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Generalised Trust, Institutional and Political Constraints on the Executive and Deregulation of Markets

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Abstract

It is frequently claimed that high levels of generalized trust are conducive for economic reforms. In contrast, the "traditional view" on institutional and political constraints on the executive (IPCE) postulates that high IPCE tend to paralyze the decision-making process, thus blocking required policy changes. By stressing credibility issues of economic reforms and transactions cost for special interest groups, a more positive view however sees IPCE as potentially conducive to reforms. This paper empirically explores the significance of these claims for the case of economic deregulation. In particular, it elaborates on the hypotheses that IPCE do not impact on economic reforms in an environment of high generalized trust and that the positive impact of trust increases with the extent of IPCE. The results provide evidence in favor of the traditional view on IPCE. However, it is also shown that IPCE are an obstacle for economic policy liberalization only in relatively low trusting environments. In contrast, a robust positive correlation of generalized trust with the extent of economic deregulation is isolated, and trust unfolds a particular strength with increasing levels of IPCE.

1. Introduction

Theoretical and empirical literature is consistent with the view that a high level of generalized trust is conducive to economic reform, including the deregulation of markets (e.g. *Boix and Posner*, 1998; *Heinemann and Tanz*, 2008). One basic transmission mechanism rests on the notion of generalized trust to reduce interventionist attitudes (*Aghion et al.*, 2010). Moreover, high levels of trust are linked to a pronounced attitude of decision makers towards focusing on the public good rather than on their private benefits (e.g., *Knack*, 2001). Put differently, high trust is paired with less market failures and improved governmental performance by enhancing coordination and cooperation between societal groups, thus reducing free-rider problems, rent-seeking by special interest groups and opportunistic behavior in general (e.g., *Leibrecht and Scharler*, 2013; *Bergh and Bjørnskov*, 2011). This, in turn, implies that in an environment of substantial generalized trust social welfare enhancing economic policy reforms have a higher probability of finding a majority even if certain groups suffer from losses in the short-run.

Likewise, the scope of potential policy changes is influenced by a country's institutional framework (e.g. *Dahl*, 2014; *Alesina et al.*, 2006). The traditional view is that substantial institutional and political constraints on the executive (henceforth IPCE), due to a divided government or a multi-party coalition, not only signal an environment of contrasting views on optimal policies. IPCE also imply that actors with views on pace and direction of reforms that are at odds with those of the chief executive can effectively block decisions. Thus, due to holdup-power of certain groups and due to a "war of attrition" within the executive, high IPCE tend to paralyze decision-making (e.g., *Roland*, 2002). For instance, as argued by *Tsebelis* (1995), a low congruence between groups of many veto players and low cohesion within a particular veto-player, locks-in the status-quo. Thus, IPCE make a political agreement in favor of reforms harder to achieve even if a policy change would be welfare enhancing from a social viewpoint.

Yet, while IPCE certainly reduce political *decisiveness*, an increasing number of actors with effective power and/or formal rights to block policy change also contributes to political *resoluteness*, i.e., "the ability […} to commit to maintaining a given policy" (*Cox and McCubbins*, 2001, pp. 26-27). In a dynamic perspective, the lack of credibility of a policy change is a major source of political stalemate. For example, ex-post transfer schemes to compensate ex-ante unidentified losers from reform are supposed to fail if partners of a deal cannot commit to keep promises not to exploit potential losers (*Fernandez and Rodrik*, 1991). A consensus to reform will be arrived at with higher probability if involved political actors can credibly commit to compensation (*Pitlik*, 2005). If many different societal groups have to reach an agreement, the likelihood of a reform reversal or for losers not being compensated is lower. Hence, according to this "positive view" substantial IPCE, due to higher

transaction costs of negotiating policy change will decrease decisiveness but will also enhance the credibility of a reform arrangement. The latter often proves to be conducive for reforms to occur.

An alternative model leading to a positive impact of IPCE on economic reform is also provided in *Gehlbach and Malesky* (2010). Their basic argument rests on the notion that more veto-players also imply higher (transactions) costs for special interest groups ("toll costs"), which may lead to reduced lobbying for the status-quo. Absent such rent seeking expenditure from special interest groups, benevolent veto-players opt for welfare enhancing reforms. Higher IPCE and a larger number of veto-players may thus encourage reforms.

Hence, while high levels of generalized trust are seen to be conducive for economic reforms, the net effect of IPCE on reform intensity is ambiguous *a priori*. Which of the two different effects of IPCE dominates has to be established empirically. Yet, it is conceivable that the effects of IPCE and of generalized trust on economic reform are intertwined:

On the one hand, IPCE should not impact on reforms in a high generalized trust environment. First, the arguments that high IPCE paralyze the decision-process (traditional view) or lead to a more credible commitment to compensate reform losers (positive view) are of minor importance in a high trust environment, where cooperation and coordination are generally high. Second, the influence of particularized interest groups decreases provided that trust is high, as rent-seeking and opportunistic behavior are of minor importance in this case.

On the other hand, the positive effect of trust on policy reforms will be more pronounced when substantial IPCE are present. First, based on the positive view on IPCE, this is because reforms gain additional credibility with increasing trust levels. Second, based on the traditional view, the higher the extent of IPCE the higher is their decision-blocking effect which can be neutralized by an increase in generalized trust.

This paper attempts to shed some more light on the complex relationship between generalized trust, IPCE and economic liberalization. Based on a broad country sample we analyze whether generalized trust exerts a positive effect on economic liberalization and whether the traditional view or the positive view on IPCE is more relevant for the sample at hand. Moreover, we explore whether trust and IPCE are indeed intertwined in their impact on economic deregulation. Specifically, we test two hypotheses:

H1: In a high generalized trust environment an increase in IPCE has no effect on economic deregulation.

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H2: When substantial IPCE are present the positive effect of an increase in generalized trust on liberalizing policy reforms is more pronounced.

The paper adds to existing literature by jointly considering generalized trust and IPCE as factors impacting on economic reforms. Existing literature predominately deals with one of these factors in isolation. Insofar our analysis provides a more complete perspective on the institutional and political factors influencing economic deregulation. Moreover, to the best of our knowledge, so far no study elaborates on possible interacting effects between trust and IPCE. This is unfortunate as exploring interacting effects of informal and formal institutions provides us with valuable information which countries could speed-up deregulation by altering IPCE and for which countries high IPCE may matter less for the extent of economic policy liberalization.

The structure of paper is as follows: section two provides a brief overview of related literature. Section three outlines data, variables and empirical methodology applied. Section four presents our main results and robustness tests, and section five concludes.

2. Generalized trust, IPCE and economic reforms - some related literature

Empirical literature exploring institutional determinants of economic reforms gained in importance in recent years. In that respect, a number of papers address the relationship between economic liberalization and generalized trust, employing trust data taken from World Value Survey (WVS) project (World Values Survey Association, 2014).

Heinemann and Tanz (2008) consider generalized trust as a direct determinant of economic reform. The latter is defined as the 1995 - 2005 difference in the Fraser Institute's Economic Freedom of the World index (*Gwartney et al.*, 2013). Their analysis is based on a broad sample of advanced, emerging and developing countries. The total Fraser-index as well as its sub-indices, for government size, legal structure, sound-money, free-trade and regulation (areas 1 to 5 of Fraser-index), are used to derive the dependent variables. The results provided are consistent with a positive impact of generalized trust for all components of the Fraser-index, but free-trade and sound-money. Heinemann and Tanz (2008) also consider the degree of legislative fractionalization in 1995 to capture the degree of political competition as factor impacting on economic reform. This variable, however, falls short of statistical significance.

Another prominent study linking trust and economic regulation is *Aghion et al.* (2010). Their main idea is that individuals who mistrust others have a stronger preference for government regulation of economic activities, while people with high levels of generalized trust are in favor of less strict

regulations and state control. Moreover, trust and regulation are mutually interdependent and co-evolve to either a high trust-little regulation or to a little trust-high regulation equilibrium. In their empirical analysis *Aghion et al.* (2010) conclude that "both country-level and individual data … support our model's prediction that distrust leads to support for government regulation". (p. 1035)

Pinotti (2012) similarly confirms for a sample of up to 51 mostly developed nations that differences in generalized trust can explain a large fraction of the observed cross-country variation in market entry regulations. Moreover, he shows that holding constant the trust-driven component of the demand for government intervention, a higher level of regulation is no longer associated with worse economic outcomes. Also building on *Aghion et al.* (2010), *Pitlik and Kouba* (2014) find that the asserted effect of distrust on government intervention attitudes is reduced if state actors are perceived to be inefficient and less competent than private companies.

Berggren et al. (2014) analyze the relationship between trust and the implementation of reforms in central banking. Their analysis is based on a broad sample of 149 countries. They argue that the relationship between trust and central-bank independence is U-shaped: On the one hand, high social trust increases the ability to undertake necessary reforms, as it is easier to agree on delegation of power and to overcome social conflict and strife. On the other hand, the need for institutional change such as the establishment of an independent central bank is more pronounced in societies with low trust levels, as the credibility problems of monetary policy are higher in a low-trusting environment. Hence, it is societies both with rather low and with rather high trust levels which create independent central banks. At trust levels in between neither the need for nor the ability of change are strong enough to generate those reforms. They find empirical support for their claim.

Turning to the role of IPCE for economic reform, the traditional view centers around the "war of attrition model" proposed by *Alesina and Drazen* (1991). A key ingredient of this model is the conflict among the executive over the distribution of costs of reform (*Alesina et al.*, 2006). This conflict leads to delay of stabilization and, thus, reduced economic reforms as a "waiting game" is played (*Wiese*, 2014). The essence of the model is that only the passage of time can reveal which of the opponents is weaker, that is, which group has higher waiting costs. The conflict among the executive is higher in heterogeneous governments (e.g., multi-party coalition governments) and if formal institutions provide opponents with effective veto-power (e.g., "divided governments"). This model (and variants thereof) has been tested empirically in numerous studies and various contexts. So we only provide a very selective review.

Using a large sample of developed and developing countries over the years 1960 to 2003, *Alesina et al.* (2006) explore delay in the adjustment of the public budget balance, and conclude that "less

constrained governments adjust more substantially, […]" (p. 16), which is consistent with the predictions of the traditional view on IPCE. In a similar vein, *de Haan et al.* (2013) show for a sample of EU countries that ideologically fragmented coalition governments are associated with higher budget deficits. However, the effect of IPCE on fiscal positions is mitigated by adequate budgetary institutions.

Based on a sample of OECD countries and data for the 1971 to 1996 period *Volkerink and de Haan* (2001) *inter alia* establish a positive correlation between central government deficit and political fragmentation of the government. Furthermore, *de Haan et al.* (1999) find a positive correlation between the number of parties in government and central government debt growth. *Ricciuti* (2004) uses a panel of 19 OECD countries over the 1975 – 1995 period and shows that a higher number of spending ministers statistically significantly increases government expenditures and government deficits. These results can be interpreted as indication for the relevance of public funds as "common pools" prone to overexploitation. Moreover, the findings are consistent with partisan veto-players to hinder market-oriented reforms. Note that *Ricciuti* (2004) does not find a robust effect of IPCE in form of checks and balances on the executive.

Heckelman and Knack (2008) relate market-oriented economic reform, measured by the Fraser-index of Economic Freedom of the World, to foreign aid received by developing countries. They also include IPCE in their analysis (presence of coalition government, fractionalization of parliament, checks on the executive). However, they find none of these variables to play any role in their sample of developing countries for the years 1980 until 2000.[1] In contrast, *Heckelman and Knack* (2008) establish that higher aid slowed liberalizing economic reform despite foreign aid being frequently granted to help developing countries in such reforms.

Wiese (2014) analyses reform in the healthcare sector among OECD countries. He uses both, economic output and policy input data to isolate successful reforms which he then relates to a variety of factors including political and institutional variables. He shows that crises trigger reform in the healthcare sector. However, counter to "many previous studies" (p. 344), *Wiese* (2014) cannot establish a significant relationship between political and institutional variables like political ideology or government fractionalization and privatizations of healthcare financing.

Gehlbach and Malesky (2010) provide evidence in favor of the positive view on IPCE. They test the assertion that many veto-players may weaken the power of special interest groups which, in turn, leads to full rather than partial reform. *Gehlbach and Malesky* (2010) use a sample of 25 post-

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[1] Note that *Heckelman and Knack* (2008) state: "We do not conclude from these tests that policy reform is unaffected by political institutions. […] they are treated here merely as control variables […]". (p. 539)

communist countries over the years 1992 to 2004. They find that the "presence of multiple veto players may be beneficial in the early stages of reform, but this becomes ineffective once reform is sufficiently advanced." (p. 969) The authors also find a significant negative effect of veto-players in case of already high levels of reform. Taken together these findings suggest that "the conventional view on veto players may be more informative once broad efficiency-enhancing reforms have been completed". (ibidem) This also suggests that one should control for the already achieved level of economic reform in empirical analysis.

