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The Politics of Second-Generation Reforms

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What Does "Reform" Mean?

More than a decade after market-oriented reforms were launched in almost every Latin American country, the picture is not encouraging. Per capita growth reached almost 2 percent a year in the 1990s—a far cry from the dismal negative 0.7 percent during the "lost decade" of the 1980s—but hopes have been dashed nonetheless. Only Chile managed to achieve "Asian" rates of growth during the 1990s. In other countries—Argentina and Mexico are good examples—vigorous growth spurts have been followed by periods of stagnation or decline. Huge budget deficits and hyperinflation are a thing of the past (one hopes), but low investment and dismal public services are not. Income distribution has not worsened, but it has not improved either; Latin America remains the world champion of inequality. Prescriptions differ, but most observers agree that the time has come for a new round of policy reforms in the region.

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What new policies could these be? The distinction between first- and second-generation reforms, originally made (to the best of our knowledge) by Naím (1994), still provides a useful way of organizing the discussion. Table 10.1, taken from Naím's paper, lists the reforms involved and their characteristics. First-generation reforms include the usual suspects: macroeconomic stabilization, tariff and budget cuts, privatization, and the like. Second-generation reforms are a motley crew, encompassing broad reforms of the state, the civil service, and the delivery of public services; of the institutions that create and maintain human capital (e.g., schools and the health care system); and of the environment in which private firms operate (more competition, better regulation, stronger property rights). In contrast to first-generation reforms, which were really statements about the instruments to be used and the inputs needed (reduce inflation by cutting money-supply growth and the budget deficit), many second-generation reforms are really statements of desired outcomes (e.g., civil service reform or improving tax collection), without a clear sense of policy design. This is not a failure in Naím's conceptualization; rather, it is a signal of our ignorance of how to achieve these goals.

First- and second-generation reforms overlap, but do not coincide entirely, with variations on Williamson's famous 1994 "Washington Consensus" (for a detailed discussion of the history and use of this term, see the appendix at the end of this book). Table 10.2, adapted from Rodrik (2002), contains the original 10 prescribed policies plus 10 more that originate in what Rodrik calls the "Augmented Washington Consensus." The extended list contains some items that are not new reforms in themselves but rather are changes that he argues are necessary to make the policies in the original list work, or to prevent some of those original reforms from failing. Examples are "financial codes and standards," "prudent capital account opening" and "nonintermediate exchange rate regimes," all intended to moderate the macroeconomic and banking instability brought by the initial round of financial reforms.

Other elements in the extended Washington Consensus are more properly second-generation reforms, involving legal, regulatory, and political institutions. Notice again that many are outputs and not inputs; poverty reduction is a lofty goal, but the Washington pundits are silent on how to achieve it. Indeed, a striking feature of second-generation reforms is their sheer technical difficulty. Any economist can tell you that curtailing inflation requires lower money growth; fewer are prepared to put forward a proposal for supervising operations in derivatives by banks and other financial institutions, or for solving failures in the market for health insurance.

Thorny Political Obstacles

Differences in the politics between the two stages are no less striking. With the important exceptions of import-competing industrialists facing

Table 10.1. The two stages of economic liberalization: from changing rules to changing institutions

Aspect	Stage 1: Launching	Stage 2: Consolidation
Priorities	• Reduce inflation • Restore growth	• Improve social conditions • Increase international competitiveness • Maintain macroeconomic stability
Reform strategy	• Change macroeconomic rules • Reduce size and scope of state • Dismantle protectionism and statism	• Institutionalization: creation and rehabilitation • Boost competitiveness of private sector • Reform health, education, and other public services • Create the "economic institutions of capitalism" • Build new "international economic integration"
Typical instruments	• Drastic budget cuts and tax reform • Price liberalization (including exchange and interest rates) • Trade and foreign investment liberalization • Private-sector deregulation • Creation of "social emergency funds" • "Easier privatization" (e.g., hotels, airlines, some manufacturing)	• Labor market reform • Civil service reform • Restructure government (especially social ministries) • Overhaul administration of justice • Upgrade regulatory capacities (for privatized utilities and other monopolies, antitrust, antidumping, financial sector, environment, labor, etc.) • Improve tax collection • Sectoral restructuring • Build export promotion • Restructure relations between state and federal governments
Principal actors	• Presidency • Economic cabinet • Central bank • Multilateral financial institutions • Private financial groups and foreign investors	• Presidency and cabinet • Congress • Public bureaucracy • Judiciary • Unions • Political parties • The media • State and local governments • Private sector
Public impact of reforms	• Immediate • High public visibility	• Medium and long term • Low public visibility
Technical and administrative complexity of reforms	• Moderate to low	• Very high
Nature of political response	• "Temporary corrections" • Widely distributed among the population	• Permanent elimination of special advantages for specific groups
Main government challenge	• Macroeconomic management by insulated technocratic elites	• Institutional development highly dependent on midlevel public-sector management

Source: Naím (1994).

Table 10.2 The Washington Consensus is dead; long live the new Washington Consensus

Original Washington Consensus	Augmented Washington Consensus
	The original list plus
• Fiscal discipline	• Legal and political reform
• Reorientation of public expenditures	• Regulatory institutions
• Tax reform	• Anticorruption
• Financial liberalization	• Labor market flexibility
• Unified and competitive exchange rates	• World Trade Organization agreements
• Trade liberalization	• Financial codes and standards
• Openness to foreign direct investment	• "Prudent" capital account opening
• Privatization	• Nonintermediate exchange rate regimes
• Deregulation	• Social safety nets
• Secure property rights	• Poverty reduction

Source: Reprinted from Rodrik (2002) with permission.

lower tariffs and unions in parastatals facing privatization, the "victims" of the first-stage reforms were often atomistic or too poor to matter politically. By contrast, the set of interests potentially affected in the next stage reads like a *Who's Who* of highly organized and vocal groups: teachers' and judicial unions, the upper echelons of the public bureaucracy, state and local governments, owners and managers of private monopolies, and the medical establishment.

The complications of second-generation reforms have been evident in countries attempting to move forward. Public school teachers and public health-sector employees have been in a state of semipermanent warfare against governments that have attempted to meddle in their affairs. Chile under Patricio Aylwin and Eduardo Frei and Bolivia under the first administration of Gonzalo Sánchez de Losada are examples. Similarly, cleaning up the finances of free-spending provincial governments proved a politically formidable task for Carlos Menem, Fernando de la Rúa, and Eduardo Duhalde in Argentina and for Fernando Henrique Cardoso and his team in Brazil.

The political process required by second-generation reforms is turning out to be very different from that for first-generation reforms. The first wave of changes was often carried out in unique emergency situations. Many of the measures (e.g., monetary and exchange rate stabilization) did not require parliamentary approval; in areas that normally should (e.g., deregulation or fiscal reform), even democratic governments were able to resort to "emergency rule by decree." By contrast, deep changes in such priority areas as judicial and regulatory systems can hardly be carried out without lengthy discussion and the participation and technical expertise of the affected parties. Rule by committee and consensus has to be the norm from now on. But as governments everywhere are finding out, that is more easily said than done.

All of this necessarily requires that the institutions of democracy be strengthened. There is much talk in the revamped Washington Consensus about the importance of institutions. But as Rodrik (2002, 3) puts it, "The question before policy-makers therefore is no longer 'do institutions matter' but which institutions matter and how does one acquire them?" In his words, such institutions must facilitate the development and consolidation of a "clearly designated system of property rights, a regulatory apparatus curbing the worst forms of fraud, anti-competitive behavior and moral hazard, a moderately cohesive society exhibiting trust and social cooperation, social and political institutions that mitigate risks and manage social conflicts, the rule of law and clean government."

The study of institutions and their relation to economic performance is just beginning in the region. Questions on how institutional features shape and influence public policy and social interactions in Latin American countries have only recently captured the attention of scholars who possess the methodological training to produce research designs that can be replicated and lend themselves to comparative studies. Simple cross-country regressions that introduce institutional or political variables have not yet shown much explanatory power.[1] But we have learned a few lessons, which we review below.

Some Necessary Disclaimers

Two disclaimers are necessary when writing about second-generation reforms. The first is that one may view them as desirable goals in themselves (who could be against less corrupt courts or better hospitals?) without having many illusions about their broader economic impact. In some particularly exalted moments, the authors of the several Washington Consensuses promised that the sum of first- and second-generation reforms would provide the answer to the question of development in general and of economic growth in particular. But cooler heads and some research have revealed that these reforms are no panacea, particularly when it comes to generating long-term growth. More schooling may be a great thing, but its empirical link to increases in per capita income is tenuous indeed, as Pritchett (2001) and Easterly (2001) have found. Not even the relationship between trade and growth is clear. Sachs and Warner (1995) and Frankel and Romer (1999) were early optimists, claiming that greater openness means faster growth; Rodríguez and Rodrik (2000) are skeptical.

1. In his study of the determinants of first-generation reforms, Lora (2000, 13) introduces several political variables, acknowledging that "we are aware that none of the variables considered is a satisfactory indicator of the concepts used in the theoretical literature." Unsurprisingly, he concludes that "the timing and composition of reforms do not appear to be strongly influenced by the political variables highlighted in the theoretical literature. Neither the number of effective parties, nor governing party representation, which are proxies of political fragmentation, has explanatory power in the regressions."

The second disclaimer has to do with the political labels of reform. Policies associated with the Washington Consensus are often thought to strengthen the market and weaken the state. Yet in many areas, second-generation reforms involve "bringing the state back in." Regulation, judicial adjudication, and (to a lesser extent) the provision of social services are government activities almost by definition. The question, then, is how to strengthen the state without allowing it to again become bloated. Or in the words of former Spanish prime minister Felipe González, how to acquire a "small but muscular state."

The fact that second-generation reforms may imply strengthening the state is important for identifying the opponents of reform. Public-sector employees and their privileges are the plausible villains in some stories—health care and education, most prominently. But in other areas, the villains come well dressed and directly from the private sector. The strengthening of regulation is vehemently opposed by the powerful owners—both domestic and foreign—of privatized electricity, telecommunications, and water companies; greater disclosure in financial markets is sure to upset bankers and their friends; and enhanced competition will find enemies both in protected farmers and among shipping and airline owners granted monopolies over domestic transport. This means, in plain but old-fashioned language, that second-generation reform mongering need not be a right-wing affair; it can be a progressive or left-wing affair just as well.

