

# **Fostering Civil Society to Build Institutions: Why and When<sup>\*</sup>**

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## **Abstract**

We revisit the ubiquitous claim that aiding civil society improves institutional outcomes. In our model, a vibrant civil society initiates public debate in a reform process that would otherwise be dominated by partisan interest groups and politicians. By altering the incentives of interest groups submitting institutional reforms, the presence of civil society sometimes solves adverse selection problems that arise because interest groups are better informed. Because aid increases the cost to the politician of excluding civil society, it affects institution-building. We show that the welfare implications of fostering civil society critically depend on the specifics of local politics, thereby casting new light on the experience of civil society aid in post-communist and developing countries. Our analysis uncovers a particularly disturbing instance of the tragedy that aid can be counter-productive where institutions are poor.

**Keywords:** civil society, institutional reform, civil society aid, interest groups, post-communist countries, developing countries

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## 1. Introduction

Civil society—"the realm of organized social life that is voluntary, self-generating (largely), self-supporting [and] autonomous from the State" (Diamond 1994, p.5)—has received much emphasis in development circles. Greater involvement of civil society is frequently viewed as crucial in attaining development goals. Advocates see civil society organizations as bringing citizens' concerns to broader public attention, thereby counteracting narrow interests, which can be especially problematic when institutions function poorly (Edwards 2004, Rosenblum and Post 2001).<sup>1</sup> Accordingly, fostering civil society through foreign aid is seen as a means of promoting institutional development, with the hope that the improved institutions will later enhance the effectiveness of aid where past efforts have been disappointing (Frisch and Hofnung 1997, Van Rooy 1998, Ottaway and Carothers 2000, Howell and Pearce 2001).<sup>2</sup> Yet in practice, this quest has proven elusive, raising doubts about whether fostering civil society is worth the money (Carothers 2004, Robinson and Freidman 2005) and calling for "contextualized political and social analyses that can properly inform donor interventions" (Howell and Pearce 2001, p.235).

The general agreement on the practical importance of civil society has not led to sustained formal analysis within economics. There is no clear analytical understanding of what role civil society plays and what functions it serves. Our aim therefore is to provide an exploratory formal analysis. We embed core features widely attributed to civil society in a framework that captures the essence of the politics of institution-building. Of course, any suggestion about what features are logically inherent in the nature of civil society is bound to

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<sup>1</sup> In this paper, we emphasize the role of civil society as it interacts directly with the political sphere. This is the role that is most likely to have an immediate effect on institution building in market economies. Other functions of civil society commonly identified in the literature are substituting for poorly functioning states in service provision (World Bank 2003) and breeding social capital (Putnam 1993). See e.g. Azam (2003), Gibbons and Rutten (2004), Besley and Ghatak (2001), Jack (2001), and Khwaja (2004) for theoretical analyses of the service-provision aspect of civil society organizations. See e.g. Knack and Keefer (1997), Temple and Johnson (1998), Glaeser et al. (2000), Guiso et al. (2004), and Huang (2003) for empirical and theoretical analyses of social capital.

<sup>2</sup> Of course, much of foreign aid involving civil society is channeled *through* rather than *to* civil society organizations as in the case of NGOs providing services in the areas of health, population control, agriculture, poverty reduction etc.

be debatable. The phenomenon is so amorphous in many existing discussions that any formal approach would seem narrow. Nonetheless, since even the most basic and preliminary questions about civil society remain unanswered, an exploratory analysis can be highly informative. By making explicit one apparent channel through which civil society influences the politics of reform, we characterize conditions determining the desirability of civil society aid. To date, such conditions have not been derived analytically, meaning that our results extend far beyond existing illustrative and informal discussions.

In characterizing civil society, we focus on the irreducible core of many existing definitions of civil society that are relevant to institutional reform (Edwards 2004, Howell and Pearce 2001, Van Rooy 1998, Ottoway and Carothers 2000, Orenstein 2000, Robinson and Friedman 2005). In our framework, civil society stands above the realm of policies for sale: it holds no direct stake in the outcome of reforms. It strives to open up and expand public debate within a reform process that would otherwise be dominated by aggressive lobbies and self-interested politicians. Civil society participation thus inevitably prevents hasty, ad hoc implementation of reform proposals.

When interest groups are better informed about the reforms that they propose than politicians are, there can be adverse selection problems, which the presence of civil society can either solve or exacerbate. If the objectives of the groups proposing reforms and those in the rest of the economy are misaligned, civil society solves some adverse selection problems. However, when reforms proposed by special interests have widespread benefits—for example, because a country is far from its institutional possibility frontier—the intervention of civil society decreases the likelihood of a successful reform. Civil society's involvement in this specific reform process is then undesirable.

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Importantly, "[s]uch programs clearly have effects on the development of civil society...even though the programs are not designed explicitly with civil society development as an objective" (Carothers and Ottaway 2000, p.13).

The welfare impact of civil society thus critically depends on the intricacies of local politics—the degree to which the objectives of empowered interest groups are aligned with those of the rest of society, the level of democracy, and the amount of political stability. Our findings thus caution against the very common portrayals of civil society in development circles as an indisputably "good thing" (Van Rooy 1998, p.30). The results qualify the nearly universal assumption of a link between the presence of civil society and successful economic development (Howell and Pearce 2001, p.235; Robinson 1996, p.3).

The effect of aid that strengthens civil society is to make it more costly for a politician to exclude civil society from reform processes. Exclusion can be optimal for the politician even when inclusion would be welfare enhancing because the politician also wants to please powerful interests whose favored reforms might not pass through a process that includes civil society. Hence, aid affects institutional outcomes by changing the politician's decision on whether to include civil society in reform processes. By comparing the welfare implications of the reforms undertaken with and without civil society, we can characterize the conditions determining the desirability and effectiveness of civil society aid.

Because the exclusion of civil society from reform processes is sometimes socially optimal, using aid to strengthen civil society is beneficial only under special political conditions. The benefits from aid decline as the objectives of special interests and those of society become more closely aligned. For a given the degree of alignment, however, the welfare effect of aid to civil society also varies with levels of political stability and democracy. These results provide context for the frequent reports of the disappointing effects of civil society aid targeted at promoting good governance (Carothers 2004, Ottaway and Carothers 2000, Robinson and Friedman 2005).

The contingent effect of civil society aid results in a particularly pernicious paradox. We argue that civil society aid for institution building will likely be harmful in those

circumstances where optimism about its effects would normally be highest—when institutions are poor and the country is very open to reform. Hence, in contrast to many advocates, we find little reason to support the view that aid to civil society is a way of jump-starting the development process when poor institutions reduce the effectiveness of foreign aid.

At a more general level, our results contribute to the ongoing debate about the effectiveness of foreign aid (see e.g. Burnside and Dollar 2004, Rajan and Subramanian 2005, Shirley 2005, Moss et al. 2006). We highlight the impact of a particular segment of foreign aid, that to civil society, and derive the efficiency implications of such aid. Our main conclusion—that different political conditions lead to drastically different welfare consequences of a given amount of aid—thereby bolsters the selectivity argument for aid dissemination (Drazen 1999, Dollar and Svensson 2000, Kosack 2003, Burnside and Dollar 2004, Shirley 2005).

The rest of the paper is organized as follows. The next section examines the literature on civil society that has arisen in development circles, arguing that there has been almost universal agreement that civil society has a beneficial role in institution-building. Sections 3 to 6 revisit this ubiquitous premise by presenting our model, deriving its results, and interpreting them. Section 7 concludes.

## **2. Civil Society and Institution-Building: The Ubiquitous Argument**

According to Carothers and Ottaway (2000, p. 4): "In the eyes of many donors and recipients...the idea that civil society is always a positive force...is unassailable. An active...civil society is both the force that can hold the governments accountable and the base upon which a truly democratic political culture can be built. There follows from this assumption the related idea that promoting civil society development is key to democracy-building." Similarly, an extremely common argument is that civil society influences the

process of institution-building and that fostering civil society *per se* should promote adoption of institutional best-practice (Carothers 2004, Frisch and Hofnung 1997, Howell and Pearce 2001, and Van Rooy 1998). "In the political domain, civil-society development is deemed crucial to stimulating the public pressure and participation necessary to force poorly functioning state institutions to become more responsive and accountable" (Carothers 2004).

In the context of post-communist transition, a vibrant civil society was seen as a means of facilitating the creation of many of the components necessary for a market economy (Carothers 2004; Buiter 2000, pp. 617–619). In Africa, civil society's involvement is expected to improve governance by "challenging the power of the state to dominate political affairs and decision-making" (Robinson and Friedman 2005, p.2). A strong civil society has been expected to "broaden participation in public life and influence state policy" (Robinson and Friedman 2005, p.1) and favorably "[steer] the direction of debates and policy around economic reforms and democratic consolidation" (Hearn 1999, p.22).

Roland (2004) argues that civil society's participation is particularly desirable when institutional construction occurs through transplantation. Those who endeavor to transplant institutions will likely find that dialogue with governments is not fruitful, because governments are prone to capture by elites with vested interests. Civil society's involvement in assessing the correct institutional mix is therefore crucial, especially as it compensates for deficiencies in outsiders' knowledge of local conditions. In Hoff and Stiglitz (2004), a weak civil society decreases the likelihood of the emergence of the rule of law. In Beck and Laeven (2006), civil society counterbalances political elites and therefore helps in the process of building better institutions.

Systematic empirical evidence is scarce. It is also subject to serious measurement problems given the lack of precision in the concept of civil society—a deficiency that would be corrected by a more rigorous analysis that pinpoints precise effects. Campos (2000)

shows that civil society's participation in public affairs increases transparency of policy making.<sup>3</sup> Civil society involvement may thus substitute for some institutions of good governance such as the publicness of policy-making and accountability of the executive. Likewise, Dethier et al. (1999) argue that the presence of a vibrant civil society helps to explain the success of economic liberalization.<sup>4</sup>

We question the ubiquitous conjecture that civil society's involvement in reform processes always improves institutional outcomes. While intuitively appealing, this conjecture has not, to the best of our knowledge, been pursued within the disciplining framework of an analytical model. Moreover, the emerging anecdotal evidence on effectiveness of civil society assistance, although scant, reveals at best meager success in promoting good governance. In the bulk of the post-communist region and the developing world, aid to civil society seems to have had little impact on institutional development (Ottaway and Carothers 2000, Carothers 2004, Quigley 2000, Robinson and Friedman 2005).

### **3. Revisiting the Ubiquitous Argument: A Model**

#### *3.1. Overview*

The objective is to present a realistic tractable scenario where civil society participates in the institutional reform process. Then, analytical results bear directly on the many very general claims about the effects of civil society on institutional reforms, reviewed above. We believe that this is the first analytical paper to meet this objective.

A society is contemplating a fundamental reform. The process occurs once and the outcome is not reversible in the time period covered by the model, making our analysis applicable to institutional reform but not to standard policies. Interest groups initiate reform programs and devote resources to influence a politician's (i.e., the government's) decision. Separate from the sphere of interest groups and politicians, civil society can shape the

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<sup>3</sup> To measure the strength of civil society, Campos combines the Freedom House measures of civil liberties and political rights with the "civil society" indicator from Karatnycky et al. (1998).

institutional reform process by opening up debate and expanding deliberation. The government can exclude civil society from that process, but only at some cost, which increases with levels of democracy and the strength of civil society. By strengthening civil society, aid can affect institutional outcomes.

