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PREREQUISITES FOR SUCCESSFUL FISCAL REFORM: SOME PRELIMINARY RESULTS

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ABSTRACT. This paper examines whether any relationship exists between success or failure of policy reform on the one hand, and various political/economic conditions in place at the time of reform on the other. Nineteen countries were scored using three financial variables to measure the degree of success or failure of the reform. The independent variables were country scores for ten different economic and political conditions. The independent variables were used to try and predict a priori which of the nineteen countries would succeed and which would fail. Eighteen of the nineteen countries were correctly placed into their respective success group. However only three of the ten conditions appeared important in predicting success: a visionary leader, a crisis, and a comprehensive program. Other writers have suggested different sets of predicting variables.

INTRODUCTION

In a recent series of papers edited by Williamson (1994), the political conditions necessary for successful economic and fiscal reform were discussed in detail. In one of the most illustrative papers, Williamson and Haggard (1994) examined thirteen countries to see

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whether or not a particular country's ability to embrace economic reform was in any way influenced by the political process in the country. The study methodology was a country-by-country review to derive some empirical generalizations on the politics of economic reform. Williamson and Haggard (1994: 589) concluded "It is obvious at a glance that there are no fully robust empirical generalizations; in every case there is at least one partial counter example."

Williamson and Haggard's approach was descriptive. This paper extends their ideas by seeking a statistical link between existing political and economic conditions on the one hand and a country's subsequent success or failure in economic and fiscal reform on the other hand. In other words, can we describe some set of political and economic conditions which will allow us to predict the likelihood of success or failure of fiscal reform?

Much has been written on what constitutes economic reform.(1) For many economists, including Hirschman (1958), the most beneficial type of reform for long-run development was land reform. While Williamson and Haggard conclude that land reform is still an important and viable policy tool (especially for Latin American economic development), they adopt a broader definition of policy reform developed in the late 1980s and named the "Washington consensus" (see Willamson, 1990). The Washington consensus, comprised of ten separate policies, can be summarized under the three broader headings of macroeconomic stabilization, economic liberalization toward a market system, and the opening of the economy to world influences. It is interesting to note that these policies are "good" for First, Second and Third World countries.

Since the conviction that economic reform will lead to long-run benefits may not be widely held by either economists, politicians, the general public, or especially specific interest groups which may suffer immediate or short-term losses, Williamson and Haggard focus on the strategy of economic reform. They conclude that economists ". . . must be concerned with the conditions under which their advice is followed, and this implies a need to concern themselves with questions of political economy" (Williamson and Haggard, 1994: 531).

CONDITIONS FOR SUCCESS OR FAILURE

Williamson and Haggard (1994) list thirteen conditions

economic reforms. The thirteen conditions are grouped under four general categories: economic conditions, political conditions, the position of the implementing team, and the nature of the program itself. These are described as follows:

Economic Conditions

1. Crises: may shock countries from traditional approach and disorganize opposing interest groups.
2. External help: may support change through both intellectual and financial aid.

Political Conditions

3. Authoritarian regime: may be more successful in carrying out potential reforms.(2)
4. Right wing government: policy reform is inherently a right wing function and more than likely only introduced by such a government.
5. Honeymoon hypothesis: economic reformers may have greater success in implementing change soon after election.
6. Solid political base: needed even if reforms are unpopular.
7. Fragmented/demoralized opposition: weak and divided opposition makes reform easier.
8. Social consensus: policies reach through consensus are more likely to last.
9. Visionary leader: strong leadership and willingness to take risks.

Position of Team

10. Coherent economic team: must be united on economic strategy.
11. Presence of a technopol: economists should be in a position of political responsibility as opposed to merely technical advisers.

The Reform Program

12. Comprehensiveness of program: reformers need to set up a comprehensive program capable of quick accomplishment.

13. Voodoo politics: reformers should not declare specific intentions to the public before election -- rather promise they can cure economic ills painlessly.

COUNTRY CHOICE

As noted, Williamson and Haggard (1994) conducted a case by case study of individual countries -- a sample which included both developed and developing countries. The criteria for a country to be included in their sample was (a) that the country had attempted a well-defined post-1960 economic reform program, and (b) that enough data existed. The thirteen countries examined were: Australia, Brazil, Chile, Colombia, Indonesia, South Korea, Mexico, New Zealand, Peru, Poland, Portugal, Spain, and Turkey. Only in the cases of Brazil and Peru was reform not successfully consolidated.

