their despair. Such a measure suddenly reduces their already extremely low standard of living, and once they have arrived at this point, the poor have nothing more to lose. In addition, mention must be made of the skill with which opposition parties or unions can stir up the resentment of these destitute populations. In certain countries, this risk has been eliminated because the government has managed to meet basic needs even in the poorest districts, but it is well known that this is not yet the case in many Latin American, African and Asian countries.

In principle, the risk of strikes is less dangerous politically, as it concerns only modern-sector workers, who are not among the poorest classes. Strikes do not call the regime into question, as is the case when demonstrations turn into riots and the security forces lose control. It is indeed this which explains the absence of any statistical correlation between strikes and repression. The government can always end strikes by making concessions. However, strikes have the serious disadvantage of encouraging demonstrations. By definition, the strikers have the time to participate in demonstrations and, above all, if secondary and higher education teachers go on strike, they free an uncontrollable mass of secondary and university students who can join demonstrations. This is a very dangerous phenomenon, for in this case repression can very easily lead to bloodshed.

It might be thought that democracies are less prepared than autocratic regimes for maintaining order, but this is not certain: first, autocratic regimes do not enjoy the legitimacy derived from universal suffrage and, second, they hesitate to use the ruthless repression of dictatorships. Since any big demonstration poses a threat to these regimes (whereas in a democracy they are a threat only to a government), the leaders resort more quickly to repression, which triggers a process of escalation, with the opposition calling for further demonstrations in the name of the victims. The experience of several Latin American and African

countries shows that this process is often dangerous for the survival of the regime. Thus, contrary to what might be expected, an autocratic regime might be well advised in these difficult circumstances to defend itself by using democratic methods, for example by holding a referendum to fight against entrenched interest groups or by holding really free legislative elections, after having formed a coalition in its favour. The fact is that a well-thought-out stabilization programme, with a substantial social component financed by bilateral aid, may be supported by a fairly broad coalition.

Dangerous Stabilization Measures

Owing to the high risk of riots in the poorest districts, the first concern of those responsible for adjustment measures should be either to avoid any increase in the prices of basic necessities or to apply any increases very carefully. Among the products concerned are not only foodstuffs, but also water, electricity, transport, medicines and the fuels used for cooking and heating. What matters politically is simply the price increase, regardless of what causes it: removal of subsidies, devaluation, increased indirect taxes or reduction of the deficit of parapublic enterprises (transport, water or electricity suppliers). If it is impossible to avoid a price increase, a number of precautions must be taken. It is necessary, as in Morocco in 1983-84, to increase the prices of intermediates first, not those of basic products consumed by poor households. If the prices of the latter are to be increased, it is necessary to proceed by imposing moderate increases (less than 20 per cent) over a period of time. It is desirable to delay the introduction of the final increases until the benefits of the adjustment are starting to appear and can compensate for them. It is possible also to attenuate the impact of a price increase by such measures as distributing foodstuffs to workers hired for public works projects. Lastly, prices must never be increased at times when households experience particular difficulties, such as the end of the month or during religious festivals.

The fact remains that, even for a resourceful government, this problem of the prices of basic foodstuffs is a very difficult one. People need only fear a price increase for shopkeepers to start building stocks or speculating on the next increase: strict control of prices and stocks is difficult to enforce. What is more, if these products are of local origin, the government is subject to opposing pressures (the producers claiming higher prices, the poor urban populations claiming lower), while it no longer has the resources to finance subsidies to consumers. It is easy to understand that governments, on the horns of this dilemma, normally sacrifice the interests of the producers: since the urban population is concentrated the risk of serious unrest is high, while the rural populations cannot exert such pressure because they are dispersed.

Lastly, to avoid unrest, the government should make a particular effort to inform public opinion, explaining the reason for price increases, publishing lists of recommended prices, carrying out many price checks, possibly followed by legal action against shopkeepers who have increased their prices more than others. These interventions may be more showy than effective, but in such circumstances the only thing that matters is the image the government creates for itself, not the real impact of its interventions, which should not be judged solely in technical terms when they form part of a political campaign. The government can also finance compensatory measures which do have real impact, such as free meals in the primary schools of poor districts.

