

Capital, Trade, and the Political Economies of Reform

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Abstract

Existing approaches to the study of economic reform have focused on the mobilization of special interests that oppose liberalization, and have tended to assume that reform dynamics follow a similar logic across distinct policy arenas. Analysis of the dynamics of capital account and trade liberalization in 19 Latin American countries between 1985 and 1999 demonstrates otherwise. Movement toward liberalization is shaped systematically by the timing and salience of each reform's distributional costs, and partisan political dynamics. In turn, the timing and magnitude of costs are mediated by the economic context, while salience depends on the informational environment. Our findings thus differ from the conventional wisdom on several scores, particularly by emphasizing the ways in which good rather than bad economic conditions can facilitate reforms, the conditionality of legislative politics of reform enactment on whether reforms are characterized by *ex ante* conflict or fears of *ex post* blame, and how the type of reform shapes its political dynamics.

Keywords: Capital, Trade, Economic Reform, Liberalization, Veto Players, Blame Avoidance

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The past twenty years in Latin America have been a period of tremendous economic transformation. For many scholars, this has been a tale of the continent-wide collapse of the post-war regime of Import-Substituting Industrialization (ISI) and its replacement by an outward-oriented, neoliberal developmental strategy (e.g., Edwards 1995). This policy shift has had wide-ranging implications, as the prior emphasis on the state as the motor of economic development was replaced by the valorization of market mechanisms to guide the allocation of capital, the setting of wages, and the organization of the structure of production. For the vast majority of citizens, moreover, the short-term material consequences of reform have often been decidedly negative. Nevertheless, this tidal change in economic organization has coincided with a near-universal process of political liberalization and democratization in Latin America. In the late 20th century more than any other time in their history, Latin American citizens could hold governments to account for their actions, and politicians have had to anticipate policy's effects on broad swathes of the electorate.

Not surprisingly, the dramatic political and economic upheavals in Latin America have stimulated a prolific stream of research seeking to define the political underpinnings of economic liberalization. For most scholars, the central question defining this research was to understand how painful economic liberalization – however desirable in the long term – was made viable in increasingly free political systems? While some scholars focused on a single dimension of liberalization, others treated market-oriented reforms as a coherently-implemented package and sought to understand their political correlates. Both streams of research shared a common premise that the initiation of reform will be painful for large portions of the population in the short term, while in the long term laying the foundation for improved allocative efficiency, greater investment, higher growth and rising living standards. The social scientific dilemma thus focused on understanding when political elites seeking these long-term goals will be able to

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overcome or withstand short-term opposition to reform from ‘special interests.’

Unfortunately, this literature failed to predict empirically the outcomes of economic reform and thus cannot provide a sound interest-based theory of the politics of economic liberalization (see Schneider 2004). Our approach seeks to transcend this theoretical and empirical dilemma. Without dispensing with an appreciation for the interests that have clearly emerged in many cases to oppose market-oriented reform, we seek to qualify and refine a critical set of assumptions that drove earlier models in order to explain the *distinctive* politics of capital account and trade liberalization. In the first place, we think it analytically inappropriate to lump free market reforms together as part of a package by assumption, and thus to presume that the political dynamics that characterize reform efforts are necessarily similar across policy arenas. This does not imply that such reforms were not conceived of as forming a coherent package – they often were. Moreover, they were avidly promoted as such by Washington-based multilaterals (Armijo 2002; Remmer 1998, 16; Williamson 1990). Nevertheless, it is our contention that even where conceived as a coherent package, the political dynamics shaping the enactment of different elements of market-oriented reform vary systematically with the characteristics of the particular reform in question, leading to heterogeneous outcomes, despite homogeneous reform objectives. This is consonant with recent scholarship that has shown that stable economic policy packages may fall outside the traditional liberal/statist antipodes, involving new *mixes* of liberal and illiberal policy approaches or pernicious partial equilibria (Schrank and Kurtz 2005; Macario 2000; Krieckhaus 2002; Hellman 1998). Finally, since reforms may be causally linked through time—i.e., sequenced in enactment—separate consideration is crucial so that theoretically relevant intertemporal interdependencies can be evaluated.

We choose two important components of market-oriented reform programs – capital account and trade liberalization – as the cases through which to advance our argument about the multiple

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politics of economic liberalization. These reforms are among the most important and distributionally-consequential elements of structural adjustment programs (Kaufman and Segura 2001, 573-5) and are measures that in some cases were undertaken together (Agosin and Ffrench-Davis 1995, 17). Trade and capital account opening thus provide critical cases in which to find different political underpinnings to market-oriented reform.

We seek through this analysis to recast the standard theoretical expectations that liberal reforms are disruptive in the short term and produce collective benefits only in the medium to long term, and that reform politics will necessarily revolve solely around efforts to circumscribe short-term opposition to enactment. While it is widely held that such protest cycles obtain in the case of trade liberalization, the same cannot be said of capital account reform. What matters are citizens' and politicians' *ex ante* expectations about the implications of reform. While scholars and politicians disagree on the merits of capital mobility, most citizens lack information about financial openness. Interests regarding economic liberalization thus are not necessarily given or held consistently across policy areas; rather, the informational environments surrounding each reform should give rise to *distinct* strategic dilemmas for career-minded politicians. Specifically, where the distributive costs of a given reform are fairly clear and immediately-felt for important and organized segments of the population, elites face the dilemma of precluding or overcoming credible counter-mobilization. Where such costs and consequences are *not* clear to most citizens *ex ante* – as is the case capital account liberalization – then the political dilemma is less one of overcoming resistance than of providing political cover for the potential *ex post* consequences of reform. Distinctive constellations of short-term interests thus should underpin differences in the political dynamics of reform across distinct policy areas.

We also re-examine the link between crisis and reform. Rather than viewing these phenomena as necessarily tied, we argue that the economic context – and hence the distribution, timing, and intensity of potential pain induced by reform – shapes the interests surrounding

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economic liberalization in different ways, depending upon the type of reform and type of crisis. Thus the political obstacles or opportunities surrounding reform in crisis contexts are highly conditional and are mediated by short-term expectations that vary across policy domains and types of crisis. Where particular economic reforms have the potential to *ameliorate* aspects of economic crisis in the short term, their enactment is likely to be facilitated by crisis. In the more typical case, however, where political actors do not anticipate immediate improvements in economic conditions as a result of liberalization, we expect economic crisis to impede the enactment of reforms. We thus differ from the conventional wisdom that often posits a more general reform-inducing effect of economic crisis by providing a more contingent view of the effect of crisis on reform that emphasizes the way that political dynamics, distributive impact, and political accountability affect the prospects for reform in separate policy arenas.

POLITICS AND ECONOMIC CRISIS IN THE PROCESS OF ECONOMIC REFORM

Much of the work on the political foundations of liberal economic reforms has emphasized the role that democratization or political opening might play in making painful, market-friendly reforms more or less likely. While initial research on this topic suggested that authoritarian governments might be privileged in imposing such painful reforms, subsequent empirical work found such regimes to have no particular advantage (Geddes 1995, 196; Remmer 2002). More recently, important hypotheses have come forward suggesting that democratic regimes might be better positioned to advance liberal economic reforms, even if they impose large short-term costs on citizens, as democratization may empower reform beneficiaries in different ways (Milner and Kubota 2005; Frye and Mansfield 2004). In other cases it has been found that the potential barriers to reform embedded in democratic politics are not nearly as severe as previously thought (Remmer 1998; Stokes 2001a; Weyland 1998).

