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REFORM FATIGUE: SYMPTOMS, REASONS, IMPLICATIONS[1]

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Abstract

After more than a decade of pro-market reform in Latin America, symptoms of fatigue are evident among all the major players: public opinion polls show that most individuals think the reforms have not been beneficial, policymakers seem to have lost their reform zeal, and neither opinion leaders nor the international community remain unified around the thesis that pro-market reforms are the key to accelerating development. This paper describes the symptoms and causes of reform fatigue, and explores the implications for the future of reform. Clearly, economic reasons are behind the reform fatigue. Although the reforms seem to have increased incomes and growth, they did so in a modest way, probably below the expectations created by the reformers. Furthermore, evidence based on public opinion surveys shows that as growth has faltered, support for reform has declined. Political reasons play a much lesser role. Although the political opinions and socioeconomic characteristics of the public have played a role in shaping people's views on pro-market reforms, those variables do not go a long way toward explaining why rejection of reform has increased over time. However, the political implications of reform fatigue should be reason for concern because the political parties that pursued reforms have paid a hefty political price.

Introduction

The era of ambitious economic reforms is over. Gone are the days of boldly slashing import tariffs, lifting interest rate controls or opening large infrastructure sectors to private participation in order to boost competition and efficiency. True, most blatantly inefficient economic policies have been corrected in many Latin American countries. But this is not the only reason why the era of ambitious economic reforms is over. A lot more could be done to introduce efficiency into infrastructure services, to improve the functioning of public administration or to make labor markets both more flexible and equitable. The main reason for the hiatus is that all the major players in the difficult game of economic reform are showing signs of fatigue. Most notably, public opinion has become opposed to further pro-market reforms. But fatigue is also affecting the views of policymakers, the opinions of international organizations and the prescriptions of top international economic advisers. None of these groups of players is any longer unified around the idea that promoting a key set of reforms to even the playing field for investors and liberalize markets is essential to accelerate growth.

This paper aims at documenting and explaining these signs of fatigue in order to explore the future of reform. The first section following this introduction uses a variety of statistical indicators, from opinion surveys to reform indices, as well as more casuistic evidence to measure and describe the symptoms of fatigue in public opinion, policymakers, opinion leaders and international organizations and advisers. The second section attempts to uncover the reasons for the fatigue. It explores economic, social, political and psychological reasons. A discussion of the economic and social effects of the reforms draws from a review of existing literature, but new empirical research using opinion surveys data is also presented to analyze the mismatch between the actual and perceived consequences of the reforms. The third section discusses the implications of fatigue for the sustainability of reform. While political reasons are not a major reason behind the fatigue, they will probably be the key determinant of the future of reform because pursuing pro-market reform has proved to be politically costly and will probably remain so.

Symptoms of Reform Fatigue

The sustainability of reform will hinge on the beliefs and attitudes of the main players: voters, policymakers, opinion leaders and the international community. The purpose of this section is to gauge the symptoms of reform fatigue among these four groups of actors. Reform fatigue is defined as the lack of public support, the loss of confidence in the benefits of pro-market reforms and/or a less pro-active stance towards reform.

Public opinion

Pro-market reforms stand accused of being one of the causes of the economic crisis that Latin America is suffering. The attitude of Latin Americans towards pro-market reforms has become increasingly critical. In 1998 more than 50 percent of Latin Americans thought that privatization was beneficial for their country. This percentage dropped to 31 percent in 2001 and to 25 percent in 2003. At the same time, in 1998, 77 percent of Latin Americans thought that market economy was good for the country. In 2003, the percentage of people who support market economy dropped to 18 percent.[2] These results come from the *Latinobarómetro* annual surveys, which cover 17 Latin American countries since 1996.[3] These surveys also provide information on the attitude towards international trade and foreign direct investment and towards price controls and state intervention in productive activities. Table 1 shows the average values for the six aspects of market reform considered by the surveys. It indicates that more than 50 percent of Latin American tend to agree with the basic tenets of pro-market reforms (the exception being privatization). However, the table clearly shows that the support for pro-market policies has been decreasing since 1998.[4]

Figures 1 and 2 show that there are large cross-country differences in the support for reform. Figure 1 shows that support for privatization ranges between 37 percent (in Brazil) and just above 10 percent (in Argentina and Panama). Argentina, Bolivia, Ecuador, El Salvador, Guatemala, and Paraguay are the countries where the support for privatization dropped by the largest amount. Figure 2 shows a similar trend in the decline of support for market economy.

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[2] This may be partly due to the fact that there was a slight change in the question. For the years 1998 and 2000 the question was: "Do you think that market economy is good for the country?" For the year 2003 the question was: "Are you satisfied with the functioning of the market economy."

[3] The surveys comprise an average of 1,200 respondents per country-year. Although the Latinobarómetro data offer an unprecedented wealth of information, there are some problems with the survey, namely that it focuses exclusively on urban population and, especially the early rounds of the survey tended to over-represent individuals with relative high levels of education (Gaviria and Seddon, 2000).

[4] Panizza and Yánez (2003) show that the correlation between these variables while being positive and statistically significant is also rather low indicating that the different questions do capture different angles of the attitude toward pro-market reforms. See Appendix 2.

Policymakers

Policymakers are our second group of key players in the reform process. In order to gauge whether their inclination to pursue pro-market reforms is faltering we first assess evidence coming from policy announcements during pre-electoral periods by those elected, and then discuss the record of actual policy decisions while in office.

In recent years, political leaders in Latin America have increasingly tended to blame free market policies for low economic growth and high unemployment. During recent political campaigns in Argentina, Bolivia, and Ecuador, candidates critical of "neoliberal" economic policies performed well. In Argentina, Nestor Kirchner won the presidency campaigning against the "neoliberal" model and "lamentable and disastrous" IMF-imposed policies and instead favored a greater role for the state in the economy. In Bolivia, Evo Morales, who came within a percentage point of winning the election, described his electoral campaign as representing "the victims of neoliberalism." In Ecuador, Lucio Gutiérrez, who was compared to Venezuela's Hugo Chávez because of his military background and populist message, also spoke of how neoliberal policies had brought "disaster" to the country.

In the case of Brazil, the prospect of Lula's election was also perceived by many as a general repudiation of market-oriented reforms. Despite Lula's moderate campaign rhetoric and his shift to the center, investors panicked and sovereign bond spreads soared prior to the election. Canada's *National Post* remarked that "Brazil's presidential election represents a final unraveling of the so-called Washington consensus." (National Post 2002). Yet after assuming office, markets regained confidence in Brazil once it became apparent that Lula's administration would continue, and even deepen the policies of the Cardoso administration.

Of course anti "neoliberal" campaign rhetoric can fade once a candidate takes office. Lucio Gutiérrez is the latest elected leader to pull such an about-face. He won the presidency in Ecuador with the support of left-wing and indigenous groups, yet upon taking office appointed an orthodox finance minister and signed an agreement with the IMF that promised large budget surpluses and opened the state-controlled energy sector. Gutiérrez is just the latest president to win a campaign based on populist anti-market rhetoric only to moderate the message once in office. During the 1989 Argentine presidential campaign, Carlos Menem supported a nationalist and redistributive state-led development model, but by 1991 he was advocating the free market orthodoxy of his opponent. In Peru, Alberto Fujimori followed the same pattern in his 1990 campaign against Mario Vargas Llosa — he attacked Vargas Llosa's plan for structural reforms only to adopt virtually the same measures once in office.

In other words, while the volume of the rhetoric is up, it hasn't yet translated into a region-wide trend of policy rollback. For example, while Argentina's President Kirchner may have rejected the neoliberal policies of the Menem-era, his differences with the model appear to be one of degrees (economic policy in Argentina remains geared toward recovering from the disastrous default and devaluation in 2001-2002). Hugo Chávez's populist policies have not spread elsewhere, and Lucio Gutiérrez continues to work with the IMF. Looking ahead, a more sincere anti-reform candidate could be elected in the near future. Frente Amplio leader Tabaré Vazquez will be a strong candidate in Uruguay, while Alan Garcia has undergone a political rebirth in Peru. Nevertheless, for now the gap between rhetoric and policy persists.

Can we offer more rigorous support to the claims that while there is no region-wide retrenchment of pro-market policies, recent governments are no more inclined than their predecessors in the early nineties to maintain or advance market-friendly reforms? In order to answer this question we can draw from the main conclusions by Lora and Panizza (2002), who use a set of indicators that attempt to measure the extent of pro-market reform in the areas of trade, financial, tax, privatization and labor market policies. A composite index covering all these areas, calculated for 17 Latin American countries, rose from 0.34 in 1984 to 0.58 by the late 1990s (on a scale from 0 to 1). This increase is significant in and of itself, yet it also suggests that many countries have a very broad margin of unexploited potential for the introduction of additional reforms, especially in the areas of privatization and tax policies, where the process of reform has been very uneven across countries, and in labor regulations and institutions, the least active area of reform. Reforms expanded the most between 1989 and 1994, when an improvement of 0.12 points was registered out of a total increase of 0.24 for the entire period. In the second half of the nineties the gain was only 0.04 points, implying that the process has lost momentum (see Figure 3). Since this system of indices is available up to 1999 only, we have complemented them with information from reports of the regular missions of the International Monetary Fund in the countries (See Appendix 1.). On that basis, we have classified countries in three groups according with the extent of reform since 2000 (see Table 2). Ten countries have shown reform progress, seven have stalled and two have had reversals. This implies that although the process of reforms have continued in several countries, its pace has declined even further and, for the first time since its inception in the mid-eighties, a few major setbacks have occurred. A rough calculation suggests that the overall reform index stayed put at 0.58 between 1999 and 2002, or went slightly up from 0.58 to 0.61 if Argentina and Venezuela are excluded.

It is important to notice that there are more differences than similarities in the reform reversals of these two countries. In Argentina, the policy reversals (described in the Appendix) started as a last-resort response to a prolonged crisis that threatened (and eventually destroyed) the monetary and financial system. In Venezuela, no such crisis was apparent at the beginning of the anti-reform process, which was initiated as a political strategy by the President against the opposition. As events unfolded in Argentina, and the crisis reached its peak in 2002, public opinion moved strongly in favor of anti-market policies, which were then given additional impetus during the 2003 electoral campaign by several candidates, including the winner. In Venezuela, a severe economic crisis surfaced after the general strike in late 2002 that was aimed at removing the President, which gave him further leeway to deepen the anti-market policies (also summarized in the Appendix). However, it is unclear that these policies have the support of public opinion at large while, unlike in Argentina, they are strongly rejected by the private sector.

The Opinion Leaders

Opinion leaders are the third group of players to be considered in the reform process. The views of opinion leaders are important for several reasons. First, because leadership within the executive, and to a lesser extent, the legislature, increases the probability that a reform proposal will be approved. Second, because public opinion is subject to considerable uncertainty when faced with reform proposals that attempt to substantially alter the status quo ante, and opinion leaders may be decisive in dispelling or reinforcing doubts about the convenience of reform (Graham et al 1999). And thirdly, because ex-post facto judgments are often biased and distorted (as we will see below), and may be susceptible to manipulation by the opinion leaders. Therefore, the views of opinion leaders may influence not only the probability that a reform is introduced but also the way its effects are perceived by the public, and therefore may make the difference between sustainability and rejection of the reform.

The Global Poll conducted by Princeton Survey Research Associates for the World Bank offers the most recent survey of the views of opinion leaders on globalization and pro-market reform in 49 countries of all world regions, including several Latin America countries (Brazil, Chile, Colombia, Honduras, Jamaica, Mexico and Peru). The poll was done through interviews of leaders from government, the private sector, the media, civil society, academics and trade unions, and it was conducted between October 2002 and March 2003. For our purposes, the questions of interest are those related with trade liberalization, foreign direct investment, the "neoliberal model" and privatization. The first one is comparable with a similar question applied to the public at large in eight Latin American countries (although there are only four countries in common in both surveys). The two last questions were only applied in Latin America and therefore cannot be compared with other regions.

Eighty-three percent of opinion leaders in Latin America consider the greater opening of national markets to trade and business with other countries to be either very good or somewhat good. This percentage does not differ much from those of other developing regions, although it is somewhat below that in industrial countries (93 percent, see Figures 4.1 and 4.2). However, differences within Latin America are important: while 94 percent of opinion leaders in Chile are in favor of trade liberalization only 70 percent in Colombia are. Furthermore, while in Chile two of three opinion leaders consider trade opening very good, in Colombia less than one of every five opinion leaders share that view. Interestingly, opinion leaders are less enthusiastic about trade liberalization than those polled in the four countries where the comparison can be made (notice, however, that the wording of the question was not identical).

Seventy-seven percent of opinion leaders are in favor of foreign direct investment in the manufacturing sector. Again, that percentage is roughly similar to that of other developing regions, but lower than in the developed world, where the figure is 89 percent. Differences of opinion between countries are less pronounced than in the previous question, but still, while 40 percent of opinion leaders in Honduras consider foreign companies very good, compared to only 12 percent in Mexico (Figure 5).

The majority of opinion leaders in Latin America are in favor of privatizing inefficient state-owned enterprises, from 90 percent in the case of Jamaica to 70 percent in the cases of Chile and Honduras. However, this is far from a blank endorsement to privatization: many of those in favor consider that the effect is only "somewhat positive." This is especially so in the cases of Mexico, Jamaica and Colombia.

Finally, opinion leaders in the region are divided with respect to the impact of the "neoliberal economic model" on poverty. In Jamaica and Peru a slight majority believes that the model, defined as liberal trade policies, privatization, fiscal discipline, tax reform, property rights reform and deregulation, can pull people out of poverty. In Brazil, Colombia and Honduras, those in favor and those against are matched, while en Chile and Mexico the majority does not believe that the model can pull people out of poverty.

In synthesis, on average opinion leaders in Latin America have similar views to those of other developing regions with respect to trade liberalization and foreign direct investment, although large differences can be found between countries within the region. Unlike public opinion at large, opinion leaders are supportive of privatization, but many consider that the effects are expected to be only "somewhat positive". Opinion leaders are clearly divided about the impact of the so-called neoliberal model on poverty. Since they do not oppose the core elements of that model, which they consider beneficial for their countries, their views seem to imply that the reform agenda should not be reversed, but expanded, as has also been the trend among the international organizations.

The International Community

The international pressure to liberalize was ubiquitous during the early nineties. "Everywhere state leaders turned, they were bound to feel this pressure (…): they encountered a battery of international scholars, policy advisers, financiers and investors who demanded market-oriented reforms as a condition for extending their blessing" (Corrales, 2002, page 3)[5]. Although much international advice and pressure are still in favor of pro-market policies, they are not any more given the utmost importance in the policy agendas of the international organizations or in the views of international advisers or financiers.

During the 1990s, the mantra of international organizations such as the International Monetary Fund, the World Bank and the Inter-American Development Bank, was clearly aligned with the "neoliberal model", as defined in the previous section --liberal trade policies, privatization, fiscal discipline, tax reform, property rights reform and deregulation--, and largely

[5] Corrales (2002) cites the following references for discussions of international pressures on behalf of economic liberalization: Williamson (1994), Kahler (1992 and 1994), Frenkel and O´Donnell (1994), and Stallings (1991).

reflecting the so-called "Washington Consensus."[6] However, as economic growth stalled and social indicators failed to improve, especially during the second half of the decade, the breadth and scope of the agenda of the international organizations expanded with four new reform items: crisis proofing, completing first-generation reforms, advancing second-generation reforms, and improving equity. Crisis proofing aims to reduce vulnerability to crises through such measures as accumulating budget surpluses and reserves, adopting a flexible currency, strengthening supervision and regulation, and increasing domestic savings. Completing first-generation reforms includes making labor markets more flexible, and deepening privatization and free trade. Second-generation reforms include judicial, social security, regulatory, tax, education, and political reforms geared toward establishing an institutional foundation that can sustain economic growth. Finally, equity-improving policies comprise improved education, titling programs to secure property rights, land reform, and micro-credit (see Williamson 2003b).

The expansion of the agenda represents an important change of attitude towards reform, as priority is no longer given to the original set of reforms over the rest, and because policy recommendations in the original neoliberal agenda have become more qualified. For instance, emphasis on privatization is now made conditional on the possibility of adjusting the institutional and regulatory environment to reduce the risk of inefficiency, corruption and regulatory capture. In a similar way, much greater emphasis is now placed on the quality of supervision and prudential regulation as conditions for a successful financial liberalization process. However, as discussed below, this expanded agenda is not free of strong criticism for failing to provide solid foundations for growth while expanding the reform requirements beyond the political and practical capabilities of any government.

Furthermore, a growing number of leading international scholars has moved away from the notion that pro-market reform is the essential precondition to achieve economic development. To name just four influential international advisers, Paul Krugman shocked the international community when, in the midst of the Asian crisis of 1997-98, recommended the adoption of controls to international capital flows and other heterodox financial policies (Krugman, 1998a, 1998b, 1999). Joseph Stiglitz followed suit with his strong criticism of the multilaterals' emphasis on several key ingredients of the standard stabilization package, such as interest rate increases and fiscal restraint. He has also criticized some core components of the pro-market reform agenda, most notoriously financial liberalization and privatization (Stiglitz 1998, 2002a, 2002b,

[6] The term originated in a 1986 study issued by the Institute for International Economics that was edited by

Chang 2002.). In a similar vein, Dani Rodrik has advanced the thesis that the key ingredients for economic growth are macro stability (monetary, fiscal and financial), strong property rights, the rule of law, and producer incentives aligned with social costs and benefits; universal principles that do not necessarily translate into the standard set of pro-market policies and institutions recommended by Washington (Rodrik, 2003). Jeffrey Sachs has emphasized the need for social protection and human capital accumulation over the standard stabilization-cum-liberalization approach. His views are partly motivated by his conviction that geographic limitations play a more important role in economic and social outcomes than is generally recognized in the profession (Sachs, 2003). However, he has also criticized the lack of basis for the standard stabilization package: "Indeed the phrase ´debt sustainability analysis´ is truly Orwellian in scale of distortion. The IMF and World Bank procedures for measuring sustainability have absolutely nothing to do with ability to pay and 100 percent to do with the arbitrary limits on debt relief imposed by the G-7" (Sachs, 2000).

Reasons for the Fatigue

After more than a decade of pro-market reforms, symptoms of fatigue are evident among the major players: public opinion considers the reforms not to have been beneficial; policymakers in a growing number of countries seem to have lost their reform zeal and the process is now stalling in many countries; and both opinion leaders and the international community are no longer unified around the thesis that a set of core pro-market reforms is *the* key to accelerate development. What are the reasons for the fatigue? In this section we discuss four alternative – though not mutually exclusive—explanations: (1) the economic effects of reforms have been modest, (2) reforms have failed to improve social outcomes, (3) political forces and public opinion have moved towards the left, and (4) perception biases and other psychological reasons may be behind the loss of appetite for further reforms.

Economic Reasons[7]

Increasing productivity and growth were the main purpose of the pro-market structural reforms. But, although economic growth in Latin America improved throughout the 1990s, it was disappointing, and less than the averages for the 1960s and 1970s (table 3). Indeed, whereas during the so-called "lost decade" of the 1980s annual growth in the region was only 1.2 percent

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Balassa et al entitled Toward Renewed Economic Growth in Latin America (see Williamson 2003 p.323).

and per capita income fell at a rate of 0.7 percent, in the 1990s those rates rose to 3.8 and 2.1 percent, respectively. However, in the 1960s and 1970s, average annual growth was more than 5 percent and per capita income increased by around 3 percent. Something similar may be observed with regard to trends in total factor productivity. In the 1990s, total factor productivity contributed practically nothing to the average growth of countries in the region, after having fallen sharply in the 1980s (when it took away around 2 percentage points of growth). Productivity improvements typical of the 1990s were not substantially different from those typical (also very low) of the 1960s and 1970s.

These results could be taken as an indicator that the reforms failed to achieve their central objective of speeding up economic growth through more efficient use of productive resources. Yet this conclusion is far from warranted. First, it should not be forgotten that these averages conceal notable differences between some countries and others in the region. In terms of per capita income, for example, 10 of the 26 countries in question performed better in the 1990s than in the 1960s and 1970s. Some countries, such as Argentina, Chile, Guyana, and El Salvador, had significant increases in the rate of growth. An equal number of countries also registered improvements in overall factor productivity, which outpaced that of the 1960s and 1970s. Second, structural reforms significantly differed from one another in depth, pace, and manner of implementation from one country to another. Finally, it should be kept in mind that the structural reforms were not the only factor influencing productivity and growth in recent decades. In this regard, it should be emphasized that growth trends in developed countries and in the world economy as a whole, which had been encouraging in the 1950s and 1960s, fell in the following decades. In the 1990s, per capita income growth in the developed countries was the same as that of Latin American countries (1.5 percent per year for Latin America, 1.7 percent for the entire world), whereas in the 1970s it had been 4.3 percent (4.1 percent for all countries). The international context has also limited Latin American countries because of instability in the international prices of the region's typical exports and because of the major changes in the amounts and costs of capital resources for the region. Growth was also affected by the quality of macroeconomic policies and other circumstances specific to each country.

Given the multiplicity of factors that can influence growth and productivity, it is not surprising that experts have different opinions about the effects of the reforms. Until a few years ago, the prevailing opinion on the effectiveness of the reforms was quite optimistic. Table 4

[7] This and the next sub-section are an updated version of a survey contained in Lora and Panizza (2002).

presents the results of five studies that evaluate the effects of the reforms. The first three studies analyze the reforms up to the mid-1990s and have consistent results (Easterly, Loayza, and Montiel 1997; Fernández-Arias and Montiel 1997; Lora and Barrera 1997). According to these studies, the effects were positive and substantial. For example, using the previously mentioned indices of reform, Lora and Barrera find that the reforms had a significant and ongoing impact on growth, productivity, and investment. According to their estimates, until the mid-1990s, the economic reforms raised Latin America's growth rate by 1.9 percentage points (that is, to 2.2 percentage points including the impact of macroeconomic stabilization).

More recent studies point to less encouraging effects. Escaith and Morley (2001), who use a modified version of the same indices for 1970-95, also find a positive effect, although smaller in magnitude and less robust than those reported in previous articles. By using the same indices for 1985-99, Lora and Panizza (2002) make new estimates of the effects of the reforms on growth. They find that the effects were more modest and of a transitory nature because they seemed to be diluted after the reforms were in place for some time. For example, during their high point (1991-93), the reforms increased annual growth by 1.3 percentage points. When the reform period began to slow down, the growth effect declined considerably, and in 1997-99 it entailed only 0.6 percentage points of additional growth (compared with a hypothetical situation with no further reforms; figure 6). The study also finds that the effectiveness of the reforms depended crucially on the institutional environment in which they took place. In particular, the reforms seem to have had a greater effect in countries with good rule of law, possibly because it lessened uncertainty about the new rules and limited the undue interference of interest groups in the design and implementation of regulations. Loayza, Fajnzylber, and Calderón (2002) also find more modest effects of the reforms in their update of the estimates of Easterly, Loayza, and Montiel (1997).

Opening up to international trade is an area of structural reform whose effects on growth have been the subject of debate. According to most studies that make comparisons between countries, there is a clear and positive correlation between opening to international trade and economic growth (Dollar 1992; Sachs and Warner 1995; Frankel and Romer 1999; Ben-David 1993; Edwards 1998; Dollar and Kraay 2000). Studies of domestic experiences reach the same conclusion (see a summary in Srinivasan and Bhagwati 1999). Although criticisms have been raised about the validity of some of these studies,[8] no study has suggested that opening up to trade has adverse effects on growth. Studies more specifically focused on Latin America also find a positive relationship between liberalization and growth (Lora and Barrera 1997; Stallings and Peres 2000; Loayza, Fajnzylber, and Calderón 2002).