Dahl (2014) elaborates on the effect of institutional and partisan veto-players on government size. His findings are also consistent with the positive view on IPCE. *Dahl* (2014) bases his analyses on a sample of 20 OECD countries and, depending on the data source, years from 1960 to 2008. Using different proxies for veto-points (Tsebelis-index; government fractionalization and checks and balances from *Beck et al.* (2001), Polcon3 of *Henisz* (2010)) he finds that for growth in government size partisan veto-players clearly matter while the effects of institutional veto-players are somewhat less robust. Specifically, *Dahl* (2014) finds that starting in the 1980s "a larger number of effective veto-players is systematically related to lower rates of government growth – as well as larger reductions in the size of government […]" (p. 430) This may be interpreted as many veto-players being conducive for market-oriented economic reforms leading to lower government expenditures in GDP.

Clearly, generalized trust and IPCE are only two among a variety of factors impacting on economic reforms. One strand of literature analyzes the relationship between economic reforms and the level of democracy. A positive relationship between economic reforms and the level of democratization is frequently postulated as a higher responsiveness of democracies to changing circumstances and political preferences may speed up the political response of elected governments (e.g. *Rodrik* 1999; *Pitlik*, 2008). Democracies might better be able to balance (short-run) costs and benefits of economic reforms among vested economic interest groups as compared to dictatorships.

In line with this reasoning *Rode and Gwartney* (2012) find that democratizations strongly increase the likelihood for economic liberalization, as measured by a change in the Economic Freedom of the World Index. *Giuliano et al.* (2013) also find that the level of democracy has a positive and significant impact on economic reforms while little evidence for reforms fostering democratization is established. However, *Campos and Coricelli* (2012) argue that reform intensity might be high in autocracies as well. One argument rests on the notion that political elites "that aim at appropriating resources from the economy […] have an interest in efficiency-enhancing reforms, which will increase the resources in the economy." (p. 486) According to the empirical analysis of *Campos and Coricelli* (2012) a U-shaped relationship between democracy and financial sector reform is plausible. Financial

sector reform is relatively low in "partial democracies". Gradually moving from an autocracy to a full democracy, thus, is paired with reversals in financial sector reforms.

In a nutshell, empirical evidence is in favor of a positive impact of generalized trust on economic reform while the evidence for IPCE is mixed. However, there is a lack of studies that simultaneously relate these two variables to economic reforms in general and economic liberalization in particular. From this it directly follows that possible interaction effects between generalized trust and IPCE are underexplored as well.

3. Variables, Data and empirical methodology

Our empirical analysis is based on a broad sample of countries comprising democracies as well as more autocratically governed economies. The 2013 version of the Economic Freedom of the World (*Gwartney et al.*, 2013) sub-index for reform in economic regulation[2], $EFW\_(it)$, is used to derive the dependent variable.

Following related literature (e.g., Giuliano et al., 2013; Campos and Coricelli, 2012; Heinemann and Tanz, 2008; Pitlik, 2008; Pitlik and Wirth, 2003) the first difference in $EFW\_(it)$ is used as proxy for economic reform ($D\_EFW\_(it)$). It is scaled from 0 to 10, with higher values indicating less regulatory burden. Hence, a positive first difference in $EFW\_(it)$ signals deregulation.

In form of a yearly time series the efw-index is only available for the time period between 2000 until 2011. Hence, our analysis comprises the most recent history of reform episodes.[3] We use the unchained version of the efw-index for two reasons. First, the chained version, which considers changes in quality and quantity in the data sources used to construct the efw-index, is only available for a smaller sample of countries. Second, in the 2013 edition the chained version is not available for components of the regulation-subindex (area 5). However, as robustness-check, we also show results derived from the chained version as well as from a series which substitutes missing values in the chained version by values from the unchained version ($EFW\_chained\_(it)$ and $EFW\_chained2\_(it)$).

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[2] The efw-index is well established in the literature (see *de Haan et al.*, 2006, for an evaluation). In this paper, specifically, the efw-subindex in area 5 ("regulation") and its components (business operations, credit and labor markets) are used.

[3] Before 2000 the efw-index is provided with gaps of five years starting from 1970 (i.e., 1970, 1975, 1980, 1985, 1990 and 1995). Hence, taking first differences over consecutive years is impossible. In addition, the second variable of main interest, generalized trust, is available for specific years only (see main text). These years may not match the years for which the efw-index is provided. For these reasons we refrain from using these data points. Using a panel of economic reforms defined over five-year-differences from 1980 to 2010 is an interesting avenue for complementary, future research, as it captures longer-run developments.

It is important to stress that we focus on the regulation sub-index because recent theoretical applications (Aghion et al., 2010; Pinotti, 2012) establish a clear link between generalized trust and economic regulation. Second, empirical studies show that, for example, the extent and enforcement of property rights (area 2) is among the determinants of generalized trust (see *Robbins*, 2012 and the literature cited therein).[4] Hence, by focusing on the regulation part, potential problems from reverse causality are mitigated. Yet, following *Aghion et al.* (2010) trust and regulation may also be mutually interdependent. Specifically, regulation may impact on generalized trust "by changing the relative payoffs of civic and uncivic individuals." (*Pinotti* 2012, p. 655) Therefore we also test for exogeneity of generalized trust.

Generalized trust is taken from the World and European Value Surveys projects. It is defined as the percentage share of interviewed persons in a particular country who approvingly answer the value survey question "Most people can be trusted" (trust_(it)). Trust_(it) is available for a broad range of countries, yet, for particular years only. To date seven combined waves of World and European Value surveys are provided by the Value Surveys projects. As the efw-index is available in yearly time-series format from 2000 onwards this implies that we use the most recent value survey waves in our analysis. These data availability issues imply that our analysis is based on a rather short panel for a broad range of countries.

Generalized trust is frequently seen as a rather inert institutional variable (e.g. *Uslaner,* 2002; *Bjørnskov*, 2007) that evolves only slowly over time. Nevertheless, trust_(it) taken from the Value Surveys shows pronounced variation over time for a range of countries. To some extent this time variation in measured generalized trust comprises measurement error (see *Paldam*, 2009). It is well known that measurement errors in explanatory variables bias econometric results, especially if country-fixed effects are modeled (e.g., *Wooldridge*, 2010, p. 365ff).[5]

To cope with a broad but very short country panel and a likely measurement errors in a variable of main interest, we (i) base our analysis not only on the contemporary value of trust_(it) but also on averages of generalized trust (trust_av_(it)); thereby averages are taken over trust values up to the specific year under consideration.[6] This exercise reduces the variation in generalized trust over time

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[4] The key assumption is that trust between random individuals is enhanced by market transactions. Sufficient extent and credible enforcement of property rights are a necessary condition for private markets to work. Hence, property rights may determine generalized trust (e.g. *Berggren and Jordahl*, 2006).

[5] In OLS without country-fixed effects it may happen that the attenuation bias due to measurement error is cancelled by the omitted variable bias arising from excluding fixed effects (Wooldridge, 2010, p. 366).

[6] For example, if the year under consideration is 2008 then we average trust_(it) over all values available until (and including) the year 2008; but we leave out years 2009 - 2011 to avoid that reform in 2008 is explained by measured level of generalized trust in, say, 2011). Note, for Iran we use the generalized trust value of about 0.106 provided by the most recent survey as an earlier survey shows a questionable high value of 0.653.

and makes our series more compatible with the assertion of Uslaner (2002) and Bjørnskov (2007). Moreover, averaging is frequently used to reduce the influence of atypical trust values in our analysis (e.g., *Berggren et al.*, 2014). We (ii) rely on the Pooled-OLS estimator with time effects and country-group effects instead on the two-way-Fixed effects estimator. On the one hand, excluding country-fixed effects increases the likelihood of an omitted variables bias. We cope with this issue by controlling for time-invariant or very slowly evolving institutional variables like a country's political and electoral system. On the other hand, Pooled-OLS allows us to exploit the between-country variation which is important for identification in case of slowly evolving institutional variables of main interest especially if the time dimension is short.[7] Thus, one should be careful to arrive at a strong causal interpretation even though our findings deliver a rather clear and robust message.

To test for possible exogeneity of trust_(it) and trust_av_(it) we rely on an instrument variable approach. We use as excluded instruments for trust

- the importance of hierarchically organized religions in a country as of 1980 (e.g., *La Porta* et al., 1997; *Berggren and Jordahl*, 2006; hier_relig_(i));
- the absolute value of the latitude of a country's capital city (latitude_(i));
- the (log of) mean bilateral distance of capital city in country i from the various capital cities in Scandinavia (Oslo-Norway, Helsinki-Finland, Stockholm-Sweden and Copenhagen-Denmark; ln_mean_distance_(i))[8].

Data for the construction of the exogenous instruments are taken from Teorell et al. (2013) and Mayer and Zignago (2011). Compared to non-hierarchically organized religions (e.g., Protestantism) the high importance of hierarchically organized religions (Muslim as well as Roman Catholic and Eastern Catholic churches) should lead to lower levels of generalized trust. Specifically, hierarchically organized religions impose "a hierarchical structure on the society, often in symbiosis with the state" (*La Porta et al.* 1997, p. 336), which discourages the formation of trust (ibidem). Scandinavian countries are worldwide the countries with the highest levels of generalized trust. Assuming spill-

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Averaging these two values would very likely lead to a substantial overestimation of the true generalized trust level in Iran. Also note that averaging generalized trust reduces the influence of the low value for Canada in 2000, which is considered as unreliable in related literature (e.g., *Berggren et al.* 2014). High values of generalized trust for China and Vietnam, while consistently estimated over various survey waves, are also seen as questionable. We deal with this issue in robustness checks (i.e., by dropping Confucian countries from the analysis, *cf*. Table 9).

[7] Note that we include the lagged level of the efw-index in our empirical model. It is well known that in a small T-environment the FE-estimator leads to a severe downward-bias in the lagged dependent variable whereas the Pooled-OLS-bias is upward (e.g., *Bond*, 2002). The FE-estimator, thus, does not help in this respect. Applying GMM-based estimators of the Arellano-Bond- and Blundell-Bond-type is precluded as these estimators need T > 2. This requirement leaves us with very few countries, which is unfortunate as the GMM-estimators' econometric properties are based on a large N dimension.

[8] The four Scandinavian countries have entry zero in the (log of) mean bilateral distance.

over effects in generalized trust, for instance through day-to-day interactions or through migration and trade, it is conceivable that countries geographically closer to Scandinavia also have higher levels of generalized trust. These spill-over effects are captured by ln_mean_dist_(i)). Joint inclusion of latitude_(i) with ln_mean_dist_(i)) into the set of instruments implies that spill-over effects are assumed to wash-out not only vertically (i.e. farther away to the south) but also horizontally (i.e. for a given latitude the farther away to the West or to the East).

Based on this set of instruments the Hausman-type tests do not reject the hypothesis of exogeneity of our proxy for generalized trust, which is in line with recent literature (e.g., *Robbins*, 2012).

Data on IPCE are taken from the most recent version of World Bank's Database on Political Institutions (DPI; *Beck et al.*, 2001). Specifically, the DPI's checks and balances variable (checks_(it)) is used as our main variable capturing constraints on the executive. This variable focuses on the number of institutional veto-players (see *Dahl*, 2014 for a discussion) and its construction is rather straightforward (see *Keefer*, 2012 for details). To capture the influence of partisan veto-players we count the number of government parties (num_coal_(it)) based on information provided by DPI (gov1seat, gov2seat, gov3seat and govoth variables).[9]

We also apply the frequently used political constraints-index of *Henisz* (2010; Polcon_(it)). Broadly speaking, Henisz' Polcon3-index consists of two parts, a variable measuring number and congruence of institutional veto players and a variable capturing legislative fractionalization (Frac_legis_(it)). We also provide results from *Beck et al.*'s (2001) govfrac and oppfrac variables which measure governmental fractionalization and fractionalization of the opposition (Frac_govern_(it) and Frac_oppos_(it)), respectively. Furthermore a variable of executive constraints (Xconst_(it)) taken from the Polity IV project (*Marshall and Jaggers*, 2002) is used in a robustness-check. Note that the variables provided by DPI as well as by *Henisz* (2010) are measured for the 1st of January of a particular year, which reduces the likelihood of reverse causality.[10]

Control variables are chosen following related literature (e.g., *Dahl*, 2014; *Wiese*, 2014). Specifically, we consider both economic and political factors. Economic controls include:

(1) a financial crisis dummy capturing the presence of severe financial crises (in the definition of *Laeven and Valencia*, 2012) lagged one year (lag_D_crisis_(it)); economic crisis are frequently considered as a motor for economic reforms (e.g. *Wiese*, 2014; *Pitlik and Wirth*, 2003);

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[9] In addition we use a dummy-variable indicating the presence of a coalition government (D_coal_(it)).
[10] Specifically, if a reform leads to an institutional change in the year of reform then this institutional change will be recorded in the year after the reform took place.