Democratic Politics, Interests and Citizens' Expectations

The next step forward in this research thus is to consider precisely how democratic politics

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might incite in the enactment of economically liberal reforms in a much more specific way.

That is, what *particular features* of the political system matter, and with respect to *what sort of* reform? Perhaps the most critical feature of open political systems is that they provide a mechanism – however imperfect – by which citizens can hold elites accountable for their actions that is absent under authoritarianism. This observation transforms the question of whether economic reforms will be implemented at least in part into a question of where the political support for reform can be found (e.g., Stokes 2001a; Weyland 1998). Perhaps the most common formulation is developed in the context of trade liberalization. Here the contention is that if trade reforms bring gains to all (or to most), then democratization will propel trade liberalization as leaders who resist it will be subject to electoral sanction, or that leaders will anticipate reward for such gains *ex post*, if not *ex ante*, and thus will liberalize trade regardless of their own personal or partisan preferences (e.g., Stokes 2001b).

The question of whether democracy impels or impedes trade and/or capital account liberalization begs a series of accessory questions about the politics of these measures, to which existing literature has produced no clear or consistent response. In the case of trade liberalization there is evidence that Latin American citizens expect that if it may ultimately bring benefits (at least in improved consumption and thus living standards, if not employment or growth) – and if they experience such gains in personal conditions – then citizens will offer support for free trade (Baker 2003; Kaufman and Zuckerman 1998, 364). Moreover, pro-reform executives have not faced the harsh electoral punishment that was widely anticipated to follow the enactment of deep economic liberalization (Armijo and Faucher 2002, 28; Stokes 2001a; Weyland 1998). But it is also quite clear that concentrated, organized interests (e.g., industrial unions and import-competing firms) will fight it strenuously, as their very survival may be at stake (Etchemendy 2001, 9). Under such conditions, democratic leaders must weigh the uncertainty and the time-delay surrounding a putative return to growth when pursuing reform, and cannot assume that

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political support for trade opening will necessarily be amenable alone to skillful ‘selling’ of such reforms (Schneider 2004, 475). Moreover, while the adjustment costs of trade reform are felt almost immediately, the task of activating diffuse popular beliefs about trade reform and building electoral coalitions behind them are more time consuming. Thus it is not altogether clear that politicians will succeed in building legislative support for trade opening, particularly where fragmented political authority expands the opportunities for opposition vetoes to be expressed (Haggard and Kaufman 1992; Mainwaring and Shugart 1997).

In the arena of capital account liberalization, however, there is no academic consensus as to the likely medium-term effects of openness on growth or living standards (e.g., Eichengreen 2001; Eichengreen and Leblang 2003; Rodrik 1998; Stiglitz 2000). The potential benefits of financial opening to capital-scarce countries such as those in Latin America are significant, and have been vigorously touted by the IMF in recent years to include the eventual reduction of interest rates, expansion of investment options and enlivening of domestic capital markets (Eichengreen and Mussa 1998). But these benefits are at best uncertain and openness simultaneously increases the risk of systemic financial calamity; even where the benefits obtain, their impact is often felt only in the medium term. This puts policy-makers in a bind; although they often face strong macroeconomic or international political pressure to liberalize, they also know that capital account liberalization entails considerable risks such as exposure to greater volatility and capital flight (Brooks 2004). And since most voters have little clear sense *ex ante* of the likely consequences of capital market deregulation, democratic accountability cannot be hypothesized to impel this reform in any straightforward fashion.¹ But for the same reason, pursuit of financial openness should also entail far less up front organized opposition; thus it will not imply a struggle to overcome legislative veto players.

What does this mean for the role of political interests in the process of reform? One approach to this question suggests that as democratization necessarily expands the “selectorate”

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in the political system, it brings into political relevance formerly-excluded citizens who are in the rural sectors and urban informal areas, and who, given Stolper-Samuelson assumptions, could be thought to favor trade opening as abundant factors that gain from trade (Milner and Kubota 2005). While labor is relatively abundant in Latin America, at least with respect to its principal trading partners in North America, there are empirical and theoretical problems with this explanation. Theoretically, peasants and the informal sector are exceedingly unorganized ‘groups’ lacking extensive political information, and are thus not easily mobilized around this issue – especially since employment and wage improvements in the wake of liberalization have been slow to obtain in the region (IDB 2004; Rodrik 1999). Individual level survey evidence poses a further problem: it is not these groups, but rather the more skilled middle-class and educated citizens that are most supportive of trade opening (Baker 2003, 449).

An alternative approach puts the problem of collective action at the center of the analysis (e.g., Gowa 1988). Recent research suggest that the interests guiding economic policy come not from the median voter, but from organized and concentrated import-competing groups and their partisan allies with a strong vested interest in the perpetuation of the status quo (Nielson 2003, 473). This is a marked improvement insofar as it emphasizes the question of how politically relevant groups affect policy change, rather than assuming that the preferences of the median voter are fairly seamlessly transformed into outcomes. But it is not at all clear that organized business interests will uniformly favor a protected trade posture or a closed capital market. If one makes Heckscher-Ohlin assumptions about easy reallocation of capital from one use to another, one can expect holders of (relatively scarce) capital in Latin America to be protectionist. But if investments are fairly sticky by sector, then holders of capital may no longer be as overwhelmingly protectionist, but may instead divide along export-oriented versus import-competing lines, and according to the level of inter-industry factor mobility (Alt et al. 1996, 692; Hiscox 2002). Thus business interests may not be as uniformly or intensely opposed to trade

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liberalization as has been expected.

We do not seek to push this point too far—after all the status quo ante throughout Latin America was quite protectionist, and as a consequence it is safe to assume that protectionist business interests remain quite influential. That said, in almost all of these countries exporters in agriculture, minerals and oil, and sometimes manufacturing, remained politically important; and their import only grew with the sudden scarcity of foreign exchange after the debt crisis of the early 1980s. Thus, while not dominant, the potential foundation for an export-oriented, liberal coalition did exist in most of Latin America. Moreover, some of the larger import-competing firms were not necessarily threatened with extinction or decline under trade opening, and thus their opposition could be mitigated. Many of these firms, while creations of import substitution, ultimately managed to adjust and thrive in the open economy.² It should be noted that the analogous situation does not obtain for labor unions, which are in many sectors threatened with the vitiation of their ability to bargain effectively, or even with extinction, as trade barriers are removed. As we will see below, it is this differential political pressure from core constituents—coupled with basic ideological convictions and the constraints that liberalization puts on other policy options—that is the theoretical foundation for our expectation that executives of the partisan right should generally be more prone to liberalization than those of the left.

Rather than emphasizing a comparatively prostrate state and political elite at the mercy of the lobbying power of vested interests, our approach to the political dynamics of liberal reforms puts political decision-makers at the center of the analysis. This does not mean that we think that societal interests do not matter, for surely they do. Rather, we assume that they matter more to some political leaders – such as to the particular partisan forces that represent them – than to others (as in Murillo 2003). Whether such interests' voices are heard thus depends critically on the question of who governs – and, we argue, on the economic context in which they govern. Union opposition should be more important to left- or labor-based political parties, while the

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voices of import-competing firms are most salient to right or business parties.

Because voters have been shown to hold executives more accountable for economic reforms than they do legislators (O'Donnell 1994; Stokes 2001a), we focus here on the partisan stripe of the executive. In particular, we offer a two-fold set of expectations. The simplest expectation is that, *ceteris paribus*, executives of the right will, for ideological reasons, more strongly prefer liberal economic policies (across most dimensions) than those of the left. Critically, partisanship should matter *net* of macroeconomic pressures and institutional contexts. This seemingly small point has been in actual fact quite problematic: the empirical evidence for partisanship's import has been at best mixed (Haggard and Webb 1994; Kaufman and Segura 2001; Remmer 1998, 2002). Such effects may have been masked, however, by the consequences of economic pressures that have induced governments, even sometimes those of the labor left, to liberalize.

