Interest Groups, Stakeholders, and the Distribution of Benefits and Costs of Reform[∇]

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1 Introduction

Over the past two decades, a large number of developing and socialist countries have moved towards implementing wide ranging economic reforms aimed at introducing or strengthening economic freedom and replacing state interference with the market economy. Often, economic reforms were accompanied or followed by political liberalization as well. While this trend towards greater political and economic liberalism was particularly pronounced in Latin American and Central and Eastern Europe, a number of African and Middle Eastern countries followed suit during the 1990s. The reforms bore fruit in many countries by delivering higher growth, low inflation, stable public finance and, ultimately, greater political and economic stability. Yet, reform programs that originally appeared as if they all followed similar blueprints (typically motivated by the so-called Washington Consensus) frequently delivered very diverse results. Thus, all too often, the reform was stalled or reversed, painful belt-tightening was not followed by the hoped-for rapid recovery but instead by prolonged muddling through, seemingly stable economies were plunged into disarray by currency and banking crises, and/or reformist governments were democratically voted out of the office only to be replaced by nationalist or populist politicians.

The term *reform* is generally used to refer to any substantial departure from previously pursued policies. A reform is efficiency enhancing if, in the long term, it increases social welfare – by delivering greater price stability, sound government finances, higher economic growth and the like. A reform often requires a costly adjustment in the short to medium term and when its benefits finally arrive, they are usually not shared equally by all members of the society. Therefore, a reform results in winners and losers; even if the average member of the society is better off, there are some socio-economic groups who are worse off as a consequence of the reform. Furthermore, the balance between the winners and losers may change over time, reflecting the realization of individual gains or losses as well as changes in uncertainty about the reform's outcomes.

An efficiency-enhancing reform, if successful, should deliver substantial improvements in the long term. Yet, any change that brings about benefits to the society as a whole but has negative consequences for certain minority groups may face opposition by the latter. Often, the losers are sufficiently powerful (economically or politically) and organized to stage considerable opposition and may even succeed to slow down or stifle the change. Resistance to reform and economic change is not a new phenomenon. In Western Europe, the industrial revolution was strongly opposed by guilds and workers alike, who saw mechanization of production as a threat to their power and, indeed, their very survival (see Mokyr, 1990; Landes, 1999). Innovation and technological progress in many respects resemble reform programs: they benefit the majority of citizens but certain minorities suffer from their introduction. Under certain conditions, both can be hindered or blocked by interest groups. Yet, resistance to change is not an inevitable consequence of reform as the groups supporting and opposing the change can also find a way of sharing the benefits so that opposition is minimized. Understanding the roles played by the various groups and the interactions between them therefore is a crucial step towards understanding why reform programs succeed or fail.

In the following section, we review the theories of lobbying and interest groups formulated in Economics and Political Science alike and discuss the available empirical evidence. Section 3 reviews the literature on political economy of reform in transition and developing countries. Section 4 presents a summary of key findings that can serve as guidance when studying individual country experiences with reforms and Section 5 offers a few conclusions.

2 Theories of Lobbying and Interest Groups

Economists and political scientists alike have devoted much effort to the analysis of interest groups. The theoretical literature not only rationalizes their emergence but also provides a number of explanations of their activities and strategies. Empirical studies, on the other hand, have focused on identifying the various determinants of lobbying as well as explaining the impact of rent-seeking activities. Note that most theories and empirical studies that address lobbying and rent seeking, and their impact on economic policy-making, have been developed in the context of the United States. This however, does not mean that there are no studies devoted to other countries and in particular to developing countries. Krueger (1974) and Rama and Tabellini (1998) are examples of studies that analyze lobbying in the context of developing countries.

In this section, we analyze the motivations and the activities of groups to get organized in order to prevent the implementation of the reform or divert it from its originally intended purpose. To do that, we first address the question of why interest groups try to influence policy-makers. Are they motivated by protecting economic rents or by avoiding the loss of political powers? Do other factors such as uncertainty play play a role in explaining interest groups' actions against reforms? After briefly analyzing the implications of uncertainty we focus on the activities of interest groups and the type of activities and strategies they use to achieve their goals. We also discuss the impact of lobbying on welfare. Are interest groups always detrimental to economic welfare or may they play some positive roles as well? We end this section of the paper by briefly reviewing the empirical literature.

2.1 Interest Groups and Stake Holders: Who Are They and How Do They Come About?

For the purposes of our analysis, we understand interest groups as collections of individuals who share a specific common interest. Various interest groups can overlap. For instance, the same individual can be an entrepreneur, a house owner and an avid golf player. Stake-holders then are members of an interest group whose interests are affected by a particular decision. The aforementioned individual thus becomes a stake-holder if the government contemplates discontinue subsidizing and protecting the domestic industry or if it decides to build a nuclear power plant near the individual's area of residence. A final important distinction is whether interest groups and stake-holders are organized – in other words, whether they pursue their common interest jointly in a coordinated fashion. Examples of organized interest groups are labor unions, professional and trade associations, religious groups, clubs and the like.

Before analyzing the activities of interest groups, we will briefly ask who will engage in lobbying activities. As the reform requires political support to be initiated and sustained, identifying losers of the reform in general but especially those who are politically (and otherwise) active as opponents of reform is an important step toward successful completion of the reform. At a first sight, it seems that stake-holders especially will exert pressure on policy makers. This however, needs not to be always the case. First, not all stake-holders are organized. Since Mancur Olson's (1965) celebrated book, social scientists have analyzed the logic of collective action. On the one hand, individual members of a given group have much to gain from pooling their resources and pursuing a coordinated political aim. On the other hand, each member is tempted to free ride on actions of the others. The reason is that the group's action is akin to a public good. Along this line of reasoning, one should expect that the smaller the groups the more successful they are in overcoming the collective action problem. Second, some members of the society other than direct stakeholders (i.e. Olsonian coalitions against changes) may be opposed the reform. Schumpeter (1950) for instance argued that intellectuals, motivated by their ideological beliefs, may resist economic changes, or reforms.

2.2 Why Engage in Lobbying? Political Economy of Pressure Groups

Why do interest groups get organized and exert effort to influence policy-makers? Why do societies fail to implement the reforms that benefit a majority of their citizens? Organized interest groups may have essentially two motivations: protecting economic rents and protecting political power. In addition, if individuals are highly risk-averse, they may resist changes because of the uncertainty inherent in them.

