The Political Economy of Financial Reform: 
*de Jure* Liberalization vs. *de Facto* Implementation

Witold J. Henisz  
Department of Management  
The Wharton School, University of Pennsylvania  
henisz@wharton.upenn.edu

and

Edward D. Mansfield  
Department of Political Science  
University of Pennsylvania  
emansfie@sas.upenn.edu
Introduction

Over the past thirty years, social scientists have displayed growing interest in the political economy of financial reform. During this era, many observers have touted the economic benefits of financial openness and have urged countries to engage in financial liberalization (Kose, et al., 2009; Williamson, 1990). Yet there has been substantial variation in the extent which countries have embraced financial reform, stimulating an extensive empirical literature on its economic and political sources. Virtually all of the studies conducted on this topic have focused on explaining neoliberal policy changes in the financial sector, without addressing the extent to which the adopted reforms actually generate neoliberal policy outcomes. This issue is important because it is widely acknowledged that, in many cases, financial policy reforms are not implemented or enforced, and that they can be offset or undermined by other policies (Campos and Coricelli, 2012; Kose, et al., 2009; Mosley, 2010; Quinn, Schindler and Toyoda, 2011; Walter, 2008). Consequently, we need a better understanding of the conditions under which de jure financial reforms are undertaken and the conditions under which those reforms are implemented, yielding de facto financial liberalization.

In this paper, we address these topics. Consistent with previous studies, we argue that reforms are likely to reflect both interest groups preferences and the domestic institutions through which these preferences are aggregated. Equally, domestic economic conditions and external pressure exerted by the International Monetary Fund (IMF) are likely to influence financial policy.

We test these claims by combining a well-established data set with a novel one that we develop. Initially, we identify cases of de jure financial reform based on a widely-used data set that includes over 90 countries compiled by Abiad and Mody (2005) and updated by Adiad,
Detragiache, and Tressel (2010). Our results, which cover the period from 1980-2005, indicate that such reform tends to be conducted by poorer countries, those with smaller financial sectors, and participants in the IMF Standby Arrangement and its Poverty Reduction and Growth Facility (PRGF). However, there is no evidence that either domestic institutions or fluctuations in the domestic economy influence *de jure* reform.

Next, we distinguish between *de jure* reforms that have little bearing on the economy and those that precipitate structural breaks in time series data covering various aspects of finance and capital flows. We argue that the former are *de jure* reforms that are not fully implemented for whatever reason, whereas the latter are *de facto* reforms that are implemented. Moreover, we find that the political economy of *de jure* reforms differs substantially from the political economy of *de facto* reforms. The implementation of *de jure* reforms is inhibited by economic crises, a democratic regime type, a large financial sector, and participation in the IMF’s PRGF. There is also weaker evidence that implementation is promoted by economic recessions.

Our findings therefore confirm the importance of societal interests, political institutions, domestic economic conditions, and international institutions, each of which has been linked to financial reform in prior research. But these results break new ground by revealing important differences in how these factors influence policy reforms, on the one hand, and the economic effects of these reforms, on the other.

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**The Political Economy of Financial Reform**

It is widely argued that financial reform is affected by domestic interest groups, political institutions, macroeconomic fluctuations, and international institutions. First, the financial sector is likely to exert an especially important effect on financial reform (Haggard, Lee and Maxfield,
1993; Pepinsky, 2013). As a general matter, the financial sector in any country is likely to oppose liberalization since greater openness exposes it to foreign competition and reduces rents associated with financial repression. Banks prefer to avoid foreign competition, prudential regulation and oversight, and government-mandated shut downs in the face of non-performing loans. Financial firms also prefer to avoid costly changes in accounting standards or global codes that reduce the rents they can realize from financial repression (Mosley, 2010; Walter, 2008). Even in those cases where the financial sector has an interest in certain aspects of reform—e.g., capital account liberalization in developing countries, which increases the flow of foreign capital that it can intermediate—this sector is also likely to prefer that other aspects of the financial regime remain closed—e.g., limits on foreign entrants into the banking system (Haggard and Maxfield, 1996; Pepinsky, 2013). We expect that the political influence of this sector will be directly related to its size (Pepinsky, 2013). Consequently, countries marked by a large financial sector are less likely to experience financial reform because this sector is powerful enough to thwart liberalization efforts.

Even if they are unable to block policy change, the financial sector has an interest in blocking the implementation of *de jure* reforms. A number of studies argue that financial sector interests with ties to domestic regulators or other key government officials can block or distort policy implementation, giving rise to a process that Walter (2008; see also Mosley, 2010) refers to as “mock compliance.” In countries with a large financial sector, these ties are likely to be tighter and denser, reducing the likelihood that reforms that threaten this sector are fully undertaken.

Second, political institutions are also likely to influence financial liberalization. Various studies have concluded that a country’s regime type is particularly important in this regard,
although there is no consensus on the type of regime that promotes reform. Some research indicates that democracy inhibits financial liberalization (Darcillon, 2011; Huang, 2009; Omori, 2007). One reason is that such reform promotes income inequality (Quinn, 1997). Voters, most of whom have an interest in a relatively uniform distribution of income, will punish leaders who enact policies that aggravate inequality. Furthermore, taxing capital to redress inequality is difficult in the face of financial liberalization because capital can flee to more tax-friendly overseas destinations.

Other studies, however, conclude that democracy promotes financial openness (Giuliano, Mishra and Spilimbergo, 2013; Quinn, 1997). It has been argued that the broader “selectorate” empowered in such polities benefits more from financial openness than repression (Giuliano, Mishra and Spilimbergo, 2013; Kim and Kenny, 2007). In addition, Quinn (1997) points out that democracy promotes the rule of law and the protection of property rights, factors that are of substantial importance for investors. He further observes that the political rights that underlie democracy tend to encourage the establishment of economic rights, including the right to conduct unfettered international financial transactions. In contrast, autocrats have an incentive to avoid financial liberalization because such reforms might give rise to an investor class that would demand greater political liberalization, thereby imperiling the leader’s rule. Haggard, Lee, and Maxfield (1993) offer a similar assessment, maintaining that autocrats often prefer a repressed financial sector because they are able to dole out credit to themselves and their domestic allies on preferential terms.