A timeline of reform is depicted in Figure 1. The following subsections describe the various elements of the timeline, not in chronological order but in a sequence that develops the logical structure of the reform process.

### *3.2. Reform Programs*

Reform programs are combinations of individual reforms. Reform of type  $j$  (reform  $j$ , in short) is completely characterized by the benefits to interest groups  $\alpha$  and  $\beta$ ,  $B_{\alpha j}$  and  $B_{\beta j}$ , respectively. Classifying reforms according to whether  $\alpha$  or  $\beta$  win or lose and whether the sum of payoffs is positive or negative, there are only six possible generic reform types. Table 1 defines them. Given that all possible types of reforms are included in these six, any reform program can be characterized by a combination of at most one reform of each type.

Reforms 2–5 are redistributive (gains for one group come at the expense of losses for the other) but with different consequences for aggregate welfare. Reforms 2 and 4 redistribute with a deadweight loss. Reforms 3 and 5 redistribute with a net aggregate welfare gain. Pareto-improving reform 1 is of interest to both  $\alpha$  and  $\beta$ . Reform 6 is Pareto inferior to the status quo, and can be dropped from the analysis since neither  $\alpha$  nor  $\beta$  ever proposes it.

This structure of possible reforms captures a fundamental aspect of institutional change. Programs proposed by interest groups contain various sub-components, some contributing to general welfare, some reducing it. The central problem of institutional reform is to foster adoption of efficiency-enhancing components and limit rent-seeking redistributions.

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<sup>4</sup> Dethier et al. measure the strength of civil society with the Freedom House index of civil and political liberties.



### 3.3. Interest Groups and Politicians

A and B are the two rival politicians. The one forming the government has the power to implement reforms, which are proposed by interest groups. The government accepts a submission only if the interest group pays a lobbying fee, which can be interpreted very generally as a campaign contribution or a bribe or some other favor. Interest groups are much more knowledgeable than the politician about the effects of reforms. The politician is at an informational disadvantage and cannot recognize reform types. Both interest groups can recognize reforms, but their statements on which reforms are being proposed would hardly be credible.

To set the scales of variables, assume the fee does not vary with reform type:  $\Psi_{ik}$  is the payment when the government of politician  $k \in \{A, B\}$  accepts a submission of any reform  $j$  from interest group  $i \in \{\alpha, \beta\}$ . (Submission of a reform program with  $n$  reforms thus costs  $n\Psi_{ik}$ .) The fee is a *quid pro quo* for the cost incurred by the politician in placing a submitted reform proposal onto the political agenda. This is the political cost that the politician must bear by proposing a redistribution from  $\alpha$  to  $\beta$  (or  $\beta$  to  $\alpha$ ). The assumption that the fee does not vary with reform type then implies that reforms 2 and 3 (or 4 and 5) should entail a similar cost for the politician, which makes the following assumption a natural one:

$$B_{\beta 2} = B_{\beta 3} \text{ and } B_{\alpha 4} = B_{\alpha 5}.$$

The structure of payoffs in Table 1 naturally pits  $\alpha$  and  $\beta$  against each other. Hence, enactment of reforms 2 or 3 is inconsistent with enactment of reforms 4 or 5.<sup>5</sup> No politician could credibly implement proposals from both groups. Accordingly, each politician is willing to consider reform proposals only from the interest group associated with that politician. This is the politics of fundamental institutional reform. Interest groups oppose

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<sup>5</sup> The assumption of direct conflict is common in the analysis of the effect of interest groups on policy. For examples, see e.g. Grossman and Helpman (2001, sections 4.2.2, 8.4, and 9.3), Drazen (2000, sections 3.7, 13.5) and Mueller (1989, pp. 108, 230, 245, 247, 279, and 453).

each other in a manner that correlates with political ideologies and the characteristics of politicians. The politician in office thereby effectively blocks one interest group from influencing the reform process, while simultaneously welcoming proposals from the other. The interest group associated with the government is thus referred to as the *empowered* one. In the model,  $\alpha$  is paired with A and  $\beta$  with B.<sup>6</sup>

### 3.4. Social Welfare and the Politician's Objectives

The lobbying fee ( $\Psi_{ik}$ ) is a pure transfer. Hence, the (ex post) aggregate impact from implementing reform  $j$ ,  $W_j$ , is the sum of the payoffs to the two interest groups:  $W_j = B_{\alpha j} + B_{\beta j}$ . The ex ante expected social welfare (*social welfare* in short) from a reform program is then a weighted sum of the appropriate  $W_j$ 's, where the weights are the probabilities of implementation of respective reforms (we clarify these in sections 4.1. and 4.2. below).

We follow the recent literature on lobbying and special-interest politics (see e.g. Persson and Tabellini 2000, Ch. 7; Grossman and Helpman 2001, Ch. 7–8) in positing that the politician's payoff from a proposed reform program is a weighted average of the social welfare and collected lobbying fees:

$$\lambda \times \{\text{social welfare}\} + (1 - \lambda) \times \{\text{lobbying fees}\},$$

where  $\lambda \in (0, 1)$ . The common-agency models of lobbying (Grossman and Helpman 1994, Persson 1998) that assume complete information derive the policy (or reform) choices of politicians by endogenizing lobbying contributions. In contrast, we fix the size of the lobbying fee  $\Psi_{ik}$  and focus instead on the consequences of informational asymmetries between politicians and interest groups.

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<sup>6</sup> This is equivalent to assuming (a) that for all  $j$  such that  $B_{\alpha j} > 0$ ,  $\Psi_{\alpha A} < B_{\alpha j} < \Psi_{\alpha B}$ , and for all  $j$  such that  $B_{\beta j} > 0$ ,  $\Psi_{\beta B} < B_{\beta j} < \Psi_{\beta A}$ , or, it can be shown, even (b) that for all  $j$  such that  $B_{\alpha j} > 0$ ,  $\Psi_{\alpha A} < \Psi_{\alpha B} < B_{\alpha j} < \Psi_{\alpha B} + \varepsilon$ , and for all  $j$  such that  $B_{\beta j} > 0$ ,  $\Psi_{\beta B} < \Psi_{\beta A} < B_{\beta j} < \Psi_{\beta A} + \varepsilon$ , where  $\varepsilon > 0$  is arbitrarily small. The resultant structure of lobbying ( $\alpha$  lobbies only A and  $\beta$  only B) is consistent with empirical work on campaign contributions, which shows alignment between the objectives of special interests and politicians (Poole and Romer 1985; Poole, Romer, and Rosenthal 1987).

The parameter  $\lambda$  will tend to be smaller in autocracies but increases with levels of democracy. As in Glaeser and Shleifer (2002), we refer to  $\lambda$  as a measure of democracy.<sup>7</sup>

### *3.5. Politicians and Civil Society*

Before interest groups submit proposals, the incumbent government can choose to allow the active participation of non-partisan, policy-minded civil society groups that have the capacity to stimulate debate about reform. Civil society groups open up "the arena for argument and deliberation" and create the "non-legislative, extra-judicial, public space in which...public policy, government action and matters of community...are developed and debated" (Edwards 2004, p.55).<sup>8</sup> We assume that the benefits of civil society arise solely from changes in reform outcomes. This instrumental view arises from our focus on civil society involvement in one specific reform: we do not view our results as reflecting on broader issues of the place of civil society in the socioeconomic structure of the country as a whole.

A vibrant civil society is therefore sand in the wheels of the political process, preventing quick, ad hoc adoption of reforms. This delay changes reform outcomes, which is how civil society affects welfare in our model. (There are no time preference effects on welfare.) In characterizing civil society in this way, we focus on the irreducible core of the many definitions of civil society relevant to institutional reform that appear in the literature (Edwards 2004, pp. 55-63; Howell and Pearce 2001, pp. 2-3; Van Rooy 1998, pp. 20, 49; Ottoway and Carothers 2000, pp. 11-12). Thus, the notion of civil society used here, although narrower than that of many commentators, would certainly be a prime ingredient in any generally acceptable definition.

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<sup>7</sup> Glaeser and Shleifer's (2002) interpretation of their parameter that captures the degree to which the preferences of the sovereign differ from those of the society exactly corresponds with our interpretation of  $\lambda$  as a shorthand measure of democracy.

<sup>8</sup> Edwards (2004) quotes McClain and Fleming (2000).

A compelling example of a characterization of civil society congruent to ours is provided by Orenstein (2000) who presents case studies of design and implementation of pension reform programs in Hungary, Poland, and Kazakhstan. In Kazakhstan, pension reform deliberations were conducted in secrecy by a single governmental commission under the direct authority of the prime minister, with full approval of the president. Orenstein argues that this was because in Kazakhstan, civil society organizations "face[d] greater sanctions for voicing opposition" and had "fewer opportunities to access the policy process" than in Poland and Hungary. In fact, "[c]ivil society groups did not even know about the progress of governmental pension reform proposals" (Orenstein 2000, p. 18). Consequently, the deliberative process was significantly shorter in Kazakhstan than in the more democratic Hungary and Poland, where civil society groups contributed actively in the reform process.

Similarly, Robinson and Friedman (2005, p. 11) report that in South Africa "at various stages of the legislative process there was...extensive public consultation on proposed bills through formal and informal processes in which civil society groups played a significant role." On occasions, prominent civil society organizations delayed the progress of reforms, for example, the privatization of state industries. In light of civil society's effect on the reform process, the government even "declared that...excessive negotiation on policy would delay delivery of the fruits of democracy to citizens" (Robinson and Friedman 2005, p. 11).

In our model, the effect of delay is that the incumbent, A, might lose an election or be usurped in a non-democratic fashion and replaced by the contender, B, before being able to implement a submitted reform program. Following Persson and Tabellini (2000, Section 13.3), the probability of A continuing in power is interpreted as a measure of political stability. In our model, this exogenous probability is denoted by  $p \in (0,1)$ . The use of the term stability is apposite in the present context because when A is replaced there is a

fundamental change in politics. Since the interest groups associated with each of the politicians have opposing views on institutional reforms, A's loss of power leads to the country taking a different institutional path. In the model, the direct consequence of a change in government is that the interest groups have to incur lobbying costs again if they still want their reforms to be considered.

Of course, a slowing of reform processes can occur for many reasons, some of which have been a focus of the literature on reform.<sup>9</sup> We are not interested in the process of delay *per se*. Instead, we argue that a slow-down in the reform-implementation process is merely an inevitable by-product of a vibrant civil society deliberating on the proposed reform agenda. Civil society's proverbial autonomy adds political legitimacy and credibility to the government's decision to accept delay, disappointing powerful interest groups pressing for fast reforms. Clearly, other institutional mechanisms, such as formal procedural rules, could also slow the pace of reform. However, for a politician facing major pressure from powerful interest groups, the involvement of an independent civil society provides a productive, politically valuable mechanism of changing the speed of reform processes.

Civil society naturally increases the amount of deliberation within the political process. To those advocating deliberative democracy, this is a positive, but it is clear that the effect of deliberation is ambiguous in general (Przeworski 1998, Stokes 1998, Drazen and Isard 2006). We abstract from the effects of deliberation itself, choosing to undertake a *ceteris paribus* analysis of the effect of delay. A fuller analysis, beyond the scope of this paper, would incorporate the effects of delay and deliberation into a single analytical model.