The most common explanation of lobbying is protection of economic rents. Existing powerful interest groups block the introduction of new rules in order to avoid the losses that they will incur if the reform is implemented. Economic monopolies are an obvious example. A firm in a monopoly position, for example, will block the introduction of new technologies that might enable its (potential) rivals to enter and eventually capture the market. In the context of trade policy, Grossman and Helpman (1994) provide an explanation for the structure of trade policy protection and the contributions by different lobbies that support the policy outcome. In their model, organized groups provide contributions in order to influence an incumbent politician's choice of trade policy. The interest groups bid for protection with their campaign support. Politicians' welfare depends on total contributions collected and on the welfare of voters. They also show that the lobbies may in some cases prefer to have the government use trade policy to transfer income, rather than pursue more efficient means.

Protecting economic rents is not the only motivation for resistance to reform. Other motivations such as protecting political powers or avoiding negative externalities may as well explain why some groups resist reforms. The correlates of reforms create stronger incentives for intellectuals and the elite in power to resist a change in the society. In addition, and more importantly, the loss of political powers maybe a central incentive for resistance to changes. Acemoglu and Robinson (2000) develop a model to show that existing powerful interest groups block the introduction of new technologies. The main motivation of the interest groups is not the protection of economic rents but political power. In their analysis, the introduction of new technologies, or economic reforms, affect the distribution of political power. Political elite in power may resist the reform simply because its members fear that they would be the political losers. By emphasizing the role political losers as a barrier to economic development their explanation is in sharp contrast with a large number of previous studies that focused on the role of economic losers.

Uncertainty is another important factor that may well explain why there is so much resistance to reforms. Most reform programs are risky in that their outcomes cannot be identified with certainty beforehand. With risk aversion, the uncertainty inherent to the reform may outweigh its potential benefits. Therefore, people may rationally choose to resist the reform. The role of uncertainty is discussed in greater detail in the second part of the paper.

2.3 Activities of Pressure Groups

Interest groups engage in a variety of activities to promote their interests. According to survey findings (see e.g. Grossman and Helpman, 2001) activities of organized interest groups in the United States center on informing and persuading lawmakers of merits of the groups' positions. The activities of interest groups can be mainly classified into two categories. First, they provide information to policy-makers, and, often, also to citizens. Influencing the mass is important especially in the periods of elections. Second, they provide contributions to politicians. When policy-makers compete with each other, advertising becomes an important strategic element of competition. Consequently, those politicians who have more access to sufficient financial resources, usually provided by interest groups, will have a substantial advantage over competitors.

Because organized interest groups are better informed than the citizenry at large, they can provide key personalities (the government officials,legislators) with intelligence of various kinds. Providing information in a world characterized with various asymmetries of information is of high importance, especially to those who draft bills in a legislature. Therefore, interest groups may provide information to lawmakers by giving testimony for parliamentary (or congressional) hearings and committees. Interest groups also seek informal contacts with legislators and government officials at conventions and provide them with presentation of research results and technical information. They also break logrolling deals between legislators.[1] It thus seems that lobbyists' access to information is the most important element of their force.

Theoretical contributions addressing the information-providing role of interest groups are plentiful. It is beyond the scope of this paper to review exhaustively the literature. Nonetheless, it is worthwhile to briefly review some of the most remarkable contributions. Dewatripont and Tirole (1999) have an interesting paper on advocates. Advocacy in their theory can be easily interpreted as lobbying. By assuming that more information is always good for better decision making, they show that advocacy (i.e. lobbying) is good for welfare when it creates information. But lobbying is bad when it distorts information. Other notable contributions are Nelson (1976), Prat (1999, 2000), Rasmusen (1993) and Lohmann (1991).

The literature rationalizing the emergence of interest groups as providers of contributions to policy-makers is also very voluminous. Indeed, when political competition for seats is of great consequence, there is a great demand among policy-makers for contributions. There are two motives why interest groups provide campaign contributions: an *electoral motive*, whereby interest groups promote the electoral prospects of their preferred candidates, and an *influence motive*, whereby they attempt to influence the policy-makers' decisions. The seminal work of Grossman and Helpman

[1] More detailed information on interest groups activities can be found for instance in Milbrath (1963), Nownes and Freeman (1998), and Scholzman and Tierney (1986).

(1994) reviewed earlier focuses on the determination of export taxes and subsides in a small open economy. Austen-Smith (1987) and Baron (1989) study policy determination in a two-party model of electoral competition. A positive theory of how interest-groups competition shapes the organization of Congress is provided by Kroszner and Stratmann (1998). Their model explains campaign contribution patterns in financial services. Given that interest groups cannot enforce fee-for-service contracts with legislators, legislators have an incentive to create specialized, standing committees, which foster repeated dealing between interest groups and committee members. Their model's prediction (i.e. the resulting reputational equilibrium) supports high contributions and high legislative effort for the interest groups. Other excellent contributions are notably Grossman and Helpman (1996) and Snyder (1990).

Note that most authors have considered essentially information provision and vote-buying (i.e. contributions) by interest groups. While these are the main strategies of interest groups and can provide interesting insight, cooperation or competition between stakeholders remained an understudied topic in the literature. Alesina and Drazen (1991) is an exception to this regard. They provide an explanation for why stabilizations are delayed. We will come back to this contribution in the second part of this paper.

2.4 A Simple Model of Lobbying

To illustrate how lobbying is modeled and to emphasize the main messages of a large number of studies in the economics and political science literatures, we use a standard though simplified model of lobbying. Following Persson and Tabellini (2000) and Grossman and Helpman (2000) we study the allocation of a publicly provided good by a government that uses a common pool of tax revenues. Note that public good allocation is conceptually similar to undertaking a reform program, so that, without loss of generality one can see decision on allocation of a public good as a reform. The benefit of the publicly provided good is concentrated to well-defined groups. Though simple, the model highlights the main features of lobbying. That is, it addresses the following questions:

- When are the interest groups willing to give a contribution in order to influence the government's choice?

- What is the implication of interest groups lobbying activity on allocation of public goods?

Consider a society with 2 distinct groups of identical individuals. For simplicity, both groups are assumed to be of the same size, which is normalized to unity. Suppose the government has the authority to allocate a budget of size g to various public services. Each service benefits a distinct group of citizens. For example, the service may be road projects that reduce the transport costs for firms in different regions. One can also consider the allocation of the budget as undertaking a reform project that benefits a majority of the citizens. An individual who is a member of group j has utility $W\ (g^j)$ over g^j which is the allocation of the public good or service. We assume that $W(.)$ is increasing and concave. All groups' individual incomes are equal $y^j = y$ and a unit of income can be transformed into one unit of publicly provided good.