Empirical research on the effects of financial liberalization has shown that while it does not contribute to an increase in savings (Bandiera et al., 1999), it does increase financial deepening that, in turn, is associated with growth (Levine, 1998).[9] In particular, cross-country analyses indicate that severe financial repression (measured by the presence of large negative real interest rates) adversely affects productivity growth. Country-level studies for Ecuador, Mexico, Chile, and Indonesia also indicate that financial liberalization leads to a more efficient allocation of capital and relaxes credit constraints faced by small firms (Harris et al., 1994; Jaramillo et al., 1996; Gelos and Werner, 1999; Gallego and Loayza, 2000).[10] However, research has also shown that financial liberalization may lead to crisis. This is because the previous system of interest rate controls and directed credit may have created weak bank portfolios and not promoted a good "credit culture". This suggests that post-liberalization financial crises are due less to the liberalization per se than to the pre-liberalization environment, the sequencing of financial reforms and the legal, regulatory, and supervisory structures (Caprio and Hanson, 1999).

Given that state-owned enterprises can correct market failures, one would expect that the advantages of public enterprises are greater in developing countries, where market failures are more pervasive than in developed countries. If such were the case privatization would be less beneficial for welfare and growth in the developing countries. The empirical evidence, however,

[8] According to Harrison and Hanson (1999) and Rodríguez and Rodrik (2001), the literature that finds a positive relationship between liberalization and growth is plagued with problems of methodology and data errors, and the results are not particularly solid in comparison with alternative specifications and data series. Rodrik (2000) likewise asserts that contrary to what is suggested by Srinivasan and Bhagwati (1999), the evidence for liberalization derived from country studies is far from overwhelming. Nevertheless, Jones (2001), commenting on the article by Rodríguez and Rodrik, shows that the standard results of a positive relationship between market opening and growth are quite solid, and that few of the results commonly accepted in the economic literature would pass the strict evidence of solidity of Rodríguez and Rodrik. Wacziarg and Welch (2002) take up the discussion begun by Rodríguez and Rodrik and find that their criticisms are valid for cross-section analyses, from which it cannot be concluded that opening helps growth. Nevertheless, time series panel analyses do show high and robust effects of liberalization on growth.

[9] Reforms that eliminate negative real interest rates seem to have the largest impact on growth.

[10] Laeven (2000) supplies cross-country evidence for the fact that financial liberalization relaxes the financial constraints faced by small firms but does not affect large firms.

seems to suggest that the opposite is true[11], implying that government failures have the upper hand over market failures. Even though, as in the case of financial liberalization, a successful privatization process requires an adequate regulatory framework and political and social institutions that direct and supervise the activities of the regulatory boards (World Bank, 2001a: Chapters 5 and 8; IDB, 2001: Part IV). Thus, reforms in the financial and infrastructure sectors have had positive effects when the reforms have generated a climate favorable to competition and an adequate regulatory system. When these conditions are met, the effect on growth of the financial reform and the privatization of key infrastructure sectors can be substantial (Mattoo, Rathindram, and Subramanian 2001).

Despite the differences between the various studies, the conclusion that can be drawn is that the reforms have had a positive but modest effect on growth. Even considering the more optimistic calculations, which place the effect at close to 2 points of additional growth, the reforms by themselves could not have raised per capita growth from -0.07 percent in the 1980s to rates around 3 percent, like those seen in the 1960s and 1970s. One of the reasons for the modest impact of the reforms may have been that they were incomplete, did not have enough internal institutional support, and took pace in an unstable international environment, especially in the realm of financing, which in turn may have compromised national macroeconomic policies. This debate suggests that the reforms changed the operation of the economy less than is generally assumed and hence their impact on productivity was muted. This view has inspired the extension on the Washington consensus to several other areas of reform, as summarized above, an approach that is not immune to serious criticism as it places demands of reform that are beyond the political and practical possibilities and any government and it fails to convey any sense of priority and even direction. According to Rodrik (2003), jump-starting growth and sustaining growth are two separate enterprises. The former seldom requires such a wide array of policy changes, and it is unclear that the latter must be necessarily based on that combination of policies. He notes that several celebrated cases of economic success, most notably in Asia, seem to defy the standard policy prescriptions of either the Washington consensus or its extended version. Both South Korea and Taiwan relied upon public enterprises and utilized industrial policies including

[11] Shirley and Walsh (2000) surveyed 52 studies of the impact of privatization on economic efficiency and welfare and found that 32 studies concluded that privatization is welfare-enhancing, 15 studies found an ambiguous effect of privatization, and five studies found a negative effect of privatization. However, out of 20 studies that covered developing countries, 17 found that privatization is welfare-improving and three found an ambiguous effect of privatization, but no study found a negative effect of privatization in developing countries.

directed credit, trade protection, export subsidization, and tax incentives, while China grafted a market system onto its planned economy.

The fact that reforms had a modest impact on productivity and growth may be at the core of the reform fatigue, even if its effects were positive. Many people probably formed their expectations of the benefits of reforms based on the promises and announcements of the reformers and the prevailing views at the beginning of the process, which were certainly over-optimistic, as we have seen. As people have later corrected those expectations according with the actual results, they may consider that there are better policy packages to deal with the problem of low growth. Therefore, even if they do not demand a reform reversal, they become less committed to the original reform process. If this view is correct, policymakers who oversold the potential benefits of the reforms could now be blamed for the reform fatigue. Interestingly, this phenomenon does not seem to be exclusive of Latin America. It is also happening in the East European countries, in spite of the fact that, over the last decade, some of them have had a very good growth performance (Krizsan, 2003). But it should be even more valid for Latin America because, contrary to the typical East-European case where the initial effect of the structural reforms was a decline in incomes (Merlevede 2001), reforms in Latin America produced initial growth gains that turned out to be temporary (Lora and Panizza, 2002).

Another explanation, however, is that opinion on the effectiveness of reforms is not based on complete information on its expected and actual results, but rather on a rough association between reform and macroeconomic outcomes. In the oft-cited, though not very polite quote: "It´s the economy, stupid". Appendix 2 presents econometric support for this view, taken from Panizza and Yáñez (2003). Using *Latinobarómetro* data, they have found that several macroeconomic variables affect attitude towards privatization and towards the market economy (the only two questions that have been included in at least four annual surveys). The variables tested were the deviation of GDP from its trend (a simple way of capturing the economic cycle), the depth of the economic crisis (defined as the deviation of GDP from its trend when it is below it, and zero otherwise), the unemployment rate and the inflation rate (computed as the loss of purchasing power of a domestic currency unit). Except for inflation, the other three variables influence people's attitudes in the expected way, and are able to explain a substantial part of the loss of support for the reforms. As we have seen, support for privatization went from 52 percent in 1998 to 25 percent in 2003. One third of that decline seems to be associated with the economic cycle, according to their calculations. The case of Argentina is a striking example of the importance of macroeconomic factors. In this country, it explains a drop in support of privatization equivalent to 25 percentage points, which is about 80 percent of the observed drop in the support for privatization in that country (it went from 45 to 13 percent).

In sum, economic reasons are clearly behind reform fatigue. Although the reforms seem to have increased incomes and growth, they did so in a modest way, probably below the expectations created by the reformers. However, as growth has recently faltered for short-term reasons, support for reform has declined as many people are probably unable to isolate the influence of the cycle from the permanent effect of the reforms.

Social Outcomes as Reasons for the Reform Fatigue

While the majority of economists agree that most of the structural reforms described above tend to increase average income, those who criticize this kind of reforms emphasize their distributional consequences and claim that they generate a pattern of economic growth that only benefits the richest segments of the population.[12]

The most quoted papers holding the view that reforms tend to be beneficial for the majority of the population are Gallup et al (1998), Dollar and Kraay (2000a, 2000b), and a recent World Bank report (World Bank, 2001b). The basic point of these papers is that reforms (especially trade openness and globalization) increase economic growth without producing major income distribution shifts. Therefore, these authors conclude that the increase in average income brought about by economic liberalization is fully translated into an increase in the income of the poor.

While these authors present strong evidence in support of the fact that growth is distribution neutral, Ravallion (2001) shows that, by going beyond averages, one discovers that there are large differences among countries in how much growth benefits the poor. In particular, he points out that the drop in the poverty rate brought about by a 1 percent increase in the growth of average household income can range between 0.6 and 3.5 percent. At the same time, Foster and Székely (2001) show that when one uses an index that emphasizes the income of the poor, the latter does not grow one-for-one with average income, but considerably less. This last result seems to indicate that reforms may hurt some groups with very low income and hence, while they do help in reducing overall poverty, they may worsen income distribution among the poor. There is, therefore, a role for policies that take into account the distributional impact of growth.

The IDB (1997, Part 2) found that structural reforms led to a slight improvement in income distribution and that tax reforms were not regressive (in the sense that they did not contribute to worsening income distribution). However, Behrman et al. (2000) studied wage differentials in Latin America and found that during 1980 through1998 economic reform had a short-run disequalizing effect.[13] One of their main results is that, while domestic financial market reforms, capital account liberalization, and tax reforms widened wage inequality, privatization narrowed wage inequality. At the same time, they found no significant impact of trade openness on wage inequality. Spilimbergo, et al. (1999) found that, on average, trade openness increases inequality and that the effect is stronger in countries where physical capital is relatively scarce.

The fact that economic reforms (especially trade openness) may increase inequality in developing countries seems to go against standard economic theory (or at least economic theory rooted in the simplest version of the Heckscher-Ohlin model of international trade) that suggests that trade openness should increase the income accruing to the relatively abundant factor of production. Given that most developing countries are abundant in unskilled labor, which is also the factor of production controlled by the poor, one would expect trade openness to improve income distribution and hence improve the relative (and not only the absolute) well-being of the poor. However, the distributional effect of reforms is extremely complex. In some countries external tariffs focused on labor intensive products (as in the case of Mexico, Hanson and Harrison, 1999); in other countries the most abundant factor of production is land or natural resources.

Much has been said about the short run impact of trade liberalization and other structural reforms on employment and unemployment. Undoubtedly, the widely held perception that the reforms were detrimental to workers is behind the opposition of the public to the so-called neoliberal agenda. One of the best efforts to gather opinions on the labor and social impact of the reforms was recently undertaken by the Structural Adjustment Participatory Review International

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[12] Given that some reforms emphasize greater international trade and capital account openness, very often the process of reform is identified with the term "globalization."

[13] Morley (2000) finds small regressive effects of reforms. He points out that while tax and trade reforms tend to be regressive, financial reforms are progressive.

Network (SAPRIN), which used participatory methods to examine the experiences of nine countries, three of them in Latin America.[14] According to this study, the effects of the structural reforms on labor have been predominantly negative:

"Domestic manufacturing sectors and employment have been hit hard by indiscriminate import liberalization [while] while increased exports have failed to generate significant domestic economic activity and employment." (pp. 174-76).

"Coupled with trade liberalization measures, financial-sector reforms have had a particularly devastating impact on small and medium-sized firms and the large number of jobs they provide." (p. 175)

"Unemployment and job insecurity have increased and working conditions have often deteriorated with the increase in privatizations and the introduction of flexibilization measures." (p. 180)

Likewise, an ambitious participatory project recently carried out by the World Bank in 23 countries (4 of them Latin American) gathered the opinions of poor people, who clearly stated their concern about the effects of the reforms on labor. According to Narayan and Petesch (2002):

"Depending on the country, poor people mentioned privatization, factory closures, the opening of domestic markets […] and other related changes as having depleted their assets and increased their insecurity." (pp. 471-72) "In all four countries of Latin America and the Caribbean, people described the economic and social devastation of their communities in the wake of macroeconomic crises and policy reforms. They felt directly harmed by numerous plant closures, the shift to a service economy, and the rise of the informal economy." (p. 474) "A common theme underlies the sentiments expressed by men and women […] in Argentina: the quality of their lives has deteriorated. In urban areas, they attribute the decline mostly to unemployment and crime. In their words, a dramatic picture emerges of the personal and social consequences of market reforms and factory closures." (p. 335) And in Ecuador, "many urban study participants say the 1990s brought deep declines in their well-being, and they express little support for the economic reforms made by the government." (p. 400)

[14] See SAPRIN (2002). The countries included are Bangladesh, Ecuador, El Salvador, Ghana, Hungary, Mexico, the Philippines, Uganda, and Zimbabwe.

In spite of these opinions, no study has been able to provide support for the belief that import liberalization increases unemployment or reduces (aggregate) employment. If anything, the opposite is found. Interestingly, trade liberalization seems to have produced very little employment reallocation, either between the tradable and non-tradable sectors or within them (IDB, 2003, Chapter 5). The impact of privatization on unemployment has also been overstated. Even in countries where layoffs in privatized countries were massive, the effect on overall unemployment was small. The dismissal of close to 150,000 workers in Argentina due to privatization between 1987 and 1997 can only account for 13 percent of the increase in unemployment during the same period. However, between 80 and 90 percent of the personal cuts were offset by new jobs in the same sectors, leaving a very small net unemployment effect. Similar results obtain for other big privatizers, such as Bolivia, Mexico or Peru (McKenzie and Mookherjee, 2003). Furthermore, though work conditions in the privatized firms often deteriorated, wages seem to have gone up substantially, as has become clear at least in the cases of Argentina, Chile and Mexico. Therefore, the social losses appear to concentrate in those laid off who were not reinstated directly or indirectly in the privatized firms. Many of them moved to the informal sector with earnings substantially below their previous wages (IDB, 2003, Chapter 5).

As we have seen, the social consequences of reforms can hardly be used as factual support for the reform fatigue. Although there is no consensus on some of the distributional effects, the prevalent view among the researchers is that these effects were mild. And in spite of all the fuss about the employment implications of trade liberalization and privatization, there is very scant evidence to support it. However, as discussed in connection with the economic reasons, peoples' views are not necessarily formed on the basis of the indicators and models used by economists. In forming their opinion about the social and distributional consequences of the reforms, people may attach an important weight to some observations that may not be representative of the general outcome. This is due to two reasons. First, people tend to compare their own economic situation with those of their immediate "reference group" (neighbors, peers, relatives, etc.) rather than with the society at large. Due to this "rivalry effect" people resent when others in their reference group do better than themselves, even if all are getting better off or even is income concentration for the society as a whole is improving. "That is why there was so little economic discontent [in Europe] during the Second World War. By contrast, the great inflation of the 70s created great discontent because throughout most of the year other people's wages were raising rapidly, while one's own wage was constant" (Layard 2003, pag 8). The second reason is the high visibility of the consumption patterns of those at the very top. In the "winner-take-all-society" a few at the top in some professions (especially arts, sports and some other businesses) make astoundingly high incomes and consume accordingly, gaining the attraction of the media and the public opinion (Frank and Cook, 1995). Both the rivalry effect and the winner-take-all effects may have had deleterious effects on the Latin Americans' opinion on reforms, because economic liberalization created new opportunities, opened the way to greater social and economic mobility and facilitated the adoption of conspicuous patterns of consumption by those able to afford them.

Political Reasons for the Fatigue

One possible cause (or consequence) of the decrease in support towards pro-market reforms maybe be an overall movement of the population towards the left. This maybe part of a global trend with the end of the Reagan-Thatcher era and the beginning of a new worldwide movement towards the left following, with a lag, the leadership of Bill Clinton and Tony Blair. *Latinobarómetro* allows us to investigate this hypothesis because it includes a question on the respondent political orientation. In particular it asks: "On a scale 0 to 10 how right wing are you?" (0 being the most left wing and 10 the most right wing). The results for this question do not point towards any change in political orientation and, if anything, they would show a small movement towards the right.[15] Panizza and Yáñez (2003) have also studied the behavior of extremists based on these data. They have found that the share of those who define themselves as being of extreme left is more or less constant since 1996, but the share of those who define themselves as being of extreme right increased during the two crisis years of 1998 and 2001. During the 1998 crisis left extremism also peaked in Brazil, Colombia and Ecuador.

In order to further explore the political reasons behind the rejection of reform is useful to look at the socio-economic characteristics and the political opinions of those who are against reforms. From a political economy point of view we are interested to see if the rejection is more concentrated among specific socio-economic groups and if those who oppose share other opinions or attitudes with respect to the political institutions.

To identify who is against the reforms we draw from results by Panizza and Yáñez (2003), who have used the *Latinobarómetro* data to run a set of regressions where the dependent variables are the indicators of attitude toward reforms and the explanatory variables are socio-economic variables.[16] Their results show that men tend to be more supportive of pro-market reforms than women (the difference ranges between one and five percentage points), and that wealth and education tend to be associated with more support for reforms (an individual who belongs to the top quintile of the wealth distribution and who holds a university degree is 20 percentage points more likely to support economic integration than an individual who belongs to the bottom quintile and has no education) see Figure 7. However, education and wealth are only weakly correlated to the support for privatization and free market.

With respect to political orientation, those who describe themselves as being just to the right of the center tend to be more supportive of pro-market reforms than those who describe themselves as being left to the center or to either extreme of the political spectrum (even though those at the extreme right are more supportive of reforms than those at the extreme left, Figure 8). Given this weak correlation between political orientation and attitude towards reform it is not surprising to find that changes in public opinion towards reforms were not associated with a net movement to the left of the electorate.

The support for reforms tends to be associated with other political views. Those who think that elections are clean are between 3 and 8 percent more likely to be in favor of economic integration and privatization. This is an important finding because it may mean that a clean and well working democratic system could make the reforms process more sustainable.[17] Interestingly, those who perceive that corruption is a serious problem are more in favor of economic openness (they support economic integration and think that FDIs are beneficial for the country). This support the finding of Ades and Di Tella (1999) who show that openness can help in reducing corruption. At the same time, those who think that corruption is a serious problem tend to be more skeptical of the privatization process and the working of the private sector. This is in line with the findings of Lora and Panizza (2002) who discuss that privatization works better in countries characterized by low levels of corruption.

[15] The average values are 5.33 (1996), 5.53 (1997), 5.58 (1998), 5.33 (2000), 5.87 (2001) and 5.52 (2003). See Appendix 2.

[16] All the regressions also include country fixed effect and country specific time effects. To make the results more intuitive the regressions were estimated using a linear probability model. Probit estimations yield similar results. Full regression results are reported in Appendix 2.

[17] However, this could also mean that those who benefits from reforms are also those who benefit from an electoral system that does not work well but that, in their opinion is fair and clean.

Whether the support for reforms has waned or not, there is the perception that those who oppose pro-market reforms have been able to get their message through and to gain influence in the decision making process. To assess the validity of this perception, Panizza and Yáñez (2003) have checked whether there are differences in political participation between those who support and those who oppose reforms. In general, those who support reforms are more interested in politics than those who oppose reforms. While this is not surprising because there is a positive correlation between interest in politics and education and, in turn, a positive correlation between education and support for reforms, it should be noticed that the positive correlation between support for reform and interest in politics is rather weak.

Going beyond the declared interest in politics, Panizza and Yáñez (2003) have also checked if those who oppose reforms are more likely to get involved in what they call "violent political activities."[18] Their results show that those who oppose reforms are between 1 and 2.5 percentage points (corresponding to a ten percent difference) more likely to participate in this kind of activities. While this finding lends support to the idea that those who oppose reforms tend to "make more noise" than those who support reforms, it should be recognized that the difference is rather small. Furthermore, there is no evidence that those who are against reform have become more involved in this type of activities in recent years

Loss of credence of political parties may be another political reason behind the lack of support for reforms. Scholars of economic development argue that political parties are important in the reform process because of their programmatic orientation and because they may facilitate the process of aggregating disperse views and striking compromises for the adoption of reforms (Boix, 1998 cited in Corrales, 2002; and Graham and others, 1999). However, parties may also be important for the sustainability of reforms because they can help build credibility and reduce skepticism. "For economic agents to cooperate with the reforms, they must be persuaded that the state is fully committed to carrying through with them… [otherwise] they are hesitant to cooperate, not because they fear losing, but because they fear being cheated by other players who fail to do their part" (Corrales, 2002, page 32). Reforms are therefore more likely to lose the support of the public in countries where confidence in political parties is low and when implemented by personalistic governments or by unpopular or unstable parties. A related argument is that, since political parties do not reflect but rather shape the preferences and

[18] The index ranges between 0 and 1 and is built as the principal component of a set of question that ask whether the individual has ever participated in violent demonstrations, occupation, lootings etc). For further details see Appendix 2.

responses of the electorate, cohesive parties increase the sustainability of reforms, especially when aligned with the executive (Corrales, 2002, chapters 7, 8, and 9).

Based on this reasoning, Panizza and Yáñez (2003) have tested whether there is a relationship between support for reforms and trust in political parties. They have measured trust and identification with political parties with two variables taken from the *Latinobarómetro*. The first measures the level of trust in political parties on a scale from one to four (where four means a lot of trust in political parties). The second measures identification with political parties on a similar scale (four if the respondent feels very identified with political parties). Figure 9 shows that there is a strong and positive correlation between support for reforms and trust in political parties. The results indicate that an individual that fully trusts political parties is 14 percentage points more likely to support the market economy than an individual who does not trust political parties (and 20 percentage points more likely to support privatization). While there has not been a substantial drop in trust and identification in political parties, the association between trust and political parties and support in reforms (in particular, support for the market economy) has become stronger, marginally helping to explain the increased rejection to pro-market reforms. As we will discuss below, the adoption of structural reforms has apparently taken a heavy toll on the parties that pursued them while in power, which is consistent with this result.

In summary, there are linkages between socio-economic characteristics and political support for pro-market reforms. However, those variables do not go a long way towards explaining why rejection of reform has increased thorough time. The change of attitude of public opinion is not due to a profound change in political views or to an increase in the ability of those opposed to get their position through but, as discussed before, to short term economic circumstances. Although this may be a good omen for the future of reforms, it is not entirely clear that acceptance of market-friendly policies will revive when and if these economies recover, since it is likely that negative attitudes will tend to linger, making the acceptance of further reforms difficult even when the current crisis subsides.

Psychological Reasons

Neither the economic nor the social consequences of structural reforms can explain the attitude of the public towards them. Nor is there any evidence that Latin Americans are moving ideologically towards the left, which would imply a reduced appetite for the market vis-à-vis the

State. The only evidence that helps explain to some extent the lack of support for reforms is the recent deterioration of macroeconomic conditions in the region. Given the insufficiency of our previous explanations, we conclude our exploration of possible causes for the reform fatigue with some very tentative hypotheses based on behavioral economics.

Some analysts have turned to cognitive psychology to explain why structural reform becomes bogged down. Pioneering research by Kahneman and Tversky (1979) found that individuals are more willing to take risks in order to recover a loss than when they are seeking to protect their gains. Weyland (2002) argues that this pattern can explain why presidents tend to back away from structural reform programs even after having administered a successful "shock" program of structural reform. If the initial reform overcomes an acute economic crisis and restores stability, presidents are less motivated in a stable environment to push for additional reforms than they were during the initial crisis. According to this hypothesis, once the recovery has taken place, leaders become less willing to take risks. Weyland suggests that this was precisely the case in the early 1990s in both Argentina and Peru – after both economies recovered following bold reforms, presidents Menem and Fujimori became more risk-averse and the process of structural adjustment slowed.

More recently, as finance minister Fernando Henrique Cardoso introduced the *Real* plan when Brazil was suffering from high inflation in 1994, but once he became president the following year, the reform process slowed considerably during his two terms in office. In Ecuador, President Mahuad initiated a process of dollarization during a severe crisis that helped stabilize the economy, however the structural reforms that would enhance the viability of dollarization have not yet been achieved.

Of course a crisis is no guarantee that significant structural reforms will occur (Argentina since 2001 is an example), however Weyland's point is that in an atmosphere of crisis, politicians generally find greater public acceptance of reform, although once stability returns, that support can erode. During the past half decade there has been weak economic growth, but full-blown crises have occurred only in a handful of countries (Argentina, Ecuador, Uruguay and Venezuela). Consequently, this relative stability combined with growing dissatisfaction with reforms already in place, did not create a receptive climate for reform. On the contrary, the recent economic downturn in the region has created a fertile environment for political actors who oppose the process of structural reform.

