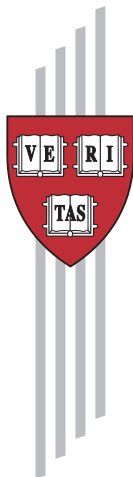


**In Quest of the Political:
The Political Economy
of Development Policy Making**

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Abstract

This paper explores some of the central debates in the application of political economy to development policy making. It is particularly concerned with the connection between theory, empirical observation, and the practice of policy decision making. It explores distinct traditions of political economy, some drawn from economics, others based in sociological theory, that generate distinct insights about why and when change is likely to occur in policies and institutions. The paper then raises the question of whether such traditions provide effective guidance about the politics of decision making and the process of policy reform and whether they generate helpful insights for reformers interested in encouraging such processes. It suggests that current approaches to political economy present a stark tradeoff between parsimony and elegance on the one hand and insight into conflict and process on the other. Both both traditions of political economy borrow assumptions about political interactions from contexts that may not be fully relevant to developing and transitional countries. In addition, when theory is compared to the extensive empirical literature that now exists about experiences for policy and institutional change, it fails to provide convincing explanations for some of the most important characteristics of real world politics--leadership, ideas, and success. Further, much theoretical and empirical work in political economy has fallen far behind in exploring the policy agendas that now confront developing and transitional countries.

Keywords: political economy of development, policy making in developing countries, policy reform, development policy choice

JEL codes: O20

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In Quest of the Political: The Political Economy of Development Policy Making*

Merilee S. Grindle

Political economy is alive and well among those who seek to explain policy decision making in developing and transitional countries.¹ That this is the case can be credited to the assiduity of the “real world” in outdistancing our ability to explain politics. During two decades of extraordinary policy and institutional change, real world experiences consistently raised intriguing and difficult-to-answer questions about the intersection of policies and politics: Why would governments select and maintain policies that are demonstrably inefficient for economic development? Why do some governments choose to alter development policies and strategies in significant ways while others maintain adherence to ones that are economically, socially, and politically destructive? Why are some reforming countries able to sustain new policies while others are forced to abandon them? How do institutions shape opportunities for reform?

Efforts to provide responses to these puzzles spawned a small industry of case studies and cross-national analyses of the determinants of policy and institutional change in developing and transitional countries. As a result of such work, we know a great deal more about the political economy of development policy, and particularly about when and why it is likely to change, than we did twenty years ago. We have extensive evidence about how powerful economic interests develop around policies and the ways in which they resist reductions in the benefits they receive from these policies.² We have gained significant insight into how to calculate the distributional consequences of policy change.³ We have seen considerable evidence that economic crises—particularly crises associated with inflation, hyperinflation, and foreign exchange shortages—are powerful stimuli for reform initiatives.⁴ We have also learned, however, that crisis is neither a necessary nor a sufficient condition to spur successful reform initiatives.⁵ In other work, researchers have shown us that opportunities to introduce new policies tend to cluster in so-called honeymoon periods directly after elections.⁶ Moreover, we have good reason to believe that the actions of policy entrepreneurs and the character of technocratic teams are critical to the success of reform initiatives.⁷ In addition, we have gained greater appreciation for the role of ideas and leadership in the process of change.⁸ And we have begun to generate insights into why new institutions are created and what their consequences are for the management of policy.⁹

Luckily for the employment prospects of political economists, the real world continues to provide interesting puzzles about development policy making. And, usefully for scholarly debate, there is considerable difference of opinion about the most appropriate way to go about studying these puzzles. In this paper, I consider some of the central debates in the application of political economy to development policy making.¹⁰ At the outset, I am particularly interested in the insights that distinct traditions of political economy—some drawn from economics, others based in sociological theory—generate about why and when change is likely to occur in policies and institutions. Subsequently, I consider whether such traditions provide effective guidance about the politics of decision making and the process of policy reform and whether they generate helpful insights for reformers interested in encouraging such processes. Throughout this paper,

then, I am concerned with the connection between theory, empirical observation, and the practice of policy decision making.

I suggest that current approaches to political economy present a stark tradeoff between parsimony and elegance on the one hand and insight into conflict and process on the other. I also find that both traditions of political economy borrow assumptions about political interactions from contexts that may not be fully relevant to developing and transitional countries. In addition, when theory is compared to the extensive empirical literature that now exists about experiences for policy and institutional change, it fails to provide convincing explanations for some of the most important characteristics of real world politics—leadership, ideas, and success. Further, much theoretical and empirical work in political economy has fallen far behind in exploring the policy agendas that now confront developing and transitional countries. I draw modest conclusions from this survey of how political economists approach the issue of policy choice and change, the ways in which theories model reality, and the research agenda for the future: political economists of whatever persuasion should consult the empirical world more frequently, question assumptions more assiduously, stretch theory beyond overgeneralization or overspecificity, and keep an eye open for the policy agendas of today and tomorrow as well as those of yesterday.

In this paper, I have opted to understand political economy broadly to refer to efforts to investigate the intersection of economics and politics in policy choice and in policy and institutional change, whether these efforts reflect the “new political economy” rooted in economics or a distinct tradition of analysis based in sociology.¹¹ For some in each tradition, political economy means understanding how economic interests shape political behavior. For others, the central question is rather how political behavior shapes economic policy. At the end of the paper, I suggest an even broader arena for political economy in a series of policy issues that go beyond traditional concerns with economic interests and economic policies to focus on the reform of the state and the emergence of demands related to social policy. My purpose in doing so is to highlight some of the relatively unexplored territory in the real world that should stimulate the interest and challenge the ingenuity of political economists.

Policy Choice and Change: Contending Paradigms

Currently, two broad traditions in political economy provide alternative ways of understanding choices about policy and the factors that influence the adoption, implementation, and consolidation of policy reform initiatives.¹² These approaches not only differ fundamentally about the structure and meaning of competition over policy decisions, they also provide distinct ways of understanding institutions and the relationship between institutions and actions. In the following pages, I describe traditions that draw on economics and sociology in attempting to understand four real world puzzles: *Why and when are politicians interested in supporting policy change? How do political institutions affect the choices made by politicians? How are new institutions created or transformed?* and, *What are the consequences of new rules of the game for economic and political interaction?*

The divide between political economists who draw on economic theory and those who draw on sociological theory to explain policy is deep and often contentious. Those who look to

economics for insight into policy seek to develop a general theory of politics that is deductive, powerful, and rigorous.¹³ They are in search of explanations that hold across an extensive range of empirical cases. In contrast, those who draw on sociology insist that political behavior is always deeply rooted in context and specificity and that to be useful, theory must be able to evoke, explore, and explain this complexity and specificity.¹⁴ They further insist that political institutions are central to explaining why the study of policy is primarily a study of how similar issues in collective life work out differently in distinct contexts. These two approaches offer strikingly different responses to questions about policy choice and change. They also pose a stark contrast in whether generality or specificity is the best way to understand political dynamics.

Why and when are politicians interested in supporting policy change?

In the real world, politicians must initiate, support, or accept new policies if change is to occur. During the 1980s and 1990s, the support of politicians became critically important to officials of international financial institutions and other policy advocates who were deeply committed to encouraging major policy reforms. Many times, however, they found that politicians rejected reform proposals, even when these were clearly superior to a broken or deeply inefficient status quo. Other politicians embraced policy change and assumed active leadership of efforts to introduce and sustain major innovations in national development strategies. Ongoing involvement with a series of reform initiatives provided sufficient evidence that the desire to enhance social welfare, the suasion of technical analysis, or surrender to the pressure of international agencies could not explain the diversity of responses to economic stagnation and crisis afflicting countries around the world.¹⁵

Some political economists turned to economics to understand the motivations of politicians in resisting or embracing policy change. Much of the ensuing effort drew on rational choice theory. The rational choice approach asserts that political actors, like *homo economicus*, act to maximize utility, generally assumed to reflect their self-interest. Voters, politicians, lobbyists, bureaucrats, and party officials are understood to be rational in that they have preferences and seek to achieve them through action. Preferences are taken as given and, in research, must be asserted *ex ante*, usually as a statement of reasonable first order objectives. Thus, in seeking to explain the behavior of politicians, rational choice theorists generally assert that politicians naturally prefer more power to less; survival in office to defeat; reelection to loss; influence to irrelevance. Voters naturally prefer politicians who provide benefits that improve their individual welfare to those who do not. Bureaucrats naturally prefer higher budgets to lower ones, more discretion to less, more opportunities to promote their own welfare to fewer, career promotion to demotion. These individuals are distinct from economic actors only in that they are conceptualized to be interacting in a political market in which competition is about power to provide or receive benefits from public policy, public investments, and resources controlled by government.

If politicians prefer power, survival in office, influence, and electoral support to not having these things, then in democratic systems politicians must be particularly sensitive to the interests of voters or particular constituencies that help them achieve their objectives. The interests of voters are particularly important in rational choice political economy because they

constrain the choices available to politicians and compel them to make decisions that are characteristically geared toward electoral gains. Moreover, because of periodic elections, politicians must discount the future heavily. Thus, it is rational for politicians to sacrifice policy choices that will pay off in the longer term to those that produce short-term advantages, like staying in office. In some cases, so powerful is the need of politicians to trade policy benefits for votes that policy making can be captured by particular interests extorting preferential treatment in return for votes or resources for electoral campaigns.¹⁶ In such cases, the politicians and particular interests are both engaged in rent-seeking.