Regardless of whether democracy promotes or inhibits de jure financial reform, there is reason to expect it to hamper the implementation of such reform. In democracies, special interests that are hostile to reform may have greater opportunity to capture financial regulatory
institutions than in other countries (Giuliano, Mishra and Spilimbergo, 2013). Equally, democracies are typically marked by checks and balances among the branches of government. Financial policy changes made by one branch can more easily be challenged by other branches in a democratic than a non-democratic state. More generally, as one study concludes, “a democratic environment and a participatory approach to economy policies are no panacea. Consultation and consensus building can (and do) delay policy implementation. The strategies chosen sometimes involve too many compromises or are too timid” (Leite, et al., 2000, 1).

Third, various studies have found that economic crises spur financial reform because the cost of maintaining the status quo rises drastically during a crisis, leading to a domestic consensus that steps must be taken to address the downturn (Akerlof, 1991; Alesina, Ardagna and Trebbi, 2006; Alesina and Drazen, 1991; Armijo and Faucher, 2002; Drazen and Easterly, 2001; Tommasi and Velasco, 1996). In this vein, some studies argue that the short-term costs of neoliberal reforms—which otherwise discourage their enactment—become more bearable when compared to the costs of policy inaction during a crisis (Armijo and Faucher, 2002; Weyland, 1996) or that crises weaken the political power of and reduce the economic rents captured by entrenched incumbents (Nelson, 1994; 1990; Olson, 1965; Remmer, 1998). As a result, crises create a political opening for advocates of neoliberal reforms, despite the uncertainty over their timing and distributional consequences (Fernandez and Rodrik, 1991; Laban and Sturzenegger, 1994).

Irrespective of their influence on policy change, however, crises may undermine the implementation of de jure reform. Nelson (1994), for example, raises the possibility that a crisis can spur initial efforts at reform, but that interest in implementing reform may wane if the crisis
subsides. Equally, crises may inhibit implementation by eroding the government’s capacity to actually change the financial regime.

Finally, there is ample reason to expect IMF loans to promote *de jure* financial liberalization (Burgoon, Demetriades and Underhill, 2012; Chwieroth, 2007; Elhorst, Zandberg and De Haan, 2013; Joyce and Noy, 2008; Karcher and Steinberg, 2013; Lee and Schumacher, 2011; Omori, 2007; Pinheiro, Chwieroth and Hicks, 2014). It has been argued that the IMF can help to tilt the domestic balance of power toward groups favoring reform by providing them with resources and legitimacy, and by prompting other groups to join the pro-reform coalition (Campbell, 2004; Elkins and Simmons, 2005; Levi-Faur, 2005). For instance, various studies on IMF lending practices conclude that intervention by external actors that provide short-term resources conditional on the implementation of a reform, and threaten subsequent punishments if the policy change is not implemented, may alter the domestic political balance of power in favor of reform (Dixit, 1998; Drazen, 2002; Putnam, 1993; Vreeland, 2003).

The first amendment to the IMF charter, which was passed in 1952, granted the agency the ability to seek policy changes in debtor countries. For many years, however, the actual imposition of conditionality terms by the IMF was rare and the imposed terms were narrow in scope. But over the past few decades, this organization has imposed a growing range of terms on borrowing countries (Buira, 2003). Some observers attribute the change in IMF behavior to an ideological shift in favor of neoliberal economic policies that began in the 1980s (Buira, 2003). One consequence of this change has been a political backlash against the IMF in various borrowing countries, which resent what they consider an infringement of their sovereignty (Ayres, 2004; Best, 2007; Chorev and Babb, 2009; Pauly, 1999). Indeed, a few studies have found evidence that countries are less likely to fully adhere to reforms that key domestic interests
view as having been imposed upon them by a coercive foreign actor (Weber, Davis and Lounsbury, 2009; Zelner, Henisz and Holburn, 2009). Others have argued that countries do not adhere to the conditions of IMF loans when—as is often the case—deviating from those conditions creates rents that benefit influential segments of society (Vreeland, 2003). Still others have pointed out that states with close political ties to powerful IMF members are subject to less stringent enforcement of loan conditions than other countries, suggesting that states with such ties may not implement reforms linked to IMF programs (Stone, 2002; 2004; 2008). As such, regardless of whether exposure to IMF programs promote financial policy reforms, such exposure may reduce the likelihood that de jure reforms are implemented.

**Model and Measures**

To assess the effects of the factors described in the preceding section, we estimate the following model of financial reform in two ways. Initially, we examine the factors that stimulate de facto reforms, taken as a homogeneous group, using a logit specification. Next, we estimate a multinomial logit model in which cases of de jure reform that are subsequently implemented and yield de facto reform are distinguished from cases that do not produce de facto reforms.

\[
\text{REFORM}_i = \beta_0 + \beta_1 \text{FINANCIAL SECTOR}_i + \beta_2 \text{REGIME TYPE}_i + \beta_3 \text{CRISIS}_i + \beta_4 \Delta \text{GDP}_i + \\
\beta_5 \text{IMF PRGF}_i + \beta_6 \text{IMF EXTENDED FUND}_i + \beta_7 \text{IMF STANDBY}_i + \\
\beta_8 \text{PER CAPITA GDP}_i + \beta_9 \text{LEFT}_i + \beta_{10} \text{OTHER}_i + \beta_{11} \text{OPENNESS}_i + \gamma_i + \theta_i + \varepsilon
\]
**de Jure Reform**

The vast bulk of the literature discussed earlier analyzes the formal adoption of *de jure* policies that liberalize the financial sector.¹ These policies are designed to replace a policy regime of government allocated and subsidized credit with a more market-oriented allocation system. Throughout the period since World War II, many countries have repressed their financial regimes. They have adopted policies requiring a certain portion of lending to be allocated to priority sectors (i.e., credit controls), the maintenance of a higher share of bank’s reserves as deposits in the Central Bank than could be reasonably expected for prudential regulation (i.e., reserve requirements), the capping of interest rates (i.e., interest rate controls) with the aim of subsidizing the price of capital but in effect insuring its politicized rationing, limiting entry into the banking sector or the scope of operations of banks, requiring or privileging state ownership of the banking sector, and restricting capital account flows. Financial reform, as promoted by McKinnon (1973) and Shaw (1973) was meant to liberalize each of these five policies so as to support the market allocation of capital and promote economic development. In addition, the government would support private financial institutions by providing adequate prudential supervision and promoting securities markets. We follow much of the extant literature and measure *de jure* reform in these financial policies using data compiled by Abiad and Mody (2005) and updated by Abiad, Detragiache, and Tressel (2010).