As can be seen, any increase in consumer prices is a very tricky operation, because the opposition can easily take advantage of it to stir up demonstrations and even riots. Instead of just deciding on a sudden series of increases, then leaving the field open to the opposition, the government should carefully plan and then apply a strategy extending over several months and including many interventions in different fields. In short, it is not simply a matter of technical intervention which can be justified on solely economic grounds, but a long and complex political operation. To forget this is the surest way to head for a serious political crisis which can halt the entire adjustment programme.

Drawing the lessons of the serious riots of 1989, the Venezuelan government — which had concluded a stand-by agreement with the IMF for \$1.4 billion in April 1996 — made an effort to communicate and decided to introduce compensatory measures, whereas it had done neither in 1989. The Minister for Planning was given the task of preparing public opinion by travelling the length and breadth of the country for several weeks to explain the adjustment plan and the measures to be taken in favour of the poorest people: transport subsidies, free school meals and aid for the unemployed and elderly.

Another politically risky measure would be to reduce the number (or amount) of grants paid to secondary school and university students. Even though this measure has no negative social effect if the government maintains all types of aid for the children of poor families, the risk involved is considerable, because the group affected is politically conscious, easy to mobilise, supported by the media and, in principle, close to the opposition. It is therefore preferable to proceed with caution, for example by freezing the nominal amount of the grants despite inflation, or introducing additional administrative constraints. This example is proof, however, that the first precaution to take is to avoid laxist policies in periods of prosperity, because such policies create “acquired rights” which are difficult to call into question later on.

The reduction of wages and employment in the administration and in parapublic enterprises normally appears among the principal measures in stabilization programmes. In principle, it is less dangerous politically than increasing consumer prices: it gives rise to strikes rather than demonstrations and hits the middle classes rather than the poor (there are few government employees among the poorest 40 per cent). That this measure can be justified from the standpoint of equity does not mean, however, that it involves no political risk. In fact, these are the sectors with the highest proportion of unionised workers, where the workers do not risk anything by striking, unlike those in the private sector, and where strike action can be a very effective weapon: the economy can be paralysed by a strike of transportation or power plant workers, and the state is deprived of income if tax collectors stop work. A teachers' strike does not in itself cause much trouble for the government, but it is indirectly dangerous, as we have seen, since it frees young people to demonstrate. These strikes can thus become trials of strength which are difficult to manage. The government can always restore calm by cancelling the measures which triggered the strike, of course, but in so doing it abandons the aim of reducing the fiscal deficit.

The government nevertheless has ways of appealing to the pragmatism of civil servants. It can, for example, explain that since the IMF has imposed a cut of 20 per cent in the public-sector payroll, the only options open are either redundancies or pay cuts, and it prefers the second solution in the interest of all. The experience of several African governments shows that this argument may be listened to.

While the analyses based on large samples have shown a relationship between these austerity measures and strikes, the case studies have also shown that the government still has a certain amount of room for manoeuvre, which has been successfully exploited in countries such as Morocco and Côte d'Ivoire. Nominal wages can be frozen (which rapidly reduces the payroll in real terms if the annual rate of inflation is 7 or 8 per cent); some retiring workers may not be replaced; or bonuses can be eliminated in certain departments, using a discriminatory policy so that all civil servants will not join together in a common front. It is obviously inadvisable to eliminate the bonuses paid to security forces in difficult political circumstances when the government may have need of them. As can be seen, provided that it makes strategic concessions a government can, by proceeding slowly and by means of sectoral (not economy-wide) measures, reduce its payroll costs considerably. The main thing is to avoid a general strike in the public sector, which would call into question an essential objective of the stabilization programme, the reduction of the fiscal deficit.

Stabilization Measures Involving Little Risk

After this description of risky measures, we can now recommend many measures which cause no political difficulty. To reduce the fiscal deficit, very substantial cuts in public investment or the trimming of operating expenditure involve no political risk. If operating expenditure is trimmed, the *quantity* of service should not be reduced, even if the *quality* has to suffer. For example, operating credits for schools or universities may be reduced, but it would be dangerous to restrict the number of students. Families will react violently if children are refused admission, but not to a gradual reduction in the quality of the education given, and the school can progressively and for particular purposes obtain a contribution from the families, or eliminate a given activity. This should be done case by case, in one school but not in the neighbouring establishment, so that any general discontent of the population is avoided.