The partisan effect is also rooted in differential political costs of reform. Where conservative politicians pursue vigorous liberalization, they may conflict with some (though not all) vested business interests who are their core supporters. However, liberalization will also create new export-oriented sectors likely to become core supporters of these same politicians. For right executives, then, the key is to sustain reform (and their tenure in office) long enough to generate new supporters of liberal policy from export-oriented business elites. Where left wing executives pursue vigorous liberalization they are likely to encounter opposition from their core constituents in organized labor. But even where liberalization is sustained and successful, a new *organized* constituency is unlikely to emerge and take labor's place at the social democratic table. Since the workers in newly-created export firms are very seldom organized, they are likely to lie outside normal patterns of institutionalized mobilization. Thus organized interest groups are much more likely to impede liberalization by left wing executives than by the right, and as a consequence we should expect in general more rapid moves to liberalize trade and capital movements on the part of conservatives.

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This does not mean that left executives never liberalize trade; rather, they should merely be less likely to do so, all else being equal. However, we do expect the left to pursue trade liberalization under one specific condition: in the context of uncontrolled inflation. In this setting, the price stabilization attendant upon external opening is immediately and directly beneficial to the core constituents of the left. And it is further notable that the oft-highlighted instances in Latin America of such governments ‘playing against type’ or engaging in post-electoral policy reversals occur in such inflationary contexts (see the examples cited by Cukierman and Tommasi 1998; Stokes 2001a). For us, this represents an instrumental response to a macroeconomic exigency that bears only a coincidental relationship to partisanship or ideology; after all, one would expect the same policy choices of right/business governments. Once proper controls for specifically-inflationary crisis are included, we contend that traditional partisan differences over trade liberalization, whose foundation is outlined below, will become apparent.

With respect to capital account deregulation, we expect right governments to be more amenable on basic ideological grounds, and expect their core constituents generally to provide support as well. Left governments, by contrast, should be particularly averse to this, not so much because of *ex ante* pressures by organized constituents, but rather because of the ways in which open capital accounts place substantial restrictions on the viability of heterodox economic policies or the ability to engage in expansionary fiscal policies (Mosley 2003). Moreover, the potential benefits for their constituents are typically few, as lower-income workers are less able to take advantage of expanded investment options to hedge against new risks attendant upon financial openness. As for right/business governments, since capital account openness holds the potential to reduce sharply the cost of capital, such governments should win support among their business constituencies for this policy, facilitating moves toward financial openness. Similarly, such constituents may also benefit from the newly-expanded possibility of outward investment.

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Time Horizons and the Role of Economic Contexts: Expectations

Scholars have only begun to explore the roles that time, time dynamics, and economic conditions play in the process of reform. Yet it is precisely these factors that are likely to differentiate crucially between *types* of economic reform. For many analysts, both trade and capital account liberalization are likely to involve ‘near-term’ economic pain, hopefully in exchange for longer-term benefits (Quinn and Inclán 1997; Li and Smith 2002; Frye and Mansfield 2004; Biglaiser and de Rouen 2004). But the suddenness of the onset and the duration of the adjustment costs of opening are critical problems, and capital account and trade liberalization differ markedly on this dimension. Moreover, it is not simply the case that market-oriented reforms can induce economic downturns; sometimes they are implemented in *response* to economic problems. Here again we argue for differentiation: the effect of crisis on economic reform depends both on what type of crisis and on what type of reform are at stake.

Trade and capital account liberalization differ substantially on two crucial dimensions: what voters believe their effects to be *ex ante*, and the suddenness and severity of potential economic downturns that may subsequently emerge in the adjustment process. On the first issue, much of the population has priors about the likely short- and medium-term consequences of trade liberalization – even if there remains some disagreement along class and educational lines over its merit, and even if such views are not ‘correct.’ What this means from the perspective of decision makers is that politicians cannot so easily manipulate beliefs about the likely consequences of trade opening, but rather must directly confront immediately-affected vested interests (both industrial and union) in proportion to how able they are to organize and exert political pressure.

The high salience and relative tenacity of preferences surrounding the issue of trade opening are less apparent with capital account liberalization. Here the average citizen is in a difficult position to evaluate the likely consequences of the freer movement of investment across

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international borders, and most typically is not aware of such reforms prior to their adoption.

Accordingly, studies of the politics of financial liberalization have largely focused on elite-level negotiations (e.g., Mahon 1996) rather than mass-level politics. Even among specialists, there is far from a consensus as to the short and long-term macroeconomic (let alone distributional) effects of capital account opening (e.g., Bhagwati 1998; Eichengreen 2001). While capital account opening broadens the range of investment opportunities for savers and allows for more effective hedging against inflation or economic downturns, these benefits may be of little relevance to most citizens in Latin America who simply do not have liquid assets available for investment. Nor, given the lower salience of capital account regulations, are most citizens in the developing world likely to have strong priors as to *either* what the current status of the capital account is, or the likely consequences of its liberalization.

This difference in the salience and consistency of citizens' beliefs about different types of economic reform has important implications for the policy-making process. Because in the case of trade liberalization the affected interests – particularly organized labor in protected manufacturing sectors – are likely to be well aware of the looming consequences of opening, the political challenge becomes one of overcoming resistance *ex ante*. In the short term, efforts to sidestep these veto actors rest on hopes that reform will generate stakeholders (and mobilize latent support) that contribute to the consolidation of such measures *ex post*. Here partisanship matters, as executives from right parties will be more willing to pay the costs of adjustment up front, since their core constituents are less virulently opposed to trade liberalization – or can be recomposed along new lines. Thus our first expectation is that, *all else being equal, left leaders should be less likely to advance trade liberalization than right executives*. This should hold regardless of institutional conditions, i.e., whether legislative authority is fragmented or concentrated. *For right executives, however, we expect the principal problem to be building legislative support in the first place, a task made much easier in less fragmented political*

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systems (Johnson and Crisp 2003, 136).

The risks and uncertainties facing politicians in the arena of capital account liberalization are quite different from those of trade opening. To begin, capital account opening was promoted vigorously in recent decades by the IMF, and offered capital-scarce countries the prospect of much-needed finance to remonetize local banking systems, fuel investment and growth. However, Latin America's experience with foreign capital flows since the 1970s demonstrated that the many medium-term rewards of capital mobility were far from guaranteed, and the potential for down-side calamity was very real. Indeed, unlike trade opening, the risks attendant on capital account openness can be severe *both* if it fails to attract new investment *and* if it attracts too much (Brooks 2004; Quinn and Inclán 1997, 773). This is coupled with the reality that financial openness reduces the overall policy-making freedom of any government by subjecting it to a constant referendum in international capital markets (Kastner and Rector 2003; Li and Smith 2002, 770; Mosley 2003; Sobel 1999). Yet, the severity and distribution of the adjustment costs of capital account openness are not particularly well understood by most members of society in the developing world. These risks – of vertiginous exchange rate overvaluation or undervaluation, and/or explosive capital flight and financial system collapse – are however, likely to be quite vivid for political elites.³ But since the perception of these costs, if they obtain, will be delayed until after the reform has been put in effect, political concerns surrounding capital account liberalization should revolve around avoiding the allocation of blame *ex post*, rather than around *ex ante* veto dynamics, as in the case of trade liberalization. *Accordingly, we expect Latin American governments to be most likely to pursue financial openness where political authority in the legislature is fragmented, and thus where ex post political responsibility for reform enactment can be widely-spread (should a downturn emerge).*

