The Political Economy of Simultaneous Transitions: An Empirical Test of Two Models

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Traditional political economy emphasizes the difficulty of conducting simultaneous transitions toward market economy and democratic government. There are two major theories that seek to explain why some reform programs are never fully implemented or are reversed shortly after their inception. The J-Curve model (JCM) (Przeworski 1993) implicates the short-term losers from reform as the major opposition, and the Partial Reform Equilibrium model (PREM) (Hellman 1998) implicates the winners. I subject the models to empirical analysis with data from 25 post-communist countries and find that the data do not support the contention of the JCM. High unemployment rates do not threaten the survival of reform programs, and government instability does not necessarily translate into bad economic policies. These results suggest that the common concern that socially costly economic reforms endanger the consolidation of democratic norms may be misplaced.

During periods of strained economic circumstances, voters who are most hurt by their government's policies will punish elected officials by removing them from office and replacing them with ones more likely to enact policies sympathetic to the voters' plight. Because the benefits of economic reforms are dispersed while the costs are concentrated, disadvantaged voters are likely to be effective in undermining economic reform efforts by destabilizing their government under democratic regimes.

The alternative view holds that economic reforms generate a pattern of concentrated benefits and diffuse costs, which enables the groups most favored by the reform to capture the government and freeze the reform programs in a state most beneficial to them.

Despite many case-studies and statistical analyses of related questions, there has been no attempt to construct a statistical test that will examine the hypotheses generated by the two different models directly. This article bridges this gap and addresses several questions: Are the losers from economic reforms threatening to the progress of these reforms? Does their influence vary across countries? What are the policy implications that we can derive from the results? Can a democracy sustain socially costly economic reforms?

The results from the statistical analysis of 25 former communist countries are strong, internally consistent, and startling: democracies do universally better than nondemocracies when unemployment is low; when unemployment is high, democracies do as well as nondemocracies in short-term reforms, but consistently outperform nondemocracies in long-term reforms. Government stability has no impact on the performance of democracies, but has a weak beneficial impact on the performance of nondemocracies. As a whole, the results provide strong support for the view that losers from reform do not endanger the success of reforms, and that it is possible (and probably necessary) to create democratic institutions for these reforms to succeed.

These results have special relevance in theorizing about simultaneous political and economic transitions in former communist countries. Traditionally, it is assumed that building and maintaining a stable democratic regime require an advanced capitalist society. The problem in former communist states is especially acute because their governments are conducting a transition from command to market economy while building democratic norms and institutions at the same time. Depending on which of the two theoretical views about the pattern of gains and losses is correct, one would prescribe diametrically opposed policies. In the first case, one would seek to isolate the government from the pressure of reform losers to enable it to conduct economic policies that hurt a substantial segment of voters. In the other case, one would attempt to open the government to voter pressure and minimize the influence of reform winners.

MODELS OF SIMULTANEOUS TRANSITIONS

Whatever the long-term implications for sustainable economic growth and high living standards, the immediate effect of reforms is unemployment, rampant inflation (Marer and Zecchini 1991), resource misallocation[1] (Roland 1994), volatility in income distribution (Milanovic 1995), declining output (Kolodko 1999), and a faltering social safety net (DeMelo, Denizer, and Gelb 1996). This is the starting point for both models, which then diverge in their claims about who is the most important agent of opposition to transition. The JCM approach identifies the net losers as the culprit,

NOTE: I thank Curt Signorino, Renée Smith, David L. Weimer, and Robert Walker for their comments. I am especially grateful to Randy Stone for many discussions and for providing me with his data. A previous version of this article was presented at the 2000 annual meeting of the Midwest Political Science Association.

Political Research Quarterly, Vol. 58, No. 2 (June 2005): pp. 279-294

[1] These are due to the absence of properly defined property rights (Weimer 1997), continued presence of inefficient firms and monopolies, and insufficiently developed human capital, all of which distort the response to market incentives (Hellman 1998).

while the PREM analysis concludes that it is the net winners who are most averse to continuing with the reform.

The J-Curve Model

Przeworski (1993) describes the reform process as a JCM with regard to distributional costs and benefits. In the short run, the transition generates substantial social costs in terms of high unemployment, rising prices, inflation, and low productivity as the economy adjusts to the market (Marer and Zecchini 1991). During this period, the government faces severe pressure from groups negatively affected by the transition because it can only offer promises for future gains in exchange for political support and economic hardship today. Anti-inflationary macroeconomic stabilization policies that the government can undertake are further eroded by the lack of credibility caused by the short time horizons that elected officials have and by further price increases caused by inflationary expectations that get built into new contracts. Stern fiscal measures that usually include curtailment of benefits and social services by the government, privatization with the entailing layoffs, interest rate hikes to prevent the exit of capital, and price liberalization, make a sizeable fraction of the population disaffected by the reform (Mygind 1999). Under democratic rule, this group may have enough influence to stem the process and even nullify some of the changes.

Why would people oppose a reform whose outcome is a better living standard for some of them and a situation at least as good (as the pre-reform status quo) for the rest? This apparent paradox arises from the time inconsistency problem (Kydland and Prescott 1977, Mankiw 1988). Actors must accept losses in exchange for promises of future gain. Because the government is unable to make credible commitments to maintain the reform until it delivers the promised gains, and to refrain from confiscating the gains once actors realize them, it is rational to reject reforms even before they are initiated.

The erratic nature of policymaking is further exacerbated under less stable governments. As the security of their tenure in office becomes less and less certain, incumbents are tempted to dole out benefits to many different groups in their constituency to win their support. Short time horizons make bribing voters an attractive option for rational policymakers, leading them to sacrifice the rigidity of the necessary reform programs to win the support of decisive societal actors. Governments that are more isolated from distributive pressure provide for greater security of office for the incumbents, and thus enable them to implement the requisite policies.

Low inflation, free trade, and a stable currency are nonexcludable public goods. Even though the society as a whole (or a very large group) stands to reap the benefits, perverse incentives on the individual level make it impossible to sustain cooperative behavior. For example, curbing high inflation requires workers to accept deindexation of their wages. Their efforts to protect their income, however, put them in opposition to such policies. The temptation to free-ride destroys the norms of cooperative behavior necessary to sustain the reform. Interest groups have incentives to pursue private goods rather than public goods, which results in distributive demands on the government. Because costs of reform are concentrated upon groups favored by the status quo and the benefits are dispersed, net losers have selective incentives to engage in collective action to block the policies that harm them.

The Partial Reform Equilibrium Model

Hellman (1998) introduced the partial reform equilibrium model. He argues that instead of looking at the population as the (temporary) loser that may attempt to reverse or halt reform, we should concentrate our attention on the people who stand to win from the partially implemented measures. These are managers of state owned enterprises, commercial bankers, local government officials, and organized crime. These are the ones who will hinder the continuation of the transition because they are a smaller group, are better able to organize, and are in position to influence politicians. Because the JCM analysis claims that the net loser is the population at large, Olson's theory of collective action applies: it will be hard to mobilize such a group for coherent political action. It is possible, however, that the public will punish elected officials by voting them out of office. The net winners, on the other hand, have both the resources and incentive to organize and push through policies that will dampen the reform effort.