¹ Much of this data originates in the IMF’s *Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER)*, although each set follows a different protocol and Abiad and Mody (2005) and Abiad, Detragiache, and Tressel (2010) supplement these data with a number of additional measures. A similar source is Bekaert, Harbey and Lundlad (2005), which focuses on the liberalization of equity markets. A much smaller number of studies draw upon measures of actual international financial flows. With the exception of the studies using the TOTAL index of Lane and Milesi-Feretti (2007), these studies analyze variation in the level of liberalization than discontinuous changes therein. The number of studies using these measures is too small to highlight consistent differences across the class of measures but it is notable that no study has attempted to integrate the various theoretical mechanisms using a *de facto* measure of reforms nor has a study compared the drivers of *de jure* and *de facto* reform.
This dataset “records financial policy changes along seven different dimensions: (1) credit controls and reserve requirements, (2) interest rate controls, (3) entry barriers, (4) state ownership, (5) policies on securities markets, (6) banking regulations, and (7) restrictions on the capital account. Liberalization scores for each category are then combined in a graded index that is normalized between zero and one” (Abiad, Detragiache and Tressel, 2010, 3). The data are available for 91 countries over the period from 1973-2005. For each state, $i$, Abiad, Detragiache, and Tressel (2010) indicate whether financial reform has taken place from year $t-1$ to year $t$. As shown in Figure 1, the aggregate data exhibits a secular trend toward greater financial liberalization, particularly from the mid-1980s to the mid-1990s.

**De Facto Reform**

To measure *de facto* policy reform, we introduce a novel measure based on the identification of points in time where any one of seven macroeconomic data series exhibited a structural break in trend:

- Private credit by deposit money banks and other financial institutions as a share of gross domestic product (GDP) (Čihák, et al., 2012)
- Demand, time and saving deposits in deposit money banks as a share of GDP (Čihák, et al., 2012)
- Demand, time, and saving deposits in deposit money banks and other financial institutions as a share of GDP (Čihák, et al., 2012)
- Inflation, consumer prices (annual %) (World Bank, 2015)
- Inflation, GDP deflator (annual %) (World Bank, 2015)
- Interest rate spread (lending rate minus deposit rate, %) (World Bank, 2015)
• Real interest rate (%) (World Bank, 2015)

These seven series are the readily observable macroeconomic outcome variables that McKinnon (1973) and Shaw (1973) argued should change if *de jure* liberalization is implemented and financial repression ends. Specifically, once interest rates are no longer capped, they should rise and attract added deposits into financial institutions. The reduction of the subsidization of credit should also reduce inflation. Finally, the more competitive financial sector spawned by liberalization should lower interest rate spreads and contribute to growing disbursement of credit by private sector financial institutions.

For each time series, we begin by testing for the presence of a unit root using the Zivot-Andrews (1992) test. Where we fail to reject the null hypothesis of a unit root, we calculate the first difference of the time series. Next, we estimate $y_t = \beta_0 + \beta_1 t + \epsilon$ and identify structural breaks in the intercept. More specifically, we identify the years in which estimating a new intercept for subsequent years improves the model fit according to BIC statistics (Bai and Perron, 2003; Zeileis, et al., 2003). Of those years in which a structural break was recorded, we code as *de facto* reform instances in which: (1) we observe an increase in private credit and deposits or a decrease in inflation, the interest rate spread, and real interest rates; and (2) the structural break occurs within three years after a *de jure* reform took place. A number of prior studies have used structural breaks in time-series data to identify reforms, although we are unaware of any previous research that uses this technique to distinguish between *de jure* reforms that are and are not implemented (Baccini and Urpelainen, 2015, chapter 6; Wiese, 2014). Based on our data, no reform was undertaken in 67.3% of the country years, *de jure* reform that did not yield *de facto* reform occurred in 19.3% of the country years, and *de jure* reform that did culminate in *de facto* reform took place in 13.4% of the country years.
To illustrate instances that we code as *de facto* reform, consider the cases of the Philippines from 1981-1985, Mexico and Ghana in 1987, and Thailand in 1989-1990. After a period of rapid growth in the 1970s, the Philippine economy was hit hard by the commodity price boom of 1979 (Solon and Floro, 1993). Public and private firms found themselves overleveraged and efforts by President Marcos to selectively bail out favored distressed firms triggered massive capital flows and stagnant domestic investment. In the period 1980-1982, the economy experienced “declining growth rates, deteriorating terms of trade, rising inflation, growing balance of payments deficits and accumulating large external debt” (Solon and Floro, 1993, 9). Further, the conditions of a $200 million loan that the IMF negotiated with the Philippines included “Liberalization of interest rates to reflect market conditions” and “financial liberalization” entailing the adoption of universal banking and the removal of interest rate ceilings (Solon and Floro, 1993, 9). Intal and Llanto (1998) further note that the policy reforms included a liberalization of reserve requirements on these universal banks. According to Abiad, Detragiache, and Tressel (2010), entry barriers were loosened in 1980, interest rate controls were loosened in 1981, 1982, and 1983, directed credit declined in 1982, credit controls were loosened in 1982 and 1984, credit ceilings were removed in 1984 and capital account controls were weakened in 1984. In the aftermath of these extensive *de jure* financial reforms, real interest rates surged from -16% in 1984 to 14% in 1986. Inflation fell from 50.3% in 1984 to 0.75% in 1986 when measured via consumer prices and from 53.3% to 3.0% when measured using the GDP deflator. Private credit—which had plummeted from 44% of GDP in 1982 to a low of 17% in 1987—began to grow again and financial and bank deposits as a share of GDP similarly began a long-term secular increase. *De jure* reform was followed by *de facto* implementation.
The other three reform cases were not as dramatic, but nonetheless triggered structural breaks in some of our financial indicators. The Ghanaian reforms of 1987 liberalized interest rates (Aryeetey, 1997). After steadily declining from 13.7% of GDP in 1971 to approximately 5% of GDP during the mid- to late-1980s, financial and bank deposits began a steady recovery in 1989 and rise to over 15% of GDP within a decade. The Mexican reforms of 1987 focused on a different policy instrument but were followed by a similar boom. The government offered 34% of the shares of the banks it had nationalized in 1982 to investors. Financial sector and bank deposits, which had plummeted from 24.5% in 1981 to 9.1% in 1989, subsequently reversed course and steadily climbed to record highs of over 28% in 1999. Finally, the 1989-90 reforms in Thailand included a loosening of interest rate controls and entry barriers as well as privatization and reform to securities law (Montiel, 2013). In 1992, financial and bank sector deposits which had been growing slowly for some time, accelerated their upward trend reaching a high of 106% of GDP in 2001.