Individuals are the unit of analysis in a rational choice approach to the explanation of political behavior. But because, empirically, much political activity involves the behavior of groups, Mancur Olson and others have explained how and when self-interested individuals will act collectively to achieve their policy goals.¹⁷ They will do so when they can be assured that the energy exerted by acting as a group will pay off efficiently in terms of individual benefits received. For reasons having to do with the potential for free-riders to benefit from group action without expending the energy necessary to cooperate, groups tend to coalesce around very specific interests that, if achieved, will not provide benefits to those outside the group. Politically, this translates into the tendency for exchanges between politicians and a multitude of interest groups, each of which is pursuing a narrowly focused and usually immediate benefit. The task for the politician, then, becomes that of parceling out public policy or public resources to a large number of competing groups, each of which has some capacity to punish the provider. The larger purposes of government, such as "the public interest," are difficult to achieve, given the exchange relationships between politicians and interests.

Given the orientation of rational choice theory, the approach offers at least two hypotheses about why and when politicians would support policy change. In one case, politicians could make a rational strategic calculation that promoting policy reform would bring them increased support at the ballot box; they could also choose to resist championing change because of their rational expectation that doing so would diminish their chances of staying in office. An alternative hypothesis is somewhat different in that it would posit that the pressure of particular interests is intense enough to give politicians no option but to support (or resist) change; if they do not respond to the pressures, they will lose their jobs.¹⁸ In the first case, support of policy reform is a strategic option, in the second case, it is the result of lack of options, given the preferences of politicians.

Comparative institutionalism, a broader and less theoretically rigorous tradition in social science, provides a very distinct way of approaching the question of policy choice and change.¹⁹ Drawing on sociology for analytic tools and on history for empirical insights, researchers who follow this tradition view political actors as embedded within contexts that shape their behavior in profound ways. These contexts are far more than the strategic decision making arenas described in rational choice theory. They are complex environments that have roots in the past and that not only constrain and channel action but actually shape the perspectives, preferences, and values of the political actors. Comparative institutionalists understand political actors to be groups, classes, interests, or other collectivities. While these are the primary units of analysis, it is important that their behavior be analyzed and understood as an outcome of the complex and historically evolved context within which they find themselves. Thus, central to the tradition is

the notion that events such as policy change are resultants of collectivities interacting within a specific context.

In addition, comparative institutionalists place conflict at the center of political analysis in ways that differ significantly from an economic perspective.²⁰ In rational choice theory, conflict exists when two or more individuals simultaneously seek to act on their preferences, and when these cannot be achieved through joint action. Comparative institutionalists, in contrast, view conflict as ongoing interactions through which groups compete for predominance in particular economic, social, and policy arenas and in which prior conflicts shape the nature of current conflicts and determine the issues that are contested. Conflict over policy is the normal stuff of politics, then, and outcomes are shaped by the relative power of distinct groups, a condition that is itself determined by the outcomes of prior conflicts.

As a result of these premises, analysts who draw on the sociological tradition tend to produce research that is rich in depth and complexity rather than in breadth and parsimony. They are less interested in a general theory of politics than in understanding the conditions under which political actors will behave in particular ways; they tend to generate middle range theory and to be intensely engaged in understanding the historical record around particular conflicts. Far more than is true of those who explain policy from a rational choice perspective, they are concerned about institutions. And, while they focus on the factors that shape the actions of collectivities rather than on the logic of individual choice, they have also sought to understand “statecraft.”²¹ In pursuit of this goal, comparative institutionalists have studied the ways in which individual political actors or political entrepreneurs maneuver within institutional contexts to build coalitions, engineer consensus, negotiate, and bargain to generate new policies, new legislation, and new institutions.²² They find that some individuals are motivated to bring about change while others resist it. The motivations of these politicians can draw on ideas, collective identities, group interests, and values as well as on self-interest. Similarly, within this tradition, some politicians are more skilled in the use of political resources, as well as having greater or lesser access to these resources, than others.

In contrast to the hypotheses put forward by rational choice theorists, comparative institutionalists offer much more contingent statements about why and when politicians will initiate or support policy change.²³ The position taken will depend upon the nature of existing and past conflicts over policy, the ways in which institutions privilege or discriminate against particular individuals or groups, and the commitments and skills of the politicians who are contending over policy. Choices are not discrete, but are influenced by positions on other policy matters and larger strategic issues that are important to the longer term concerns that divide and unite groups in political conflict. For political economists who draw on this tradition, much of the story of policy choice and change can only be understood if institutions are properly taken into consideration.

How do political institutions affect the choices made by politicians?

No one who has tried to untangle the web of day-by-day politics in any country can ignore the ways in which policy decision makers are constrained by formal and informal rules of the game for doing politics. Decisions are affected by such institutions as party and electoral

systems, formal allocations of power within government, legal systems, and informal norms about how political debates are carried out. Who is entitled to make decisions is a consequence of institutions that constrain and privilege various actors. What processes are mandated for approving and implementing policies can determine their success or failure. Who has access to policy debates and how opposition is manifested are also determined by formal and informal institutional arrangements that vary from country to country. What electoral rules are in force shape the ways in which political actors calculate the costs and benefits of various courses of action. In these and other ways, institutions shape the resources available to political actors and the dynamics of policy choice. Because institutions are complex and multifaceted, however, analysts do not agree on how they shape the activities of politicians or the options available to them. Indeed, rational choice and comparative institutionalist approaches vary considerably in terms of how they assess the role of institutions in policy choice.

While the rational choice approach is rooted in assumptions about the preferences of generic individuals, it is not blind to the context in which political behavior occurs. Context, in terms of the particular constraints imposed by political institutions or incentive systems, shape the opportunities available to political actors to pursue their preferences.²⁴ In this way, politicians become strategic actors who accumulate information about the options available to them and select actions that are most likely to allow them to maximize power, votes, influence, or political survival within the political context that surrounds them. From the perspective of research, given assumptions about the preferences of political actors, knowledge of the context in which they operate provides information necessary to explain and predict the policy choices they make. In seeking to provide generalizable statements about the political behavior of individuals, rational choice theory deals with institutions as a strategic arena for individual choice.

Comparative institutionalists place institutions much more at the center of explanations of policy. They insist that to understand political actors as generic individuals pursuing generic preferences is to miss the role of institutions and history more generally in shaping the preferences, orientations, values, and strategies of collective actors. The nature and meaning of conflict is similarly shaped by institutions, which channel and influence how conflict is played out. Thus, institutions are much more than contexts that inform rational strategic action. For comparative institutionalists, political actions are embedded in historically evolved institutions which are, in turn, the site of on-going struggles to define public policy and distributions of economic and political power. In this way, institutions are determining factors in policy decision making. This perspective allows comparative institutionalists to explain how similar policy problems—the provision of health care in modern industrial countries, for example—have generated distinct solutions in different contexts.²⁵ They are results of the distinct institutional environments that have shaped the goals and behaviors of groups and interests and have determined how they contest for influence over policy.

Comparative institutionalists generally argue that political actions are shaped by institutions, which in turn are shaped by the actions of political agents. In fact, however, they tend to focus much more on how actions are shaped by institutions than they do on the transformative effect of action on institutions. This reiterates quite realistically the dynamics of everyday politics in most advanced industrialized countries, where much of the work in this tradition has been carried out. In such countries, political actions take place in relatively stable

institutional settings. Moreover, these institutions and the political actions they spawn are understood to be embedded in the political system.²⁶ Embeddedness means that new institutions are evolutionary descendants of older institutions, altered to accommodate new power relationships or the consequences of conflicts over policy. Thus, an important question for political economy generally is the issue of institutional creation or evolution.

How are new institutions created or transformed?

Throughout much of the 1980s, many of those concerned about the prospects for development of poor countries insisted on the importance of “getting the policies right.” In practice, however, while a number of countries were successful in getting the policies right, only some of them were able to generate sustained economic growth. Gradually, policy advisors and policy makers came to the conclusion that the ability of new policies to generate improved welfare depended on the kinds of institutions that were in place for managing economic and political transactions. This perspective was spurred by a number of analyses of the “East Asian miracle” that pointed to the role of government institutions in paving the way for sustained development.²⁷ In a very different way, it received considerable impetus from the early experiences of post-communist countries that adopted a wide range of market-oriented policies in the absence of formal and informal institutions for managing economic transactions.²⁸ Democratization, a struggle occurring in large numbers of countries around the world, called attention to equally important rules of the game for political interactions.²⁹ Thus, creating or transforming institutions of governance acquired increased importance as policy reformers undertook initiatives to put in place autonomous central banks, independent tax authorities, securities and exchange commissions, professional civil services, authoritative legal systems, party and electoral systems, and other new institutions. Analysts of these experiences sought understanding about how such changes could occur. They found that political economists had more than one response for their questions.

Many working within the rational choices approach were particularly intrigued by the creation of new institutions that constrained the power of politicians, such as the creation of independent central banks and autonomous tax agencies. Given the assumptions of the theory, how could this behavior be explained? One answer invoked standard assumptions about the preferences of politicians: if politicians are acting both rationally and strategically, they might create new institutions that constrain their power over the longer term in order to achieve some more immediate political advantage, such as winning an election, or they might be responding to overwhelming pressure from electoral constituents.