While Williamson and Haggard (1994) did not claim randomness in the sample selection, and also admitted to bias is choosing "successes," they concluded that none of the conditions was either necessary or sufficient for successful reform. However, they concluded that certain conditions seemed important: the need for a strong political base, for visionary leadership, and for a coherent economic team. Several other conditions were important enough to be considered by reform-minded leaders. This was especially true for external financial support (Williamson and Haggard, 1994: 589).

A COUNTRY PROFILE ANALYSIS

In extending Williamson and Haggard's study, we employed a discriminant analysis to see if we could predict success or failure based on a set of existing conditions (the independent variables). Before starting the analysis, we enlarged the original sample of countries by six to get more robust results. Argentina, India, Pakistan, Sri Lanka, Thailand, and Venezuela met the original inclusion conditions set forth by Williamson and Haggard and were included for a sample size of nineteen.

The Independent Variables

Initially, each country was "scored" in terms of the pre-existing conditions described above. In our opinion, three of the original thirteen conditions (honeymoon period, technopols, and voodoo politics) were too subjective for measurement and were excluded. Each of the four general groups listed by Williamson and Haggard were still represented by the remaining ten conditions.

For each country, the ten conditions were given a score between 1 and 4. A score of 1 represented a non-existent condition (in Williamson and Haggard's terminology an "unsatisfied hypothesis"), and a score of 4 indicated a fully satisfied condition. Table 1 describes the attributes required for scores of 1 and 4. Scores of 2 or 3 would represent conditions close to 1 or 4, respectively. The scoring was completed using content analysis applied to the original study by Williamson and Haggard, various country studies, and the ***Financial Times***. The scores, shown in Table 2, represent the predicting (or independent) variables in the

TABLE 1
Scoring of Existing Conditions

Variable	Score of 1	Score of 4
Authoritarian Regime	Democracy	Authoritarian
Rightist Government	Left-wing Government	Rightist Government
Crises	No Crises	Severe Crises
Political Base	No Political Base	Broad Political Base
Demoralized Opposition	Strong Motivated Opposition	Demoralized Opposition
Social Consensus	No Social Consensus	Strong Social Consensus
Visionary Leader	Weak Visionless Leader	Strong Visionary Leader
Coherent Team	No Organized Coherence	Organized Coherent Team
Comprehensive Program	Piece-meal Program	Comprehensive Program
External Aid	No Aid	Intellectual and Financial

Source: Williamson and Haggard (1994).

TABLE 2
Scoring of Independent Variables

Country	Authoritative Regime	Rightist Government	Crises	Political Base	Democratic Opposition	Social Consensus	Visionary Leader	Coherent Team	Comp. Program	External Aid
Argentina	1	2	3	3	3	3	4	3	3	3
Australia	1	2	1	3	3	3	4	4	3	2
Brazil	1	4	3	1	2	2	2	3	1	4
Chile	4	4	3	4	4	4	4	4	3	4
Colombia	1	3	1	3	2	2	2•	4	2	2
India	1	2	3	2	2	2	3	4	2	2
Indonesia	4	3	3	4	4	4	3	1	2	3
South Korea	3	4	3	4	4	4	3	4	3	2
Mexico	2	3	3	4	3	3	3	4	3	4
New Zealand	1	2	3	3	4	4	3	4	3	2
Pakistan	2	3	3	2	1	1	2•	3	3	2
Peru	1	3	4	2	2	2	2	3	2	2
Poland	1	3	4	3	4	4	4	4	4	4
Portugal	1	3	1	3	4	4	4	3	3	4
Spain	1	2	4	3	4	4	4	4	3	4
S. Lanka	2	2	3	3	2	2	4	4	3	4
Thailand	2	3	3	2	2	3	2	2	3	2
Turkey	2	4	3	1	4	2	4	2	2	4
Venezuela	1	2	3	2	2	2	4	4	3	2

Note: Classification is based on weighted average score from data in Table 2.

discriminant analysis. While these scores are necessarily arbitrary, we feel that Table 2 results fairly represents the conditions in place when reforms were enacted.