Now suppose that one group (e.g. group 1) becomes organized to influence the allocation of the public good in their favor but the other is not. The organized group provides politician with campaign funds. The objective of the organized group is to maximize the net welfare of the group $W\ (g^1) - c$, where c is the per capita contribution that members of the group give to the government conditional on the chosen policy. The contribution can be to a campaign fund or any other kind of political gift.

The government chooses g in order to maximize the weighted sum of social welfare and the gains it derives from receiving contributions:

$$G(g,c) = h[W\ (g^1) + W(g - g^1)] + (1-h)c\ ,$$

where h is the weight the government attaches to social welfare relative to contributions. The equilibrium allocation must be jointly efficient for the organized group and the government. In other words, it must maximize the utility of one, given the welfare of the other. Thus maximizing $W\ (g^1) - c$ subject to $G(g,c) \geq \hat{G}$, where

$$\hat{G} = h \max_{g^1}[W\ (g^1) + W(g - g^1)] = 2hW(g/2)$$

is the same as maximizing $W\ (g^1) + hW(g - g^1)$ so as to satisfy $W^{'}(g^1) = hW^{'}(g - g^1)$. In the absence of lobbying, or when the government attaches no importance to campaign contributions, the allocation that maximizes social welfare is the one that divides the budget equally, i.e. $g^1 = g/2$. But when the government attaches positive weight to campaign contributions, the allocation to the unorganized group is lower than the one without lobbying. Given these allocations, the model also predicts the size of equilibrium contribution. It can be easily shown that the equilibrium contribution is given by

$$c = \frac{h}{1-h}[2W\ \ (g/2) - W(g^1) - W(g - g^1)].$$

It is interesting to observe that the equilibrium contribution does not monotonically respond to the government's taste for the contribution. If the government attaches no importance to the welfare, i.e. $h = 0$, then contribution is zero. That is, the organized group does not gain by giving contributions to a government that does not attach any importance to social welfare. Contribution is also zero when the government cares only about social welfare. In that case, it is too costly for the interest group to influence the government. They thus refrain from trying to give any contribution. Using the same framework it is also possible to show that the first best allocation is reached when everybody in the society gets organized and tries to influence the policy-makers. That is, lobbying is a problem only when a fraction of the citizens are politically inactive[2]. It is important to note that this conclusion would not hold if one assumes that the act of lobbying was costly. The first implication of this in the case of reforms is that reform implementation will be easier when the pro-reform faction is as politically active and organized as the anti-reform one. There is thus room for government intervention for discouraging the anti-reform organized groups to take actions. Alternatively, if that turned out to be too costly, the government can encourage all stakeholders, specially the would-be gainers from reforms, to become politically active. The second implication of the analysis concerns the attitude of government towards the social welfare as opposed to the contribution. The government's commitment in pursuing the social welfare would discourage the anti-reform parties from being active.

Before reviewing the empirical literature one may wonder whether a strong state (e.g. an autocratic or dictatorial regime) is more successful at reducing lobbying and

[2] See Persson and Tabellini (2000) for more details.

implementing reforms. A priori, it seems that a strong state that takes a firm position against interest groups will enhance the implementation of reforms. But a strong government may also prevent reform if it fears a change of power as a result of introducing innovation. History tells us that powerful governments took a firm stand against the opponents of change such as the Luddites and even actively encouraged technological progress. According Mokyr (1992), Britain's edge during the Industrial Revolution rested on its government consistently and vigorously siding with innovators. In Italy, by contrast, where the guild system remained particularly strong, its rigidity is blamed for the failure of the rich Northern city-states of Venice, Florence and Genoa to adjust to changing demand and new technological opportunities and thus largely miss out on Industrial Revolution (Landes, 1999, p. 174). In any case, states that build up reputation for being "tough" on implementing reform may do better, though it is less obvious how easy it is to build such reputation in the short run.[3]

2.5 The (In)Efficiency of Lobbying

The economic literature on (in)efficiency of lobbying is dominated by a controversial debate between, on the one hand, Chicago school and, on the other hand, the Virginia school. The Chicago view is that political competition between interest groups leads political leaders to take efficient decisions. The Virginia school, on the other hand, argues that lack of information on the part of voters induces policy makers to favor inefficient methods of redistributions(see Coate and Morris (1995) for more details).

Within the Chicago school, Becker (1983) builds a model of competition among pressure groups. In his model, individuals belong to groups that use political influence to enhance the well-being of their members. Political parties, politicians and voters are assumed to transmit the pressure of active groups. Competition among these groups determines the equilibrium structure of taxes, subsides, and other political favors. Stigler (1971) develops a theory of economic regulation. Another notable contribution is due to Wittman (1989) who argues that democracies produce efficient results. According to

[3] The importance of institutions is emphasized by Douglas North (1990) who argued that efficient institutions play an important role in implementing reforms. But he also argued that good institutions might not be adopted by those elites that have political power. See also Krueger (1974).

these scholars, political competition between pressure groups ensures that the most efficient method of redistribution is chosen. Thus, if a politician takes an inefficient decision he or she will be voted out of office.

The Virginia school takes a different view by emphasizing the importance of imperfect information in explaining the inefficient form of redistributions by policy-makers (see e.g. Nelson 1976, Tullock 1983).

In addition, political scientists have addressed the question of the powers and efficiency of the interest groups' actions. Susanne Lohmann (1998) provides an information rationale for the power of special interest groups. After observing that "political decisions are often biased in favor of special interests at the expense of the general public, and they are frequently inefficient in the sense that the losses incurred by the majority exceed the gains enjoyed by the minority" she explains the bias in terms of information asymmetries and the free-rider problem. According the model, the incumbent policy makers increase their reelection chances by biasing policy toward specific groups that are better able to monitor their activities. In addition, because smaller groups are better able to overcome the free-rider problem of costly monitoring, policy will be biased in their favor. Interestingly, the analysis shows that inefficiencies created by the policy bias are offset by a positively valued selection bias. That is, incumbents who demonstrate competence are more likely to survive voter scrutiny.

In a closely related paper, Lohmann (1993) develops a signaling model of informative and manipulative mass political action. She shows that self-interested individuals may engage in costly political action despite the free-rider problem. Their political actions can be informative to policy-makers or may intend to manipulate the political leaders.

2.6 Empirical Evidence

On the empirical front, the literature is again dominated by studies focusing on the experience of the United States. The empirical contributions typically used two types of dependent variables: behavior of individual policy-makers, and actual policy choices. Within the former approach, most studies use roll call votes from the US House and Senate to investigate whether interest groups exert a significant influence on legislators' voting behavior. The latter strategy uses a large array of policy variables ranging from the level of expenditure on a specific sector to the overall government budget.