Importantly, in our characterization, civil society does not hold a direct stake in the outcome of reform. Instead, civil society's interest in the reform process arises from the elevation in its prestige or ideological pursuit of the "pluralism that allows individual groups

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<sup>9</sup> See Drazen (2000, Chapter 10) for literature review and discussion about sources of delay in reform processes.

to exist" (Ndegwa 1996, p.6). This assumption allows us to draw a clear analytical separation between two associational realms, one dominated by aggressive lobbying interests and self-interested politicians, and the other consisting of grassroots movements, religious groups, public interest organizations, and professional groups comparatively less entangled in the web of active politics.<sup>10</sup> The assumption is necessary in understanding the specific effect on institutional outcomes of the latter types of groups, which are central in all characterizations of civil society.

Suppressing civil society is feasible but costly for the politician. The politician may exclude civil society at a cost of  $c\lambda$ , where  $c \geq 0$  reflects the political strength of civil society.<sup>11</sup> Among many other things (Hadenius and Ugglä 1996; Robinson and Friedman 2005), this strength depends on foreign aid purposefully aimed at relevant groups. Aid, then, makes it costlier for a politician to exclude civil society from reform processes.

### *3.6. The Timeline*

There is a single reform process beginning when A takes office. The reform process can last two periods, A's initial incumbency and the following time interval when either A or B forms the government. Note, however, that time preference between the two periods plays no role in our model: the effects of delay are through changes in reform outcomes not a trivial result of impatience. In both periods, interest groups decide on submission of reform proposals. The strength of civil society is exogenously determined at the outset. The decision on whether to allow civil society's participation is made at the beginning of A's incumbency and holds for the entire reform process. With no civil society involvement, there is immediate implementation of any proposed measure passed by the government and then

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<sup>10</sup> While the question of boundaries between "political society" and "civil society" has been discussed in the literature separation between the two for analytical purposes is common (see e.g. Arato 1994, p.6). Carothers and Ottaway (2000, p. 10) argue that "[the] donors have chosen to consider civil and political society as separate realms...because doing so helps defend the claim that it is possible to support democracy without becoming involved in partisan politics or otherwise interfering unduly in the domestic politics of another country."

the reform process ends. If civil society participates, the reform program is debated until the second period. Then, if A remains in office, the reforms submitted in the first period are implemented. If B takes over,  $\alpha$  is no longer empowered and drops out of the lobbying game, but the lobbying arena opens for  $\beta$ . However, any of  $\beta$ 's proposals submitted in the second period that differ from the ones submitted by  $\alpha$  in the first are subject to public debate and delayed beyond the end of the reform process. Figure 1 summarizes the timeline.

#### 4. Civil Society and Institutional Outcomes: Basic Results

We now summarize the logic of how civil society affects institution-building. (We relegate to an appendix many details of the analysis proving that statements made in the text are correct.) The results appear in Figures 2, 3, and 4 showing how the effect of civil society depends on the level of democracy, the degree of political stability, and, crucially, whether the empowered interest group is aligned with society. This section abstracts from the issue of how aid affects outcomes, to which we return in Section 5.

In the first period, the incumbent, A, considers reform proposals only from  $\alpha$ , the empowered interest group. The politician cannot recognize reform types when they are submitted: there is the possibility of adverse selection. We make standard assumptions that appear in adverse selection models, implying a focus on a scenario where without a screening mechanism some reforms always take place, with the possible effect of civil society being a change in the quality of reforms.<sup>12</sup> Without civil society, reforms occur if and only if:

$$\frac{1}{3}\{\lambda W_1 + (1-\lambda)\Psi_{\alpha A}\} + \frac{1}{3}\{\lambda W_2 + (1-\lambda)\Psi_{\alpha A}\} + \frac{1}{3}\{\lambda W_3 + (1-\lambda)\Psi_{\alpha A}\} > 0,$$

which is the condition that ensures that A implements any reform proposed by  $\alpha$ .<sup>13</sup>

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<sup>11</sup> This simple functional form is chosen for ease of exposition. All of the qualitative features of results carry over when, e.g., the costs of excluding civil society are constant, independent of democracy, or when they are an increasing function of  $\lambda$  and the first derivative with respect to  $\lambda$  increases with the civil society's entrenchment.

<sup>12</sup> Dewatripont and Maskin (1995) and Qian (1994), for example, restrict their analysis to an analogous sub-set of equilibria.

<sup>13</sup> Rearranging, observe, first, that  $\lambda(W_1+W_2+W_3) + (1-\lambda)3\Psi_{\alpha A} > 0$  with symmetry between reforms 2 and 4, and 3 and 5, implies that any politician in power accepts any reform. Second, note that we impose no assumption about the sign of  $W_1+W_2+W_3$ . Clearly, if  $W_1+W_2+W_3 > 0$ , then A approves all reforms for any  $\lambda \in (0,1)$ . If in contrast  $W_1+W_2+W_3 < 0$ , A approves all reforms if and only if  $\lambda < \Psi_{\alpha A} / [\Psi_{\alpha A} - \frac{1}{3}(W_1+W_2+W_3)] < 1$ . The results of the model do not depend on the sign of

#### 4.1. Equilibrium without Civil Society

Without civil society and with A in power,  $\beta$  never lobbies, while  $\alpha$  lobbies for reforms 1, 2 and 3. A implements the entire proposed reform program in the first period, ending the reform process. Thus, without civil society involvement, the proposed reforms 1, 2, and 3 are all implemented immediately and with certainty. Denote by  $W^-$  social welfare when there is no civil society involvement. Hence,

$$W^- = W_1 + W_2 + W_3.$$

Similarly, let  $V^-$  be politician A's payoff when there is no civil society. Then,

$$V^- = \lambda(W_1 + W_2 + W_3) + (1 - \lambda)3\Psi_{\alpha A} > 0.$$

#### 4.2. Equilibrium with Civil Society

Denote by  $W^+$  expected social welfare when civil society is involved in the reform process. With the presence of civil society, Pareto-improving reform 1 is implemented with certainty if  $\alpha$  lobbies for it in the first period, which  $\alpha$  does. (See the Appendix for proof of all such statements.) In contrast, the redistributive reforms 2 and 3 are implemented only if A stays in power throughout a reform process prolonged by civil society's deliberation.

Consequently, redistributive reform  $j \in \{2, 3\}$  is put on the agenda only when  $\alpha$ 's expected benefit of doing so ( $pB_{\alpha j}$ ) outweighs the cost ( $\Psi_{\alpha A}$ ). Thus, in the first period  $\alpha$  lobbies for reforms 2 and 3 if  $p > \Psi_{\alpha A}/B_{\alpha 2}$  and  $p > \Psi_{\alpha A}/B_{\alpha 3}$ , respectively.  $\beta$  does not lobby for any of the reforms in the first period. In the second period,  $\beta$  lobbies for reform 1 if politician B is in power.  $\alpha$  does not lobby for any reform in the second period, regardless of which politician is in power. A implements all of  $\alpha$ 's proposals.

Then, expected social welfare with civil society involvement is:

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$W_1 + W_2 + W_3$  as long as  $\lambda(W_1 + W_2 + W_3) + (1 - \lambda)3\Psi_{\alpha A} > 0$  holds. All diagrams summarizing the results are thus without any loss of generality drawn for the case when  $W_1 + W_2 + W_3 > 0$ .



$$W^+ = \begin{cases} W_1 & \text{when } p < \Psi_{\alpha A}/B_{\alpha 3}, \\ W_1 + pW_3 & \text{when } \Psi_{\alpha A}/B_{\alpha 3} < p < \Psi_{\alpha A}/B_{\alpha 2}, \\ W_1 + p(W_2 + W_3) & \text{when } p > \Psi_{\alpha A}/B_{\alpha 2} \end{cases}$$

Figures 2, 3, and 4 summarize the effect of civil society on social welfare by presenting the relationship between  $W^-$  and  $W^+$  under three different scenarios. These scenarios differ in terms of the size and sign of the aggregate welfare impact of a redistributive package comprising reforms 2 and 3,  $W_2 + W_3$ . Variations in  $W_2 + W_3$  naturally capture different degrees of alignment between the objectives of the empowered interest group ( $\alpha$ ) and the welfare of society.

The first scenario is when  $W_2 + W_3 < 0$ , which we refer to as *misalignment*, in which the society's adverse selection problems are clear. The second is for values of  $W_2 + W_3$  that are positive but small. For these values, there is *weak alignment* between the empowered interests and society, but there is still an adverse selection problem that civil society can solve:  $(-W_2)$  and  $W_3$  are sufficiently close in magnitude that losing reform 3 is worth risking in order to be sure of avoiding the loss entailed in reform 2.<sup>14</sup> In the third scenario, covering the largest values of  $W_2 + W_3$ , there is *strong alignment*. The benefits from reform 3 clearly dominate the losses from reform 2 and therefore the risk of losing reform 3 is not worth taking: there is no adverse selection problem that civil society can solve.

The effect of civil society depends crucially on the types of interest groups present in the polity. When the empowered interest group is misaligned with society ( $W_2 + W_3 < 0$ ), civil society's participation always raises social welfare (Figure 2). In contrast, with alignment ( $W_2 + W_3 > 0$ ) civil society's participation often reduces social welfare. This is always the case for strong alignment (Figure 4), but also holds under weak alignment for all but intermediate levels of political instability (Figure 3).

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<sup>14</sup> The exact statement of these three scenarios is given in the Appendix.

Contrary to many claims in the literature, therefore, civil society's participation can sometimes be disadvantageous to society. When the agenda of the empowered interests is aligned with society's aims, civil society participation is usually detrimental. The redistributive package proposed by  $\alpha$ , although not first-best, improves upon the status quo. When there is strong alignment, any mechanism that decreases the chances of implementing the empowered group's favorite package is undesirable.

From the social welfare perspective, the advisability of including civil society in the reform process depends on the configuration of interest groups, that is, the degree of alignment, and levels of democracy and political stability. This is hardly surprising—a simple change in the structure of the political process, such as the inclusion of civil society, is unlikely to be Pareto improving under all circumstances. However, this observation is a crucial one, since it exhibits the importance of using a clear conceptual framework to interpret the effects of civil society. Without a clear conceptual framework, a general result on the importance of alignment of interests groups and society would not suggest itself. Without a systematic analysis that gives civil society a precise role, there is little to suggest that levels of democracy and stability affect when civil society involvement is desirable and when it is not.

#### *4.3. Endorsing or Excluding Civil Society*

The possible contribution of civil society identified above is only a potential one, contingent on whether the politician decides to allow civil society to participate.  $V^+$ , politician A's expected payoff with civil society's involvement, is:

$$V^+ = \begin{cases} \lambda W_1 + (1-\lambda)\Psi_{\alpha A} & \text{when } p < \Psi_{\alpha A}/B_{\alpha 3}, \\ \lambda(W_1 + pW_3) + (1-\lambda)2\Psi_{\alpha A} & \text{when } \Psi_{\alpha A}/B_{\alpha 3} < p < \Psi_{\alpha A}/B_{\alpha 2}, \\ \lambda(W_1 + p(W_2 + W_3)) + (1-\lambda)3\Psi_{\alpha A} & \text{when } p > \Psi_{\alpha A}/B_{\alpha 2}. \end{cases}$$

Recall that the cost to the politician of excluding civil society is  $c\lambda$ ,  $c \geq 0$ . Then, the politician chooses to exclude civil society when  $V^+ > V^- - c\lambda$ . In the remainder of this section, we set  $c$  to zero to simplify the exposition and highlight how alignment, democracy ( $\lambda$ ) and political stability ( $p$ ) affect the politician's incentives to endorse or suppress civil society's involvement. We examine how the size of  $c$  matters when we analyze the effect of civil society aid in Section 5. The politician's decisions on whether to exclude or to endorse civil society are summarized in Figures 2, 3 and 4.