(2) the mean unemployment rate over the three prior years (lag_unemp_(it)) to signal severe economic turbulences not captured by the financial crisis dummy variable; averages over three years are taken to separate structural unemployment from short-run business-cycle-related unemployment; the higher the mean unemployment rate the higher are the waiting costs of non-reforming; hence a positive relationship with D_EFW_(it) is expected;

(3) the mean consumer-price inflation (absolute value thereof to avoid canceling of (high) negative and positive entries) over the three prior years (lag_infl_(it)); similar to lag_unemp_(it), this variable intends to capture economic turbulences but with a focus on product markets; on the one hand persistent highly positive or negative rates of inflation may signal high waiting costs of non-reforming; this suggests a positive correlation of lag_infl_(it) with D_EFW_(it); yet, as policy responses to high inflation might very well be in form of tighter price controls, that is more regulation, a negatively signed coefficient is also plausible *a priori*;

(4) the level of a country's economic development, as proxied by GDP per capita in PPP is included in our empirical model not least to avoid that trust_(it) and trust_av_(it) merely pick-up a "level of development" effect[11]; moreover, GDP per capita frequently is used to capture many different aspects of a country's institutional environment (e.g., *Benassy-Quere et al.* 2007); unemployment, inflation and GDP per capita data are taken from World Bank's WDI database.

Political controls included are:

(1) an election year dummy (election_(it)) derived from information provided by the DPI database (exelec and legelec variables); it is conceivable that due to uncertain effects of economic reforms incumbent governments will refrain from economic reforms in election years (e.g., *Gancia and Bonfiglioli*, 2011); note that we purge premature elections from election_(it) as premature elections may be due to reforms conducted[12];

(3) a dummy variable for leftist orientation of the chief executive (left_(it)) also taken from DPI database (execrlc variable); it is expected that left-oriented governments conduct less economic policy liberalization (*Potrafke*, 2010);

(4) variables capturing the political and voting system: D_Prop_(i) is a dummy variable with entry one for proportional representation as opposed to majoritarian systems; D_pres_(it), D_parl_(it) and D_assem_(it) are dummy variables with entry one for presidential (D_pres), parliamentary (D_parl)

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[11] For instance, *Paldam* (2009) argues that the level of generalized trust crucially hinges upon a country's development level.
[12] If the variable counting years until next elections (DPI's yrcurnt variable) has entry different from zero but legelec or exelec variable pinpoints an election we consider this election as premature.

and assembly elected presidential systems (D_assem); these variables also capture the level of a country's democratization to some extent as dictatorships are frequently recorded under the two versions of presidential systems;[13] these dummy variables are generated based on DPI's 'system' variable; as the extent of IPCE crucially hinges upon the political system and the electoral rule (*Keefer*, 2012; *Persson and Tabellini*, 2008), we control for these structural features of the political system in our empirical analysis to avoid the IPCE variables merely picking-up the influence of these factors on economic reform;

(5) the backing of the government in the legislative (winmar_(it)) derived from the DPI database (maj variable); governments with a stronger backing in the legislative may have a higher propensity to reform as uncertainty surrounding the political costs of reforms is less harmful compared to governments with tiny win margins; hence, we expect a positive correlation with D_EFW_(it); note, from Table A1 we see that winmar_(it) has a somewhat pronounced pairwise correlation (-0.67) with the variable capturing legislative fractionalization (Frac_legis_(it)); yet, correlations with the variables capturing IPCE introduced above are substantially lower; the correlation coefficient between checks_(it) and winmar_(it) for D_parl_(it) = 1 is -0.32; the corresponding for D_pres_(it) = 1 is -0.33; this rather low correlation indicates that executive constraints may be high even in case of a strong backing of the government in the legislative; in parliamentary systems this could happen if a government is formed by several different government parties; in presidential system this may happen in case of several chambers comprising the legislature and / or the presence of parties coded as allied with the president's party but which have an ideological orientation closer to that of the main opposition party than to that of the president's party (see *Keefer*, 2012, p. 19); table A3 shows that in our sample high and low values of winmar_(it) are both paired with higher checks_(it) values.

We also include the one year lagged level of regulation (lag_EFW_(it)), to capture the notion of a target-level of regulation towards which a country-group evolves (e.g., *Giuliano et al*, 2013) and to capture that the effect of IPCE may depend on the already achieved level of reform (*Gehlbach and Malesky*, 2010). Time effects are used to capture aggregate shocks, and country-group dummies to account for model differences in time invariant institutional environments for economic deregulation across country-groups. Specifically, ten different dummy variables are created: (i) for the EU-15; (ii) for the 13 new EU-Members; (iii) for South-Eastern European countries (excluding Turkey); (iv) for CIS-countries (excluding Russia); (v) for Asian-countries (except India, China, Japan, South Korea and Singapore as well as Arab world countries in Asia); (vi) for Central- and South-American countries (excluding Brazil); (vii) for Arab world countries; (viii) for advanced-non-EU countries (including

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[13] In robustness-checks we also include a variable separating democracies from non-democracies (polity2_(it)). Moreover, we show results with non-democracies dropped from the country-sample.

Japan, South Korea and Singapore), (ix) for African countries (excluding South Africa) and (x) for emerging economies (i.e., China, India, South Africa, Brazil, Russia and Turkey). Various further variables are used in robustness- and sensitivity checks as additional controls; see Table A4 for details.

The empirical specifications estimated are represented by equations (1) and (2):

$$D\_efW\_(it) = a + \gamma_t + \vartheta_l + \beta_1 TR_{it} + \beta_2 IPCE_{it} + \sum_{j=3}^{k} \beta_j X_{k,it} + \varepsilon_{it}$$

(1)

$$D\_efW\_(it) = \alpha + \gamma_t + \vartheta_l + \delta_1 TR_{it} + \delta_2 IPCE_{it} + \varphi(IPCE_{it} * TR_{it}) + \sum_{j=3}^{k} \delta_j X_{k,it} + \xi_{it}$$

(2)

i = country i (i = 1,…77)[14]; t = year t (t = 2001 -2011); $\gamma_t \ and \ \vartheta_l$ are time and country-group dummies (l = 1,…10). TR_{it} is either trust_(it) or trust_av_(it) and $IPCE_{it}$ includes the various proxies for IPCE. $X_{k,it}$ capture various control variables (k = 1,…K). ε_{it} is the remainder error term. Standard-errors of ε_{it} are clustered on the country-level throughout. Note that for several countries the cluster-size is 1 (only one value survey is available from 2001 to 2011). The number of observation in our baseline regressions is 122.

The hypotheses (H1 and H2) are tested by using an interaction-term between TR_{it} and $IPCE_{it.}$ The total marginal effect of IPCE and generalized trust, respectively, on D_efw_(it) in equation (2) is evaluated following *Brambor et al.* (2006)[15].

Evidence in favor of hypothesis *H1* implies that the confidence interval around the total marginal effect of IPCE on economic reform should not contain zero for low values of generalized trust but zero should lie within the interval in case of substantial high values of trust. In addition, a non-negligible share of sample observations should fall into the range of significance as well as into that of insignificance. Evidence is in favor of hypothesis *H2* if the positive total marginal effect of generalized trust is increasing with IPCE. Moreover the total marginal effect has to be statistically significantly different from zero across meaningful ranges of IPCE.

Tables A1 and A2 in the appendix show descriptive statistics and pairwise correlation coefficients for variables used in our analysis. Notice the lower within-country variability of trust_av_(it) compared to trust_(it) (cf. Table A2). Also note that the pairwise correlation coefficients among covariates are rather low (cf. Table A1). The vast majority of more pronounced correlations (above 0.50) are either as expected (esp. between trust_(it) and trust_av_(it) and proposed excluded instruments (variables

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[14] Included country-year-pairs are displayed in Table A5.
[15] See *de Haan et al.* (2013) for a recent application.

(31)-(33)), or between several variables which aim at measuring IPCE, as well as between D_pres and D_parl)). Checks_(it) only shows a higher correlation with its close substitute num_coal_(it). The correlation with the trust variables is small and positive. Taken together these correlations suggest that multi-collinearity should be of minor concern in our application.

4. Results

4.1. Baseline Results

Table 1 displays our baseline results from OLS. Equations (1), (2) and (3) employ trust_(it), and equations (4), (5) and (6) use trust_av_(it) to measure generalized trust. Columns (1) and (4) contain the "full model" which includes the variables of interest as well as all main control variables. Columns (2) and (5) exclude insignificant control variables ("tested-down model"), and columns (3) and (6) display results for our most parsimonious specification. The latter only includes trust and IPCE measures, the lagged level of the EFW-index, as well as country-group and time dummies.

Results for the two variables of main interest are robust across these different specifications. Higher levels of generalized trust impact positively on economic reforms, whereas the coefficient of checks_(it) is negative. These results are in line with the traditional view on the relationship between IPCE and economic reforms. The coefficients on the trust variables in column (5) imply that an increase in generalized trust by one standard-deviation increases economic reform by about 0.075 points which is about one-fifth of the sample standard-deviation of D_EFW_(it) (*cf*. Table A1). An increase of checks_(it) by one standard-deviation reduces economic reform by 0.042 points.

Turning to control variables, it appears that changes in the EFW-index are lower in election years and in periods with high levels of inflation. The latter is an indication of increased price controls to combat high rates of inflation. In line with the notion of a crisis hypothesis the recent occurrence of financial crises fosters reform intensity. A positive relationship is also established for periods of high (persistent) unemployment, and deregulations are more pronounced in countries with a higher GDP per capita. Evidence also points towards a higher reform intensity in parliamentary systems than in presidential or assembly-elected presidential systems. A left orientation of chief executives and a system of proportional representation appear to be uncorrelated with D_EFW_(it).

An already high level of regulation implies lower subsequent liberalizing economic reforms, an effect also found by recent studies (e.g., *Giuliano et al*. 2013). The coefficient on the lagged EFW-index is about -0.13 in specifications including control variables. It is somewhat larger (around -0.085) in the

parsimonious models. Note that using the Blundell-Bond estimator (*Roodman*, 2009) to estimate equation (1) with only the lagged EFW-index as well as time dummies included[16] comes up with a similar estimate for the coefficient on the lagged EFW-index of about -0.15 and with satisfying test-statistics.[17]

Table 2 gives the results when we instrument trust_(it) and trust_av_(it) by various combinations of the three instruments discussed above (hier_relig_(i); latitude_(i) and ln_mean_distance_(i)). From various tests (Hansen-test, underidentification test, first-stage F-test) we see that the instruments are strong and valid. Moreover, different instrument sets lead to rather similar estimates (see the notes to Table 2) which enhances the credibility of the instruments used (e.g., *Murray*, 2006). We also see that the TSLS coefficients on generalized trust are rather similar to their Pooled-OLS counterparts. Consistent with this similarity in coefficients the Hausman-type tests do not reject the null-hypothesis of exogeneity of trust. Note, that the generalized trust variables do not reach statistical significance in the TSLS estimations. This, however, is expected given the inefficiency of TSLS compared to OLS.

Table 3 contains results for different proxies of IPCE. For ease of comparison column (1) replicates column (4) of Table 1. All alternatives to checks_(it) underscore the negative relationship of IPCE with changes in the EFW-index. Num_coal_(it) and Frac_govern_(it) achieve statistical significance. The latter variable is significant only when Frac_oppos_(it) is in the model as well.[18] The majority of the remaining variables show p-values slightly above 0.2. Only Frac_oppos_(it) and Frac_legis_(it) are highly insignificant. For the latter this depicts its rather high correlation with winmar_(it). As Frac_legis_(it) is an integral part of Polcon_(it) one may deduce that its insignificance has the same source. Indeed, if winmar_(it) is dropped the coefficient of Polcon_(it) comes up with a p-value of 0.13. From column (8) of Table 3 we see that splitting Polcon_(it) in two of its integral parts, checks_(it) and Frac_legis_(it), signals once more that IPCE in form of checks and balances matter for the speed in regulatory reform. Taken together, Table 3 confirms the idea that IPCE in general and institutional and partisan veto-points in particular are prejudicial for liberalizing economic reforms.

Table 4 displays findings when D_EFW_(it) is replaced with its chained counterparts (D_EFW_chained_(it) and D_EFW_chained2_(it)). Columns (1) and (2) as well (5) and (6) are based on the OLS estimator, while entries in the remaining columns are from TSLS. The lower number of

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[16] Applying the Blundell-Bond estimator on a model including generalized trust would leave us with very few countries as outlined above (footnote 7).

[17] P-values of the Arellano-Bond AR(1) and AR(2) tests: 0.000 and 0.775; P-value Hansen-test on all instruments: 0.163; p-values for Difference-in-Hansen tests of exogeneity of instrument for levels: 0.105 (instrument list excluding level instruments) and 0.490 (level instruments). Number of instruments: 37, number of groups: 87. Results are based on the one-step robust version of the estimator with a total of 917 observations.