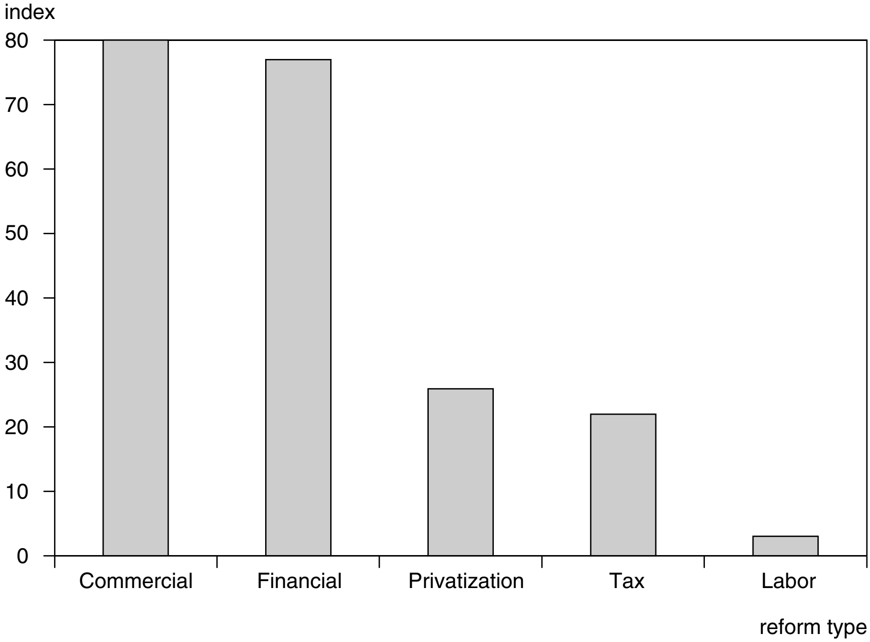
How Much Reform?

Lora (2001) has developed the most comprehensive measure of Latin American first-generation reforms (what he calls "structural" policies). He computes regionwide indices in five areas—trade, finance, taxation, privatization, and labor—normalized so that zero is the lowest rating in any country at any time in the sample, and one the highest. Therefore, the levels of the index are rather hard to interpret, but the changes in the index over time offer a good measure of progress in these areas.[2]

Figure 10.1 shows such changes between 1985 and 1999. The results are consistent with conventional wisdom. Two sets of first-generation reforms—trade and finance legislation—have gone farthest, with the relevant index rising by more than 75 percent during the period. Two other sets of reforms—privatization and tax changes—are in an intermediate category, with the index rising by about 25 percent in both cases. Finally, in labor market regulations—hiring and firing costs, nonwage costs, rules on overtime, and part-time work—there has been hardly any change at all since the mid-1980s. Some countries, such as Argentina, have attempted

2. Notice that Lora classifies changes in labor laws as a first-generation reform, whereas Naím and Rodrik relegate them to the second stage.

Figure 10.1 The advance of first-generation reforms in Latin America, 1985-99



Note: The advance is calculated as the change in the respective index between 1985 and 1999, divided by 1 minus the value of the index in 1985.

Source: Lora (2001).

labor reform again and again, only to have bills defeated or passed in highly watered-down form. In others, such as Chile, firing costs have actually risen in the past decade.

We know of no similar attempt to assess the progress of second-generation reforms across countries and across time. It is revealing that a special International Monetary Fund conference on second-generation reforms held in October 1999 had papers on every topic imaginable, but nothing on the extent of such reforms in the real world. The evidence, therefore, is mostly informal. But the general picture that emerges is quite clear: in Latin America, second-generation reforms are in their infancy at best. There is one area—social security and pensions—where change has been widespread (though one might argue that this was really a first-generation tax reform).[3]

On other fiscal issues, such as relations between national and subnational governments, much has been tried in such countries as Brazil and

3. See Lora and Pages-Serra (2000).

Argentina, with mixed results. (There is also the case of Colombia, where fiscal decentralization has made great strides since 1990, though not necessarily for the better.) Regulatory and prudential systems in finance have improved vastly, if for no other reason than that recurrent financial crises made change inevitable; Chile, Colombia, and Mexico (and in some domains Argentina) stand out in this regard. Modern regulation for some privatized utilities has also sprung up here and there, again with Argentina and Chile taking the lead (though the regulation of telecommunications in Argentina has been far from successful).[4]

But the farther one goes from macroeconomics or big-ticket items such as electricity, and the closer one gets to institutional and microeconomic reform, the less hopeful the panorama becomes. State reform is much talked about but seldom clearly defined and even more rarely implemented. When it comes to poverty alleviation, the tendency has been not to reform existing policies and institutions but to bypass them. First came the fashion for social-emergency funds, invented in Bolivia in 1985 and widely copied elsewhere; then the fashion shifted to contingent cash-transfer programs, paid to female heads of households: Mexico's Progresa is the best-known such scheme, but Ecuador under Jamil Mahuad tried something similar (Skoufias and Parker 2001). Judicial reform is also just starting; perhaps Chile's wide-ranging changes to its penal system are the most striking example.[5] And finally there is the most important of second-generation reforms: education. Progress here is also spotty, as chapter 8 of this book reports.

In one sense, it is not surprising that Latin America has not gone very far in implementing second-generation reforms. We saw above that they are typically defined in terms of outputs (eliminate poverty) instead of inputs (change this or that regulation). But those are the outputs that make advanced nations advanced. If Latin America had alleviated poverty, guaranteed good education and decent health care, acquired upstanding police officers and judges, and learned to regulate highly sophisticated private banks and companies, it would have advanced—and all in a mere decade and a half.

Just as George Orwell's animals are all equal, but some are more equal than others, Latin America's countries are all underdeveloped, but some a great deal more so than others. This difference can be attributed to varying endowments and initial conditions but also to widely varying policy regimes. The political determinants of such policy options, and the polit-

4. On regulating the electric sector, see Serra and Fischer (2000); on telecommunications, see Estache, Manacorda, and Valletti (2002).

5. In this case, what such a reform ought to entail is particularly contentious and unclear. There is a vast literature on the efficiency of legal systems in industrial countries, but applications to developing nations are few and far between. See López-de-Silanes (2002) for a review of the issues.

ical circumstances that make policy reform more or less likely, are the very big topics to which we now turn.

The Timing and Sequencing of Reforms

In this section, we revisit two questions that received much attention in the early literature on the political economy of reform. First, do economic crises, either domestic or international, cause reform? Second, what determines the sequence and bundling of different reform initiatives? Our aim is to ascertain what importance, if any, these two issues have for the prospects of second-generation reforms in Latin America.

Are Crises Necessary for Reform?

In the frenzy of reform activity of the early to mid-1990s, it became a truism that economic crises facilitate or outright cause reform. Aside from Colombia, which at that time undertook deep policy changes without a crisis (and, outside Latin America, Australia), in almost every other country reform seemed to be triggered by default, hyperinflation, or worse. The consensus among prominent analysts was almost unanimous. According to Bates and Krueger (1993a, 454), "In all cases, of course, reforms have been undertaken in circumstances in which economic conditions were deteriorating. There is no recorded instance of the beginning of a reform program at a time when economic growth was satisfactory and when the price level and balance of payments situations were stable." In short, things had to get very bad before they could get better.

This idea was appealing and intuitive, but not without problems. Rodrik (1996) provided the most cogent criticisms, pointing out that there is an element of tautology in the explanation: "Reform naturally becomes an issue only when policies are perceived to be not working. A crisis is just an extreme case of policy failure. That reform should follow crisis, then, is no more surprising than smoke following fire."

There were plenty of models around built to formalize how the politico-economic equilibrium changes to permit reform, and of what role crises can play in this context. In all these models, agents (groups) decide what to do by comparing expected streams of payoffs. Typically, the (flow) payoff associated with "nonreform" is expected to deteriorate.[6] A reform occurs in this context when the payoff associated with the policy change first exceeds that associated with the status quo. What role do crises play in all of this?

6. This deterioration can come about because of exogenous (terms of trade and other) shocks, as in Velasco (1994) and Tomell (1995), or because of the endogenous evolution of state variables—financial adaptation in Labán (1994) and Mondino, Sturzenegger, and Tommasi (1996), or government debt in Alesina and Drazen (1991) and Velasco (1999).

Two papers dealt with this question of crises explicitly. Drazen and Grilli (1993), using the model in Alesina and Drazen (1991), looked at a case in which the cost of inflation increases exogenously, and showed that by making delay more costly this shock can accelerate the arrival of stabilization. Velasco (1999) showed that an adverse shock to government revenue could cause debt to accumulate more quickly and thereby bring forward in time the occurrence of fiscal reform. More strikingly, both papers showed that crises can be "good" for welfare; if the indirect (beneficial) effect of reducing delay outweighs the direct (adverse) effect of the crisis, then a bad shock can make everyone better off.

When applied to first-generation reforms, the crises-cause-reform hypothesis found some empirical confirmation. Lora (2000), using data from 1985 to 1995, regressed his policy reform index (both the average and its components) on a crisis proxy, defined as the gap in a year's income per capita relative to its previous peak. The corresponding coefficient, which he found to be robust to the inclusion of all other explanatory variables, indicated that a gap of 10 percent in income per capita leads to an annual increase in the total index of between 0.005 and 0.008. The result was strikingly significant in statistical terms. The coefficient, however, was also strikingly small; the average increase in the total reform index between 1985 and 1995 was 0.25, so the measured contribution of crises to this change turned out to be tiny.

All this intellectual activity (to which one of us contributed) was exciting. But from the vantage point of the time of this writing, 2001 and 2002, and especially when thinking about second-generation reforms, it all seems like *much ado about little*. A decade has passed since the peak of the reforming frenzy. During that period, the economic performance of the countries of the region has varied widely, from outright success stories (Chile and the Dominican Republic), to volatile but positive growth (Mexico), to outright crisis (Argentina and Ecuador since 1998). Yet the process of reform has slowed down almost everywhere, regardless of economic circumstances.[7]

One possible retort is that the most recent crises have not been deep enough. But a moment's thought robs this alternative of much plausibility. The 1995 tequila crisis in Mexico, with its repercussions in South America, and the 1999 blowups in Brazil and Ecuador were very costly, as was the recent meltdown in Argentina. In all of these countries, macroeconomic stabilization policies of varied effectiveness were implemented. Brazil reduced its social security deficit, and Argentina tinkered with its

7. The index of first-generation reforms computed by Lora (2001) shows an average annual rate of increase of 4.5 percent between 1986 and 1994. For 1995-99, the equivalent figure is 3.1. If second-generation reforms were to be included, the region's performance in 1995-99 would be weaker. Note, however, that with much already done in some areas—e.g., trade liberalization—some slowing down of reform was inevitable.

labor code. But in none of these nations did the crises prompt deep structural changes.