In our initial analysis, we address whether each state, i, conducted a *de jure* reform in each year, t, where we observe 1 if this is the case and 0 otherwise. Next, we identify which of the following three mutually exclusive conditions characterizes state i in year t: (1) no *de jure* reform, (2) *de jure* reform, but no *de facto* implementation within the following three years, and (3) *de jure* reform and *de facto* implementation within the following three years.

**Independent Variables**

As we discussed earlier, financial reform is likely to be influenced by a variety of economic and political factors that are included in our model. Unless otherwise noted, all of these independent variables are measured in year *t*-1.
First, we expect interest group pressures to influence financial reform and the financial sector in a given country to be a particularly salient interest. To measure its size and power, we include FINANCIAL SECTOR\(_i\), which is the ratio of total financial assets (i.e., central bank and deposit money bank assets) to GDP, based on data from the Global Financial Development Database (Pepinsky, 2013). Second, we expect a country’s domestic institutions to influence reform and that its regime type will be especially important in this regards. To measure a country’s regime type, we use the Polity IV data. REGIME TYPE\(_i\) is an index that ranges from 1 for the most autocratic countries to 21 for the most democratic states (Gurr and Jaggers, 1995; Gurr, Jaggers and Moore, 1989; Marshall and Jaggers, 2009).

Third, various observers have argued that fluctuations in the business cycle and economic crises influence financial reforms. We therefore include \(\Delta GDP\)\(_i\), which is the percentage change from year \(t-1\) to year \(t\) in purchasing power parity converted GDP (chain series), measured in 2005 international dollar constant prices (Heston, Summers and Aten, 2011). We also include CRISIS\(_i\), which equals 1 if state \(i\) experiences a sovereign debt restructuring, sovereign debt default, systemic banking crisis, or currency crisis, based on data compiled by Laeven and Valencia (2012).

Fourth, to assess the influence of IMF programs on financial reform, we analyze three dummy variables indicating whether country \(i\): (1) is currently accessing the PRGF Arrangement or the antecedent (Enhanced) Structural Adjustment Facility (IMF PRGF\(_i\)), (2) has agreed to an Extended Fund Facility Arrangement (IMF EXTENDED FUND\(_i\)), or (3) has agreed to a Standby Arrangement (IMF STANDBY\(_i\)). For each of these variables, we rely on data indicating whether a country has been covered by an IMF agreement for at least five months in year \(t-1\) (Dreher, 2006).
In addition to these factors, it is important to account for various influences that previous research has linked to financial reform. Initially, we focus on three such influences, although we address a wide variety of additional variables later. One possibility is that economic development affects financial reform. Poorer countries tend to have less institutional capacity to undertake reforms and the governments of such countries may prefer to repress the financial system because doing so allows them to actively direct credit toward those sectors that create positive externalities (Abiad and Mody, 2005). Alternatively, advanced industrial countries tend to have more liberalized financial sectors than developing countries, which creates less need to reform those sectors. We therefore include PER CAPITA GDP, which is the per capita GDP of country $i$, based on purchasing power parity (chain series) and measured in 2005 international dollar constant prices (Heston, Summers and Aten, 2011).

Further, various studies of financial reform have addressed a government’s ideology. It is frequently argued that right-wing governments exhibit a particular affinity for neoliberal reform—including financial reform—although the evidence on this score has been mixed (Brooks, 2004; Brooks and Kurtz, 2007; Darcillon, 2011; Elhorst, Zandberg and De Haan, 2013). We measure ideology using three dichotomous variables drawn from the Database of Political Institutions identifying whether the head of state’s political party has a RIGHT (“Conservative,” “Christian Democratic,” or “right-wing” economic policy), LEFT (“Communist,” “Socialist,” “Social Democratic,” or “left-wing” economic policy), or OTHER (which includes governments with a centrist economic policy orientation and the small number of cases coded as “not applicable”) orientation. In the following analysis, a right-wing party orientation is arbitrarily selected as the reference category.
We also need to account for the possibility that *de jure* reform is characterized by a ceiling effect, in which countries that are already more open with respect to finance have less room to further liberalize their financial regime and are therefore less likely to do so. To this end, we include OPENNESS, which is country i’s annual level of financial openness and liberalization, based on Abiad, Detragiache, and Tressel’s (2010) data. To account for any unobserved heterogeneity across countries or years, we also include country fixed effects (γᵢ) and year fixed effects (θₜ). Finally, ε is a stochastic error term. Table 1 provides summary statistics for the variables included in our analysis.

**Results**

Initially, we estimate our model using a logit specification, since the observed value of our first dependent variable is dichotomous. The results shown in the first column of Table 2 indicate that FINANCIAL SECTOR, IMF PRGF, PER CAPITA GDP, OTHER, and OPENNESS strongly affect financial reform. The likelihood of enacting such reform rises as the financial sector decreases in size, if states have an active PRGF agreement, as per capita GDP declines, and as the level of financial openness and liberalization falls. Further, centrist and unclassifiable governments are less likely to reform than right wing governments. The effect of each of these factors is statistically significant and quantitatively substantial. A one standard deviation increase in the mean value of FINANCIAL SECTOR reduces the predicted probability of financial reform by about 15%, a one standard deviation increase in the mean value of PER CAPITA GDP yields over a 40% reduction in this probability, an active PRGF raises it by roughly 60%, and a one standard deviation increase in the mean value of OPENNESS decreases it by about 60%. Equally, centrist governments are roughly 30% less likely to engage in liberalization than their
right-wing counterparts. In contrast, our results yield no evidence that the business cycle, crises or regime type influences *de jure* financial reform.

It is widely recognized that including country fixed effects in a nonlinear model such as ours can produce incidental parameters problems (Greene, 2002). We therefore estimated our model using a conditional logit specification, which side-steps any such problems while continuing to account for any unobserved heterogeneity across countries. As shown in the second column of Table 2, the results based on this specification are very similar to those based on the fixed effects logit specification, suggesting that incidental parameters do not pose a problem.

Thus far, we have focused on explaining *de jure* reform, an approach that mirrors virtually all of the empirical literature on financial reform. Further analysis, however, reveals that this tack masks a great deal of information about the conditions under which *de jure* reforms are or are not implemented and generate *de facto* reforms.

The third and fourth columns of Table 2 present the results of a multinomial logit model, in which *de jure* reform that does not yield *de facto* reform is the reference category. Consequently, the estimates in the third column reflect the effects of the independent variables on enacting a *de jure* reform that does not generate *de facto* reform, whereas the estimates in the fourth column indicate the effects of these variables on whether *de jure* reform does or does not produce *de facto* reform. In light of our objectives in this study, the latter column of results is particularly important.