There are a large number of empirical contributions examining the actions and strategies of interest groups and the consequences of their interventions on economic welfare. Kau, Keenan and Rubin (1982) specify a model in which politicians, constituents and campaign contributors simultaneously decide on behavior. Constituents and contributors desire to influence the voting behavior of politicians (i.e. legislators); politicians, on the other hand, want to be elected and vote accordingly. They empirically test their model using roll call voting on eight bills dealing with economic regulation. Their results show that part of the voting behavior of politicians can be explained by non-economic factors (i.e. ideology).[4] Interestingly, they also find that unions and businesses as campaign contributors are sometimes influential. They show that unions are more often influential than firms. Finally, ideological factors are also important in explaining voting. Other examples of empirical studies in the literature are Kau and Rubin (1978), Kalt and Zupan (1984) and Poole, Romer and Rosenthal (1987). Kau and Rubin (1978) studied the determination of the minimum wages. Kalt and Zupan (1984) assess the nature and significance of capture and ideology in a particular instance of economic policymaking: U.S. Senate voting on coal strip-mining regulations. Finally, Poole, Romer and Rosenthal (1987) analyze the "revealed" preferences of political action committees. These papers typically find that while interest groups' pressure is important, ideology is an equally important determinant of policy-making activity.

2.7 Summary Findings

To summarize the main findings of the empirical literature on interest groups we borrow extensively from Potters and Sloof (1996):

1 Campaign contributions and lobbying alter legislators' behavior, particularly with respect to bills with narrow focus and low public visibility.

[4] Ideology's measure is given by the percentage of voters in the Congressman's district who voted for the right-wing candidate (i.e. Ford in the 1976 presidential election).

2 The strategy of ideological groups is oriented toward supporting like-minded legislators; corporate groups focus more on changing legislators' positions; labor groups employ an intermediate strategy.
3 Larger organized groups have more political influence.
4 A group's stake in influencing the policy can explain both its political activity and its success.
5 The relation between the number of potential participants of collective action and their influence is characterized by two opposing forces: free-riding and the availability of resources.
6 The presence of an opposition (coalition) force in the political arena hurts (helps) a group's case in politics.
7 Strong electoral pressures on the polity and the presence of a well informed electorate reduce the organized groups' influence.

3 Winners, Losers and the Political Support for Reform

The early contributions on policy reform and transition was largely normative in nature and typically equated the reformist government with a benevolent social planner that seeks to maximize social welfare and implements efficiency-enhancing reforms accordingly. This literature, accordingly, focused primarily on formulating a list of policy prescriptions that a benevolent government should follow (see, for example, Lipton and Sachs, 1990) in order to achieve its noble objectives. Yet, governments are not always benevolent – instead, officials may pursue their own private aims, as public choice tells us (see Mueller, 2003). Moreover, even when the government intends to implement efficiency-enhancing policies, its ability to do so is constrained by the need to obtain and sustain support for the reform program from the electorate at large and the various holders of veto power (Roland, 2000; Drazen, 2000; and Persson and Tabellinni, 2000). The notion of a benevolent government implementing a reform along a J-curved trajectory therefore does little justice to the complex nature of the issues at hand. In this section, we discuss the various factors that underlie successes or failures of reforms. The following list collects some of the key issues relating to the political economy of large-scale reform programs, which are then discussed in greater detail in the remained of this section:[5]

1 Reform is often associated with a high degree of aggregate uncertainty in that the required duration and the overall outcome of the reform is uncertain.
2 The government (or certain interest groups) may possess superior information about the reforms outcome but may be unable to communicate this information to the voters in a manner that is credible.
3 There is also considerable individual uncertainty about the identity of winners and losers. The net gains from implementing the reform different across the various socio-economic groups.
4 The situation before the reform is often one of progressive deterioration and as such is not sustainable in the long term. Crises beget reforms. Nonetheless, a reform may be procrastinated until the situation deteriorates into a full-blown crisis.
5 Ex ante acceptability of the reform can be ensured by a promise that the losers will be compensated ex post. However, such commitment may not be credible.
6 In order to be implemented and sustained, reform needs sufficient political support ex ante and ex post. The nature of the winning coalition can change as the reform progresses.
7 Interest groups representing narrow segments of the overall population often enjoy political influence that is more than proportional to their size, thus allowing them to capture the government. The nature of the initial political equilibrium determines which policies get implemented subsequently, thus giving rise to virtuous or vicious circles.
8 Reforms initiated and implemented by an authoritarian regime do not result in better performance or have a greater probability of success.

[5] Dewatripont and Roland (1996), Tommasi and Velasco (1996) and Rodrik (1996) present early surveys of literature on political economy of reform. See also Buiter (2000) and Roland (2000, 2002) for more recent surveys. The volumes edited by Bates and Krueger (1993a), Williamson (1994a) and Rodrik (2003) present a number of case studies drawing mainly on the experience of developing countries.

3.1 Uncertainty and Signaling

Before the reform is completed, there is considerable uncertainty about its outcome or the length of period required for its successful implementation. This uncertainty arises because the reform's outcome depends on a number of exogenous factors, frequently referred to jointly as *states of nature*: initial conditions, external developments (including, for example, availability of foreign assistance), response of various economic actors to the reform (for example removal of price controls may result in monopoly rents for the incumbent firms, or massive entry of new firms into the industry) and the like. Another source of uncertainty is the nature of interactions between various partial reforms. The individual elements of reforms may be largely independent of each other or highly complementary (for example, liberalization of capital flows may result in an inflow of foreign investment if it is accompanied by improvements in quality of the rule of law and enforcement of property rights, and in capital flight otherwise). With uncertainty, voters may reject an efficiency-enhancing reform before it can be implemented because of pessimistic expectations. Similarly, once a reform is implemented, it may fail to deliver the hoped-for improvement and may have to be reversed.

Dewatripont and Roland (1995) argue that in presence of aggregate uncertainty, a gradual reform may have an advantage over a big bang one because implementation of each reform step reveals partial information about the final outcome. Consider a reform program that consists of two reform measures that can be carried out simultaneously or sequentially, such as price liberalization and privatization). The outcome of the full reform and of each partial reform measure is not known beforehand. Once the reform is implemented, it can be turned back but reversal is costly – for example, re-instating price controls stifles competition and also undermines credibility of future reforms). Finally, reversing the full reform costs more than reversing a single partial reform measure. The outcome of the reform program crucially depends on the state of nature (e.g. the response of the nascent private sector: either the reform results in a host of new entrepreneurs stepping forward to take advantage of the new opportunities, or it ends up in inflation and bankruptcies of undercapitalized privatized firms).