[18] Frac_oppos_(it) is missing for several countries leaving us with 116 observations.

observations of 108 in case of D_EFW_chained_(it) is due to missing values in this series.[19] In case of D_EFW_chained2 these missing values are substituted by the corresponding entries in D_EFW_(it). Most importantly, results provided in Table 4 are in line with those displayed in Tables 1 and 2. The only relevant difference to the unchained series is the insignificance of GDP per capita (PPP).

We also conduct estimations for the three-components of the overall regulation index, i.e., for regulation of credit markets, of labor markets and of business operations (cf. Table 5). These results imply that generalized trust and checks and balances are especially relevant for reforms in regulation of business operations. While trust is positively correlated with changes in credit and labor market regulation it is not statistically significant (p-value of 0.19 and 0.17) in these cases. The same, but with opposite sign and higher p-values, applies to checks_(it). Note that a high persistent unemployment rate impacts positively on labor market liberalizations while high rates of inflation hinder liberalizing reforms of credit markets. Financial crises matter most for credit market regulations. Finally, in line with common sense, a leftist chief executive implies less liberalizing reforms in labor markets.

Table 6 contains results when we substitute D_EFW_(it) by binary variables, one having entry one in case of deregulation (D_EFW_(it) > 0 (dereg_(it))) and the other, (rereg_(it)), having entry one in case D_EFW_(it) < 0, i.e. a re-regulation. As the Probit-estimator is applied, average partial effects are displayed.[20] The probability of liberalizations increases with higher trust and lower IPCE, and the likelihood of re-regulation is lower the higher generalized trust and the lower IPCE. However, while checks_(it) approaches statistical significance in case of liberalizations, for re-regulations it remains insignificant even if other insignificant variables are excluded from the estimations. We interpret these results as indication that veto-players, as captured by checks_(it), lock-in the status-quo.

4.2. Robustness checks

A first set of robustness-checks is performed with respect to (i) omitted country characteristics (democracy; openness, corruption, federal country, former colony; post-election year; net-receiver of development aid in the 1990s; government spending on transfers and subsidies in GDP (area1b of EFW-index); *cf*. Table 7 and the Notes provided there) and (ii) country-groups (country-groups defined above are dropped from the analysis one at a time; *cf.* Table 8 and the Notes provided

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[19] The following countries are missing: ARM, AZE, BIH, ETH, GEO, KAZ, KGZ, MDA, MKD and VNM.

[20] Note that the number of observations drops to 116 as the dependent variable is perfectly predicted in 6 cases by time dummies.

there). These robustness checks do not alter our main conclusions derived and displayed in Tables 1 and 2.

Furthermore, according to *Delhey et al.* (2011), the trust variable derived via World and European value survey is not without any problems. More specifically, the definition of generalized trust is based on the assumption of a wide trust radius. That is, one trusts people one meets for the first time, people with other religion or of other nationality. It is not clear whether in all countries the value surveys are conducted such a wide trust radius is in the mind of the respondents when answering the "Most people can be trusted" question. As the analysis of *Delhey et al.* 2011 shows, especially in several Confucian countries (esp. China and Vietnam) the trust radius is quite narrow. This implies that *de facto* generalized trust may be rather low. To cope with this measurement issue we drop Confucian countries from the estimation (CHN, JPN, KOR, VNM, TWN and SGP). In addition we drop all the countries for which the trust radius is relatively narrow according to Figure 4 in Delhey et al. (2011). Substantive results remain unaltered (cf. Table 9).

Table 9 also contains two additional sensitivity checks (columns (3) to (5)). In columns (4) and (5) only democracies are used in the country sample. We define a country as being democratically governed in case the polity2 variable is positive. The second robustness check keeps only EU countries and other advanced countries in the sample (column (3) of Table 9). Again our results are robust (*cf.* Table 9 and the Notes provided there).

4.3. Interacting generalized trust and IPCE

Table 10 includes the findings for the interacting effects of generalized trust and IPCE. For this aim we extend models (1) and (2) as well as (4) and (5) of Table 1 by including an interaction-term between (demeaned) variables of generalized trust and IPCE. In columns (1) to (4) IPCE is defined as checks_(it), which captures institutional veto-points. In columns (5) − (8) partisan veto-points, num_coal_(it), are used to proxy for IPCE.

The interaction terms carry a positive sign. Consistent with hypothesis *H1* the negative effect of IPCE diminishes with the level in generalized trust; and consistent with *H2* the positive effect of generalized trust increases with the extent of IPCE. For IPCE = checks_(it) the interaction terms fall short of statistical significance individually, but statistical significance increases substantially for partisan veto-points. In each case the F-test on the joint significance of the interaction-term and IPCE and generalized trust, respectively, rejects the null-hypothesis of joint insignificance.

Moreover, it is well known that in models with interaction-terms the total marginal effect a variable exerts on the dependent variable consists of two parts – the coefficient on the interaction term multiplied by the interacting variable as well as the coefficient on the individual variable of interest. The statistical significance of the total marginal effect can be graphically explored as outlined by *Brambor et al.* (2006) and as displayed in Figures 1 to 4.

Figures 1 and 2 suggest that IPCE do not exert a statistically significant impact on D_EFW_(it) in countries with a relative high level of generalized trust. Countries with a trust level of above 37 percent fall in the range of insignificance. About 22 percent of all observation of trust_av_(it) lie in this range, including the Scandinavian countries as well as advanced countries like the Netherlands, Great Britain, Canada, New Zealand and Australia.[21] Hence, IPCE hinder liberalizing economic reforms but mostly so in low trusting environments, while the negative impact washes-out with higher levels of generalized trust.

Figures 3 and 4 show the corresponding impact of generalized trust on economic reform at various levels of checks_(it) and of num_coal_(it), respectively. The effect of generalized trust is positive throughout and it is statistically significantly different from zero across relevant ranges of IPCE. Yet, at low levels of IPCE (< 2) the positive effect of trust on reforms is not statistically different from zero. 11 percent of observation on checks_(it) are below 2, but 38 percent of observations of num_coal_(it) fall in this range.[22] This result stresses that the effect of generalized trust on economic reforms clearly depends on IPCE. In case of low institutional or partisan veto-points, where the decision-blocking effect of IPCE is low, generalized trust is helpful for economic reform (positive total marginal effect), yet generalized trust unfolds a particular reform-enhancing effect with increasing IPCE.

5. Summary and concluding remarks

A widely held view in the literature on policy reforms is that generalized (interpersonal) trust is conducive to economic liberalization and the deregulation of markets. The basic idea is that a high level of trust moderates interventionist attitudes of voters and improves the coordination and cooperation between societal groups, thus lowering the transaction costs of political agreement about reform, and increasing the credibility of a policy change. However, institutional and political constraints on the executive (IPCE) thanks to a multitude of effective formal and informal veto

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[21] Note that some of the Confucian countries fall into the range of insignificance as well. However, due to their narrow trust radius the level of generalized trust likely is overstated.
[22] Thus, we have 38 percent single-party governments in our sample.

players not only signal possibly contrasting views on optimal policies, but are also often said to reduce political decisiveness and thus lead to a blockade of pressing reform decisions.

While the positive impact of higher trust on economic liberalization has generally been confirmed in the empirical literature, the IPCE channel is somewhat disputed, because in a dynamic perspective IPCE increase the credibility of a policy change and may therefore also reduce stalemate. Yet, it is conceivable that the effects of IPCE and of generalized trust on economic reform are intertwined – an aspect that has largely been disregarded in the relevant literature. On the one hand, the arguments that high IPCE paralyze the decision making process (traditional view) or lead to a more credible commitment to reform (positive view) are less decisive as higher trust is expected to foster cooperative behavior regardless of the formal institutional framework. Moreover, the influence of special interest groups supposedly decreases when trust is high. On the other hand, the positive effect of trust on liberalization will be more pronounced if substantial IPCE are present because policy changes gain additional credibility. Moreover, the higher the extent of IPCE the higher is their decision-blocking effect which can be neutralized by increasing trust levels.

Based on a broad sample of countries for the years 2000 to 2011 the paper adds to the literature by jointly considering trust and IPCE as factors impacting on regulatory reforms and by exploring the relevance of interacting effects between trust and the formal institutional framework. Reform is measured by changes in the deregulation index (area 5) of the Economic Freedom of the World dataset.

First, our results support the traditional view that IPCE, in particular institutional and partisan veto-players, are an obstacle to regulatory reforms. However, the analysis also implies that such a blocking effect is only present in countries with low levels of general trust. Second, our investigations also confirm previous findings that generalized trust is positively related to economic liberalization. Thereby the positive impact of trust on reforms increases with the extent of IPCE.

Hence, not only do the effects of trust depend on a variety of economic and formal institutional factors (e.g. *Bjørnskov*, 2010), but the effects of formal (political) institutions on economic policy and reforms are also conditional on the levels of generalized trust in a society.

These results imply that voters and politicians in countries with low levels of generalized trust must be aware that substantial institutional and partisan constraints on the executive reduce the chance for welfare improving economic reforms. As shown, keeping IPCE low in a low trust environment has a direct positive effect on liberalization as well as an indirect effect via the reduced importance of generalized trust for market-oriented reforms.

In contrast, in highly trusting societies substantial IPCE are less of an issue when it comes to the implementation of economic reforms. Higher trust eases the cooperation and coordination among societal groups and thus compensates any possible negative effects of IPCE on reform intensity. The fundamental trade-off between the decisiveness and resoluteness effects in the design of formal institutional arrangements appears to be less pronounced in a generally trusting environment. Thus, high trust levels have a double facilitating effect on reform implementation.

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	(1)	(2)	(3)	(4)	(5)	(6)
trust	0.394**	0.404**	0.284*			
	(0.023)	(0.018)	(0.058)			
trust_av				0.426**	0.439**	0.354**
				(0.016)	(0.014)	(0.023)
checks	-0.024**	-0.022**	-0.022**	-0.024**	-0.022**	-0.023***
	(0.019)	(0.033)	(0.011)	(0.015)	(0.025)	(0.006)
winmar	0.455**	0.421**		0.476**	0.441**	
	(0.017)	(0.022)		(0.014)	(0.017)	
D_Prop	0.058			0.060		
	(0.290)			(0.282)		
D_parl	0.130	0.125*		0.127	0.124	
	(0.101)	(0.088)		(0.124)	(0.106)	
D_pres	-0.006	-0.012		-0.014	-0.016	
	(0.943)	(0.883)		(0.876)	(0.842)	
lag_EFW	-0.130***	-0.136***	-0.086**	-0.131***	-0.137***	-0.087**
	(0.000)	(0.000)	(0.036)	(0.000)	(0.000)	(0.032)
left	0.024			0.0186		
	(0.656)			(0.721)		
election	-0.108**	-0.103**		-0.097*	-0.092*	
	(0.031)	(0.031)		(0.060)	(0.061)	
lag_D_crisis	0.588***	0.598***		0.582***	0.593***	
	(0.000)	(0.000)		(0.000)	(0.000)	
lag_mean_unemp	0.009**	0.010**		0.009**	0.010**	
	(0.0435)	(0.032)		(0.050)	(0.039)	
lag_mean_infl	-0.019***	-0.019***		-0.019***	-0.018***	
	(0.000)	(0.000)		(0.000)	(0.000)	
lag_ln_GDPcap_PPP	0.108**	0.098**		0.108**	0.099**	
	(0.021)	(0.026)		(0.016)	(0.021)	
EU_NMS	0.374***	0.371***	0.174*	0.376***	0.374***	0.187**
	(0.000)	(0.000)	(0.056)	(0.000)	(0.000)	(0.039)
CIS	0.571***	0.549***	0.125	0.566***	0.546***	0.132
	(0.000)	(0.000)	(0.185)	(0.000)	(0.000)	(0.148)
SE_EUR	0.438**	0.427**	0.434***	0.441**	0.432**	0.439***
	(0.016)	(0.020)	(0.002)	(0.010)	(0.013)	(0.001)
ADV_OECD	0.307***	0.304***	0.240**	0.313***	0.310***	0.243**
	(0.001)	(0.001)	(0.011)	(0.001)	(0.001)	(0.011)
Africa	0.898***	0.827***	0.206	0.900***	0.829***	0.225
	(0.000)	(0.000)	(0.292)	(0.000)	(0.000)	(0.238)
Asia	0.231*	0.192	-0.129	0.232*	0.196	-0.119
	(0.098)	(0.142)	(0.253)	(0.084)	(0.117)	(0.300)
Arab	0.540***	0.506***	0.195*	0.540***	0.508***	0.204*
	(0.001)	(0.001)	(0.081)	(0.000)	(0.000)	(0.058)
South_America	0.413***	0.393***	0.0993	0.421***	0.402***	0.115
	(0.001)	(0.002)	(0.316)	(0.001)	(0.001)	(0.230)
Emerging	0.320**	0.304**	0.0200	0.313**	0.297**	0.0273
	(0.014)	(0.019)	(0.836)	(0.011)	(0.014)	(0.768)
Observations	122	122	122	122	122	122
R-squared	0.480	0.476	0.200	0.476	0.472	0.203

Results from **OLS** based on the ivreg2 estimator of Baum et al. (2010) displayed; in bold variable of main interest; endogenous variable is first difference of EFW-Area-5-index (reform); Country-level-cluster robust p-values in parenthesis; *** p<0.01, ** p<0.05, * p<0.10; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Time dummies included but partialled-out and, thus, not shown.