More interesting responses focused on the relationship between new institutions and the preferences of reformist politicians. If politicians have supported policy reform, then they may create new institutions to signal commitment to it or to lock in their choices against the capacity of future incumbents to alter them.³⁰ In the first case, that of signaling commitment, the message is aimed at domestic and international economic agents to convince them that the policy choices made will remain stable, unaffected by the immediate electoral needs of (implicitly, other) politicians. In the second case, the target is future politicians who might seek to undo a set of reforms and thus undermine the preferences of current incumbents. The logic of these choices is interesting: politicians prefer choices that constrain their power in the future to maximizing

power in the present in order to reduce uncertainty about future choices, particularly those that might be made by other politicians. Thus, the creation of institutions that lock in policy preferences can actually be understood as a way of maximizing individual preferences over the longer term.

Despite these forays into explaining institutional creation, rational choice political economists have been widely criticized for their failure to generate a broader understanding of how institutional contexts emerge, persist, and change. Led by Douglass North and others, a "new institutionalist" perspective has sought to address this shortcoming.³¹ New institutionalism takes as a founding insight the idea that all exchanges involve transaction costs.³² In economics, transaction costs, such as acquiring information or enforcing rules, decrease the efficiency of exchange relationships. A critical insight in North's approach is that institutions are not simply a result of efforts to lower the transaction costs of market exchanges, but are also a function of political and social interests and differences in the allocation of power in a society. Thus, institutions "are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise the rules. In a zero-transaction-cost world, bargaining strength does not affect the efficiency of outcomes, but in a world of positive transaction costs it does...."³³ Institutional change is promoted when actors with power perceive that their interests can be better achieved through alternative sets of rules.

Extrapolating from this explanation, transaction costs also exist in political life and are present in political exchanges such as those that occur between politicians and voters or politicians and interest groups. Politicians often do not have full information on the activities and interests of important constituencies nor the time or ability to acquire such information. They may also face conflicting demands from different interest constituencies. Voters and particular constituencies may not have full information on the behavior of the public officials they want to respond to their concerns. Nor do they necessarily know how many votes or how much campaign money is efficient for getting what they want from the politicians. Legislators do not necessarily have information on the preferences of other legislators. The difficulty of acquiring information such as this increases the risks of making choices for politicians, voters, campaign contributors, and others. To lower these transaction costs, implicit or explicit rules of the game emerge that allow politicians and voters to act on the basis of incomplete information without undue risk or without having to invest heavily in collecting information.

In this way, institutions such as electoral systems, political parties, and rules or procedures in legislatures emerge over time to lower the transaction costs of doing politics. At the same time, these rules structure the interactions of citizens, politicians, and would-be politicians by providing incentives and sanctions to behave in certain ways and by distributing bargaining power differentially. The behavior of political actors becomes predictable over time as it conforms to these incentives, sanctions, and power relationships. Moreover, these rules and procedures structure the way other transaction costs problems are treated. When such problems emerge and, over time, generate pressures for changes or the introduction of greater stability in how they are dealt with, legislation is introduced, debated, and voted upon according to the rules that have evolved over time for dealing with legislation, debates, and votes. As change occurs in

the nature of transaction costs, the institutions themselves can evolve in ways that lower these costs, although such a response is not always timely or efficient.

Over time, institutions accommodate to important changes in the nature of transactions, such as those caused by technological innovation, the availability of information, and the influence of other institutions (which are also evolving). Over time also, history demonstrates certain "path dependencies" that result from the way power relationships lock in distributional biases. Thus, the histories of different countries or different regions of the world are likely to differ as each pursues a path that evolves from institutional adjustment and adaptation, producing an economic theory that explains why "history matters." What North refers to as "discontinuous change" occurs much less frequently and is generally a result of revolution or conquest. "Although formal rules may change overnight as the result of political or judicial decisions, informal constraints embodied in customs, traditions, and cultural constraints not only connect the past with the present and future, but provide us with a key to explaining the path of historical change."³⁴

The new institutionalism of North and others is particularly concerned with explaining institutional evolution and adaptation. An "institutional design" approach provides an interesting alternative for explaining institutional creation. This approach is explicitly theoretical and non-empirical in that it posits characteristic problems faced within organizations or institutions, typically of a principal-agent nature, and seeks to develop rules and organizational principles that allow for the efficient solution of these problems.³⁵ Principal-agent problems are found everywhere in political life--in the relationship between the voter and the representative, the politician and the bureaucrat, the bureaucratic superior and subordinate, the policy maker and the implementer. The essential problem is that the principal—in these cases, the voter, the politician, the bureaucratic superior, and the policy maker—does not have sufficient information or control over the actions of the agent—the representative, the bureaucrat, the subordinate, and the implementer—to ensure that his or her commands are actually being carried out. This creates a problem of moral hazard for the principals in that they cannot be certain about the motivations or actions of those entrusted with carrying out their promises or wishes.

The task for institutional design, then, is to find ways to structure this difficult relationship to minimize the principal-agent problem. Characteristically, work in this field focuses attention on the incentive structures that surround the actions of agents. That is, it is concerned with ensuring that agents have incentives that encourage them to be attentive to the wishes of the principals and efficient in responding to them. In solving principal-agent problems, the institutional designer asks: How can rules, procedures, and incentive structures be created that ensure that agents *commit* to the goals of the principal? Often, the issue is posed in terms of the principal's desire to ensure future commitment to particular policy or institutional preferences.

Approaching the issue of institutional creation through an institutional design perspective is intriguing because it suggests that history and process are not important nor is path dependence a constraint. With this perspective, explaining the creation of new institutions at particular moments becomes that of demonstrating how political actors self-consciously design new rules of the game through a technical process of analysis, much as an engineer would

analyze a particular problem relating to say, weight bearing capacity, and then design a structure that solves the particular problem. Indeed, the “reengineering” approach to organizational change is based on similar assumptions and the reorganization of New Zealand’s public sector in the 1990s was significantly influenced by such a design experience.³⁶ This approach suggests that new institutions are created because a group of institutional designers sits around a metaphorical table, identifies a set of on-going principal-agent problems to be solved, self-consciously designs new ways to resolve them, and then puts them into effect. In a recent study of “democratizing reforms” in three countries, I found such institutional designers playing critical roles in each case.³⁷

Comparative institutionalists would balk at such an apolitical explanation of institutional change. They would wonder about what drove the institutional designers to the table in the first place and what authorization they had to solve the problems they identified. They would argue that such a rational problem-solving explanation cannot explain away conflict over goals and the allocation of power. They would argue instead that conflicts and differences in the power of collectivities can result in new rules being negotiated or imposed on society. New rules thus emerge out of past conflicts and past structures of power. Comparative institutionalism thus suggests that new institutions come into being as a result of historically embedded conflicts about the distribution of power and benefits in a society and can be understood as negotiated or imposed resultants of contestation among interests.³⁸ They might or might not deal with transaction costs or principal agent problems, but only as contingent outcomes of conflicts over power.

What are the consequences of new rules of the game for politics?

When new institutions are created and take on reality, they introduce new rules and new incentives into decision making. When put into practice, they can alter long-existing power relationships, introduce new sources of conflict, resolve some long-standing problems, or alter the motivations of political actors in important ways. Thus, the story of institutional creation is incomplete unless it also addresses the consequences of new rules of the game for political actors and policy decision making. Again, distinct political economy approaches provide very different responses to this puzzle.

A rational choice explanation of the consequences of introducing new institutions would anticipate that a new set of constraints on the options available to politicians would lead to new strategies for achieving first order preferences. Politicians would have to adjust to new constraints in their efforts to maximize power, survive in office, or win elections. Thus, given institutional change, political actors will select policies that are rational in terms of their predictable preferences for more power rather than less, more electoral advantage rather than less, more career stability rather than less, and so forth. Rational choice theorists would thus anticipate a new equilibrium in policy decision making, reintroducing stable expectations about rational behavior.

If, as in the new institutionalism, rules of the game are created in response to transaction costs problems in politics, then it can be predicted that new institutions will lower the costs of doing politics. The task for empirical research would be to focus on the extent to which this is

true. Even in cases in which institutional disjuncture occurs, it could be predicted that path dependence would reassert itself as an explanation for the subsequent evolution of institutions. Presumably, new institutions eventually experience the accumulation of transaction costs problems and then the further evolution of the institution or its rupture through the creation of a new institution. The institutional design literature offers a similarly interesting hypothesis: if new institutions are created with an eye toward resolving principal-agent problems, then we should anticipate that they will create more accountability in the sense of ensuring a closer link between what principals want and what agents do.

A comparative institutionalist assessing the consequences of the creation of new institutions would explore a more dynamic hypothesis about change. In distinction to the equilibrium situation predicted in economic models, a sociological approach would anticipate that institutional change would create new sources of conflict, new claims for resources, new spaces for contestation, or efforts by various collectivities to undo the impact of the new institutions on their claims to power and influence. It would also encourage research on new political actors—whether these are collectivities, their leaders, or those who benefited or lost from the redistribution of power and access to benefits—and new ways of organizing for political contestation. Political actors would reorganize, recombine, or reassert themselves to take advantage of new resources or reclaim lost ones; they would re-connect in conflict, coalition building, and bargaining over the distributional consequences of change, probably with reconfigured access to political, economic, and leadership resources.