Another psychological reason may help explain the rejection of pro-market reforms when countries are away from the pressure of an economic crisis. Most people tend to prefer outcomes that are known with certainty to be positive over the uncertain possibility of a much larger benefit, even when the expected value of the latter is much bigger (Kahneman and Tversky, 1979). In the popular saying “better the devil you know”. This implies a psychological bias in favor of the status quo ante, which can help explain popular resistance to any type of reforms. However, in the case of pro-market reform, this bias can also help explain the rejection of the reforms once implemented, because a larger role for the markets vis-à-vis the State implies that people are faced with more risks (Rodrik 1997). Even if the aggregate outcome is welfare enhancing, many people may prefer the previous situation where uncertainty was lower. Furthermore, willingly exposing people to risks without offering them means of protection is considered unethical or at least unfair by many people (Schwartz, 1998).

Psychology may offer another fundamental reason why, after a trial period, most people tend to reject reforms even when relatively successful: cognitive biases. Two types of cognitive biases are universal aspects of human behavior. One is “confirmatory bias,” that is the tendency to misinterpret ambiguous evidence as confirming pre-existing hypotheses or beliefs. Experiments performed by psychologists show that if people have different initial beliefs, when they receive *the same* additional information, their views do not tend to converge, but to become more polarized, as they process that information selectively in order to confirm their initial beliefs. The second universal behavior is “self-serving bias,” that is people´s tendency to truly believe the hypothesis that best serves their interests. An implication of this bias is the tendency to attribute success to one´s own effort but failure to external forces, such as bad luck or ill-intentioned behavior of others (Pinker, 2002). The implications of these biases can be devastating for the sustainability of reform. Pernice and Sturzenegger (2003) have argued that, in the case of Argentina, these biases are at the root of the social resistance to reform. In spite of the initial success of privatization and foreign direct investment deregulation in the early nineties, even before the Tequila crisis of 1995, people were already focusing on the (alleged) negative outcomes of those reforms, such as unemployment and wealth concentration. A series of well-known events provided further ammunition to those anti-market beliefs, polarizing public opinion and reinforcing a deep-rooted position against both free markets and foreign influences. As the authors conclude, “it is then perfectly consistent with these cognitive biases that people will turn against a successful reform process if the principles of these reforms are at odds with their self-serving view of the world."

Therefore, cognitive psychology offers some hypotheses that may help explain lack of support for reform. They are related to some principles of behavior toward risk—namely, that when confronted with losses, people are better prepared to assume risks than when they find themselves in a situation that they consider normal—and some universal cognitive biases: confirmation bias and self-serving bias. Since only casual evidence has been advanced in favor of these hypotheses, their actual relevance is an open question.

Implications of Reform Fatigue

Whether we can identify the causes for the reform fatigue or not, a major concern arises: the loss of popular support for pro-market reforms and the lack of appetite in the political arena for the "neoliberal model" may be signaling an increasing risk of a backlash. Even if the reform process is not reversed, the economic and social benefits of what has been done so far largely depend on further reforms in order to give institutional support to previous liberalization measures (the so-called, second generation reforms) and to advance social policy reform. The future of the reform process therefore depends on political support, not only to maintain the reforms already implemented, but also to pursue these additional reforms.

The Political Costs of Pro-market Reform

This section explores the political implications of reform fatigue. We start by addressing a central question: What has been the electoral pay-off of the reforms? If parties that pursue pro-market reforms are rewarded by the electorate, political selection will tend to deepen the reform process. But if the electorate punishes the reformers, those who want the process to be halted or derailed will stand a better chance of achieving that.

Theories of political economy provide strong arguments to explain why structural reforms may be difficult to implement and may carry political costs. Reforms must defy the status quo ante and reallocate income among different social groups (Rodrik 1994). Most likely, while those who stand to gain from the reforms are a diverse and disorganized group, the losers are a smaller group, often organized and politically vocal, intent on protecting its interests. Reforms are also opposed because their effects are uncertain, both at the macro and the micro level. Uncertainty about the allocation of losses among the members of the group most affected can elicit ex-ante opposition even if the overall pay-off for the group is positive (Fernández and Rodrik, 1991). These potential political costs can be outweighed by the benefits of the reforms, which come from the improvement in macroeconomic conditions (lower inflation, higher growth, less unemployment). According to political economy theory the chances of reform improve when the expected benefits are large enough to tilt the political balance against those who oppose reform. For this reason, reform is more likely in the midst of a crisis (Alesina and Drazen 1991, Drazen and Grilli 1990, Rodrik 1994.).

Since these economic theories concentrate on the ex-ante political costs of reform, their arguments are less adequate to explain the resistance to reforms already implemented. But political scientists have advanced several hypotheses to explain the ex-post political pay-off of the reforms. They argue that the pay-off must be positive when the reforms have been implemented in response to a crisis, and when reforms are followed by higher growth (and other desirable macroeconomic outcomes) that may be viewed by the public as a consequence of the reforms. The reasons for these hypotheses are the principles of behavior towards risk and the limited understanding by most people of the actual workings of the economy, as mentioned above. Based on case studies for a handful of Latin American countries, Stokes (2001) has found support for these arguments. He has also found that the response of the electorate is not independent of the pre-electoral campaign promises of the incumbent. The voters do punish the “switchers” who opt to implement pro-market reforms after having campaigned against them. Therefore lying may be a good bet ex-post facto, but only if the reforms do deliver substantially better macroeconomic results.

Lora and Olivera (2003) have attempted to test the validity of these hypotheses with the outcomes of around 40 presidential elections in 17 countries between the mid-eighties and the end of the nineties. They have found mixed but extremely interesting results (see Appendix 3). A party that has been in power gains votes if the rate of inflation is reduced during its term, but loses votes if pro-market reforms are adopted. Their estimates suggest that if inflation is reduced, say from 100% to zero during the term of the administration, the electoral pay-off is a handsome doubling in the vote share for the party. Such large reductions in inflation are not common, however (the average reduction in the sample is just 9%). In contrast with this, when a government pursues aggressive structural reforms, say an increase in the reform index of 0.24

points (which corresponds to the average increase in the index in the entire period 1985-99 as we have seen above), the electorate punishes the incumbent's party by slashing about a quarter of its votes. (However, the typical amount of reform represents just 0.08 points of gain in the reform index, with a correspondingly lower electoral cost). These results support the widely held view that aggressive liberalization policies are more easily pursued from a political point of view when combined with an anti-inflationary package, as happened in Argentina and Peru at the beginning of the nineties. It is also consistent with the fact that virtually all governments have tried to protect price stability at all costs during the last decade. These results imply as well that, being politically costly, pro-market reforms are bound to hit a political wall, since the parties that backed them in the past may be in retrenchment and the whole party system may now be more fragmented in many countries than a decade ago, partly as a result of those policies. As we have mentioned, case studies suggest that these political costs may be lower when the reforms are pursued in response to a crisis, when they are in line with the incumbet's pre-electoral promises and when growth picks up. It may be so in a few, specific cases, but Lora and Olivera have not found support for any of these hypotheses with their sample of elections.

Does all this imply that the reforms are doomed to be stalled or, even worse, that a reform reversal should be expected? Not necessarily. First of all, it is not clear whether different types of reforms carry similar political costs. Lora and Olivera have found that the costs seem to be much more clearly associated with the adoption of trade liberalization reforms than to any of the other four reform areas considered, which comprise financial liberalization, tax reform, privatization and labor reform. Since trade liberalization happens to be the area where the potential for reform has been exploited the most, it may be possible that deepening the rest of the first generation reforms or pursuing second generation reforms may turn out to be less politically costly, or even beneficial. Second, our knowledge of the political costs of reform are based, almost entirely, upon the experience of reform adoptions and advances. It would be a big leap to assume that reform reversals produce correspondingly large political benefits. Remember that a basic tenet of the political economy theory of reform is that changing the status quo is politically costly. Today´s status quo is based on a much larger role for markets than a decade ago, which implies that the stakes of investors and other market participants are also much larger.

This does not mean, however, that investors are always in favor of pro-market, neutral economic policies. On the contrary, a real concern for the future of reforms is that the appetite of private firms for (and ability to get) interventionist policies seems to have increased in recent years. In their annual surveys to around 100 firms per country, the World Economic Forum poses this question: “When deciding upon policies and contracts governments officials usually: favor well-connected firms (=1) … are neutral among firms and individuals (=7)”. Figure 10 shows the average responses in the 11 Latin American countries surveyed both in 1999 and in 2002. In eight countries the responses signaled towards a significant decline in the neutrality of policies[19]. The only exceptions were Chile, Brazil and Mexico. However, domestic firms are only one group of stake-holders in the reform process. International financial investors are another, and one of no little importance, given the high levels of external indebtedness of most Latin American countries. Have they also become more lenient?

International Financiers Sensibility to Reform Retrenchments

Have international markets become more tolerant of unorthodox economic policy announcements? How do international markets respond to presidential elections when leading candidates promise to halt or reverse the process of structural reform? A brief survey of the region’s most recent elections—in Argentina, Brazil, and Ecuador—is not conclusive, but suggests that investors have become more tolerant to those announcements. In order to analyze the linkages between international market sensitivity and pre-electoral uncertainty, we look at the country risk premia.[20]

The economic collapse of Argentina and the subsequent ineffectiveness of the Duhalde administration led to a general perception that only a new government could begin to resolve the country’s problems. This is despite the fact that the leading candidate for president, Nestor Kirchner, promised a greater role in the state economy and fiercely criticized Argentina’s “neoliberal” economic path. After Kirchner’s election, bond spreads fell from the 7000 trading range to the 5000 range, indicating some hope that the debt situation would be resolved under his leadership.

In Ecuador, as the political campaign heated up, bond spreads widened only slightly. The response of the bond market was minimal despite the fact that the winner, Lucio Gutierrez, a 2000 coup leader and an admirer of Hugo Chávez, reached the second round after running a

[19] The change in those eight countries was more than twice the standard deviation of the eleven values in 1999, suggesting that there was a real change of perception, not just a random change in the responses in the different countries.

populist campaign against banana tycoon Alvaro Noboa with the support of the left and indigenous groups. With bond spreads already hovering at around 2000 basis points, it appears that financial markets had already discounted the risks posed by fiscal and foreign debt constraints.

Prior to the 2002 election in Brazil, the *real* weakened, the stock market plummeted, and bond spreads soared to over 2000 basis points amid fears of an imminent Lula victory. In August, spreads narrowed by 500 basis points as investors were cheered by the presidential candidates' pledges to honor the $30 billion loan package from the IMF. However as Lula gained strength in the polls in September, bond spreads again surpassed the 2000 basis point level. After the elections, market sentiment improved as investors gained confidence in Lula's commitment to respect fiscal constraints, and by October 2003, bond spreads had fallen to the 750 basis point level.[21]

This brief preliminary survey of country risk suggests that Brazil is the exception, rather than the rule, in that international financial markets strongly reacted to unorthodox economic policy announcements. But is Brazil really an exception? If we compare the performance of Brazilian sovereign bonds with U.S. corporate high-yield bonds, we see a similar movement of bond spreads, suggesting that more than a "Lula effect", there has been a recent "Enron effect."[22] Since high-yield U.S. corporate bonds and sovereign bonds are perceived as high-risk investments with some degree of substitutability, their performance shows a positive correlation.[23] However, that co-movement became much stronger following the eruption of the Enron scandal (see Figure 11), which put into question the reliability of the balance sheets of the major corporations. This reduced the appetite for foreign direct investments in emerging markets, where the lack of accounting transparency may be an even more serious issue than in the United States.

Whatever the explanation for the recent strong co-movement, on close inspection the "Lula effect" might be less than initially supposed. This suggests that international investors have

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[20] The indicator for country risk is the interest rate spread in basis points between the country's emerging market bond index over 30-year US treasuries.
[21] For an analysis of the Lula effect see Martinez and Santiso 2003.
[22] This remark is due to Guillermo Calvo and Ernesto Talvi: "Lula Effect? Look Again", *Financial Times*, October 23, 2002.
[23] As part of a forthcoming paper on financial market sensitivity to political and economic uncertainty in Latin America, Quispe-Agnoli and Kay ran preliminary regressions where the country-risk premium was the dependent variable and the exchange rate and corporate bond spread were independent variables.

become very lenient with the threats of reform backlashes, which may increase their likelihood. However, this evidence is still very inconclusive. The casual evidence just reviewed may be consistent with other hypotheses. For instance, investors may have learned to distinguish between political “noise” and real threats to the sustainability of structural reform. In fact, Lucio Gutiérrez and Lula da Silva have proved to be much more orthodox than expected, while it is debatable whether Kirchner has substantially altered the course of structural policy decisions. Furthermore, in all three cases debt spreads were already at excessively high levels, indicating that international investors were all too aware of the flaws of the economic situation and the structural policies. More research is clearly needed to know whether international investors have become more or less lenient with unorthodox economic policies and what effect this change may have on the future of reforms.

Conclusion

If the sustainability of reform hinges upon the beliefs and attitudes of the main players, there are serious reasons for concern in Latin America, as symptoms of reform fatigue are plenty. Public support for pro-market policies has been waning since 1998 and currently only a minority of the public declares themselves in favor of privatization or free markets. As policymakers have also become less enthusiastic, the reform process is now stalling in many countries and two countries have experienced major setbacks. Unlike public opinion at large, opinion leaders are supportive of privatization, but many qualify their support and they are clearly divided about the impact of the so-called neoliberal model on poverty. Not even international organizations or top economic thinkers are any longer unified around the need and convenience of pursuing a core set of pro-market reforms in order to improve the chances of economic and social development.

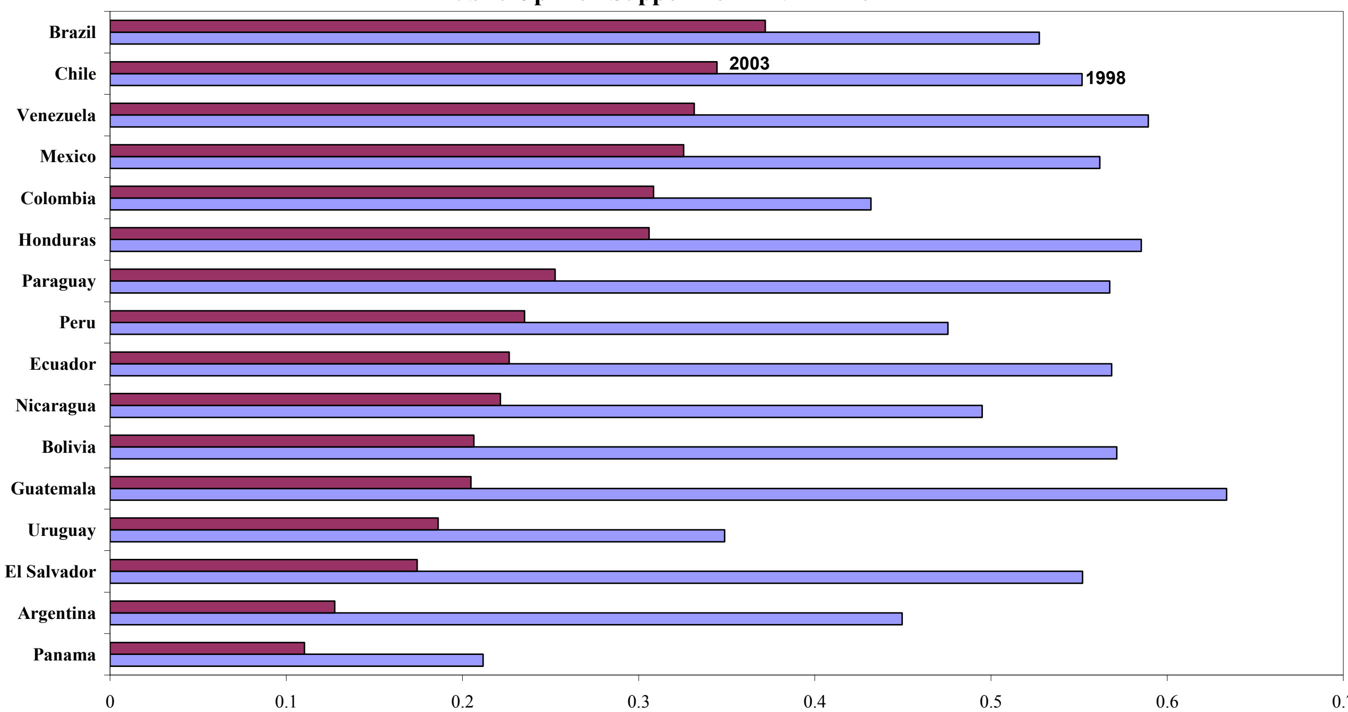
This paper has explored a variety of hypotheses that may help explain the increasing rejection of reform. Economic hypotheses gain the upper hand. Although positive, the effect of reforms on productivity and growth seems to have been moderate, largely transitory, and certainly below the expectations originally created by the reformers. Granted, reforms in most countries have been incomplete and have lacked institutional and regulatory support, but the political and practical demands this would imply put them beyond the reach of those countries in most need of them. However, what seems to have influenced public opinion the most is the short-run macroeconomic situation of the countries, rather than complex analyses about what makes reforms more or less successful. The recent deterioration of some social indicators and the perception of increased inequality may have reinforced those negative views, in spite of the fact that the association between those outcomes and the reforms is extremely weak.

Political explanations cannot account for the increased rejection of reform. There is no evidence of an ideological turn toward the left or of a greater ability on the part of reform opponents to spread their views in the political arena. However, politics is bound to play the decisive role in the future of reform, because the parties that have pursued them have paid a hefty electoral cost. This cost has only been mitigated when the reforms have been packaged with ambitious anti-inflationary policies, but other circumstances do not seem to have affected the reaction of the electorate.

Since a large part of the increased rejection of reform is associated with the recent growth slowdown in many countries of the region, an eventual recovery could be expected to facilitate the re-initiation of the process. This is far from guaranteed, however, for at least two reasons. One is the fragmentation of the political system and the disarray of the political parties in many countries, partly a consequence of the reform process. The other is the nature of public opinion. If, as cognitive psychology maintains, people form their opinions in order to support their previous beliefs and serve their own interests, economic recovery will not necessarily restore confidence in reforms. Though this does not bode well for the likelihood of further ambitious pro-market reforms, it must not lead to the conclusion that reform reversals, such as those of Argentina and Venezuela, should be expected in other countries. A more likely scenario is that, especially where pro-market reforms are well advanced, the eventual recovery of economic growth will lead to further institutional and social policy reforms that buttress the original reforms. Of course, this good scenario would probably not materialize if the incipient recovery aborts, particularly in the case of Brazil.

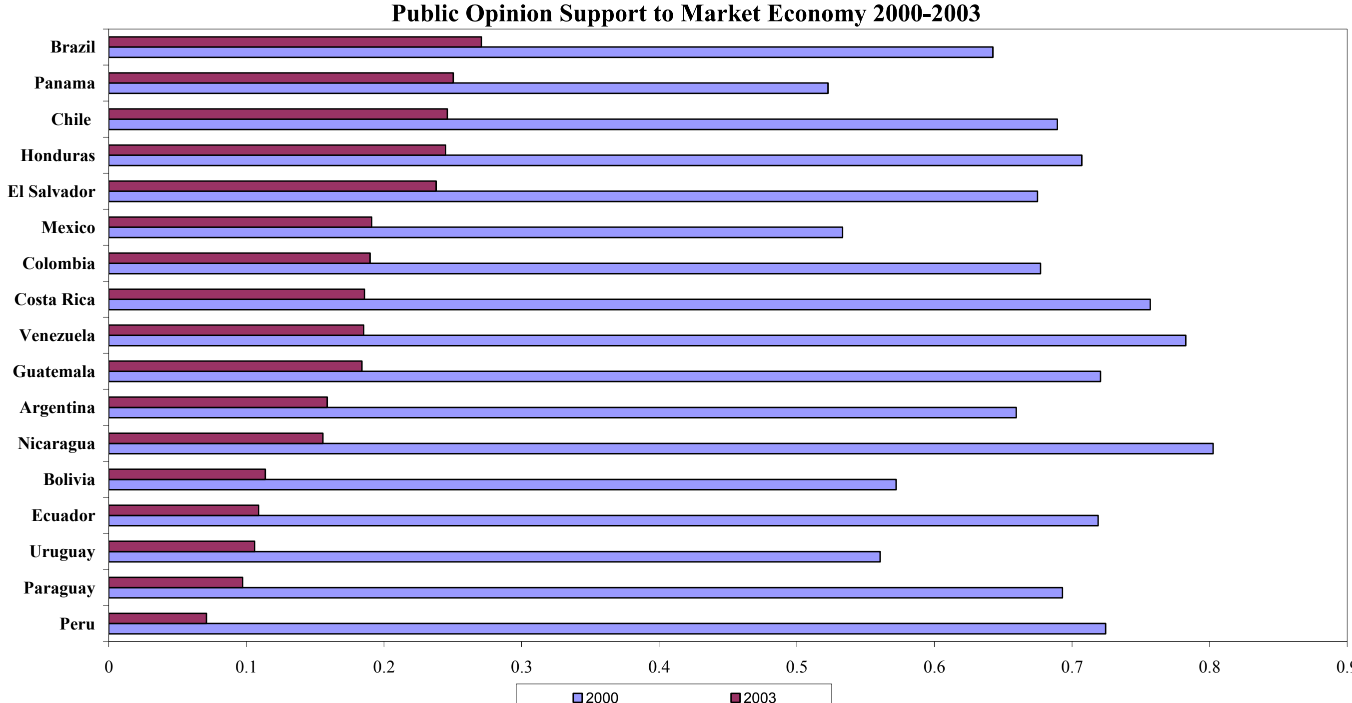
Figures and Tables

Figure 1
Public Opinion Support for Privatization



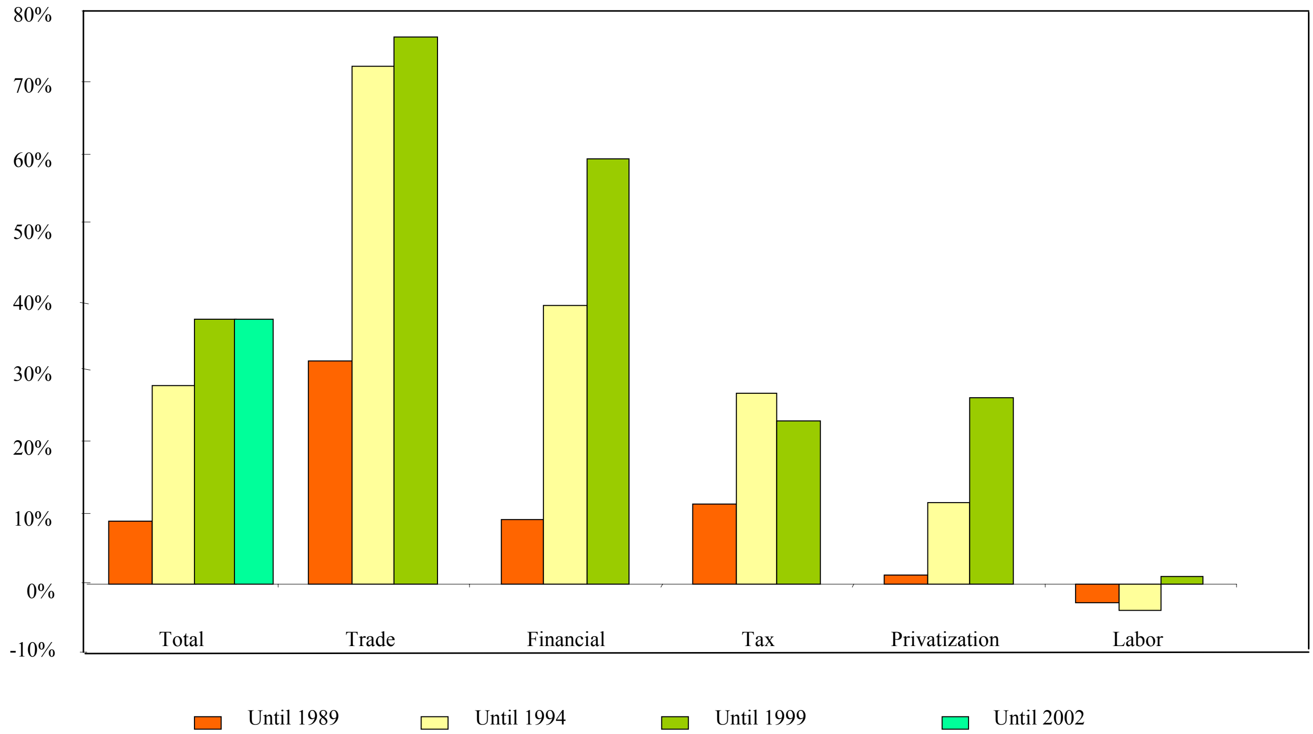
Source: Panizza and Yáñez (2003)