With the empowered interests misaligned (Figure 2), the politician endorses civil society at high levels of either democracy or stability or both. At lower levels of either democracy or stability, they effectively become substitutes. The politician endorses civil society's involvement in an unstable environment only at high levels of democracy. When there is political stability, however, civil society's involvement is attractive to the politician even at lower levels of democracy.

When there is misalignment, political objectives and social welfare considerations are often at odds: there is a considerable range of the parameters where the politician will not choose the optimal arrangement for society. When either democracy or stability is low the short term benefits of lobbying fees outweigh the politician's longer-term gain from civil society's improving the quality of reforms. When there is misalignment civil society can always positively contribute to the reform process by solving adverse selection problems, but this contribution is only valued by the politician in stable, democratic regimes.

With empowered groups aligned, there is a much wider set of the parameters in which the politician chooses the optimal arrangement for society. Because the reforms proposed by

interest groups are better for society than the status quo, for many levels of democracy and stability, civil society has little to contribute to reform processes. Only when civil society can solve the adverse selection problem—in the middle ranges of stability when there is weak alignment (Figure 3)—is there a socially inefficient political decision, and then only if democracy is low. When there is strong alignment between interest groups and society (Figure 4), there is also alignment between the decisions of the politician and the socially optimal choice on civil society—that is, excluding civil society from the deliberative process because its presence aggravates adverse selection problems.

## 5. Fostering Civil Society: The Impact of Civil Society Aid on Institutional Outcomes

Aid matters when it induces the politician to endorse civil society where it was excluded before. The cost to the politician of excluding civil society equals  $c\lambda$ ,  $c \geq 0$ . Aid increases this cost by increasing  $c$ , say from 0 to some  $c_{\text{AID}} > 0$ .<sup>15</sup> Let  $\Delta$  denote the change in social welfare following this change in  $c$ . Without civil society aid, social welfare equals  $W^+$  if  $V^+ > V^-$ , and  $W^-$  if  $V^+ < V^-$ . Social welfare with civil society aid equals  $W^+$  if  $V^+ > V^- - c_{\text{AID}}\lambda$ , and  $W^-$  if  $V^+ < V^- - c_{\text{AID}}\lambda$ . The resulting values of  $\Delta$ , which vary greatly with democracy, stability, and alignment, are depicted in Figures 5, 6, and 7.<sup>16</sup>

A first observation is that civil society aid can indeed be a means of promoting productive institutional change. Even given our very limited conception of what civil society can do, there are many circumstances where aid has a strongly positive effect. However, civil society participation can decrease social welfare: then using aid to encourage a politician to

<sup>15</sup> We do not elaborate on how a certain monetary amount of aid translates into an increase in  $c$ . Studies show that foreign aid exhibits non-linear and possibly decreasing returns. See Harms and Lutz (2004) for references.

By imposing these assumptions and treating  $c_{\text{AID}}$  as exogenous, we bypass important considerations regarding the internal structure of civil society that in turn determine whether and how aid affects the civil society's political power. How exactly donors' involvement affects the strength of civil society and what organizational structures of civil society organizations (at both micro and macro level) are most conducive to a vibrant civil society contributing to good governance are in themselves immensely important questions. See e.g. Hadenius and Ugglä (1996) and Edwards and Hulme (1996) for illuminating discussion.

<sup>16</sup> For a given degree of alignment of the empowered groups and the society, different amounts of aid are needed at different combinations of democracy and stability to change the politician's decision on civil society (and hence affect social welfare). However, in all configurations of alignment, for any  $c_{\text{AID}} > 0$  there is at least one combination of democracy and stability

include civil society worsens institutional outcomes. This negative effect is possible only when empowered interests are aligned. When alignment is weak, the negative effects of aid arise when there are high levels of democracy combined with instability, or when there is great stability (Figure 6). When alignment is strong, aiding civil society is always ill-founded and often harmful (Figure 7). In great contrast, when there is misalignment, aiding civil society is, at worst, ineffective, but sometimes can be productive (Figure 5).

These observations make it clear that the effects of aid are deeply dependent on the circumstances of a country. When aid would be productive in a society with misalignment, it could be harmful when there is weak or strong alignment. Under some circumstances aid is beneficial at higher levels of democracy. In other circumstances an increase in democracy would mean that aid becomes harmful. Thus, to be sure of success, aid would have to be administered selectively, with an understanding of the intricacies of local politics.

## **6. Implications for Policies on Aid to Civil Society**

We have shown that alignment is a particularly critical factor in determining the effectiveness of civil society aid, since when misalignment turns to alignment, civil society involvement changes from a mechanism to solve adverse selection problems to one that exacerbates these problems. Hence, by identifying the characteristics of economies where strong alignment, or its opposite, occurs and relating those characteristics to the model's structure, useful extensions of the above results are obtained.

Strong alignment exists when the empowered interest group is able to propose reforms that confer large benefits on the group itself while imposing little harm on others. This is most likely when a society is far from the institutional possibility frontier, when interest groups have license to propose alternatives to existing arrangements, and when the society has the capacity to design feasible effective reforms. Such circumstances provide the

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where aid does change the politician's decision. Similarly, in all configurations of alignment,  $c_{AID}$  at low levels will be ineffective in at least one combination of democracy and stability. See the Appendix for proof of these statements.

opportunity for Naim's (1994) Stage-I reforms, ones that are not technically difficult to design, have immediate widespread benefits, and share costs broadly. These include tax reform, deregulation, and reform of arrangements for foreign investment.

Stage-I reforms, and hence strong alignment, arise in new democracies established after a civil war, or repressive occupation by another power, or a period of poorly functioning autocracy (Naim 1994). The old regime bestows the inefficient arrangements and the new regime gives an opportunity to question them. Strong alignment is therefore more likely when institutions are weak, that is, where there are many Stage-I reforms that can be pursued.

By the same reasoning, misalignment is more likely where institutional reforms have advanced beyond Stage-I, when arrangements have reached a level of maturity after a period of comparatively easy reform. Interest group politics then become a zero-sum game, or worse. Thus, misalignment is more likely the stronger are existing institutions. Then the society confronts Naim's Stage-II reforms, where the benefits are longer-term and harder to discern, while the costs are narrowly confined to specific groups. Examples are reform of the judiciary, complex privatizations, and labor laws.

The above observations, together with the results of our model, suggest a disturbing paradox. Civil society aid aimed at improving institutions will be most effective where institutions are already well functioning. Civil society aid is ineffective, and sometimes counter-productive, when a society has poorly functioning institutions. Indeed, the negative effect of aid under strong alignment is most likely to be severe when democracy or stability is high. That is, aid will be particularly counter-productive in exactly those situations that would, at first glance, seem most hopeful—a society exhibiting benign political preconditions with much scope for improving institutions.

The paradox becomes more acute after reflection on the role that advocates bestow on civil society. Within an institutional development strategy based on by-passing government,

strengthening civil society is seen as a first step in making aid more effective by helping to generate better institutions (Howell and Pearce 2001, p. 92). But our analysis suggests that such logic is faulty: where institutions are poor, civil society aid has a detrimental effect.<sup>17</sup> Aiding civil society in the hope of building better institutions entails exactly the same Gordian knot as elsewhere: it does not offer any escape from the tragedy that aid is often least effective where it is most needed.

More generally, our results lend general support to the view that foreign aid works only if channeled into the right environment. This selectivity argument has been advanced in the literature on the relationship between foreign aid and economic growth (Burnside and Dollar 2000, 2004), quality of life (Kosack 2003), and the success or failure of adjustment programs (Dollar and Svensson 2000). We show that it also applies to the much less studied relationship between aid and institutions (see e.g. Shirley 2005 and Moss et al. 2006). But this particular relationship is crucially important given the large role now attributed to institutions in development and because well functioning institutions are thought to be crucial to the effectiveness of foreign aid in general.<sup>18</sup>

Our results go well beyond showing the need for selectivity. There are enough regularities to indicate some rules of thumb. For example, when the empowered interest groups are misaligned, civil society aid is often productive and never harmful. That is, civil society aid is likely to work better where interests are highly divergent. If the degree of alignment is unknown then aid is most likely to be productive in the mid-ranges of political stability and democracy. Aid can be harmful only if either stability or democracy is high.

Given the need for selectivity, there is no surprise in finding disappointing experience from the widespread civil society assistance to developing and transition countries (Carothers

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<sup>17</sup> That aid can have negative effects on institutions is known (Moss et al. 2006). However we show that this effect is most likely when institutions are already poor and when civil society is the focus of the aid. In our model, when aid worsens institutions, it does so not because of ex post moral hazard in government (see e.g. Moss et al. 2006), but rather because civil society aid aggravates the adverse selection problem in the reform-implementation process.

2004, Ottaway and Carothers 2000, Robinson and Friedman 2005). Our findings suggest aid will work only under a limited set of political conditions: searching for widespread success inevitably results in disappointment. Nevertheless, to the extent that civil society was given to countries marked by political instability and low levels of democracy, it is unlikely to have caused harm.

## **7. Conclusion**

The immediately preceding comments, and all the results in this paper, are conditional on the way in which we have modeled civil society. We highlighted a core feature of civil society's interaction with the political system, which is always present when institutional building is the concern. We did not assume that civil society has superior knowledge of citizens' circumstances, which would be tendentious. We did not assume that civil society acts in the public interest, because we do not see any practical mechanism that makes this reliably so. We did not assume that civil society has greater power to convince politicians than lobbyists, since partisan interest groups have comparative advantage in this respect. Rather, we simply assumed that the single, direct aim of civil society groups is to open up political debate. The status of civil society, possibly enhanced by foreign aid, is what allows it to achieve this aim, in particular when politicians would have excluded civil society had it been weak.

In casting our analysis in this way, we claim only to offer one acceptable model that captures a core aspect of how civil society affects institutional development. We certainly do not contend that our approach is definitive. Nevertheless, building a model constitutes a significant step because there has been no previous purposeful analytical attempt to address the questions of 'why and when' fostering civil society improves institution building. Hence, our approach contrasts greatly with the existing literature in providing a transparent analysis

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<sup>18</sup> Drazen (1999) provides a theoretical argument on this latter point.



of the relationships between core variables discussed in that literature. Such analysis is crucial in addressing the selection of the time and place to aid civil society. Given the limitations of our model, there remains much to accomplish in the analysis of how civil society affects political and economic outcomes. For example, the question of 'who' should be aided in the plethora of heterogeneous civil society groups is an important one that we leave for further research.

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## **Appendix**

The presentation in the text whenever possible avoids resorting to algebraic description of results or including any detailed derivation of them. This Appendix, in contrast, provides all the details necessary for a reader to understand all statements made in the text and all relationships depicted in the Figures. The presentation of the logic and algebra follows the presentation in the text.