Implementing the full reform program then amounts to a lottery: either the outcome is positive and then the reform is sustained, or it is negative and the reform is reversed at a cost. In contrast, a gradual approach reveals partial information about the state of nature. If that information indicates that the full reform will lead to an adverse outcome, the partial reform can be reversed at a lower cost than the full reform. Otherwise, the next reform measure is also implemented and the full benefit of the reform program is realized with a delay compared to the big bang approach.

The option of early reversal can be of critical importance. Because it allows partial learning about the outcome without implementing the full reform, it can help save the higher cost of reversing an inefficient reform. Dewatripont and Roland (1995) show that this option has an unambiguously positive value and therefore can make an otherwise unattractive reform program politically acceptable. This argument is even stronger when considering a reform program consisting of multiple steps, where gradualism entails improved precision of the signal about the final outcome after each individual step, with the option of early reversal at any point in the course of the reform program. Note that the value of the option of early reversal is higher when uncertainty is greater or reversal of the full reform more costly.

Countries contemplating undertaking reform can also learn from observing experience of other countries with implementing similar reforms. Several instances of such *informational cascades* – with reform programs gradually gathering momentum and eventually sweeping through a number of countries – can be brought from recent history: hyperinflation stabilizations in Latin America and Israel, the movement towards greater economic and eventually also political liberalization throughout much of the developing world during the 1980s and early 1990s, privatization and deregulation in Western Europe during the 1990s, trade liberalization and the rise of regional preferential trade areas throughout the world, and, most notably, the domino-like end of communism throughout Eastern Europe and the former Soviet Union. Such waves of reform are not merely cases of copycat practices or herding behavior. By observing the experience of a few frontrunners, the laggards update and improve the precision of their expectations so that by the time they too join the bandwagon, they have a much better idea as to what the reform will bring to them. Therefore, observing the experience of others also can affect the choice of the reform strategy. The front-runners face a high degree of uncertainty and therefore a gradual reform may be the only politically feasible approach. In contrast, the late reformers benefit from the experience of others and therefore support for a big bang reform may be easier to muster. Fidrmuc et al. (2002) argue that the different degree of uncertainty explains why Hungary chose a gradual reform in 1990 whereas Czechoslovakia, which had been able to observe the early outcomes in Hungary and Poland[6], chose a big bang reform in 1991.

The amount of uncertainty that various groups and actors in the society face often differs. The government has teams of expert advisors at its disposal and therefore is in a better position to predict the outcome of the reform. As obtaining relevant information is costly, organized interest groups have an advantage over individual unorganized voters. Groups can pool members' resources and exert expense to obtain information and therefore have superior knowledge about future outcomes of alternative policies. Clearly, voters benefit if the government or interest groups disclose their information about the reform's outcome, however, such disclosure must be credible: the government and interest groups may disclose incorrect information in order to induce voters to adopt the reform that they favor.

The issue of credible signaling is tackled by Cukierman and Tommasi (1998). They argue that the ability of the government to signal information about the reform's outcome depends also on the government's political orientation. Conventional wisdom suggests that market-oriented reforms are more likely to be implemented by right-wing governments. This belief reflects the fact that the natural constituency of right wing parties – the middle class, entrepreneurs and relatively affluent voters – stand to gain most from economic liberalization, reduction of the tax burden and deregulation. Therefore, right-wing politicians have an *a priori* ideological bias towards implementing market-oriented policies. This *a priori* bias, however, may play against the government when it comes to selling the reform to the public. Because right-wing politicians may be pursuing a party agenda, the voters cannot distinguish whether the government is proposing a reform because it knows that it will increase efficiency or because of its ideological bias.

[6] Unlike Hungary, Poland started the reform under conditions of near hyperinflation, which necessitated radical and rapid reform measures.

To see how the government's ideological background can affect the credibility of its signals, Cukierman and Tommasi formulate the following model[7]: utility of voter i depends on the distance between the policy implemented by the government, x, and his preferred point alongside a single-dimensional policy spectrum, c_i+g, or, with superscript e denoting expectations: $U_i = -\left|x^e - \left(c_i + g^e\right)\right|$. The voter's preferred point, in turn, consists of a constant term (for example the voter's ideological bias), c_i, and a state-of-nature variable γ. The voter's preferred policy thus depends on the state of nature, but the voter observes g only after the election. The kind of policy that a party implements if elected depends on the state of nature but also on the party's ideological position. The utility that party j derives from being in office then is: $U_j = h - \left|x_j - \left(c_j + e_j + g\right)\right|$, where h is the party's benefit from holding office, x_j is the policy the party implements if elected, c_j is a party-specific constant term and, finally, e_j is a shock to the party's ideological position – for example a specific ideological bias of the current leadership. Both g and e are white-noise stochastic variables with zero mean and variance s_g and s_e, respectively, and their distributional properties are publicly known.

Suppose now that the government observes that the state of nature is such that it should optimally implement a market-oriented reform. Then, when it proposes such a reform to the voters, it may be interpreted in two ways: that the state of nature indeed requires a pro-market reform, or that the current realization of the party-specific ideological shock, e, merely moved the party further to the right. In other words, a proposed policy change entails a signal about the current state of nature but the signal is *noisy* – and the true nature of the signal will only be revealed after the election. Cukierman and Tommasi show that when shocks to party ideology are more volatile than state of nature shocks, then dramatic departures from previous policies (reforms) are more likely to be implemented by an unlikely party – a right-wing reform by a left-wing party and vice versa (although their argument centers on parties and governments, the same argument goes forth for interest groups that support specific policies or policy reforms). The intuition is straightforward. Consider a case when a right-wing government

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[7] While their paper only discusses the political orientation of the incumbent government, the same argument can be applied to ideologically oriented interest groups.

proposes a market-oriented reform. Because party ideology is more volatile than the state of nature, voters will interpret this policy change largely as a move by the party to the right. If, on the other hand, a left-wing party proposes such a policy reform, the signal entailed in it is more credible.