Different strokes for different folks?

Two distinct theoretical traditions provide important contrasts in terms of how they explore and explain policy decision making and policy and institutional change. The purpose of theory building, levels of analysis, assumptions about the nature of politics, and methods of inquiry differ significantly between the two. In recent years, adherents of both traditions have been outspokenly harsh about the other. Those who favor the elegance and parsimony of economic models of political behavior accuse comparative institutionalists of avoiding rigorous theory and scientific methodology and of producing primarily descriptive studies.³⁹ Those who work from within the sociological tradition retort that economic models produce political banalities and historically inaccurate analyses that ignore empirical evidence.⁴⁰ Acrimony as well as very distinct basic assumptions makes talking across this divide in political economy increasingly difficult. Indeed, it is rare to find scholars working in either tradition acknowledging the work of the other.

The purpose of this section has not been to choose up sides in this debate, however. It has been, rather, to lay out how distinct visions of political economy deal with central questions of policy decision making. Having done so, it is time to consider whether the theoretical lenses of the economic and sociological traditions are helpful in providing insight into what we know about policy making and policy and institutional change in developing and transitional countries. This comes somewhat closer to choosing up sides. As the next section suggests, however, holding theory up to the mirror of empirical studies to ask how usefully theory models reality finds both schools of political economy deficient in important ways.

When Theory Meets Practice

To be relevant in the real world, political economy theory ought to be useful in at least one of two ways. It ought to be able to model reality by reflecting basic dynamics of political interactions in the design and implementation of development policy and in the creation or transformation of institutions. If it can do this, it can inform the political strategies of those actively engaged in promoting policy and institutional change. Additionally or alternatively, theory ought to be able to predict the behavior of political agents in designing, adopting, and implementing policy change or predicting the political consequences of alternative policy and institutional choices. This is another way of informing the strategic choices that policy reformers make.

Of course, theory does not necessarily need to be relevant to the real world. Its objective can be to provide added insight into generic questions about cause and effect relationships, to provide frameworks for thinking about issues in ways that add to our understanding of them, to provide elegant statements of logical deduction, or to predict outcomes given certain assumptions. At the level of theory, it may not matter if underlying assumptions of political economy approaches are inadequate or wrong if the logic of the argument is rigorous and parsimonious, if the modeling is elegant, or if the ideas advanced are novel and interesting.

At the same time, the field of development has long sought to bridge the gap between theory and the real world in efforts to understand the policies and strategies that can best lead to improvements in welfare in developing, and now transitional, countries. Just as insistently, it has sought to apply the insights of theory to advice about what policies developing and transitional countries ought to adopt. Considering how such advice is filtered through political and decision making contexts to inform strategic action is merely an extension of this long-existing concern to link theory to practice. Political economy analyses should be able to feed back into helpful ideas about what might be done to improve practice. If it identifies inappropriate dynamics about why reform is initiated, who the principal actors are, and what conditions characterize the institutions within which decisions are made, advice is likely to be unrealistic or misleading. In consequence, it is appropriate to ask how well different political economy approaches model characteristic features of politics in developing and transitional countries, and how well they account for characteristic features of policy reform efforts in those same countries.

Imagining reality

The political economy traditions of interest here emerged primarily through scholarship in and on advanced industrial countries. Economic approaches have been most frequently advanced in the United States. European scholars have been much more frequently drawn to sociological theory for understanding politics, although the tradition is strong in the United States also. Inadvertently, perhaps, their origins show through in the underlying assumptions they hold about the normal behavior of political actors and the characteristics of political institutions. Both traditions tend to view politics as society-centric, in the sense that initiative for action, including policy change, emerges from parties, interest groups, public opinion, or other mechanisms in civil society. This assumption may not necessarily hold for characteristic aspects

of politics in developing and transitional countries, where politics has much more often been state-centric, reflecting the actions of elites within government rather than the pressures of civil society on government or on political officials.⁴¹ With democratization in many countries, this tradition is undergoing change, yet it remains the case in many countries that policy decision making is carried out in relatively closed contexts. In addition, politics often occurs in unstable institutional settings, a condition that differs significantly from the institutional environments of developed countries.

Assumptions that conform to basic conditions of politics in the United States underlie much of the work that derives from economics. Typically, for example, such approaches assume that voters are sovereign and that votes are meaningful in the sense that they unambiguously decide outcomes. Further, political parties are generally considered to be non-programmatic and decentralized, to be electoral organizations that mobilize voters around periodic elections, and to be few in number. Similarly, it is assumed that politicians can be reelected and that they face frequent electoral contests. In addition, interest groups are assumed to be concerned with single issues, government to be highly porous to interest group pressure, politicians and political leaders to be reactive to pressure rather than the initiators of policy agendas, and the power of political executives to be highly circumscribed by the power of other institutions, such as legislatures. Perhaps most important, politics is considered to be played out in stable institutional environments in which past behavior provides a template for predicting current and future behavior.

Assumptions about normal politics in comparative institutionalism are more diverse, but certainly much of the orientation of the approach is most comfortable in European contexts. In this perspective, the most important identities of those who engage in political conflict are class-based or derive from structural conditions of the economic and political systems. Parties, which tend to be few, provide important ideological and programmatic foundations for their membership and thus are often movement or membership organizations rather than electoral parties. As such, they embrace and define their adherents more fully than is true of electoral parties. It is normally assumed that politicians represent group interests and are accountable to those interests for programmatic commitments. History and structure matter deeply in that the legacies of past conflict and relationships emerge in current conflict. As a consequence, continuities are more likely than disjunctures in politics and positions on policy issues. Institutions are stable and evolve over time. Conflict is the normal stuff of day-to-day politics and negotiation over issues is endemic.

Both images of politics miss important features of politics in developing countries. Among these are that voters are not necessarily sovereign but are often nodes in long chains of clientelistic relationships controlled by political bosses. Moreover, votes often ratify decisions already taken, compete with other ways of deciding outcomes—such as the use of force—or are in other ways peripheral to deciding outcomes. Parties tend to be highly centralized and often they are ephemeral. Some systems have only one party and others have numerous parties that contest for positions of influence in government. Winning elections often represents extraordinary opportunities for patronage and spoils, and change in government can be extensively reflected in the public service and the public purse and in conflict over the rules of the game. Politicians may be barred from reelection to the same position. Interest groups can be

powerful but organizationally inchoate. Government is often highly centralized and closed to formal lobbying while at the same time very porous to informal relationships of influence or public displays of power, such as strikes, protest marches, and even violence. As indicated, politics is frequently state-centric in that high level politicians initiate policy and have extensive formal and informal power. In addition, policy is frequently approved without the intent of putting it into practice, thus playing havoc with the interpretation of official pronouncements. Negotiation is one form of conflict resolution, but it is frequently joined by confrontation, coercion, and winner-take-all *faits accomplis*. In large numbers of cases, institutions are unstable and are changed frequently. Even the basic rules of the game for how politics is to be carried on can change radically and frequently, such as when regimes are overthrown or when new constitutions are introduced.

What happens, then, when theoretical lenses are focused on instances of policy decision making and policy and institutional change in these unstable institutional contexts? The inherent power of the rational choice model, based on the simplicity of its assumptions and its deductive logic, can easily lead to research that is logically compelling but empirically false—and thus unhelpful. For example, it can encourage students of political economy to focus on the behavior of individuals, groups, and institutions as if they mattered, when in fact they may be peripheral to the dynamics of real world policy and institutional choice and change. In many parts of the world, for example, legislatures are peripheral to policy decision making. Yet political economists of this tradition have at times chosen to study them as if they were powerful influences in this process, in part because legislative voting data can be readily used to test hypotheses and, more fundamentally, because of inappropriate assumptions about the importance of legislatures in the policy process.⁴² Moreover, the approach emphasizes the society-centric origin of pressure for policy change. It thus tends to reason forward from interests (given particular interests, groups will press for particular kinds of policies) or backward from outcomes (if certain interests benefit from policy, they must have been central to influencing policy choices).⁴³ In either case, process is treated as a black box and the question of who takes the initiative to promote policy and institutional change is assumed rather than investigated. Process, however, is extremely important if the purpose of political research is to improve decision making about policy.

Despite its origins, comparative institutionalism has generally shown itself to be more adaptive to the realities of developing and transitional country policy making. This tradition is, in fact, more inductive and empirical in its practice and, given its sensitivity to the importance of the particularities of context, is more geared to unfolding the particularities of cases. It is also an approach that, given its interest in investigating conflict and how it plays out, is able to focus analytic attention on process. As a fairly open-ended framework of analysis, it invites investigation of a broad range of issues and questions, constrained only by the tendency to see groups, conflict, and contextual peculiarities behind every bush. As we have seen, however, the approach tends to inhibit generalization. Outcomes are highly contingent and, while the approach is rich in the ability to reconstruct, describe, and analyze what has happened, it eschews the capacity to predict what will or might happen. Moreover, it tends to emphasize pressures for change that are located in social groups and movements rather than allowing for the possibility of a more state-centric view of process.