The political advantage of these measures does not mean, of course, that they are the most rational or the most equitable. A cut in public investment expenditure will in time have a negative impact on growth. What is more, if this measure hits poor rural areas, it slows the reduction of income inequality. From the standpoint of effectiveness, maintaining the quality of higher education may be preferable to the rapid growth of student numbers accompanied by a decline in standards. Classifying stabilization measures according to the political risk involved is not a matter of efficiency or justice; it is the result of the balance of forces between the interest groups affected by the adjustment and a government in a position of weakness. There must be no ambiguity on this point. It must not be thought that this political classification implies approval. Our earlier publication, Policy Brief No. 1, *Adjustment and Equity*, shows precisely what a government should do if it is concerned with justice, which is the only classification criterion that can always be approved of.

The other stabilization measure which may be recommended is a tight monetary policy. Since this affects all incomes in the same way and since its negative effects are both delayed and indirect (workers who lose their jobs when an enterprise goes bankrupt do not demonstrate against the central bank), it involves little political risk.

Normally, the magnitude of the imbalances in the case of financial crisis means that the stabilization programme cannot be limited to these low-risk measures. The government must also reduce the payroll and cut subsidies. To succeed in this, it must pay the greatest attention to detail and adopt a disaggregated approach. Nothing is politically more dangerous than taking economy-wide measures to solve a macroeconomic problem. For example, if civil

service wages are to be reduced, the government should cut them in one sector, freeze them in nominal terms in another and even increase them in a politically sensitive sector. If subsidies are to be reduced, those on some products should be cut while those on others are entirely maintained. There is no limit to this concern with detail: if poor households consume only granular sugar, the price of lump sugar can be increased provided that the subsidy on granular sugar is retained.

A stabilization programme which minimises the political risks for a given reduction in the external deficit is thus the result of a number of measures chosen according to their political cost (this cost being estimated by means of polls or reports from local authorities), to which it is necessary to add media campaigns, and even high-profile policing actions, in order to obtain the support of the population and counter the opposition, which will attempt by all possible means to exploit the inevitable discontent aroused by the stabilization programme.

This conclusion means that a government can fail in two ways: either it entrusts the task of developing the programme to competent technicians who fail to take account of the political costs; or the political leaders alone choose measures according to their political costs, without adopting a package of measures sufficiently coherent and effective to re-establish macroeconomic equilibrium.

The Best Strategy for Structural Reform

Complementary to stabilization programmes, adjustment frequently brings structural reforms which, apart from two important exceptions, involve less political risk. These reforms are generally less difficult to implement because while certain interest groups suffer from them, others benefit. The government can thus easily organise a coalition of winners to support it against that of the losers. Several examples can be given: financial liberalisation benefits lenders at the expense of borrowers, liberalisation of agricultural markets — through eliminating public monopolies and their profits made at the expense of the farmers — obtains the support of the farmers while the employees of these monopolies oppose it. The most striking case is that of trade liberalisation. The protectionist coalition is admittedly powerful, because it includes protected entrepreneurs, senior officials who want to retain their powers, some unions, leftist parties and nationalist parties, but if the government has a clever strategy it can still win. This is the case if the government reduces first the customs duties on goods such as packaging, purchased by all enterprises, or removes quotas on intermediates that

small enterprises have difficulty in obtaining. Such a strategy makes it possible to form a coalition in support of this policy of openness as rapidly as possible. Furthermore, structural reforms are generally not as urgent as stabilization measures. The government can therefore stagger them over time and thus avoid the formation of a solid coalition of the discontented, such as appears if a number of unpopular stabilization measures are introduced simultaneously.