In the initial stages of reform, the benefits are concentrated and the costs are diffuse. The primary political challenge to reform comes from the net winners in the overall process (Hellman 1998). As many informal analyses of post-communist transitions have shown, certain economic policies meet with serious obstacles generated by segments in society that can hardly be characterized as losers. These include managers of state enterprises, commercial bankers, officials in the state bureaucracy, and organized crime. The early winners oppose hardening of budget constraints, and the enforcement of property rights laws, as well as rules dealing with market competition and exchange-rate stabilization (Handleman 1998). The winners have incentives to block any measure that would eliminate the distortions conducive to their operations.

Because partial economic reforms enable those winners to affect directly (holding office) or indirectly (bribes) policymaking during the transition, we should see evidence of stalled reform efforts in countries where their influence is more pronounced. Indeed, a cursory evaluation reveals that states with "bandit capitalism" have done poorly compared to the ones that were better able to limit the pressure of the net winners (Hellman 1998; McKinnon 1991).

HYPOTHESES ON PROGRESS OF REFORMS

Both models make claims about the way in which government accountability to the median voter is important.

In the JCM, governments that are more susceptible to reaction from the losers are less likely to adopt radical comprehensive reforms (ex ante opposition), and are more likely to suffer reversals of reform (ex post reaction). As argued in the previous section, these losers constitute a significant portion of the population as a whole. Therefore, a government that is responsive to the median voter is less likely to reform, while a government that is less accountable to the median voter is more likely to reform. The PREM suggests otherwise—greater participation of losers makes it easier to constrain the winners and therefore sustain reform. Also, as stated earlier, the winners are a small identifiable sector of society, and governments that are more accountable to the median voter are less likely to be captured by those interests. Therefore, a government that is responsive to the median voter is more likely to reform, while a government that is less accountable to the median voter is less likely to reform. Thus, government accessibility, or its accountability to the median voter, can be used to derive the following hypotheses, which form a critical test of the theories:

H_1: *Governments that are not responsive to the median voter initiate and sustain comprehensive reforms under JCM. Responsive governments are associated with low levels of reform.*

H_2: *Government that are responsive to the median voter initiate and sustain comprehensive programs under PREM. Unresponsive governments are associated with low levels of reform.*

The JCM claims that stable governments are able to initiate wider reforms and sustain them against pressure from the opposition. Governments are stable to the extent of their independence from the pull of distributive politics (Haggard and Kaufman 1992). On the other hand, the PREM suggests that secure governments are a consequence of entrenchment of the interests of winners and solidification of their influence. Because of the incentives these winners face, such governments will be averse to implementing and consolidating serious reforms. This model claims that the less stable the government, the more likely are reforms to stick.[2]

It is important to emphasize that the effect of government stability is mediated through the polity type. Governments in a democratic regime with competitive elections survive while they are able to build and maintain the necessary parliamentary majorities. Stability is a reflection of how much popular support these governments enjoy. In an authoritarian regime governments survive while they are able to satisfy the interests of a much smaller constituency of influential people. Stability is a reflection of how well these governments use their arbitration powers for preferential treatment of these interests.

Thus, we have the following set of hypotheses, which form another critical test of the two theories[3]:

H_3: *Stable governments initiate and sustain comprehensive programs under JCM. Transient administrations are associated with low levels of reform.*

H_4: *Transient administrations initiate and sustain comprehensive and successful programs under PREM. Stable governments are associated with low levels of reform.*

The effectiveness of opposition depends on its size and the resources it can deploy to forward its preferences. Higher levels of unemployment (especially when compounded with a deteriorating social safety net) inflate the size of the constituency that demands revision of the policies that resulted in their loss of jobs. The PREM model does not make any predictions about the effect of unemployment itself.

H_5: *Higher levels of unemployment increase the probability that reforms will suffer reversal under JCM.*

Before testing these hypotheses, it is necessary to discuss several important aspects of data coding. The following sections also provide the theoretical justification for inclusion of particular control variables.

MEASUREMENT AND RESEARCH DESIGN

Measuring Progress of Reforms

It is very difficult to measure the progress and success of reforms in a way that is comparable across countries and time.[4] Since there are no direct measures that can track all countries and all periods, I rely on two proxy indicator variables: inflation management and economic growth.

Inflation Rate (CPI). Stone (2002) shows that bringing inflation under control is crucial for the success of transition. It is inevitable that inflation levels will rise at the beginning of the economic transition. However, the success of reform is predicated upon the government's ability to keep inflation down. Persistent high inflation is a symptom of deeper problems because it results from government

[2] For example, Yegor Gaidar called his government "kamikaze" precisely because he was aware that the sweeping reforms he intended to implement were bound to provoke the reaction of entrenched interests, which were powerful enough to bring the downfall of the administration. This is exactly what happened.

[3] There may exist an endogeneity problem here. Even if the hypothesized relationships hold, we may be observing the reverse direction of causality. For example, it may be the case that we are simply finding that high levels of reform cause governments to fall, as opposed to transient administrations conducting more reforms. This issue is resolved in the section entitled Analysis and Discussion which finds that government stability is very weakly associated with reform levels.

[4] In a related paper I explore the hypotheses using the European Bank for Reconstruction and Development measures of transition. These tests support the conclusions in this paper but because data is not available for the entire period, I do not include the results here.

policies that have deleterious consequences (Berg 1994), and hence it is an indicator of failure of reforms. Conversely, low inflation is an indicator of government's commitment to reform because it reduces uncertainty about the rate of return and risk, which is an important signal to foreign investors (Maxfield 1997; Sobel 1997). CPI is the annual average percent change in the Consumer Price Index. The series are from International Financial Statistics (IFS), supplemented with data from World Development Indicators (WDI) and European Bank for Reconstruction and Development (EBRD). I use the natural log of the inflation rate.

Economic Growth (GDPDIFF). The ultimate goal of reforms is sustainable economic growth. For the purposes of assessing new production occurring within the borders of the countries, gross domestic product (GDP) is the appropriate measure. It is necessary to make two adjustments to nominal GDP (that is, the value of output at current market prices). First, changes in nominal GDP will be a combination of changes in prices and physical output. Since I am interested in the latter, I use real GDP, which is the value of current output in baseline year prices (here, the year is 1995). Using real GDP makes it possible to determine growth in one country over time. Second, real GDP was adjusted for population size and expressed in terms of U.S. dollars per capita. Using this average income makes the measure of growth comparable across countries.

GDPDIFF is the percent difference between current real GDP per capita and the real GDP per capita of a representative pre-transition year (1987). The series are from WDI, supplemented with data from EBRD.