Crisis and Reform. Perhaps one of the least-understood, but most commonly discussed correlates of economic reform is economic crisis. On the one hand, scholars have argued that

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economic crises are crucial moments that make it possible to effect such sharp changes to developmental trajectory as the opening of markets (Haggard and Kaufman 1992, Weyland 1996). Serious economic difficulties are seen as disrupting the long-standing political bargains that underlay protectionist developmental trajectories, weakening the power of anti-reform vested interests, and/or discrediting inward-looking strategies in the eyes of citizens. Others, however, have pointed out that just because an existing equilibrium comes under substantial strain, this does not imply that economic reform – less so specifically *liberal* economic reform – will inevitably be forthcoming (see, e.g., Garrett 1996; Armijo and Faucher 2002; Mahon 1996). Economic crisis could equally be seen as a spur to tighter closure in an effort to gain greater control over trade and macroeconomic parameters and enable demand stimulus in an effort to induce recovery. Indeed, in several Latin American countries the initial response to the 1982 debt crisis was capital market closure, nationalization, and regulation (Diaz Alejandro 1985; Edwards 1995). Alternatively, political systems may simply fail to generate a new political-economic consensus, leaving policy vacillation or the status quo in place despite crisis (as in Brazil and Venezuela, according to Weyland 2002).

The critical issue is, however, whether specific liberal reforms will necessarily be seen as the antidotes to the particular problems at hand. Our hypothesis then is that whether reform is impelled or impeded by crisis depends on the type of crisis and the type of reform. Where the economic problems facing a country are rooted in uncontrolled inflation, we expect more rapid movement in the direction of trade opening. There are two reasons for this. First, trade opening is by itself a concrete strategy to combat inflation and inflationary expectations. It forces domestic producers to compete with international suppliers, making global prices a hard ceiling on the cost increases that can be passed along to local consumers. Consumers and workers will also *know* that this occurs, helping to check their expectations of future inflation, and thus to snap inertial price and wage pressures. The disinflation consequent on trade liberalization in a

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very-inflationary context is also directly materially beneficial to large swathes of the working class and informal sectors, whose incomes are generally poorly indexed to price changes. And trade opening can produce a short to medium-term consumption boom as prices fall – at least until adjustment leads to employment declines in import-competing sectors. Thus in the very short term, trade opening can be almost globally beneficial when adopted during inflationary times. In such conditions, it will be politically much easier to adopt.

This is not the case for trade opening in a recessionary context (Agosin and Ffrench-Davis 1995, 25-26). Where growth is low and economic pain is widespread, it is less likely that politicians of all stripes will want to liberalize trade. Indeed, this is precisely when they will be *least* able to bear the political costs of the resulting increase in unemployment. Adjustment to trade liberalization when economies are growing and trade balances are positive, by contrast, should be politically and economically more palatable, since workers dislocated by adjustment will have an easier time finding alternative employment in other, expanding sectors of the economy. Capital reallocation in response to new opportunities for international trade should also proceed more easily in such contexts (Devereux 1997; Edwards 1993). Access to foreign capital, moreover, is typically pro-cyclical in developing countries, meaning that credit is more plentiful (and available at a lower price and longer maturity) in good times, and rationed in bad times, further aggravating the costs of adjustment in recessionary contexts (Kaminsky et al. 2004; Stiglitz 2000, 1079). The added infusion of capital during economic expansion should help further to buffer the costs of adjustment to trade openness. *Thus we expect politicians will tend to liberalize trade in two starkly contrasting contexts: in good times, when growth is strong and the current account balance is positive, or in hyperinflationary crises, when the economic (and political) rewards for such a reform are likely to be immediate and broadly felt.* In both contexts, the *ex ante* opposition to trade liberalization should be muted.

The dynamics of capital account liberalization, however, are expected to be entirely distinct.

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Here politicians are caught in a fairly severe double bind. Although international market actors may exert strong pressure in favor of capital account liberalization in general (Eichengreen and Mussa 1998; Brune et al. 2001), they will also respond vertiginously to very short-term changes in a nation's macroeconomic fundamentals that can occur as a consequence of it (Easterly et al. 1999). Once the effects of crisis are considered, the putative growth-enhancing effects of capital account liberalization largely disappear (Eichengreen and Leblang 2003, 213). The risk that capital outflows will end in a full-fledged banking crisis, moreover, is greatest where the macroeconomic environment is weak (Demirgüç-Kunt and Detragiache 1998). Thus in Latin America, where traumatic episodes of capital flight have left government actors with little doubt as to the political and economic risks attendant upon vulnerability to capital flight, governments in the most capital-scarce economies have moved most cautiously toward financial openness (Brooks 2004; Calvo et al. 1996, 133). This expectation is consistent with the broader finding in empirical research that more developed economies tend to move faster and farther toward full liberalization of capital flows than poorer, less developed economies (Chinn and Ito 2002; Edison et al. 2004, 235; Eichengreen 2001, 347). *Political leaders thus should advance capital account opening where macroeconomic fundamentals are positive rather than negative, in order to reduce the risk of economic calamity in the event of sudden reversals of capital flows, and thus to avoid as well the potential political backlash associated with such a crisis.*

RESEARCH DESIGN, MEASUREMENT, AND MODELS

We examine the dynamics of trade and capital account liberalization in the nineteen countries of the Latin American region for which data were available over the period 1985-1999 (see Appendix I). Both the choice of region and time period provide clear analytical advantages. With the respect to the former we think it important to consider a set of cases that are all middle- to upper-middle income countries. This is in part due to an earlier set of scholarship that has emphasized that the effects some of the political variables of interest here, whose effects may

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well depend on the relative abundance or scarcity of different factors of production, are potentially causally heterogeneous across different levels of development. An analysis, then, that combined both wealthier OECD nations as well as substantially poorer areas with decidedly different production profiles would thus be mis-specified with respect to some of the principal variables of interest to us, as assumptions of causal homogeneity would not be valid. It is also the case that regionally-dominant states or blocs can have an effect on economic liberalization, and by sharpening the focus to Latin America, we examine countries that are similarly situated – with the exception of Mexico – with respect to the liberalizing influence of the United States and the relevant regional and international financial institutions, especially the World Bank and IMF. We are quick to add, however, that we do not seek to generalize our claims beyond this set of cases; we contend only that our hypotheses bear further investigation in other contexts.

The time period selected was chosen to situate the analysis squarely within the post-debt crisis period in Latin America. The debt crisis has been compared to a watershed on the scale of the Great Depression with regard to economic policy-making in the region (e.g., Edwards 1995). Most critically, it marked the first time since the era of the Gold Standard that liberal economic ideas held any substantial political or intellectual support among major domestic political players in the region. That is, it is only after this point in time that it makes sense to interrogate the causes of economic liberalization, for the dynamics that would have driven what little variation in openness occurred in the pre-1982 protectionist era are likely to be decidedly different from those prevailing from the mid-1980s onward. Thus we are not seeking here to explain when or how new paradigms come to be regarded as viable in the region (i.e., the ideational diffusion process), but rather what explains their concrete adoption once they have entered the national political debate. For this reason we confine our analysis to a time period when market-liberal economic ideas were widely available from credible sources such as the World Bank and regional development banks, the IMF, and even from within national governments in Latin

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America. This is also a period in which most countries of the region had competitive political regimes – and the few country-years that did not were excluded from our analysis, as the theoretical expectations we develop do not apply in authoritarian contexts.⁴

The Dependent Variables. A short description of our variables and sources is provided in Appendix I. Our measure of trade liberalization is taken from Lora (2001). This is a composite measure based on both the average tariff level as well as tariff dispersion. The variable is coded continuously on the [0,1] interval, with the endpoints being determined by the most closed and most open country-year across the entire dataset. The remaining scores are then normalized onto this interval. The measure of capital account openness is taken from Chinn and Ito (2002), and the reported value is the first standardized principal component for four indicators of capital account regulation: the use of multiple exchange rates, restrictions on current and capital account, and the compulsory turnover of export receipts. The variable is bounded at roughly -1.8 at the low end and 2.7 at the upper end, with a higher number indicating a more open capital account.