A more important objection is that the crises-cause-reform literature failed to distinguish between macroeconomic blowups and those of other types. Most actual crises were macroeconomic: hyperinflation, debt default, and the like. Hence, they prompted a temporary political consensus (or "special politics," or honeymoon) to do something about *that*. If budget cuts and wage freezes were what it took, so be it. But once the macroeconomic emergency evaporated, so did the political consensus. What is so surprising about that?

Just as important, the consensus often extended to policies that had a plausible link with the collapsing macroeconomic variables, but no further. A few governments tried to sneak in other policy changes. Others were forced by the international financial institutions to bundle macroeconomic and microeconomic structural reforms. Tariff cuts (which also had an immediate anti-inflation impact) and privatization (which often reduced the fiscal deficit) were the most conspicuous example of such bundling (more on this below). But in retrospect, it seems clear that the political system's newfound tolerance for reform did not amount to carte blanche for reforming technocrats to do as they pleased—certainly not to change the way teachers are paid or the system by which electricity rates are set.

The point is important, for macroeconomic changes have a very different structure of costs and benefits than do other kinds of policy changes. A reform's political viability depends crucially on its political cost-benefit ratio. Macroeconomic stabilization provides huge efficiency gains (and hence has large political benefits) that are widely spread across the population while redistributing relatively little income across groups (hence, its immediate political costs are limited).[8] A crisis, in this context, is nothing but a deepening of the distortions associated with inflation and the like, and hence a sharp rise in the potential efficiency and political gains associated with stabilization. It is not surprising, therefore, that macroeconomic crises seem to lead to macroeconomic reforms.

The situation is much different for other kinds of reforms. Take public education or garbage collection, two public services that ought to improve under second-generation reforms. Deterioration in these services typically occurs gradually rather than over a few months, as can happen with inflation. (True, there are cases when garbage simply goes uncollected, but these are the exception rather than the rule.) Moreover, in cases such as education or judicial proceedings, monitoring the quality of the service can be hard (is that math teacher really no good?), and a population used to dismal standards of service can take a while to notice a decline.

8. To be sure, macroeconomic stabilization has a distributional impact, because the costs are not born homogeneously by everyone. It is precisely the struggle over who will bear certain costs of adjustment that drives the delayed stabilization models of Alesina and Drazen (1991) and Drazen and Grilli (1993).

However much politicians may like to talk about a "crisis in education," no such thing exists from the perspective of the immediate political costs of *not* reforming. And reforming these sectors, as we saw above, involves large redistributions of income, with the losses being concentrated among relatively few people and sectors. This is true with or without a crisis. In short, it is hard to envision a situation in which the political cost-benefit ratio of educational or public service reform is altered drastically, all of a sudden making change more likely.

Reform and the International Economic Cycle

A closely related question is how domestic reform correlates with the international economic cycle. It is painfully well known that economic activity in Latin America tends to move hand in hand with activity in the countries belonging to the Organization for Economic Cooperation and Development, with prices of primary commodities, and especially with the size of capital flows to the region. But is an upturn or a downturn in the world economy more likely to provoke reform at home? The crisis hypothesis would readily suggest that downturns are the necessary catalyst. But as we have seen, this theory provides little help when it comes to second-generation reforms. More important, a period of capital inflows and affluence may provide fiscal resources with which to compensate the losers, making reform more likely.

Start with the connection between first-generation reforms and capital movements. It is suggestive that the largest increases in the index occurred in the first half of the 1990s (4.5 percent a year between 1986 and 1994, against 3.1 percent for 1995-99), at a time when foreign capital was plentiful (especially after 1992). This just amounts to eyeballing the data, but more formal work suggests the same conclusion. Lora (2000) incorporated the capital-flows variable into a regression using data only to 1995. He found that, except for labor, all other areas of reform were facilitated by capital flows to the region. The coefficients were large and robust to the inclusion of other regressors. In particular, an increase in capital flows of 1 percent of Latin American GDP was associated with "an improvement of between 1 and 2 percent in the total index of structural policies" (p. 17). These results have to be taken with more grains of salt than usual, for causality very much remains to be sorted out.[9] However, they do lend

9. In a very influential paper, Calvo, Leiderman, and Reinhart (1993) argued that, in contrast to received wisdom, capital flows to Latin America had been until then largely exogenous—i.e., not influenced statistically by the region's domestic developments. This would allow one to think that it is capital flows that prompt reform, and not vice versa. Lora (2000) tests this hypothesis by carrying out causality tests. He finds that, when using an appropriate number of lags, the reforms appear to have caused capital flows to the region as a whole, though not to individual countries. So causality does seem to be an issue.

some credence to the intuitive notion that international capital flows have helped push reform forward.

These are mostly private capital flows, which do not come with overt conditionality attached. Hence, it is unlikely that the enlightened advice of the IMF or the World Bank is what stands behind the increase in first-generation reforms reported by Lora (2001). What accounts then for this correlation? One possibility is the already mentioned availability of funds to compensate losers. But this hypothesis also has problems. One is that it is hard to identify real-life compensation schemes. "Virtue is its own reward," the then-US trade representative used to tell Latin American ministers in the early 1990s, and many seemed to take it to heart. Note also that statistically it is not clear that compensation mechanisms mattered that much. Lora (2000) considered real depreciations (which compensate producers of import-competing goods) and trade pacts (which presumably help potential exporters). Neither seemed to be associated with movements in the index of trade reforms.

Probably more important is that the capital abundance of the early 1990s came at a time when several countries were already experimenting with trade liberalization and, more important, with exchange-rate-based stabilizations. We know from the work of Calvo and his fellow researchers (e.g., see Calvo and Vegh 1994) that such stabilization packages more often than not are associated with a temporary consumption boom and a sharp appreciation of the real exchange rate.

Given that governments in the region rely mostly on value-added taxes, the rise in consumption typically also meant an increase in tax revenues. The combination of plentiful capital and (at least temporarily) sound public finances made it easier to undertake fiscal reform and to reduce remaining controls on capital outflows. If the current account deficit was not too large, the situation was ripe to cut tariffs further. Governments also tended to loosen bank regulation, allowing cash-rich banks to relend more freely.[10] Put it all together, and it is not surprising that the period of capital inflows coincided with an increase in measured first-generation reforms.[11]

This suggests that the connection between capital inflows and fiscal, financial, and trade reforms may have been fairly specific and is unlikely to be replicated automatically when capital returns to the region. This is es-

10. Of course, this procyclical movement in prudential requirements turned out to be a fatal mistake. Pre-1994 Mexico is the perfect example of the problem.

11. In Chile and Colombia in the early 1990s, concerns over an excessively appreciated exchange rate were the main reason to reduce controls on outflows and cut tariffs. Both policies were intended to cause dollars to leave the country, helping weaken the exchange rate—something that did not happen in earnest until overall capital flows turned around as a result of the Asian crisis. Note that this happened in both countries during a boom and not a crisis, explaining why both countries—and especially Colombia—appeared to defy the crises-cause-reform hypothesis.

pecially true where second-generation reforms are concerned. Enlightened policymaking may ensure that next time dollars are plentiful, they will get spent improving education, health care, and the judiciary, but we would not bet on it.

In any case, the question may be mostly academic. Flows to Latin America have never recovered from the Asian and Russian crises. Today, with Argentina and Uruguay near bankruptcy, asset prices down almost everywhere, international financial markets in disarray, and investors' appetite for risk diminished even further by the terrorist attacks on the United States of September 11, 2001, the scarcity of foreign funds may be with us for a long time. Indeed, for many countries in the region, the next few years may be ones of muddling through—not so crisis ridden that some reform becomes inevitable, but not so flush with dollars that anyone's political support can be bought off.

Big Bangs, Sequencing, Bundling, and All That

Once, for one reason or another, a government is willing and reasonably able to pursue market-oriented reform, a whole set of issues arises on how to proceed. One question that was at the forefront of the academic and policy discussion in the early to mid-1990s involved the appropriate sequencing of reforms. Should political leaders endeavor to push for as many reforms as possible at once, or should they introduce them one after the other?

The optimal sequence of reforms depends on both economic and political criteria. The neoclassical economics benchmark is simple: If you can, do all reforms simultaneously. Radical or big-bang reform is the best reform strategy, Mussa (1982) argued early during the debate. As long as the perceived private costs and benefits correspond to the true social costs and benefits, private economic agents will choose the socially correct pace of adjustment following a full-scale liberalization.[12] Things looked different on the ground, however. In Latin America, the literature on the sequencing of economic reforms was spurred by the failed Southern Cone stabilizations of the late 1970s and early 1980s. One influential view attributed these unfortunate outcomes to mistakes in the order of liberalization.[13]

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12. The only caveat applies when one can clearly identify a distortion that places the economy in a second-best world; if that is the case, one might be able to design a particular sequencing strategy that can take care of the second-best problem. Put differently, arguments for unbundling must be based on the existence of an unremovable distortion or market failure—or perhaps concerns over income distribution—and of a sequencing second-best solution.

13. That view was due to Díaz Alejandro. Debate centered on the order of liberalization of the trade and capital accounts, with most researchers in favor of opening the former before the latter to avoid destabilizing capital flows; see Edwards (1984) and McKinnon (1991).