### **The reform programs proposed and implemented with and without civil society**

Recall that A is in power in the first period, hence only  $\alpha$  is eligible for lobbying in the first period. Note also that

$$\frac{1}{3}\{\lambda W_1 + (1-\lambda)\Psi_{\alpha A}\} + \frac{1}{3}\{\lambda W_2 + (1-\lambda)\Psi_{\alpha A}\} + \frac{1}{3}\{\lambda W_3 + (1-\lambda)\Psi_{\alpha A}\} > 0 \Leftrightarrow$$

$\lambda(W_1 + W_2 + W_3) + (1-\lambda)3\Psi_{\alpha A} > 0$  implies A accepts any reform proposals. Therefore, without civil society involved in the reform process,  $\alpha$  lobbies for reforms 1, 2 and 3 and A implements them immediately, closing the reform process.

Now assume that civil society is included in the reform process. Consider first Reform 1 which is of interest to both  $\alpha$  and  $\beta$ . The following scenarios are possible in the second period:

1. If  $\alpha$  lobbied for reform 1 in the first period and A is in power in the second period, then  $\alpha$  does not have to lobby A again since reform 1 has already been subject to public debate and will be implemented anyway.
2. If  $\alpha$  lobbied for reform 1 in the first period and B is in power in the second period, then it pays for  $\beta$  to lobby B for reform 1 since reform 1 was already under civil society's scrutiny in the first period. Another submission, albeit by a different interest group and to a different politician, will not result in further delay but rather in immediate implementation, since the process of civil society deliberation has already occurred.
3. If  $\alpha$  did not lobby for reform 1 in the first period and politician A is in power in the second period, then  $\alpha$  will not lobby A in the second period since any attempt of implementation would be delayed beyond the second period.
4. If  $\alpha$  did not lobby in the first period and politician B is in power in the second period, then  $\beta$  will not lobby since the reform will be under scrutiny of civil society and hence the implementation will be delayed beyond the second period.

In the first period, A is in power. If  $\alpha$  lobbies A for reform 1,  $\alpha$ 's terminal payoff from reform 1 equals  $pB_{\alpha 1} + (1-p)B_{\alpha 1} - \Psi_{\alpha A} = B_{\alpha 1} - \Psi_{\alpha A} > 0$ . If  $\alpha$  does not lobby A in the first period, its expected payoff is zero. Therefore, in the equilibrium,  $\alpha$  lobbies in the first period (and  $\beta$  of course does not). In the second period, neither  $\beta$  nor  $\alpha$  lobby if A stays in power; if B comes to power,  $\alpha$  does not lobby and  $\beta$  does. Thus, regardless of who is in power in the second period, reform 1 is always implemented.

Consider now reforms 2 and 3.  $\beta$  will never want to lobby for  $j \in \{2, 3\}$ , since  $B_{\beta j} < 0$  for  $j \in \{2, 3\}$ . The following scenarios are possible at the beginning of the second period, depending on whether  $\alpha$  chose to lobby for reform  $j \in \{2, 3\}$  in the first period or not and whether A or B is in power in the second period:

1. If  $\alpha$  lobbied for  $j \in \{2, 3\}$  in the first period and A is in power in the second period, then lobbying A again is not needed anymore. Reform  $j \in \{2, 3\}$  has already been subject to public debate initiated by the civil society and is thus implemented.
2. If  $\alpha$  lobbied for  $j \in \{2, 3\}$  in the first period and B is in power in the second period, then  $\alpha$  clearly does not lobby and reform  $j \in \{2, 3\}$  is not implemented.

3. If  $\alpha$  did not lobby for  $j \in \{2,3\}$  in the first period and politician A is in power in the second period,  $\alpha$  does not lobby: civil society's deliberation would delay implementation beyond the second period.
4. If  $\alpha$  did not lobby for  $j \in \{2,3\}$  in the first period and politician B is in power in the second period, then  $\alpha$  clearly does not lobby and reform  $j \in \{2,3\}$  is not implemented.

Thus, if  $\alpha$  chooses to lobby for  $j \in \{2,3\}$  in the first period, its terminal payoff is  $pB_{\alpha j} + (1-p)0 - \Psi_{\alpha A} = pB_{\alpha j} - \Psi_{\alpha A}$ . If  $\alpha$  chooses not to lobby for  $j \in \{2,3\}$  in the first period, its terminal payoff is 0. Therefore,  $\alpha$  chooses to lobby for  $j \in \{2,3\}$  in period 1 if  $p > \Psi_{\alpha A}/B_{\alpha j}$ .

Finally, consider reforms 4 and 5.  $\alpha$  will never lobby for  $j \in \{4,5\}$ , since  $B_{\alpha j} < 0$  for  $j \in \{4,5\}$ . Because A is in power in the first period,  $\beta$  could potentially lobby for  $j \in \{4,5\}$  only in the second period if B came to power. Yet even in the latter scenario implementation of  $j \in \{4,5\}$  would be delayed beyond the second period since it would have to be subject to civil society's scrutiny. Thus, neither  $\alpha$  nor  $\beta$  will ever lobby for  $j \in \{4,5\}$ .

### **The effects of civil society on social welfare summarized in Figures 2, 3 and 4.**

Recall that  $W^- = W_1 + W_2 + W_3$  and that A implements all reform programs. The comparison of social welfare with civil society ( $W^+$ ) to social welfare without civil society ( $W^-$ ) then proceeds as follows:

If  $p < \Psi_{\alpha A}/B_{\alpha 3}$ ,  $\alpha$  lobbies A for reform 1 in the first period, so  $W^+ = W_1$ .

- When  $W_2 + W_3 < 0$ ,  $W^+ > W^-$ .
- When  $W_2 + W_3 > 0$ , in contrast,  $W^+ < W^-$ .

If  $\Psi_{\alpha A}/B_{\alpha 3} < p < \Psi_{\alpha A}/B_{\alpha 2}$ ,  $\alpha$  lobbies A for reforms 1 and 3 in the first period, so  $W^+ = W_1 + pW_3$ .

- When  $W_2 + W_3 < 0$ ,  $W^+ > W^-$ .
- When  $W_2 + W_3 > 0$ ,  $W^+ > W^-$  if and only if  $[-W_2 - (1-p)W_3] > 0$ . The benefit of solving the adverse selection problem lies in preventing the passage of reform 2, the value of which is  $-W_2$ . The cost of solving the adverse selection problem using civil society is delaying reform 3, an expected value equal to  $(1-p)W_3$ . Therefore when  $[-W_2 - (1-p)W_3] > 0$  for all  $p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2})$ , there is an adverse selection problem that civil society can solve for all  $p$  in this range. Figure 3 is drawn for this case. Note, however, that  $[-W_2 - (1-p)W_3]$  may be positive only for some subset of  $\{p: p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2})\}$ . Then, the region in Figure 3 in which  $W^+ > W^-$  would shrink accordingly, without any changes in the central conclusions of our analysis. In contrast, when  $W_2 + W_3 > 0$  and  $[-W_2 - (1-p)W_3] < 0$  for all  $p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2})$ ,  $W^+ < W^-$  for all  $p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2})$ . In the text, the figures, and the remainder of the analysis in this Appendix, we refer to the case when  $W_2 + W_3 > 0$  and  $[-W_2 - (1-p)W_3] > 0$  for  $p > \Psi_{\alpha A}/B_{\alpha 3}$  in shorthand as ' $W_2 + W_3 > 0$  small', which we interpret as *weak alignment* between the empowered interests and the society. Analogously, we refer to the case when  $W_2 + W_3 > 0$  and  $[-W_2 - (1-p)W_3] < 0$  for  $p < \Psi_{\alpha A}/B_{\alpha 2}$  as ' $W_2 + W_3 > 0$  large', which we interpret as *strong alignment* between the empowered interests and the society.

If  $p > \Psi_{\alpha A}/B_{\alpha 2}$ ,  $\alpha$  lobbies A for reforms 1, 2 and 3 in the first period, so  $W^+ = W_1 + p(W_2 + W_3)$ .

- When  $W_2 + W_3 < 0$ ,  $W^+ > W^-$ .
- When  $W_2 + W_3 > 0$ , in contrast,  $W^+ < W^-$ .



**The effects of civil society on the politician's welfare summarized in Figures 2, 3 and 4.**

Recall first that without civil society  $V^- = \lambda(W_1 + W_2 + W_3) + (1-\lambda)3\Psi_{\alpha A}$ , which is positive because  $\frac{1}{3}\{\lambda W_1 + (1-\lambda)\Psi_{\alpha A}\} + \frac{1}{3}\{\lambda W_2 + (1-\lambda)\Psi_{\alpha A}\} + \frac{1}{3}\{\lambda W_3 + (1-\lambda)\Psi_{\alpha A}\} > 0$ .

The comparison of the politician's payoff with civil society ( $V^+$ ) to the payoff when civil society is excluded ( $V^-$ ) proceeds by examining different values of  $p \in (0,1)$ .

(1) Suppose  $p < \Psi_{\alpha A}/B_{\alpha 3}$ . Then  $\alpha$  lobbies A for reform 1 in the first period and  $V^+ = \lambda W_1 + (1-\lambda)\Psi_{\alpha A} > 0$ . Define  $\lambda^*$  s.t.  $V^+(\lambda^*) = V^-(\lambda^*)$ . Then,  $\lambda^* = 2\Psi_{\alpha A}/(2\Psi_{\alpha A} - (W_2 + W_3))$ .

- When  $W_2 + W_3 < 0$ ,  $\lambda^* \in (0,1)$  and thus  $V^+ > (<) V^-$  iff  $\lambda > (<) \lambda^*$ .
- When  $W_2 + W_3 > 0$ ,  $\lambda^* \notin (0,1)$  and thus  $V^+ < V^-$  for all  $\lambda \in (0,1)$ .

(2) Suppose  $\Psi_{\alpha A}/B_{\alpha 3} < p < \Psi_{\alpha A}/B_{\alpha 2}$ . Then,  $\alpha$  lobbies A for reforms 1 and 3 in the first period and  $V^+ = \lambda(W_1 + pW_3) + (1-\lambda)2\Psi_{\alpha A} > 0$ .

Then  $V^+ > (<) V^-$  iff  $\lambda(pW_3 - (W_2 + W_3) + \Psi_{\alpha A}) > (<) \Psi_{\alpha A}$ .

For a given  $p$ , there exists a  $\lambda^{**} = \Psi_{\alpha A}/(pW_3 - (W_2 + W_3) + \Psi_{\alpha A} + c)$  s.t.  $V^+(\lambda^{**}) = V^-(\lambda^{**})$  with the following characteristics:

- When  $W_2 + W_3 < 0$ ,  $\lambda^{**} \in (0,1)$  and  $V^+ > (<) V^-$  iff  $\lambda > (<) \lambda^{**}$ .
- When  $W_2 + W_3 > 0$ , however, whether  $\lambda^{**}$  lies in the interval  $(0,1)$  or not depends on the size of  $W_2 + W_3$ . When  $W_2 + W_3 > 0$  is small (i.e.  $[-W_2 - (1-p)W_3] > 0$  for  $\Psi_{\alpha A}/B_{\alpha 3} < p$ ),  $\lambda^{**} \in (0,1)$  and  $V^+ > (<) V^-$  iff  $\lambda > (<) \lambda^{**}$ .
- When  $W_2 + W_3 > 0$  is large (i.e.  $[-W_2 - (1-p)W_3] < 0$  for  $p < \Psi_{\alpha A}/B_{\alpha 2}$ ),  $\lambda^{**} > 1$  and  $V^+ < V^-$  for all  $p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2})$ .