Figure 2
Public Opinion Support to Market Economy 2000-2003



Source: Panizza and Yáñez (2003)

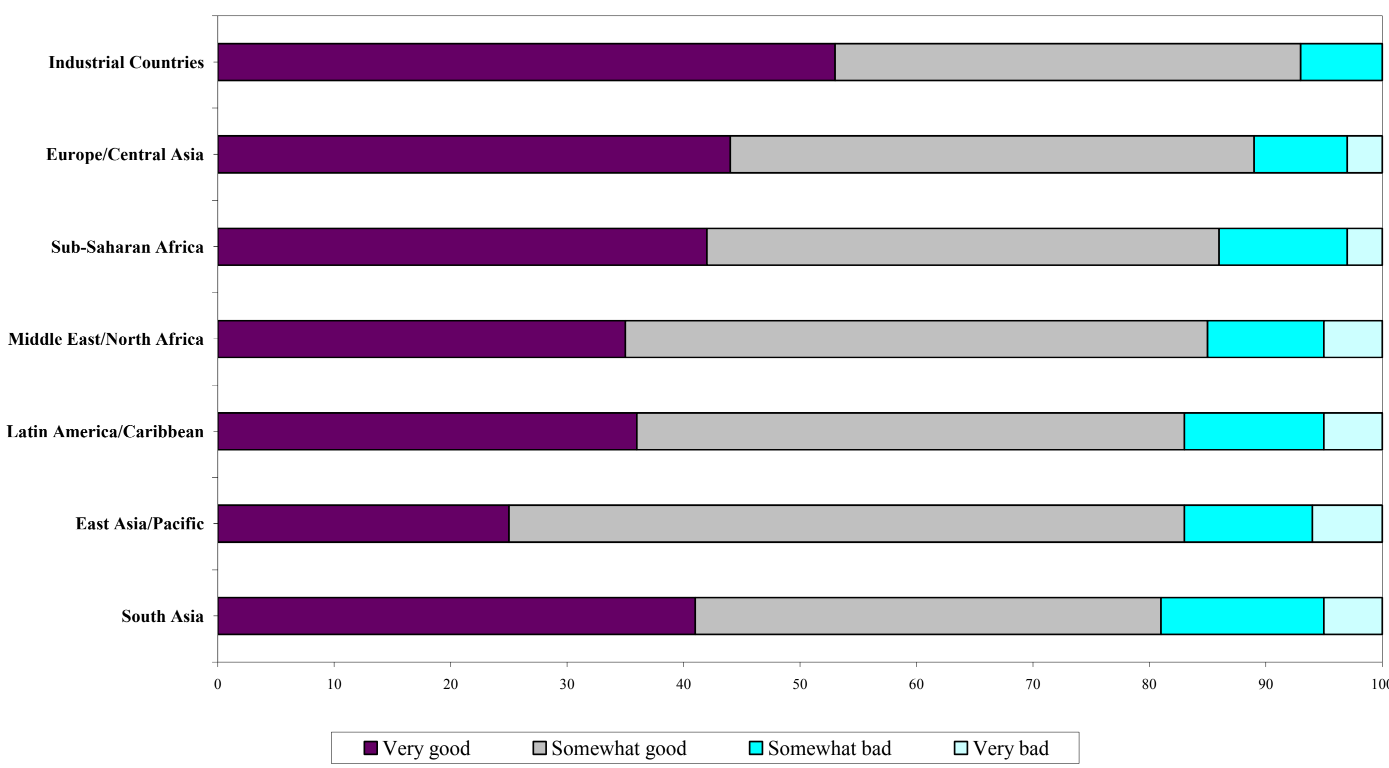
Figure 3
Progress of Reforms in Latin America
(Margin of Reform Put to Use)



Note: Progress in reforms is measured as that part of the potential for reform as of 1985 that was actually used by the years 1989, 1994, and 1999.

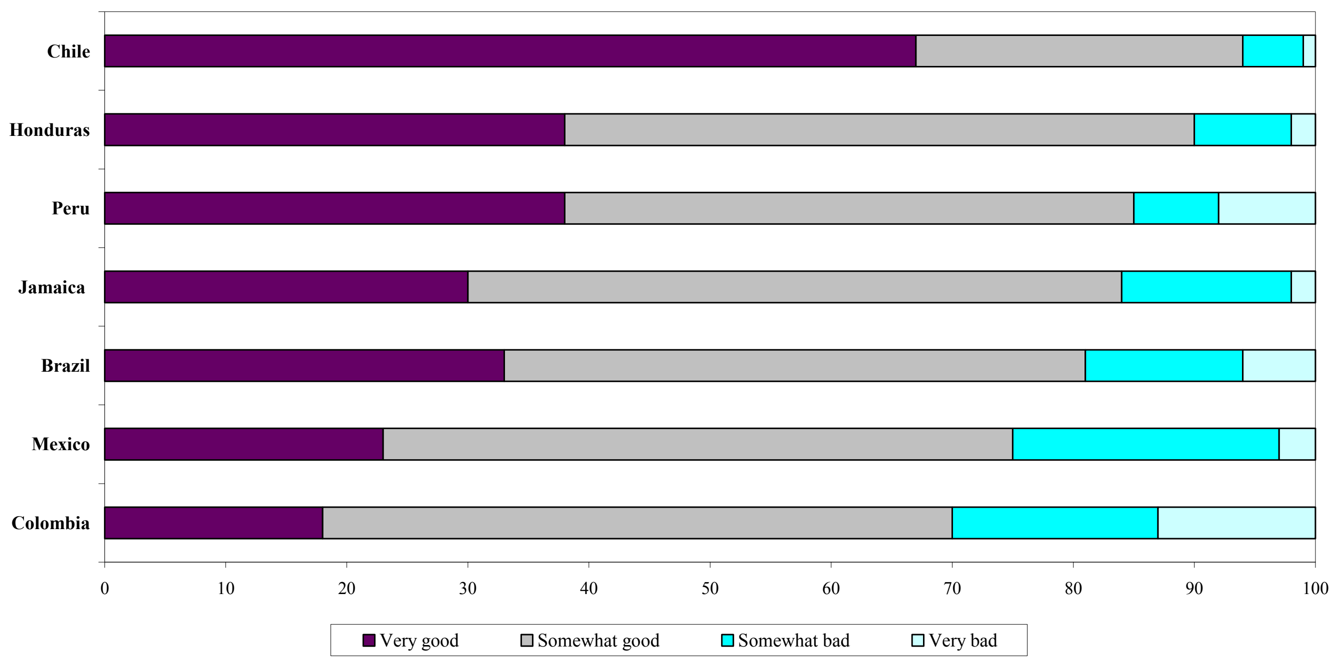
Source: See Appendix 1.

Figure 4.1
Opinion Leaders' Support for Opening Markets and Trade



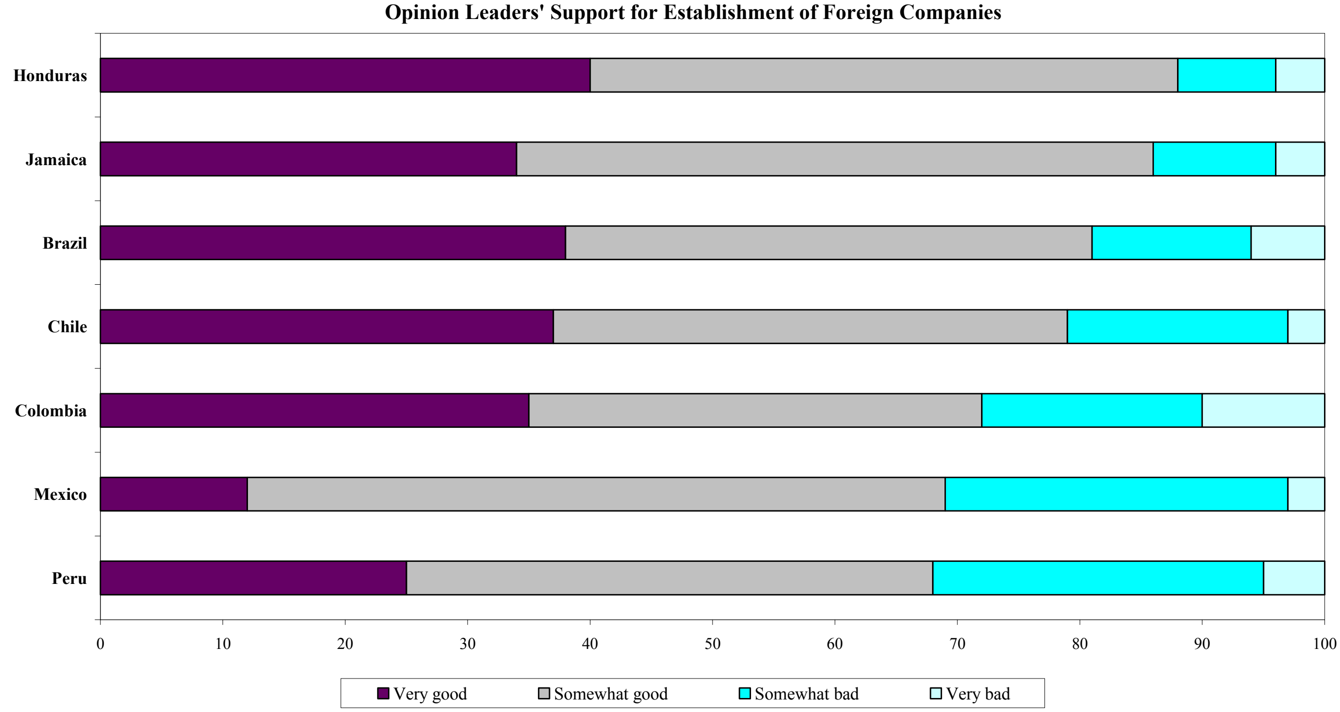
Source: The Global Poll. Princeton Survey Research Associates for The World Bank

Figure 4.2
Opinion Leaders' Support for Opening Markets and Trade



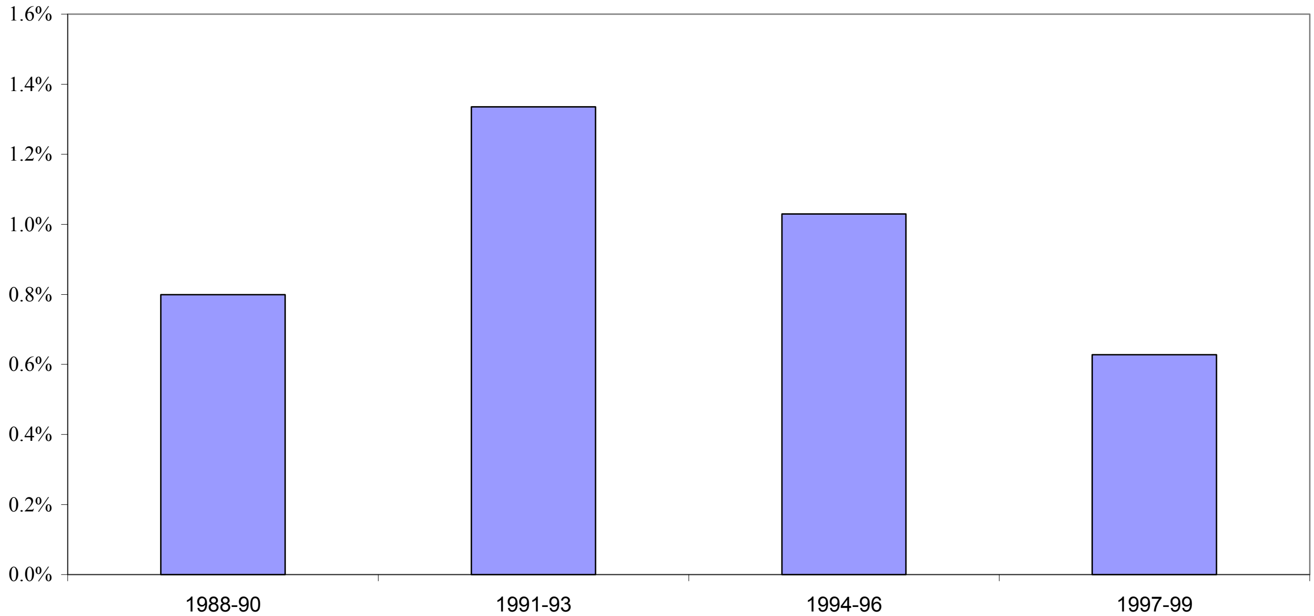
Source: The Global Poll. Princeton Survey Research Associates for The World Bank

Figure 5
Opinion Leaders' Support for Establishment of Foreign Companies



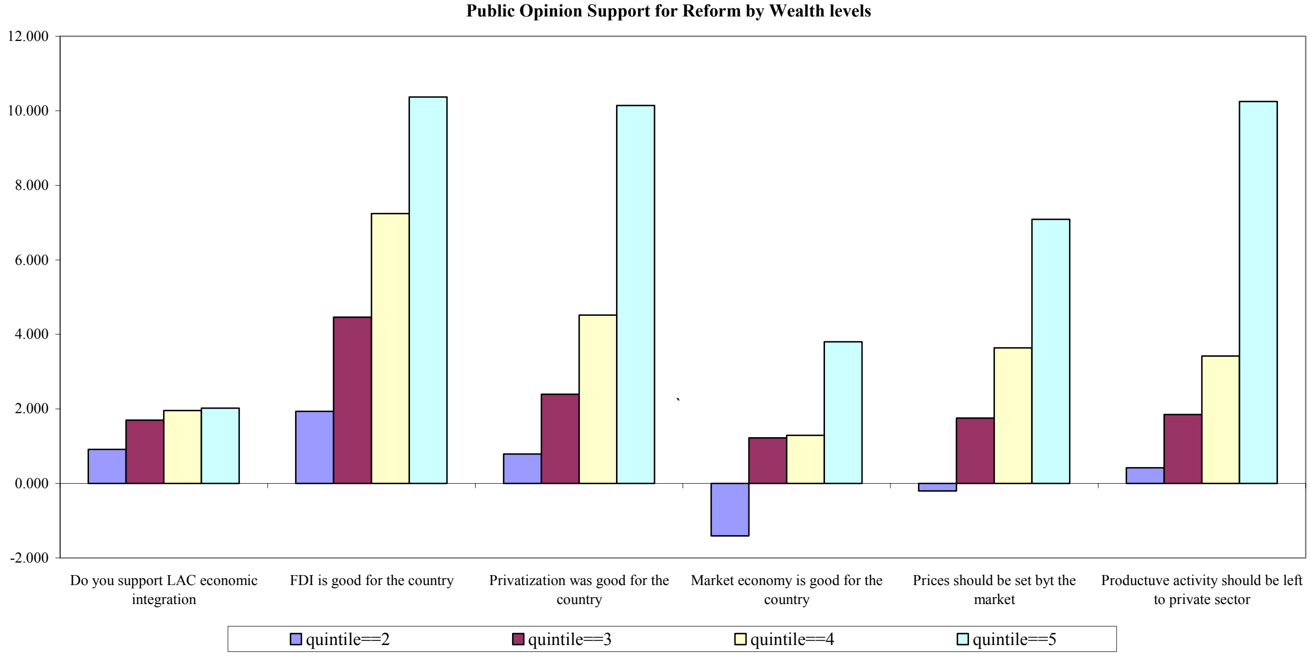
Source: The Global Poll. Princeton Survey Research Associates for The World Bank

Figure 6
Effect of Reforms on Growth
(Latin American average)



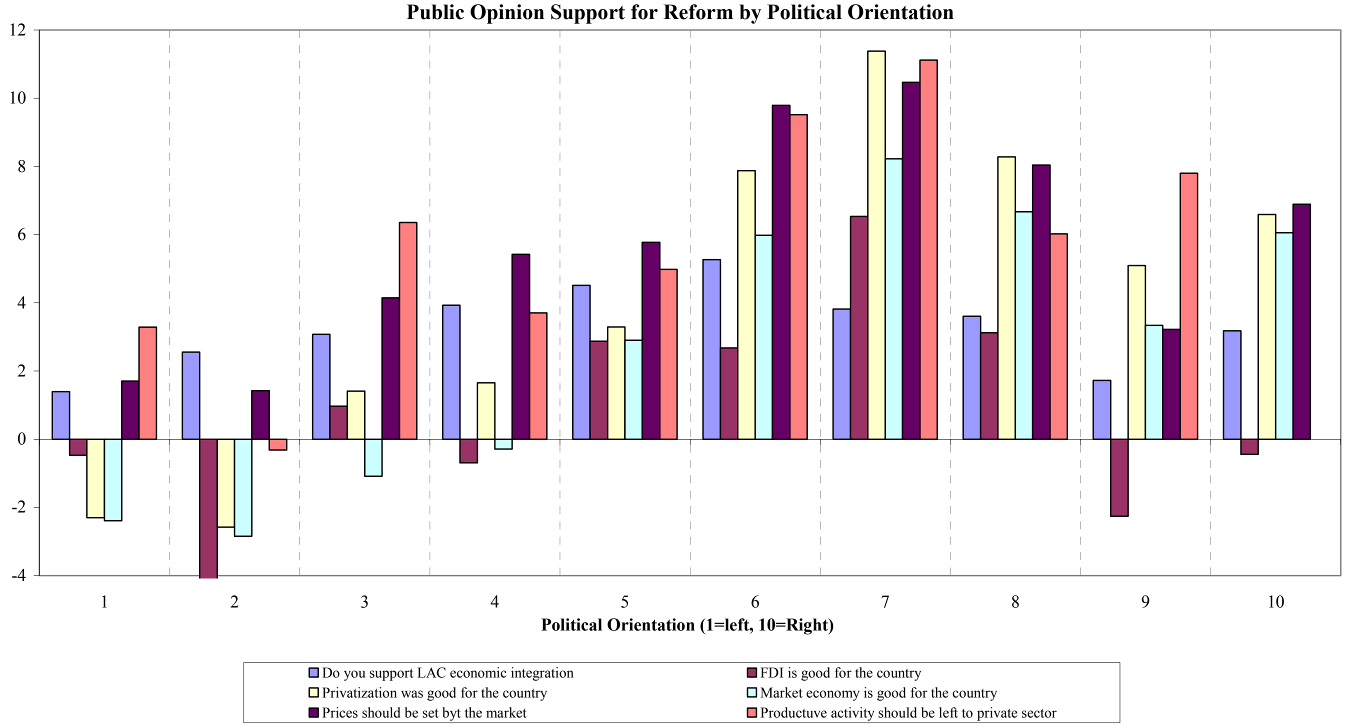
Source: Lora and Panizza (2002)

Figure 7
Public Opinion Support for Reform by Wealth levels



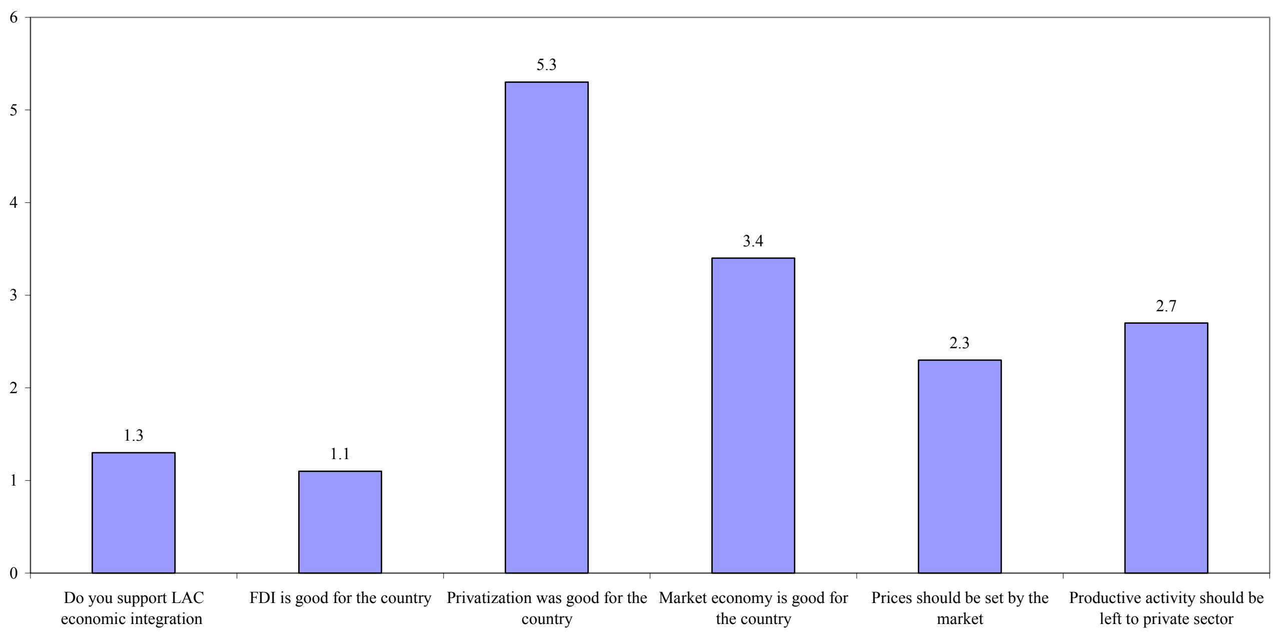
Source: Panizza and Yáñez (2003)