Underexplaining reality

Case studies of the political economy of policy decision making regularly point to important determinants of outcomes that are not fully considered in either political economy tradition. At least three factors appear to be underexplained. First, leadership consistently plays an important role in reform situations but continues to be largely exogenous to theory. Similarly, ideas—particularly ideas about the appropriate content of development policies—emerge as important factors in case study research and have been shown to have important connections to power relationships. Theory has little to say about ideas, however. Third, the real world is full of examples of the successful introduction of reformed policies and improved institutions. Theory, however, overdetermines resistance, stasis, and failure.

Leadership. Leadership matters in reform initiatives. It matters in terms of the timing of reform initiatives, the content of reform proposals, and the process of generating support and managing opposition to change. Studies of policy reform initiatives indicate that for successful change, reform leaders must emerge, commit themselves to the content of a reform, empower and protect technocrats who provide substantive input into reform planning, mobilize reformist coalitions, provide a vision of a more hopeful future to help citizens tolerate the disequilibrium of change, and deal effectively with those whose opposition threatens to derail reform.⁴⁴ In fact, the empirical literature is almost unanimous: reform leadership is essential to successful policy and institutional change.

In political economy theory, however, leadership is not well explained. Both economic and sociological traditions are uncomfortable with the notion of agency in history. Despite considerable evidence that individuals can make a difference to the destinies of countries, this evidence fits poorly with the desire to identify generic rationales for human behavior or to analyze how institutional structures and rules constrain behavior. Moreover, because the issue of leadership is difficult to pin down, academics have tended to observe it and then to underexplain its implications for both theory and analysis. Nevertheless, policy reform initiatives may be one area in which individuals can make a difference to the outcome of history.

Political economy approaches that draw on economics for insight into human behavior anticipate reform leadership only when such action can be clearly linked to political self-interest. For example, sponsorship of policy change can be expected when it will result in electoral advantage or when politicians are forced to accede to the wishes of powerful interests whose support is necessary to remain in office. The empirical record of many policy changes put in place in the 1980s and 1990s fit uncomfortably with this logic, however. In cases of policies for stabilization and structural adjustment, and unless politicians are attempting to control very high levels of inflation, widespread opposition generally meets proposals for policy change. This opposition is normal because, as pointed out by political economists from this tradition, potential losers from altered policy tend to be well organized and conscious of the losses they face while winners tend to be dispersed and generally unaware of the benefits of reform.⁴⁵

Given that many politicians in developing countries are constitutionally barred from reelection, political economists have posed another motive, that of keeping a political party in office. But this hypothesis is also suspect in light of considerable evidence that reform leaders

often act against the wishes of their political parties and support reforms that impose costs on their traditional support bases.⁴⁶ Indeed, reformist leaders consistently act in the absence of a preexisting coalition of support and often in the face of overwhelming opposition from powerful groups in the population.⁴⁷ In fact, one of their critical roles is to identify and mobilize a reform coalition in the absence of any powerful constituency for it. Empirical studies also demonstrate consistently that politicians who are forced unwillingly into reform by powerful international actors renege on their agreements.⁴⁸ In many cases, then, leaders appear to act autonomously from the stated preferences of powerful groups and even against their own immediate political self-interest.⁴⁹

The new institutionalism is largely silent on the issue of agency. The model, for example, does not specify actors. Institutions evolve naturally over time to deal with transaction costs; but in the real world, particular actors take particular decisions that cause change to happen. Thus, it would be interesting to consider how transaction costs are identified, who they accrue to, how affected interests behave, who takes the initiative for change, and so forth.⁵⁰ A more difficult problem is that of predicting whether transaction costs are in fact lowered in something as complex as a political market. In a recent study, I found that new political institutions raised transaction costs for some actors, lowered them for others, and made no difference to yet others. It was similarly difficult to determine if politics more generally was proceeding more efficiently in the wake of change.⁵¹

Comparative institutionalism fares somewhat better in providing insight into the leadership roles of reform politicians. In this approach, the issue of why politicians behave as they do is an empirical question and need not be asserted *ex ante*, as in rational choice approaches. Traditionally, also, comparative institutionalism has recognized the importance of statecraft in its research agenda. Leaders are generally not accorded much autonomy, however. Given the basis of the approach in assumptions about the role of collectivities and conflict, leadership is usually treated as a function of group interests and resources for engaging in conflict over policy and institutional preferences. Thus, leaders are those who represent and advance group interests in conflicts. At the same time, leaders can be counted as resources that groups have—or don't have—in their quest for policy results. This would be the case in demonstrating, for example, that some groups or interests have leadership skilled in negotiation and some don't, some have leaders in powerful official positions and others don't, and so forth. The notion that leaders act more autonomously in the sense that they initiate proposals and mobilize group support around particular policy issues is elusive in the theory, although it appears to be a normal case in practice.

The issue of reform leadership, then, emerges strongly in empirical literature but is underdetermined in theory. Nevertheless, generating greater understanding of reform leadership will be a difficult challenge for any theory. Indeed, based on a wide range of case studies on policy reform, it is tempting to conclude that leadership is idiosyncratic. If this is the case, it could only be studied on a case by case basis. It could be useful, however, to devote time to exploring how leaders emerge, what basis they claim for exerting leadership, what particular political tasks they must perform, and what strategies they select to promote reform in particular contexts. One interesting insight of the case study literature is that leaders often invoke ideas as

reasons for championing reform and as ways of mobilizing support for it. Thus, leadership and ideas may need to be explored jointly.

Ideas and power. Ideas matter in reform initiatives. Ideas appear to play an important role in how problems are interpreted and how options to deal with those problems are selected and assessed.⁵² In the past two decades, for example, neoclassical economics has had a significant impact on the development of policy in a very wide range of countries. In a typical case, reformers are convinced that their country is in economic stagnation or crisis because of development policies that accorded a leading role to the state in economic development. They believe that the country must liberalize markets and international trade and diminish the size and role of the state to allow more scope for markets to function well. They champion reform because they believe in the superiority of markets to states in the process of development. These reformers have often had important educational experiences that convinced them of the rightness of neoclassical economics and/or they are part of transnational networks of practitioners who speak a common language of ideas.⁵³ Not infrequently, leaders of reform initiatives act on the basis of ideas that directly contradict ideas they claimed in the past.⁵⁴

Understanding the role of ideas in policy reform initiatives is important because of the link between ideas and power. Those who have found ideas to be important ingredients of the reform situations they study are often implicitly or explicitly arguing that expertise affects the distribution of power in the reform process. For example, one of the more interesting insights to emerge from early case studies of economic policy reform was the central role that technocratic teams played in crafting reform initiatives.⁵⁵ Disciplinary training, particularly in economics, underlay the way in which such teams understood national economic problems and the language they used to communicate about these problems among themselves, with influential policy makers, and with international actors. Although the power of the technocrats was derivative of their relationship to political leaders, they frequently filled seats at the policy table that had previously been occupied by representatives of interest groups, economic elites, party officials, or heads of line ministries.⁵⁶ In a very direct way, then, ideas reshaped power relationships in many policy decision making situations. Similarly, ideas became explicitly political resources as policy entrepreneurs used them to bring people together around reformist agendas, to put together broad new reform coalitions, and to define issues in conflict situations.

Implicitly, many international actors promote policy change as if ideas matter. International financial institutions, for example, put money into research and training for their own staff and also for those who are or might be engaged in policy discussions. They promote policy dialogue and consensus building based on discussions of ideas about, for example, how economies work most efficiently. They engage with technocrats in the countries they deal with and help generate national development strategies that owe much to current understanding of how market economies are developed and sustained. Thus, ideas may be one important means through which international actors become players in domestic policy debates.

In political economy theory, however, ideas generally get short shrift, overshadowed by focus on the economic interests of political actors. In economic approaches, with the exception of institutional design, ideas are not treated seriously. The normal case is one in which politicians and others make decisions based on self-interested logic that leaves no room for

attributing influence to ideas. In the comparative institutionalist literature, ideas are acknowledged to have a role in group consciousness and both inter- and intra-group conflict. Ideas thus help groups understand their own situation or define their identity and interests in distinction to those of others. They can be the fault lines along which conflict occurs. In some cases, of course, ideas are treated primarily as consciously adopted window dressing for the promotion of economic interests.⁵⁷ Most commonly, ideas are understood as political resources, a form of capital that is used to promote particular positions or to influence the outcome of decisions. In neither approach is there much attention to how political actors take on commitments to ideas, how ideas can be distinguished from interests, or the way ideas about how to solve particular problems become the dominant language of policy discussion.

Of course, as with the concept of leadership, there is good reason for theoretical caution when dealing with the issue of ideas. Ideas are difficult to track and measure and to separate from interests. The influence of ideas must be inferred from the statements and policy preferences of actors. It is almost always a conundrum to know how much individuals or groups are acting out of conviction or out of some more self-interested motivation. Only in cases in which actors assert and act on ideas that are in direct conflict with their immediate and longer-term self-interest can a good case be made for the independent influence of ideas. In practice, the impact of ideas in policy reform situations is frequently asserted but rarely is it possible to provide fully convincing proof that ideas explain policy choices. Nevertheless, given the frequency with which ideas emerge in experiences of reform, it is a concept that deserves more attention in political economy theory.