Measuring the Explanatory Variables

Measuring the influence of winners in a systematic way is extremely difficult, if not impossible. First and foremost, this is so because the winners influence policy through indirect informal pressure or personal contact. Second, locally powerful elites can thwart decisions of the center through illegal means or by exploiting loopholes in existing legislation. These methods can be uncovered by careful case studies but there is no way to quantify them.[5]

Accountability to the Median Voter (AUTH). The index of freedom ranks countries according to their scores in two categories: political rights and civil liberties (Freedom House 1998). This ranking is especially appropriate because it takes into account fairness of elections, the freedom of independent media, and the financial viability of interest groups and NGOs, among other things. Democracies are less likely to permit the winners to consolidate their hold of policy because of transparency associated with free and fair elections, media independence, and constraints on the executive. At the same time democracies are more likely to allow the losers to organize and influence policy because of their ability to punish elected officials, and create viable interest groups and NGOs without fear of government reprisals. The extent of democratization of a particular regime is a reliable indicator of how responsive the executive is to the median voter. AUTH is the sum of political rights and civil liberties scores, with higher numbers representing fewer rights and liberties.[6]

Tenure of the Executive (TENURE). I measure government stability with the duration of executive's tenure. I use the Hellman-Tucker Executive Powers index updated to 1999 by Stone (2002) to determine whether the President or the Prime Minister is the more influential executive. Table 3 reproduces the index and attending classification of the countries along with the average tenure scores. Tenure is the number of months the current executive has been in existence at the end of the year.

Unemployment Rate ($UNEMP_{t-1}$). The rate of unemployment is the fraction of the economically active population that is excluded from gainful employment. To account for the lag in effects, for each year in the series, $UNEMP_{t-1}$ holds the unemployment rate for the preceding year. Data is from WDI, supplemented with data from IFS, EBRD, and national sources.

Initial State of the Economy (GDP87). Initial conditions can play a role in the transitional process (DeMelo, Denizer, Gelb, and Tenev 1997). This variable accounts for structural differences in the levels of social and economic development and is the real per capita GDP in 1987; data from WDI.

Governing Coalition Fragmentation (GOVFRAG). The fragmentation of governments and legislatures influences macroeconomic policy (Haggard and Kaufman 1995). Fragmented governments are unlikely to agree on policy choices either because increasing the number of veto players makes it more difficult to move from the status quo (Tsebelis 1995) or because players try to shift the cost of stabilization between one another (Alesina and Drazen 1991). This variable is the average annual number of parties in the governing coalition; data from Stone (2002).

Left-Right Partisanship (IDEOLOGY). The position that governments occupy along a left-right dimension has significant effects on economic policies (Kitschelt et al. 1999). The extent to which officials can implement their preferences is moderated by the parliamentary support the government commands, which is measured by the percentage of seats controlled by the largest party in the government. The ideology score developed by Stone (2002) is measured on a left-right scale from –10 (extreme left on economic issues) to 10 (extreme right). IDEOLOGY is the left-right

[5] See Stone (2002: 172) for a revealing description of a Russian case in 1996. For the effects of economic reforms and attending inequality on expansion of presidential powers, see Frye (2001). For a recent overview of state capture and corruption, see Hellman, Jones and Kaufmann (2000).

[6] The substantive results do not change if the POLITY IV (Marshall and Jaggers 2002) democracy and autocracy scores are used. The statistical significance on some control variables changes slightly. The results of these robustness checks are in the replication package available from the author's website at http://polisci.ucsd.edu/slantchev/pubs/.

score of the largest party in government times the percentage of seats it controls.[7]

Influence of the European Union (EUTRADE). The accession of Central and Eastern European (CEE) countries to the European Union (EU) heavily influences economic and social policies governments implement during the transition. These policies in turn affect both reforms and the prospects for long-term economic growth (Pinder 1994, Barbone and Zalduendo 1996, Kaminski 1999). Data for the Czech and Slovak Republics, Latvia, and Romania have been adjusted with the FOB/CIF conversion factor recommended by the International Monetary Fund (IMF); data from Directions of Trade Statistics (DOTS).

International or Civil War (WAR). Some countries have been involved in interstate and/or civil wars at various times during the transition (e.g. Armenia 1992-94, Azerbaijan 1992-94, Georgia 1992-94, Russia 1994-96, 1999, and Tajikistan 1992-98 among others). There is a total of 28 country-years with some form of violence. Data from author's calculations and Stone (2002), cross-checked with the PRIO/Uppsala Armed Conflicts Database.

Foreign Direct Investment (FDI). The amount of foreign resources coming into the country reflects the uncertainty associated with such investment (Bond, Chiu and Estache 1995). Economic aid can either help governments in pursuing reforms by offsetting some of the short-term costs (Williamson 1994) or can encourage governments to stall reforms by making the status quo less painful (Rodrik 1996). FDI is the per capita foreign direct investment in US dollars; data from WDI and EBRD.

Interaction Effects. Some models include the interaction terms TENAUT and UNEMPAUT to test whether stability and unemployment have effects that vary with the level of democracy.

Research Design

The data analysis uses a Time-Series Cross-Section (TSCS) data set consisting of twenty-five countries for the years 1989-99 for CEE countries, and 1992-99 for Former Soviet Union (FSU) states, or $N = 210$. TSCS data analysis allows for valid generalizations concerning the representative sample of countries across time, but raises statistical problems that standard OLS cannot handle.

It is reasonable to suppose that the variances in the 25 time-series are quite different because macroeconomic and political factors affect the countries in varying degrees (Greene 2000: 594-99). In addition, it is reasonable to suppose that external shocks affect all countries in the sample, which implies that the error terms should be correlated across panels. A Lagrange Multiplier test rejects the null hypothesis of cross-sectional independence (Greene 2000: 601). The model therefore assumes that the disturbances are groupwise heteroskedastic and contemporaneously correlated across panels. The estimation method for the continuous dependent variables is OLS with Panel-Corrected Standard Errors (OLS-PCSE) (Beck and Katz 1995).

We would expect some form of an autoregressive process to affect the dependent variables. One reason to think that this process might be country-specific is the institutional legacy of the old communist regime (Kitschelt et al. 1999; Elster, Offe, and Preuss 1998). However, Beck and Katz (1996) argue against unit-specific serial correlation and propose that it is better to assume a common AR(1) process or use a lagged dependent variable instead. To properly account for effects of previous performance, the estimations use the lagged dependent variable method. I present major findings with Monte Carlo simulations that account for estimation and fundamental uncertainty (King, Tomz, and Wittenberg 2000).

The presence of multiplicative terms in some of the statistical models also requires attention. It is very common for the main variables to lose statistical significance when the variable also appears in an interaction term. This is not due to multicollinearity, as usually asserted, but is rather the result of the conditionality of estimates. The coefficient of the multiplicative term is the change in the slope of the dependent variable on the principal explanatory variable conditional on a one-unit change in the other principal variable in the interaction term. The effect must be calculated for particular values of the second variable (Friedrich 1982: 326).