Hence, contrary to the conventional wisdom, right-wing government is not a necessary condition for successfully implementing a market-oriented reform, and may even make the government's job of garnering support for the reform more difficult. Indeed, the evidence on political color of parties implemented major policy reforms in developing countries is very mixed. Williamson (1994) finds that among the 13 reforming countries surveyed in Williamson and Haggard (1994), only in three cases the government implementing the reform program was a right-wing one. Among the remaining eight cases of successful reforms, five were initiated by centrist governments and three by left-wing ones, whereas the two failed reforms were both carried out by centrist governments. In transition countries, at least initially, reform programs were typically initiated by right-wing parties (or at least by parties that were perceived as right wing at the time) – although given that these parties replaced the communist regime, this is not all that surprising. Later on, however, a number of important reform steps were implemented by left-wing parties – the former communists carried out painful fiscal austerity measures, including privatizing pension insurance, in Hungary after 1995, and the social democrats in the Czech Republic privatized much of the banking sector in the late 1990s.

Uncertainty about individual outcomes of the reform may also induce voters to reject a reform that is socially optimal, as shown by Fernandez and Rodrik (1991). Consider a reform that results in two types of outcomes: winners and losers (with all winners realizing the same outcome and likewise for losers). The reform will be supported ex ante if the expected gain is positive (i.e. if $pg + (1-p)l > 0$, with p being the probability of being a winner and $g>0$ and $l<0$ representing the net payoffs of winners and losers, respectively. The reform will be supported ex post if the winners represent a majority of the population, i.e. if $p>0.5$. A reform that meets both conditions will be initiated and then sustained once implemented. Yet, when either of the two conditions is not met, the reform will either not be attempted at all, or may be implemented only to be reversed again later. Specifically, a reform may benefit a majority ex post, i.e. $p>0.5$, but carry a negative expected payoff ex ante, $pg+(1-p)l<0$, in this case, the reform will not be attempted but would be sustained if implemented. Alternatively, the reform may have a positive expected outcome, $pg+(1-p)l>0$, but a majority incurs a negative payoff, $p<0.5$, and would therefore favor reversing it ex post (or, if reversal is costly, this case too will result in reluctance to undertake the reform). The latter case is interesting also because the reform could be made acceptable if the winners can credibly commit to compensate the losers ex post. Without credible redistribution schemes, individual uncertainty results in a *status quo bias*.

Reducing the uncertainty, however, does not always make the reform more likely to succeed. Consider the following simple example, a reform will benefit 60% who will realize a gain of 10 while the remaining 40% will make a loss of –12. A clear majority will benefit from implementing the reform and the expected gain is 1.2 so that the reform proposal is approved. However, suppose that the identity of a third of the winners is revealed beforehand so that 20% know for sure that they will gain and will therefore vote in favor of the reform proposal. This reduction of uncertainty, however, has rather dramatic consequences for preferences of the remaining 80% who are now equally likely to gain and lose from implementing the reform. The expected payoff for them now becomes –1 and the reform will be rejected by an overwhelming majority of voters. This kind of resolution of uncertainty thus reinforces the status-quo bias.

3.2 Distributional Concerns

Reform programs are frequently undertaken to halt on-going economic decline before it develops into a full-blown crisis. The status quo is therefore usually not attainable in the long term and the choice is between the reform and a further continuing deterioration (or in the words of Anatoli Chubais, an erstwhile Russian reformer later turned oligarch, there is "the road to reform and the other road"[8]). Yet, reforms bring about substantial adjustment costs, especially in the short term and these costs are often asymmetrically distributed across the various socio-economic groups. Because of this, reforms can be delayed inefficiently, frequently until the underlying economic problems develop into a full-blown crisis. This has lead to the common observation that *crises beget reform* (see Williamson, 1994; and Drazen and Easterly, 2001): only after experiencing a major crisis, the public at large will acquire a feeling of urgency necessary to make a costly reform politically acceptable. In fact, Williamson (1994) goes as far as speculating that a crisis might be desirable because a combination of a crisis and a subsequent reform is superior to continued muddling through. Alesina and Drazen (1991), on the other hand, emphasize the role of asymmetric distribution of the costs of reform. Consider a situation where there are two groups, each powerful enough to block the reform. The status quo is costly for both groups and therefore unattainable in the long term. Yet, the group that espouses the reform first will bear an asymmetric share of the costs (for example, once one group endorses the proposed reform, the government can sway the remaining group by offering it more favorable terms). Therefore, even though delaying the reform is costly in the long term, by holding out a group increases the probability that the other group gives in first. In the end the reform is postponed through a war of attrition until a further delay becomes unbearable for one group, which then concedes defeat and the reform is implemented. Hence, in contrast to the conventional wisdom, the reform may be postponed even if all segments of the society agree on the need for change but the various groups stand to gain by being the last to give in.

When the reform brings about asymmetric outcomes for different groups, a commitment to compensate the losers may be crucial for ensuring that it is ex ante acceptable. Yet, such a commitment may lack credibility: once the reform is implemented, reversal is costly or outright impossible and therefore the incentive for reneging is high. What is more, the reformist government may intentionally pursue a *scorched earth* policy to make a reversal prohibitively costly and thus bind the hands of its successors in office.[9] As Dewatripont and Roland (1992a,b) argue, because of this lack

[8] International Herald Tribune, January 2, 1996.

[9] For example, after Estonia adopted a currency board, the government entered into a number of long-term futures contract that would make departures from the adopted parity very costly. Bias and Perotti (2002) argue that mass privatization at bargain prices, as undertook in the UK and later in the Czech Republic, leads to wide-spread share ownership and thus creates a powerful constituency against renationalization. Earle and Gelbach (2000) find empirical evidence that Czechs who participated in mass privatization and retained shares indeed show greater support for market-oriented reform.

of credibility, the losers may require compensation ex ante, which imposes a considerable fiscal burden on the reformist government. Moreover, when the losers are not known in advance, the fiscal burden is even greater because all *potential* losers need to be compensated –for example, employees of state-owned firms may have to be offered generous severance packages in order to accept privatization, even if some of them will eventually receive better paying private sector jobs or start their own businesses and thus will end up as winners rather than losers. Therefore, the reform program will likely receive greater political support ex ante when there are established frameworks for compensating losers such as an effective system of unemployment insurance and/or when there are sufficient provisions for upholding the losers' interests (e.g. through a broadly representative system of government).