Success. In surveying the policy history of countries around the world in the past 20 years, the extent of change is remarkable. While countries have moved at different speeds and with varying degrees of completeness, the vast majority of countries have, by 1999, adopted market-oriented economic development strategies and have moved far in the direction of trade liberalization, privatization, and government retrenchment and reorientation. The rapid pace of economic globalization has certainly pushed many governments in this direction, but historical memories should remind us how far so many countries have come in the past twenty years. Whatever the forces at work, each of these countries has had to devise new policies, find political support for them, put them in practice—often through the creation of new institutions—and work to sustain them over time. This represents an extensive record of success in initiating and implementing reform.

Meanwhile, political economy theory continues to predict failure in efforts to promote policy and institutional change. The larger the change, the more theory would anticipate resistance and reaction rather than successful adaptation.⁵⁸ In many ways, current political economy approaches begin and end in agreement with Machiavelli's pronouncement, written in 1513:

It must be considered that there is nothing more difficult to carry out, nor more doubtful of success, nor more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit from the new order, this lukewarmness arising partly from the fear of their adversaries, who have the laws in their favor; and partly from

the incredulity of mankind, who do not truly believe in anything new until they have had the experience of it.

Notwithstanding growing evidence of the adoption of significant policy changes, theory continues to approach the politics of reform by anticipating factors that are likely to inhibit it.⁵⁹

The reasons for this focus are both empirical and theoretical. Empirically, it is true that in most cases, reform does threaten important or broad interests and imposes costs that have real meaning in the calculations of politicians. Thus, success often occurs despite Machiavelli's warning. More to the point of theory, however, failure in policy reform initiatives may be overdetermined because both economic and sociological approaches to political economy begin with a concept of individuals or groups acting within contexts that limit action and initiative. Constraints come in the guise of negatively affected interests, the machinations of other politicians, or the political institutions that limit the power of reformers. As indicated, these factors are all important and usually are empirically identifiable. The problem is not whether constraints exist or not, it is rather that an initial concern for identifying constraints tends to bias researchers to focus on why reform won't fly. Thus, most begin with a conservative bias in considering likely outcomes of reform efforts.

For example, a general theory of politics, the objective of political economy rooted in economics, is a theory about politics understood generally, concerned with explaining what is likely to happen most frequently or most of the time. As indicated, it is most appropriate in stable institutional contexts in which the objective is to explain the behavior of the generic politician, voter, bureaucrat, or interest group member. Such an approach, then, may fail to anticipate the kinds of choices that can make a real difference in political life. Although it takes individuals as the unit of analysis, the approach can be faulted for not taking individuals seriously enough, in the sense that individuals can be agents of history and not simply captives of the "games" that are in play.

Moreover, in the economics-based political economy literature, politics is treated as a negative input into policy decision making. In this approach, the politics of self-interest distort policy choice so that general purposes and social welfare objectives become lost in efforts to pursue narrow individual and group interests. The logical consequence of this orientation is that resultant policies are likely to be ones that are socially and economically irrational, even though they serve the interests of identifiable individuals and groups. Again, the bias is toward anticipating socially unproductive policies. It is, however, possible to view politics through more neutral lenses and to understand policy makers as "strategic managers within complex policy contexts who have a set of complex preferences and who are seeking politically, bureaucratically, and economically viable outcomes."⁶⁰ Viewed in this way, the outcome of a process of decision making could be good, bad, or indifferent with regard to change in policies or institutions. A more process oriented approach to understanding policy decision making illuminates more fully the fact that contexts offer both constraints and opportunities for change and that good analysis demonstrates not only how constraints will be felt but also how opportunities can be identified and acted upon.

A process oriented approach also draws more attention to the fact that the power of particular individuals or groups can fluctuate considerably over time and alter the dynamics of politics in important ways. Again, particularly in economic approaches, interests are treated as fixed in terms of their positions of power and in the preferences they have. But it is useful to remember that part of the reason many macroeconomic reform packages were introduced without greater resistance was that in many countries, the power of unions and import substituting interests had declined considerably under the impact of the global recession and domestic economic crisis of the early 1980s. Static concepts of power cannot explain why what appears to be a constraint one day becomes an opportunity the next. Theory needs to attempt to capture more fully the dynamic interactions that surround policy decision making and the dynamics of change over time in the power and interests of political actors.

Conclusion: Agendas for Political Economy and Policy Reform

In the past decade or more, real world initiatives for change have been ahead—often far ahead—of what political economists have chosen to study. In fact, most work on the political economy of development policy making remains focused on the factors that affect decision making about stabilization and structural adjustment, the so-called first generation reforms. Yet a quick visit to many countries in the world today is sufficient to note that the development policy agenda is long on other issues. In many countries, the policies promoted to engender a sound market-oriented economy are accepted as necessary and the political economy surrounding their adoption and sustainability has become less crisis-ridden. Of course, the Asian financial crisis has reintroduced issues related to macroeconomic management in the context of volatility in international capital markets and these remain as critically important concerns on the table for policy discussion and debate. In addition, considerable work on international institutions and policy regimes that increasingly influence the domestic politics of developing and transitional countries is illuminating important political economy issues. Among these are the conditions under which such institutions influence decision making, the ways in which international and domestic actors form alliances to affect domestic policies, the range of options available to countries to manage globalization in institutions and policy regimes, and explanations for the choices they make. At the same time, other issues have crowded onto the table, and they have received much less attention from political economists than they warrant.

More specifically, political economists need to devote more attention to issues of institutional change. While there is an evolving literature on the political economy of institutional creation and change in terms of those that are important for economic management—central banks, tax agencies, ministries of finance—there remains much work to be done in terms of the reform of the state more generally, including decentralization, civil service reform, and capacity building. Political economists need to consider where the initiative for institutional change comes from, how new institutional models are generated, the way in which the dynamics of institutional creation may differ from those of institutional evolution, and how political and economic actors adapt to such changes.

Similarly, one of the most important policy issues on the table at present is improvement in the quality and reach of social policies and their impact on poverty alleviation. Political economists should be challenged to explore how and why the politics of social policy reform

differ from the experiences of first generation reform, how new structures and incentive systems affect bureaucratic behavior in social service delivery organizations, the distributional consequences of alternative social policies and delivery systems, and the impact of alternative models on poverty alleviation.⁶¹

Equally important issues surround a wealth of real world experiments with political reform around the world. Recently empowered local governments, efforts to incorporate participation by civil society in policy decision making—such as participatory budgeting—the creation of offices of ombudsmen and national consumer protection agencies, the reform of judicial systems, the emergence of new political parties, and mechanisms to bring greater accountability and transparency to public affairs are among the innovations that hold the potential to alter political dynamics in important ways. Political economists ought to be studying these phenomena and seeking to stretch theoretical models to provide useful insights into what political interactions bring them into being and what consequences they have for the way politics get done.

If theory seems stuck on understanding the political roots and implications of stabilization and structural adjustment while the agenda for development in the real world has expanded far beyond this focus, the agenda for political economists is a challenging one in the future. Despite the political turmoil they involve, the kinds of changes made through first generation reforms are relatively simple in terms of political interactions. In the typical case, political leaders initiate proposals for change, empower technocratic teams to design reform programs, negotiate at high levels with international financial agencies, and centralize power in the executive branch to facilitate decision making, which is often carried out in secret among a relatively small group of officials. Many macroeconomic reforms do not require extensive implementation. So-called “stroke of the pen” reforms—deregulation is a good example—call on governments to desist from doing things, thus avoiding issues of institutional capacity and the management of implementation. Decisions are difficult to make because of the political costs they impose, but once made, they are relatively easy to carry out.⁶²

While this is a highly stylized portrait of what has occurred in adopting and implementing first generation reforms, and it does not hold for more complex tasks such as privatization and regulation, the experience of such policy changes stands in considerable contrast to efforts to build credible and capable new institutions, promote important reforms in health and education services and in social security and labor policy, and create more decentralized and participatory forms of governance.⁶³ These activities involve many more moving parts in terms of how they are planned and put in practice. They also require extensive consultation, negotiation, and consensus building if they are to be successfully adopted. They call for decentralized forms of decision making and need on-going and time-consuming monitoring and capacity building if they are to be implemented. In contrast to the general consensus that exists about macroeconomic policy, many of the newer reforms do not have well-recognized templates that explain the central problem and the appropriate solution to it.⁶⁴ Policy makers are thus dealing in much more complex political environments and often walking blind in terms of what needs to be done to resolve issues of public importance.

The politics involved in these second generation reforms are more complicated than those of the earlier economic policy changes and appear to be very contingent on histories of conflict and the structural characteristics of state-society relations in particular countries. Yet these complex policy and institutional changes may be as important to encouraging development as the macroeconomic reforms already adopted. They are important subjects for theory building and analysis, even though they may require the development of new theoretical models and more contingent explanations of change. Given the number of policy makers and advisors struggling with these issues currently, however, the quest to understand their political dynamics can be directly useful in the real world, if not to provide answers, at least to suggest strategies for improving the life chances of a wide variety of welfare-enhancing changes.

Notes

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¹This paper is intended to be relevant to the use of political economy in understanding policy decision making in the developing countries in Africa, Asia, Latin America, and the Middle East and on the transitional countries of East and Central Europe and the states of the former Soviet Union. While there are enormous differences among countries within and between these regions, I believe that everyday politics in these countries continues to demonstrate significant differences from politics in advanced industrialized countries that are carried out in more institutionally stable conditions.