The Grouping Variable

The grouping variable in this paper is a composite measure of actual success (or failure) each country experienced in adapting to economic and political reform. Since no individual measure reflects "success," three financial indicators were used and then combined into one score. The indicators are changes in (a) the fiscal deficit or surplus as a percent of Gross Domestic Product (GDP), (b) the level of aggregate domestic credit as a percent of GDP, and (3) percentage changes in the Consumer Price Index (CPI). All data came from the International Monetary Fund (various issues).

Data were collected for each country for a seven year period:[(3)] three years before and three years after reform introduction and also for the year in which the reform took place. Percent changes in the variables were calculated for a one, two, and three year period before policy implementation and the same measure was calculated for three similar periods after reform introduction. The percentage changes for the similar time periods (before and after) were then compared and assigned a score from 1 to 3. Countries showing a consistent positive change in the variable-- consistently lower deficits, increases in domestic credit or lower inflation-- received a score of 3. A score of 1 was assigned for consistent negative change. A score of 2 was assigned where the pattern was mixed.[(4)]

A weighted average of the scores was calculated: the deficit and the CPI were each weighted twice as heavily as the domestic credit score reflecting the main emphasis of the initial reform which was to immediately enjoy lower deficits and inflation. The weighted average was expressed in a three point scale as follows:

Aggregate Score	Code
0 - 9	1
10 - 13	2
14 - 15	3

Thus individual countries fell into three distinct groups depending on their relative success or failure (see Table 3). It is interesting to note that our results for Brazil and Peru -- a failure -- replicate those suggested by Williamson and Haggard (1994). However, our scoring indicates reform failure in Colombia.

Results

A step-wise discriminant analysis was conducted where the initial grouping was the country success/failure score in Table 3. The independent variables are used to predict the grouping based on the existing conditions at time of reform (Table 2). Importantly, the discriminant analysis correctly predicted the country's group in 18 of the 19 cases -- approximately 95 percent of the time. The exception was Mexico whose initial grouping was a 2 (the weighted average was 13). The discriminant analysis indicated that Mexico should have scored a 3 based on the existing economic and political variables. After further analysis we conclude that the original score of 2 was correct -- apparently

TABLE 3
Success/Failure Scoring, by Country

Country	Score	Country	Score
Australia	3	Turkey	2
Colombia	1	Brazil	1
New Zealand	3	Peru	1
Poland	2	Pakistan	3
Portugal	3	Argentina	2
Spain	2	Venezuela	2
Chile	2	India	2
Indonesia	2	Thailand	3
South Korea	3	Sri Lanka	2
Mexico	2		

Source: International Monetary Fund (various years).

the country has peculiarities (mostly political) which do not lend the country fitting into our hypotheses. Recent economic problems in Mexico reflect the inconsistencies of economic policy and the subjugation of economic policy to political desires.

Interestingly, the results show that only three of the ten existing conditions --a visionary leader, a comprehensive program, and the existence of a crisis-- seem important in predicting ultimate success or failure of policy reform. Williamson and Haggard concluded a different set of important pre-existing conditions --a visionary leader, a strong political base, and a comprehensive reform program (and to a lesser degree external aid)-- were suggestive of success.

SUMMARY AND CONCLUSION

This paper has extended Williamson and Haggard's work (1994) by examining whether or not any statistical relationship exists between successful reform and existing political/economic conditions in place at the time of reform. The initial grouping variable was a score reflecting relative success or failure in nineteen different countries. The independent variables were assigned scores for ten existing conditions at the time of reform. Our purpose was to see if we could predict success or failure using this set of variables. We were able to do so in eighteen of nineteen cases, with Mexico as the exception. However, only three conditions -- existence of a visionary leader, whether or not a comprehensive reform program exists, and the presence of a crisis in the country-- seem to account for subsequent success. These three variables fall under the general categories of political conditions and the nature of the program itself. The remaining seven variables which fall under the "economic conditions" or "position of the team" apparently had little effect on reform. While important in their own right, they did not seem to be prerequisites for predicting success in this sample of countries. The Willamson and Haggard study suggested a different set of variables are important as the base for successful reform. Further research would be well directed at more in depth case studies and also statistical analyses to uncover valid predictors of successful reform.

NOTES

1. For an excellent review of the literature, see Sachs and [illegible]

2. For a wider discussion on regimes, see Looney and Frederiksen (1987).
3. Available from authors upon request.
4. Where a data point was missing, a score of 2 was automatically assigned.

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