These findings indicate that crises, a democratic governance system, a large financial sector, and participation in an IMF PRGF reduce the odds that *de jure* reform will be implemented and produce *de facto* reform. There is also evidence that upswings in the business
cycle reduce these odds, although further analysis discussed below reveals that this result is not robust.

Not only are these relationships statistically significant, they are also sizable. A crisis reduces the predicted probability of implementing a *de jure* reform by 45%, an IMF PRGF reduces this probability by almost 50%, and a one standard deviation increase in the average size of the financial sector decreases it by about 45%. A change from an autocracy (defined as a value of 4 for REGIME TYPEi) to a democracy (defined as a value of 18 for REGIME TYPEi) decreases this predicted probability by over 55%. A one standard deviation reduction in the average annual percentage change in GDP yields a 14% rise in the predicted probability that a *de jure* reform will become a *de facto* reform.

Additional analysis provides some insight into why democracy inhibits the implementation of financial reform. The widely-used index of regime type on which we rely is based on five factors: (1) the competitiveness of the process through which a country’s leader is chosen, (2) the openness of this process, (3) the extent of institutional constraints on the leader’s decision making authority, (4) the competitiveness of political participation within the country, and (5) the extent to which binding rules regulate such participation (Gurr and Jaggers, 1995; Gurr, Jaggers and Moore, 1989; Marshall and Jaggers, 2009). Analyzing these factors individually indicates that the extent of the institutional constraints on the chief executive is central to the observed effects of regime type. If we include these five variables into our model, one at a time, only executive constraints and the competitiveness of political participation have a statistically significant effect on whether a *de jure* reform will culminate in a *de facto* reform. When these two variables are included in the same model, however, only executive constraints
have a significant effect, with more extensive constraints inhibiting implementation. As the
architects of this data set point out, these institutional constraints are comprised of
“accountability groups” that create checks and balances on the leader. In democracies, these
constraints typically stem from legislatures (Marshall and Jaggers, 2009, 24). Consequently, the
observed effects of democracy seem to reflect a more uniform distribution of power among the
branches of government in this type of regime than others. Under these conditions, de jure
reforms initiated by one branch can more easily be derailed by another branch with different
interests prior to implementation.

Furthermore, it is important to recognize that what underlies this relationship is not the
effect of “veto players” more generally (i.e., incorporating information on the distribution of
party preferences within the legislative branches(s)). Including a well-known measure of veto
players that includes both data on the number of institutional veto points and the distribution of
party preferences within them yields no significant evidence that this factor affects reform, and
the estimated coefficient of institutional constraints continue to be positive and statistically
significant (Henisz, 2000; 2002). Instead, it is the checks and balances that exist between the
executive and legislature (and to a lesser degree, the judiciary) rather than the overall distribution
of party preferences within and across each branch that is centrally important.

Returning to the broader findings and mirroring the logic that led us to present the results
of conditional logit specification in the second column of Table 2, we address the possibility that
the problem of incidental parameters is introducing bias into our multinomial logit estimates by
using what has variously been referred to as the hybrid method (Allison, 2009), “poor man’s

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2 This is the case regardless of whether we analyze the original seven-point scale on which this variable is measured
or a dummy variable that distinguishes democracies from non-democracies based on these constraints (Mansfield
and Snyder 2005: 77).
conditional likelihood” (Neuhaus and McCulloch, 2006), and the “between-within” method (Sjölander, et al., 2013). This technique involves mean-deviating the independent variables of interest from the country-specific means and clustering the standard errors at the country-level.\(^3\)

As shown in the final two columns of Table 2, this technique yields results that are similar to the findings based on a fixed effects multinomial logit estimator, although the estimated effects of \(\Delta GDP\) —which was significant at the .05 level—is no longer significant, and the preexisting level of financial openness is negatively significant.

Finally, these results are very robust to the inclusion of a battery of variables that have been linked to financial reform in previous research:

- measures of openness to international trade (e.g., ratification of Preferential Trade Agreements, trade as a percentage of GDP);
- additional political institutions (e.g., Bureaucratic Quality, Investment Profile or Government Stability subjective ratings from the *International Country Risk Guide* or measures of opposition or government fractionalization or plurality from the *Database of Political Institutions*);
- measures of political business cycles and leader tenure (e.g., an indicator value for the first year in office and the count of the number of years in office from the *Database of Political Institutions*);
- the size of the public sector (i.e., government consumption share of GDP);
- measures of peer adoption of *de jure* or *de facto* reforms with peers defined either by geographic contiguity, region or trade weights;

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\(^3\) We also tried to estimate a conditional multinomial logit model using the femlogit command in STATA. But despite over 100 hours of estimation on a high performance computer cluster with 32-nodes and 512 cores, the model failed to converge.
- global monetary conditions (i.e., interest rate on 3 month US government treasury bills or long-term US government bonds); and
- more fine-grained measures of democratic political regimes (e.g., Parliamentary democracy, mixed Presidential-Parliamentary democracy or Presidential democracy).

Adding these variables to our base model one at a time and in clusters generates no substantive changes to the results we reported above and none of them have a robust effect on either de jure reform (in the logit specification) or the likelihood of implementing de facto reform (in the multinomial logit specification). In sum, the findings in Table 2 are very robust.

Illustrative Country Cases

Having generated a set of statistical findings, we now turn to a brief discussion of why the factors analyzed earlier influence whether financial reforms are implemented. To begin, consider Thailand’s financial reforms, which illustrate the effects of each of the four variables that we have highlighted. Despite liberalizing reserve requirements, lifting credited controls, liberalizing the current account and pledging to undertake privatization of banks, these de jure reforms did not produce de facto reforms. Two arguments have been advanced to explain this gap. First, McCargo (2001) focuses on the role of democratization and the anti-Western backlash to the East Asian crisis and its IMF bailout. He argues that constitutional reforms in 1997— which altered the electoral system to reduce the potential for vote buying, increased the separation of powers between party-list and constituency members of parliament, and created a series of independent regulatory bodies designed to increase transparency, accountability, and popular rights—enhanced democracy but undermined the government’s ability to rapidly implement de jure reforms. As the East Asian crisis deepened in 1998, nationalist political forces
gained strength. These forces sought to blame the IMF, Western creditors, and urban elites. Their criticisms of the IMF and these creditors were well-received by a country that failed to understand how after following western recommendations on financial reform for close to a decade, the same Western creditors and international financial institutions were now dictating that they turn over ownership in their largest banks and corporations to foreign entities. While Westerners label this episode “the East Asian Crisis,” many Thais refer to it as the “IMF crisis.” The 11 bills associated with the IMF bailout became seen as a “national security threat, a form of colonization and oppression” (McCargo, 2001, 100) by a coalition of the hard left, monarchists, and rural populists. This coalition gained increasing power in the coming years, setting the stage for a divisive political conflict in the legislature that contributed to scuttling the policy reforms.