² See, for example, Robert Bates, *Markets and States in Tropical Africa*. Berkeley: University of California Press, 1981; Anne O. Krueger, *Economic Policy Reform in Developing Countries*. Oxford: Basil Blackwell, 1992; Alberto Alesina and Allan Drazen, “Why are Stabilizations Delayed?” *American Economic Review*, Volume 81 (December 1991); Anne O. Krueger, “The Political Economy of the Rent-Seeking Society,” *American Economic Review*, Vol. 63, no. 3 (1974). On industrial countries, see Mancur Olson, *The Rise and Decline of Nations*. New Haven: Yale University Press, 1982; Robert Bates and Anne O. Krueger, eds., *Political and Economic Interactions in economic Policy Reform: Evidence from Eight Countries*. Oxford: Basil Blackwell, 1993.

³See, for example, Stephan Haggard and Robert R. Kaufman, ed., *The Politics of Economic Adjustment*. Princeton, N.J.: Princeton University Press, 1992; Joan M. Nelson, ed., *Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World*. Princeton, N.J.: Princeton University Press, 1990; Mariano Tommasi and Andres Velasco, “Where Are We in the Political Economy of Reform?” *Policy Reform*, Vol. 1 (1996); Raquel Fernandez and Dani Rodrik, “Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty,” *American Economic Review*, Vol. 81 (December 1991); Hector E. Schamis, “Distributional Coalitions and the Politics of Economic Reform in Latin America,” *World Politics*, Vol. 51, no. 2 (January 1999).

⁴See, for example, Allan Drazen and Vittorio Grilli, “The Benefit of Crises for Economic Reforms.” *American Economic Review*, Vol. 83 (1993); Merilee S. Grindle, *Challenging the State: Crisis and Innovation in Africa and Latin America*. Cambridge: Cambridge University Press, 1996; John Williamson, ed., *The Political Economy of Policy Reform*. Washington, D.C.: Institute for International Economics, 1994; Nelson, ed., *Economic Crisis and Policy Choice...*; Anne O. Krueger, *Political Economy of Policy Reform in Developing Countries*. Cambridge, MA: The MIT Press, 1993, Ch. 7; Jennifer A. Widner, ed., *Economic Change and Political Liberalization in Sub-Saharan Africa*. Baltimore, MD: The Johns Hopkins University Press, 1994.

⁵Crisis hypotheses encounter difficulty in specifying threshold conditions that define a crisis and in accounting for why some governments act expeditiously in the face of a crisis or to

avert crisis while other governments allow situations to go from bad to worse to worse yet. See Grindle, *Challenging the State...*; Dani Rodrik, "The Rush to Free Trade: Why So Late? Why Now? Will It Last?" in Stephan Haggard and Steven Webb, eds., *Voting for Reform: Democracy, Political Liberalization, and Economic Adjustment*. New York: Oxford University Press for the World Bank, 1994; Nelson, ed., *Economic Crisis and Policy Choice...*

⁶See, for example, Haggard and Webb, eds., *Voting for Reform*.

⁷See, for example, John Williamson, "In Search of a Manual for Technopols," in John Williamson, ed., *The Political Economy of Policy Reform*. Washington, D.C.: Institute for International Economics, 1994; Grindle, *Challenging the State...*, Ch. 5; Jorge Domínguez, *Technopols: Freeing Politics and Markets in the 1980s*. University Park, PA: Pennsylvania State University Press, 1997; Joan M. Nelson and Contributors, *Fragile Coalitions: The Politics of Economic Adjustment (check)*. New Brunswick, N.J.: Transaction Books.

⁸See, for example, Peter Hall, *The Political Power of Economic Ideas: Keynesianism across Nations*. Princeton, N.J.: Princeton University Press, 1989; Jeffrey M. Puryear, *Thinking Politics: Intellectuals and Democracy in Chile*. Baltimore, MD: The Johns Hopkins University Press, 1994; Diane Stone, Andrew Denham, and Mark Garnett, eds., *Think Tanks across Nations: A Comparative Approach*. Manchester: Manchester University Press, 1998.

⁹See, for example, Barry R. Weingast, "The Political Foundations of Limited Government: Parliament and Sovereign Debt in 17th and 18th [Century] England." Paper prepared for a conference on the Frontiers of Institutional economics, Washington University (March 17-19, 1995); Torsten Persson and Guido Tabellini, eds., *Monetary and Fiscal Policy*. Cambridge, MA: MIT Press; Hilton L. Root, "Tying the King's Hands: Credible Commitments and Royal Fiscal Policy during the Old Regime," *Nationality and Society*, Vol. 1, no. 2 (October 1989); Douglass C. North and Barry R. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth Century England," *Journal of Economic History*, Vol. 49, no. 4 (December 1989); Merilee S. Grindle, *Audacious Reforms: Institutional Invention and Democracy in Latin America*, forthcoming.

¹⁰I have chosen to use the term political economy broadly to capture distinct approaches to understanding the ways in which economics and politics intertwine to influence the content and dynamics of policy. This broad definition encompasses the work of economists and political scientists and distinct traditions of social science inquiry.

¹¹On the "new political economy," see Gerald M. Meier, ed., *Politics and Policy Making in Developing Countries: Perspectives on the New Political Economy*. San Francisco: International Center for Economic Growth, 1991.

¹²Useful overviews of a wide variety of approaches to political economy can be found in James A. Caporaso and David P. Levine, *Theories of Political Economy*. Cambridge: Cambridge University Press, 1992; and Jeffrey S. Banks and Eric A. Hanushek, eds., *Modern Political Economy: Old Topics, New Directions*. Cambridge: Cambridge University Press, 1995.

¹³For reviews of the literature that draws on economics, see Gary J. Miller, “The Impact of Economics on Contemporary Political Science,” *Journal of Economic Literature*, Vol. 35, no. 3 (September 1997); James A. Caporaso and David P. Levine, *Theories of Political Economy*; Barbara Geddes, “The Uses and Limitations of Rational Choice,” in Peter Smith, ed., *Latin America in Comparative Perspective: New Approaches to Methods and Analysis*. Boulder, CO: Westview Press; Dani Rodrik, “The Positive Economics of Policy Reform,” *American Economic Association Papers and Proceedings*, Vol. 83, no. 2 (May 1993).

¹⁴For discussions of the literature that draws on sociology, see Peter Evans, *Embedded Autonomy: States and Industrial Transformation*. Princeton, N.J.: Princeton University Press, 1995; Ch. 2; Sven Steinmo, Kathleen Thelen, and Frank Longstreth, eds., *Structuring Politics: Historical Institutionalism in Comparative Analysis*. Cambridge: Cambridge University Press, 1992; Mark Granovetter, “Economic Action and Social Structure: The Problem of Embeddedness,” *American Journal of Sociology*, Vol. 91, no. 3 (November 1985); Joel Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World*. Princeton: N.J.: Princeton University Press, 1988.

¹⁵See Stephan Haggard and Robert R. Kaufman, “Introduction: Institutions and Economic Adjustment,” in Haggard and Kaufman, *The Politics of Economic Adjustment*.

¹⁶See, for example, Bates, *Markets and States in Tropical Africa*; Krueger, “The Political Economy of the Rent-Seeking Society.”

¹⁷Mancur Olson, Jr., *The Logic of Collective Action: Public Goods and the Theory of Groups*. New Haven, CT: Yale University Press, 1965. In much of the work on groups that has grown out of Olson’s work, however, scholars have failed to make a distinction between groups as organized interests and collectivities of individuals who share a similar economic interest. Thus, “groups” have often been taken to be expressions of sectoral interests, such as “industrialists,” “trade unions,” or “agricultural producers,” but treated as if they were entities capable of actively representing interests in policy discussions, such as a national association of manufacturers, a teachers’ union, or a rice growers’ association. In predicting action when organization is overlooked, political economists can also overlook the consequences of change for particular interests.

¹⁸This is an important dynamic underlying the explanation of economic and political decay in Africa, according to the foundational work in this area by Robert Bates, *Markets and States in Tropical Africa*.

¹⁹The term “comparative institutionalism” is taken from discussions of a symposium on “The Role of Theory in Comparative Politics: A Symposium,” *World Politics*, Vol. 48 (1995). In Steinmo, Thelen, and Longstreth, *Structuring Politics...*, this approach is referred to as “historical institutionalism. Among those who are often cited as leaders in this tradition are Theda Skocpol, Peter Katzenstein, Peter Evans, and Peter Hall. See also work by Charles Tilly and Alain Touraine: Charles Tilly, “Models and Realities of Popular Collective Action.” *Social*

Research, Vol. 52, no. 4, 1985; Alain Touraine, “An Introduction to the Study of Social Movements.” *Social Research*, Vol. 52, no. 4, 1985.

²⁰See especially Kathleen Thelen and Sven Steinmo, “Historical Institutionalism in Comparative Politics,” in Steinmo, Thelen, and Longstreth, eds., *Structuring Politics...*, as well as the case studies in that volume for discussions of the importance of institutions, conflict, and history in comparative analysis. See also contributions to the symposium in *World Politics*, Vol. 48 (1995).