Independent Variables. Our analysis centers on a set of political and institutional variables as well as the effects of different types of economic crisis. On the political side, we employ a measure of partisanship that codes the occupant of executive office on a three point scale [0,2] from left, through center, to right.⁵ We focus on the executive branch rather than seat distributions in the legislature in assigning the partisan character of government because in most instances trade or capital account reforms are initiated (or propelled) by executives. This does not mean that we consider legislatures irrelevant, but rather that in assessing the overall partisan coloration of government, we think the executive provides the clearer picture.

That said, however, we consider the legislature important in a different sense. Of critical theoretical relevance to us is whether the legislature is highly fragmented – divided among a large number of competing political parties – or is quite majoritarian, with the dominant party or

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small coalition controlling a commanding share of the seats. We measure this legislative fragmentation as a Herfindahl index for the legislature. On such a [0,1] scale, one represents a situation of complete unity – one party controls all the seats in the legislature – and zero would be maximum fragmentation.

We also code for two different types of economic crisis. On the one hand we measure basic economic conditions – growth or recession – through the lagged percentage change in real per capita GDP. We also, however, measure antecedent inflation to investigate whether a specifically inflationary problem characterizes an economy in the previous year. Because the level of inflation is distributed very non-normally, we use the lagged natural logarithm of the inflation rate in this analysis. It is important to note that recession and inflation are distinct types of crises in two senses: many normal, recessionary crises are not characterized by high inflation, while many inflationary crises occur during times of growth.

Finally, with respect to capital account liberalization we include controls for the short-term constraints imposed by international market forces. Investment decisions in bond and equity markets are heavily shaped by a very few easily-observed macroeconomic parameters such as fiscal deficits, current account balances, and the ratio of external debt to GDP. Given the political and financial risks associated with financial opening, countries that are vulnerable to speculative attack (based on these measures) should be least likely to liberalize their capital accounts, even if these countries are most in need of external finance. We measure vulnerability to systemic financial crisis in three ways. First, we consider the level of external debt in relationship to GDP, which signals the government's default risk in the event of reductions in foreign exchange. Second, we examine the trade balance (measured as a percentage of GDP). Trade surpluses make financial liberalization less risky as they provide a foreign exchange cushion that can buffer unexpected capital outflows. Finally, we control for the level of domestic investment (fixed capital formation as a percentage of GDP, lagged by a year to avoid endogeneity), as

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where economies are already capable of generating adequate levels of investment, external opening poses far less of a threat of systemic crisis – speculative attacks are less likely as external dependence is lower.

Of course, trade and capital account liberalization are also likely related to basic economic characteristics of countries that are slow to change in the short term, and whose effects must be controlled for in the analysis. In both cases we control for the aggregate size of the economy (measured as the natural logarithm of GDP in constant US dollars of 2000) and for the level of development (GDP per capita in thousands of constant US dollars of 2000).

Controls for two further potential causes of liberalization are included as well: external pressure and cross-reform interdependence. With respect to the former, we measure exposure to external pressure as the weight of IMF or World Bank loan flows as a share of GDP. With respect to sequencing and reform interdependence, for each type of reform we estimate the effects of antecedent reform on the other dimension.

Approach to Modeling. We examine the process of trade and capital account liberalization using a pooled time-series/cross-sectional model (see Appendix 1 for a list of the countries included in the analysis). Cross sectional heterogeneity and correlation in the errors is corrected by the use of panel corrected standard errors, while we also adjust for the effects of AR-1 autocorrelation to capture time dependencies among them (Beck and Katz 1995). For each of the models we employ a lagged dependent variable specification, for we feel that this is justified on theoretical and methodological grounds. It is virtually certain that policy-makers, when considering trade or financial reforms, take as their starting point the status quo levels of protection or regulation. Failure to account for this would lead to very substantial biases in the coefficients of included explanatory variables, and would also imply that trade and financial policy is “re-set” every year in relationship to a set of exogenous variables.

That said, there are obviously econometric problems that arise with such a specification (see

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Greene 1990, 419-23). Achen (2000) points out that lagged dependent variables can unfairly reduce the estimated effect of other included variables in the model – and that there is little that can be done to correct for this. But since the bias is toward the *reduction* of the effect of other included variables, the inclusion of the lag represents a sharply conservative test of our basic hypotheses. While we may miss some effects, we are very unlikely to reach inaccurate positive conclusions. Moreover, since we are most interested in patterns of covariation in order to assess our theoretical propositions, and not specific point estimates in a forecasting sense, these problems clearly outweigh the alternative of excluding the legacy of the prior year’s policy in the model.

We also control for unobserved differences among countries in the analysis by including country-specific fixed effects.⁶ And, because it is possible to obtain spurious correlations between data series that are trended, we also include a control for a linear time trend to purge these effects from our estimates. On balance, we consider this a very conservative approach to hypothesis testing.

RESULTS AND DISCUSSION

The results of our analyses of trade and capital account liberalization in Latin America underscore our contention that it is inappropriate to think about a generic politics of economic reform. The political dynamics involved in liberalization are not only quite different across the two types of reform, but also are differently conditioned by the domestic political and economic milieu in which they are enacted. We begin our discussion with the analysis of trade liberalization in Table 1.

Trade liberalization is generally thought of as a policy position characteristic of more conservative political forces. Our expectations were squarely in line with this line of argument. Critically, however, trade reform differs from capital account liberalization insofar as the likely material consequences of the former are far better understood by citizens. That is, the adversely

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affected organized interests, such as labor unions, are often clearly defined and are likely to know just how severely they will be affected by trade liberalization. This forces politicians into a much more bare-knuckled fight to implement trade reform in the face of potentially vigorous opposition of groups with vested interests in the status quo. Because of this, it should be generally much more difficult to implement in deeply fragmented legislative settings – the task of constructing majorities in these settings is vastly more complicated than in settings in which a single coherent party has a governing majority. Not only is bargaining more complex as more actors are involved, but parties that do contemplate cooperating in reform efforts are more likely to face (a larger number of) competitors for the same core constituents than in less fragmented polities. Each of these competitors could easily use any support for trade reform as an electoral cudgel, thus increasing the political risks of cooperation. As the number of parties or factions in the legislature becomes large, overcoming the collective action problem can be quite difficult.

[Table 1 About Here]

Our results bear out both contentions. First, partisanship is robustly related to trade liberalization in the conditional way we expected. Right wing executives are no more likely to liberalize trade than are left executives in highly fragmented legislative settings. As the level of legislative fragmentation declines, however, right executives are much more likely to do so. This is not, however, a simple effect of legislative fragmentation, as the direct effect of this variable is indistinguishable from zero in the presence of the interaction term. In essence, it suggests that right executives liberalize trade in settings where they are more likely to be able to overcome potential opponents (where there is less fragmentation and thus fewer veto players). Left executives, owing to the vulnerability of their core constituents to liberalization, and their likely inability to reconstruct a new, organized political base in society in the wake of liberalization, appear to remain generally loath to undertake it. We are quick to add that this does not mean that left executives never liberalize trade. Rather, this is typically a product, for

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them, of economic constraints, and net of these effects left partisanship is associated with lower levels of liberalization.