Table 2: Instrumental Variables Estimation

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
trust	0.388	0.401	0.335	0.383				
	(0.161)	(0.105)	(0.250)	(0.137)				
trust_av					0.487	0.488	0.415	0.474
					(0.163)	(0.106)	(0.244)	(0.133)
checks	-0.024**	-0.024**	-0.024**	-0.024**	-0.025**	-0.025**	-0.024**	-0.024**
	(0.021)	(0.021)	(0.018)	(0.020)	(0.015)	(0.015)	(0.014)	(0.014)
Observations	122	122	122	122	122	122	122	122
First_stage F-value	63.10***	31.62***	58.66***	43.83***	49.13***	22.86***	42.58***	32.57***
Underident. test p-value	0.002	0.000	0.004	0.000	0.004	0.001	0.004	0.000
Hansen test p-value	0.674	0.732	0.948	0.912	0.685	0.693	0.897	0.907
Exogeneity test p-value	0.986	0.986	0.7383	0.940	0.802	0.832	0.928	0.853
First-stage results								
hier_relig	-0.002***	-0.003***		-0.0021***	-0.0016***	-0.002***		-0.0017***
	(0.001)	(0.000)		(0.000)	(0.006)	(0.000)		(0.003)
ln_mean_distance	-0.031***		-0.037***	-0.021***	-0.024***		-0.028***	-0.015**
	(0.000)		(0.000)	(0.000)	(0.000)		(0.000)	(0.019)
latitude		0.446***	0.236*	0.271**		0.381***	0.227*	0.255**
		(0.000)	(0.069)	(0.019)		(0.001)	(0.076)	(0.033)

Results from **TSLS** based on the ivreg2 estimator of Baum et al. (2010) displayed; in bold variable of main interest; endogenous variable is first difference of EFW-Area-5-index (reform); Underident. test = Kleibergen-Papp underidentification test; Country-level-cluster-robust p-values in parentheses; *** p<0.01, ** p<0.05, * p<0.10; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Same control variables included as in columns (1) and (4) of Table 1 but not shown for brevity; Time dummies included but partialled-out and, thus, not shown.

<u>Notes</u>: *The first-stage F-values in case only one instrument is used at a time are for trust_(it): 16.38 (latitude_(i)): 120.29 (ln_mean_distance_(i)); 36.79 (hier_relig_(i); for trust_av_(it) the corresponding values are: 14.81 / 93.23 and 25.99. Substantive conclusions wrt the coefficients on the generalized trust variables are unaltered in each of these cases. Coefficients are 0.32 / 0.34 / 0.45 for trust_(it) and 0.38 / 0.43 / 0.55 for trust_av_(it).*

Table 3: Different Proxies for Constraints on the Executive

IPCE is:	(1): checks_(it)	(2): num_coal_(it)	(3): D_coal_(it)	(4): lag_xconst_(it)	(5): Frac_govern_(it)	(6): Frac_govern_(it)	(7): Polcon_(it)	(8): checks_(it)
trust_av	0.426**	0.489***	0.487***	0.341*	0.467***	0.701***	0.396**	0.476***
	(0.016)	(0.007)	(0.008)	(0.055)	(0.008)	(0.001)	(0.032)	(0.012)
winmar	0.476**	0.480**	0.528***	0.361*	0.589***	0.835***	0.512***	0.403*
	(0.0147)	(0.011)	(0.006)	(0.091)	(0.003)	(0.003)	(0.008)	(0.078)
D_Prop	0.060	0.060	0.059	0.060	0.074	0.092	0.049	0.074
	(0.282)	(0.295)	(0.341)	(0.260)	(0.231)	(0.184)	(0.365)	(0.240)
D_parl	0.127	0.136	0.083	0.084	0.082	0.070	0.067	0.089
	(0.124)	(0.135)	(0.310)	(0.294)	(0.311)	(0.400)	(0.405)	(0.212)
D_pres	-0.014	-0.012	-0.059	-0.072	-0.048	-0.031	-0.071	-0.061
	(0.876)	(0.895)	(0.495)	(0.433)	(0.589)	(0.733)	(0.412)	(0.392)
lag_EFW	-0.131***	-0.135***	-0.149***	-0.119***	-0.149***	-0.150***	-0.142***	-0.136***
	(0.000)	(0.000)	(0.000)	(0.002)	(0.000)	(0.001)	(0.000)	(0.000)
left	0.0186	0.001	-0.006	0.007	0.001	0.002	-0.010	0.009
	(0.721)	(0.982)	(0.908)	(0.900)	(0.992)	(0.968)	(0.851)	(0.868)
election	-0.097*	-0.087*	-0.076	-0.054	-0.081	-0.130**	-0.075	-0.085*
	(0.060)	(0.087)	(0.137)	(0.291)	(0.119)	(0.013)	(0.124)	(0.081)
lag_D_crisis	0.582***	0.587***	0.591***	0.473***	0.574***	0.592***	0.551***	0.553***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
lag_mean_unemp	0.009**	0.009**	0.011**	0.012**	0.010**	0.008	0.012**	0.010**
	(0.050)	(0.047)	(0.034)	(0.025)	(0.034)	(0.142)	(0.021)	(0.040)
lag_mean_infl	-0.0185***	-0.020***	-0.019***	-0.018***	-0.018***	-0.018***	-0.018***	-0.017***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
lag_ln_GDPcap_PPP	0.108**	0.0923	0.130***	0.093*	0.123***	0.143***	0.115**	0.120***
	(0.016)	(0.061)	(0.005)	(0.065)	(0.007)	(0.003)	(0.012)	(0.009)
IPCE	-0.024**	-0.027***	-0.074	-0.035	-0.129	-0.224**	-0.159	-0.022**
	(0.015)	(0.006)	(0.215)	(0.204)	(0.222)	(0.033)	(0.259)	(0.030)
Frac_oppos						-0.040		
						(0.622)		
Frac_legis								-0.048
								(0.805)
Observations	122	122	122	116	122	116	121	121
R-squared	0.476	0.482	0.472	0.453	0.471	0.481	0.484	0.461

Results from **OLS** displayed; in bold variable of main interest; Endogenous variable is first difference of EFW-Area-5-index (reform); Country-level-cluster-robust p-values in parentheses; *** p<0.01, ** p<0.05, * p<0.10; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Host country dummies included but not shown for brevity; Time dummies included but partialled-out and, thus, not shown.

Table 4: Chained EFW-Index

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
trust	0.362*	0.348**	0.374	0.361				
	(0.060)	(0.038)	(0.169)	(0.170)				
trust_av					0.437**	0.377**	0.462	0.450
					(0.020)	(0.021)	(0.163)	(0.164)
checks	-0.022**	-0.024***	-0.022**	-0.024***	-0.022**	-0.024***	-0.022***	-0.024***
	(0.014)	(0.008)	(0.013)	(0.008)	(0.011)	(0.007)	(0.010)	(0.006)
lag_EFW_chained	-0.098**		-0.099**		-0.102**		-0.103**	
	(0.015)		(0.020)		(0.011)		(0.018)	
lag_EFW_chained2		-0.105***		-0.105***		-0.106***		-0.109***
		(0.004)		(0.006)		(0.004)		(0.006)
lag_ln_GDPcap_PPP	0.004	0.055	0.004	0.055	0.011	0.056	0.011	0.056
	(0.944)	(0.193)	(0.942)	(0.195)	(0.834)	(0.176)	(0.827)	(0.182)
Observations	108	122	108	122	108	122	108	122
First_stage F-value			60.28***	41.63***			47.05***	31.19***
Hansen test p-value			0.639	0.900			0.634	0.906
Exogeneity test p-value			0.970	0.920			0.998	0.732
Underident. test p-value			0.001	0.000			0.002	0.001
R-squared	0.547	0.494			0.549	0.491		
First stage results								
hier_relig			-0.0011***	-0.002***			-0.001**	-0.002***
			(0.009)	(0.001)			(0.031)	(0.005)
ln_mean_distance			-0.029***	-0.022***			-0.022***	-0.017**
			(0.000)	(0.003)			(0.000)	(0.012)
latitude			0.253**	0.261**			0.229**	0.243**
			(0.024)	(0.022)			(0.049)	(0.039)

Results from **OLS** displayed in columns (1), (2), (5) and (6); Results from **TSLS** in columns (3), (4), (7) and (8); Endogenous variable is first difference of EFW-Area-5-index (reform); chained=chained series; chained2 = chained series with missing values substituted by unchained series; For ten countries values of the chained EFW-index are missing (hence observations=108); chained EFW-index also not available for subpart of EFW-area-5-index; In bold variables of main interest; Country-level-cluster-robust p-values in parentheses; *** p<0.01, ** p<0.05, * p<0.10; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Same control variables included as in columns (1) and (4) of Table 1 but not shown for brevity; Time dummies included but partialled-out and, thus, not shown.

	(1) Business operations	(2) Credit markets	(3) Labor markets
	Table 5: Components of EFW-regulation-index		
trust_av	0.443**	0.508	0.272
	(0.035)	(0.186)	(0.172)
checks	-0.043***	-0.012	-0.007
	(0.000)	(0.624)	(0.634)
winmar	0.406*	0.539	0.178
	(0.068)	(0.124)	(0.516)
D_Prop	-0.007	0.248*	-0.036
	(0.917)	(0.057)	(0.626)
D_parl	-0.134	0.0383	0.124
	(0.392)	(0.799)	(0.251)
D_pres	-0.164	-0.177	0.0685
	(0.375)	(0.294)	(0.492)
lag_EFW_business / cred_mar / lab_mar	-0.161***	-0.181***	-0.037*
	(0.000)	(0.002)	(0.061)
left	0.003	0.026	-0.095**
	(0.957)	(0.826)	(0.013)
election	-0.158*	-0.119	0.014
	(0.061)	(0.251)	(0.830)
lag_D_crisis	0.214	1.313***	-0.014
	(0.143)	(0.003)	(0.894)
lag_mean_unemp	0.008	0.012	0.016**
	(0.115)	(0.194)	(0.015)
lag_mean_infl	-0.004	-0.040***	0.001
	(0.498)	(0.000)	(0.609)
lag_ln_GDPcap_PPP	0.050	0.181	0.128*
	(0.464)	(0.109)	(0.069)
Observations	117	121	117
R-squared	0.351	0.386	0.306

Results from **OLS** displayed; in bold variable of main interest; Endogenous variable is first difference of subparts of EFW-Area-5-index (reform); Country-level-cluster-robust p-values in parentheses; *** p<0.01, ** p<0.05, * p<0.10; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Host country dummies included but not shown for brevity; Time dummies included but partialled-out and, thus, not shown.

	(1)	(2)	(3)	(4)
trust_av	1.588***	1.484***	-0.645**	-0.716**
	(0.000)	(0.000)	(0.027)	(0.022)
checks	-0.051	-0.0515*	0.0405	0.0360
	(0.146)	(0.099)	(0.187)	(0.163)
winmar	0.268		-0.322	
	(0.401)		(0.359)	
D_Prop	-0.069		-0.113	
	(0.412)		(0.217)	
D_parl	0.288**	0.249*	0.0550	-0.016
	(0.026)	(0.051)	(0.692)	(0.911)
D_pres	-0.104	-0.173	0.238*	0.198
	(0.467)	(0.122)	(0.080)	(0.152)
lag_EFW	-0.227***	-0.212***	0.113**	0.132***
	(0.000)	(0.000)	(0.027)	(0.009)
election	-0.086		0.196**	0.161*
	(0.412)		(0.037)	(0.076)
left	-0.226***	-0.201**	0.0911	
	(0.007)	(0.013)	(0.228)	
lag_D_crisis	0.783***	0.853***	-1.178***	-1.316***
	(0.001)	(0.000)	(0.000)	(0.000)
lag_mean_unemp	0.019**	0.017**	0.002	
	(0.013)	(0.012)	(0.770)	
lag_mean_infl	-0.012*	-0.016**	0.034**	0.036***
	(0.09)	(0.015)	(0.012)	(0.008)
lag_ln_GDPcap_PPP	0.127	0.139*	-0.299***	-0.258***
	(0.181)	(0.090)	(0.003)	(0.008)
Observations	116	116	116	116

Results from Stata's **Probit** estimator displayed; Average partial effects are displayed; observations lower than 122 as some country-year pairs are perfectly predicted by time dummies; Columns (1) and (2) have as endogenous variable a dummy variable with entry 1 in case of deregulation and 0 otherwise; Columns (3) and (4) have as endogenous variable a dummy variable with entry 1 in case of reregulation and 0 otherwise; Deregulation = first difference of EFW-index is positive; nationalization = first difference of EFW-index is negative; Country-level-cluster-robust p-values in parentheses to cope with serial correlation; *** $p<0.01$, ** $p<0.05$, * $p<0.10$; Base group = EU-15, assembly elected president no-crisis; non-proportional representation; Host country dummies included but not shown for brevity; Time dummies included but not shown.