²¹Max Weber, a principal icon of comparative institutionalism, considers the work of statecraft in “Politics as a Vocation.” See H. H. Gerth and C. Wright Mills, eds., *From Max Weber: Essays in Sociology*. New York: Oxford University Press, 1946. “Politics as a Vocation” was originally published in 1919. See also William Ascher, *Scheming for the Poor: The Politics of Redistribution in Latin America*. Cambridge, MA: Harvard University Press, 1984; Domínguez, *Technopols...*

²²See, for examples case studies presented in Steinmo, Thelen, and Longstreth, *Structuring Politics...*; Stephen Skowronek, *The Politics Presidents Make: Leadership from John Adams to George Bush*. Cambridge, MA: The Belknap Press of Harvard University Press, 1993.

²³Typically, scholars in this tradition explore the context within which political actions take place as a dense set of rules and relationships that actually shape motivations and inform action.

²⁴According to Barbara Geddes, “[t]he most compelling use of this approach results from the creative synthesis of the rational actor assumptions with, one, a plausible attribution of goals and, two, a careful interpretation of the effects of institutions and other factors on the feasible strategies available to actors for achieving these goals” (“Uses and Limitations of Rational Choice, p. 82).

²⁵See, for example, Ellen Immergut, “The Rules of the Game: The Logic of Health Policy-Making in France, Switzerland, and Sweden,” and Desmond S. King, “The Establishment of Work-Welfare Programs in the United States and Britain: Politics, Ideas, and Institutions,” both in Steinmo, Thelen, and Longstreth, eds., *Structuring Politics...*

²⁶See Evans, *Embedded Autonomy*.

²⁷See, for example, Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*. Princeton, N.J.: Princeton University Press, 1990; World Bank, *The East Asian Miracle: Economic Growth and Public Policy*. New York: Oxford University Press, 1994.

²⁸See Ronald H. Coase, “The Institutional Structure of Production.” *American Economic Review*, Vol. 82 (September 1992).

²⁹See Stephan Haggard and Robert R. Kaufman, *The Political Economy of Democratic Transitions*. Princeton, N.J.: Princeton University Press, 1995. Arend Lipjhart and Carlos Waisman, eds., *Institutional Design in New Democracies*. Boulder, CO: Westview Press, 1996; Joan M. Nelson, ed., *A Precarious Balance: Democracy and Economic Reform in Eastern Europe*. San Francisco: Institute for Contemporary Studies, 1994; Adam Przeworski, *Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America*. Cambridge: Cambridge University Press, 1991.

³⁰See, for example, Persson and Tabellini, *Monetary and Fiscal Policy*; North and Weingast, *Constitutions and Commitment...*; Brian Levy and Pablo Spiller, "The Institutional Foundations of Telecommunications Regulation." *Journal of Law, Economics, and Organization*, Vol. 10, no. 2 (October 1994); Dani Rodrik, "Promises, Promises: Credible Policy Reform via Signalling," *The Economic Journal*, Vol. 99 (1989).

³¹See especially Douglass C. North, *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press, 1990. See also Lee J. Alston, Trainn Eggertsson, and Douglass C. North, eds., *Empirical Studies in Institutional Change*. Cambridge: Cambridge University Press, 1996; Oliver E. Williamson, "The Institutions of Governance," *The American Economic Review*, Vol. 88, no. 2 (May 1998); Oliver E. Williamson, "The Institutions and Governance of Economic Development and Reform," *Proceedings of the World Bank Annual Conference on Development Economics*, 1994.

³²Foundational work in this tradition is generally traced to Ronald Coase's 1937 work, "The Nature of the Firm," *Economica*, Vol. 4.

³³North, *Institutions, Institutional Change and Economic Performance*, p. 16.

³⁴*Ibid.*, p. 6.

³⁵"The principal-agent model is an analytic expression of the agency relationship, in which one party, the principal, considers entering into a contractual agreement with another, the agent, in the expectation that the agent will subsequently choose actions that produce outcomes desired by the principal." Terry M. Moe, "The New Economics of Organization," *American Journal of Political Science*, Vol 18, no. 4 (November 1984). The problems of delegation and commitment are thus central concerns in a principal-agent framework. See especially Murray Horn, *The Political Economy of Public Administration: Institutional Choice in the Public Sector*. Cambridge: Cambridge University Press, 1995.

³⁶See Horn, *The Political Economy of Public Administration*.

³⁷Grindle, *Audacious Reforms...*

³⁸See, for example, Theda Skocpol, *States and Social Revolutions: A Comparative Analysis of France, Russia, and China*. Cambridge: Cambridge University Press, 1979; Jack Knight, *Institutions and Social Conflict*. Cambridge: Cambridge University Press, 1992.

³⁹See, Gary J. Miller, “The Impact of Economics on Contemporary Political Science,” *Journal of Economic Literature*, Vol. 35, no. 3 (September 1997).

⁴⁰See Evans, *Embedded Autonomy*, Ch. 2;

⁴¹On the distinction between state-centric and society-centric explanations of politics, see Merilee S. Grindle and John W. Thomas, *Public Choices and Policy Change: The Political Economy of Reform in Developing Countries*. Baltimore, MD: The Johns Hopkins University Press, 1991.

⁴²See, for example, Barbara Geddes, *Politician’s Dilemma: Building State Capacity in Latin America*. Berkeley: University of California Press, 1994.

⁴³This is characteristic of Marxian analysis also, as it is with many scholars who treat policy decision making as a “black box.”

⁴⁴Nelson, *Economic Crisis and Policy Choice...*; Williamson, *The Political Economy of Policy Reform*; Joe Wallis, “Understanding the Role of Leadership in Economic Policy Reform,” *World Development*, Vol. 27, no. 1 (1998).

⁴⁵Nelson, *Economic Crisis and Policy Choice*; Schamis, “Distributional Coalitions and the Politics of Economic Reform in Latin America;” Jeffry Frieden, *Debt, Development, and Democracy*. Princeton, N.J.: Princeton University Press, 1991.

⁴⁶President Carlos Menem in Argentina is the most frequently cited example of this kind of situation, but Carlos Salinas in Mexico and Carlos Andrés Pérez are also good examples.

⁴⁷See Grindle, *Challenging the State*, especially Ch. 4.

⁴⁸See Miles Kahler, “External Influence, Conditionality, and the Politics of Adjustment,” in Haggard and Kaufman, eds., *The Politics of Economic Adjustment...*

⁴⁹Thus, leaders of economic reform are referred to as heroes in some discussions. See Arnold Harberger, “Secrets of Success: A Handful of Heroes,” *American Economic Review*, Vol. 83 (May 1993).

⁵⁰Empirical work is beginning to respond to these questions. See the case studies in Alston, Eggertsson, and North, *Empirical Studies in Institutional Change*.

⁵¹Grindle, *Audacious Reforms...*

⁵²Hall, *The Political Power of Economic Ideas*; Wallis, “Understanding the Role of Leadership in Economic Policy Reform;” Grindle, *Challenging the State*, Ch. 5.

⁵³See Domínguez, *Technopols....* Considerable work on “epistemic communities” in international and domestic arenas has also illuminated the impact of ideas on policy choice. See, for example, William Drake and Kalypso Nicolaïdis, “Ideas, Interests and Institutionalization: ‘Trade in Services’ and the Uruguay Round.” *International Organization*. Vol. 46, no. 1 (Winter 1992).

⁵⁴Again, Menem in Argentina and Pérez in Venezuela are good examples of this.

⁵⁵Nelson and Contributors, *Fragile Coalitions...*; Williamson, “In Search of a Manual for Technocrats.”

⁵⁶Grindle, *Challenging the State*, Ch. 5.

⁵⁷This is the case, for example, in Marxian analyses.

⁵⁸Kurt Weyland has used “prospect theory” to advance an argument for why decision makers may take large risks when confronted with the potential for high losses. See “Risk Taking in Latin American Economic Restructuring: Lessons from Prospect Theory,” *International Studies Quarterly*, Vol. 40, 1996.

⁵⁹For example, see Rodrik, “The Positive Economics of Policy Reform.”

⁶⁰Merilee S. Grindle, “The New Political Economy: Positive Economics and Negative Politics,” in Gerald M. Meier, ed., *Politics and Policy Making in Developing Countries...*, p. 67.

⁶¹For an example of the kind of work that needs to be done in this area, see Javier Corrales, “The Politics of Education Reform Implementation.” Amherst College, December 1998. In addition, useful work is currently under way in areas related to regulatory, pension, and labor market reform.

⁶²Sustaining such reforms is, of course, often a very difficult task also.

⁶³First and second generation reforms are described in Moisés Naím, “Latin America’s Journey to the Market: From Macroeconomic Shock to Institutional Therapy.” Occasional Paper No. 62, International Center for Economic Growth. San Francisco, CA: ICS Press, 1995; Carol Graham and Moisés Naím, “The political Economy of Institutional Reform in Latin America,” in Nancy Birdsall, Carol Graham, and Richard H. Sabot, eds., *Beyond Trade-offs: Market Reform and Equitable Growth in Latin America*. Washington, D.C.: Inter-American Development Bank and Brookings Institution Press, 1998.

⁶⁴This is a point made by Joan Nelson in “Reforming Social Sector Governance: A Political Perspective.” Paper prepared for a conference on Governance, Poverty Eradication, and Social Policy,” Harvard University, November 12-14, 1997.