Speculative Attacks and Political Responsiveness in Latin America

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Outline

Motivation
- The Case of Lula
- Other Cases
- Literature

Rationale
- The Left’s Dilemma
- Argument
- Hypotheses

Empirical Analysis
- Research Design
- Results
- Conclusions and Next Steps
Investors’ Behavior in Two Brazilian Presidential Elections

Cardoso 1994

- S&P Indexes: Jan/Oct 94
- Brazil: +94%
- Emerging Markets: +25%

Lula 2002

- S&P Indexes: Jan/Oct 02
- Brazil: -52%
- Emerging Markets: -8%
## Currency Crisis and its Consequences

From success story to Nigerian risk levels in one month: “Da Lula Monster” and the “Lulameter”

### Magnitude of the crisis
- Capital outflows: US$ 1.1bi/month
- Devaluation: 40% in 9 months
- Inflation: From 8% in March to 15% in April
- Interest Rates: From 18% in 2001 to 27% in 2002

### Confidence building
- Primary surplus of 5% after a two-year recession
- 21% interest rates
- Social security reform (taxation of retired workers)
- Central bank independence
- Further financial liberalization
More of the same

- France 1981
- Argentina 1989
- Peru 1990
- South Korea 1997
- Venezuela 1998
- Ecuador 2002
- India 2005
- ...

Policy Switches

Speculative attacks during elections $\Rightarrow$ Move towards investors policy preferences early in the term
Recent Research

Elections & Speculative Attacks


Speculative Attacks & Policy Choices

- Limits on redistribution (Boix 2003)
- Confidence building (Santiso & Martinez 2003)
- “Room to move” (Mosley 2003)
- Financial liberalization during balance of payments crises (Haggard & Maxfield 1996)
Leftist presidents make policy choices subject to:

- Voters’ redistributive demands
- Investors’ exit capacity
• Currency crises move policy choices closer to investors’ preferences.
• Currency booms provide presidents with more capacity to respond to voters’ redistribute demands.
Empirical Analysis

Hypotheses

- Currency crises/booms should increase/reduce the likelihood that leftist presidents switch to a conservative program.
- Currency crises and booms should not affect the behavior of conservative presidents.

Sample

- 89 presidential elections
- 15 Latin American countries
- From 1980 to 2006
Research Design

Dependent Variable: Policy Switch

- \( \text{Switch}_i = \begin{cases} 
1, & \text{if Campaign}_i \neq \text{Government}_i \\
0, & \text{otherwise} 
\end{cases} \)

Independent Variable: Currency Crises

- \( \text{EMP}_{i,t} = \frac{\Delta s_{i,t}}{\sigma \Delta s_{i,t}} - \frac{\Delta r_{i,t}}{\sigma \Delta r_{i,t}} \)
- \( \text{Scarcity}_{i,t} = \begin{cases} 
1, & \text{if} \ \text{EMP}_{i,t} > \mu(\text{EMP}_{i,t}) + 2\sigma(\text{EMP}_{i,t}) \\
0, & \text{otherwise} 
\end{cases} \)
- \( \text{Abundance}_{i,t} = \begin{cases} 
1, & \text{if} \ \text{EMP}_{i,t} < \mu(\text{EMP}_{i,t}) - 2\sigma(\text{EMP}_{i,t}) \\
0, & \text{otherwise} 
\end{cases} \)
- \( \text{Crises}_i = \sum_t \text{Scarcity} \), for various choices of \( t \).
- \( \text{Boom}_i = \sum_t \text{Abundance} \), for various choices of \( t \).
- \( \text{Crises} \ast \text{Ideology}, \text{Booms} \ast \text{Ideology} \)
Research Design (cont.)

Controls - Hypotheses

The less opposition a president faces, the easier it is to switch.
  • $\uparrow$ Constitutional powers of the president $\Rightarrow$ $\uparrow$ Switches
  • $\uparrow$ Share of legislative seats $\Rightarrow$ $\uparrow$ Switches

The more institutionalized a party is, the harder it makes for presidents to switch
  • $\uparrow$ Party age $\Rightarrow$ $\uparrow$ Switches

The higher the share of retrospective voters, the more incentives presidents have to switch in face of currency crises
  • $\uparrow$ Electoral volatility $\Rightarrow$ $\uparrow$ Switches
Results: Investor Behavior and Policy Switches

\[ P(\text{Switch}) = \alpha + \beta_1 \text{Crises} + \beta_2 (\text{Crises} \times \text{Ideo}) + \beta_3 \text{Boom} + \beta_4 (\text{Boom} \times \text{Ideo}) + \gamma \text{Controls} \]
Political and Institutional Variables

- Weak opposition increases the chances of policy switches.
- Higher share of economic voting unexpectedly reduces the chances of a policy switch.
- Effect of party institutionalization not statistically significant.

First Differences

<table>
<thead>
<tr>
<th></th>
<th>Exec</th>
<th>Seats LH</th>
<th>Volatility</th>
<th>Party Inst.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Left</td>
<td>0.51***</td>
<td>0.65 ***</td>
<td>-0.33*</td>
<td>-0.15</td>
</tr>
<tr>
<td>Right</td>
<td>0.30*</td>
<td>0.46*</td>
<td>-0.14</td>
<td>-0.15</td>
</tr>
</tbody>
</table>
Conclusions and Next Steps

Conclusions

- Currency crises near inauguration increase the likelihood that a leftist president switches to a neoliberal program early in his term.
- Currency crises and booms do not affect the policy choices of conservative presidents.
- Political institutions matter - constraints, not motivations.

Next Steps

- Improved measure of government policies
- Computer-based content analysis of campaign discourses