The two reforms which, in contrast, may cause serious political difficulties are land reform and reform of the parapublic sector. In the case of land reform, the government confronts the political power of the big landowners, which may be very great in rural areas; what is more, this power is sometimes linked to that of other powerful groups (the military or businessmen). It also faces an economic problem: in certain cases, the reform inevitably compromises the growth of agricultural production; while in others, very substantial public aid to the beneficiaries of the reform is essential during a transition phase, but in a period of adjustment the government does not have the budget resources to finance such aid. Lastly, even in the most favourable cases, the application of this reform gives rise to many technical problems, such that it can lead to an economic failure. For all these reasons, a gradual approach seems the most appropriate, negotiations being held with the landowners so that they can progressively change over to other activities, with the aid of compensation, or to other forms of farming. In view of the technical difficulties and the lack of budget resources, gradualism is the best strategy for adjustment.

The reform which is needed the most often, and is the most dangerous, is the reorganisation or privatisation of public enterprises. This reform is very difficult because the workers in this sector are often well organised and control strategic parts of the economy. They will fight with every possible weapon to defend their advantages, and the government will not be supported by public opinion because the benefits of the reform will not appear until several years later and will be diffuse, whereas the losers will be hit immediately. The bigger the parapublic sector, the more difficult the implementation of the reform will be, the extreme case being that of the socialist economies, where the dangers are the greatest.

Some precautions are called for. In the first place, this reform must not coincide with a stabilization programme, because the opposing coalition would be very dangerous, with a combination of mass demonstrations and strikes in key sectors. Second, these workers must not be driven to despair by outright dismissals. Retraining funds to help them find other jobs are essential. Lastly, it might be considered necessary to exclude strategic sectors such as energy or transport from the reform, leaving these measures for a later date when the political and economic situation has improved.

This estimation of the risks calls for some comment: as compared with the situation in developed countries, governments of developing countries have more freedom of action. For example, it is easier for them to remove picket lines or replace strikers by other workers. It is also easier for them to reduce the weight of these enterprises, for example by cutting investment financing or introducing private competitors where the activity permits this. The experience of certain countries where rationalisation or privatisation operations have been successfully carried out (Bouin and Michalet, 1991) shows that a government's room for manoeuvre can be greater in the developing than it is in the developed countries. In these conditions, it is sometimes possible to envisage the reform of strategic sectors at the outset, which is desirable because of the impact of this reform on the rest of the economy.

How to Adapt the Constitution to Facilitate Adjustment

It is normal to reason in terms of the political feasibility of the adjustment "other things being equal", taking the institutional framework as an exogenous parameter. It is entirely democratic, however, to change this framework with the agreement of the population. Experience shows in fact that certain provisions of the constitution may be real obstacles to adjustment. This is the case in Ecuador, for example, where the short terms of office and the absence of a stable parliamentary coalition due to proportional representation prevented successive presidents during the 1980s from implementing the essential stabilization programmes. In addition, two studies (Roubini and Sachs, 1989; Grilli, Masciandaro and Tabellini, 1991) have shown that countries where the parliament is elected by a first-past-the-post system control their debt better than those with proportional representation.

Certain constitutional reforms, such as those concerning the length of terms of office, the voting system, the referendum or the right to strike, may facilitate the adjustment. The length of terms of office is an important variable, because adjustment is characterised by negative short-term effects and positive medium-to long-term effects. If the terms of office of the parliament or the executive are too short, it will be very difficult to implement a stabilization programme because the next elections will arrive before the benefits of the adjustment are really felt. It is therefore important that terms of office last at least five years, it being understood that the new government uses the first months — the period when the resistance of the *status quo* is weakest — to introduce unpopular measures. In addition, elections to different bodies should be held at the same time, to avoid turning a series of elections into a series of referendums on adjustment.

If a government is to have sufficient room for manoeuvre to adjust, it must be supported by one or two big parties in the parliamentary majority, not by a coalition of small parties, which means that a straight majority system for parliamentary elections is to be preferred to proportional representation (or at least it is advisable to have a combination of the two). There are other methods of reinforcing the executive, such as the possibility of temporary special powers or *ex post* control by the judicial power, to prevent the *ex ante* blocking of the programme by the judiciary. A referendum may be an effective weapon for a government provided that only the government can initiate it, since interest groups which are opposed to the adjustment measures often defend particular and minority interests under the cloak of the general interest. Recourse to a referendum to get a particular measure approved permits the government to explain its policy and break up a coalition of opponents. In addition, if the initial measures have triggered a cumulative process of protest and repression, a referendum can calm the political climate and help to restore order through replacing the pressure of demonstrators by a democratic choice.