Subsequent research was more precise in identifying potential welfare gains or losses associated with different sequences. One possible argument for gradualism rested on the need to minimize short-term changes in income distribution (Gavin 1996). Another relied on the presence of preexisting distortions (policy-induced or otherwise) in one or several markets that cannot be removed at the time the reform plan is announced. Potential candidates were labor market interventions, domestic capital market imperfections, and limits to foreign indebtedness that are not perceived as binding by individual agents (Edwards and Van Wijnbergen 1986 and Edwards 1992). In all of these cases, one could imagine circumstances in which the second-best reform strategy should involve some degree of gradualism—for instance, in the sequencing of trade and capital account liberalization.[14]

In that early literature, the arguments for one type of sequence or another were mostly economic. Where did politics come in? The simplest political case was implied in Jeffrey Sachs's 1994 "emergency room" metaphor: While the patients are in there, treat them not just for the symptoms but also for the underlying disease as well. This view was predicated on the huge uncertainty the patient was likely to face once out of the hospital. Reforming administrations often face a nontrivial likelihood of being ejected from office. In that situation, the only strategy is "do as much as you can."

Other arguments for bundling suggested that political constraints could be loosened if different reform policies were bundled together. Rodrik (1994, 1996) emphasized the agenda-setting role of reformist governments. He asked: How could wide-ranging trade and industrial policy reforms be rendered palatable to the interest groups that had been their beneficiaries for so long? His answer was that macroeconomic crises enabled reformist governments to package fiscal reforms—which were absolutely crucial for the return to price stability—with trade and industrial-policy reforms—which may have been desirable in the long run but were incidental to the immediate crisis.[15]

Dewatripont and Roland (1994) argued for unbundling, because it has lower experimentation costs than does a big bang. At each stage of the transition, the choice is between accepting the next set of reforms and re-

14. A related argument by Calvo (1989) emphasized that imperfect credibility is equivalent to an intertemporal distortion. If the public wrongly believes that trade liberalization will be reversed in the future, some control of the capital account may be called for.

15. Martinelli and Tommasi (1997) also argued that political-economy considerations tended to cause several possible reforms to be carried out simultaneously. Their point was that in societies with powerful interest groups and characterized by a cobweb of redistributive and distortionary policies, "optimal" unbundled plans will be time inconsistent: winners of early reforms who are hurt by later reforms have an incentive to stop the gradual path in its later stages. Knowing that, losers from reform will oppose the earlier measures.

versing the previous one. If the initial reforms have been a success, people are more willing to accept less popular reforms so as not to lose the gains of the first reforms and to save on reversal costs.[16] In some situations, the degree of complementarity could be such that the logic is reversed. Shleifer, Murphy, and Vishny (1992) argued that in former socialist countries, where the basis of a market economy was completely absent, partial reform would be infeasible in the long run. Political sustainability would then argue for bundling.

This was a hopeful view. It emphasized that one could not have inflation stabilization without fiscal reform, but that in turn required better tax enforcement, which in turn necessitated both civil service reform and a revamping of the judiciary. But of course none of it made sense without capable administrators and an educated population, so educational reform was also a must. The reform plan started with the lowly goal of limiting price increases, and soon this logic had the government trying to reinvent practices and institutions that had been in place for decades if not centuries. The perspective was hopeful indeed—too much so. Panglossian is a better label.

We know today that a market economy can survive in Latin America for a long time (it has been almost 200 years since independence, and 10 since most big reforms kicked in) with an inefficient state, imperfect contract enforcement, and dismal public schools. By the same token, capitalism is alive (if not well) in Russia, but so are rampant insider trading, huge private monopolies, an increasingly corrupt state, and a system of property rights that gives mafiosi, former apparatchiks, and new oligarchs a big upper fist.

Bundling and big bangs were indeed prevalent in the early efforts of reform. A key reason must have been the "emergency room" or "window of opportunity" logic. A good politician does not waste an opportunity to do as he or she pleases, and the initial crises afforded precisely such an opportunity, however transitory. Just as important, there was strong complementarity among many of the early first-generation reforms. One cannot lower inflation if the budget deficit is 10 percent of GDP and there is no market for government bonds. Some monetary, fiscal, and financial reforms had to go hand in hand.

But complementarity between first- and second-generation reforms seems to be much weaker, both economically and politically. We also know that we do not even know enough to make statements about that with any degree of confidence. Labor market flexibility may have much to recommend itself, but Europe lived without it for decades, even if it meant high unemployment.

Even more troubling is our ignorance about such matters as education. The notion that human capital investment is key to long-term growth

16. Another argument in favor of unbundling was advanced by Wei (1998). He argued that gradual sequencing might allow the building of constituencies for reform, in the presence of individual specific uncertainty, as in the framework of Fernández and Rodrik (1991).

seems unexceptionable. But as Pritchett (2001) has forcefully argued, that link is awfully hard to find in the data.[17] If policymakers are unsure about the outcome of economic reforms and worry about the costs of experimentation, as Dewatripont and Roland (1995) argued, all this conflicting advice is likely to make them even more risk averse and to strengthen the case for a very careful and gradual phasing in of the reforms—perhaps so gradual that second-generation reforms only get implemented in the indefinite future.[18]

All the resulting unbundling may be prudent, but it also has political costs of its own. Rodrik's point (1994, 1996) remains valid: crafty packaging of reform initiatives can offer *something for everyone* and therefore weaken opposition. By letting a decade or more elapse between first- and second-generation reforms, many possibilities for creative dealmaking have been wasted; the history of health care reform in Chile provides an example.

The democratic administration of President Aylwin came to power in 1990 mindful of polls that showed that public dissatisfaction with health care services was a main force behind the vote against Augusto Pinochet and his handpicked candidate. The finance minister, Alejandro Foxley, raised value-added taxes in 1990 and used the additional revenue to finance greater social expenditures, of which health care was a big beneficiary. A revamping of the public health system was postponed as too politically troublesome; the governing team was also unsure what kind of health care model it wanted to adopt—European or US style?

A decade and several strikes by health care workers later, Chile's real public spending on health care has doubled, but total output in the state-run health care system has barely increased. Technocrats today are aware that the system is a black hole and that a thoroughgoing reform of its management and incentives is essential. But they have no more money with which to placate the vehement opposition of doctors and hospital workers. Prospects for health care reform look very dim indeed.

Does It Matter Who the Reformers Are?

The political affiliations of those who undertake reforms also matter. Even when reforms are identical, they will most likely be perceived differently by the electorate when they are promoted by leftist governments than

17. Hanushek and Kimko (2000) do find an effect of labor force quality (as opposed to years of schooling) on growth.

18. This of course does not mean that second-generation reforms are unimportant. It just means that policymakers have received much contradictory advice. Naím (2000) stresses the extent to which supposed wisdom emanating from Washington has been subject to fads and fashions, starting in the 1950s but especially in the past decade.

when rightist leaders push for them. There is no agreement, however, as to whether right-handed or left-handed leaders will fare better when driving their countries through the next level of reforms. Although some argue that it takes a Richard Nixon to go to China, others correctly point to how difficult it is to get a government to adopt policies that adversely affect its constituencies. With the advent of a number of social democratic governments in the larger countries of Latin America, this question seems more pressing than ever.

Neoliberalism by Surprise

One striking feature of first-generation reforms in many countries is the degree to which they were done by stealth. Presidents Carlos Menem in Argentina (1989-99), Alberto Fujimori in Peru (1990-2000), and to a much lesser extent Patricio Aylwin in Chile (1990-94) were elected on antistructural-reform platforms. The most radical conversion from antireformist to militant reformist was that of Fujimori. As a candidate, he denounced the structural reforms proposed by conservative leader Mario Vargas Llosa as destructive and damaging to the interests of the Peruvian poor. Despite the skyrocketing inflation, economic stagnation, and widespread poverty, Fujimori managed to build political support without a clear plan for how he intended to address these pressing issues. As a political unknown, Fujimori was elected primarily because he was perceived as the only way to prevent the reformist Vargas Llosa from winning office.

Yet once elected, Fujimori experienced a radical change of mind and turned himself into a champion of reform. The economy was stabilized after the populism of the Alan García years and began a period of tentative growth. For a few years, Peru was the darling of international investors. And Fujimori was also popular at home. Public opinion in Peru even approved of his 1992 decision to dissolve Congress and the judiciary, and—with the support of the military—to take on dictatorial power (Stokes 2001). International actors—not yet converted to the gospel of good governance—seemed more concerned with the adoption of Washington Consensus policies than with the destruction of these institutions.

In the end, of course, the Fujimori experience was a disaster. In addition to adopting structural reforms, his government committed widespread human rights violations and had little respect for constitutional provisions—even after his custom-made Constitution was adopted in 1993. After 10 years of Fujimori, Peru's economic policies reflected the Washington Consensus, but no groundwork had been done to build second-generation reforms. Institutions were weak, and the rapid and dramatic fall of Fujimori from power further weakened the only two institutions that had apparently worked reasonably well: the military and the secret police. The Fujimori experience underscores an important point: Even if it takes a Nixon to go to China, it might very well be that some Nixons turn out to be crooks.

Menem and Aylwin (less drastically) also carried out a "policy switch." Democracy was consolidated in Argentina and Chile during their terms in power, and economic performance was quite good (in Argentina, better in Menem's first term than in his second). In Chile, where the reversal was less dramatic, the economy began a boom that lasted until the Asian crisis.

How should we understand the apparent success of these policy reversals? Przeworski, Stokes, and Manin (1999) have posed an interesting question: Do voters care about policies or about results? If they care about policies, the policy switches experienced in Argentina, Chile, Peru, and Venezuela should worry those who believe in institutions, accountability, and responsiveness. Conversely, if voters care about results more than policies, changing one's avowed policy might be in the best interest of one's constituency. It is true that voters often use policies as proxies for results. Yet if a politician elected on a certain policy platform learns once in office that those policies led to positive results in the past but will no longer work, should that politician stay with the policies she campaigned on? Or should she adopt policies that will maximize the possibilities of achieving the results voters expect?

The Nixons of the world might go to China because they realize that it is no longer convenient or that it has become much more costly not to be on talking terms with China. They can command the support of public opinion in their countries because they can credibly claim that they have changed their policy preferences upon learning new information. They can also credibly present themselves as economic reformers committed to helping ease the costs for their constituencies—a "social-oriented market economy" was the phrase that Aylwin used to portray his adoption of the economic policy framework inherited from Pinochet, mitigated by a tax reform that allowed for more social spending. Aylwin's and the Concertación alliance's economic policy conversion paved the way for the acceptance of the market-based model by a large majority of Chileans.

To continue with the analogy, when Nixons go to China, they also help reduce national animosity against China. It is true that the positive economic results of the model in Chile helped convince the population that the model worked, but these results, which were visible before 1988, were not sufficient to allow Pinochet to win that year's plebiscite.