3.3 Politics of Reform

Reform programs instigated through a democratic process often displays specific dynamics of political support. Initially, the public shows a large degree of support for the reform (sometimes referred to as the *honeymoon effect*, see Williamson, 1994). Yet, as the reform proceeds, popular support gradually dissipates, often to the point that the reformist government is voted out of office. This may result in a halt or complete reversal of the reforms, although frequently the new government only changes the course or speed of reform, without completely abandoning it (this has, for instance, been the case when former communists and socialists returned to government in the post-communist countries). Such political developments, however, need not indicate that the public at large has turned against the reform. Rather, the dynamics of political support for the reform reflect the gradual learning on behalf of the voters about the reform's outcomes and their individual realizations and adjust their political behavior accordingly. Rodrik (1995) and Fidrmuc (1999) present formal models of such political dynamics. Consider again a reform that will result in two groups, winners and losers. Assume that the reform is socially optimal, i.e. the expected gain is positive. Such a reform will receive unanimous support ex ante – every individual expects to gain and therefore voters will support implementing the reform as rapidly as possible. Over time, as individual outcomes become revealed, the preferences of the losers are likely to change. Yet, as the reform is socially optimal, reversing it is not desirable, even for the losers. Instead, the losers can partake of the winners' gains by voting for parties that support greater income redistribution – the various left wing parties. Hence, the pendulum-like swings in political support between pro-reform and left-wing parties may just as well reflect the gradual learning about the reform's outcomes rather than a rising sentiment against the reform. The reform gives rise to constituencies of winners who continue to support further rapid reforms and losers who support parties that will tax the winners' gains and thus secure that the losers' losses are (partially) compensated.

Constituencies of winners or losers sometimes gain political influence that is more than proportional to their size, their *privileged* position being attributable to their inherited political contacts or the financial means they acquired in the course of the reform. This may have important consequences for the further progress of the reform program. Narrow interest groups, by definition, represent narrow interests (see Olson, 1982 and 2000) and may therefore force through actions and policies that are not in the interest of the population at large. This may lead either to virtuous or vicious circles, as argued by Krueger (1993) and Hellman (1998). Early reform measures often entail considerable benefits to specific groups whose gains are crucially dependent on the further progress (or lack thereof) of the reform. A vicious circle arises when the initial partial reform gives rise to rents to certain segments of the society (such as the new owners of previously state-owned firms that enjoy monopoly positions or industries that benefit from continued protection against import competition under incomplete trade liberalization). Their rents dissipate once liberalization is completed and therefore the winners of partial reform have a strong incentive to capture the government to secure their rents and block further reforms or support reforms that further increase their gains. A virtuous circle arises in a similar way, although the final outcome is dramatically different with respect to efficiency and overall social welfare. Therefore, the question of sequencing is crucial – reforms that benefit relatively broad socio-economic groups and/or that are highly complementary with subsequent reform measures are likely to create a constituency in favor of further reform and thus give rise to a virtuous circle. In contrast, reforms that yield extraordinary but temporary rents for narrow groups are likely to result in state capture resulting in a vicious circle.

It has been often argued that a fundamental policy reform has a better chance of success when carried out by an authoritarian regime – a sort of *benevolent dictator* (again, this is one of the hypotheses proposed by Williamson, 1994b; see also Cheung, 1998; and Intriligator, 1998). The reformists, it is argued, need to be shielded from the political backlash caused by the short-term costs of reform. Once the reform starts bearing fruit, the dictator presumably will depart to make way for political liberalization. There are a number of reasons why this argument is flawed. Developing and post-communist countries experienced numerous dictators – yet, only a handful of those turned out to be benevolent. Authoritarian government frequently tend to pursue narrow interests. As argued by Olson (2000), broadly representative democratic governments have a much greater degree of *encompassing interest* than any authoritarian regime or a democratic regime captured by narrow interest groups. Fidrmuc (2003) studies this issue empirically in a cross section of post-communist countries and finds that democracy improves growth performance, albeit indirectly by facilitating economic liberalization (which in turn is associated with higher growth). Thus, countries that implemented greater degree of political liberalization in turn found it easier rather than more difficult to implement economic reform measures and, therefore, eventually outperformed those countries that chose a lower degree of political freedom.

Finally, Doyle and Fidrmuc (2003) subject the theoretical models of political constraints to an explicit empirical test. They utilize a sequence of 11 opinion surveys conducted during the first eight years of the Czech transition (1990-98) to analyze the changing nature of political preferences. They find that variables that reflect economic outcomes of the reform program, such as individual income and employment status and regional unemployment rate, do not seem to affect voting preferences in the early surveys but become increasingly important later on, once the gains and losses from the reform have been revealed. This pattern is consistent with the theory on the impact of uncertainty on support for the reform. Early on, while uncertainty is high, the identity of winners and losers from the reform is not known. Later on, as the underlying uncertainty gradually dissipates, coalitions of winners and losers start emerging and they vote accordingly.

3.4 Empirical Evidence on Winners and Losers of Reform

Empirical evidence on interest groups and their role in facilitating or opposing reform is scarce, mainly because of lack of suitable data. One approach that circumvents the lack of quantitative data is the writing of case studies – see the volumes edited by Bates and Krueger (1993a), Williamson (1994a) and Rodrik (2003). Although the case studies are rich in insight and local knowledge, they are largely descriptive and it is difficult to generalize and determine unambiguously the causes and effects of the various phenomena. Nevertheless, the summary chapters of the aforementioned volumes do an excellent job at identifying common patterns.

The extent of public acceptance of reform seems to depend crucially on economic outcomes. Lora and Panizza (2002) report that public satisfaction with economic reform and with democracy in Latin America is positively correlated with growth and negatively correlated with income inequality. Hayo (2003) reports similar findings for the transition economies of Central and Eastern Europe – high inflation, unemployment and income inequality all tend to drive down public support for market-oriented reform. MacCulloch (2001) and MacCulloch and Pezzini (2002), similarly, find that high inequality and low growth tend to increase the desire for radical change through revolutionary action. Using regional data, Pacek (1994), Clem and Craumer, 1995a,b, 2000; Bell (1997), Fidrmuc (1999a,b) and Warner (1999) find that areas with adverse macro-economic conditions (high unemployment, low incomes and low economic growth) tend to have lower turnout rates and display greater support for parties opposed to economic reform. Not surprisingly, when reform fails to deliver the hoped-for improvements, a political backlash occurs – but when the reform bears fruit by delivering stable prices and greater prosperity, its popularity rises accordingly.

The evidence for developing countries is largely similar. Nonetheless, Pacek and Radcliff (1995) find, somewhat surprisingly, that the impact of macro-economic conditions on support for the incumbent government is asymmetric: while the government loses a great deal of support during recessions, it gains little or nothing when growth is positive. A possible explanation for this asymmetry is that in less developed countries gains from growth are not universally shared. Rather, economic growth tends to originate in the manufacturing and service sectors. The workers in these sectors, in turn, are the main beneficiaries of economic growth, but they account only for a relatively small fraction of the society. The majority that remains in the agricultural sector gains little during periods of growth but nonetheless is hurt during recessions (when falling incomes in the other sectors spill over to falling demand for agricultural products). Furthermore, growth in such segmented societies may further contribute to increasing income inequality: the rich get only richer whereas the well-being of the poor undergoes little change so that their relative position within the society in fact worsens. Then, the votes from those in the traditional sector may largely cancel out the votes from those in manufacturing and service sectors.