Figure 8
Public Opinion Support for Reform by Political Orientation



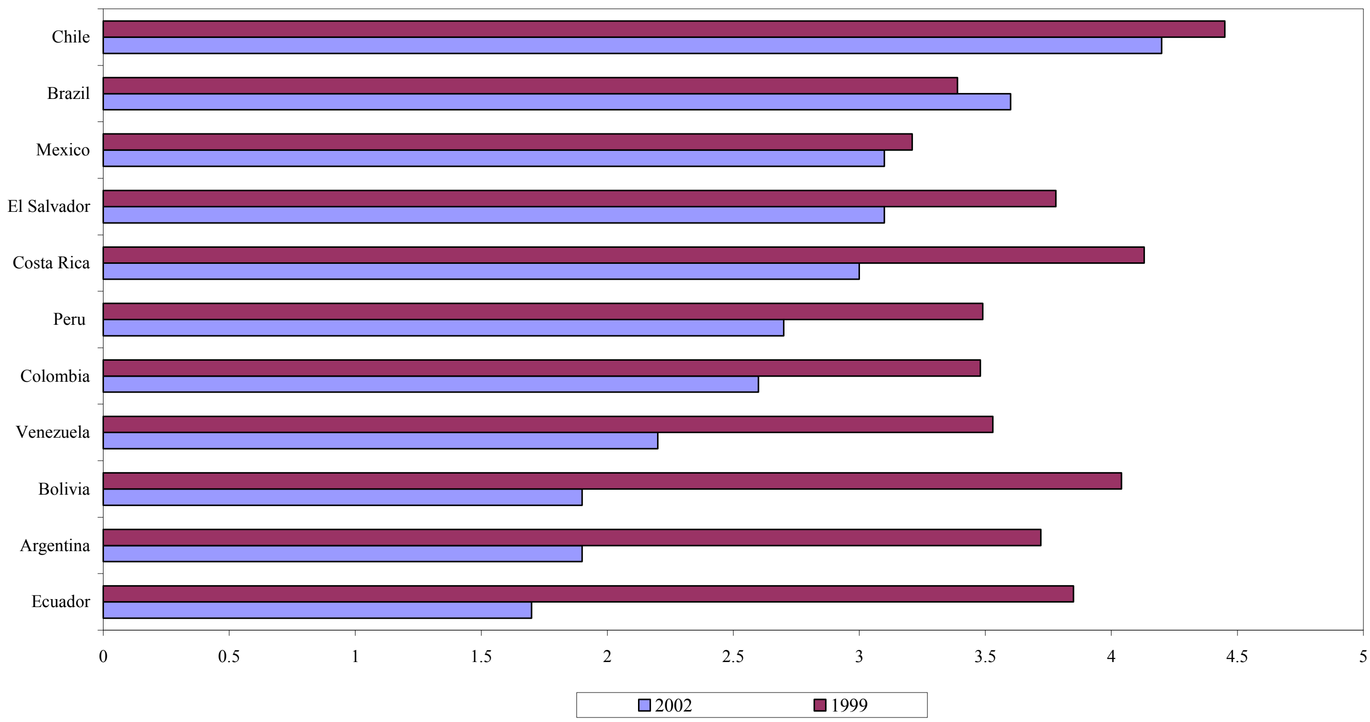
Source: Panizza and Yáñez (2003)

Figure 9
Public Opinion Support for Reform by those Who Trust Political Parties



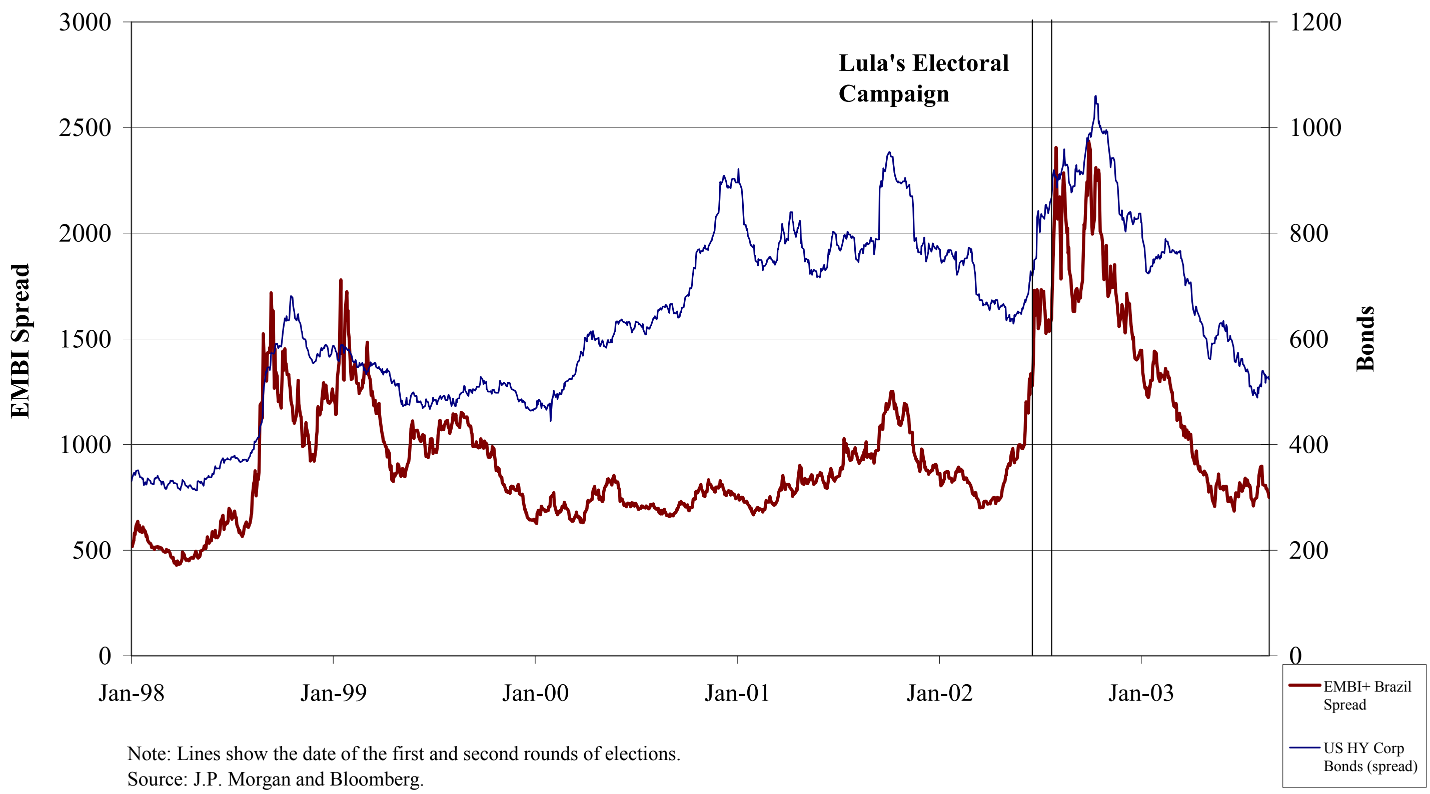
Source: Panizza and Yáñez (2003)

Figure 10
Business People's Perception of Favoritism in Government Policies



Source: World Economic Forum. Global Competitiveness Report 1999 and 2002

Figure 11
US High Yield Corporate Bonds and Brazil EMBI+ Spread



Note: Lines show the date of the first and second rounds of elections.
Source: J.P. Morgan and Bloomberg.

Tables

Table 1
What Latin Americans think of pro-market reforms
(Percentage)

	In favor of Economic Integration	In favor of Foreign Direct Investment	In Favor of Privatization	In favor of the Market Economy	In Favor of Price Freedom	In favor of Leaving Productive Activities to the Private Sector
1996	74					
1997	87					
1998	88	77	52	77	63	56
2000			38	67	57	
2001	84		31		59	50
2003			25	18		

Source: Appendix 1

Table 2
The Progress of Reforms since 2000

Progress	Brazil, Chile, Colombia, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Peru
Stalling	Bolivia, Costa Rica, Dominican Republic, Ecuador, Paraguay, Trinidad and Tobago, Uruguay
Reversal	Argentina, Venezuela

Source: See Appendix 1.

Table 3
Growth and Productivity in Latin America

Latin America and the Caribbean	GDP growth rate	Per capita GDP growth rate	Total factor productivity growth rate
1961-70	5.3	2.7	1.0
1971-80	5.5	3.4	-0.3
1981-90	1.2	-0.7	-0.2
1991-99	3.8	2.1	0.1
2000-02	0.6	-1.1	

Source: Loayza, et al (2002) and World Bank (2001)

Table 4
Effects of Reforms on Growth

	Simple average of selected countries	Weighted average of selected countries
Easterly, Loayza and Montiel (1997)		
1991-93 vs 1986-90	2.2	1.7
Lora and Barrera (1997)		
1993-95 vs 1987-89	2.2	2.2
Fernandez-Arias and Montiel (1997)		
1991-95 vs 1986-90	1.6	1.7
Lora and Panizza (2002)		
average 1988-1999	1.0	n.a.
Loayza et. al (2002)		
1990s vs 1980s	1.3	n.a.

Source: Taken from IDB (2003, Chapter 5)

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Appendix 1. Progress and Setbacks in the Process of Reform in 2000-2002[1]

In **Argentina,** the process of reform since 2000 has lacked any sense of direction. While many measures have reduced market incentives and introduced distortions, implying a reversal in the reform process, other measures have attempted to limit government interference in economic decisions and re-establish market freedoms, especially since 2002:

- In trade policy, non-Mercosur import-duties were raised to 35%, subsequently in April 2001 a so-called "fiscal" devaluation of about 8% was established for trade operations and an eventual re-pegging of the peso to the dollar and the euro (with equal weights) once the euro reached parity with the dollar, was announced. After the devaluation in early 2002, foreign exchange controls were imposed, including the surrender of export receipts. These controls have been gradually liberalized during 2003. Additionally, tariffs in the order of 20 percent were imposed on agricultural exports in April 2002.
- In the finance area, a policy was instituted in April 2001 to impose immediate surcharges of six-tenths of one percent (.6%) on financial transactions in the hope of narrowing the gap between fiscal revenues and expenditures. In June, the central bank charter was modified allowing greater room for liquidity injections, undermining the currency-backing rule under the Convertibility Law. In response to a run on bank deposits in late 2001, withdrawals were blocked. Once the peso was devalued in early 2002, debts to financial institutions were converted to an exchange rate below the rate used for the conversion of deposits, which exposed the financial sector to heavy losses that were supposed to be offset by the government. Moreover, deposits were indexed to the CPI, while loans were indexed to wages, thus introducing a dynamic wedge in banks' balance sheets. In addition, during 2001 and 2002, the federal government engaged in issues of quasi-money (lecops), and several provincial government issues soon followed, in an amount equivalent to about 50% of all peso-denominated currency in circulation. Pension fund holdings of government debt were converted to pesos, but subsequent pressure from these funds led to re-dollarization of these holdings, but, in turn, the government announced that these holdings would be included in the ongoing debt restructuring process, and, thus, be subject to steep write-offs.
- In the area of tax policies, changes were numerous, many of them making the system less neutral. Thus, while in 2000 payroll taxes were reduced from 49% of gross wages to 43% and the tax on commercial borrowers' interest payments was reduced in stages, the same year, tax amnesties were reintroduced, taking a significant toll in tax revenues, credits were established for payment of value-added taxes (VAT) to be applied against several other taxes, extensions were given on the time available in which to use deductions from business losses to pay the minimum business tax. Furthermore, a policy was instituted to award individual income tax credits for a proportion of the interest payments made on home mortgages. In May 2001 "competitiveness" plans for specific economic sectors were introduced, consisting of tax benefits, such as exemptions from employer charges and other taxes in recognition of VAT payments and the use of tax credits to pay off debts to the central government.

In the area of privatizations, major setbacks took place after the devaluation, as government commitments with private firms in the infrastructure sectors were ignored and tariff caps and freezes were imposed. Congress is now in the process of voting a law authorizing the Executive to renegotiate existing contracts with these companies.

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[1] Based on the document series of the International Monetary Fund, titled *Staff Report for the Article IV Consultation and Selected Issues for 2000 and 2001*, and the *Country Reports* of The Economist Intelligence Unit.

In **Bolivia,** the ambitious privatization process continued in 2000 and 2001, as sales of assets took place in the gas, hydrocarbon, and electric energy sectors. But little progress was evident in other areas. In the tax arena, significant steps were taken to strengthen customs administration and tax management. However, a more comprehensive tax reform, which had been agreed upon with the IMF for the year 2000, has been postponed and a reform geared at strengthening the regulation of the financial system has gone very slow. Draft laws have been presented to Congress for corporate bankruptcy and voluntary corporate restructuring. In the labor area, where comprehensive reform would be necessary, there has been no progress whatsoever.

In **Brazil,** the privatization process has remained on track. Electrical power and cellular telephone concessions were awarded, and reforms were adopted to encourage the deregulation of the hydrocarbon market. Nevertheless, critical disruptions in the supply of electric energy in 2001 led to the postponement of a program to sell off energy companies. Federalized state banks continued to be privatized, but progress in other areas was more tepid until 2002. However, reform regained momentum with the government of President Lula da Silva. In April 2003, a draft constitutional amendment was submitted to Congress to reform the social security system, aimed at increasing the age of retirement of federal civil servants and limiting pension benefits, thus substantially improving the financial situation of the system. A proposal was also presented to streamline the system of state value added taxes and increase the efficiency of other indirect taxes. Other reform proposals include the modernization of the bankruptcy law. As is widely recognized, market sentiment towards Brazil has been favorable with the new administration, as it has become clear that will adhere to orthodox macro and structural policies.

In **Chile,** requirements for cash reserves as a prerequisite for investment of foreign capital were eliminated in 2001, as were other administrative controls on transactions involving foreign capital. Measures were taken to facilitate multipurpose banks and to loosen controls on operations in capital markets. In the tax reform area, the individual tax rate, one of the highest in Latin America, was reduced, whereas the corporate tax rate was raised. In terms of privatization, the government moved ahead with its program to award infrastructure concessions, but it has not contemplated new programs to sell state enterprises to the private sector. In labor legislation, a system of unemployment insurance was passed, which would combine individual accounts with a collective insurance fund, and measures were adopted to facilitate union activities. However, more rigorous controls were imposed to restrict employee layoffs or dismissals and regulate workers' overtime. The authorities are working with the private sector on several structural reforms aimed at enhancing efficiency and stimulating investment. These reforms would encourage the development of venture capital, improve regulation in electricity and telecommunications, strengthen the institutional framework for the resolution of anti-monopoly cases, and improve the tax code and its institutional environment.

In **Colombia**, important reforms have been taken in several areas in the last few years. In the area of privatization, plans to sell two major electric power companies in 2001-2 did not materialize, and the private sector's anticipated announcement that it would raise capital for domestic power distributorships was put off due to a lack of interest and unclear regulatory conditions. Nevertheless, the government of Andrés Pastrana managed to launch the successful public sale on the stock market of a 15% stake in ISA, as part of a program to democratize stock holdings. Furthermore, the financial sector witnessed the sale of some financial institutions, and the recapitalization and restoration of some bank portfolios that had encountered difficulties in 1999. During the last year, several measures were taken to strengthen prudential regulation and financial supervision.

A reform passed in late 2002 introduced a one-time wealth tax, an income tax surcharge and extensions to the VAT base. Although expected to raise revenues by 1.6 percent of GDP in 2003, these measures further reduce the neutrality of the tax system.

Pension reform took important strides during the first year of government of Alvaro Uribe. In December 2002, Congress approved a reform that lengthens minimum contribution periods, lower replacement ratios and raises contribution rates, lowering the actuarial deficit from over 200 percent of GDP to 160 percent of GDP. More ambitious pension reforms require Constitutional amendment, which the government is now pursuing through a referendum to take place in late 2003.

A labor market reform was also approved in late 2002, which reduces wage and nonwage costs for certain employee groups.

In **Costa Rica** the attempt to set up a legal framework that would open the door to privatization in the telecommunications and television areas was defeated. (The 2000 legislative session of the Assembly enacted the legislation, which the Supreme Court subsequently voided.). In the area of financial reform, a regulation was implemented requiring banks to list offshore holdings on their balance sheets and file reports, and guidelines for credit classifications were improved. However, attempts to further strengthen bank supervision and level the playing field between public and private banks have been very limited.

In the **Dominican Republic**[2] the process of privatization of the electricity sector has zigzagged in the last years. In 1999 the state-owned company was split into generation, distribution and transmission arms, followed by the privatization of the first two. But the new system failed to solve the problems of the sector due to a flawed regulatory framework and a lack of market pricing mechanisms. In September 2002 the government reached an agreement with private generators and distributors in an attempt to solve the situation of crisis of the sector. The agreement provided for large tariff increases, the elimination of state subsidies and the renegotiation of contracts. However, the process suffered a major setback in 2003 with the sale back to the State of 50 percent of two electricity distribution companies by an important international investor who declared that “current macroeconomic and regulatory conditions have decisively altered the evolution of business plans in the country” (AFP, September 11, 2003). In the area of financial reform, a law was passed in 2001 creating a new social security system that allows the operation of private pension funds. A new monetary and financial code opening the market to new investments was approved by Congress in 2002. However, major deficiencies of regulation of the financial sector surfaced in 2003 when the government revealed the biggest bank fraud scandal in the country´s history. The second largest bank was declared insolvent as a result of embezzlement, fraud and bad deals.

In **Ecuador,** the private sector received approval to participate in several areas of hydrocarbon activity, allowing for the groundbreaking on a construction project to build an oil pipeline traversing the country from the Amazon region to the Pacific Coast. The project is estimated to be receiving $1 billion in direct foreign investment. Drinking water and waste treatment services in Guayaquil were contracted out, but then suspended due to fears that private ownership of companies that generate and distribute electric power would be found unconstitutional. Labor legislation was enacted in the form of a modest amendment that will make it easier to engage temporary employees. The Supreme Court signed off on private sector participation in pension fund management, raising the possibility of a significant reform of the pension system. As part of a Stand-By Agreement with the IMF, measures were taken to resolve

[2] Summary based on The Economist Intelligence Unit, *Country Profile 2003: Dominican Republic.*

pending issues with two failed banks, a customs reform was passed and an ambitious civil service reform proposal was submitted to Congress in 2003.

In **El Salvador,** a new banking law was passed in late 1999, followed the next year by the passage of legislation on the other financial intermediaries, in order to improve oversight and prudent regulation. The banking law provides for consolidated oversight of financial conglomerates, and sets increased requirements for the capital-to-asset ratio (weighted according to the level of risk) until it reaches 12% in the year 2005. In 2002, reforms to the 1999 banking law to strengthen the protection of depositors and improve the ability of the superintendency of the financial system to take preventive and corrective measures against banks. Considerable progress was made since 2001 in strengthening the regulatory framework and modernizing the payment system. In the tax area, some VAT exemptions were eliminated along with personal income tax credits for VAT payments. In the interest of promoting trade integration, El Salvador signed a free trade agreement with and Dominican Republic Mexico in the year 2000, and with Chile in 2002.

Guatemala lowered its duties on imports from Honduras and El Salvador within the framework of a free trade agreement. Tariffs were increased for three months to compensate for the revenue loss when the constitutional court declared the gasoline distribution tax unconstitutional on December 2002. In the financial area, new legislation gave the Central Bank greater independence, and the Congress approved four financial sector laws which strengthen supervision and prudential regulation. The Congress also enacted a reform in the social security system (which is operated as a pay-as-you-go system) resulting in increases in the rates of individual contributions and, as of 2008, the retirement age. Effective in 2002 the value-added tax (VAT) was raised from 10% to 12%, which was considered essential in order to increase public revenues.

Honduras signed a trade integration agreement with Mexico. It also once again postponed the sale of minority shares in the state telephone company. In response to a financial crisis that affected several banks, steps were taken to strengthen prudent regulation. A more comprehensive financial reform approach was taken in early 2003 with the presentation to Congress of a reform proposal. A tax package was approved in early 2003 which expands the income and sales tax bases and, complemented with administrative measures, will raise the tax yield by up to 2.5-3 percent of GDP.
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Jamaica[3] achieved progress in the rehabilitation of the financial sector. With the sale of all its major assets, the Financial Sector Adjustment Company created in the wake of the 1996 to administer the banks in trouble, has virtually completed its mandate and is expected to be wound in 2003. Furthermore, the Financial Services Commission was set up in 2002 to regulate the activities of non-deposit taking financial institutions, and legislation to strengthen the ability of the Bank of Jamaica to regulate the deposit-taking financial institutions has been passed. The restructuring has also allowed the reduction of cash reserve requirements to 9% in 2002 from 13% in 2000. Privatization and liberalization have advanced in several infrastructure sectors. Since the issuing of two new telecommunication licenses in 2000, the cellular market has grown rapidly. The final phase of the liberalization process involved the opening of land-based and voice communication services in March 2003. In electricity, a majority share of formerly government owned Jamaica Public Service Company was sold in 2001. In the area of tax reform,

[3] Summary based on The Economist Intelligence Unit, *Country Profile 2003: Jamaica,* and *Country Report: Jamaica*, October 2003.

major recent developments were the broadening of the consumption tax base and the introduction of a 2% percent import tax.

Mexico made major advances in its structural policies for the financial sector, including: re-privatizing banks that had undergone interventions, strengthening the regulatory framework, introducing more stringent reporting requirements, and new bankruptcy and loan collateral legislation, which substantially improve creditors' rights. Important advances were made in tax policy in 2001. The income tax was simplified and several minor taxes were increased. However, the government's proposal for eliminating VAT exemptions, which was the cornerstone of the reform was not approved. Nor did the government make much headway with its initiative to open up the electricity and hydrocarbon areas to the private sector.

In **Nicaragua,** the Bolaños Administration, inaugurated in early 2002, took deep tax and financial reforms to arrest the severe economic decline of the previous years. The tax reform entails a significant improvement in the quality of the tax system, including the elimination of the zero-VAT rate, streamlining VAT exemptions, a new minimum corporate income tax, and taxation of interest on bank accounts and securities. In the area of financial reform, during 2002 the authorities formally ended regulatory forbearance on non-performing loans, upgraded asset classification and provisioning norms and ensured that all banks met the capital adequacy requirement. Further steps are taken in 2003 to strengthen supervisory practices and procedures for resolving distressed banks.

In **Paraguay,** Congress approved proposals to sell off the state phone company and the water and sanitation state enterprise, but the law was not implemented, as the government suspended the privatization program in June 2002. A bank in problems was s liquidated and swift measures were taken to avoid contagion in 2002 No progress was made in several areas begging attention, in particular the tax system and the social security system.

In **Peru** leases were awarded to the private sector for the transportation and distribution phases of the Camisea gas project, forest management, administration of the Lima airport, and the management of several regional ports. Faced with public opposition the program of privatization of state enterprises was slowed down (receipts in 2002 were about half the amount envisaged under the program). Several measures were taken to strengthen the banking system and improve supervision. Special lending programs have been implemented in a prudent manner and steps were taken to strengthen corporate governance and restructuring procedures. A number of tax reforms were implemented broadening the income tax base, rationalizing excise taxes on petroleum products, narrowing the scope of future tax-stability contracts, eliminating certain VAT exemptions and strengthening tax audit programs. Pension reforms implemented have standardized the pension base, lowered replacement rates and reduced other benefits, thus reducing the net present value of government pension liabilities.

In **Trinidad and Tobago**, the process of structural reforms has remained virtually stalled since 2000. In 2001 Parliament approved a one-point reduction in the corporate and individual income tax rates. Despite reaching an agreement in principle to sell part of the operations of the sugar company, and for allowing private sector participation in the state telecommunications, water and broadcasting companies, there was no follow through, partly reflecting the absence of a functioning Parliament until the October 2002 general election. The divestment program was later rekindled with the proposed restructuring of the sugar company, while some other state-owned entities are slated for private sector participation.

The authorities in **Uruguay** in 2000 proposed beginning a process of deregulating and breaking up monopolies among the main public sector corporations that market hydrocarbons, natural gas, and asphalt, as well as opening to private participation telecommunications services, sales of insurance policies, real estate brokerage activities, and port administration. In 2001 these proposals met stiff opposition, which led the government to take only gradual and very timid steps to increase private sector participation in these sectors. In 2002 a financial crisis led the central bank to suspend the operations of four private domestic banks, reprogram foreign currency demand deposits in public banks and establish a fund for the stabilization of the banking system. To further deal with the crisis, Congress approved several amendments of the banking law and a new government-owned bank was created with the good-quality assets of three suspended banks. In the tax area, two tax packages were approved in 2002, which included an increase in the tax on wages and pensions, new excise taxes and a broadening of the VAT base. An additional tax reform package was submitted at the end of the year aimed at further broadening the VAT base while reducing the tax rates, streamlining the excise taxes and generalizing the corporate income tax. In view of these mixed trends and policy decisions demanded by a crisis situation, pro-market reform remained stalled between 2000 and 2003.