ANALYSIS AND DISCUSSION

Tables 4 and 5 in the appendix show the effects of the explanatory variables on inflation rate management (a short time-horizon reform) and on real economic growth (long time-horizon reform). The running example for all statistical simulations uses a hypothetical country where pre-transition development, trade with EU, and foreign investment are at their medians, there is no war, and all other variables are at their means.

WAR retains statistical significance in seven models and has a very strong negative effect on the government's ability to pursue economic reforms.

GDP87 is not statistically significant in any of the four models of inflation. While pre-transition income is not very important for government's ability to handle short-term reforms, it has a strong and positive effect on the prospects for long-term growth, consistent with arguments advanced by Stark and Bruszt (1998).

GOVFRAG is not statistically significant in any of the models of economic growth, but it is highly significant in all four models of inflation. The expected inflation rate is 88

[7] The scale is based on "perceived or announced policy preferences of the governments before taking office." Since the rules of forming coalitions differ across countries and because the ideological position is idiosyncratic, this measure should be treated with great caution. However, recent studies have found that the percentage of seats held by Communists are important in determining the success of reform (Åslund, Boone, and Johnson 1996, Hellman 1996, Fish 1998). Because there are strong reasons to believe that such a variable is significant, dropping it completely would lead to specification error.

TABLE 1
ANALYSIS OF INTERACTION EFFECTS

Variable	AUTH = 3	AUTH = 8	AUTH = 14
Inflation Rate			
Model 3			
TENURE	–.0185**	–.0238***	–.0303***
	(.0067)	(.0051)	(.0068)
$UNEMP_{t-1}$	–.0284	–.0368*	–.0469
	(.0212)	(.0157)	(.0460)
Model 4			
TENURE	–.0103	–.0185***	–.0284***
	(.0067)	(.0045)	(.0065)
$UNEMP_{t-1}$	–.0188	–.0680***	–.1270*
	(.0224)	(.0182)	(.0519)
Economic Growth			
Model 3			
TENURE	.0821*	.1040***	.1302***
	(.0323)	(.0213)	(.0267)
$UNEMP_{t-1}$	.5949***	.3097***	–.0327
	(.1585)	(.0825)	(.2426)
Model 4			
TENURE	.0661	.0935***	.1264***
	(.0348)	(.0205)	(.0261)
$UNEMP_{t-1}$	.4982***	.3343***	.1376
	(.1518)	(.0818)	(.2484)

Coefficients and standard errors computed for three values of AUTH.
***$p < .001$; **$p < .01$; *$p < .05$

percent for a one-party government, and 42 percent for a four-party coalition. Party fragmentation does not appear to endanger reforms, which directly contradicts the JCM because the inherent need to strike bargains with coalition partners does not lead to compromise with reforms. Fragmentation may make it harder to arrange deals under the table to satisfy particularistic interests, as the PREM predicts.

IDEOLOGY is statistically significant in all four models of economic growth, but in no model of inflation. Left-wing governments are associated with higher economic growth than right-wing governments. However, in many countries, right-wing democratic governments presided over the initial most painful reforms, and saw the largest declines in output. Their left-wing successors came to direct the recovery, which may not have been forthcoming without the initial decline.

EUTRADE is borderline significant in the two models of inflation where it appears, and is not statistically significant in any of the models of economic growth. I conjecture that the EU affects the transition through its insistence on institutionalizing democracy, in which case AUTH picks up the effect.

FDI is statistically significant in all models except the most restricted model of economic growth. It has a strong positive effect on reforms, which supports the arguments in Williamson (1994), and Bond, Chiu, and Estache (1995).

All three principal variables are statistically significant in all eight models. See Appendix, and note that the standard errors reported in the third and fourth columns of Tables 4 and 5 should be interpreted as conditionals because of the presence of interaction terms. I computed the coefficients of TENURE and $UNEMP_{t-1}$ for several different values of AUTH with results reported in Table 1.

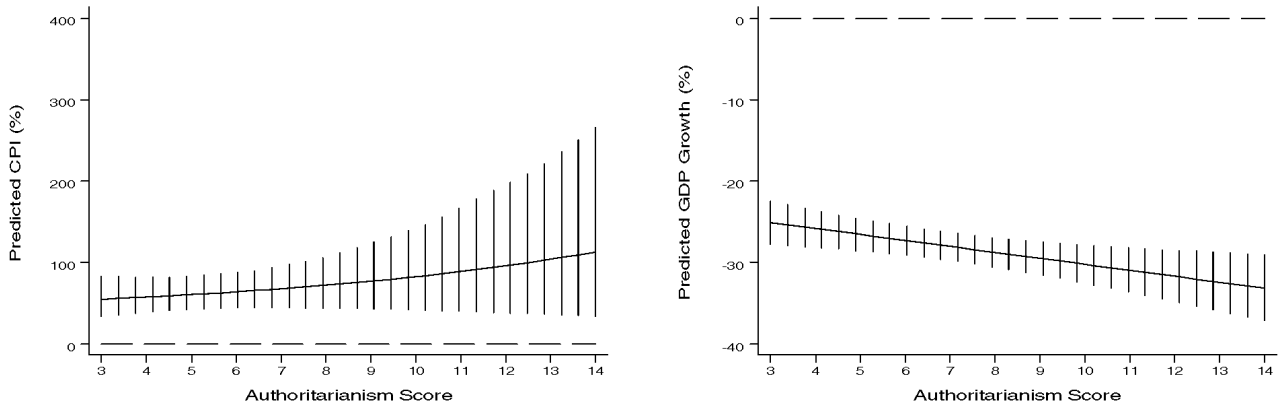
It is evident from this table that both variables retain statistical significance when evaluated conditional on AUTH being different from 0.[8] The following discussion utilizes the estimates from the richest model (Model 4).

Accountability to the Median Voter

AUTH is highly statistically significant in seven of the eight models. It retains the significance in the presence of interaction terms in all cases except one. In order to examine the behavior of AUTH, I performed Monte Carlo simulations for polities over the entire observable range in the

[8] It is worth noting that the lowest possible value AUTH can take is 2 (3 in this data set), which means that the result reported by standard regression is conditional on an impossible value.

FIGURE 1
PREDICTED INFLATION LEVEL AND GDP GROWTH BY POLITY TYPE



Vertical lines indicate 95% confidence intervals, the horizontal lines represent expected values.

data set and computed 95 percent confidence intervals for the predicted inflation levels and GDP growth. Figure 1 demonstrates what happens to the dependent variables when the polity type goes from democratic (3) to authoritarian (14). In both cases, I set the pre-transition income level, trade with the European Union, and foreign investment to their median values, party fragmentation and ideology to their means,WAR to 0, government tenure to 24 months, and unemployment to 10 percent.

