

Political Considerations

28. When reform targets benefits to truly needy families, less needy families will suffer. The latter families may be part of politically powerful groups. If governments perceive the risk of political fallout—including apprehension about violent protest—as too large, they may be deterred from implementing reforms. In some countries—Ecuador in 1998–99, for instance—the government’s popularity was eroded in the wake of the implementation of reforms.

29. As noted above, political considerations influence the speed of reform. These considerations include (see also Box 1):

- *Popularity of the government.* It is easier for a popular government to implement difficult policy reforms. For example, the election of a new government with strong public support can provide an opportunity for rapid reform. Furthermore, an economic crisis may temporarily engender greater support for actions that would be otherwise unpopular. For example, in Peru, President Fujimori continued to enjoy approval ratings of 64 percent in 1992 and 69 percent in mid-1993 despite sharp reductions in price subsidies without accompanying compensatory measures. Graham (1994) attributes this to the extreme economic shock that preceded reforms and to the on-going civil strife.

In some instances, a reduction in the international price of imported subsidized items has provided a window of opportunity for governments to implement reforms (e.g., Yemen in 1998). When such opportunities arise, a government intent on reform should act quickly. Indeed, implementing reforms rapidly may even bring political benefits. Evidence from transition economies suggests that incumbent radical-reform governments have done well in elections, whereas incumbent slow-reform governments have been defeated (Åslund, Boone, and Johnson, 1996). In the same vein, evidence from the Russian Federation suggests that in regions that have implemented radical reforms, support for reformist parties is stronger (Warner, 1997). Governments that lack political and economic credibility may face insurmountable

obstacles in the implementation of price-subsidy reform (e.g., Indonesia in 1998 before the change in government).

- *The level of political organization of the middle class.* In many cases, protests against price-subsidy reforms are fueled, and sometimes led, by the urban middle class (civil servants, teachers, university students, and affiliated labor organizations). These groups may protest because they would lose the benefit from existing, poorly targeted subsidies without a compensating reduction in their tax burden (Hausmann, 1998, and Nelson and others, 1994). In Venezuela, in the early 1990s, for instance, the lukewarm political support of the middle class for a cash-transfer and food-stamp program targeted through the basic education and primary health care system sharply contrasted with this group's opposition to realigning public-sector prices with their true economic cost. Over time, subsidies can become entrenched as entitlements for current and future generations, which intensifies resistance against reform (Samuelson, 1995).

30. In general, violent reactions to price-subsidy reform are the exception rather than the norm, and often are not triggered by the reform alone (Box 4). Subsidy reductions that have touched off civil unrest are those for staple foods, such as bread (Egypt, Jordan, and Morocco), maize (Zambia and Zimbabwe), and petroleum products (Ecuador, Indonesia, Nigeria, and Venezuela).

31. To assess the political risks associated with price-subsidy reform, policymakers should, to the extent feasible:

- *Identify the winners and losers from price-subsidy and other economic reforms.*¹³ One way to establish winners and losers is to examine the benefits of existing subsidies for different income classes (see, for example, Chu, Davoodi, and Gupta, 2000). Furthermore, the characteristics of the winners and losers need to be identified. For example, urban dwellers tend to be hit the hardest by food price increases, while

¹³Hausmann (1994) argues that entitlements, such as subsidies, imply a negative-sum game leading to a highly inefficient but stable political (Nash) equilibrium. Moving to a better, Pareto-efficient equilibrium, requires a package of policies that yields benefits over the medium term for all groups. Ravallion and Lokshin (2000) examine support for government redistribution in the Russian Federation in 1996. They find that support for redistribution not only depends on whether the population is poor or well-off, but also on whether it expects to suffer an income loss or gain.

Box 4. Subsidy Reform and Civil Unrest

The following examples illustrate the risk of political disruption where rapid reform was attempted without credible social protection mechanisms and governments were unpopular:

In *Jordan*, in April 1989, an attempt to raise fuel prices resulted in riots that brought down the unpopular prime minister. In August 1996, Jordanians again took to the streets in response to a 200 percent increase in the price of bread and associated price increases for other items (see Footnote 1 in main text). Observers noted that the unrest was also rooted in the absence of economic opportunities (GDP per capita fell by 2.5 percent in 1996) and dissatisfaction with the lack of public participation in decision making.

In *Zimbabwe*, in 1998, riots erupted in the wake of a currency devaluation when the poor and the middle class faced higher prices for a wide range of items. Higher-income groups were perceived to be benefiting through large wage adjustments amid accusations of widespread and growing corruption. In early 1999, the government pegged the Zimbabwean dollar at a fixed rate against the U.S. dollar.

In *Zambia*, in 1990, the government faced public protest and a coup attempt when it announced an increase in the price of maize meal without an explanation. The subsequent government, after great efforts to explain its reform program to the public, freed the price of maize, resulting in its quadrupling, virtually without public protest (Graham, 1994).

rural consumers are less affected because they grow more of their own food. Some ethnic groups can be poorer than others; opposition against price-subsidy reform was strong among the poor indigenous population in Ecuador in 1998–99.