With respect to economic conditions, the linkage between crisis and trade reform is bipolar. A simple recession does not augur for the liberalization of foreign trade. Indeed across all model specifications antecedent growth rates are not significantly associated with liberalization – recessionary crisis does not drive reform. This undermines claims that politicians can utilize economic crisis to justify potentially painful adjustment processes, and suggests that they are unwilling to raise the already-high unemployment rates that would characterize a recessionary economic situation. In the context of inflation, especially hyperinflation, however, we expected that politicians would be more willing to pursue trade liberalization, for there it can simultaneously carry both short-term and (potential) long-term benefits. Across all model specifications, a high level of antecedent inflation is associated with increases in trade openness. The theoretical point is that in the context of high inflation there is no ‘valley of tears’: trade liberalization can bring benefits to nearly all groups in the short term, by stabilizing prices amidst poorly-indexed incomes. By contrast, the short-term dislocations associated with trade liberalization in times of recession are likely to be particularly painful for affected interests, and thus costly to politicians as well, given their constrained time horizons.

Perhaps the most surprising result with respect to economic conditions is that trade liberalization tends to happen during trade surpluses, rather than in response to deficits. While economists argue that trade liberalization will in the long term generate increased exports, it seems likely that Latin American policymakers are much more concerned that in the short term it may only worsen existing imbalances. After all, it takes a substantial amount of time and investment for new exports to come on line, while imports are available immediately. Thus, liberalization tends to proceed where trade balances are in surplus and something of a cushion exists that can get countries through the adjustment trough.⁷ However, it is the political logic

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here that is crucial. Liberalization in good times implies a (politically and economically) far easier reallocation of workers from import-competing to export sectors than would be the case during recessions. It also means that in the short-run expanded imports (and hence trade deficits) will not worsen current account balances enough to risk speculative attack, sudden devaluation, or financial panic.

No examination of economic policy choices in Latin America after the debt crisis would be complete without considering the role of international financial institutions (IFIs) or market actors, and reform efforts in other areas. While much has been written about IFI influence, demonstrating a direct and plausible causal impact has been exceedingly difficult. Our results are no exception. We consider the effect of antecedent financial flows from the World Bank and the International Monetary Fund (IMF) on levels of trade liberalization. While there is no evidence that World Bank financial flows predict subsequent levels of liberalization, the results with respect to IMF flows are even more perplexing: the greater the antecedent flows, the lower the levels of subsequent liberalization. There are at least two possible interpretations here, the first is that this reflects a failure of IMF inducements to produce a concrete policy change (as opposed to agreements that may or may not be implemented). Alternatively, IMF outflows (i.e., direct ‘punishment’) may induce subsequent increases in the level of openness. Neither general vulnerability to international pressure – as captured by antecedent debt/GDP levels – nor antecedent levels of capital account openness predict trade reform.⁸ The latter is unsurprising as trade opening typically predated capital account liberalization in the region.

Controls for background economic conditions are correlated with levels of trade liberalization largely in the expected fashion. Across most specifications, larger economies are linked with lower levels of trade liberalization, owing to their characteristically lower dependence on the external sector for necessary goods and services. Wealthier countries are, however, no more likely to be liberal in their trade orientation than are poorer ones. Given the

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relatively constrained variation in the level of development across the Latin American region, this is perhaps not surprising. Indeed, openness to trade is characteristic of smaller, very wealthy countries able to afford an “embedded liberal” compromise that cushions the adjustment shocks of exposure to international competition with an extensive set of social protections and/or active labor market policies (Katzenstein 1985; Ruggie 1982). But in the Latin American context we would not expect a positive wealth-trade openness relationship as none of the states in the region can afford anything like the set of social buffers available in the small European economies. Whatever fiscal leeway Latin America did have was in any event decimated under the permanent austerity imposed by the debt crisis of 1982.

Table 2 presents our results with respect to capital account liberalization. We expected that partisan/ideological considerations should be important factors explaining this reform, since available information on capital account openness’ consequences is neither as widespread nor as definitive as is the case with trade liberalization. Indeed we find that partisan and institutional conditions are of importance in understanding capital account liberalization, and their dynamics are different from those involved in trade reform. The simplest version of the partisan explanation finds substantial support in our analysis – right wing executives implement capital account liberalization more than do those on the left. There are a variety of reasons why this would be the case, including the fact that liberal ideas are substantially more hegemonic within the intellectual and technocratic circles associated with conservative political parties. More importantly, left executives may be unwilling to pursue open capital accounts because of the Mundell-Fleming style restrictions it places on policy initiatives in other areas. If open capital markets allow capital flight in response to increased taxation or regulatory changes, or if they make it impossible to finance fiscal deficits, this would impede the demand-stimulus and/or social-protection initiatives more commonly pursued by executives of the left.

We do not, however, expect that interest group conflict is the principal driving force in the

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political arena. As we pointed out above, the sectoral and distributional implications of capital account liberalization are much less clear, and do not necessarily cut cleanly along the lines of existing organizations to the extent to which they are *ex ante* apparent at all. Instead, we hypothesized that executives will want to spread *ex post* responsibility for capital account liberalization as widely as possible if they are to pursue it, in an effort to insulate themselves from potential criticism – and political retribution – should an economic crisis occur as a consequence of openness. That is, instead of the task of constructing a difficult majority over the bitter resistance of entrenched organized interests *ex ante*, we expect a very different dynamic: capital account liberalization will be greater in contexts where legislative authority is widely shared, and thus where any initiative will require the cooperation of a broad range of parties, not necessarily all of them ideologically proximate. The key is widespread sharing of responsibility to avoid potential *ex post* political punishment should things go awry. This result is borne out by our analysis – highly fragmented legislatures (those with a low Herfindahl index) – are characterized by higher levels of capital account openness. This is despite common, more generic, arguments that policy initiatives are inherently more difficult in politically-fragmented settings. We find that this is not the case where the initiative in question is *not* likely to detonate massive *ex ante* resistance, the mobilization of interests, and thus a veto-player dynamic in the legislature. Unlike the trade liberalization case, thus, the directionality of the effect is opposite (fragmentation impels reform), and it is not conditional on the partisanship of the executive.

[Table 2 About Here]

As with trade liberalization, underlying economic characteristics are of importance. As expected, larger economies show lower levels of capital account openness. This is likely a consequence of the fact that such economies are large enough to reach scale economies in terms of financial services, and typically have more well-developed domestic financial sectors. They are therefore less pressured to risk the volatility of unregulated integration into international

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financial markets in order to make credit more available in the local economy. Underscoring the point that capital account liberalization is undertaken when the short-term risks attendant upon opening are mitigated, such deregulation occurs where current account balances are in surplus. Contra the conventional wisdom, it is not the “need” for foreign capital that drives liberalization, but rather its availability that makes financial openness politically and economically less risky.