Although policy reversals were very common in the early 1990s, they have vanished in recent years. After more than a decade—almost 20 years in the case of Argentina—of regular elections, parties and leaders have built track records on their positions on structural reforms. There are two other reasons why "neoliberalism by surprise"[19] seems to be on the de-

19. The phrase is due to Stokes (2001).

cline. One is that presidential candidates are less and less inclined to commit themselves to strict policy initiatives. This reflects politicians' greater concern with winning and holding onto office than with policies themselves. Moreover, "mandates are not instructions." As Przeworski, Stokes, and Manin (1999, 13) put it: "At the beginning of the term voters need not even have a clear view of what to expect and to demand. It is up to the incumbent to guess what voters will reward and what they will punish." What politicians are increasingly doing is filling out the agenda after being elected, rather than throwing out the old agenda and adopting a new one.

This is especially so for second-generation reforms, which are much less clear-cut than first-generation ones. It is one thing to promise to end inflation or to stick to a given parity between the peso and the dollar. All voters can understand the promise and monitor whether it is fulfilled. It is a very different thing to promise "health care reform" or "educational reform." Because the candidate's advisers themselves are unlikely to know exactly what this means, they will inevitably be vague about it. Monitoring is also trickier; people may perceive easily whether waiting time at public hospitals goes down, but how many can evaluate the quality of teaching their children are receiving? With vague promises and fuzzy results, surprises are less likely.

Betraying Your Constituents?

But the Nixon-in-China hypothesis is not just about policy surprises. It is also about constituent accountability, about politicians doing things on behalf of "their" people. It may be, as we argued above, that in a competitive democracy politicians are concerned with results. But not all results affect people equally. Nixon's achievement was to persuade the American right wing and the business community that a rapprochement with China was in their interest. But what if a reform is in the national interest but not in the specific interest of the group that voted for this or that politician? What is a budding Nixon to do then?

The question is relevant for today's Latin America for two reasons. Second-generation reforms have many winners but some highly visible losers, concentrated in a few sectors. From labor unions to the owners of monopoly utilities, from public health employees to judges, from protected farmers to agricultural workers, those affected by second-generation reforms are ready to use the tools available to them in democracies to retain their acquired rights. Social democratic leaders elected in Argentina (1999), Brazil (1998), Chile (2000), Peru (2001), and, arguably, Mexico (2000) were faced with the choice of adopting reforms that may have general benefits but, that, in the short run, would adversely affect some of their basic constituencies. Are radicals in Argentina or Socialists in Chile likely to cut the privileges enjoyed by large numbers of state workers? Are social democratic (or more left-wing) governments bad news for second-generation reforms? Or on the contrary, can Nixon's logic prevail once again?

Social democrats have generally refrained from adopting reforms that could damage their electoral support among their core constituencies, even when by not acting they risk losing support elsewhere. Public employee unions strongly supported the candidacy of Ricardo Lagos in Chile, despite Lagos's promises to undertake radical health care and education reforms. Health care reform would most likely result in policies that are detrimental to the public health workers' union. Rather than abandoning one of his constituencies and cultivating a different electoral base elsewhere, the president has mostly chosen to avoid a confrontation with the union, watering down a much-needed health care reform. The decision may be wise for short-term electoral reasons; it is easier to stay with a winning coalition than to try to build a new one.

In Brazil, Fernando Henrique Cardoso was somewhat bolder in adopting reforms that are opposed by some of his constituencies. But he was perceived within Brazil more as a right-wing president than as a socialist. His heart might have been with the international left, but the left in Brazil votes for the Workers' Party and against him. Mexican president Vicente Fox gathered his support from a combination of traditional conservatives and those whose main interest was to see the Institutional Revolutionary Party (PRI) defeated. In his first months in office, Fox's two main campaign pledges were derailed or blocked by his own constituency.

Paradoxically, taking on vested interests should be less of a problem for social democratic leaders today than two decades ago. With less influential unions than decades ago and a growing number of voters who are not members of organized groups and show less partisan identification, all candidates are adopting catchall electoral platforms.

The experience of the early 1990s showed that politicians do adopt policies that adversely affect their constituencies when they know that new constituencies can be fostered, so that, measured in electoral support and public opinion approval, the benefits of reform become greater than the costs of alienating some of their constituencies. An example is the rise of export-oriented sectors in almost every country, which bitterly oppose the currency overvaluation common in previous decades.

The strength of the opposition might also help left-of-center leaders to rally their constituencies behind certain reforms. Public employees' unions might prefer to negotiate a reform with a friendly government than risk having to face a hostile right-wing government in the future. High levels of political competition might facilitate reform; uncertainty about what party will be in power in the future can lead key constituencies to agree to limited reforms today as a way of preempting more drastic reforms tomorrow.

Electoral Uncertainty Can Be the Ally of Reform

Social democrats and right-wingers alike face similar incentives in competitive electoral democracies: they need to foster electoral majorities to stay in power. Although they are naturally more inclined to appease their constituencies and adopt policies that will have distributional consequences in favor of their constituencies, they are also inclined to adopt policies that will strengthen and protect their constituencies in the future. Uncertainty about future electoral outcomes will make it easier for politicians to actively build new bases of support.

This growing uncertainty comes from two sources. The first is long-term cultural and social change. With voters behaving much less ideologically and declining traditional clientelistic practices, attachments to political parties are weakening. As reported by IDB (2000b, 174-82), the percentage of people in Latin America that "feel very close or fairly close to a political party" is low by international standards and tending to fall over time.[20] Changing social structure also matters. The traditional middle class linked to the state (teachers, some professionals, and public-sector employees) owed its very existence to its ability to extract redistribution through the political system. Hence, its political preferences were strong and sharply defined. The newer middle classes (e.g., owners of small and medium-sized firms and the self-employed) that arguably provide the pivotal voter in many countries today have much less clear political attachments. Their preferences can be volatile, as recent presidential elections in Brazil, Chile, Mexico, and Peru suggest.

The other source of growing electoral uncertainty is the transformation of the rules of the political game (IDB 2000b). Government financing for presidential campaigns—so that all candidates who qualified can have enough resources to get their message across—facilitates competition and makes outcomes less predictable.[21] The adoption of runoff provisions for presidential elections—rather than plurality rule or throwing the election to the parliament—helps make elections more competitive and reduces the influence of loyal voting blocks. Independent electoral oversight agencies and simplified electoral registration and voting procedures also help foster turnout and weaken the power of organized voting blocks.

In short, uncertainty about future electoral results leads politicians to adopt policies that will maximize their chances of winning future elec-

20. An exception is Uruguay, where more than 40 percent of people claim to feel very close or fairly close to a political party.

21. This does not require limits to campaign spending, but only enough government support so that all qualifying candidates can have their message heard. The Chilean and Brazilian system of free television time during peak hours—with the obvious inconveniences—provides such access even better than televised presidential debates.

tions. This can weaken the attachment to traditional constituencies (holding on to your "core" or "traditional" vote may not be enough to get you elected) and make leaders of all political stripes bolder in pushing reform. That provides one reason for optimism about the future of second-generation reforms in the region.

Improving the Institutions of Democracy

During the 1990s, democratic institutions became, as US president Bill Clinton told the Santiago Summit of the Americas, the only game in town. But the rules under which this game is played vary substantially across the Western Hemisphere's countries. Moreover, some of the rules have changed within individual countries, and many more institutions will change as democracy consolidates in some countries and dissatisfaction with democracy grows in others (IDB 2000b).

When asking whether political institutions work well in Latin America, four issues call for attention: (1) executive-legislative relations, (2) federal versus provincial and local governments, (3) majoritarian versus proportional representation electoral systems, and (4) the timing of elections. Here we review each, trying to draw some preliminary inferences about what institutional features constitute obstacles to good governance and to adopting second-generation reforms.

Executive-Legislative Relations

Who controls the legislative agenda? Does the president have the ability to govern by decree? What prerogatives does the legislative power have in shaping the budget and government expenditures in general? How does the parliament actually produce legislation? These questions matter a great deal for the quality of governance and the ability to carry out policy reforms.

From the 1960s to the 1980s, when scholars of the developing world were concerned with authoritarian regimes and transitions to democracy, useful models to understand executive-legislative relations were being produced in well-established democracies. Using these theoretical models, recently published studies of legislative-executive relations in Brazil (Figueiredo and Limongi 2000; Mainwaring 1999), Chile (Siavelis 2000; Londregan 2000; Baldez and Carey 1999), Mexico (Negretto 2001), Argentina (Jones et al. 2001, 2002; Tommasi, Saiegh, and Sanguinetti 2001), and Uruguay (Altman 2001), among others, have mapped out how parliaments actually work and how executive-legislative relations lead to the adoption of laws and regulations, beyond the constitutional framework in specific countries. These contributions have made it clear that small variations in institutional design or different informal social and political norms may lead to drastically different outcomes.

Latin American countries are for the most part presidentialist. The president holds overwhelming power compared with that of Congress. In countries with term limits for members of parliament, the executive tends to exert even more power and influence. When the president has influence in determining the government party's electoral lists of candidates, party discipline in Congress is easier to achieve. Government by decree also facilitates party discipline, but it weakens the power of the legislature (Negretto 2001).

The works of Jones et al. (2001, 2002) and Jones, Sanguinetti, and Tommasi (2000) on the Argentine Congress and the comparative project on legislative politics in Latin America by Morgenstern and Nacif (2001) have helped clarify how executive-legislative relations play themselves out in the region. These studies not only have utilized the rigorous models developed in the field of executive-legislative relations in the United States and Europe but have gone a step further by adapting them to the particular characteristics of most Latin American governments (i.e., strong presidentialism, multiparty systems, and short-lived parties). They have sought to answer basic questions: Can an effective and independent legislature exist in a country marked by strong presidentialism? For the legislature to be strong—and for checks and balances to exist—does the president need to lose power and the legislature acquire more constitutional prerogatives? Is a strong legislature a recipe for inaction and red tape? And, ultimately, does a strong legislature foster or hinder the adoption of second-generation reforms?

The answers found by researchers of course depend on the country. Figueiredo and Limongi (2000) identify more features associated with strong and efficient legislatures in the Brazilian Congress than previously believed. The Chilean Congress has asserted itself as a player, despite Chile's strong presidential system. The Mexican Congress has played an important role and challenged the overwhelming power of the president since 1997. Conversely, the Argentine and Ecuadorian Congresses have acted irresponsibly and have jeopardized economic and political stability in recent years.