(3) Suppose  $p > \Psi_{\alpha A}/B_{\alpha 2}$ . Then  $\alpha$  lobbies A for reforms 1, 2 and 3 in the first period and  $V^+ = \lambda[W_1 + p(W_2 + W_3)] + (1-\lambda)3\Psi_{\alpha A} > 0$ .

Then,  $V^+ > (<) V^-$  iff  $p(W_2 + W_3) > (<) (W_2 + W_3)$ .

- When  $W_2 + W_3 < 0$ ,  $V^+ > V^-$  always.
- When  $W_2 + W_3 > 0$ ,  $V^+ < V^-$  always.

Finally, to draw figures 2 and 3 note that  $\lambda^*$  and  $\lambda^{**}$  may be interpreted as borders that separate the relevant segments of the  $(\lambda, p)$  space into regions where the politician prefers to endorse civil society ( $V^+ > V^-$ ) and regions where the politician chooses to exclude civil society ( $V^+ < V^-$ ).

The following easily verifiable features explain the shapes and positions of  $\lambda^*$  and  $\lambda^{**}$ :

- (i)  $\lambda^*$  does not depend on  $p$ ,
- (ii) when  $W_2 + W_3 > 0$ ,  $\lambda^* > 1$  and thus  $V^+ < V^-$  for all  $\lambda \in (0,1)$  when  $p < \Psi_{\alpha A}/B_{\alpha 3}$ ,
- (iii)  $\lambda^{**}$  is decreasing and convex in  $p$ , and increasing in  $W_2 + W_3$ ,
- (iv) when  $W_2 + W_3 < 0$ ,  $\lambda^{**}$  intersects the  $p = \Psi_{\alpha A}/B_{\alpha 3}$  locus at  $\lambda_H = \Psi_{\alpha A}/[(\Psi_{\alpha A}/B_{\alpha 3} - 1)W_3 + |W_2| + \Psi_{\alpha A}]$  and the  $p = \Psi_{\alpha A}/B_{\alpha 2}$  locus at  $\lambda_L = \Psi_{\alpha A}/[(\Psi_{\alpha A}/B_{\alpha 2} - 1)W_3 + |W_2| + \Psi_{\alpha A}]$ , where  $0 < \lambda_L < \lambda_H < 1$
- (v) when  $W_2 + W_3 > 0$ ,  $\lambda^{**} \in (0,1)$  when  $W_2 + W_3 > 0$  is small (i.e.  $[-W_2 - (1-p)W_3] > 0$  for  $p > \Psi_{\alpha A}/B_{\alpha 3}$ ) and  $\lambda^{**} > 1$  when  $W_2 + W_3 > 0$  is large (i.e.  $[-W_2 - (1-p)W_3] < 0$  for  $p < \Psi_{\alpha A}/B_{\alpha 2}$ ).

### **Establishing the boundaries between regions in Figures 5, 6, and 7.**

$\lambda^*$ ,  $\lambda^{**}$  and  $p^{***}$  are now redefined to include the possibility that  $c>0$ :

$\lambda^*=2\Psi_{\alpha A}/(2\Psi_{\alpha A}-(W_2+W_3)+c)$ , which is defined on  $p<\Psi_{\alpha A}/B_{\alpha 3}$ ,

$\lambda^{**}=\Psi_{\alpha A}/(pW_3-(W_2+W_3)+\Psi_{\alpha A}+c)$ , which is defined on  $p\in(\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2})$ ,

$p^{***}=1-c/(W_2+W_3)$ , which is defined on  $p>\Psi_{\alpha A}/B_{\alpha 2}$ .

$\lambda^*$ ,  $\lambda^{**}$  and  $p^{***}$  form the boundaries separating the  $(p, \lambda)$  diagram into regions where the politician chooses to endorse civil society from the regions where the politician chooses to exclude civil society and appear in Figures 5, 6, and 7.

(1) Suppose  $p<\Psi_{\alpha A}/B_{\alpha 3}$ . Then, there exists a  $\lambda^*$ , as defined above, for which

$$V^+(\lambda^*)=V^-(\lambda^*)-c\lambda^*.$$

- When  $W_2+W_3<0$ ,  $\lambda^*\in(0,1)$  for any  $c\geq 0$  and thus  $V^+>(<)V^- - c\lambda$  iff  $\lambda>(<)\lambda^*$ .
- When  $W_2+W_3>0$ , however, whether  $\lambda^*\in(0,1)$  or not depends on the size of  $c$ . In principle for any  $W_2+W_3>0$ , there always exists a  $c>0$  such that  $\lambda^*\in(0,1)$  and  $V^+>(<)V^- - c\lambda$  iff  $\lambda>(<)\lambda^*$ . A necessary and sufficient condition for  $\lambda^*\in(0,1)$  is that  $W_2+W_3<c$ . If  $W_2+W_3>c$ , then  $V^+<V^- - c\lambda$  for all  $\lambda$ .

(2) Suppose  $\Psi_{\alpha A}/B_{\alpha 3}<p<\Psi_{\alpha A}/B_{\alpha 2}$ . Then, for a given  $(p, c)$ , there exists a  $\lambda^{**}$  as defined above such that  $V^+(\lambda^{**})=V^-(\lambda^{**})-c\lambda^{**}$ :

- When  $W_2+W_3<0$ ,  $\lambda^{**}\in(0,1)$  and  $V^+>(<)V^- - c\lambda$  iff  $\lambda>(<)\lambda^{**}$  for any  $c\geq 0$ .
- When  $W_2+W_3>0$ , whether  $\lambda^{**}$  lies in the interval  $(0,1)$  or not depends on the relative sizes of  $p$ ,  $c$  and  $W_2+W_3>0$ . In principle for any  $p$  and  $W_2+W_3>0$  there always exists a  $c>0$  such that  $\lambda^{**}\in(0,1)$ , and hence  $V^+>(<)V^- - c\lambda$  iff  $\lambda>(<)\lambda^{**}$ . For an arbitrary  $c>0$ , a sufficient condition for  $\lambda^{**}\in(0,1)$  for  $\{p:p\in(\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2})\}$  is that  $W_2+W_3>0$  is small (i.e.  $[-W_2-(1-p)W_3]>0$  for  $p>\Psi_{\alpha A}/B_{\alpha 3}$ ) in which case  $V^+>(<)V^-$  iff  $\lambda>(<)\lambda^{**}$ .
- When  $W_2+W_3>0$  is large (i.e.  $[-W_2-(1-p)W_3]<0$  for all  $p<\Psi_{\alpha A}/B_{\alpha 2}$ ),  $\lambda^{**}\in(0,1)$  for large  $c$ . For small  $c$ ,  $\lambda^{**}>1$  in which case  $V^+<V^- - c\lambda$  for all  $\lambda\in(0,1)$ .

(3) Suppose  $p>\Psi_{\alpha A}/B_{\alpha 2}$ . For a given  $c\geq 0$ , there exists a  $p^{***}=1-c/(W_2+W_3)$  such that

$$V^+(p^{***})=V^-(p^{***})-c\lambda.$$

- When  $W_2+W_3<0$  and  $c\geq 0$ ,  $p^{***}\geq 1$  and thus  $V^+>V^- - c\lambda$  always.
- When  $W_2+W_3>0$  and  $c>0$ ,  $p^{***}<1$  and thus  $V^+(p)>(<)V^- - c\lambda$  iff  $p>(<)p^{***}$ .  
 $p^{***}>\Psi_{\alpha A}/B_{\alpha 2}$  if and only if  $(1-\Psi_{\alpha A}/B_{\alpha 2})(W_2+W_3)>c$ .

### **The regions of Figure 5.**

Let  $U^{\text{noaid}}$  denote social welfare without civil society aid ( $c=0$ ). Then  $U^{\text{noaid}} = W^+$  if  $V^+>V^-$  and  $U^{\text{noaid}} = W^-$  if  $V^+<V^-$ . Let  $U^{\text{aid}}$  be the social welfare when the civil society has been aided:  $c = c_{\text{AID}}>0$ . Then,  $U^{\text{aid}} = W^+$  if  $V^+>V^- - c_{\text{AID}}\lambda$  and  $U^{\text{aid}} = W^-$  if  $V^+<V^- - c_{\text{AID}}\lambda$ . Define  $\Delta = U^{\text{aid}} - U^{\text{noaid}}$ . Civil society aid – an increase in  $c$  from  $c = 0$  to  $c = c_{\text{AID}}>0$  – thus affects social welfare for those combinations of  $(\lambda, p)$  where it alters the politician's choice from excluding to endorsing civil society.

Define the following sets for some  $c_{\text{AID}}>0$ ,  $p\in(0,1)$  and  $\lambda\in(0,1)$ :

$$P = \{(p, \lambda): p<\Psi_{\alpha A}/B_{\alpha 3} \text{ and } V^- - c_{\text{AID}}\lambda < V^+ < V^-\}$$

$$Q = \{(p, \lambda): p\in[\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2}) \text{ and } V^- - c_{\text{AID}}\lambda < V^+ < V^-\}$$

$$R = \{(p, \lambda): p<\Psi_{\alpha A}/B_{\alpha 2} \text{ and } V^+ < V^- - c_{\text{AID}}\lambda < V^-\}$$

$$S = \{(p, \lambda): V^+ > V^-\}$$

The sets  $P$ ,  $Q$ ,  $R$  and  $S$  are pair-wise mutually exclusive and their union is

$\{(p, \lambda): (p, \lambda)\in(0,1)\times(0,1)\}$ .  $P$ ,  $Q$ ,  $R$ , and  $S$  are always non-empty. The following

characteristics follow immediately from the definitions of the sets, the observation that  $\lambda^*$

and  $\lambda^{**}$  form the boundaries of the sets, and the characteristics of  $\lambda^*$  and  $\lambda^{**}$  derived above:

- (i)  $\Delta = 0$  for all  $(p, \lambda) \in R \cup S$ ,
- (ii)  $\Delta = -(W_2 + W_3) > 0$  for all  $(p, \lambda) \in P$ ,
- (iii)  $\Delta = pW_3 - (W_2 + W_3) > -(W_2 + W_3) > 0$  for all  $(p, \lambda) \in Q$ .