Finally, **Venezuela** would require a chapter unto itself. Reforms continued in a few areas, but have become bogged down or suffered setbacks in many others. Progress was evident in the enactment of laws that provide for equal treatment of foreign and national investment. Other laws establish legal frameworks for activities in such areas as electric power, gas, telecommunications, and mining, all sectors in which foreign investment is being actively sought. However, especially since 2002 the government has pursued policies that severely reduce market spaces for the private sector. Most notably, a stiff foreign exchange control, price caps and freezes of public service tariffs, and widespread intervention by the government in the foodstuff market have badly damaged the business climate. Other important setbacks are associated with a series of *ad hoc* measures to provide incentives in many different sectors and the announcement of rules that grant the Executive discretionary powers to expropriate farmland and to intervene in a broad array of private activity. This has fed the perception that property rights have been weakened. Legislation in the hydrocarbon sector has been a source of as much forward movement as it has of setbacks, at least in terms of the conditions on and for private sector participation. Income taxes were reduced, but royalty fees were raised in order to encourage investment in downstream activities. Nevertheless, in late 2001 additional charges and restrictions on foreign capital were announced. In the area of financial policy, setbacks have been associated with the imposition of a minimum share of loans that banks are required to make to small businesses and other sectors. Finally, an area of reform that has stagnated is social security, as a reform package that had been approved under 1998 legislation was never implemented.

Appendix 2
"Why Are Latin Americans So Unhappy about Reforms?"

Ugo Panizza
Monica Yáñez

1. Introduction

There is by now a large literature that describes and discusses discontent with the process of pro-market reforms that is usually subsumed under the heading of the "Washington Consensus" (Williamson, 1990) and often associated with the process of "Globalization" (for a survey see Lora and Panizza, 2003, and Stiglitz, 2002). The objective of this paper is to use opinion polls to document Latin Americans' increasing discontent with reforms and to explore possible explanations for this trend. We test four possible explanations for the rejection of reforms. The first focuses on a change in political orientation. The second focuses on a change in political activism on the part of those who oppose reforms. The third focuses on trust in political actors. The fourth focuses on the economic situation. There is also an important set of explanations for the rejection of reforms that we do not consider in this paper. This set of explanation focuses on the role of cognitive biases in the formation of public opinion. A very interesting paper by Pernice and Sturzenegger (2003) studies the case of Argentina and uses cognitive bias (especially confirmatory and self-serving biases) to explain rejection of reforms.

The paper is organized as follows. Section 2 describes some indicators aimed at measuring support for pro-market reforms and describes their evolution over time. It also describes the demographics of those who support and oppose reforms. Section 3 explores possible explanations for discontent with the reform process. Section 4 concludes.

2. What Do Latin American Think of Reforms

The purpose of this section is to gauge the attitude of Latin Americans towards pro-market reforms. In order to do so, we use individual-level data from the *Latinobarómetro* annual surveys. This data-set covers 17 Latin American countries over a period of 8 years (1995, 1996, 1997, and 1998, 2000, 2001, 2002 and 2003) and consists of an average of 1,200 respondents per country-year.[1] Even though the sampling method varies slightly from country to country, as implementation is contracted out to national polling firms, in most cases the selection includes some quotas to ensure representation across gender, socio-economic status, and age.

Although the *Latinobarómetro* data offer an unprecedented wealth of information, there are some problems with the survey. First of all, as *Latinobarómetro* focuses on urban populations, it prevents us from exploring the opinions of residents of rural areas. Second, as the surveys are conducted using the country's official language (Spanish or Portuguese), they are not representative of those portions of the indigenous population that are not fluent in the official language. Moreover, there is some evidence that, at least in the early years, the pool of survey respondents over-represented individuals with relatively high levels of education (Gaviria, Panizza, Seddon and Stein, 2000).

[1] The countries covered in the survey are: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, Paraguay, Uruguay, and Venezuela. We do not use the 1995 survey because it covers a smaller set of countries and do not use the 2002 survey because we were not able to obtain the data.

We build several indicators to measure attitudes toward reforms. The first set of variables measure the general attitude toward a market economy. PRIVATIZATION (available for 1998, 2000, 2001, and 2003) takes a value of one if the respondent thinks that the privatization process was beneficial for the country and zero otherwise. MARKET (available for 1998, 2000, and 2003) takes a value of one if the respondent thinks that a market economy is good for the country and zero otherwise. PRICES (available from 1998, 2000, and 2001) takes a value of one if the respondent thinks that prices should be set by the market and zero if he/she thinks that prices should be decided by some central authority. PRIVPROD (available for 1998 and 2001) takes a value of one if the respondent thinks that productive activity should be left to the private sector and zero otherwise.

The second set of indicators deals with attitudes towards international trade and foreign direct investment. In particular, LACINT (available for 1996, 1997, 1998, and 2001) is a dichotomous variable that takes a value of one if the respondent holds a favorable view of economic integration in Latin America and a value of zero if the respondent is against the integration process. FDI (available for 1998 only) takes a value of one if the respondent thinks that foreign direct investment is beneficial for the country and zero if he/she thinks that foreign direct investment is harmful.

Table 1 summarizes the average values of the six variables mentioned above.[2] The most striking fact is the large drop in support for reforms. In 1998 more than 50 percent of Latin Americans thought that privatization was beneficial for their country. This percentage dropped to 31 percent in 2001 and to 25 percent in 2003. In 1998, 77 percent of Latin Americans thought that a market economy was good for the country. In 2003, the percentage supporting a market economy dropped to 18 percent.[3] Support for private production and market prices also dropped, but by a smaller amount, and there was no change in support for economic integration in Latin America.

It is however misleading to talk of Latin America as a homogenous entity. There are large cross-country differences in support for reforms. Support for privatization in 2003 ranged from 37 percent (in Brazil) to just above 10 percent (in Argentina and Panama). Argentina, Bolivia, Ecuador, El Salvador, Guatemala, and Paraguay are the countries where support for privatization dropped by the largest amount. There was also a similar negative trend in the decline of support of market economy.

Before moving on and attempting to explain this drop in the support of reforms, it is interesting to look at the demographics of those who support and oppose reforms. We do so by running a set of regressions where the dependent variables are the different indicators we are using to measure attitude toward reforms and the explanatory variables include a set of socio-economic variables that include respondents'age, sex, education, wealth and economic situation (Table 2). To make the results more intuitive the regressions were estimated using a linear probability model[4] and all of the regressions include country fixed effects and country-specific time effects.

In all cases, we find that men tend to be more supportive of pro-market reforms than women. We also find that support for economic integration increases with education (an individual who belongs to the top quintile of the wealth distribution and who holds a university degree is 20 percentage points more likely to support economic integration than an individual

[2] Table 1A in the Appendix shows that the correlation between these variables, while positive and statistically significant, is also rather low, indicating that the different questions do in fact capture different aspects of attitudes towards pro-market reforms.

[3] This may be partly due to the fact that there was a slight change in the question. *Latinobarómetro* surveys from 1998 and 2000 ask: "Do you think that a market economy is good for the country?" For the year 2003 the question was: "Are you satisfied with the functioning of the market economy."

[4] Probit estimations yield similar results.

who belongs to the bottom quintile and has no education). This is an interesting finding, because according to standard trade theory it is the relatively abundant factor of production (unskilled labor in the case of Latin America) that is likely to benefit the most from economic integration.

We also find that wealth is only weakly correlated with support for economic integration and education is weakly correlated with support for privatization and the free market in general.

3. Reasons for the Discontent

The purpose of this section is to analyze the possible reasons for the discontent with the reforms process. We analyze four possible explanations: (i) an overall movement of the population to the left; (ii) an increase in the political activism of those who oppose reforms; (iii) a decrease in trust for political actors; and (iv) the economic crisis.

3.1 Have Latin Americans Moved to the Left?

One possible cause for the decrease in support for pro-market reforms might be an overall movement of the Latin American population towards the left. This could be part of a global trend with the end of the Reagan-Thatcher era and the beginning of a new worldwide movement towards the left following, with a lag, the leadership of Bill Clinton and Tony Blair.

Latinobarómetro allows us to investigate this hypothesis because it includes a question on the respondents' political orientation. In particular it asks: "On a scale of 0 to 10 how right wing are you?" (0 being the most left wing and 10 the most right wing). The last column of Table 1 reports the average values for the answer to this question. The data suggest that there was no net change in political orientation and, if anything, they show a small movement towards the right. We also look at the behavior of extremists. Table 3 reports the share of people that define themselves as being extremist, either right wing or left wing.[5] The table shows that most Central American and Andean countries are characterized by a large share of right-wing extremists. Nicaragua, Panama, Venezuela, and Brazil appear to be the most polarized countries, with a large share of the population defining themselves as either right-wing or left-wing extremist. Argentina, Bolivia, and Chile are the countries with the smallest share of extremists. These cross-country differences could be due that the definition of being right wing is country-specific.[6] What is interesting from the table, however, is the relative stability of political opinion, providing prima facie evidence that Latin Americans did not move towards the left.

Next, we augment the regressions of Table 2 with a variable that measures political orientation (Table 3). We find that those who describes themselves as being just to the right of center tend to be more supportive of pro-market reforms than those who describe themselves as being left of center or to either extreme of the political spectrum. Among people at the extremes, we find that those at the extreme right are generally more supportive of reforms than those at the extreme left. This weak correlation between opposite political extremism and support for reforms, together with the fact that political orientation has been stable over the period under observation, leads us to the conclusion that there is no evidence for the fact that the rejection of reforms is linked to a movement of the population towards the left.

In the regressions of table 3, we also control for three variables that check whether the respondent feels that: (i) elections are clean; (ii) success in life is due to hard work rather than to connections; and (iii) corruption is an important problem. We find a positive correlation between the perceived fairness of the political system and support for reform. Those who think that

[5] Left-wing extremists are defined as those that choose values 0 or 1 to the question how right wing are you and right-wing extremists are defined as those who answered to the same question with 9 or 10.

[6] For instance, it is commonly thought that those who classify themselves as being liberal (i.e., left wing) in the U.S. often have political ideas that would classify them as centrist in most European countries.

elections are clean are between 3 and 8 percentage points more likely to be in favor of economic integration and privatization. This is an important finding because it may mean that a clean and well-functioning democratic system could make the reforms process more sustainable.[7] We also find that those who think that hard work is more important than connections tend to be more supportive of reforms.

Interestingly, we find that those who perceive that corruption is a serious problem are more in favor of economic openness (they support economic integration and think that FDI is beneficial for the country); this supports the finding of Ades and Di Tella (1999), who show that openness can help in reducing corruption. At the same time, those who think that corruption is a serious problem tend to be more skeptical of the privatization process and the working of the market economy. This is in line with the findings of Lora and Panizza (2003), who find that privatization works better in countries characterized by low levels of corruption.

3.2 Those Who Oppose Reforms Have Become More Vocal

Another possible explanation for the rejection of reforms could be that, following the worldwide resonance of the anti-globalization protest during the WTO meetings in Seattle and of events like the World Social Forum, those who oppose reforms have become more vocal and thus have been able to better promote their cause among the general population. Next, we check whether there are differences in political participation between those who support and those who oppose reforms. In order to test this hypothesis, we run a set regressions where the dependent variable measures whether an individual is interested in politics or not (measured by the question "Are you interested in politics?" (Possible answers range from 1 to 4, with 1 representing little or no interest and 4 a high level of interest.)

In general, we find that those who support reforms are more interested in politics than those who oppose reforms. Even though this is not surprising, because there is a positive correlation between interest in politics and education (and thus a positive correlation between education and support for reforms), it should be noticed that the positive correlation between support for reforms and interest in politics is rather weak.

Next, we move beyond pure interest in politics and build an index of violent political activities.[8] Those who oppose reforms are between 1 and 2.5 percentage points (corresponding to a 10 percent difference) more likely to participate in violent political activities. While this finding lends support to the idea that those who oppose reforms tend to "make more noise" than those who support reforms, it should be recognized that the difference is rather small. We also checked whether the correlation between attitude toward reforms and participation in violent political activities has been changing over time. In particular, we checked whether those who are against reforms have become more active in recent years, but we did not find any evidence in support of this idea.

3.3 People Have Less Trust in Public Institutions and Political Parties

Another possible explanation for the discontent toward reforms in Latin America has to do with the fact that people stopped trusting political parties and/or the elites that promoted the reforms process. Scholars of economic development reckon that political parties may be important in the reform process because of their programmatic orientation and because they may facilitate the process of aggregating disparate views and arriving at compromises for the adoption of reforms

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[7] However, this could also mean that those who benefit from reforms are also those who benefit from an electoral system that does not work well but that, in their opinion, is fair and clean.

[8] The index ranges from 0 to 1 and is built as the principal component of a set of questions that ask whether the individual has ever participated in violent demonstrations, occupations, lootings, etc.

(Boix, 1998, cited in Corrales, 2002, and Graham and others, 1999). Moreover, political parties may also play an important role for the sustainability of reforms because they can shield the reforms from interest group pressures. Reforms are therefore more susceptible to losing the support of public opinion in countries where confidence in political parties is low.

Of course, if we were to find any support for this hypothesis, then we would have the difficult task of explaining why trust in political parties has decreased over time. It is nonetheless interesting, though, to look at whether there is a relationship between support for reforms and trust in political parties. We measure trust in and identification with political parties by using two different variables. The first, CONFIPP (available for 1996, 1997, 1998, 2000, 2001, and 2003) measures the level of trust in political parties, taking a value of 4 if the respondent has a great deal of trust in political parties and 1 if the respondent does not trust political parties. The second, IDENTPP (available for 1996, 1997 and 2003) measures respondents' identification with political parties, with values ranging from 1 if the respondent feels little or no identification with political parties to 4 if the respondent feels very identified with political parties. The first two columns of Table 5 summarize the data and show a small decline in trust in political parties (from 1.8 in 1998 to 1.5 in 2003). Table 6 shows that there is a strong and positive correlation between support for reforms and trust in political parties. The results indicate that an individual who fully trusts political parties is 14 percentage points more likely to support a market economy than an individual who does not trust political parties (and 20 percentage points more likely to support privatization). However, when we multiply the coefficient obtained in column 7 of Table 6 with the change in trust of political parties, we obtain a value of half a percentage point, indicating that changes in support for political parties can only explain a minuscule share of the change in support for privatization (which dropped by almost 30 percentage points).

The last two columns of Table 5 look at the evolution of trust in the national congress (TR_CON) and trust in the president (TR_PRE). As in the case of support for political parties, we find that support for the president or the executive has somewhat declined, but not enough to explain the drop in support of reforms. In particular, Table 7 (column 3) shows that those who trust the president tend to be more supportive of the market economy, but by multiplying the coefficient (0.05) of the change in support for the president over the 1998-2003 period (0.23) we obtain 0.012. This implies that change in support for the president can explain a 1 percent drop in support for the market economy. Over the same period of time, support for the market economy dropped by approximately 60 percentage points. Again, this indicates that the finding that people who trust the President or the Congress tend to be more supportive of reforms does not help us in explaining discontent with reforms.

3.4 Is it the Economy?

The last set of explanations can be summarized with the famous sentence: "It's the economy, stupid!"

Table 8 summarizes the recent behavior of four macroeconomic variables: (i) the output gap (computed as the log deviation of actual GDP from trend GDP);[9] (ii) the unemployment rate; (iii) adjusted inflation (computed as $1\text{-}1/1+\pi)$); and (iv) the depth of economic crisis (obtained by multiplying GDP gap by minus one and setting economic expansion equal to zero). Table 8 shows that the macroeconomic situation deteriorated on all fronts with the exception of inflation. The GDP gap went from positive to negative, average unemployment increased by 2.5 percentage points, and economic crises became deeper and more prevalent.

Table 9 looks at how macroeconomic variables affect attitude towards reforms. As dependent variables, we use attitude towards privatization and attitude towards the market

[9] Trend GDP is calculated by applying a Hodrick-Prescott filter to real GDP (in local currency) for the 1980-2002 period.

economy. Besides the standard set of control variables used in Table 2, we now include the four macroeconomic variables of Table 8 lagged one year.[10] All the estimated coefficients have the expected sign (positive for output gap and negative for the other variables), with the exception of inflation, which enters in the regression with a positive sign (statistically significant when unemployment, inflation and output gap are entered in the same regression). Interestingly, unemployment is not statistically significant when all the macro variables are entered in the same regression.

Our results suggest that some macroeconomic variables play an important role in explaining attitude towards reforms. For instance, if we look at the relationship between the output gap and the support for privatization during the 1998-2003 period, we can see that support for privatization went from 52 to 25 percent. The average output gap was 3 percent in 1997 and –3 percent in 2002 (a change of 6 percentage points). By multiplying 6 by the estimated coefficient (0.012), we obtain 0.072, which is close to one third of the total drop in support for reforms. The case of Argentina is a striking example of the importance of macroeconomic factors. In this country, the output gap went from 7 percent in 1997 to –14 percent in 2002. This by itself explains a drop in support for privatization equivalent to 25 percentage points, which is about 80 percent of the observed drop in support for privatization in Argentina (which fell from 45 to 13 percent). It should be noted that what we are finding here is somewhat in contrast with the findings of Pernice and Sturzenegger (2003), who suggest that, in the case of Argentina, opposition to the economic program of the government started picking up when the economy was still growing at a fast rate. However, if one focuses on unemployment instead of GDP growth we find a stronger negative correlation between support for the government's economic plan and unemployment.

There is in fact evidence that a large share of Latin Americans tend to blame globalization (or one of its two main forces, the International Monetary Fund and the World Trade Organization) for the recent economic crisis (Table 10). Feelings against globalization are particularly strong in El Salvador and Panama. At the same time, more than 20 percent of Argentineans, Bolivians, Hondurans and Uruguayans think that the International Monetary Fund is responsible for the economic crisis. The case of Argentina is particularly interesting, because few residents of this country seem to be opposed to globalization or to the WTO, but more than one quarter of the population is opposed to IMF policies. Overall, there are 6 Latin American countries where more than 40 percent of the population blames globalization (or one of its two main actors) for the economic crisis.

A majority of Latin Americans also blame their own government for the economic crisis. Criticism of the government is particularly strong in Bolivia, Nicaragua, Peru, Paraguay and Uruguay. There are only three countries (Chile, Colombia and Mexico) where more than 2 percent of the population does not blame anybody for the economic situation.

So, Table 10 shows that Latin Americans associate the reform process with the economic crisis, it corroborates the idea that the difficult economic situation is responsible for the rejection of pro-market reforms.

[10] This is because the *Latinobarómetro* surveys are collected in the middle of the year. All the regressions are estimated using country fixed effects and by clustering the standard errors in order to control for the fact that macroeconomic variables have no within country-year variation.

4. Conclusions

In this paper, we use opinion polls data to document discontent with pro-market reforms among Latin Americans and test several theories aimed at explaining this discontent. We find support for the simplest and most intuitive theory. The backlash against reforms is mostly explained by the recent collapse in economic activity. So, in the words of the 1992 Clinton campaign, “It’s the economy, stupid!”

This finding bears very different implication depending on the causes of the recent economic crisis. If the crises were indeed due to the fact that the reform process increased volatility and contributed to economic instability (as some of the opponents of reforms think), then those who oppose reforms are right and the change in opinion registered by the survey is a healthy phenomena, in which citizens reject something that did not work. However, if the crises were mostly due by external shocks and international contagion, then those who oppose reforms would make the mistake of giving a causal interpretation to a spurious correlation.

There is, in fact, some evidence, that this may be the case. Birdsall and de la Torre (2001) suggest that, while not fully successful, the process of structural reforms played a positive role in limiting the damaging effect of the large external shock that hit Latin America in the late 1990s.

The disillusionment with reforms may also be due to excessive expectations. Policymakers may have made the mistake of overselling the reforms (by promising too much), and the disillusionment with reforms documented in this paper could be due to unmet expectations. In fact, it is interesting that a similar rejection of reforms is now happening in some East European countries that, over the last decade, displayed excellent growth performance (The Economist, September 11, 2003).

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Table 1: What do Latin Americans Think of Pro-Market Reforms

	LACINT	FDI	PRIVATIZ.	MARKET	PRICES	PRIVPROD	RIGHTWING
1996	0.74						5.33
1997	0.87						5.53
1998	0.88	0.77	0.52	0.77	0.63	0.56	5.58
2000			0.38	0.67	0.57		5.33
2001	0.84		0.31		0.59	0.50	5.87
2003			0.25	0.18			5.52

Table 2: Attitude towards Reform and Socio-Economic Characteristics

	(1)	(2)	(3)	(4)	(5)	(6)
	LACINT	FDI	PRIVATIZATION	MARKET	PRICES	PRIVPROD
AGE	0.032	0.045	-0.355	-0.120	-0.057	0.428
	(0.62)	(0.33)	(5.63)***	(1.77)*	(0.72)	(4.31)***
AGE2	0.000	-0.001	0.003	0.001	0.001	-0.004
	(0.04)	(0.39)	(4.40)***	(1.55)	(1.16)	(3.24)***
SEX	-1.243	-5.486	-1.749	-2.088	-3.973	-4.140
	(4.02)***	(6.80)***	(4.69)***	(5.18)***	(8.64)***	(7.02)***
quintile==2	1.851	3.350	-0.815	-0.030	-0.052	-0.453
	(3.53)***	(2.56)**	(1.31)	(0.04)	(0.07)	(0.46)
quintile==3	3.502	4.669	-0.138	0.877	2.143	0.522
	(6.36)***	(3.37)***	(0.21)	(1.25)	(2.65)***	(0.50)
quintile==4	3.859	7.957	0.617	0.337	3.132	1.925
	(6.68)***	(5.53)***	(0.89)	(0.45)	(3.70)***	(1.76)*
quintile==5	4.691	11.077	4.521	1.981	5.838	5.498
	(7.33)***	(6.80)***	(5.83)***	(2.39)**	(6.18)***	(4.47)***
EDUCA==2	1.505	1.459	-2.511	0.027	1.945	-0.303
	(1.65)*	(0.52)	(2.55)**	(0.02)	(1.52)	(0.19)
EDUCA==3	3.210	4.775	-3.541	-1.283	2.012	-1.278
	(3.55)***	(1.72)*	(3.60)***	(1.19)	(1.57)	(0.79)
EDUCA==4	4.549	5.915	-4.551	-0.604	2.290	-1.241
	(5.07)***	(2.14)**	(4.59)***	(0.55)	(1.81)*	(0.77)
EDUCA==5	5.255	7.948	-3.320	-0.106	3.199	-1.758
	(5.92)***	(2.90)***	(3.35)***	(0.10)	(2.54)**	(1.10)
EDUCA==6	7.524	8.764	-2.552	-2.284	2.272	-2.082
	(7.75)***	(2.98)***	(2.30)**	(1.88)*	(1.63)	(1.16)
EDUCA==7	7.336	11.113	1.222	-0.598	3.653	1.448
	(7.52)***	(3.76)***	(1.08)	(0.49)	(2.58)***	(0.78)
SOC_EC==1	1.240	1.806	-0.640	-0.790	-1.468	0.116
	(1.22)	(0.70)	(0.57)	(0.67)	(1.00)	(0.06)
SOC_EC==2	2.302	0.901	-0.152	0.694	-0.801	-1.851
	(2.37)**	(0.36)	(0.14)	(0.59)	(0.55)	(0.98)
SOC_EC==3	3.638	0.244	1.063	2.371	0.191	-1.153
	(3.59)***	(0.09)	(0.90)	(1.91)*	(0.13)	(0.58)
SOC_EC==4	4.503	3.727	4.536	4.015	2.807	2.791
	(3.95)***	(1.24)	(3.31)***	(2.82)***	(1.62)	(1.22)
Constant	77.147	58.929	25.636	70.298	68.660	44.428
	(37.64)***	(12.35)***	(10.96)***	(28.49)***	(24.11)***	(12.87)***
Observations	55192	11534	60813	43815	44187	28062
R-squared	0.07	0.06	0.08	0.30	0.04	0.04