A related and likely complementary argument is advanced by Charumilind, Kali and Wiwattanakantang (2006), who demonstrate the extent of politically-motivated lending practices in Thailand throughout the 1990s. Despite financial policy liberalization during this decade, banks continued to make loans based upon political connections. McIntyre (1999) details that in the months prior to the onset of the crisis, regulatory efforts to force increased capital reserves were undermined by senior members of the Chart Pattana Party (which was the second largest in the government’s coalition) who had controlling interests in banks that were subject to the regulatory policy. The same group of government coalition members would continue to block implementation of reforms even after the crisis came to a head, when policies were introduced to sweep away this endemic crony capitalism. While initially successful in reducing the ownership and control of a handful of Sino-Thai families over the financial system, the populist and nationalist opposition that we mentioned earlier was made unstoppable politically when domestic banking families joined the political alliance led by entrepreneur Thaksin Shinawatra. A new
alliance combining the rural poor and domestic financial-industrial elite overturned the post-crisis consensus in favor of liberalization and embarked upon a set of nationalist and statist policies (Hewison, 2005; Tejapira, 2002).

The financial lobby played a similarly strong role in the Philippines, which was hampered by what Paul Hutchcroft (1998) refers to as a system of “Booty Capitalism.” Despite a series of de jure policy changes during the period from 1988-1997 that were designed to improve financial supervision, liberalize entry into the financial sector, and reform interest rates (Intal and Llanto, 1998), we observe no de facto reforms. According to Hutchcroft (1998, 6-7), the gap can be explained by five factors:

- the Central Bank has been unable to defend itself from the legal attacks of bankers, unable to enforce regulations that will prevent oligarchs from looting the loan portfolios of their banks, and unwilling to challenge the cartel practices within the industry…There are five overarching characteristics of the Philippine banking system, both of which have endured despite regime change, repeated attempts at reform, and circumstances that one might initially expect to have been conducive to building more effective mechanisms of state regulation. First, is rampant favoritism, reflecting the patrimonial character of the state…Second, is the largely ineffectual state regulation of the banking sector, reflecting both the patrimonial character of the state and weakness of the state apparatus in relation to the powerful social forces concentrated in the banking sector…Third, the banking system has created a high degree of financial instability, the root cause of which is the regulators’ inability to curb the milking of loan portfolios by bank owners, directors and officers for related family enterprises…Fourth, the banking system provides enormous profits to those banks that are primarily in the business of banking for the sake of banking profits (and not for the sake of financing related family enterprises)….Finally, continual raids of oligarchs and cronies on the resources of the state seriously depleted the national treasury and killed the Central Bank.

In short, implementation of the de jure reforms was undermined by continued state involvement in credit allocation and oligarchic ties between the state and the financial sector.

A similar story emerges in Paraguay, where increases in the size of the financial sector contributed to the flawed implementation of reforms. Certain political interests sought to use financial liberalization to maintain or even extend a system of clientelist and corrupt politics
Liberalization led to the growth of the financial sector and an increase in the amount of capital flowing into it. But the sector was under heavy political pressure from the government and these political ties influenced the distribution and term of credit. Despite announcements of de jure reform following economic crises in 1990, 1993, 1996, and 2003, this financial lobby successfully undermined any substantive liberalization (Nickson and Lambert, 2002).

Large incumbent (state-owned) financial interests that retained their power despite efforts at reform also used the implementation process to limit de facto reform in Ethiopia (Addison and Geda, 2003; Harvey, 1996) and Kenya (Ngugi and Kabubo, 1998). Dominant state-owned banks in Ethiopia were neither privatized nor encouraged to compete with each other. Furthermore, although the de jure reform permitted entry into the banking sector, entrants were required to be indigenous and could not include foreign investing partners that might be able to provide the financial and human capital needed to successfully compete with the incumbent state-owned banks (Addison and Geda, 2003; Harvey, 1996). Despite lifting formal interest rate controls, no significant changes occurred in the trend of real interest rates (Harvey, 1996). New banks were further hampered by a delayed and flawed new banking law and by delays in the appointment and staffing of the supervisory authority (Harvey, 1996). As a result, the new indigenous banks seemed primed for failure given their lack of technical capacity, insufficient capital reserves, the absence of restrictions on conflict of interest by senior management, and inadequate regulatory supervision (Harvey, 1996).

Turning to the effects of regime type, Molinas, Pérez Liñán, and Saeigh (2004, 77) note that democratization in Paraguay—which began in 1989—also contributed to stalled reforms in the financial sector, particularly reforms of state-owned banks and those intended to strengthen
regulation of the financial sector. Especially important in this regard is that the democratization process did not give rise to a congressional majority for the ruling party but rather an evenly split lower legislative chamber and an opposition controlled upper chamber. Given this fractious legislative environment, the President continued to try to use its influence over key sectors and companies in the economy for the purpose of political patronage that might secure passage of key legislation (Sohn, 2005). Further, the 1995 financial crisis shifted political attention of all political parties away from structural reforms to short-term reactions to the crisis. Specifically, from 1995-1998, despite the efforts to liberalize the financial sector and eliminate credit controls, the government directed the state social security system to lend hundreds of millions of dollars to the financial sector to overcome a crisis-induced credit squeeze. The losses on these loans totaled $363 million as they were disproportionately made to weak financial institutions

The Peruvian reform efforts of 1983-1984 illustrate both how democracy can impede \textit{de facto} financial liberalization and a removal of the democratic constraint can, in some cases, accelerate implementation. Peru passed a set of \textit{de jure} reforms during an era of democratic governance in which Peru’s Polity score was 19 (on the scale from 1 to 21). These reforms were undermined by “fierce conflicts…concerning the extent and pace of the neoliberal reforms” (Pastor and Wise, 1992, 93) that pitted resurgent business interests against organized labor. Against the backdrop of a growing poverty-related insurgency, the government of Fernando Belaunde Torre began to lose critical elections at the local and regional level to the resurgent left who assumed control of the national government under the leadership of Alan Garcia Perez in 1985 (Pastor and Wise, 1992). Perez suspended or reversed the neoliberal reforms of his predecessor. Another cycle of \textit{de jure} reforms was launched by independent President Alberto Fujimori in 1990. Fujimori was initially able to push through reforms and, perhaps as a result,
resisted engaging the opposition clinging to the image of an independent outsider (Morón and Sanborn, 2006). The left responded by using their continued Parliamentary majority to resist both the growing militarization of what they perceived as social conflict and the neoliberal reforms (Torres, 2005). President Fujimori, in turn, responded by dismantling the democratic institutions of the legislature and the courts and the introduction of rule (and reform) by decree (Arce, 2003). Once Fujimori undermined democratic institutions (i.e., the Polity score fell from 19 to 8), however, de facto reforms followed quickly.