The above underscores earlier work by Brooks (2004) that found that *short-term* risk is the key economic constraint on financial sector opening. Politicians have become increasingly aware of the *ex post* risks involved in the relaxation of regulations over international financial flows – most particularly in the Latin American context.⁹ What is of critical importance is the ability to convince inherently short-sighted international market actors that financing current account or trade deficits is not precariously dependent on short-term inflows of capital. Should they perceive this to be the case, politicians know that vulnerability to speculative attack rises dramatically, risk spreads on international loans surge, and in general severely-recessionary conditions may ensue. Our expectation thus was that politicians will liberalize international financial regulations only when they are well-buffered from these potential effects is supported in the analysis. We test for this in two further ways. Across all our specifications, capital account openness is also higher where antecedent levels of debt (relative to GDP) are lower, indicating lower foreign exchange demands for debt service. At the same time, it is unrelated to antecedent levels of domestic investment, suggesting that openness is not a functional response to capital scarcity, and underscoring the centrality of the short-run risk aversion that characterizes political decision-making in this arena.

Unlike trade liberalization, however, capital account reform is not driven – positively or negatively – by general economic conditions. Nor do international investors or sanctions, at least as measured by IMF and World Bank flows, predict subsequent capital account openness, which is what we would expect given our emphasis on avoiding short-term *ex post* risks. While these

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institutions clearly promote and enable the liberalization of financial flows, it is only when macroeconomic and political conditions permit that actual policy changes are implemented. There is no evidence here that they systematically compel it. The region-wide 1994-95 'tequila' crisis does appear to have an association with subsequent openness (as captured by a dummy variable for 1995 in Model III), but general trade exposure or antecedent trade liberalization do not predict subsequent capital account opening.

CONCLUSIONS

Conventional accounts of the politics of economic reform portray the central political dilemma facing reform-minded politicians as overcoming short-term opposition from organized interests threatened by the immediate dislocations attendant upon those reforms. Liberalization in this view is said to be enacted out of necessity – particularly in response to bad economic times – and in the hope of laying the foundation for future growth. Its success thus rests on the ability of political leaders to sustain the reforms until a medium-term return to growth is achieved. This study has challenged this stylized account, beginning with two of its central premises: that the politics of different market-oriented reforms can be explained in a single political economy model, and that the basic challenge for politicians is circumscribed strictly by a time inconsistency problem caused by the short-term costs of reform. We offered instead two central hypotheses. First, we posited that the politics of market-oriented reform are shaped powerfully by the extent to which citizens and politicians perceive the likely short-term costs and consequences of reform; and second, that those perceptions depend critically on the domestic political and economic context in which reforms are advanced.

These very general propositions have important theoretical implications, for they allow us to amend the widely-held view that crisis will necessarily lead to economic reform, and that partisan divides and veto player counts will map neatly onto cross-national patterns of economic liberalization. In the first instance, our analysis of trade liberalization confirmed the expectation

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that on average, governments tend to liberalize trade in economic conditions that dampen the short-run economic dislocations associated with trade opening, thus lowering or removing altogether the immediate political costs to politicians of enacting this reform. Such conditions obtain in two opposing circumstances: in good economic times – especially where trade balances are positive – or in a very specific form of crisis, hyperinflation, where trade liberalization offers immediate distributional *benefits* to a wide swath of the population by helping to quell uncontrolled price increases. The analysis also confirmed our expectation of a conditional partisan effect on trade opening. Because the immediate effects of trade liberalization are often widely known, or at least anticipated *ex ante*, conservative politicians who may be more disposed in principle to adopt a liberal trade regime face considerable political obstacles from vested interests to building legislative majorities behind this measure, unless legislative power is highly concentrated. Domestic political institutions thus condition powerfully the realization of partisan differences on highly-salient reforms such as trade liberalization, which often involve up-front battles to build legislative majorities behind reform.

The politics of capital account liberalization provide a stark contrast to those of trade opening – a difference attributable to the lower *ex ante* political salience of this reform, whose distributional consequences tend to be widely-realized only after its enactment. This diminishes the impact of political institutions on the ability of reformers to enact this measure, which rarely has become a hot-button legislative issue prior to enactment. Unlike trade reform, which has clear and salient adjustment costs, capital account liberalization involves opaque changes that nonetheless open countries to the possibility – but not the inevitability – of sharp *ex post* devaluations, capital flight, and financial panic. The political dilemma, as a consequence, and in contrast to trade reform, is therefore one of blame avoidance. Here fragmented political authority actually facilitates reform by implicating more political parties in its initial enactment, helping to insulate the executive from sole responsibility should a crisis subsequently develop.

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The statistical analysis supported this expectation, as capital account liberalization is greatest where political authority in the legislature is widely shared. By contrast to the case of trade liberalization, the tendency for conservative governments to advance deeper capital account liberalization is not conditioned by the structure of legislative authority.

Thus, our analysis confirms at the most basic level that there is no single politics of economic reform. Instead, there is evidence of important and distinct strategic political and economic considerations underpinning movements toward policy reforms based in part on the very different short and medium-term distributional implications of the reforms themselves. Our analysis underlines – and substantially re-specifies – the importance of domestic institutional and economic contexts in explaining reform dynamics. But in doing so it highlights the distinctive political logics that govern different types of reforms, laying the foundation for more extensive examination of potential intertemporal interdependencies (tradeoffs, sequences, etc.) among different dimensions of economic liberalization. This is an avenue for future research; and one that should engage policy changes in altogether different arenas as well (e.g., regulation, privatization, the labor market, or social welfare). Similarly, further research should include efforts to link reform initiatives, their informational environments, and the behavior (or quiescence) of interest groups. This will both elaborate on the causal mechanisms hypothesized above and set the foundation for a more complete synthesis of political-institutional and interest-based approaches to the study of economic reform.

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Table 1. Understanding Trade Liberalization: Crisis, Politics, and Globalization

Politics and the Political System	I	II	III
Partisanship of Executive	-0.0165* (0.0098)	-0.0125 (0.0104)	-0.0125 (0.0104)
Legislative Fragmentation	-0.0896 (0.0715)	-0.0799 (0.0719)	-0.0805 (0.0716)
Legislative Fragmentation* Executive Partisanship	0.0798*** (0.0258)	0.0735*** (0.0260)	0.0736*** (0.0260)
Indicators or Economic Crisis			
GDP growth rate _{t-1}	0.0001 (0.0013)	0.0003 (0.0013)	0.0002 (0.0013)
Inflation (natural log) _{t-1}	0.0088** (0.0044)	0.0074* (0.0042)	0.0073* (0.0042)
Year 1995			0.0022 (0.0179)
Background Economic Characteristics			
GDP (natural log)	-0.3000*** (0.0995)	-0.3007*** (0.1003)	-0.3015*** (0.1004)
GDP per capita	0.0161 (0.0123)	0.0139 (0.0126)	0.0140 (0.0125)
Trade Balance _{t-1}	0.0032*** (0.0011)	0.0034*** (0.0011)	0.0034*** (0.0011)
International Influences			
World Bank flows/GDP _{t-1}	-0.4539 (1.0553)	-0.2848 (1.0642)	-0.2740 (1.0615)
IMF flows/GDP _{t-1}	-1.4810*** (0.5386)	-1.5565*** (0.5304)	-1.5554*** (0.5344)
Debt/GDP _{t-1}	0.0420 (0.0266)	0.0384 (0.0276)	0.0384 (0.0276)
Controls			
Trade Liberalization _{t-1}	0.7055*** (0.0578)	0.6979*** (0.0587)	0.6976*** (0.0589)
Time Trend	0.0178*** (0.0042)	0.0193*** (0.0045)	0.0193*** (0.0045)
Capital Acct. Liberalization _{t-1}		-0.0066 (0.0053)	-0.0066 (0.0053)
Country Fixed Effects	[suppressed]	[suppressed]	[suppressed]
Constant	7.5700*** (2.4620)	7.5914*** (2.4811)	7.6105*** (2.4836)
N	218	218	218

*p<0.1 **p<0.05 ***p<0.01

Notes: Prais-Winsten regression with panel corrected standard errors and adjustment for panel specific AR-1 autocorrelation. Controls for country level fixed effects included but results suppressed in the interests of clarity; pairwise selection in the calculation of the PCSEs. Complete results available on request.