The two panels in the figure show that more democratic polities unquestionably do better than authoritarian polities in both types of reforms. The expected inflation for the hypothetical country is around 55 percent if it is a democracy and over 110 percent if it is authoritarian. Notice, however, that while the prediction is relatively tight for more democratic regimes, the confidence intervals widen considerably once the authoritarianism score reaches 9 (Georgia). The performance of authoritarian polities varies from doing as good as democracies to doing far worse (the upper bound on the intervals is in excess of 200 percent). Although authoritarian countries can exhibit inflation levels comparable to democracies, they are almost certain to suffer bouts of hyperinflation over 100 percent, something that is not likely to happen to democracies. Thus, although it is possible that authoritarian regimes manage inflation well, success in their performance appears to be more sporadic, and the probability of really excessive inflation is very high.

The results from the model of economic growth are unequivocal. Although all polities are expected to decline in terms of real GDP, democracies do not decline nearly as dramatically as authoritarian regimes. The 95 percent confidence intervals are very tight regardless of polity type because of little estimation uncertainty. An established democracy is predicted to decline by less than 24 percent, while the corresponding prediction for an authoritarian regime is around 32 percent. Even the most optimistic prediction at the upper bound of the confidence interval for an authoritarian country is worse than the most pessimistic prediction at the lower bound of the confidence interval for a democracy.

These findings support the PREM with respect to the first set of hypotheses: *democracies adopt more comprehensive reform programs and are more successful in the consolidation of these programs*. Extensive reforms do not appear to endanger the consolidation of democratic norms and governance. Although non-democracies may be able to manage inflation just as well as democracies, they are more likely to suffer hyperinflation. Democracies also enjoy far better prospects for long-term economic development.

Unemployment Rate

Unemployment is highly statistically significant in all models, and in the models of economic growth, it retains its significance in the presence of interaction terms. Theoretically, we would expect that the degree to which the disadvantaged are able to press their claims is moderated by the extent to which they can mobilize in coalitions seeking policy change and the extent to which the government is susceptible to such pressures. More democratic governments are more likely to react to demands from the unemployed than authoritarian ones. In addition, more open polities make it easier for interest groups to organize in support of their claims.

The analysis of interaction effects in Table 1 shows that unemployment indeed affects democracies and non-democracies differently, and the effect also varies by reform type. With respect to management of inflation, unemployment has no statistically discernible impact on democratic polities, but strongly affects mid-range countries, like Russia, Ukraine, Moldova, and Romania. The effect is again muted for authoritarian polities. With respect to economic growth, unemployment has a very strong influence on democratic to mid-range polities but does not seem to affect non-democracies

TABLE 2
ANALYSIS OF THE EFFECT OF UNEMPLOYMENT

Variable	AUTH = 3	AUTH = 8	AUTH = 14
Inflation Rate			
4 percent	57.40 (37.86, 84.64)	97.63 (65.97, 136.25)	192.00 (92.65, 345.73)
20 percent	44.15 (21.87, 84.04)	34.98 (16.31, 68.16)	39.07 (3.33, 166.75)
Economic Growth			
4 percent	–27.75 (–30.45, –25.11)	–30.19 (–31.87, –28.36)	–33.12 (–36.13, –30.35)
20 percent	–19.78 (–24.40, –14.98)	–24.83 (–27.58, –22.19)	–30.89 (–39.50, –22.22)

95 percent confidence intervals in parentheses below the expected values.

much. Thus, it is necessary to analyze the effect of unemployment carefully, keeping this conditionality in mind.

To examine the effect of different levels of unemployment, I conducted a fitted values analysis, where all control variables were set as in the running example, and tenure was set to the median of 30 months. The results are reported in Table 2.

The table presents three sets of predictions for each of the two dependent variables. The level of democracy varies from high (AUTH = 3) to mid-range, to low (AUTH = 14). I computed expected values and 95 percent confidence intervals for the predictions.

As expected, unemployment influences different governments to varying degrees. However, its impact is the same regardless of polity type: Higher levels of unemployment are associated with lower inflation rates and higher economic growth. Consider economic growth first. A democratic country with 4 percent unemployment is expected to decline by 28 percent, but only 20 percent if the unemployment is 20 percent. Although the improvement for authoritarian regimes is not quite as dramatic, it is nevertheless sizeable: from 33 percent in the first case, to 31 percent in the second. Thus, democracies are more sensitive to unemployment, which is hardly surprising, but high levels of unemployment are not associated with lower growth.

The situation with inflation is very similar. A democratic regime is expected to have an inflation rate of 57 percent with 4 percent unemployment, and 44 percent with 20 percent unemployment. The reduction of expected inflation for authoritarian regimes is quite big: from 192 percent in the first case to 39 percent in the second. It is worth noting that even though democracies always do significantly better than authoritarian regimes when the unemployment is low, they may not necessarily do so if the unemployment is high. Thus, democracies are more sensitive to unemployment with respect to inflation as well. Still, authoritarian regimes are very likely to experience hyperinflation, as about half of the confidence interval is larger than the upper bound of the interval for a democracy (which is bounded away from hyperinflation). In addition, note that, as Table 1 shows, the impact of unemployment is not statistically significant for democracies.

These findings are quite strong and fail to support the predictions of the JCM with respect to H_5. Although unemployment affects democracies differently than authoritarian regimes, rising levels of unemployment are associated with better management of inflation, and higher rates of economic growth. Democracies have better prospects for long-term growth than authoritarian polities regardless of the levels of unemployment. Although non-democracies may do as well as democracies in reducing inflation under high unemployment, they are still more likely to experience hyperinflation.