Absolute value of t statistics in parentheses
* significant at 10%; ** significant at 5%; *** significant at 1%

Table 3: Share of Extremists

	1996		1997		1998		2000		2001		2003		TOTAL	
	LEFT	RIGHT	LEFT	RIGHT	LEFT	RIGHT	LEFT	RIGHT	LEFT	RIGHT	LEFT	RIGHT	LEFT	RIGHT
ARG	0.03	0.09	0.04	0.08	0.05	0.19	0.02	0.13	0.03	0.11	0.04	0.09	0.04	0.11
BOL	0.09	0.08	0.08	0.08	0.09	0.09	0.12	0.05	0.09	0.10	0.12	0.11	0.10	0.09
BRA	0.15	0.17	0.10	0.07	0.17	0.18	0.13	0.15	0.15	0.25	0.15	0.22	0.14	0.18
CHI	0.08	0.08	0.07	0.07	0.07	0.08	0.08	0.10	0.08	0.12	0.07	0.14	0.08	0.10
COL	0.06	0.17	0.03	0.22	0.18	0.20	0.07	0.15	0.06	0.28	0.11	0.28	0.08	0.21
CRI	0.11	0.16	0.06	0.19	0.18	0.25	0.07	0.32	0.07	0.36	0.15	0.23	0.10	0.25
ECU	0.14	0.20	0.12	0.20	0.14	0.21	0.11	0.21	0.14	0.19	0.08	0.19	0.12	0.20
ELS	0.12	0.14	0.11	0.16	0.10	0.21	0.08	0.12	0.14	0.38	0.18	0.30	0.12	0.22
GTM	0.13	0.08	0.23	0.08	0.15	0.23	0.11	0.12	0.08	0.18	0.15	0.34	0.14	0.17
HON	0.06	0.36	0.05	0.47	0.09	0.46	0.08	0.17	0.05	0.62	0.11	0.40	0.07	0.42
MEX	0.21	0.18	0.04	0.09	0.12	0.18	0.06	0.11	0.05	0.08	0.14	0.14	0.11	0.12
NIC	0.15	0.21	0.07	0.13	0.15	0.15	0.32	0.23	0.17	0.24	0.22	0.36	0.17	0.21
PAN	0.28	0.09	0.17	0.21	0.01	0.43	0.09	0.20	0.14	0.26	0.16	0.15	0.15	0.21
PER	0.04	0.13	0.04	0.13	0.08	0.14	0.05	0.09	0.06	0.12	0.08	0.12	0.05	0.12
PRY	0.04	0.07	0.10	0.09	0.12	0.15	0.07	0.08	0.13	0.19	0.05	0.17	0.08	0.14
URY	0.08	0.14	0.06	0.10	0.07	0.13	0.12	0.15	0.11	0.10	0.09	0.09	0.08	0.12
VEN	0.12	0.34	0.11	0.22	0.16	0.21	0.13	0.20	0.12	0.30	0.14	0.32	0.13	0.26

Table 4: Attitude towards Reform, Socio-Economic Characteristics, and Political Preferences

	(1)	(2)	(3)	(4)	(5)	(6)
	LACINT	FDI	PRIVATIZATION	MARKET	PRICES	PRIVPROD
AGE	-0.003	-0.002	-0.245	-0.134	-0.099	0.476
	(0.04)	(0.01)	(2.13)**	(1.21)	(0.85)	(2.64)***
AGE2	0.000	-0.000	0.002	0.002	0.002	-0.004
	(0.21)	(0.14)	(1.69)*	(1.34)	(1.38)	(1.84)*
SEX	-0.989	-4.885	-0.765	-1.484	-3.314	-3.487
	(2.09)**	(5.10)***	(1.14)	(2.30)**	(4.91)***	(3.23)***
quintile==2	0.914	1.935	0.789	-1.408	-0.202	0.417
	(1.12)	(1.22)	(0.70)	(1.29)	(0.18)	(0.23)
quintile==3	1.699	4.464	2.395	1.224	1.758	1.849
	(2.01)**	(2.66)***	(2.03)**	(1.08)	(1.48)	(0.98)
quintile==4	1.960	7.243	4.517	1.288	3.636	3.419
	(2.22)**	(4.15)***	(3.67)***	(1.09)	(2.94)***	(1.74)*
quintile==5	2.021	10.372	10.145	3.800	7.088	10.250
	(2.06)**	(5.33)***	(7.46)***	(2.92)***	(5.20)***	(4.69)***
EDUCA==2	1.578	4.036	-0.305	4.673	0.135	-1.108
	(1.00)	(1.20)	(0.14)	(2.24)**	(0.06)	(0.29)
EDUCA==3	2.958	7.785	-0.828	4.451	1.471	-0.088
	(1.91)*	(2.32)**	(0.38)	(2.15)**	(0.67)	(0.02)
EDUCA==4	4.386	7.154	-1.602	5.765	2.403	2.218
	(2.88)***	(2.15)**	(0.75)	(2.85)***	(1.13)	(0.59)
EDUCA==5	5.792	9.155	-0.290	6.466	3.952	1.969
	(3.85)***	(2.78)***	(0.14)	(3.21)***	(1.86)*	(0.53)
EDUCA==6	7.605	10.584	-0.731	3.014	1.782	1.877
	(4.68)***	(3.00)***	(0.32)	(1.40)	(0.78)	(0.47)
EDUCA==7	7.192	13.468	3.086	4.963	3.698	2.264
	(4.46)***	(3.81)***	(1.37)	(2.31)**	(1.63)	(0.57)
SOC_EC==1	3.695	0.958	1.012	0.376	-1.338	3.071
	(2.06)**	(0.30)	(0.45)	(0.17)	(0.59)	(0.85)
SOC_EC==2	3.306	1.787	1.309	1.873	-0.285	-2.309
	(1.89)*	(0.58)	(0.60)	(0.89)	(0.13)	(0.65)
SOC_EC==3	4.821	0.366	2.463	2.999	1.623	-1.609
	(2.67)***	(0.11)	(1.08)	(1.37)	(0.70)	(0.44)
SOC_EC==4	5.497	4.321	7.303	4.262	3.484	3.568
	(2.79)***	(1.19)	(2.86)***	(1.74)*	(1.35)	(0.87)
RIGHTWING==1	1.397	-0.470	-2.300	-2.386	1.704	3.285
	(0.85)	(0.15)	(1.07)	(1.16)	(0.79)	(0.91)
RIGHTWING==2	2.551	-5.379	-2.577	-2.842	1.424	-0.315
	(1.66)*	(1.85)*	(1.21)	(1.39)	(0.67)	(0.10)
RIGHTWING==3	3.074	0.973	1.413	-1.087	4.146	6.357
	(2.29)**	(0.38)	(0.76)	(0.61)	(2.22)**	(2.21)**
RIGHTWING==4	3.930	-0.695	1.653	-0.288	5.423	3.703
	(2.96)***	(0.27)	(0.89)	(0.16)	(2.93)***	(1.28)
RIGHTWING==5	4.513	2.874	3.294	2.902	5.773	4.983
	(4.09)***	(1.46)	(2.14)**	(1.99)**	(3.76)***	(2.22)**
RIGHTWING==6	5.268	2.677	7.875	5.977	9.790	9.521
	(4.03)***	(1.07)	(4.18)***	(3.33)***	(5.19)***	(3.35)***
RIGHTWING==7	3.817	6.530	11.380	8.223	10.463	11.116
	(2.90)***	(2.59)***	(5.99)***	(4.53)***	(5.51)***	(3.87)***
RIGHTWING==8	3.605	3.122	8.279	6.671	8.043	6.022
	(2.79)***	(1.28)	(4.44)***	(3.74)***	(4.31)***	(2.18)**
RIGHTWING==9	1.724	-2.256	5.096	3.338	3.222	7.796
	(1.15)	(0.71)	(2.34)**	(1.61)	(1.48)	(2.18)**
RIGHTWING==10	3.176	-0.447	6.590	6.059	6.887	0.002
	(2.60)***	(0.21)	(3.86)***	(3.73)***	(4.03)***	(0.00)
Elections are clean	4.078	7.447	6.184	3.637	4.751	3.557
	(7.72)***	(7.11)***	(8.41)***	(5.16)***	(6.44)***	(3.01)***
Connections are imp.	0.812	-0.054	0.037	1.428	0.898	3.533
	(2.27)**	(0.08)	(0.07)	(3.00)***	(1.80)*	(4.44)***
Corruption is a prob.	3.811	2.896	-2.541	0.120	-2.187	-3.067
	(9.38)***	(3.59)***	(4.11)***	(0.20)	(3.53)***	(3.41)***
Constant	67.326	43.855	28.626	53.717	61.887	46.390
	(19.79)***	(6.81)***	(6.08)***	(11.79)***	(13.03)***	(6.36)***
Observations	19077	8157	20546	19411	20328	8271
R-squared	0.05	0.08	0.08	0.05	0.05	0.05

Absolute value of t statistics in parentheses
*significant at 10%; ** significant at 5%; *** significant at 1%

Table 5: Trust in Political Parties, the Congress, and the President

	CONFIPP[a]	IDENTPP[a]	TR_CON[b]	TR_PRES[b]
1996	1.87	1.66	2.96	2.96
1997	2.04	1.75	2.78	2.70
1998	1.84		2.98	2.77
2000	1.77		3.01	2.75
2001	1.78		3.08	2.96
2003	1.50	1.55	3.32	3.01

(a) a higher value means more trust or more identification
(b) a higher value means less trust

Table 6: Support for Reforms and Confidence and Identification with Political Parties

	(1)	(2)	(3)	(4)	(5)	(7)	(8)
	LACINT	LACINT	MARKET	MARKET	PRICES	PRIVATIZ.	PRIVATIZ.
IDENTPP	0.010		0.035			0.021	
	(3.90)***		(9.70)***			(5.02)***	
CONFPP		0.013		0.034	0.023		0.053
		(7.33)***		(14.19)***	(8.71)***		(23.49)***
Constant	0.865	0.856	0.111	0.602	0.636	0.100	0.053
	(65.68)***	(70.45)***	(9.04)***	(40.73)***	(40.40)***	(7.20)***	(3.76)***
Observations	28587	59409	17153	46784	47231	15545	63552
R-squared	0.08	0.07	0.03	0.31	0.04	0.03	0.09

Absolute value of t statistics in parentheses
*significant at 10%; ** significant at 5%; *** significant at 1%

Table 7: Support for Reforms and Trust in Congress and President

	(1)	(2)	(3)	(4)	(5)	(6)
	LACINT	LACINT	MARKET	MARKET	PRICES	PRICES
TR_PRE	-0.027		-0.050		-0.033	
	(16.92)***		(24.29)***		(13.81)***	
TR_CON		-0.018		-0.040		-0.027
		(10.62)***		(17.90)***		(10.71)***
Constant	0.961	0.933	0.861	0.833	0.897	0.753
	(75.14)***	(72.59)***	(56.12)***	(52.66)***	(53.34)***	(44.18)***
Observations	59626	59081	46911	46368	47429	46928
R-squared	0.07	0.07	0.31	0.31	0.04	0.04

Absolute value of t statistics in parentheses
*significant at 10%; ** significant at 5%; *** significant at 1%

Table 8: Macroeconomic Variables

	GDP GAP		Unemployment		Inflation		Depth of Crisis	
	Average	SD	Average	SD	Average	SD	Average	SD
1994	2.04	1.99	7.49	2.68	0.27	0.27	0.07	0.17
1995	1.21	2.99	8.62	3.98	0.17	0.11	0.70	1.62
1996	1.37	2.42	9.64	4.10	0.15	0.11	0.46	1.08
1997	3.16	2.76	8.97	3.60	0.12	0.09	0.14	0.43
1999	0.37	3.27	10.38	4.45	0.08	0.09	1.26	1.84
2000	0.44	2.59	10.02	4.64	0.09	0.11	0.83	1.44
2002	-3.35	5.04	10.76	4.25	0.07	0.06	3.90	4.27

Table 9: Macroeconomic Factors and Support for Reforms

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	Privatization	**Privatization**	**Privatization**	**Privatization**	**Privatization**	**Market**	**Market**	**Market**	**Market**	**Market**
GDP Gap	0.012				0.014	0.032				0.040
	(5.36)***				(2.72)***	(5.22)***				(3.08)***
Unemployment		-0.023			-0.000		-0.050			0.022
		(3.01)***			(0.01)		(2.16)**			(0.62)
Inflation			0.416		0.585			1.826		2.146
			(1.35)		(4.18)***			(1.35)		(3.01)***
Depth of Crisis				-0.016					-0.048	
				(4.63)***					(4.66)***	
AGE	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001	-0.000	-0.001	-0.001	-0.000
	(2.87)***	(2.33)**	(3.00)***	(2.91)***	(2.35)**	(1.58)	(1.22)	(1.94)*	(1.62)	(1.17)
SEX	-0.015	-0.017	-0.016	-0.015	-0.017	-0.017	-0.022	-0.021	-0.018	-0.018
	(2.78)***	(2.89)***	(2.78)***	(2.78)***	(2.86)***	(3.28)***	(3.96)***	(3.71)***	(3.53)***	(3.07)***
quintile==2	-0.008	-0.002	-0.008	-0.008	-0.002	0.001	0.005	0.004	0.002	0.006
	(1.06)	(0.30)	(0.99)	(1.03)	(0.24)	(0.12)	(0.53)	(0.44)	(0.21)	(0.65)
quintile==3	0.003	0.010	0.002	0.002	0.011	0.016	0.018	0.014	0.015	0.021
	(0.27)	(1.12)	(0.16)	(0.25)	(1.29)	(1.61)	(1.85)*	(1.47)	(1.58)	(2.14)**
quintile==4	0.020	0.029	0.020	0.020	0.029	0.023	0.032	0.030	0.024	0.030
	(1.80)*	(2.94)***	(1.79)*	(1.82)*	(2.97)***	(2.26)**	(3.38)***	(2.86)***	(2.25)**	(3.47)***
quintile==5	0.079	0.089	0.078	0.079	0.090	0.039	0.052	0.043	0.039	0.050
	(4.84)***	(5.56)***	(4.78)***	(4.84)***	(5.66)***	(2.69)***	(3.56)***	(3.00)***	(2.67)***	(3.83)***
Constant	0.398	0.622	0.364	0.425	0.334	0.558	1.041	0.391	0.646	0.122
	(23.09)***	(8.25)***	(10.14)***	(21.66)***	(2.37)**	(34.75)***	(4.68)***	(3.02)***	(33.13)***	(0.34)
Observations	65083	58013	65083	65083	58013	48009	42615	48009	48009	42615
R-squared	0.04	0.04	0.03	0.04	0.05	0.10	0.05	0.05	0.09	0.15

Robust t statistics in parentheses, All regressions include fixed effects and clustered errors
* significant at 10%; ** significant at 5%; *** significant at 1%

Table 10: What is the Cause of the Bad Economic Situation (2003)

	A	B	C	A+B+C	D	E	F	G
	Globalization	IMF	WTO		Government Policies	Banks	Other Reasons	Nobody
ARG	13.11%	26.63%	5.09%	44.82%	65.61%	12.10%	52.08%	0.79%
BOL	14.33%	20.25%	9.33%	43.92%	72.33%	7.50%	64.42%	1.18%
BRA	13.33%	16.08%	9.83%	39.25%	65.42%	11.92%	55.25%	0.55%
CHI	11.25%	5.58%	6.75%	23.58%	49.08%	9.50%	82.08%	3.66%
COL	9.50%	11.50%	6.83%	27.83%	61.75%	10.67%	59.92%	2.44%
CRI	15.14%	10.06%	11.45%	36.65%	68.53%	4.08%	43.33%	1.94%
ECU	16.23%	26.80%	7.79%	50.82%	56.89%	20.66%	55.49%	0.66%
ELS	20.14%	9.42%	6.65%	36.21%	63.49%	10.02%	45.44%	0.91%
GTM	12.33%	6.76%	6.96%	26.04%	51.79%	9.94%	64.12%	0.77%
HON	15.51%	21.77%	9.24%	46.52%	58.05%	24.25%	97.51%	0.98%
MEX	16.92%	8.33%	8.17%	33.42%	68.92%	5.50%	53.58%	5.32%
NIC	9.50%	12.28%	5.25%	27.03%	77.13%	10.30%	35.15%	1.17%
PAN	27.99%	13.65%	17.23%	58.86%	59.26%	20.42%	76.89%	0.53%
PER	9.67%	11.17%	5.00%	25.83%	70.42%	4.33%	52.67%	0.95%
PRY	7.50%	7.50%	7.83%	22.83%	76.33%	14.17%	69.83%	0.00%
URY	17.42%	23.67%	12.92%	54.00%	72.92%	21.08%	54.25%	1.72%
VEN	6.92%	8.42%	6.33%	21.67%	46.42%	6.25%	51.75%	1.62%
LAC AVERAGE	13.93%	14.11%	8.39%	36.43%	63.78%	11.92%	59.63%	1.48%

The numbers sum to more than 100 because some respondents gave multiple answers.

Table 1A: Correlation Matrix

	LACINT	FDI	PRIVATIZ	MARKET	PRICES	PRIVPROD	IDENTPP	CONFIPP
LACINT	1							
FDI	0.2116	1						
	(0.00)							
PRIVATIZ	0.0378	0.1386	1					
	(0.00)	(0.00)						
MARKET	0.0881	0.1515	0.2959	1				
	(0.00)	(0.00)	(0.00)					
PRICES	0.0621	0.0768	0.2267	0.3727	1			
	(0.00)	(0.00)	(0.00)	(0.00)				
PRIVPROD	0.0516	0.1342	0.3067	0.1868	0.2733	1		
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)			
IDENTPP	0.0228	N/A	0.0342	0.0641	N/A	N/A	1	
	(0.00)	-	(0.00)	(0.00)	-	-		
CONFIPP	0.0186	0.0036	0.1185	0.1437	0.0281	0.0398	0.2607	1
	(0.00)	(0.66)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	

p-values in parentheses

Appendix 3

Excerpts from "The Electoral Pay-off of Economic Reforms"

Eduardo Lora and Mauricio Olivera

Abstract

This paper explores the effects of Washington Consensus reforms on electoral behavior. We base our tests on different theories extracted from political economy and political science that attempt to explain how candidates are rewarded or punished after adopting reforms depending on economic and political circumstances. We find that reducing the inflation rate has a positive electoral pay-off while adopting trade liberalization measures (and pro-market reforms in general) has a negative pay-off. However, contrary to some predictions by political scientists, based on case studies we do not find econometric evidence that the presence of economic crisis, the incumbent´s pre-electoral promises or the change in economic growth affect the response of the electorate to the adoption of structural reforms.

The Model

The purpose of our estimations is to assess how the adoption of structural reforms by an incumbent affects the electoral results for his party in the elections at the end of his administration. If V_i is the share of votes for party i, and DR is a measure of the extent of pro-market reforms during the administration, our parameter of interest is β in equation (1):

$$V_{i,t} = \alpha^*V_{i,t-1} + \beta^*DR_t + \gamma^*X + \varepsilon_i \qquad (1)$$

where t refers to the election at the end of the administration, t-1 is the election by which the incumbent gained power and X is a set of control variables discussed below.

We hypothesize that the response of the electorate to the reforms implemented by an administration depends on three sets of circumstances. First, it depends on whether the outgoing administration was initially faced with an economic crisis that prompted and facilitated the adoption of reforms. In this case, both the incumbent and the electorate were confronted with losses and, following prospect theory, were prepared to take risks that would not be taken in normal circumstances. Second, it depends on whether the administration honored its pre-electoral promises with regards to the adoption of pro-market reforms. And third, it matters whether the adoption of reforms was associated with a better economic performance in terms of growth.[1] Therefore:

$$\beta = \delta + \zeta^*CRISIS + \iota^*PROMISES + \nu^*DGROWTH + \upsilon_i \quad (2)$$

where CRISIS is a measure of the depth of the crisis, PROMISES is a measure of how pro-market oriented the campaign messages were, and DGROWTH is a measure of the change in the rate of

[1] Since pro-market reforms are usually presented to the public as policies to accelerate growth rather than control inflation, reduce unemployment, or solve other macroeconomic problems, we do not test whether the response of the electorate to the adoption of the reforms is affected by these other variables. However, as we will see below, some of these variables may affect voters' behavior directly.

economic growth. On the basis of our theoretical discussion we expect the three relevant parameters (ζ, ι and ν) to be positive; the deeper the economic crisis faced by the administration at its inception, the more market-oriented the pre-electoral stance of the elected president, and the larger the increase in economic growth, the more lenient the electorate will be with the reforms. Expression (2) also includes a constant term, which we expect to be negative on the basis of political economy considerations that consider reforms to be politically costly for several reasons. Reforms must defy the status quo ante and reallocate incomes among different social groups. Most likely, those who stand to gain from the reforms are a disperse and disorganized group; on the other hand, the losers are a smaller group, often organized and politically vocal to protect its interests. Reforms are also opposed because their effects are uncertain, both at the macro and the micro level. Uncertainty about the allocation of losses among the members of the group most affected can elicit opposition even if the overall pay-off for the group is positive.

The set of controls X is intended to isolate the influence of those variables that previous political science literature on the subject has identified as affecting voters' behavior. It includes the degree of fragmentation of the party system (FRAG) because, as discussed above, greater fragmentation reduces the ability of the governing party to maintain a majority. The basic set of controls also includes measures of (the change in) inflation (DINF) and economic growth (DGROWTH), whose importance in the behavior of the electorate has been long recognized. In extended versions of our basic model, other economic controls are included to test for the robustness of the main results.

In synthesis, the structure of the model is,

$$\begin{aligned} V_{i,t} = {} & \alpha^*V_{i,t-1} + \delta^*DR_t + \zeta^*CRISIS^*DR_t + \iota^*PROMISES^*DR_t + \nu^*DGROWTH^*DR_t + \\ & \rho^*FRAG + \tau^*DINF + \varphi^*DGROWTH + u_i \qquad (3) \end{aligned}$$

$$\text{with } \alpha, \zeta, \iota, \nu, \varphi > 0,$$
$$\text{and } \delta, \rho, \tau < 0.$$

Data and sources

Our dependent variable V, is (the log of) the share of the votes for the President's party in the elections at the end of his administration. The source of the dependent variable is Payne et al (2002), which contains presidential election results for 17 Latin American countries between 1978 and 2000. We have a total of 53 elections, but some observations are lost due to lack of information for the explanatory variables. Since we want to control for the share of the votes that brought the incumbent to power (our lagged dependent variable), we need to have information for the same party or coalition of parties before and after each administration. In a few instances, this required recomposing the votes to obtain comparable values.[2]

The measure of reform (DR) is taken from Lora (2001), who has developed a system of indices to measure the extent of pro-market reform in the areas of trade liberalization, financial liberalization, tax reform, privatization and labor legislation on an annual basis from 1985 to 1999. In our estimates we use both the change in the composite index that encompasses these five

[2] Since our dependent (and lagged dependent) variable is measured in logs, we have dropped three observations in which the outgoing president's party did not compete in the election (either independently or as part of a coalition).

areas of reform, and each of the five sub-indices. An important feature of this system of indices is that it attempts to measure policy variables, rather than policy outcomes. Therefore, the inclusion of the reform indices in the regressions does not preclude the inclusion of macroeconomic variables, such as crisis and growth.

Our measure of crisis (CRISIS) is the (log) distance between the observed level of GDP per capita at the beginning of the administration and its trend level (obtained from annual data by country since 1970 taken from IMF-WEO, to which we apply a standard Hodrick-Prescott filter). Since our purpose is to measure the depth of the crisis we have only taken the observations below the trend (the higher the value, the deeper the crisis). We also use the (log) distance between the observed level of GDP per capita and its trend to measure the change in economic growth (DGROWTH), which is simply the difference between that distance at the end and the beginning of the administration.