Sources: See Appendix I

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Table 2. Understanding Capital Account Liberalization: Risk, Partisanship, and Blame Avoidance

Politics and the Political System	I	II	III
Partisanship of Executive	0.0771* (0.0456)	0.0775* (0.0454)	0.0768* (0.0456)
Legislative Fragmentation	-0.8284** (0.4129)	-0.8626* (0.4471)	-0.7815* (0.4438)
Economic Constraints and Crisis			
Current Account (%GDP)	0.0172** (0.0077)	0.0168** (0.0076)	0.0143* (0.0076)
External Debt/GDP	-0.5903*** (0.2133)	-0.6090*** (0.2003)	-0.6332*** (0.2079)
Investment/GDP _{t-1}	-0.0057 (0.0113)	-0.0076 (0.0108)	-0.0097 (0.0109)
GDP growth rate _{t-1}	0.0106 (0.0115)	0.0081 (0.0109)	0.0078 (0.0110)
Background Economic Characteristics			
GDP (natural log)	-1.6694** (0.7302)	-1.6537** (0.6998)	-1.9187*** (0.6945)
GDP per capita	0.1235 (0.2093)	0.1643 (0.2216)	0.1896 (0.2273)
International Influences			
World Bank flows/GDP _{t-1}	1.6746 (8.1993)	4.2169 (7.9507)	4.5000 (8.0637)
IMF flows/GDP _{t-1}	-4.4058 (6.3215)	-4.7997 (6.3969)	-4.9344 (6.4424)
Year 1995		0.2680*** (0.0908)	0.2606*** (0.0922)
Trade/GDP _{t-1}			0.0054 (0.0044)
Controls			
Capital Acct. Liberalization _{t-1}	0.6034*** (0.0890)	0.5972*** (0.0898)	0.5887*** (0.0914)
Time Trend	0.1182*** (0.0301)	0.1189*** (0.0306)	0.1216*** (0.0307)
Trade Liberalization _{t-1}	0.0422 (0.2348)	-0.0270 (0.2404)	0.0330 (0.2476)
Country Fixed Effects	[suppressed]	[suppressed]	[suppressed]
Constant	41.5384** (18.2377)	40.9975** (17.3695)	47.2952*** (17.1409)
N	221	221	221

*p<0.1 **p<0.05 ***p<0.01

Notes: Prais-Winsten regression with panel corrected standard errors and adjustment for panel specific AR-1 autocorrelation. Controls for country level fixed effects included but results suppressed in the interests of clarity; pairwise selection in the calculation of the PCSEs. Complete results available on request.

Sources: See Appendix I.

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Appendix I. Variables, Sources, and Data

Variable	Mean	Standard Deviation	Source
GDP (natural log)	23.88	1.51	World Development Indicators (2005)
GDP per capita, USD of 2000, 1000s	2.941	1.870	World Development Indicators (2005)
Trade Balance _{t-1} , percent of GDP	-3.50	8.305	World Development Indicators (2005)
GDP per capita growth rate _{t-1}	1.098	3.908	World Development Indicators (2005)
Inflation (natural log) _{t-1}	3.216	1.619	Calculated from World Development Indicators (2005) [†]
Partisanship of Executive	1.311	0.863	Database of Political Institutions (2004) [‡]
Legislative Fragmentation	0.390	0.161	Database of Political Institutions (2004)
World Bank flows/GDP _{t-1}	-0.000219	0.00669	Calculated from World Development Indicators (2005)
IMF flows/GDP _{t-1}	-0.00574	0.00549	Calculated from World Development Indicators (2005)
Debt/GDP _{t-1}	0.776	1.110	Calculated from World Development Indicators (2005)
Current Account (percent of GDP)	-4.072	6.785	World Development Indicators (2005)
Investment, percent of GDP _{t-1} (fixed capital formation)	19.289	4.314	World Development Indicators (2005)
Trade, percent of GDP _{t-1}	54.233	23.751	World Development Indicators (2005)

[†] Cases where the inflation rate was less than 1 percent were recoded as one percent so that they would not be undefined (or very large negative numbers) after logarithmic transformation.

[‡] Missing data for the 1994-99 period for Venezuela were corrected. The administration of Rafael Caldera was coded as Left, following the decision rule of the database of political indicators, as the partisan coalition that brought him to office was predominantly left-of-center. This coding matches that assigned by Michael Coppedge for the legislative parties that supported Caldera's election. The Chávez administration was also coded as left.

Countries included in the analysis: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Paraguay, Peru, Trinidad and Tobago, Uruguay, and Venezuela.

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Endnotes

¹ Although international financial policy may be beset with collective action problems that are less prevalent in the organization of interests around trade policy (Gowa 1988), pressures for liberalization from financial interests with high stakes in financial remains possible. The impact of such interests is likely to be mediated, however, by the structure of state authority (Verdier 2003).

² Examples abound, in cement (CEMEX, Mexico), steel and metallurgy (Techint, Argentina; CVRD, Brazil), aerospace (EMBRAER, Brazil), and food products (Arcor, Argentina).

³ This is particularly true in the Latin American region which, after all, experienced continent-wide financial calamity during the post-1982 debt crisis, as well as subsequent localized but catastrophic financial collapses in Mexico, Argentina, and the Dominican Republic in the 1990s and 2000s.

⁴ We exclude cases code as "not free" by Freedom House. This in practice only reduced the N in the analysis slightly – reducing it from 229 to 218 in the full specification in Table 1.

⁵ Right parties are defined as conservative, Christian democratic, or right-wing, while Left parties are defined as communist, socialist, social democratic, or left-wing. Parties are defined as centrist when they self-define in that way, or when their program may be defined as centrist,

such as where the party advocates strengthening private enterprise in a social-liberal context (Keefer 2002, 7). We take this variable from the Database of Political Institutions, which relies principally on the identification of party ideologies (see Appendix I). Cases where no clear identification is possible are coded as missing data. Where executives deviate substantially from their traditional party label, the DPI records the executive's orientation, not the party's. This accommodates some of the potentially difficult cases (e.g., Fujimori, Menem). This measure also cross-checks its results with other sources, and where discrepancies exist does further investigation and sometimes changes codings. Notable in this regard is a re-characterization of the Mexican PRI as centrist in the wake of the austerity turn with the debt crisis in 1982 (formerly it was listed as a left party).

⁶ The coefficients on these variables are not presented as they are of no substantive interest, but they are available upon request.

⁷ Of course, trade liberalization alone will not generate an export supply response. This is also conditioned by the prevalence of market failures in information, capital markets, the lumpiness of necessary investments, and the level of protection of potential trading partners. Nor will such an export response necessarily compensate for the likely-increased level of imports.

⁸ Some have recently suggested simple program participation instead of actual loan flows, potentially adding an alternative way to capture international influences (see Vreeland 2006).

⁹ Indeed, there have been repeated object lessons from within the region as to the potential pitfalls of sudden, unrestricted movements of capital. While some might contend these are of only recent vintage – for example, the ‘tequila crisis’ detonated by Mexico in 1994-5, or the financial maelstrom that brought Argentina and Uruguay to their knees in 2002, there are poignant earlier examples.