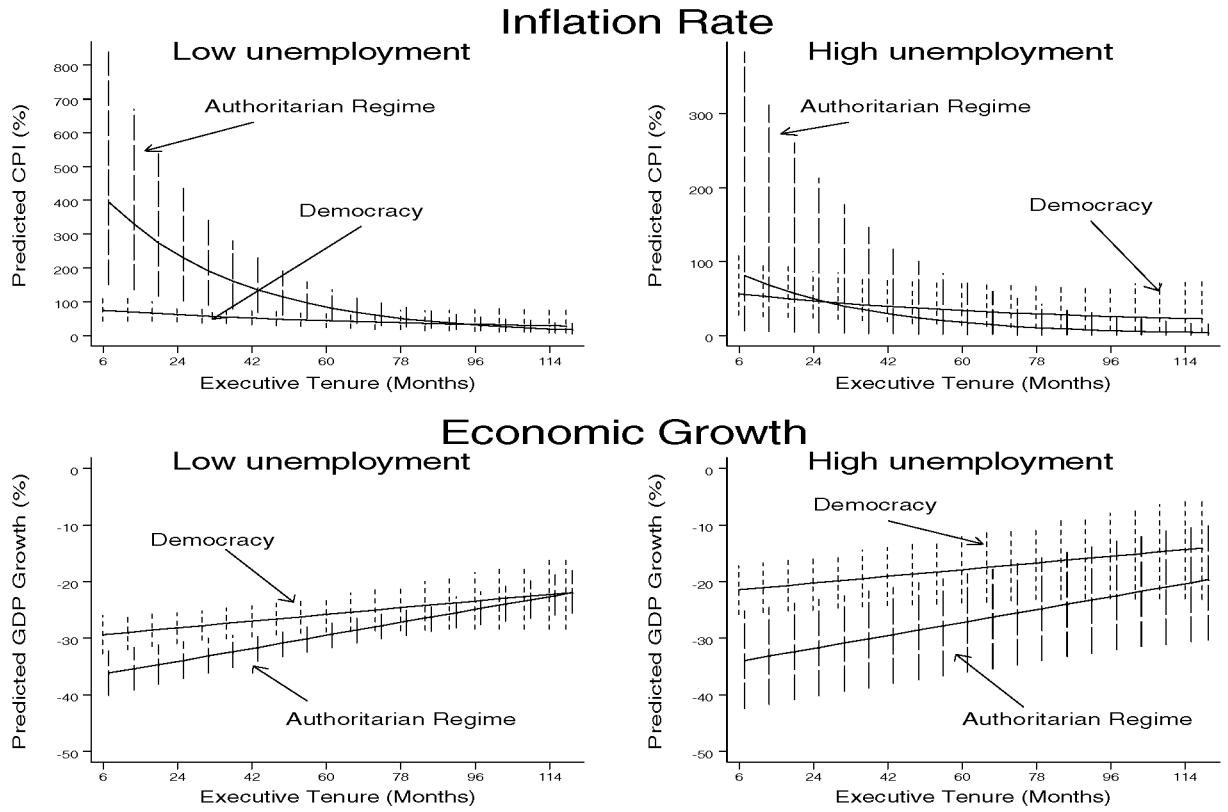
Although the PREM does not make predictions with respect to the unemployment rate, the finding that democracies do qualitatively differently than authoritarian regimes regardless of the unemployment levels, is significant and consistent with the expectations of the model.

Tenure of the Executive

By itself, TENURE is statistically significant in four models and fails to achieve significance in the other four that include the multiplicative terms (which is not surprising). The analysis of interaction effects in Table 1 reveals that TENURE is generally not statistically significant for democracies but is highly significant for non-democracies, where its substantive impact is stronger as well. This difference persists for both dependent variables, unlike the effect of unemployment. The fact that government instability (usually associated with democracies) does not have a statistically discernible impact for democracies immediately makes the JCM suspect because instability seems irrelevant precisely where it is supposed to have the largest negative effect.

To examine the effect of government stability, I conducted Monte Carlo simulations using different lengths of executive's

FIGURE 2
PREDICTED INFLATION LEVEL AND GDP GROWTH BY POLITY TYPE



Vertical lines indicate 95% confidence intervals, the horizontal lines represent expected values.

tenure. All control variables were set as in the running example. Figure 2 demonstrates what happens to the expected inflation (upper panels) and GDP growth (lower panels) when tenure varies between 6 months and 10 years and unemployment is at 4 percent (left panels) or at 20 percent (right panels). Because we already know that we need to account for different polity types, the plots have two simulations, one for a democracy, and another for an authoritarian regime.

The four panels in Figure 2 show that the impact of government stability is much weaker in democracies, although it is in the direction predicted by JCM. Generally, executives with longer tenure are associated with lower inflation rates and higher GDP growth, regardless of polity type. The substantive effect is especially pronounced in non-democracies (notice how their slopes of expected values are much steeper than the slopes for democracies).

Consider the lower two panels that represent predictions about economic growth. As a whole, democracies tend to do better at any level of stability. However, once the tenure of the executive exceeds 4 years, non-democracies that perform best may begin approaching the worst democratic performers. It is worth noting that the effect is stronger when unemployment is low: Authoritarian polities seem to be able to reach growth levels closely comparable to that of democracies. When unemployment is high, however, non-democracies perform poorly and even after ten years in office, their executives will not be able to attain the expected growth of democracies.

Consider now the upper two panels that represent predictions about the inflation rate. TENURE is extremely important for authoritarian regimes and it does reduce expected inflation quite dramatically. Stability is basically irrelevant for performance of democracies, as expected from the analysis of interaction effects. Notice, however, that when unemployment is high, authoritarian regimes that last for more than 2 years are expected on the average to be associated with lower inflation than democratic regimes with comparable tenure. When unemployment is low, the overtaking in performance does not occur until the executive has lasted around eight years. With respect to inflation, stable democracies may actually do worse than stable non-democracies.

Under the JCM, the concern with cabinet instability comes from the supposed inability of short-lived governments to pursue reforms consistently. In other words, one would expect the effect of tenure to be very strong in democracies and much weaker in authoritarian states, where the executive is mostly insulated from pressure. Figure 2 shows the exact opposite: Stability has a more pronounced beneficial impact in authoritarian regimes, and is only weakly associated with improvements for democracies. One likely explanation for that is suggested by recent

analyses of voting behavior in post-communist democracies, which demonstrate that voters are not motivated by economic concerns and do not punish governments for introducing reforms (Przeworski 1996; Powers and Cox 1997). On the other hand, authoritarian regimes are more dependent on economic performance for their survival, because they derive their legitimacy mostly from this performance, and not from democratic procedures (Huntington 1993). The combination of empirical findings for voters in democracies and Huntington's conjecture about authoritarian regimes finds empirical support in the analysis of short-term reforms.

The general conclusion is that TENURE has a directional impact consistent with the expectations of JCM in H_3. However, that conclusion must be tempered by three findings. First, government tenure does not exert a strong effect independent of polity type. Second, its beneficial influence is more pronounced in authoritarian regimes, contrary to the expectations of the JCM. Finally, with respect to economic growth, the difference in performance between democracies and authoritarian countries is great: regardless of tenure length, democracies have better prospects for long-term development than non-democracies.

Simulation of Inflation Rate Dynamics

The findings thus far present us with somewhat mixed evidence. There is very strong support for PREM prediction from H_2, and the lack of support for the JCM prediction from H_5 can also be interpreted in favor of PREM. However, for H_3, TENURE seems to have the effect expected by JCM. On the other hand, Table 1 shows that this effect is strongly conditional on AUTH. Because the effect is not monolithic, it is worth investigating carefully the interaction of the three main components.

Since democracies generally have better prospects for long-term economic growth regardless of the other factors, the critical puzzle is presented by inflation. To obtain insight into the dynamics of inflation rate management, I conducted simulations to see how a permanent one-time change in the level of democracy would affect government's ability to cope with inflation over a ten year period. Because I am interested in the effects of government stability and unemployment, I conducted simulations of inflation rate trajectories for four different hypothetical polities.

All four hypothetical countries begin at "year 0" with median values for pre-transition development level, trade with the European Union, and foreign investment; with the means for ideology and party fragmentation; and no involvement in war. The four baseline cases are then differentiated on the basis of executive's tenure and the rate of unemployment. Country A has low unemployment (5 percent) and short-lived governments (one year). Country B has low unemployment but stable governments (five years). Country C has very high unemployment (20 percent) and short-lived governments. Finally, Country D has high unemployment and stable governments. These countries correspond to the four panels in Figure 3. All countries begin with 20 percent inflation.