Institutional features that promote the formation of stable, disciplined majorities in parliament, and that do not give overwhelming power to the executive, facilitate the consolidation of democratic institutions and may reduce political obstacles for the implementation of second-generation reforms. It is true that the implementation of first-generation reforms in Latin America has been championed by presidents, not legislatures. Legislators have historically been reluctant to undertake reform. But this has been the case in no small part because when reforms are successful the president, not the legislature, takes the credit.

This situation has led to the common but misguided view that the weaker the legislature, the better for reform. This may have been true for some first-generation reforms, but is unlikely to be the case from now on. If second-generation reforms are all about strengthening institutions, a balance of power is a necessary condition to reduce corruption levels and increase accountability. As the experience of Peru taught us recently, an overwhelmingly powerful president can help facilitate the adoption of some changes, but excessive concentration of power ends up jeopardizing the whole reform effort.

However, simply transferring constitutional powers to a weak and corruption-prone legislature will not eliminate the negative by-products of presidentialism. When presidents are accountable to the national electorate and legislators are accountable to their local constituents—rather than to the executive, their party bosses, or local caudillos—the balance of power between both branches of government is grounded on their distinct representation. A bottom-up enforcement mechanism is more efficient than a top-to-bottom approach that relies on constitutional provisions that challenge the existing balance of power and are impossible to enforce.

A priority is to design institutional reforms that can help create professional legislatures that are made up of career legislators who are independent of the executive or local party bosses. This helps avoid what Jones et al. (2002) have termed the syndrome of "professional politicians and amateur legislators." For legislatures to work effectively, the structure of incentives for legislators must be different from that of the executive, party bosses, or local leaders. If an individual legislator owes his career to the state governor, he cannot be expected to act independently in Congress.

In some circumstances, a stronger legislature might ultimately represent an obstacle for a reform-oriented president. But a legislature made up of career professional legislators accountable to their local constituencies will also counterbalance an ineffectual president. In other presidential systems with strong legislators—for example, the United States—the president and members of Congress are accountable to different constituencies and yet both benefit from good economic performance. In the United States, parties are strong—not as strong as in Chile or Uruguay, but certainly much stronger than in Peru or Venezuela—but not enough to hinder the strong constituent-based political careers of professional legislators.

To strengthen the legislature and make it more professional, the system must differentiate the sources of political power (electorate, financing, etc.) that the president, parties, and individual legislators have access to. If they all derive their political strength from the same source, little can be gained by reducing the existing strong presidential tendencies in those countries.

Federal versus Provincial and Local Governments

In recent conventional wisdom, decentralization and the strengthening of local and provincial governments are positive steps toward making governments more efficient, responsive, and accountable. Targeted social spending also heavily relies on local and provincial governments to reduce waste and minimize deadweight losses. Health and educational reforms often call for greater local government involvement and give local governments more autonomy. Local governments are often seen as potential allies of national governments in the effort to reduce the strong bargaining power of influential teachers' and health workers' labor unions.

However, decentralization might also lead to unforeseen difficulties. When local governments realize that they can avoid paying the full costs of some of their actions, a problem of the commons arises (Velasco 1999). Argentina and Brazil in the 1980s and 1990s were prime examples. In those countries, provincial or state governments, through a variety of mechanisms, could get the federal government to finance their deficits. This created a situation in which the benefits of spending were local but the costs were born nationally. Understanding that at least part of the cost would be borne by others, subfederal governments were tempted to overspend and overborrow. The result was big deficits at both the local and national levels.

That is not the only problem of decentralization. The sharing of responsibilities between local and national officials, and the lack of clear demarcation between the two, can cause agency problems. Voters and public opinion need to have the ability to punish unresponsive and corrupt politicians. When voters have difficulties identifying those responsible for mismanagement, government performance will suffer. Corruption can flourish when politicians pilfer public funds and freely engage in the business of auctioning regulations and laws (IDB 2000b, 170).

Contributions to the study of federalism in Argentina (Jones et al. 2001; Jones, Sanguinetti, and Tommasi 2000) have highlighted the way in which the federal government and the provinces trade political support for financial assistance. Regional redistribution of wealth and taxes also takes places in more complex ways than a simplistic top-down, two-party analysis would lead one to believe. The work by Jones et al. (2001, 2002) points to the dependency that many national legislators have on provincial governments.

Rather than representing the interest of the federal government, legislators in Argentina often serve the interests of the provincial governors who sent them to Congress in the first place and will give them provincial government positions when their short careers in Buenos Aires are over. Legislators seek to protect the interests of their constituencies, but in Argentina the constituencies are often local party leaders and not voters.

Though Brazil and Argentina are the paradigmatic cases of irresponsible state, provincial, and local governments, decentralization efforts going on in Chile, Colombia, Mexico, and much of the region also suggest that poorly designed reforms can turn ineffectual subnational governments into players that obstruct rather than facilitate structural reform. Local accountability generated by the election of local officials might lead to an outburst of pork barrel politics, much as in the United States.

Yet federalism and strong local governments need not be enemies of second-generation reforms. In theory, certain institutional design features can make local and provincial governments more accountable for the decisions they make. For instance, though central governments are unlikely to give up their monopolies on tax collection, they might find it in their best interest to link financing for provincial governments to provinces' success in improving tax collection. Local government officials must be given a share of the political costs of adopting policies that will hurt particular constituencies. The paradigm of the bad central government and the good and understanding local government results from bad political institutional design.

Concurrent elections of provincial or state governors with the presidential election may facilitate political alliances between the president and provincial governors and could make it more difficult for provincial governments to blame the central government for their own mistakes and reckless budget behavior. Although some have advocated separating local and national elections (IDB 2000b), there are good reasons why voters are better served when they force candidates for national and local office to define in advance their future interactions if elected. Holding concurrent elections might in fact facilitate ticket splitting, reduce the influence of party bosses, and foster constituent accountability for all candidates for all offices.

Electoral Rules: Majoritarian versus Proportional Representation

Although the interaction of electoral rules and the party system is one of the best-studied fields in political science, the relationship between electoral rules and political stability and governability is far from settled. In Latin America, most countries are strongly presidentialist, but the electoral rules used to elect the members of the mostly—but not exclusively—bicameral parliaments vary widely (Jones 1995, 1997).

Most countries have parliaments chosen through proportional representation, but some countries use closed lists (party-vote) and others open lists (candidate-vote). There are also wide regional differences on malapportionment, redistricting provisions, and the timing of elections, and periodic electoral reforms have been common in many countries. From Mexico to

Brazil, from Bolivia to Guatemala, agricultural regions are overrepresented. Urbanized regions (especially recently urbanized ones) are severely underrepresented.

After the restoration of democracy in most Latin American countries, the overwhelming sense of relief led many to overlook the problem of malapportionment resulting from political negotiations with the outgoing military regimes or inherited from the old democratic regimes. Recent reports point to a growing sense of discontent and disillusionment with democracy in the region (IDB 2000b). One cause is the failure of most countries to guarantee the principle that all votes have the same weight.

Rules for presidential elections vary widely throughout the region. Whereas Mexico has a simple first-past-the-post system, Brazil and Chile have a runoff if no candidate obtains more than 50 percent of the votes. In Bolivia, the election of the president falls to the parliament if no candidate wins more than 50 percent in the first round. Uruguay recently adopted runoff provisions between the two presidential candidates with the most votes. This is one area where a great deal of change has occurred, much of it for the better. It is far easier to govern if rules for presidential elections require that the winner obtain a clear majority of votes. This is usually defined as more than 50 percent, but Argentina devised an interesting formula to avoid a runoff when the first-round winner obtains more than 40 percent of the vote and is well ahead of the runner-up.[22]

Electoral rules also influence the president's ability to build parliamentary majorities. The size of electoral districts (district magnitude) varies dramatically across countries. In Brazil, each state is guaranteed a minimum of 8 seats in the Chamber of Deputies, but the most populous states elect 70 (São Paulo) and 46 (Rio de Janeiro) deputies each. The larger the district's delegation to the chamber, the more party fragmentation is likely to occur. The rule of thumb among students of electoral rules is that proportional representation works best when districts have a magnitude close to five seats per district.

Malapportionment should be fiercely combated. If a country, for political or historical reasons, allows certain regions to be overrepresented in one chamber (as the United States does with less populous states in the Senate), the other chamber should be organized to promote equal representation for all regions.

Permissive proportional representation systems also make it difficult for a president to achieve commanding majorities, although when presidential and parliamentary elections are held concurrently, the winning presidential candidate is more likely to command an electoral majority—or plurality—in congress. Proportional representation has worked in Europe

22. Since the most recent "update" on the electoral systems of the Americas was published in 1997, Brazil, Ecuador, Peru, Uruguay, and Venezuela have made nontrivial changes to their electoral rules.

because political parties are strong and stable. In the absence of strong and stable parties in Latin America, proportional representation—especially under closed-list systems—has facilitated the formation of temporary factions and loose electoral coalitions and the rise of populist leaders.

Although proportional representation systems foster pluralism and representation for minorities, their drawbacks include hurdles to majority formation and clientelism, especially when associated with closed lists and large districts. If proportional representation is to be the formula of choice, legislators should strive to provide mechanisms for open lists (which allow voters to select individual candidates and make it easier to throw the rascals out), and for seat-allocation rules that foster the formation of majorities.[23]

The system of first-past-the-post (single-member district) is used very little in the region, and then only in former British colonies. Mexico used single-member districts until the mid-1970s, when it adopted a mixed system for the Chamber of Deputies (300 deputies elected in single-member districts and 200 elected in proportional-representation districts). The adoption of first-past-the-post systems might facilitate the formation of commanding majorities in Latin American parliaments if congressional elections were held concurrently with presidential elections, but it might also help increase reelection rates for incumbents.

One alternative is for countries to adopt single-member districts that allow for regular malapportionment corrections (e.g., after each census). These smaller districts, where legislators can relate to and understand the needs of their constituencies, provide an effective mechanism of political accountability. If anything, with single-member districts, electors have an easier time of throwing the rascals out. When voters are forced to select from a closed party list that includes individual politicians that they dislike or do not know, accountability is not well served. Similarly, when voters have to select candidates from an open list in very large districts, they often end up sending their favorite candidate along with that candidates' court of political protégés, who get elected with the trickle-down votes of the popular candidate.