- *Assess the magnitude of the losses.* This will likely provide an indication of the intensity with which those who lose will oppose price-subsidy reform.
- *Assess the political strength of the winners and losers.*

32. Even if price-subsidy reform is associated with considerable risk of political disruption, certain policies can ameliorate those risks:

- *Embed the subsidy reductions in a reform program that engenders broad support and yields widespread benefits—the stakeholder ap-*

Indonesians took to the streets in May 1998 to protest energy price increases proposed by the Suharto regime. In March 2000, there were renewed protests against a proposed hike in fuel prices and the price increase has been postponed until a compensatory scheme for the poor households can be put in place. The current government, elected in 1999, has been actively campaigning to explain why subsidy cuts are needed to support economic recovery and to finance the expansion of social programs.

In *Ecuador*, in September 1998, the government increased prices of cooking gas, gasoline, and diesel. To compensate poor households, the government introduced a cash-transfer program targeted to poor women with dependent children, senior citizens, and the disabled. Despite the success in reaching 1.3 million beneficiaries (50 percent of households), the government changed its position on the price increases after street protests in July 1999. Subsidies for fuels reemerged in 1999 as import costs increased and the exchange rate continued to depreciate.

In *Nigeria*, in June 2000, the government increased the price of gasoline by 50 percent. This price increase followed an effective doubling of civil service wages and a major adjustment of the minimum wage in May. However, in reaction to protests by organized labor and students in the major cities, the government agreed to a reduced price increase of 10 percent, while apologizing for not consulting various stakeholders more widely. Observers have linked the protests to an IMF-supported program and the absence of social safety nets in an environment of widespread poverty.

proach (Graham, 1998). By providing compensatory measures to the poor, the government can gain the support of an important constituency for implementing and sustaining price-subsidy reform. In the short term, resistance from the middle class may be overcome by providing them with temporary compensation (De Donder and Hindriks, 1998; and Gelbach and Pritchett, forthcoming). In such cases, an appropriate option for targeting may be to limit generalized subsidies to the amount consumed by the poor.

The stakeholder approach implies that governments should avoid reforms that impose an unfair burden on a narrow group of vulnerable socioeconomic or ethnic categories. Public intolerance for price-subsidy reform can be exacerbated by widespread discontent with initial living standards—for instance, in case of a high inci-

dence of poverty, particularly among certain population groups and in some regions.

In the longer term, sustained support for reforms needs to be crafted through consultative processes (see, for example, Nelson and others, 1994). In this context, consultations with civil society for the drafting of a poverty reduction strategy paper should help to alleviate public concerns. It is desirable that the program of economic reform is “owned” by the government and is not perceived to be designed by others. Greater transparency of the budget and enhanced accountability of public spending would also promote support for price-subsidy reform.

Decisions to target compensating measures to the nonpoor on the basis of political considerations are extremely difficult to make and should be approached with great caution. The fiscal cost of providing income transfers to the nonpoor may be considerable, and there is a risk of eliciting claims from other groups for similar transfers. For international financial institutions, including income transfers in one program and not in others also raises the question of fairness of country treatment. The ultimate goal of successful reform is to target assistance to the truly needy only.

- *Encourage the authorities to organize mass information campaigns.* In successful reforms, governments were able to communicate effectively to the population the drawbacks of the prereform situation and the advantages of pressing ahead with the package of reform measures. There are two basic options for such communication:
 - *Present the cost of subsidies in concrete terms.* In Egypt, for example, the budgetary burden of subsidies was illustrated by comparing outlays with the revenues from the Suez Canal. In Tunisia, the cost of subsidies was cast in terms of those of other public services, such as provision of hospitals (Razmara and others, 1999).
 - *Explain to the public how the reform package affects real household incomes.* In Zambia in 1991, for example, the government emphasized the people’s historical willingness to pay high black market prices for maize in times of shortages and the improved availability of this staple after reforms. In Peru in 1991, the presentation of the reform package on television by a popular mem-

ber of government successfully promoted the view that the government's proposal presented a viable option for addressing the severe economic crisis (Graham, 1994). In Venezuela, on the other hand, the government's efforts to explain its reforms were timid and suffered from the inability of public officials and agencies to communicate their actions clearly and credibly (Naim, 1993).

If targeted subsidies are introduced, the public should be informed about *eligibility criteria* and the steps they need to follow to obtain benefits. In Jamaica, procedures for obtaining food stamps were explained through a media campaign involving radio, television, posting of handbills, public address systems, and a series of newspaper inserts. Similarly, in Ecuador in 1998, the rapid introduction of a cash compensation program in lieu of generalized subsidies for cooking gas was aided by a comprehensive publicity campaign.