Table 7: Omitted Variables

Additional control is:	(1): lag_polity2	(2): lag_KOF	(3): lag_corrup	(4): colonial	(5): post_election	(6): federal	(7): yrcurnt	(8): D_net_aid	(9): lag_EFW_area1b
trust_av	0.401**	0.424**	0.316*	0.411**	0.420**	0.422**	0.399**	0.371**	0.429**
	(0.023)	(0.017)	(0.058)	(0.025)	(0.018)	(0.017)	(0.026)	(0.039)	(0.015)
checks	-0.018**	-0.024**	-0.022**	-0.023**	-0.023**	-0.023**	-0.022**	-0.022**	-0.026**
	(0.045)	(0.016)	(0.022)	(0.025)	(0.020)	(0.032)	(0.025)	(0.031)	(0.012)
Additional control	-0.091	0.000	0.027	-0.003	-0.046	-0.014	0.002	**-0.258****	-0.011
	(0.315)	(0.879)	(0.168)	(0.792)	(0.449)	(0.829)	(0.929)	**(0.028)**	(0.599)
Observations	121	122	120	122	122	122	117	122	119
R-squared	0.491	0.477	0.476	0.477	0.480	0.477	0.461	0.484	0.454

Results from **OLS** displayed; in bold variable of main interest as well as significant new control-variables; Endogenous variable is first difference of EFW-Area-5-index (reform);

Country-level-cluster-robust p-values in parentheses; *** p<0.01, ** p<0.05, * p<0.10; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Same control variables included as in columns (1) and (4) of Table 1 but not shown for brevity; Time dummies included but partialled-out and, thus, not shown.

<u>Notes</u>: *The table shows that including additional control variables does not change our conclusions derived from Table 1 and 2. Moreover, with the exception of D_net_aid_(i) all additional variables lack statistical significance. The negative significant impact of D_net_aid_(i) is in line with recent literature which shows that receiving development aid reduces the pace of economic reforms (e.g., Heckelman and Knack, 2008). However, as this variable is rather crudely measured this result needs to be taken with special care. Also note, that substituting election_(it) by a variable which captures the years left until the next election (yrcurnt_(it)) delivers the expected positive sign (the further away next elections are the higher is D_EFW_(it)), but the derived coefficient lacks statistical significance.*

Table 8: Country-group Jackknife (IPCE = checks_(it))

	MIN	Table 1 (4)	MAX
trust_av	0.291"	**0.426****	0.565***
country-group dropped	EU-15	All	Emerging (#)
checks	-0.031***	**-0.024****	-0.019***
country-group dropped	EU-15	All	SE_EUR

(#): Emerging = BRA, CHN, IND, RUS, ZAF, TUR; " p-value = 0.12; Results in the middle column display baseline results from model (4) in Table 1; Remaining entries are results for dropping country-groups from sample; MIN (MAX): Minimum (Maximum) value of coefficient on variable in bold; Country-group: Reports dropped country-group that leads to Min (Max) value;

Notes: *The table shows that dropping country-groups, one at a time, does not change the sign of the coefficients on the variables of main interest. In each case an increase in generalized trust exerts a positive effect on D_EFW_(it) whereas an increase in IPCE impacts negatively.*

	Table 9: Robustness check: Specific country-groups				
	(1) Confucian countries dropped	(2) countries with narrow trust-radius dropped	(3) most advanced countries only	(4) democracies – "full model" ((4) in Table 1)	(5) democracies – "tested-down model" ((5) in Table 1)
trust_av	0.546**	0.499**	0.761**	0.368	0.490**
	(0.011)	(0.016)	(0.028)	(0.123)	(0.024)
checks	-0.026**	-0.026***	-0.056**	-0.021**	-0.022**
	(0.012)	(0.009)	(0.028)	(0.030)	(0.026)
winmar	0.596**	0.494**	0.957*	0.264	0.305
	(0.020)	(0.029)	(0.057)	(0.387)	(0.291)
D_Prop	0.029	0.034	-0.043	0.099	
	(0.637)	(0.543)	(0.718)	(0.181)	
D_parl	0.104	0.097	0.149**	0.088	0.093
	(0.199)	(0.241)	(0.035)	(0.208)	(0.194)
D_pres	-0.054	-0.041	0.092	-0.033	-0.026
	(0.535)	(0.642)	(0.316)	(0.697)	(0.762)
lag_EFW	-0.134***	-0.125***	-0.125*	-0.090*	-0.115***
	(0.000)	(0.000)	(0.081)	(0.060)	(0.006)
left	0.023	0.023	-0.067	-0.049	
	(0.675)	(0.655)	(0.282)	(0.331)	
election	-0.097*	-0.092*	-0.172***	-0.134***	-0.123***
	(0.071)	(0.074)	(0.009)	(0.004)	(0.007)
lag_D_crisis	0.602***	0.635***	0.494***	0.490***	0.530***
	(0.000)	(0.000)	(0.003)	(0.001)	(0.000)
lag_mean_unemp	0.008*	0.006	0.006	0.014***	0.013**
	(0.075)	(0.152)	(0.611)	(0.008)	(0.015)
lag_mean_infl	-0.019***	-0.020***	0.001	-0.0120***	-0.014***
	(0.000)	(0.000)	(0.951)	(0.000)	(0.000)
lag_ln_GDPcap_PPP	0.107**	0.111**	0.0727	0.129***	0.124**
	(0.033)	(0.018)	(0.642)	(0.007)	(0.012)
Observations	113	109	62	104	104
R-squared	0.486	0.480	0.388	0.449	0.435

Results from **OLS** displayed; in bold variable of main interest; Endogenous variable is first difference of EFW-Area-5-index (reform); Country-level-cluster-robust p-values in parentheses; *** $p<0.01$, ** $p<0.05$, * $p<0.10$; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Host country dummies included but not shown for brevity; Time dummies included but partialled-out and, thus, not shown;

_Notes: While these robustness checks leave our main conclusions unaltered, several interesting aspects are delivered by this table. It is interesting to note that both variables, generalized trust and checks, are more important in case of advanced countries as shown by their – in absolute terms – increased coefficients. Moreover, in this country-group the inflation variable loses its statistical significance which is plausible given the rather low rates of inflation during the last decade in this country group. In this group of rather highly developed countries also GDP per capita (PPP) loses its statistical significance. In case of democracies, as defined by polity2 > 0, trust_av_(it) is marginally insignificant in the full model (which corresponds to column (4) in Table 1). However, once the insignificant variables D_Prop_(i) and left_(it) are dropped, trust_av_(it) reaches a coefficient similar in magnitude and statistical significance as established in Tables 1 and 2._

Table 10: Interaction Model

IPCE is:	(1): checks_(it)	(2): checks_(it)	(3): checks_(it)	(4): checks_(it)	(5): num_coal_(it)	(6): num_coal_(it)	(7): num_coal_(it)	(8): num_coal_(it)
trust / trust_av	0.383**	0.388**	0.408**	0.417**	0.412**	0.419**	0.475***	0.482***
	(0.023)	(0.020)	(0.020)	(0.018)	(0.019)	(0.017)	(0.009)	(0.010)
trust / trust_av * IPCE	0.035	0.048	0.086	0.098	0.140	0.146	0.220*	0.232**
	(0.743)	(0.643)	(0.350)	(0.272)	(0.121)	(0.110)	(0.078)	(0.047)
IPCE	-0.023**	-0.021*	-0.027***	-0.026***	-0.030***	-0.030***	-0.036***	-0.036***
	(0.038)	(0.059)	(0.006)	(0.009)	(0.001)	(0.003)	(0.001)	(0.002)
winmar	0.475**	0.452**	0.510**	0.486**	0.519***	0.490***	0.558***	0.538***
	(0.028)	(0.033)	(0.012)	(0.013)	(0.007)	(0.007)	(0.004)	(0.003)
D_Prop	0.054		0.051		0.047		0.039	
	(0.330)		(0.369)		(0.393)		(0.493)	
D_parl	0.122	0.113	0.112	0.106	0.120	0.117	0.103	0.100
	(0.117)	(0.115)	(0.152)	(0.138)	(0.141)	(0.122)	(0.230)	(0.218)
D_pres	-0.012	-0.021	-0.025	-0.031	-0.003	-0.005	-0.016	-0.017
	(0.886)	(0.781)	(0.763)	(0.680)	(0.975)	(0.950)	(0.858)	(0.838)
lag_EFW	-0.131***	-0.137***	-0.134***	-0.139***	-0.146***	-0.150***	-0.155***	-0.159***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
election	-0.107**	-0.102**	-0.098*	-0.094*	-0.104**	-0.102**	-0.092*	-0.090*
	(0.032)	(0.031)	(0.058)	(0.056)	(0.033)	(0.029)	(0.063)	(0.056)
left	0.025		0.020		0.018		0.011	
	(0.645)		(0.697)		(0.747)		(0.832)	
lag_D_crisis	0.587***	0.595***	0.591***	0.601***	0.609***	0.619***	0.621***	0.631***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
lag_mean_unemp	0.009*	0.010**	0.0086*	0.0093*	0.009**	0.010**	0.009**	0.010**
	(0.051)	(0.042)	(0.060)	(0.050)	(0.047)	(0.038)	(0.042)	(0.035)
lag_mean_infl	-0.019***	-0.019***	-0.018***	-0.018***	-0.020***	-0.020***	-0.020***	-0.019***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
lag_ln_GDPcap_PPP	0.102**	0.091*	0.102**	0.093**	0.083	0.075	0.089*	0.083*
	(0.040)	(0.050)	(0.025)	(0.032)	(0.101)	(0.118)	(0.062)	(0.067)
F-value joint significance of trust, IPCE and trust*IPCE	5.64* / 5.18*	4.82* / 5.44*	7.66** / 5.57*	7.07** / 5.95*	10.14*** / 7.45**	9.10** / 8.31**	10.53*** / 8.54**	9.72*** / 9.51***
Observations	122	122	122	122	122	122	122	122
R-squared	0.481	0.477	0.480	0.476	0.495	0.492	0.495	0.493

Results from **OLS** displayed; in bold information of main interest; Endogenous variable is first difference of EFW-Area-5-index (reform); checks, num_coal, trust as well as trust_av are demeaned; Country-level-cluster-robust p-values in parentheses; *** p<0.01, ** p<0.05, * p<0.10; Base group = EU-15, assembly elected president, no-crisis; non-proportional representation; Host country dummies included but partialled-out and, thus, not shown; Time dummies included but not shown for brevity;