Although most countries have no restriction on immediate parliamentary reelection—with the notable exceptions of Costa Rica and Mexico—the reelection rates of members of parliament is strikingly low when compared with those of industrial nations. That creates incentives for the development of "professional politicians and amateur legislators," as has been the case in Argentina. The persistence of amateur legislators whose political careers depend on their strength within their political party, their

23. The d'Hondt allocation formula, rather than Saint-Laguë or Largest Remainder, favors the formation of majorities because it overrepresents the party with the largest number of votes. For an explanation of different seat-allocation formulas, see the Administration and Cost of Elections Projects, www.aceproject.org.

influence with the local political bosses, or their proximity to the president hinders the quality and effectiveness of Congress. Chile and after that Colombia are the countries with the highest rates of incumbency reelection. The parliaments of these two countries also rank among the most influential in the region.

The Timing of Elections

Perhaps the clearest enemy of first- and second-generation reforms alike is the excessive number of elections in many Latin American countries. Elections are central to democracy. But holding many and frequent consecutive elections hinders the good functioning of government. Because governments need to win elections to stay in power, the nature of incentives is such that incumbents will act differently when elections are around the corner than if the next election is scheduled for 3 years down the road. It is well documented that government spending increases in election years. There are also other negative effects associated with frequent elections. When elected politicians are candidates, their productivity falls in parliament. Fewer laws are passed in the months preceding parliamentary elections. And the legislation that is passed is often a response to short-term electoral concerns.

Even in countries where fiscal responsibility has been the rule in recent years, the incentive to increase government spending during election years is almost irresistible. Chile held presidential elections in 1999, municipal elections in 2000, and parliamentary elections in 2001. The fiscal year beginning in 2002 was the first time in 3 years that no electoral considerations were in play when choices were made as to how to allocate the government's budget. With an ongoing electoral calendar, Mexican governments often switched their policy priorities and spending priorities to accommodate immediate electoral concerns. The logic was flawless. A victory by an opposition candidate would be interpreted as a rejection of government policies. So even if the government was committed to maintaining fiscal austerity, increasing government expenditure in particular states or provinces would actually facilitate achieving the goal of fiscal discipline at the national level.

Holding presidential and parliamentary elections concurrently provides a number of positive incentives to candidates and parties. The winning presidential candidate is more likely to command majority support in parliament, the new president will not need to negotiate with a congress already in session, and the same issues that define the presidential election will be present in the voters' choice for the senate and chamber. Although a majority of Latin American democracies now hold presidential and parliamentary elections concurrently, Chile is an exception.

In addition to holding concurrent presidential and parliamentary elections, there are strong arguments for reducing the number of elections. Argentina is an emblematic case. Although all deputies serve 4-year terms, half of the Chamber of Deputies is elected concurrently with the presidential elections and the other half is elected in the midterm elections 2 years after the presidential election. Although Argentina has carried out some important electoral reforms in recent years—which include the direct election of senators and the concurrent election of the president and Parliament—it has failed to modify this unusual way of electing its lower chamber. The timing of elections in Argentina always fuels political calculations of actors in the opposition who, rather than working together with the government to build consensus, choose to wait until the next election in the hope of improving their bargaining position.

In countries with a federal system of government, state elections are often held independently of national elections. Mexico is the emblematic case. Every year, there are gubernatorial elections in some of Mexico's 31 states. Although many of those elections fail to capture the attention of the Mexican national press, some of Mexico's larger state elections are seen as tests of the government's popularity, and the results of these elections are often used to mount opposition to government reform programs. Having too many elections—whether they are national or local elections—is not conducive to the successful implementation of the next generation of reforms.

Several Latin American countries have straightened and simplified their electoral calendars. For example, Chile is close to approving a constitutional reform that will make presidential and parliamentary elections concurrent after 2005. But few countries have reduced or simplified their calendar for local elections. Combining the election of regional or provincial governors with that of the president and standardizing the legislative districts to equate the constituencies for local officials and national legislators will simplify the decision of the voter and will make the election more important. When people perceive an election to be important, we know well, they turn out to vote in high numbers. More electoral legitimacy should strengthen the position of reform-minded elected officials, and fewer elections will reduce the incentives proreform politicians have to deviate from the path of second-generation reforms.

Reform-Mongering Strategies

The question of how to make economic reforms politically palatable is certainly not a new one. The modern classic on this subject (as on many others) was written by Albert O. Hirschmann, who proposed "reform-mongering" strategies that might render land reform feasible in the face of opposition by politically powerful landowners. As summarized by Haggard and Kaufman (1995), Hirschmann called for "the use of ambiguity and obfuscation, less visible extractive instruments, and timing of initiatives to exploit moments of high popular support." The recipe is still valid for contemporary politicians pushing second-generation reforms.

Honeymoons

The natural moment of "high popular support" is those weeks and months after a new government has been inaugurated. The case studies in Williamson (1994) found little evidence to link these "honeymoons" with first-generation reforms. Perhaps that was because such reforms were often triggered by crises or other exogenous events. But that is unlikely to happen again, and especially not with regard to second-generation reforms. In the second stage, the politically savvy use of a government's early time in office is turning out to be of the utmost importance.

Honeymoons are key because they give governments political capital—be it the result of a landslide victory in an election or because the new president symbolizes some type of profound change in the country (e.g., the first opposition leader in 70 years, the first woman to be elected, the first indigenous leader, or a beloved national figure). The literature on the US presidency tells us that presidents are more productive, and successful, during their first 100 days in office than during any other 100-day period during their terms. Although there is no technical reason for this honeymoon, the usual explanation has to do with the legitimacy earned in the election and the perception that elections also carry mandates to which all elected officials—not just the president—should pay attention.[24]

Although we are not aware of any comprehensive study on the success of honeymoon initiatives for Latin American democracies, the concept of the honeymoon has penetrated the region and has shaped the policy calendar of new presidents. Some have chosen to solve existing territorial disputes with neighboring countries; for example, Jamil Mahuad used most of his political capital as newly elected president of Ecuador in 1998 to settle the long-standing border dispute with Peru. Others have sought to solve internal political conflicts—Colombian president Andrés Pastrana held his first round of talks with the guerrilla leaders even before taking office in 1998—or to settle scores with a troubled national past, as

24. Note that the concept of honeymoon in the United States also relates to the new composition of Congress resulting from the last concurrent presidential and congressional election. When legislative elections are not held concurrently with presidential elections or when proportional representation, rather than single-member districts, is the electoral formula of choice, a new president may not enjoy a legislative majority, and a honeymoon may be impossible.

Argentine president Raúl Alfonsín did in 1983. All have attempted to turn initial successes in these endeavors into lasting political strength, but few have succeeded. The political capital embedded in the honeymoon is like venture capital. It helps some leaders consolidate their public stature; it leads others to embarrassing political setbacks.

How can "honeymoon venture capital" be converted into lasting political capital? The example of Chile in 1990 and Mexico in 2000 helps clarify what to do and what not to do. In Chile in 1990, the incoming Concertación government—an alliance of Christian Democrats and Socialists—took office amid growing demands for democratic consolidation, a complex human rights dilemma (human rights violators were protected by the powerful military, but human rights victims were demanding justice), and pressing social needs (half of Chileans lived in poverty).

Contrary to widespread expectations, the new Chilean government chose to postpone tackling human rights conflicts and instead used its first 100 days in office to negotiate a tax increase with the conservative opposition. After the passage of the tax reform, the government concentrated on building support for a change in labor laws, which was also approved. Patricio Aylwin's gamble paid off, and his honeymoon period extended well beyond his first 100 days.

In Mexico, incoming president Vicente Fox chose to give priority to the initiative for an indigenous-rights law agreed upon by the government of former president Ernesto Zedillo and the Zapatista rebels. A key tax increase was saved for later. The strategy backfired. The indigenous-rights law was opposed by Fox's own National Action Party. A watered-down version was eventually passed, but the president lost precious honeymoon time in pushing for a proposal that ended up not leaving anyone happy. Fox completed his first year in office without securing passage of his tax increase, a cornerstone of his ambitious program of social spending and human capital formation. His honeymoon period ended without any major legislative initiatives having passed the opposition-controlled Congress.

The need for newly elected officials to be strategic in choosing their first legislative initiatives cannot be overemphasized. Much of the future success of a president's legislative package will depend on how effectual he was when first in office in securing congressional approval for his first initiative and in sustaining little damage from his opponents in congress. Latin American presidential systems give little actual decision-making power to the legislative branch. Legislators can gain influence only by obstructing the president's initiatives. If the president's first legislative initiative is significantly damaged by the legislature, the executive will be weakened and the legislature strengthened. However, because of institutional design, the legislature will never be strong enough to control the entire lawmaking process. A weak executive irremediably leads to stalemate in government.

All Politics Is Local

Former US House of Representatives speaker Tip O'Neill's famous dictum that "all politics is local" also applies to structural reforms in the region. A judicial reform or a reduction in the defense budget is more likely in Peru after Fujimori's scandalous exodus than in Chile after Pinochet's departure from the presidency but not the army in 1990. A tax increase made more sense in poverty-stricken but fast-growing Chile in 1990 than in Nicaragua that same year. A successful reforming politician needs to be able to identify these opportunities and act upon them swiftly. For that she must be endowed with a strong sense of national history and a good nose for changing opportunities.

Thus the starting point for a successful reformer is the role of history. Countries have memories, and these shape what is politically possible and what is not. The recent history of judicial reform in Chile illustrates the point. The changes put in motion by the Frei administration entail a complete revamping of the judicial system. They are still moving forward, in spite of the initial opposition of judges and portions of the legal establishment. The political success of the reforms can be traced to 1990, and to the difficulties found by the entering Aylwin government as it struggled to prosecute the most notorious cases of human rights violations.

Before leaving office, Pinochet packed the Supreme Court with justices who were strongly committed to upholding the Amnesty Law passed in 1978. Seeking to shift the balance within the 17 life-term members of the Supreme Court, the Concertación governments (Aylwin and Frei) sought to draw justices into voluntary retirement with attractive retirement packages. Limited success and the fact that most Courts of Appeal—from which all nominees for the Supreme Court were drawn—were also packed with Pinochet loyalists led the Concertación government to seek a reform that made retirement mandatory at 75 years of age for all judges and increased the number of justices in the Supreme Court from 17 to 21, providing for the appointment of lawyers and legal scholars from outside the judicial branch. The government's interest in reforming the entire judicial system would have been much weaker if the Supreme Court had not been so strongly identified with the protection of those who committed human rights violations during the dictatorship.