As discussed in the previous section, government stability has little to do with the expected trajectory of inflation. When unemployment is low, democracies universally do better. The sole exception is the small possibility that a stable authoritarian regime might experience better inflation in "year 0" (lower left panel). The trajectories, however, quickly settle: with short-lived governments, the expected difference in inflation is enormous, well in excess of 1000 percent. With long-lived governments, the difference is smaller, but sizeable at over 60 percent. Without doubt, democracies are expected to do very well with respect to inflation when unemployment is relatively low.

When unemployment is high, however, democracies may run into problems, regardless of how stable the cabinets are. Generally, authoritarian regimes will be expected to do better in terms of inflation rate management, although to a far more modest degree. While short-lived authoritarian executives take longer to overtake similarly-lived democratic cabinets in performance (around the third year, as opposed to immediately for long-lived executives), they nevertheless do so, and the difference settles at around 20 percent. The corresponding difference with long-tenured governments is around 10 percent, also in favor of authoritarian regimes. Although this particular finding lends modest support to JCM, it should be interpreted with caution because $UNEMP_{t-1}$ was not statistically significant for democracies.

Overall, the simulation reveals that democracy, executive tenure, and unemployment interact in a complex, non-monolithic way. However, their combined effect on inflation is not difficult to predict based on the findings. When unemployment is relatively low, democracies outperform non-democracies by a huge margin, regardless of government stability. When unemployment is very high (20 percent in our case), democracies may do a little bit worse: between 10 and 20 percent, depending on government stability.

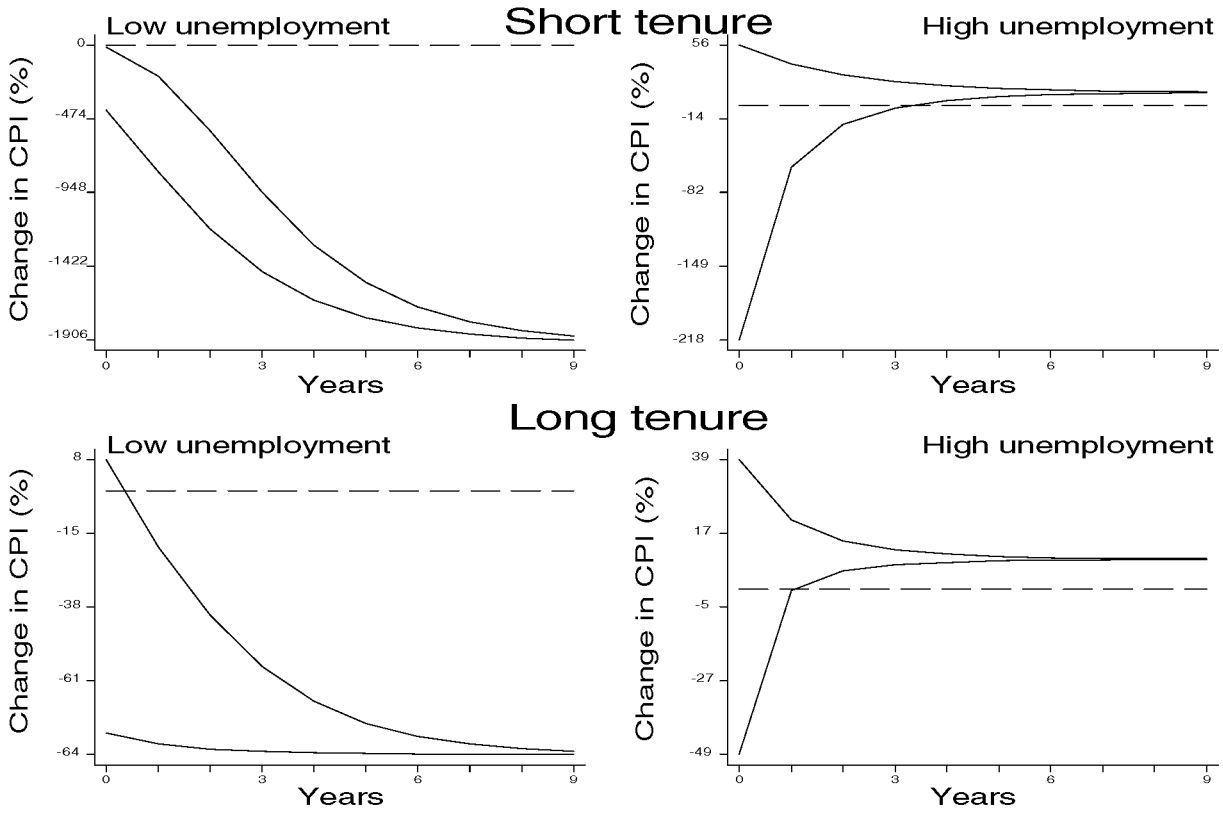
The evidence is thus overwhelmingly in support of PREM.[9] First, democracies usually succeed in managing inflation, and even under the worst unemployment, non-democracies are not expected to outperform comparable democratic polities by much. The difference is drastic, and in favor of democracies, when unemployment is low. Government stability has a very weak effect on inflation, and the effect is nonexistent for democracies.

CONCLUSION

The data do not support the contention of the JCM that losers will oppose the transition to any significant degree. They provide solid support for the predictions of the PREM,

[9] Recall that inflation was the toughest test of performance. The situation with long-term growth does not exhibit any ambiguities: all PREM hypotheses are supported, and the JCM hypothesis with respect to unemployment is rejected.

FIGURE 3
SIMULATED INFLATION RATE DYNAMICS



The panels depict the 99% confidence intervals of the change in inflation rate in response to a one-time change from authoritarianism to democracy. The dotted lines indicate no change.

which implicates the winners, and not the losers, as the main opposition to reform consolidation.

It is not the dispersed benefits and concentrated costs that drive the mechanics of opposition to reform. It is the pattern of concentrated gains accruing to those who benefit from the partially implemented programs, that forms the impetus behind the (often covert) hostility to the continuance and completion of transition. These winners enormously profit from the uncertain legal environment, the personal connections with the ruling elite, the often murky dealings with banks, and the availability of government subsidies to faltering enterprises frequently shadowed by their own private firms. These people rationally oppose any further change in the economic, political, and legal situation, which would jeopardize their personal wealth and clout. It appears that the only way to counteract their power is to neutralize it through democratic means.[10]

This article not only tested two rival theories that explain the patterns of simultaneous transitions, but also addressed several widespread notions in the literature often taken for granted. It showed that a more accessible government will not necessarily pander to the demands of the people least benefiting from its policies. The analysis further showed that even drastic reduction in welfare for many people (reflected in high levels of unemployment) does not directly translate in a change of course in the economic program. These findings are encouraging for the prospect of simultaneous transitions because they demonstrate that (1) democracy is not incompatible with austere economic policies, (2) frequent cabinet changes may actually be beneficial for the integrity of the political regime, and (3) it might be the case that a more open society and accessible government are prerequisites for a successful transition. Whether the last one is because of some inspiring qualities of being under democratic rule, or because being under such rule alters the calculations of expected benefits, remains to be seen.