Given these characteristics and the relationships between  $V^+$  and  $V^-$  when  $c_{AID}=0$ , the following adjectives describe the characteristics of the sets:

Set	Aiding civil society is...
P	<i>Productive</i>
Q	<i>Most productive</i>
R	<i>Ineffective</i>
S	<i>Unnecessary</i>

### **The regions of Figure 6.**

Now consider the case when  $W_2 + W_3 > 0$  but small so that  $[-W_2 - (1-p)W_3] > 0$  for  $\Psi_{\alpha A}/B_{\alpha 3} < p$ . Define the following sets:

- $A = \{(p, \lambda): p < \Psi_{\alpha A}/B_{\alpha 3} \text{ and } V^- - c_{AID}\lambda < V^+ < V^-\}$
- $B = \{(p, \lambda): p < \Psi_{\alpha A}/B_{\alpha 3} \text{ and } V^+ < V^- - c_{AID}\lambda < V^-\}$
- $C = \{(p, \lambda): p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2}) \text{ and } V^+ < V^- - c_{AID}\lambda < V^-\}$
- $D = \{(p, \lambda): p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2}) \text{ and } V^- - c_{AID}\lambda < V^+ < V^-\}$
- $E = \{(p, \lambda): p \in (\Psi_{\alpha A}/B_{\alpha 3}, \Psi_{\alpha A}/B_{\alpha 2}) \text{ and } V^- - c_{AID}\lambda < V^- < V^+\}$
- $F = \{(p, \lambda): p > \Psi_{\alpha A}/B_{\alpha 2} \text{ and } V^+ < V^- - c_{AID}\lambda < V^-\}$
- $G = \{(p, \lambda): p > \Psi_{\alpha A}/B_{\alpha 2} \text{ and } V^- - c_{AID}\lambda < V^+ < V^-\}$

The sets A to G are pair-wise mutually exclusive and their union is  $\{(p, \lambda): (p, \lambda) \in (0, 1) \times (0, 1)\}$ . B, C, D, E, and G are always non-empty. A is non-empty for  $c_{AID} > W_2 + W_3$ . F is non-empty for  $c_{AID} < (1 - \Psi_{\alpha A}/B_{\alpha 2})(W_2 + W_3)$ . Thus, for a given  $c_{AID} > 0$ , at least one of A and F is the null set. Note that we chose to draw Figure 6 for  $c_{AID} > W_2 + W_3$ . The following characteristics follow immediately from the definitions of the sets, the observation that  $\lambda^*$ ,  $\lambda^{**}$ , and  $p^{***}$  form the boundaries of the sets, and the characteristics of  $\lambda^*$ ,  $\lambda^{**}$ , and  $p^{***}$  derived above:

- (i)  $\Delta = 0$  for all  $(p, \lambda) \in B \cup C \cup E \cup F$ ,
- (ii)  $\Delta = pW_3 - (W_2 + W_3) > 0$  for all  $(p, \lambda) \in D$ .
- (iii)  $\Delta = -(W_2 + W_3) < 0$  for all  $(p, \lambda) \in A$ ,
- (iv)  $\Delta = (p-1)(W_2 + W_3) < 0$  for all  $(p, \lambda) \in G$ .

Given these characteristics and the relationships between  $V^+$  and  $V^-$  when  $c_{AID}=0$ , the following adjectives describe the characteristics of the sets:

Set	Aiding civil society is...
A	<i>Ill-founded and harmful</i>
B	<i>Ill-founded, but ineffective</i>
C	<i>Unproductive</i>
D	<i>Productive</i>
E	<i>Unnecessary</i>
F	<i>Ill-founded but ineffective</i>
G	<i>Ill-founded and harmful</i>

### **The regions of Figure 7.**

The definitions of A, B, C, D, F, and G are the same as in the analysis for Figure 6. Note that, as in the case of Figure 6, we drew Figure 7 for  $c_{AID} > W_2 + W_3$ , implying that while set A is non-empty, F is empty. Because  $\lambda^*$  is increasing in  $W_2 + W_3 > 0$ , we drew region A in Figure 7 smaller than in Figure 6. In Figure 7, there is no analog to set E of Figure 6. Moreover, the analyses for set C and D are different from that in Figure 6, because, in contrast to before, now  $W^+ < W^-$  in these sets and for D, in contrast to before,  $V^+ < V^-$ . D is the region where aid changes a decision to exclude civil society to a decision to involve it in the reform process. Given the assumptions applied to Figure 7 – strong alignment – that change causes a social loss:

$$\Delta = pW_3 - (W_2 + W_3) < 0 \text{ for all } (p, \lambda) \in D.$$

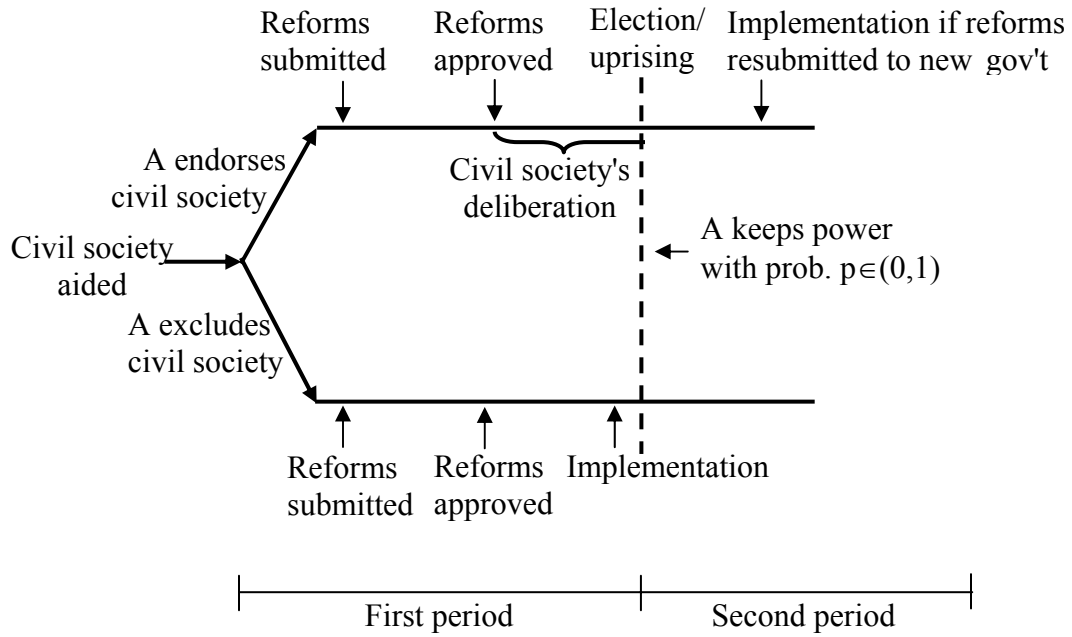
C is the region where aid is not large enough to change the decision to exclude civil society, which is fortunate since inclusion would be socially costly. Therefore, the following adjectives describe the characteristics of the sets:

Set	Aiding civil society is...
A	<i>Ill-founded and harmful</i>
B	<i>Ill-founded but ineffective</i>
C	<i>Ill-founded but ineffective</i>
D	<i>Ill-founded and harmful</i>
F	<i>Ill-founded but ineffective</i>
G	<i>Ill-founded and harmful</i>

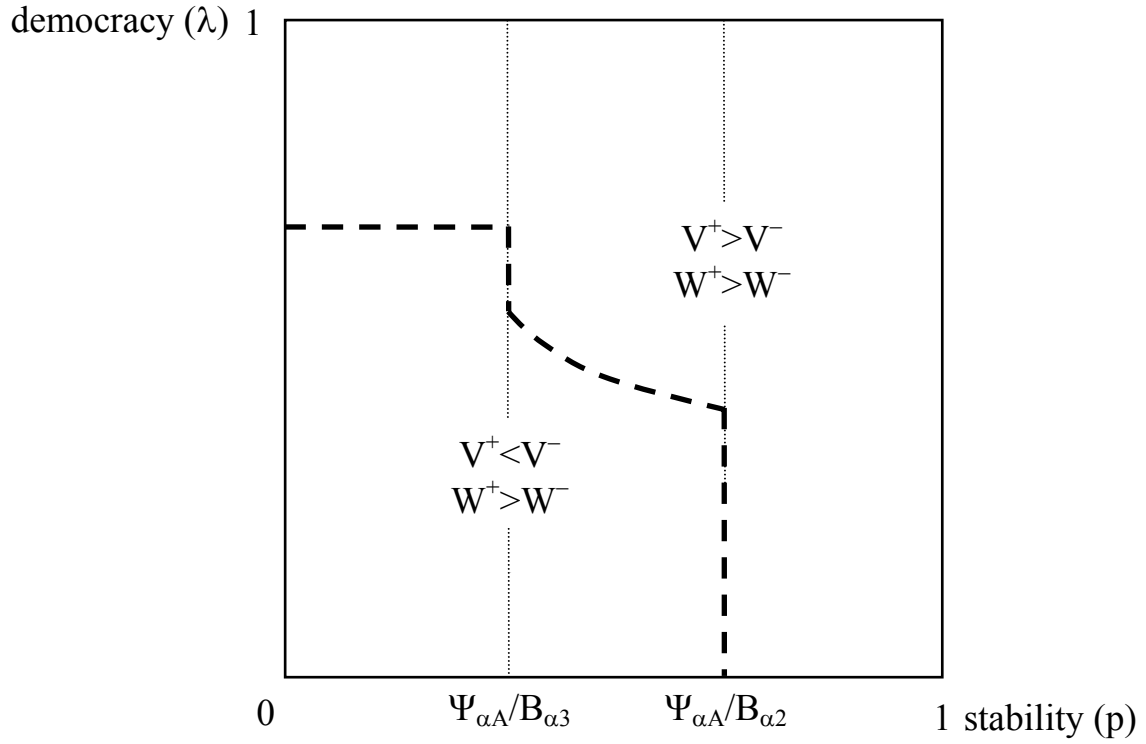
**Table 1: The Structure of Reforms**

	Interest group $\alpha$	Interest group $\beta$	Aggregate
Reform 1	$B_{\alpha 1} > 0$	$B_{\beta 1} > 0$	$B_{\alpha 1} + B_{\beta 1} > 0$
Reform 2	$B_{\alpha 2} > 0$	$B_{\beta 2} < 0$	$B_{\alpha 2} + B_{\beta 2} < 0$
Reform 3	$B_{\alpha 3} > 0$	$B_{\beta 3} < 0$	$B_{\alpha 3} + B_{\beta 3} > 0$
Reform 4	$B_{\alpha 4} < 0$	$B_{\beta 4} > 0$	$B_{\alpha 4} + B_{\beta 4} < 0$
Reform 5	$B_{\alpha 5} < 0$	$B_{\beta 5} > 0$	$B_{\alpha 5} + B_{\beta 5} > 0$
Reform 6	$B_{\alpha 6} < 0$	$B_{\beta 6} < 0$	$B_{\alpha 6} + B_{\beta 6} < 0$

**Figure 1: The Timeline**



**Figure 2: Social welfare and politician's payoff with and without civil society when the empowered interests are *misaligned* ( $W_2 + W_3 < 0$ ).**