Efforts to push judicial reform through Parliament were thus made simpler by the judiciary's diminished prestige, for it was widely perceived as ineffectual in defending victims of human rights abuses and in upholding the law during the dictatorship. The active opposition of the judiciary to the entire reform initiative during the Frei government had little influence because the judiciary could draw little support from public opinion. In contrast to the teachers' union or the public health workers, judges and judicial bureaucrats failed to make their case in the court of public opinion, and the government thus was able to force a radical reform upon them.

It Is OK to Be Opportunistic

Politicians live not only in a hostile environment, but in an ever-changing one as well. When Mexican president Vicente Fox visited Washington in early September of 2001, relations among the North American Free Trade Agreement partners were the best ever. Fox's initiatives to regularize the legal status of 3.5 million Mexicans in the United States seemed to be gaining momentum in the White House and the Capitol.

Then the terrorist attacks of September 11 dramatically shifted the US international agenda. When hosting Fox in Washington a few days before the attacks, President George W. Bush had declared that the United States has "no more important relationship in the world than the one we have with Mexico." But when Bush spoke to Congress two days after the attacks, the message was clear: "America has no truer friend than Great Britain." Although Fox vowed to keep on pushing for a speedy regularization of the 3.5 million undocumented workers, his chances for success had undoubtedly dimmed.

Policymakers always deal with the not-so-trivial question of how best to take advantage of unpredictable national or international developments. Having a battery of reform initiatives ready to send to congress and sell to public opinion, whenever a domestic or international shock creates a favorable environment for those reforms, should be a priority of all reform-oriented governments. Just as players on the bench must be ready to come into the field when called upon, reform-oriented governments need to have teams of experts preparing reforms even if they are uncertain about the immediate political feasibility of those reforms.

Corruption scandals often provide a formidable opportunity to reform bureaucracies or sectors with strong labor unions or other interest groups. They also constitute prime opportunities for privatization efforts. The Chilean severance pay scandal in 2000 is a good example. Several top executives in state-owned companies, all of whom were politically appointed during the Frei administration, wrote themselves substantial severance pay agreements in case the next government asked for their resignation.

The Chilean national oil company (Empresa Nacional del Petróleo, or ENAP), long seen as a candidate for privatization, was the most deeply touched by the scandal. Voices quickly rose calling for privatization. This idea had many advocates within the governing coalition. But they were mostly reluctant to go public; even worse, they did not have a concrete plan to sell ENAP. Opponents soon decried the calls for privatization as an exaggerated and reckless reaction to the scandal. Top ministers balked, and the idea was soon discarded. But one is tempted to ask what if. Had privatization advocates in the government had a plan ready for ENAP, perhaps they could have successfully convinced the administration that a swift sale would reduce the political costs of the scandal, at a time when vested interests were severely weakened.

Groom Your Potential Allies

It is a truism of political economy that a reform effort will succeed only if the groups supporting it are more numerous and politically more influential than the groups opposing it. The obvious but sensible conclusion is that a reform-mongering politician should spend time grooming potential allies among those who would benefit from reform. The problem arises when these potential allies do not exist politically—that is, when they are unorganized and have little or no political weight. This is especially likely to be the case with second-generation reforms, which, as we and many others have noted before, tend to generate diffuse benefits for many and losses highly concentrated among a few.

Yet the situation need not be hopeless. Successful reformers have found two ways for giving allies the necessary tender loving care. The first can be labeled *whetting the appetite of consumers*. Gradual trade reform is one example. Consumers who have never tried the pleasures of higher-quality imported goods are unlikely to be strong advocates of tariff reform but perceptions change once the forbidden fruit has been tasted. Pollsters from several countries that have carried out an initial round of tariff cuts report similar results. When citizens are asked if the government should help domestic producers against imported competition, a majority says yes; but when asked if imported goods should be made more expensive or less readily available, an overwhelming majority says no.

Another example comes from the delivery of public services. Political perceptions change once at least a portion of the public has been treated to timely garbage collection or decent health clinics. One way to accomplish this, in the words of Graham and Naím (1998), is to create "pockets of good performance within the public sector, even among very inefficient institutions, which can then serve as examples or provide impetus for further reform."

Consumers' appetites can be whetted even more drastically if they are provided with the *exit* option of purchasing the same services from the private sector, with the bill still being footed by the state. School vouchers, subsidies to buy privately built housing, and portable, government-financed health insurance all operate with the same logic. These schemes can facilitate further reform through two mechanisms: users become more demanding, and public providers feel the pressure of a withering clientele.

This last point is not without dangers. Competition from the private sector will help further public-sector reform *only* if fewer users mean fewer resources for inefficient providers. But this need not be so if funds for public hospitals or schools are allocated in the budget and are not contingent on the services provided. Political pressures may also militate against budget cuts and layoffs in the inefficient state providers. Then one can end up in the worst of all possible worlds: with a public sector that refuses to shrink while continuing to suck in large quantities of resources, and with a private sector that provides high-quality but also high-cost services at the state's expense. This is a nightmare scenario for finance ministers everywhere.

Whetting the appetite of consumers can be useful, but the political leverage of unorganized consumers has its limits. That is why it is also important to vest the interests of producers. Early reforms can give rise to a whole class of new producers; they, in turn, can become powerful advocates for further change. Trade reform again provides an example. Tariff cuts on imported inputs have led to a new range of exports in many developing countries. The new exporters, in turn, have become effective watchdogs against the dangers of overvalued exchange rates, inefficient customs services, and the like.

Pension reform provides another example. Making possible individual retirement accounts, as in Argentina, Chile, Colombia, and Peru, created a new class of savers who are advocates of macroeconomic prudence and low inflation. But perhaps more important is the lobby of pension fund administrators, who are now likely to be agitating for greater transparency in financial markets, laws against insider trading, and the like. The logic extends even to the realm of social policy. The school voucher system adopted in Chile created the *sostenedores*, who run private schools with public monies. On some issues, they have been a political force for improved education.

Of course, just as Plato had to worry about who would guard the guardians, reforming governments ought to fret over who will control the new vested interests. After all, the desires of these newfangled producers may, but need not, coincide with the general good. New exporters can already be seen lobbying for subsidies, and pension fund managers have opposed conflict-of-interest laws that could restrict board members in corporations of which they hold stock. There is no easy cure for this problem, just a need for eternal vigilance.

Politicians versus Technopols

The last item on our list of helpful reform-mongering strategies has to do with the credentials of the reformers. In their summary of the political conditions for economic reform, Williamson and Haggard (1994, 594) underlined the role of economists and economic teams in facilitating the adoption of first-generation reforms. In their words, "The only other feature that we have suggested to be a virtual prerequisite for successful reforms was a coherent economic team enjoying strong executive support . . . and there need to be some economists available who are sufficiently responsible to accept, and even sufficiently ambitious to seek, high political office, rather than limit their sights to academic debate or lucrative consulting." But their call for "technopols *al poder*" should be qualified when it comes to second-generation reforms.[25]

In consolidated democracies with regular elections and higher degrees of accountability, economists have long assumed an advisory rather than an executive advisory role. An elementary rule in parliamentary democracies—and even in presidential democracies such as the United States—is that the prime minister or president should reap the benefits of successful policies but should be shielded from paying the costs of failing initiatives. In strong presidential systems such as those in Latin America, presidents often concentrate both the benefits and costs of different policy initiatives.

When a president champions second-generation reforms—or for that matter, any policy initiative—the failure of one reform can take a heavy toll on the president's popularity and political capital. The short-term electoral success might ultimately do more harm than good to the long-term health of second-generation reforms. The overall prospects for reform are better served by technocrats who can successfully implement particular reforms and allow the president to reap the electoral benefits of success but themselves pay the political costs of failure.[26] If the president appoints a reform-minded technocrat to implement certain reforms, the president can successfully shield herself from failure. But if the technopol is the same person as the president, the failure of one second-generation reform may derail all future reform initiatives.

Conclusion

The success of second-generation reforms will be measured in long-term improvements in social welfare. In contrast to first-generation reforms, the effect of the new wave of reforms will not be felt immediately. Some of these reforms might, paraphrasing George W. Bush's description of the

25. The term *technopol* was originally coined by Domínguez and Feinberg (see Domínguez 1997).

26. This has been the case with influential finance ministers who were eventually thrown to the lions when the economy turned sour. The case of Domingo Cavallo in Argentina in 1996 comes to mind. The problem is that Cavallo and others like him (Pedro Aspe in Mexico, Alejandro Foxley in Chile, and Pedro Malan in Brazil) also illustrate the opposite phenomenon: that of a finance minister who becomes so influential and respected by financial markets that his success and that of the reform program become indistinguishable.

war on terrorism, be secret even in success. But in spite of that (perhaps *because* of that), they are important. It is hard to imagine a fairer and more prosperous Latin America without better public services and modernized government agencies.

If politics was important in achieving the first round of reforms, it is even more important in this next wave. At the beginning of the chapter, we discussed who is likely to provide the necessary political leadership, and under what circumstances. And just above, we outlined strategies that have worked to push second-generation reforms forward.

But there is more to the reform process than skillful politicking. The drive toward reform needs fewer generals and more foot soldiers. The leaders who individually championed reform, who were crucial for the success of first-generation reforms, must give way to strong and independent institutions that can foster, strengthen, and consolidate a reform-friendly environment. The success of second-generation reforms will only be assured when institutions replace visionary leaders as the foundation upon which reform rests. Above, we reviewed some changes in the rules of the political game—in electoral systems, for instance—that may render that goal somewhat less forbidding.

With the growth slowdown in Latin America becoming more pronounced, the prospects for swift second-generation reforms look dim. Analysts used to fret about reform fatigue; today, the talk is of impending populism and backsliding. But the only surprising thing about this is that it should come as a surprise. Any economy, rich or poor, advanced or underdeveloped, can achieve low inflation or tariffs. Building better schools and hospitals and more effective legal and regulatory systems is what advancing is mostly about. Who ever said that could be done easily?