At the individual level, those with high income, high education, white collar occupation, in a relatively young age and those employed in the private sector tend to show greater support for market-oriented reforms or the parties associated with such reforms. In contrast, the unemployed, blue-collar workers, the elderly and those with little education oppose the reform. (see Brainerd, 1998; Jackson et al., 2001; Lora and Panizza, 2002; Hayo, 2003; and Doyle and Fidrmuc, 2003).

These findings help identify the winners and losers from market-oriented reform. A reform imposes dramatic changes on the economic system. Whether or not economic agents are able to adjust to them depends on their flexibility and transferability of their human capital. Those with high education and skills are more likely to adopt new technologies and benefit from the new economic environment. Similarly, the young are more likely to be able to learn new skills and less likely to be burdened by legacies of the past economic system (for example, working experience and skills from a highly regulated shortage economy is not of much use in a liberal market economy). Those who cannot adjust see their real incomes plummeting and are may find themselves dependent on government transfers such as unemployment benefits that frequently do not keep pace with inflation. Similarly, pensions are often imperfectly indexed (in fact, not adjusting pensions fully for inflation may be part of an effort to transform pay-as-you-go pension system into a fully funded one). The winners then favor sustaining and extending the reform whereas the losers are apposed to it. Nonetheless, as argued above, the opposition to reform need not necessarily indicate an desire to reverse the reform. Rather, voters may oppose the reform in order to cast a protest vote and induce the government to pay more attention to their concerns (Picketty, 2000, and Castanheira, 2003, argue that voting for fringe and extremist parties can be explained as signaling).

A different category of winners and losers arises when the reform fails to achieve its intended objectives, for example because it is stalled or captured by interest groups (see Krueger, 1993; Hellman, 1998, and Hellman et al., 2000). Much of popular disillusionment about reforms in Latin America and the former Soviet Union stems the widespread corruption, lack of rule of law and rising crime that followed the reform measures. Russia is a case in point – Åslund (1999) estimates that rent seeking peaked in 1992 at staggering 81% of GDP (rents is computed by adding up the various subsidies, subsidized credits and tax exemption). Hillman (1999) and Hillman and Ursprung (2000) similarly blame increased rent-seeking for the deep economic decline experienced in Russia and much of the former Soviet Union.

In case of a captured reform, those who expected to benefit from the reform – and supported it ex ante – are not the main beneficiaries, or may even end up as losers. Lora and Panizza (2002) suggest that dissatisfaction with rampant corruption is one of the crucial reasons why many members of the middle class in Latin American countries have recently turned against market-oriented reform and democracy. Russian experience is similar – the president Putin's recent popularity seems to stem largely from his expressed commitment to rule in the oligarchs, quell economic chaos and reinstate the rule of law. The disillusionment with the current situation is so great that majority of Russians appear prepared to trade it for a rule of strong hand.

4 Suggestions for Country Study Authors

When analyzing politics of reform and the role of interest group in individual countries, the following points should be usefull:

1 What were the different interest groups and stake holders involved in lobbying in favor or against the reform process? What specific roles, in any, did they play in the reform program? Did any group succeed in blocking the reform? Were the various

interest group (whether organized or not) sufficiently represented in designing and executing the reform program?

2 Were the various interest groups organized and politically active? Organized stakeholders – winners and losers of the reform likewise – are typically in a better position to obtain relevant information about the benefits and costs of the reform. Who were they and what actions did they engage in?

3 Did the reform enjoy a broad support across the various segments of the society before it was implemented and while it was being carried out, or was the decision taken by relatively narrow interest groups? Did support for the reform across the various socio-economic groups change in the course of its implementation? Who were the winners and losers and where they broadly spread across the society or concentrated? Was the reform immediately preceded by a change of government and if so, how did that change come about?

4 Uncertainty about the reform's outcome can be reduced by an active information campaign by the government or by pro-reform interest groups, or by sequencing the individual reform measures in a way so that each step reveals information about the outcomes of further reform steps and the entire program. Simultaneous or recent experience with reforms in countries in with similar initial conditions can also reduce uncertainty. Did any of these conditions apply?

5 Was the reform accompanied by an explicit and credible scheme for compensating the losers? If so, did the government deliver on its promises of compensation?

6 Was the reform precipitated by a major crisis? Did the crisis arise largely unexpectedly or because a consensus on the reform could not be reached before the situation deteriorated so that avoiding the reform became unfeasible?

7 What was the political (ideological) background of the government and interest groups that initiated the reform?

8 Did any interest groups succeed in capturing the government and shaping the reform dynamics to their own advantage – to the benefit or detriment of the society at large? Was the reform effort captured by groups associated with the pre-reform elites or by newly risen beneficiaries of partial, incomplete reform?

9 Was the reform implemented under a democratically elected government or an authoritarian one? How did the nature of the political system contribute to the success or failure of the reform? Was democracy established (retained) in the long term? What other institutions – political, social or cultural – shaped the nature of the reform program?

10 Which interest groups were involved in lobbying activities during the reform process? What was the main reason (economic, political, ideological or uncertainty) for engaging in lobbying activities? And what was the type of lobbying activity undertaken (financial contributions, provision of information, etc.)?

11 Did lobbying activities influence or alter the reform agenda? If so, did they influence it in a positive or negative way?

12 Since lobbying is a problem when a fraction of citizens are politically active, what about the representations of various stakeholders in the country?

5 Conclusions

Interest groups and stakeholders play a crucial role in determining the outcome of an economic policy reform. They can initiate and support the reform but they can also oppose the reform effort, attempt to block it or to divert it to serve their own aims. Depending on the distribution of gains and losses, a reform can unify the society (whether in support of it or in opposition against it) or polarize it. The implications of a reform can mobilize existing interest groups or give rise to new groups. Clearly, just as no two reform programs are identical, also no countries share the same experience with political support for reform.

In this study, we have summarized a number of arguments and observations related to the role of interest groups in a reform effort. These should not be thought of as a set of universally valid truths as each country's experience with reform is unique. The proliferation of reform programs – successful as well as those that failed to deliver the expected improvements – provides an excellent opportunity for gathering further evidence in this regard.

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