In Kenya, democratization and resentment of the IMF played a joint role in stalling the passage of the privatization bill undermining the 1998 reform effort. After a series of de jure reforms which were de facto implemented in 1991, 1994, 1995, 1996, and 1997 when the Polity score ranged from 3 to 5 on the 21-point scale, the 1999 de jure reforms that were passed shortly after the process of democratization began (when the Polity score was 9) and those that followed in 2004 (when the Polity score was 19) were less successful. Were, et al. (2005) highlight the negative role of the IMF and other external donors for whom the government would announce concessions under pressure and outside of the democratic process in exchange for the short-term disbursement of (suspended) funds. Parliamentary leaders and other stakeholders resented the lack of consultation and participation and would hold up implementation including but not limited to the privatization bill leading to suspension of aid and the cycle would begin again. The authors conclude their study of two decades of reform in Kenya with the normative recommendation that:

Future economic reforms need to consider the self-seeking interest groups; patron-client relations and political elites interested in pursuing personal welfare functions; and the timing of reform implementation in terms of political climate, macroeconomic environment and synergy with reforms in other sectors. … There is need for home-grown solutions to complement the standard reform prescriptions by IFIs in order to promote ownership and sustain development efforts. This implies that all stakeholders need to be
involved because they could be assertive enough to thwart or sustain the process, depending on the extent of their influence and power (Were, et al., 2005, 50).

The IMF also played an important independent role in numerous reform episodes. The precise mechanisms by which the IMF undermined reform implementation were, however, more varied. As in Thailand and Kenya, anti-IMF and anti-Western political sentiment undermined reform in Bolivia in 2001-2003. Bolivia was an early adopter of neoliberal financial reforms, which had succeeded in taming hyper-inflation in the mid-1900s. Those reforms expanded in scope to drastically curtail the role of the state via privatization. The IMF-sponsored transfer of partial ownership over natural resources to multinational corporations and the perceptions of the unfairness of the distribution of the revenue from these new owners were, however, powerful mobilizing factors behind a broad-based anti-government and anti-neoliberal coalition that came formed in 2000-2003 and culminated in the election of Evo Morales in 2005. Morales proceeded to nationalize previously privatized oil and gas reserves (Ellner, 2012), and implement interest rate ceilings, surplus profit taxes and implement mandatory-lending quotas with the ostensible aim of enhancing financial inclusion (Dwyer, 2014; Maimbo and Henriquez Gallegos, 2014).

In other cases, IMF lending is alleged to have been politically motivated (Stone, 2002; 2004) providing liquidity to allies of major powers irrespective of the implementation of their announced reforms. In our sample, the Jordanian loans issued between 1995-2000, the Mexican loans of 1991 and, most notably, the Russian case of 1997-1998 are each consistent with this argument. The most often cited case is the Russian reform program of 1997-1998 in which a series of *de jure* reforms were recorded without any associated *de facto* reform. In 1997 and 1998, specifically, policies related to credit controls and reserve requirements and securities policies were introduced as part of a program to receive a bailout from the IMF. Despite these
formal changes in policy, we do not observe a structural break in any of the macro-economic
time series we use to code *de facto* financial reforms.

Vasiliev (2000) argues that this disconnect was the result of several distinct policy
failures. First, the government proposed to change the bankruptcy law to restrict court discretion
to overrule creditors’ decisions to liquidate an enterprise; to accelerate the transfer of operational
control of bankrupt firms to external management; to facilitate the process of restructurings
outside of the courts; and to enhance the personal liability coverage for debtor enterprise
managers. Furthermore, antitrust guidelines and minority shareholder rights were to be
strengthened. The anti-reform Russian Duma who had twice rejected President Yeltsin’s
nomination of relative reformist Victor Chernomyrdin and was subsequently under the
leadership of compromise candidate Yevgeny Primakov, who was focused on managing a
communist and trade union inspired call for a national strike while simultaneously trying to build
his own coalition of support to challenge President Yeltsin failed to pass any of these laws. The
reform goals were subsequently abandoned by President Yeltsin who, seeking to ward off any
challenge to his leadership, dismissed Primakov and appointed relative unknown Prime Minister
Victor Putin who shifted the nation’s political attention to the prosecution of the Chechen war.
The IMF programs remained in place, however, due to the support of the G-7 (Odling-Smee,
2004) for a “Grand Bargain” in which funds would be provided from the West to Russia in
exchange for economic and political reform. Western powers were, however, unwilling to
directly provide funds and, instead, used their control over the IMF to channel politically
motivated funds thus undermining the conditionality terms of the IMF. The support of Yeltsin
against the anti-reformists in the Duma became a political mission (Rosefielde and Hedlund,
2009; Thacker, 1999). Similar arguments are made in the case of Jordan, by Harrigan, El-Said,
and Wang (2006), who note that continued IMF support was based more on US desire for an exemplar case of neoliberal and democratic reform in the Middle East than tangible progress. In Mexico, Teichman (2001) observes the political basis for continued IMF support even during pauses in economic reform.

Crisis play a negative role in the implementation phase of many reform episodes typically, as was the case in Thailand, by exposing governance weaknesses in the run-up of private credit that had followed privatization and liberalization of the financial sector. The resolution of the crisis typically involves a short-term intervention by the government to assume ownership of troubled banks and increase the supply of public credit to lenders. The canonical example of such a case is the Mexican tequila crisis of 1995 which followed the successful *de jure* and *de facto* reforms of 1988-1989. Hernández-Murillo (2007) details that, in addition to the privatization described earlier, Mexico would subsequently lift controls on interest rates, remove sectoral quotas on lending and allow for universal banking. During the period 1988-1994, private credit responded increasing 25% per year or a total of 277%. A lax regulatory environment and explicit government bailout guarantee, however, led non-performing loans, often to related companies with the same owners as the banks, to increase even faster from 4% to over 50% (Haber, 2005). The 1995 bailout focused on avoiding bank runs and a collapse of the financial system transferred five times as much debt from the private banks to the public sector as the government had received during the earlier privatization. It also increased the share of public credit and offered interest rate subsidies and payment discounts to private lenders.