Figure 1: Total marginal effects of checks_(it) at various levels of trust_av_(it)
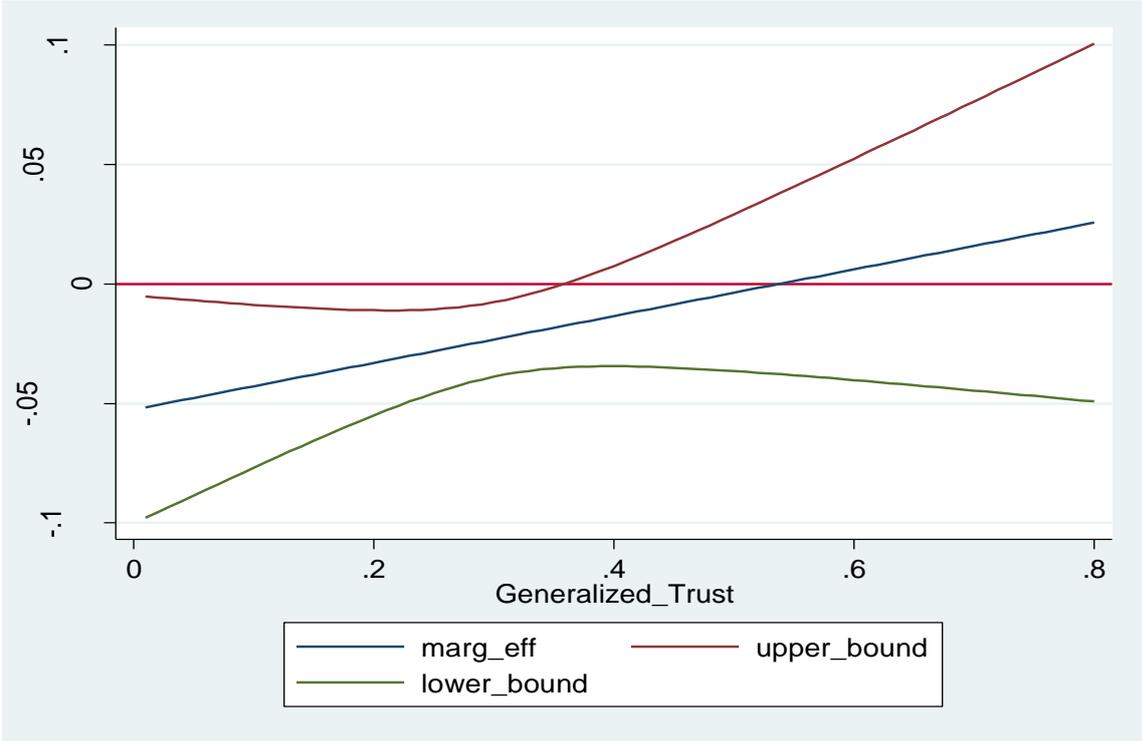
Figure 2: Total marginal effects of num_coal_(it) at various levels of trust_av_(it)
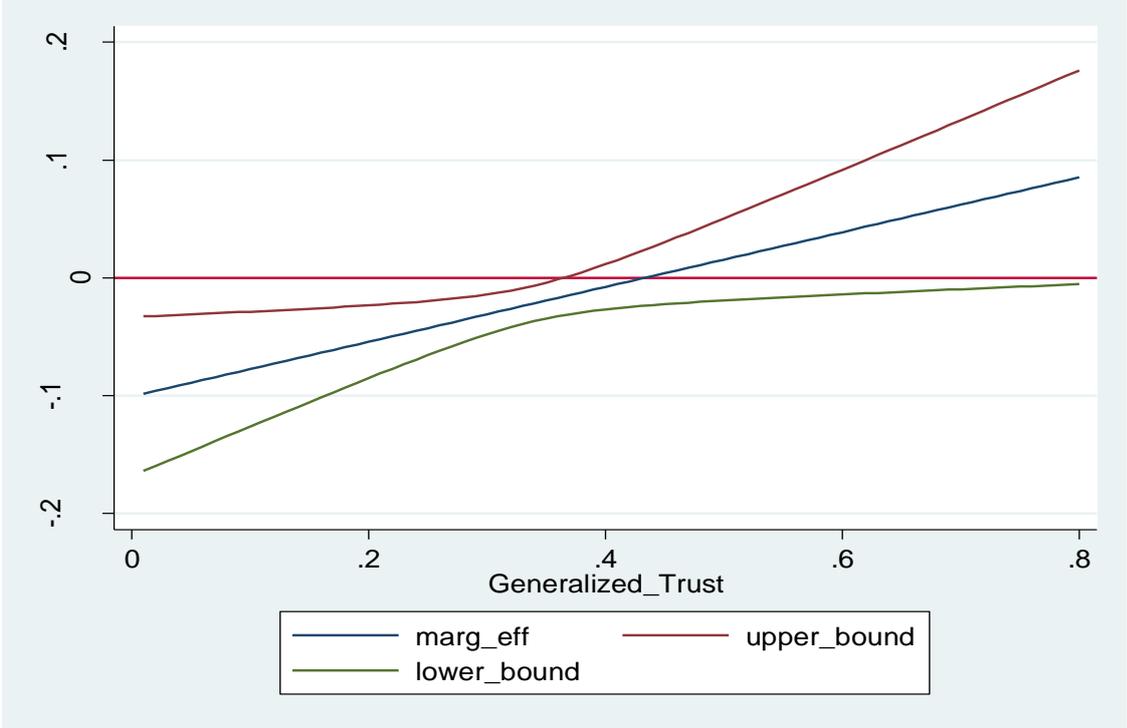
Notes: These graphs are based on Brambor et al. (2006) and on columns (4) and (8) of Table 10. The graph shows the marginal effect of checks on reform at various levels of generalized trust. The 90 percent confidence interval is displayed. The confidence interval does not include zero up to a value of generalized trust of about 0.37 trust_av_(it) ranges from about 3.5 percent to 68 percent. About 78 percent of all trust_av_(it) values are below 0.37.

Figure 3: Total marginal effects of trust_av_(it) at various levels of checks_(it)
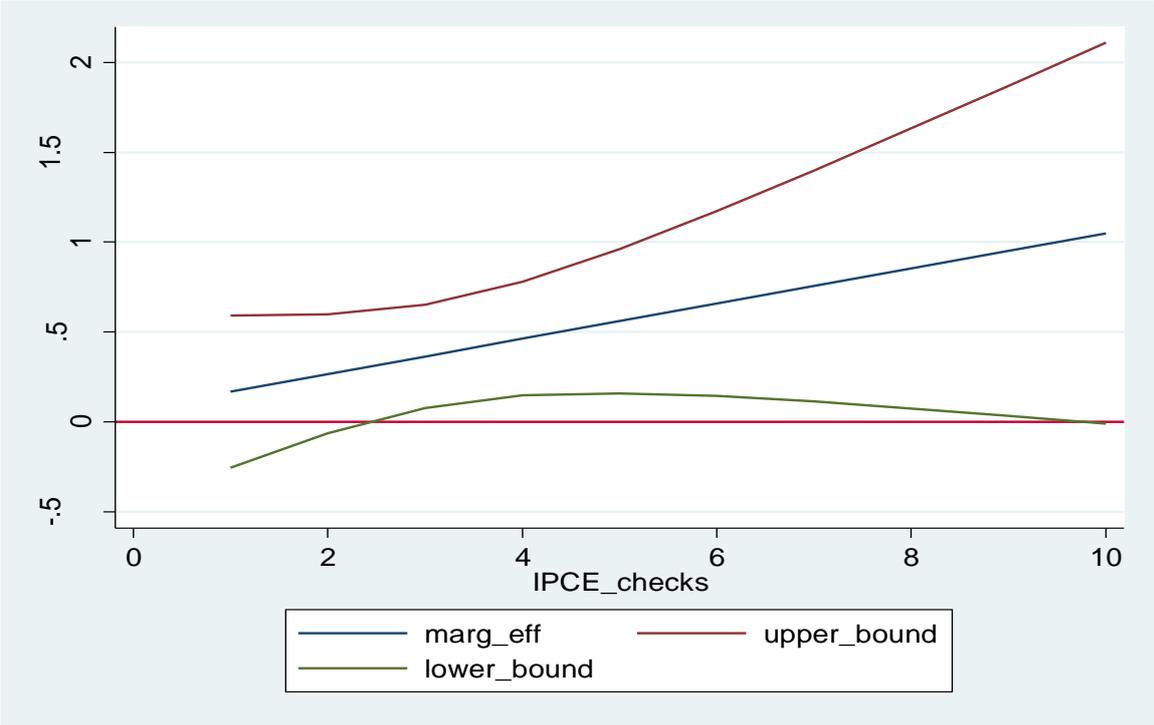
Figure 4: Total marginal effects of trust_av_(it) at various levels of num_coal_(it)
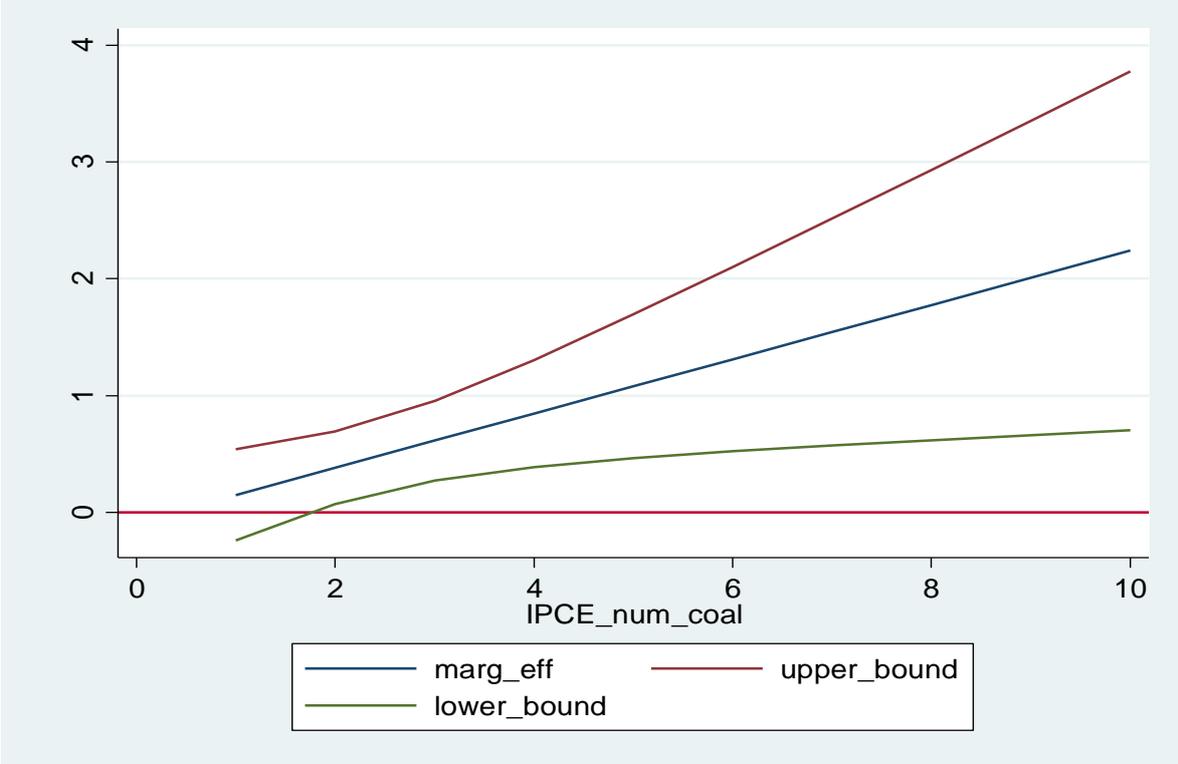
Notes: These graphs are based on Brambor et al. (2006) and on columns (4) and (8) of Table 10. The graph shows the marginal effect of generalized trust on reform at various levels of IPCE. The 90 percent confidence interval is displayed. The confidence interval does include zero up to a value of IPCE = 2. checks_(it): 11 percent of obs < 2 and 1 obs > 10; num_coal_(it): 38 percent of obs < 2 (i.e., 38 percent single-party governments).

Table A1: Descriptive Statistics		Mean	Std. Dev.	Min	Max	Obs.	Source / Derived from
reform (D_efw)	overall	-0.03	0.37	-1.30	1.30		Gwartney et al. (2013)
trust	overall	0.28	0.17	0.03	0.76		WVS and EVS
	within		**0.04**				
trust_av	overall	0.28	0.15	0.04	0.68		WVS and EVS
	within		**0.01**				
checks	overall	3.52	1.88	1.00	17.00		Beck et al. (2001)
winmar	overall	0.11	0.13	0.00	0.50		Beck et al. (2001)
left	overall	0.29	0.45	0.00	1.00		Beck et al. (2001)
election	overall	0.23	0.42	0.00	1.00		Beck et al. (2001)
D_Prop	overall	0.77	0.42	0.00	1.00		Beck et al. (2001)
D_pres	overall	0.41	0.49	0.00	1.00		Beck et al. (2001)
D_parl	overall	0.52	0.50	0.00	1.00		Beck et al. (2001)
D_assem	overall	0.07	0.26	0.00	1.00		Beck et al. (2001)
lag_D_crisis	overall	0.04	0.20	0.00	1.00		Laeven and Valencia (2012)
lag_mean_unemp	overall	8.29	5.38	0.60	36.07		World Bank WDI
lag_mean_infl	overall	6.21	8.16	0.50	68.14		World Bank WDI
lag_ln_GDPcap_PPP	overall	9.48	1.04	6.55	11.34		World Bank WDI
Num_coal	overall	2.43	1.99	1.00	16.00		Beck et al. (2001)
D_coal	overall	0.61	0.49	0.00	1.00		Beck et al. (2001)
Frac_legis	overall	0.64	0.19	0.00	0.91	N = 121	Beck et al. (2001)
Frac_govern	overall	0.28	0.28	0.00	0.79		Beck et al. (2001)
Frac_oppos	overall	0.48	0.24	0.00	1.00	N = 116	Beck et al. (2001)
Polcon	overall	0.39	0.16	0.00	0.71	N = 121	Teorell et al. (2013)
Xconst	overall	6.02	1.55	2.00	7.00	N = 118	Teorell et al. (2013)
Polity2	overall	0.86	0.35	0.00	1.00	N = 121	Teorell et al. (2013)
Colonial	overall	1.25	2.17	0.00	8.00		Teorell et al. (2013)
Federal	overall	0.19	0.39	0.00	1.00		Forum of Federations
Post_election	overall	0.28	0.45	0.00	1.00		Beck et al. (2001)
Yrcurnt	overall	1.88	1.23	0.00	4.00	N = 117	Beck et al. (2001)
D_net_aid	overall	0.68	0.47	0.00	1.00		World Bank WDI
Corrup	overall	5.11	2.37	0.40	9.70	N = 120	Teorell et al. (2013)
KOF_econ	overall	67.29	17.04	21.61	94.21		Dreher (2006)
EFW_area1b		6.53	2.01	2.30	10	N = 119	Gwartney et al. (2013)
hier_relig	overall	62.15	37.42	0.10	100.00		Teorell et al. (2013)
latitude	overall	0.42	0.18	0.01	0.72		Teorell et al. (2013)
ln_mean_distance	overall	7.55	2.18	0.00	9.79		Mayer and Zignago (2011)
Observations	N = 122	n = 77	T = 1.6				