A pre-crisis situation with increasingly serious macroeconomic imbalances is obviously not an appropriate time for a constitutional reform which gives more power to the executive, but a far-sighted government can win acceptance for such a reform in a calm situation, drawing lessons from the experience of other countries where the institutional framework has blocked any adjustment policy.

The Role of Donors

The more problematic the adjustment in political terms, the more prudent foreign countries and international organisations should be in adopting a position. External assistance in the technical development of a measure may be easily imagined, but when it comes to the political aspect matters are very different. The political constraint has meaning only for the adjusting government: it is this government, and this government alone, which has to maintain order and, in the case of serious unrest, resort to repression. In addition, any foreign intervention may give rise to nationalistic reactions, exploited by the opposition to make the adjustment fail.

This does not mean that donors must refrain from all action, but that their action must be adapted to an often very difficult domestic political context.

In the first place, it is necessary to avoid any procedural bias in the calculation and comparison of the economic, social and political costs and benefits of a stabilization measure; the analysis is likely to be misleading, because while the

foreign experts have all the tools necessary for evaluating the economic aspects, and in particular for quantifying them, evaluations of the political risks remain very subjective and imprecise. Foreign personalities can badly underestimate these risks.

Second, it may be desirable for the external partners to assume different roles, with the international organisations (the IMF and the World Bank) steering the macroeconomic policy or the structural reforms with a certain rigour, while the bilateral donors could finance compensatory measures aimed at reducing the political risks of the adjustment. It may be a matter of temporary aid to compensate for price increases on essential products, like that granted by France to the countries of the franc zone for the purchase of medicines, after the devaluation of the CFA franc in 1994. Bilateral aid in favour of the poorest urban households could avoid any fall in the standard of living for this group, which is desirable from the social standpoint as well as the political. In addition, bilateral aid could finance other compensatory measures in order to avoid a political stalemate. Aid for the retraining of surplus personnel in a public enterprise may, for example, prevent a long strike in a strategic sector which could lead to the failure of efforts to reduce the fiscal deficit.

These examples show the importance of bilateral co-operation. The fact is that the guidance offered by the international organisations is something of a standard approach, while these targeted interventions by the bilateral donors require permanent monitoring of the country being aided and a very good knowledge of its economic difficulties, the domestic political situation and the local society. These are the essential conditions for being able to intervene effectively whenever blockages or signs of unrest appear. If such co-operation is to succeed, it is not enough simply to provide credits; it is necessary also, and above all, to have a team of specialists for each recipient country, who can monitor the situation week after week in order to be able to intervene when and where required.

The experience of many adjustments has shown that the political success of the adjustment depends on a series of compromises and on pragmatism. The drawing up of a programme is already the result of a series of compromises between the government and the international organisations, and then between the different ministries within the executive; its implementation is also the result of compromises between the government and the various interest groups. As the economic situation evolves, while public opinion and the political situation change from one week to the next, the most effective strategy is that of pragmatism: the strict application of a programme point by point is politically risky. While the *objectives* of the adjustment must be pursued at all costs, the choice of the *means* to be used must remain open at all times.

As a result, it would perhaps be desirable to make the conditionality more flexible *ex ante* and to strengthen it *ex post*, closely examining the government's decisions before releasing the agreed credits. This flexibility would permit governments to manage the adjustment better politically by being more flexible and more pragmatic, adapting the implementation of the measures week by week to the political balance of power.

As can be seen, the more the donor countries and the international organisations take into account the political dimension of adjustment, the more they will be led to rethink their relations with adjusting governments in the context of an ongoing dialogue, in order not to abandon conditionality, but to adapt it to political constraints.