[10] It is worth emphasizing that the aggregate analysis cannot probe the microfoundations of the rival theories. However, the results demonstrate that the aggregate trends are consistent with one of the models, not the other.

APPENDIX

TABLE 3A
SYSTEM CLASSIFICATION AND EXECUTIVE TENURE

Country	Years	H-T	Type	Tenure
Albania	1991–99	7	Mixed	23.43
Armenia	1992–95	14.5	Presidential	33.00
	1996–99	8	Mixed	26.94
Azerbaijan	1992–99	21	Presidential	38.21
Belarus	1992–99	18	Presidential	32.69
Bulgaria	1990–99	1	Parliamentary	15.03
Croatia	1991–99	9	Presidential	65.84
Czech Rep.	1990–99	3	Parliamentary	25.93
Estonia	1992–99	4.5	Mixed	29.20
Georgia	1992–94	8	Mixed	17.53
	1995–99	20.5	Presidential	70.00
Hungary	1990–99	6	Mixed	44.47
Kazakhstan	1992	12	Presidential	34.00
	1993–99	18	Presidential	82.00
Kyrgyz Rep.	1992	11	Presidential	27.00
	1993	13	Presidential	39.00
	1994–99	14	Presidential	81.00
Latvia	1992–97	3	Parliamentary	17.78
	1998–99	2	Parliamentary	10.75
Lithuania	1992–99	6	Mixed	24.48
Macedonia	1992–99	2	Parliamentary	22.68
Moldova	1992–99	2	Parliamentary	23.15
Poland	1990–96	7	Mixed	18.83
	1997	7.92	Mixed	21.00
	1998–99	8	Mixed	31.50
Romania	1990–99	6	Mixed	28.22
Russia	1992	9	Presidential	18.00
	1993	9.5	Presidential	30.00
	1994–99	15	Presidential	72.00
Slovak Rep.	1993–99	4	Parliamentary	20.85
Slovenia	1991–99	4	Parliamentary	24.48
Tajikistan	1992–99	12	Presidential	43.73
Turkmenistan	1992–99	18	Presidential	68.00
Ukraine	1992–95	5	Mixed	14.94
	1996	11.5	Presidential	30.00
	1997–98	13	Presidential	48.00
	1999	11.75	Presidential	66.00
Uzbekistan	1992–99	18	Presidential	75.00

H-T is the Hellman-Tucker presidential powers score.

TABLE 4A
ANALYSIS OF INFLATION RATE (NATURAL LOG)

Variable	Model 1	Model 2	Model 3	Model 4
AUTH	.1277**	.0843*	.1798**	.1957**
	(.0463)	(.0371)	(.0644)	(.0595)
TENURE	–.0246***	–.0204***	–.0152	–.0053
	(.0052)	(.0048)	(.0085)	(.0089)
$UNEMP_{t-1}$	–.0338**	–.0534***	–.0233	.0107
	(.0124)	(.0143)	(.0365)	(.0392)
WAR	.6443*	.5793*	.5806*	.4699
	(1.5741)	(.2781)	(.2832)	(.2960)
GDP87	.0000	–.0000	.0000	–.0000
	(.0000)	(.0001)	(.0000)	(.0001)
GOVFRAG	–.2085***	–.2450***	–.2004***	–.2377***
	(.0521)	(.0550)	(.0518)	(.0554)
IDEOLOGY	–.0328	.0231	.0328	.0322
	(.0192)	(.0192)	(.0188)	(.0185)
EUTRADE		.0102*		.0108*
		(.0047)		(.0048)
FDI		–.0038**		–.0045**
		(.0013)		(.0013)
TENAUT			–.0011	–.0017
			(.0008)	(.0009)
UNEMPAUT			–.0017	–.0098
			(.0057)	(.0062)
CPI_{t-1}	.5910***	.5692***	.5912***	.5622***
	(.1008)	(.0876)	(.1014)	(.0859)
Constant	2.2194***	2.5100***	1.8076*	1.6417*
	(.5931)	(.5801)	(.7533)	(.7229)
N	209	201	209	201
Adjusted R^2	71.65	75.11	71.81	75.67
Wald χ^2	341.88	341.78	515.08	589.30
DF	8	10	10	12
Probability > χ^2	<.001	<.001	<.001	<.001

Linear regression with Panel-Corrected Standard Errors, contemporaneous correlation, and a lagged dependent variable.
***$p < .001$; **$p < .01$; *$p < .05$

TABLE 5A
ANALYSIS OF REAL ECONOMIC GROWTH

Variable	Model 1	Model 2	Model 3	Model 4
AUTH	–.8834***	–.4640*	–.7447*	–.5207
	(.1789)	(.1962)	(.3093)	(.3290)
TENURE	.1068***	.0963***	.0690	.0497
	(.0209)	(.0192)	(.0418)	(.0461)
UNEMPt–1	.3733***	.3701***	.7661**	.5965*
	(.0804)	(.0750)	(.2510)	(.2450)
WAR	–6.4523***	–5.8114***	–6.1882***	–5.5186**
	(1.5741)	(1.7186)	(1.6012)	(1.8124)
GDP87	.0007***	.0005*	.0007***	.0006*
	(.0002)	(.0002)	(.0002)	(.0002)
GOVFRAG	.2226	.5315	.1860	.4866
	(.3665)	(.4113)	(.3651)	(.4060)
IDEOLOGY	–.4017***	–.3569**	–.3070*	–.3000*
	(.1170)	(.1200)	(.1227)	(.1218)
EUTRADE		.0488		.0500
		(.0306)		(.0299)
FDI		.0147*		.0131
		(.0069)		(.0076)
TENAUT			.0044	.0055
			(.0038)	(.0043)
UNEMPAUT			–.0571	–.0328
			(.0335)	(.0336)
$GDPDIFF_{t-1}$	.8540***	.8587***	.8512***	.8557***
	(.0415)	(.0397)	(.0409)	(.0394)
Constant	–8.6933***	–13.9636***	–10.0124**	–13.7482***
	(2.3613)	(2.7638)	(3.4261)	(3.7779)
N	210	202	210	202
Adjusted R^2	92.83	93.56	92.96	93.63
Wald χ^2	3200.73	3233.49	3733.29	3217.04
DF	8	10	10	12
Probability > χ^2	<.001	<.001	<.001	<.001

Linear regression with Panel-Corrected Standard Errors, contemporaneous correlation, and a lagged dependent variable.
***$p < .001$; **$p < .01$; *$p < .05$

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Received: June 12, 2004
Accepted for Publication: August 22, 2004
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