Table A2	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)	(30)	(31)	(32)	(33)
reform	1.00																																
trust	0.05	1.00																															
trust_av	0.06	**0.96**	1.00																														
checks	-0.12	0.15	0.17	1.00																													
winmar	0.15	-0.08	-0.10	-0.35	1.00																												
left	0.00	0.04	0.09	0.09	-0.01	1.00																											
election	-0.04	-0.10	-0.15	-0.21	0.10	-0.13	1.00																										
D_Prop	0.02	0.13	0.12	0.24	-0.34	-0.13	0.07	1.00																									
D_pres	-0.09	-0.36	-0.35	-0.29	0.01	-0.20	0.38	-0.10	1.00																								
D_parl	0.16	0.28	0.27	0.39	-0.13	0.07	-0.33	0.13	**-0.86**	1.00																							
D_assem	-0.13	0.14	0.15	-0.21	0.22	0.24	-0.08	-0.07	-0.24	-0.29	1.00																						
D_coal	0.06	0.22	0.21	0.34	-0.15	-0.24	-0.01	0.33	-0.16	0.21	-0.10	1.00																					
lag_D_crisis	0.03	0.16	0.12	0.10	0.01	-0.04	-0.11	0.11	-0.17	0.20	-0.06	0.16	1.00																				
lag_mean_unemp	0.14	-0.23	-0.22	-0.10	0.04	0.10	0.09	0.17	0.03	-0.03	0.00	0.10	-0.09	1.00																			
lag_mean_infl	-0.38	-0.21	-0.25	-0.05	-0.01	0.01	-0.05	-0.06	0.16	-0.19	0.08	-0.10	0.27	-0.05	1.00																		
lag_ln_GDPcap_PP	0.12	0.40	0.40	0.20	-0.28	0.02	-0.08	0.21	-0.35	0.46	-0.22	0.10	0.15	-0.10	-0.34	1.00																	
Num_coal	-0.11	0.14	0.16	**0.51**	-0.15	-0.09	-0.05	0.28	-0.17	0.21	-0.09	**0.57**	0.10	0.03	-0.08	-0.12	1.00																
Frac_legis	-0.10	0.09	0.06	0.41	**-0.67**	-0.15	0.04	**0.55**	-0.01	0.15	-0.29	**0.61**	0.14	0.16	-0.04	0.18	0.47	1.00															
Frac_govern	-0.02	0.19	0.15	0.35	-0.10	-0.20	0.03	0.45	-0.11	0.15	-0.08	**0.80**	0.23	0.13	-0.06	0.10	**0.63**	**0.70**	1.00														
Frac_oppos	-0.07	-0.12	-0.12	0.25	**-0.53**	-0.11	0.03	0.24	-0.04	0.15	-0.37	0.13	0.05	0.12	0.04	0.25	0.09	0.44	0.07	1.00													
Polcon3	-0.03	0.08	0.06	0.14	-0.32	-0.14	0.00	0.39	-0.16	0.25	-0.18	0.41	0.19	0.11	-0.11	0.30	0.20	**0.55**	0.47	0.42	1.00												
Xconst	-0.05	0.15	0.15	0.45	**-0.50**	0.17	-0.11	0.47	-0.42	0.46	-0.09	0.21	0.12	0.08	-0.21	**0.52**	0.17	0.46	0.23	0.40	**0.51**	1.00											
Polity2	-0.03	0.08	0.09	0.43	-0.44	0.05	-0.06	0.40	-0.29	0.37	-0.16	0.21	0.08	0.11	-0.11	0.41	0.12	0.40	0.15	0.46	0.45	**0.85**	1.00										
Colonial	-0.11	-0.42	-0.42	-0.09	0.22	0.04	0.18	-0.31	0.33	-0.33	0.01	-0.06	-0.12	-0.12	0.09	-0.48	0.18	-0.17	-0.10	-0.26	-0.17	-0.37	-0.39	1.00									
Federal	-0.06	0.02	0.07	0.32	-0.01	0.11	0.04	-0.04	-0.06	0.09	-0.06	-0.05	0.01	0.07	-0.06	0.06	0.13	-0.02	0.11	0.11	-0.08	0.04	0.19	0.05	1.00								
Post_election	0.04	-0.06	-0.06	0.01	-0.07	-0.11	-0.25	-0.14	0.08	-0.06	-0.04	0.00	-0.04	-0.05	0.04	0.00	-0.09	-0.11	-0.13	0.14	0.01	-0.02	0.04	-0.04	-0.11	1.00							
Yrcurnt	-0.06	-0.06	-0.06	0.14	-0.01	-0.01	-0.54	-0.09	-0.11	0.09	0.03	0.01	0.09	-0.13	0.10	-0.14	0.10	-0.05	-0.01	0.14	0.05	0.02	0.01	0.14	-0.09	0.49	1.00						
D_net_aid	-0.03	**-0.60**	**-0.62**	-0.18	0.21	-0.07	0.21	-0.08	0.39	-0.49	0.19	-0.07	-0.21	0.22	-0.19	**-0.64**	0.07	-0.12	0.01	-0.16	-0.26	-0.37	-0.28	0.40	0.03	-0.04	0.06	1.00					
Corrup	0.13	**0.54**	**0.54**	0.22	-0.22	0.13	-0.17	0.10	-0.44	**0.51**	-0.16	0.13	0.15	0.01	-0.24	**0.77**	-0.03	0.18	0.20	0.21	0.34	0.48	0.28	-0.31	-0.03	-0.03	-0.03	**-0.74**	1.00				
KOF_econ	0.05	0.30	0.28	0.19	-0.23	0.06	0.03	0.25	-0.35	0.37	-0.05	0.13	0.12	0.13	-0.16	**0.76**	-0.13	0.23	0.23	0.23	0.32	**0.55**	0.41	-0.38	-0.09	-0.06	-0.16	-0.38	**0.68**	1.00			
hier_relig	0.00	**-0.60**	**-0.60**	-0.15	-0.02	-0.12	0.27	0.19	0.28	-0.15	-0.24	-0.08	-0.04	0.28	-0.14	-0.16	-0.14	0.11	-0.02	0.11	0.00	-0.09	-0.01	0.00	-0.02	-0.01	-0.09	0.41	-0.45	-0.08	1.00		
latitude	0.11	**0.52**	**0.50**	0.14	-0.26	0.03	-0.02	0.38	-0.32	0.32	-0.02	0.17	0.17	0.09	-0.17	**0.59**	-0.02	0.31	0.20	0.20	0.44	0.36	0.29	**-0.70**	-0.05	-0.03	-0.17	-0.43	0.46	**0.50**	-0.05	1.00	
ln_mean_distance	-0.05	**-0.62**	**-0.58**	-0.22	0.17	-0.01	0.05	-0.26	0.32	-0.34	0.06	-0.29	-0.15	0.03	0.17	-0.39	-0.13	-0.31	-0.36	-0.13	-0.29	-0.25	-0.18	0.33	0.13	0.04	0.08	0.38	-0.46	-0.40	0.30	**-0.63**	1.00

Notes: correlation coefficients above 0.49 in bold; the vast majority of more pronounced correlations are either as suggested (esp. trust(it) and trust_av_(it) with the three instruments (31)-(33)) or between variables which are substitutes for each other (esp. different measures for constraints on the executive and between D_pres_(it) and D_parl_(it)): Besides pronounced correlation with their instruments, trust_(it) and trust_av_(it) show higher correlation coefficients with D_net_aid_(i) and corrup_(it) only; checks_(it) only shows higher correlation with its close substitute num_coal_(it)._

Table A3: checks_(it) at various levels of winmar_(it)

winmar2	1	2	3	4	5	6	7	17	Total
0	1	0	2	11	4	5	1	1	25
10	3	12	18	10	8	4	0	0	55
20	2	5	6	6	0	1	0	0	20
30	1	0	4	3	2	0	0	0	10
40	2	0	2	1	0	0	0	0	5
50	4	1	1	1	0	0	0	0	7
Total	13	18	33	32	14	10	1	1	122

Notes*: checks_(it) ranges from 1 to 17 (only one observation); winmar2 is winmar with new scale (e.g., values of winmar_(it) > 0 and <= 10 fall into winmar2 category with value of 10 etc).*

Table A4: Additional control variables

Variable	Rationale	Expected sign	Source
Polity2 Dummy variable with entry = 1 if p_polity2 > 0)	Higher responsiveness of democracies to changing circumstances and political preferences may speed up the economic reforms;	+; yet, as we include many variables which characterize democracies (e.g, parliamentary political system; elections) statistical insignificance is expected	Teorell et al. (2013); p_polity2 variable
Federal Dummy variable with entry = 1 for federal countries)	Due to competition between jurisdictions within a country policy innovation should be higher in federations compared to unitary countries	+	http://www.forumfed.org/en/federalism/federalismbycountry.php
KOF_econ Variable ranging from 0 to 100	Due to competition between jurisdictions policy innovation should be higher in more open countries compared	+	Dreher (2006)
Corrup Variable ranging from 0 to 10	Corruption as indicator for quality of government; less corruption = better quality government	+ as higher values of corruption indicator (Heritage Foundation) used imply lower levels of corruption	Teorell et al. (2013); hf_corrupt variable
Colonial Dummy for different types of colonies	Former colonies of Western countries may inherit formal and informal institutions	? as variable used has entry zero for countries that never have been colonized – including former colonial powers	Teorell et al. (2013); ht_colonial variable
Post_election Dummy variable for first year after election	The further away elections the higher propensity to reform as uncertain political costs of reform are of lower importance	+	Derived based on Beck et al. (2001); legelec and exelec variables
yrcurnt years until next election	The further away elections the higher propensity to reform as uncertain political costs of reform are of lower importance	+	Beck et al. (2001)
D_net_aid Dummy variable with entry 1 if country is net receiver of foreign aid in the 1990s	Foreign aid granted to speed-up market-oriented economic reforms	+; however, empirical literature (Heckelman and Knack, 2008; Alesina et al., 2006) is consistent with a negative impact or no effect	World Bank's WDI database; derived from variable "Net official development assistance and official aid received (current US$)"; entry = 1 if sum over 1990s > 0 and zero otherwise
EFW_area1b Index ranging from 0 to 10 (lowest possible importance of transfers and subsidies in GDP)	Reform losers can be more easily compensated in countries with a higher importance of public transfers and subsidies	- as variable used (EFW from Fraser Institute) increases with lower importance of public transfers and subsidies in GDP	Gwartney et al. (2013), variable area 1b

Table A5: Country-Year-Pairs

country	year	country	year	country	year	country	year
ALB	2002	ETH	2007	LTU	2008	SVK	2008
ALB	2008	FIN	2005	LUX	2008	SVN	2005
ARM	2008	FIN	2009	LVA	2008	SVN	2008
ARM	2011	FRA	2006	MAR	2001	SVN	2011
AUS	2005	FRA	2008	MAR	2007	SWE	2006
AUT	2008	GBR	2005	MAR	2011	SWE	2009
AZE	2008	GBR	2009	MDA	2006	SWE	2011
AZE	2011	GEO	2008	MDA	2008	TTO	2006
BEL	2009	GHA	2007	MEX	2005	TTO	2011
BGD	2002	GRC	2008	MKD	2008	TUR	2001
BGR	2005	GTM	2004	MLT	2008	TUR	2007
BGR	2008	HRV	2008	MYS	2006	TUR	2009
BIH	2008	HUN	2008	NGA	2011	TUR	2011
BRA	2006	IDN	2001	NLD	2006	TZA	2001
CAN	2006	IDN	2006	NLD	2008	UGA	2001
CHL	2006	IND	2001	NOR	2007	UKR	2006
CHL	2011	IND	2006	NOR	2008	UKR	2008
CHN	2001	IRL	2008	NZL	2004	UKR	2011
CHN	2007	IRN	2007	NZL	2011	URY	2006
COL	2005	ISL	2009	PER	2001	URY	2011
CYP	2006	ISR	2001	PER	2006	USA	2006
CYP	2008	ITA	2005	PHL	2001	USA	2011
CYP	2011	ITA	2009	POL	2005	VNM	2006
CZE	2008	JOR	2007	POL	2008	ZAF	2001
DEU	2006	JPN	2005	PRT	2008	ZMB	2007
DEU	2008	JPN	2010	ROM	2005	ZWE	2001
DNK	2008	KAZ	2011	ROM	2008		
ESP	2007	KGZ	2003	RUS	2006		
ESP	2008	KGZ	2011	RUS	2008		
ESP	2011	KOR	2001	RUS	2011		
EST	2008	KOR	2005	RWA	2007		
EST	2011	KOR	2010	SGP	2002		