Conclusion

The experiences of the 1980s have taught us, sometimes at a high price, that adjustment must never be reduced merely to its technical aspects. Adjustment is always a risky political operation, and it is better to take as many precautions as possible *beforehand* than to interrupt a programme because of serious unrest or to impose it at the price of harsh repression and the loss of life. Precisely because the problems are of a political nature, it is not possible to give precise answers with the same degree of assurance as in the case of a technical matter. Nevertheless, the many cases studied in this project lead us to believe that certain adjustment measures are virtually always more dangerous politically than certain others, and that precautions taken *before* the adjustment can significantly reduce the risks. It is these recommendations of prudence that we wish to recall here by way of conclusion.

The first conclusion is that many measures taken *before* the adjustment can be very effective in reducing the political risks of this adjustment. Through reduction of income inequality and interest-group power, a society is made more flexible and its ability to adapt to stabilization measures is enhanced. Strengthening the executive power by various means (longer terms of office, stable parliamentary coalitions, referendums, etc.) makes it better able to defend its adjustment policy. Lastly, a government must be able to react quickly. All the case studies agree with this conclusion: the best way to minimise the economic, social and political costs of adjustment is to adjust *before* a financial crisis develops. To do this, a government needs to react as soon as macroeconomic imbalances appear. This implies that the government must be advised by teams of qualified economists

who can convince it of all the negative consequences of laxist policies, and that it must be able to take advantage of the electoral timetable: if it has just been elected it must act immediately, blaming its predecessor for the need to adjust.

If, unfortunately, the government waits for the financial crisis to hit before adjusting, there is all the more reason to construct a programme carefully which minimises the political risks, for this type of situation is always dangerous. The most important result of this research project is to have furnished proof that measures which are *equivalent* from the standpoint of the economist, because they reduce the external deficit to the same extent, entail *very different* political risks. It is therefore clear that the government can, and must, choose the package of measures which has the lowest political cost. It is necessary to give priority to the reduction of investment and operating expenditure (excluding wages) and to a tight monetary policy, because these three measures do not usually give rise to political difficulties. Often, owing to the magnitude of the imbalances, the stabilization programme cannot be limited to these measures, and cuts in payroll or subsidies are also needed. In this case, the government must act with some dexterity, taking advantage of inflation to reduce real wages (while nominal wages remain stable), or making concessions to certain civil servants but not to others, in order to avoid the formation of a common front against the government.

The reduction or removal of subsidies is an even more sensitive issue, a long and difficult political operation which requires much care and attention to detail. Hasty and sweeping measures can lead to disaster. One solution is to increase the prices of intermediate goods, in stages, without at first touching the prices of basic necessities consumed by the poorest people; the latter prices may be increased moderately later when the situation has improved.

A particular effort to inform opinion and explain price increases is essential, as well as high-profile operations to control prices, because the government must on no account leave the field open to its opponents, who will try to take advantage of popular discontent. The stabilization programme which looks best from the technical standpoint may fail because it becomes part of a political struggle to win the support of public opinion, and a government's success depends on its ability to deal simultaneously with both the political and the economic variables. Being right from the economic standpoint by no means ensures political success. Unfortunately, the reverse is equally true: it has often been governments which are politically astute and popular, but incompetent in economic matters, which have led their countries into financial crisis as the result of laxist and demagogic measures.

When the political success of adjustment depends on a series of compromises and a pragmatic strategy, where the government adapts, week after week, to the political and economic situation instead of strictly applying a programme initially defined in collaboration with the international organisations and the donor countries, it is perhaps desirable to ease *ex ante* conditionality and to tighten *ex post* conditionality, through closer monitoring of the policies pursued. This would be better adapted to the political management of adjustment.

Similarly, it seems desirable to separate the role of the international organisations, which are responsible for recalling the constraints of the adjustment, from that of the donor countries, which can grant targeted emergency aid when certain measures would, without compensation, become too dangerous for the households affected. As can be seen, the need to take account of the political constraints of adjustment affects foreign actors just as much as adjusting governments, because the foreign actors cannot remain indifferent either to the failure of programmes or to their application at the price of ruthless repression.

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