Our measure of the pro-market orientation of pre-electoral promises (PROMISES) comes from Stokes (2001, page 3). On an ordinal scale, Stokes positions the campaign messages of 40 presidents between 1982 and 1996 according to their inclination towards efficiency-oriented or security-oriented policies. We have converted his ordinal scale into a 0 to 1 scale, where higher values mean more efficiency-oriented campaign messages. Due to differences in country and time coverage, the inclusion of this variable in our estimates reduces the sample size by 12 observations. Therefore, we have used an alternative variable to measure the expectations of the electorate with respect to the orientation of reforms, namely the ideological orientation of the party (IDEOLOGY). The information comes from the Database of Political Institutions, complemented with Coppedge (2001). These sources classify parties as left, center-left, center, center-right and right, which we have used to create a numeric scale from 1 to 5 (the higher the value, the more right-wing the party).[3]

Political fragmentation (FRAG) is measured with the Laako-Taagepera index of effective number of parties and data from Payne et al (2002). In the regressions, we use the lagged values of this variable (FRAGLAG) in order to reduce endogeneity and capture the situation of the party when the incumbent was elected.

Our two main macroeconomic controls are change in inflation (DINF) and change in economic growth (DGROWTH). We measure inflation as the loss of purchasing power of a currency unit, rather than as the increase in the price index. This reduces the heterokedasticity problem that would arise from including extreme values for the usual measure of inflation. We apply the formula $1-(1/(1+\pi))$ where π is the price increase during the last year of the administration (from IMF-WEO data). Economic growth is measured by the variable DGROWTH as explained above. Notice that our two macroeconomic controls are measured in changes between the end and the beginning of the administration. By doing so we remove the permanent component of both variables. The reason for this is that our sample size does not allow for the inclusion of country fixed effects, which would remove this (and other) permanent country specific factors that could affect the estimations.

Other controls used to test the robustness of the results in extended versions of the model are the change in the unemployment rate (DUNEMP) and the change in public social expenditure

[3] In a few cases Coppedge defines some political parties (or rather, movements) as “personalist”, implying that personal leadership rather than ideological orientation defines the nature of the party. We have not included these cases in our measure of ideology.

as a share of GDP (DSOCIALE[4]). Table 1 presents summary statistics for our list of variables and Table 2 presents correlations between the main variables.

Estimation results

The method of estimation is ordinary least squares with robust standard errors. Due to the structure and reduced size of the data set we do not include time or country fixed effects. The unit of observation is the party of the outgoing president and the dependent variable is the (log of the) share of its votes. A summary of regression results is presented in Tables 3 to 7.

We start with the basic set of controls as the only explanatory variables in regression 1. The vote for the political party of an outgoing president does not seem to depend on the initial number of votes that brought him to office. This result holds even though we directly control for the degree of party fragmentation, which has the expected sign and is statistically significant. Put together, these two results lend support to the view that electoral volatility is high and party attachment extremely weak in the region (see Coppedge, 2001 and Roberts and Wibbels, 1999). The change in inflation has the expected sign and is statistically significant, confirming the importance that the electorate attaches to price stability, while the change in economic growth has the wrong sign and has no significance (See Table 3, column 1).

We then add the change in the reform indices one at a time. The negative and statistically significant coefficients for the total index and for the index of trade liberalization imply that reformers are punished by the electorate. Some of the coefficients for the other reforms are positive but none is statistically significant (see Table 3, Columns 2-7). Therefore, we find support for the usual view in the political economy literature about the political costs of reforms. In more general terms, these results seem to imply that the electorate dislikes pro-market reforms in general and trade liberalization in particular (but not the other reforms taken individually). As we have argued, however, how the electorate reacts to the reforms may depend on several circumstances.

We first test for the validity of the crisis hypothesis. While some of the coefficients obtained have the expected sign, implying that reforms are more easily accepted when the government and the electorate are confronted with losses stemming from an economic crisis, none of these coefficients is statistically significant. Interestingly, the coefficients capturing the direct effects of the composite index of reform and that of trade liberalization remain significant, implying that the political costs of, and the distaste for reform, do not depend on the state of the economy (Table 4).

The following set of regressions tests for the role of promises and ideology (Table 5). The interaction between reform and promises is never significant and in several cases has the wrong sign (Table 5 columns 2 to 7). Since the sample size is reduced with the inclusion of this variable, we have also run a set of regressions using the variable party ideology as a proxy for the degree of market orientation of the government (Table 5, columns 8 to 13). In all but one case the coefficient has the wrong sign, and in none of the cases is it statistically significant. These results are inconsistent with the view that the electorate punishes the “switchers” (Stokes, 2001), and consistent with the view that the role of parties in economic governance is unrelated to their ideological orientation (Corrales, 2002). However, the fact that the coefficients capturing the

[4] Both DUNEMP and DSOCIALE are taken from the Economic Commission for Latin America and the Caribbean (ECLAC).

direct effect of the total reform index and the trade liberalization index on the electorates' behavior become statistically insignificant seems to imply that the distaste for reform is not entirely independent of ideological considerations.

Our third hypothesis deals with the interaction between growth and reforms. We would expect that when reforms are accompanied by faster growth, the electorate would lend more support to the incumbent's party. We get the expected result in half of the regressions, and in only one case the coefficient reaches some significance (tax reform, close to 10 percent, see Table 6, column 5). Furthermore, the inclusion of this interaction variable does not affect the significance of the coefficients of the total reform index and the trade liberalization index.

For completeness we finally present a set of regressions that include the variables for the three empirical hypotheses. However, given the reduced number of degrees of freedom and the large number of coefficients we do not attach much value to these results.

In synthesis, our results disprove all three of our hypotheses; crisis, pre-electoral promises (or ideology) and growth changes do not affect the reaction of the electorate to the adoption of pro-market reforms. Instead we find that the electorate's support of the incumbent's party is more elusive when party fragmentation is deeper, when inflation increases and when pro-market and, especially, trade liberalization reforms are adopted, irrespective of the circumstances.

To conclude this empirical section we provide further tests to assess the robustness of these conclusions. Tables 8 and 9 show that the distaste for total reforms and trade liberalization is robust to a variety of specifications and to the inclusion of additional variables. To assess the robustness, we first replace the change in inflation during the administration for the average rate of inflation (measured as the loss of purchasing power, as explained in a previous section). Additionally, we add the change in unemployment and the increase of social public expenditures. The first one is another measure of policy results during the administration, while the second is a compensation mechanism against the potential political costs of the adoption of structural reforms. The results for the two variables are robust to these alternative specifications.

Conclusions

Latin American political systems have gone through a period of turmoil and in most countries they experienced major changes in the mid-1990s. These changes are probably associated with the pro-market reform process, which had its heyday between the end of the 1980s and the mid-1990s. Our empirical results lend support to the hypothesis that, while stabilization measures that reduce inflation produce handsome electoral dividends, pro-market structural reforms in general, and trade liberalization in particular, have an electoral cost. This finding is consistent with the view held by political economy theories, which are based on the assumption that reforms face opposition for a variety of reasons. On the basis of country case studies, political scientists have explored the circumstances that may condition the electoral pay-off of the reforms. We have identified and tested three hypotheses of when reforms are more palatable to the electorate: when they are adopted in response to a crisis, when promised during the pre-electoral campaign of the incumbent and when their adoption is associated with faster growth. We have not found support for any of these hypotheses.

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Table 1
Summary Statistics

Variable	Number of Observations	Mean	Standard deviation	Min	Max
Votes	41	0.368	0.149	0.006	0.644
Votes lagged	41	0.453	0.134	0.016	0.759
Fragmentation	41	3.144	1.526	1.625	8.269
Change in Reform Index	41	0.080	0.073	-0.029	0.263
Change in trade index	41	0.126	0.165	-0.182	0.589
Change in financial index	41	0.142	0.188	-0.065	0.547
Change in tax index	41	0.043	0.098	-0.087	0.311
Change in privatization index	41	0.089	0.180	-0.033	0.972
Change in labor Index	41	-0.008	0.032	-0.072	0.103
Promises measure	29	0.552	0.276	0.250	1.000
Ideology measure	38	3.211	1.044	1.000	5.000
Crisis	41	0.028	0.038	0.000	0.154
Change in growth	41	-0.007	0.079	-0.247	0.145
Change in inflation	40	-0.088	0.245	-0.744	0.320
Change in unemployment	35	-0.002	0.034	-0.076	0.089
Change in social expenditures	37	0.008	0.013	-0.020	0.040

Table 2
Correlations of Principal Variables

	Votes (log)	Votes (lagged, log)	Change in reform index	Crisis	Ideology	Change in growth	Fragmentation (log)	Change in inflation
Votes (log)	1							
Votes (lagged, log)	0.093	1						
Change in reform index	-0.017	-0.351	1					
Crisis	0.044	-0.487	0.357	1				
Ideology	-0.164	0.313	-0.045	-0.099	1			
Change in growth	0.044	-0.350	0.337	0.683	0.071	1		
Fragmentation (log)	-0.513	-0.552	0.173	0.226	-0.220	0.182	1	
Change in inflation	-0.203	0.436	-0.445	-0.570	0.266	-0.430	-0.493	1

Table 3
Basic Estimations

Dependent Variable: Votes (log)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Constant	0.102	0.447	0.296	0.224	0.271	0.212	0.223
	(0.17)	(0.63)	(0.45)	(0.33)	(0.39)	(0.32)	(0.34)
Controls and macro variables							
Votes (lagged, log)	-0.013	-0.078	-0.039	0.031	-0.001	0.003	0.049
	(0.04)	(0.26)	(0.14)	(0.12)	(0.01)	(0.01)	(0.17)
Fragmentation (log)	-1.335	-1.536	-1.427	-1.425	-1.454	1.431	-1.358
	(1.69)*	(1.83)*	(1.75)*	(1.67)*	(1.72)*	(1.63)	(1.62)
Inflation (change of loss of purchasing power)	-1.453	-1.863	-1.536	-1.871	-1.703	-1.578	-1.486
	(2.22)**	(2.28)**	(2.05)**	(2.11)**	(2.02)*	(1.99)*	(1.93)*
Growth (change, log)	-0.316	0.305	0.092	-0.238	0.119	-0.026	-0.067
	(0.26)	(0.25)	(0.08)	(0.20)	(0.10)	(0.02)	(0.06)
Reform Variables							
Change in structural reforms index (log)		-1.152					
		(2.01)*					
Change in trade index (log)			-0.549				
			(2.57)**				
Change in financial index (log)				0.025			
				(0.17)			
Change in tax index (log)					-0.407		
					(1.04)		
Change in privatization index (log)						0.015	
						(0.23)	
Change in labor index (log)							1.715
							(1.45)
R-2	0.36	0.41	0.42	0.40	0.38	0.37	0.39
Number of observations	44	40	40	40	41	41	41

Absolute value t-statistics in parenthesis
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.

Table 4
Crisis Hypothesis

Dependent Variable: Votes (log)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Constant	0.102	0.102	0.299	0.243	0.414	0.198	0.274
	(0.17)	(0.17)	(0.45)	(0.35)	(0.58)	(0.29)	(0.42)
Controls and macro variables							
Votes that elected the party (log)	-0.013	-0.036	-0.051	0.095	0.175	0.036	0.151
	(0.04)	(0.11)	(0.18)	(0.26)	(0.55)	(0.12)	(0.44)
Fragmentation (log)	-1.335	-1.511	-1.438	-1.396	-1.445	-1.450	-1.325
	(1.69)*	(1.75)*	(1.73)*	(1.57)	(1.77)*	(1.62)	(1.51)
Inflation (change of loss of purchasing power)	-1.453	-1.753	-1.581	-1.748	-1.558	-1.452	-1.421
	(2.22)**	(1.95)*	(2.00)*	(1.80)*	(1.89)*	(1.90)*	(1.72)*
Growth (change, log)	-0.316	0.087	0.238	-0.457	-0.185	-0.032	0.489
	(0.26)	(0.08)	(0.20)	(0.45)	(0.16)	(0.03)	(0.32)
Reform Variables							
Change in structural reforms index (log)		-1.338					
		(2.21)**					
Change in trade index (log)			-0.509				
			(2.57)**				
Change in financial index (log)				-0.018			
				(0.10)			
Change in tax index (log)					-1.188		
					(1.67)		
Change in privatization index (log)						-0.052	
						(0.76)	
Change in labor index (log)							0.419
							(0.22)
Hypothesis 1: Crisis							
Change in corresponding index * crisis (log)[1]		4.749	-2.055	2.717	19.319	8.692	38.430
		(0.47)	(0.43)	(0.35)	(1.43)	(0.91)	(0.75)
R-2	0.36	0.42	0.42	0.40	0.41	0.38	0.40
Number of observations	44	40	40	40	41	41	41

[1] To test the hypothesis, we multiply the change in each of the reform indexes with the crisis measure. For example, in column one the variable is the change in the total index of reforms times the crisis measure, while in the second column the variable is the change in trade index times the crisis measure.
Absolute value t-statistics in parenthesis
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.

Table 5
Promises and Ideology Hypothesis

Dependent Variable: Votes (log)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Constant	0.102	1.053	0.998	0.878	0.864	0.857	0.878	0.784	0.685	0.628	0.747	0.790	0.589
	(0.17)	(1.28)	(1.31)	(1.05)	(1.04)	(1.09)	(1.03)	(1.23)	(1.13)	(1.00)	(1.20)	(1.50)	(0.93)
Controls and macro variables													
Votes that elected the party (log)	-0.013	-0.322	-0.248	-0.215	-0.307	-0.308	0.190	-0.216	-0.243	-0.210	-0.055	-0.421	-0.167
	(0.04)	(1.00)	(0.84)	(0.75)	(0.96)	(1.21)	(0.63)	(0.61)	(0.99)	(0.70)	(0.16)	(1.95)*	(0.57)
Fragmentation (log)	-1.335	-2.223	-2.162	-2.216	-2.204	-2.273	-2.143	-2.034	-1.983	-2.030	-1.985	-2.394	-1.951
	(1.69)*	(2.22)**	(2.46)**	(2.34)**	(2.22)**	(2.33)**	(2.03)*	(2.47)**	(2.59)**	(2.49)**	(2.51)**	(3.28)***	(2.23)**
Inflation (change of loss of purchasing power)	-1.453	-2.252	-1.875	-2.548	-2.172	-1.754	-1.798	-2.098	-1.838	-2.303	-2.002	-1.566	-1.795
	(2.22)**	(1.95)*	(1.84)*	(1.96)*	(1.86)*	(1.76)*	(1.59)	(2.64)**	(2.50)**	(2.61)**	(2.52)**	(2.92)***	(2.21)**
Growth (change, log)	-0.316	-0.357	-0.551	-2.030	-0.741	-0.696	-1.497	-0.809	-0.918	-1.481	-0.950	-0.346	-1.439
	(0.26)	(0.24)	(0.40)	(1.06)	(0.56)	(0.56)	(1.07)	(0.81)	(0.93)	(1.41)	(0.98)	(0.45)	(1.38)
Reform Variables													
Change in structural reforms index (log)		-1.431						-0.295					
		(1.12)						(0.17)					
Change in trade index (log)			-0.371						-0.243				
			(0.73)						(0.48)				
Change in financial index (log)				-0.137						-0.020			
				(0.32)						(0.05)			
Change in tax index (log)					-1.416						1.505		
					(1.36)						(1.05)		
Change in privatization index (log)						0.571						1.383	
						(1.35)						(1.56)	
Change in labor index (log)							4.893						5.197
							(1.57)						(0.93)
Hypothesis 2: Promises and Ideology													
Change in corresponding index * Promises (log)[1]		0.018	-0.934	0.335	1.117	-0.865	-6.969						
		(0.01)	(0.86)	(0.41)	(0.86)	(1.44)	(1.63)						
Change in corresponding index * Ideology (log)[1]								-0.197	-0.106	0.001	-0.530	0.346	-1.313
								(0.44)	(0.63)	(0.01)	(1.25)	(1.58)	(0.90)
R-2	0.36	0.61	0.64	0.62	0.61	0.61	0.59	0.59	0.61	0.59	0.59	0.65	0.57
Number of observations	44	28	28	27	28	28	28	37	37	37	38	38	38

[1] To test the hypothesis, we multiply the change in each of the reform indexes with the promises or ideology measures. For example, in column one the variable is the change in the total index of reforms times the promises measure, while in the second column the variable is the change in trade index times the promises measure.
Absolute value t-statistics in parenthesis
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.

Table 6
Growth Hypothesis

Dependent Variable: Votes (log)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Constant	0.102	0.533	0.304	0.218	0.414	0.198	0.224
	(0.17)	(0.73)	(0.46)	(0.31)	(0.58)	(0.29)	(0.34)
Controls and macro variables							
Votes that elected the party (log)	-0.013	-0.003	-0.049	0.013	0.102	-0.036	0.055
	(0.04)	(0.01)	(0.17)	(0.05)	(0.36)	(0.12)	(0.17)
Fragmentation (log)	-1.335	-1.530	-1.432	-1.431	-1.500	-1.530	-1.355
	(1.69)*	(1.82)*	(1.74)*	(1.66)	(1.82)*	(1.68)	(1.56)
Inflation (change of loss of purchasing power)	-1.453	-1.803	-1.586	-1.908	-1.852	-1.468	-1.485
	(2.22)**	(2.20)**	(2.09)**	(2.07)**	(2.09)**	(2.06)**	(1.87)*
Growth (change, log)	-0.316	-1.362	0.694	0.162	-0.590	0.378	0.014
	(0.26)	(0.98)	(0.51)	(0.07)	(0.45)	(0.33)	(0.01)
Reform Variables							
Change in structural reforms index (log)		-1.463					
		(2.42)**					
Change in trade index (log)			-0.592				
			(2.72)**				
Change in financial index (log)				0.017			
				(0.11)			
Change in tax index (log)					-0.798		
					(1.58)*		
Change in privatization index (log)						0.075	
						(0.72)	
Change in labor index (log)							1.671
							(1.16)
Hypothesis 3: Growth							
Change in corresponding index * Growth (change, log)[1]		8.707	-2.255	-0.825	10.034	-4.009	1.258
		(1.38)	(1.28)	(0.30)	(1.68)	(1.12)	(0.07)
R-2	0.36	0.43	0.42	0.40	0.42	0.39	0.39
Number of observations	44	40	40	40	41	41	41

[1] To test the hypothesis, we multiply the change in each of the reform indexes with the promises or ideology measures. For example, in column one the variable is the change in the total index of reforms times the growth measure, while in the second column the variable is the change in trade index times the growth measure.
Absolute value t-statistics in parenthesis
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.

Table 7
Competing

Dependent Variable: Votes	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Constan	0.102	0.896	0.695	0.644	0.901	0.807	0.669
	(0.17)	(1.41)	(1.12)	(1.03)	(1.38)	(1.63)	(1.06)
Controls and macro							
Votes that elected the party	-0.013	-0.227	-0.262	-0.270	0.110	-0.552	-0.102
	(0.04)	(0.68)	(1.05)	(0.73)	(0.30)	(3.01)***	(0.26)
Fragmentation	-1.335	-2.146	-2.001	-2.097	-2.015	-2.532	-1.945
	(1.69)*	(2.64)**	(2.54)**	(2.46)**	(2.78)***	(3.69)***	(2.02)*
Inflation (change of loss of purchasing	-1.453	-2.407	-1.918	-2.392	-2.165	-1.316	-1.682
	(2.22)**	(2.82)***	(2.39)**	(2.46)**	(2.48)**	(3.10)***	(1.88)*
Growth (change,	-0.316	-3.178	-0.493	-2.649	-1.730	-0.491	-2.317
	(0.26)	(0.78)*	(0.48)	(1.62)	(1.30)	(0.60)	(1.13)
Reform							
Change in structural reforms index		0.199					
		(0.11)					
Change in trade index			-0.175				
			(0.35)				
Change in financial index				0.155			
				(0.43)			
Change in tax index					1.881		
					(1.30)		
Change in privatization index						3.057	
						(2.18)**	
Change in labor index							3.807
							(0.75)
Competing							
Hypothesis 1:		-19.870	-3.153	-5.315	-2.430	5.336	83.401
		(1.35)	(0.54)	(0.72)	(0.16)	(0.55)	(1.34)
Hypothesis 2: Promises and		-0.281	-0.113	-0.010	-0.721	-0.838	-1.403
		(0.65)	(0.67)	(0.07)	(1.59)	(2.21)**	(0.79)
Hypothesis 3:		17.168	-0.669	3.274	11.595	12.435	-31.543
		(1.83)*	(0.38)	(1.19)	(1.42)	(1.39)	(1.35)
R-2	0.36	0.62	0.62	0.61	0.63	0.69	0.59
Number of	44	37	37	37	38	38	38

Absolute value t-statistics in
* Significant at 10%
** Significant at 5%
*** Significant at 1%

Table 8
Sensitivity analysis for the (change of) total index

Dependent Variable: Votes (log)	(1)	(2)	(3)	(4)	(5)
Constant	0.296	0.010	0.685	0.494	0.685
	(0.45)	(0.02)	(1.10)	(0.70)	(1.16)
Controls and macro variables					
Votes that elected the party (log)	-0.078	-0.173	-0.245	-0.213	-0.392
	(0.26)	(0.48)	(1.03)	(0.72)	(1.57)
Fragmentation (log)	-1.536	-0.906	-1.839	-1.872	-2.185
	(1.83)*	(1.50)	(2.32)**	(2.14)**	(2.77)**
Inflation (change of loss of purchasing power)	-1.863		-2.616	-2.011	-2.817
	(2.28)**		(2.62)**	(2.43)**	(2.72)**
Inflation (average loss of purchasing power)		-1.918			
		(1.54)			
Growth (change, log)	0.305	-0.680	-1.343	-0.437	-2.125
	(0.25)	(0.38)	(1.02)	(0.33)	(1.27)
Unemployment (change)			-5.373		-6.234
			(1.73)*		(1.64)
Social Expenditures (change)				3.559	6.319
				(0.56)	(0.27)
Reform Variables					
Change in total index (log)	-1.152	0.016	-0.660	-0.751	-1.203
	(2.01)*	(0.03)	(3.39)***	(1.33)	(2.03)*
R-2	0.41	0.36	0.58	0.50	0.69
Number of observations	40	41	34	36	30

Absolute value t-statistics in parenthesis
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.

Table 9
Sensitivity analysis for the (change of) trade index

Dependent Variable: Votes (log)	(1)	(2)	(3)	(4)	(5)
Constant	0.296	0.075	0.487	0.437	0.677
	(0.45)	(0.14)	(0.81)	(0.65)	(1.16)
Controls and macro variables					
Votes that elected the party (log)	-0.039	-0.197	-0.174	-0.178	-0.316
	(0.14)	(0.56)	(0.77)	(0.63)	(1.34)
Fragmentation (log)	-1.427	-0.949	-1.697	-1.781	-2.068
	(1.75)*	(1.58)	(2.16)**	(2.08)**	(2.60)**
Inflation (change of loss of purchasing power)	-1.536		-2.141	-1.785	-2.314
	(2.05)**		(2.29)**	(2.31)**	(2.32)**
Inflation (average loss of purchasing power)		-1.688			
		(1.40)			
Growth (change, log)	0.092	-0.355	-1.416	-0.576	-1.975
	(0.08)	(0.21)	(1.11)	(0.44)	(1.27)
Unemployment (change)			-5.343		-4.452
			(1.77)*		(1.24)
Social Expenditures (change)				-0.826	-2.961
				(0.10)	(0.46)
Reform Variables					
Change in trade index (log)	-0.549	-0.373	-0.660	-0.433	-0.582
	(2.57)**	(1.69)*	(3.39)***	(1.73)*	(3.24)***
R-2	0.42	0.38	0.58	0.51	0.69
Number of observations	40	41	34	36	30

Absolute value t-statistics in parenthesis
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.