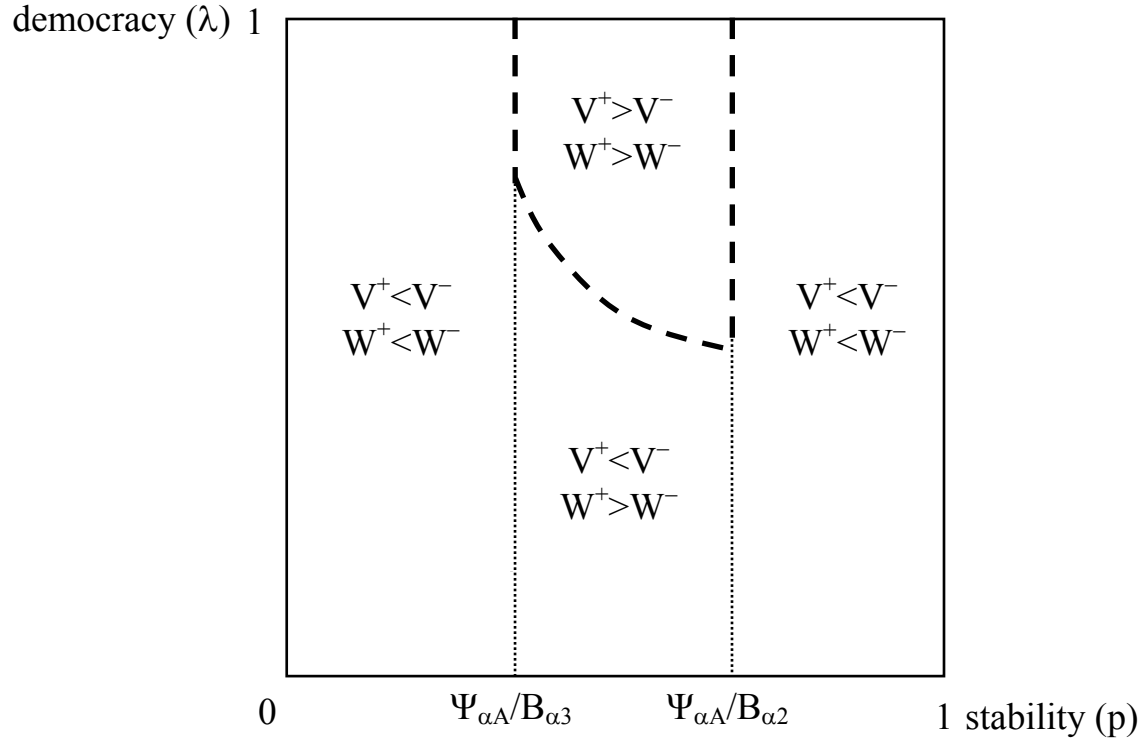
$W^+$  = social welfare with involvement of civil society

$W^-$  = social welfare without involvement of civil society

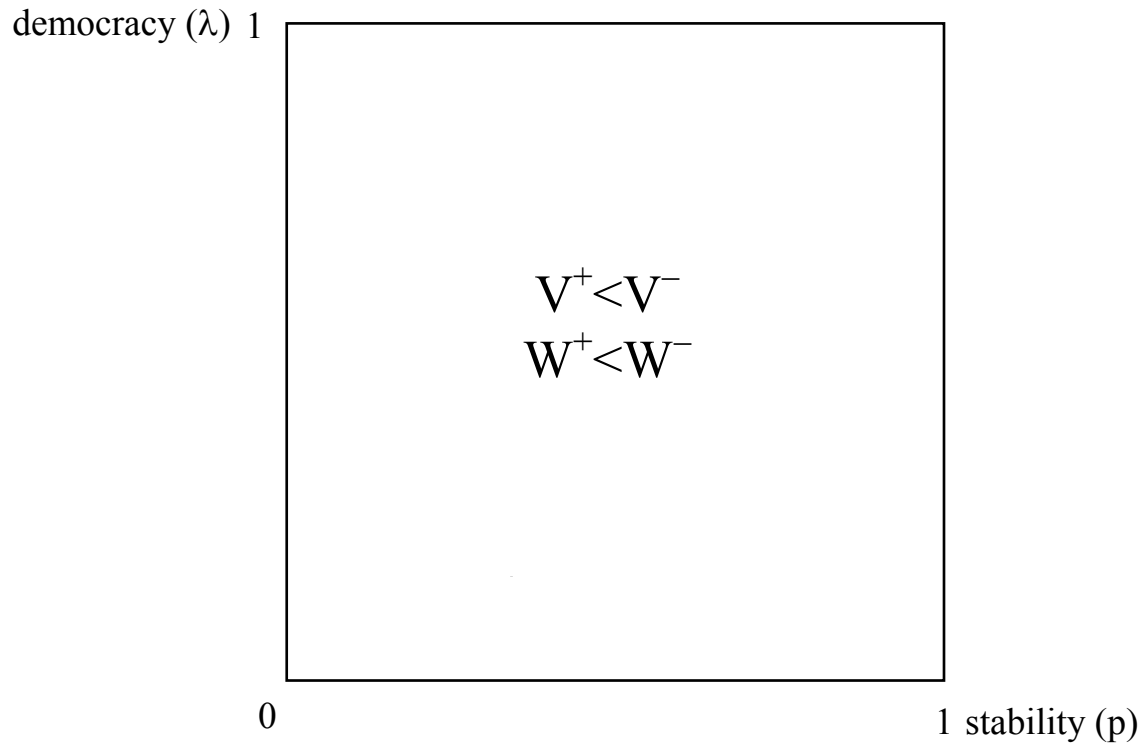
$V^+$  = politician's welfare with involvement of civil society

$V^-$  = politician's welfare without involvement of civil society

**Figure 3: Social welfare and politician's payoff with and without civil society when the empowered interests are *weakly aligned* ( $W_2+W_3>0$  small).**

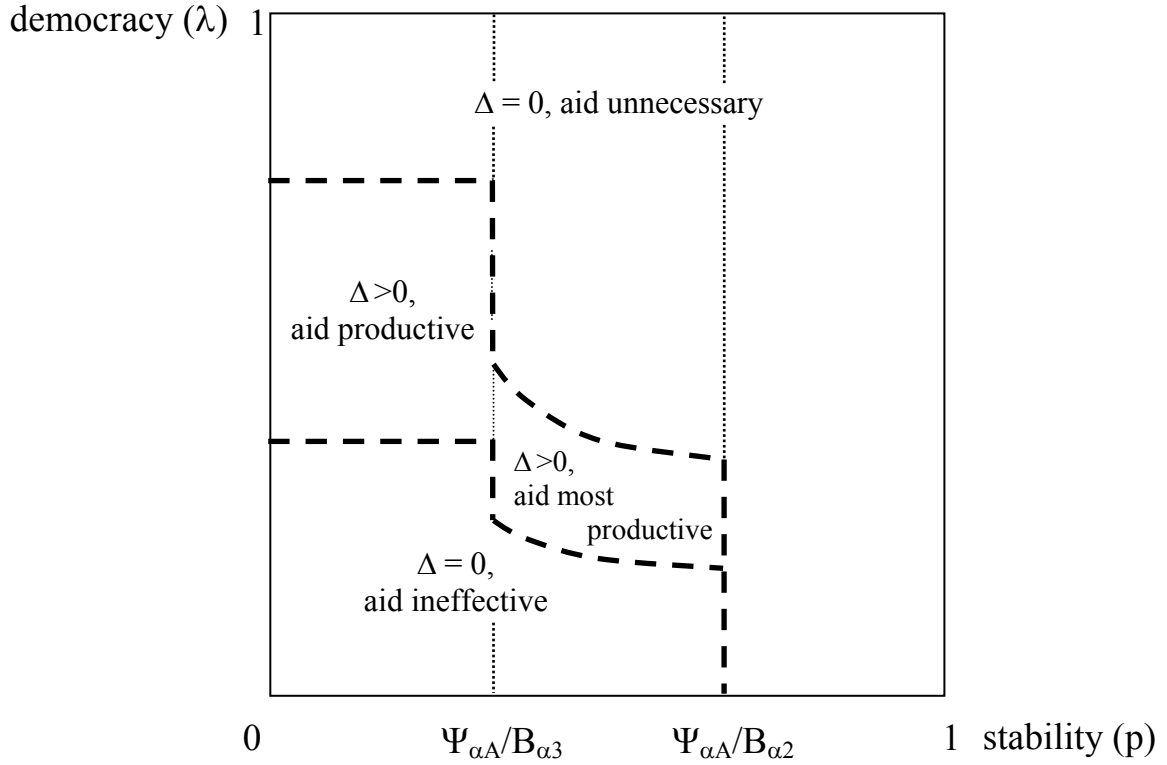


**Figure 4: Social welfare and politician's payoff with and without civil society when the empowered interests are *strongly aligned* with society ( $W_2 + W_3 > 0$  large).**

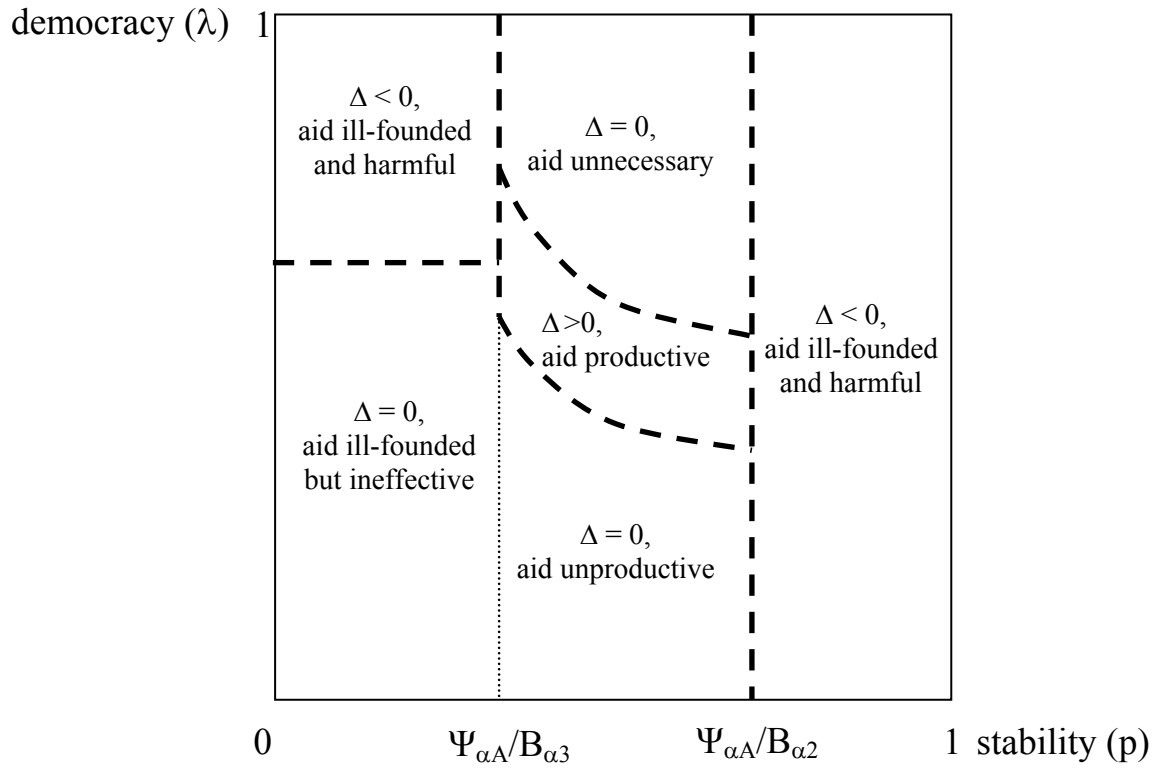




**Figure 5: Welfare effect ( $\Delta$ ) of civil society aid when the empowered interests are *misaligned* with society ( $W_2+W_3<0$ ).**



**Figure 6: Welfare effect ( $\Delta$ ) of civil society aid when the empowered interests are *weakly aligned* with society ( $W_2+W_3>0$  small).**



**Figure 7: Welfare effect ( $\Delta$ ) of civil society aid when the empowered interests are *strongly aligned* with society ( $W_2+W_3>0$  large).**