Jácome (2004, 12) maintains that the “Ecuador’s late 1990s banking crisis had much the same roots as similar episodes of systemic banking crises in other countries. It was the result of a ‘boom and bust’ cycle that took place in the context of financial liberalization, coupled with lax
financial surveillance and bad banking practices.” Liberalization begun earlier in the decade succeeded in promoting entry but failed in regulation of entrants, the provision for bankruptcy proceedings of financial institutions and, in particular, in limiting moral hazard. Credit growth surged in the 1990s but came to a grinding halt in 1998 due to the aftermath of El Nino floods, a re-assessment of the emerging market risks after the Russian and Brazilian crises and a collapse in the price of oil. The failure of a small bank in April 1998 triggered a bank run which gained momentum when a medium-sized bank was closed in August and accelerated further after the September collapse of nation’s largest bank CBE. As panic spread across the system, banking deposits plummeted and the exchange rate depreciation triggered a resurgence of inflation.

Similar arguments regarding flawed financial liberalization being halted or reversed due to crisis are made with respect to the 2001 crises in Turkey (Ekinci and Ertürk, 2007; Özatay and Sak, 2002). After the initiation of a de jure reform program to tackle high inflation (25%) and growing public sector debt in early 2000, inflation initially fell but the program was buffeted by a crisis in November 2000 and abandoned three months later. Authors differ on the drivers of the crisis but consistently point to weaknesses in the liberalized financial sector and its ability or incentives to appropriately manage risk. In the aftermath of the crisis, the state assumed the debts of numerous failed banks in the Savings Deposits Insurance Fund and permitted a rapid depreciation which triggered a return of inflation. Policymakers lost the credibility that they had built up in 2000 and several months of economic turmoil and recession followed.

An interesting observation that emerges from these case studies that lies outside the scope of our econometric analysis. Implementation failure, in hindsight, is not always perceived negatively. Many of the countries that moved slowly avoided severe financial crises caused by rapid liberalization in the absence of appropriate financial supervision. Other countries initially
liberalized rapidly, but then triggered or suffered from financial crises that undermined subsequent implementation. Still others failed to realize substantial progress in implementation over narrow reform windows, but proceeded slowly and incrementally over a longer period of time and thereby enjoyed substantial progress in liberalization. Incremental reforms that allow for adequate development of supervision and needed skills may ultimately generate more sustainable financial liberalization. One implication of this finding is the need to resist jumping to normative conclusions regarding the benefits of autocracy for financial liberalization. The country-level analysis supports our finding that democratic regimes are less likely to liberalize rapidly, but are ambiguous on whether these countries ultimately arrive at a more or less neoliberal or statist outcome. A consistent policy recommendation would be to recognize and plan for a more cumbersome implementation process in more democratic or democratizing regimes and avoid excessive reliance on foreign pressure.

Conclusions

Over the past three decades, numerous countries have engaged in financial reform, prompting widespread interest among social scientists in the sources of this development. The voluminous empirical literature that has been produced as a result has focused almost exclusively on *de jure* policy change. Such change is undoubtedly important and these studies have contributed to an improved understanding of the political economy of financial reform. Nonetheless, it is widely recognized that many *de jure* policy changes are never fully implemented, either because interests within society or the government block implementation or because the government is incapable of implementation.
In this paper, we have conducted one of the first studies of both *de facto* and *de jure* financial reforms. When these reforms are treated as a single group, we find that liberalization tends to occur in poor countries, states with large financial sectors, countries that participate in the IMF’s PRGF, and states that have more closed financial systems. These results reflect the fact that richer and more financially open countries have less room to further reform their financial regimes than poorer and less open states. Further, the financial sector frequently opposes liberalization, which exposes it to heightened competition. As its size increases, so does its political influences and hence its ability to thwart reform. Equally, the IMF often insists that countries make financial reforms as a condition for assistance. Consistent with various studies, we also find that right-wing governments are more likely to liberalize than centrist governments although we find no difference between right-wing and left-wing regimes. In contrast to much of the empirical literature, we find no evidence that crises, the business cycle, regime type, or IMF programs other than the PRGF influence financial reform, perhaps because unlike most previous research, our estimation strategy was based on using fixed effects to account for unobserved heterogeneity across countries and over time.

Moreover, we find that the political economy of *de jure* reforms that are not implemented differs substantially from the political economy of *de facto* reforms. The implementation of *de jure* reforms is hindered by economic crises, democracy, a large financial sector, and participation in the IMF’s PRGF. There is also some evidence that implementation is stimulated by economic recessions, although this effect is not robust.

As we explained earlier, the financial sector may oppose both the enactment and the implementation of financial reform since it subjects this sector to greater competition. As the financial sector’s size increases, so does the pressure that it can bring to bear on government
officials who are charged with such implementation. Equally, while potent interest groups exist in all types of regimes, democracies are more institutionally porous than non-democracies, which allows interest groups more access to the officials who are implementing policy. Implementation also seems to stall in democracies because of a more uniform distribution of power among the branches of government, which may have different interests with respect to financial policy.

With respect to the IMF, the PRGF is intended to assist low-income countries with long-term balance of payments problems. Such countries probably have these problems because they have been unwilling or unable to implement economic reform. It is also important to point out that our results are not simply an outgrowth of economic development (or the lack thereof) since our model is identified based on within country variation and we have accounted for changes over time in a country’s per capita GDP. Finally, domestic economic crises undermine the implementation of financial reform by limiting the government’s capacity to implement policy change.

Consistent with prior research, our findings indicate that international financial institutions and domestic interests, institutions, and economic conditions influence financial reform. Unlike prior research, however, our results reveal that these factors have very different effects on changes in financial policy and the implementation of that policy, an issue that warrants greater attention in future studies.
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Note: N = 1850
Table 2: Determinants of *de Jure* and *de Facto* Financial Liberalization

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Note: Columns 1, 3, and 4 include country fixed effects and year fixed effects, Column 2 presents conditional logit results with year fixed effects, and the standard errors in Columns 5 and 6 are clustered by country. For Model (5) and (6), the coefficient estimates are for variables measured as deviations from country-means. Standard errors are in parentheses. Statistical significance is indicated as follows: *** p ≤ .01, **p ≤ .05, * p ≤ .10. All tests of significance are two-tailed.
Figure 1. Annual Count of *de Jure* and *de Facto* Financial Liberalizations.
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