1 Introduction: the diffusion of liberalization

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The worldwide spread of economic and political liberalism was one of the defining features of the late twentieth century. Free-market oriented economic reforms – macroeconomic stabilization, liberalization of foreign economic policies, privatization, and deregulation – took root in many parts of the world. At more or less the same time, a "third wave" of democratization and liberal constitutionalism washed over much of the globe. Most economists believe the gains to developing countries from the liberalization of economic policies to be in the hundreds of billions of dollars. But they also acknowledge the instability and human insecurity sometimes left in liberalization's wake.[1] Political scientists argue that the rise of democracy has contributed to the betterment of both human rights and international security.[2] While the precise effects of these twin waves of liberalization are still debated, it is hard to deny that they have had a tremendous impact on the contemporary world. This book examines the forces that help account for the spread of political and economic liberalization. Why has much of the world come to accept markets and democracy?

Some commentators focus on the exercise of American power. According to this line of argument, the hegemonic United States – often acting through the Bretton Woods international economic institutions it helped create after the Second World War – has used a combination of carrots (political and military support as well as preferential access to American markets) and sticks (from strings attached to financial assistance to threats of military coercion) to impose its vision for political and economic liberalism on the rest of the world. Others see the decentralized process of technologically induced globalization at work. Sharp declines in the ability of governments to control cross-border movements of goods, services, and capital are thought to have forced countries to

[1] Dobson and Hufbauer 2001; Kaplinsky 2001; Prasad, Rogoff, Wei, and Kose 2003.
[2] Doyle 1986.

compete with each other for investment and market share by enacting political and economic reforms that reduce governmental constraints on finance and firms. Still another line of argument focuses more on the emergence of influential ideologies, from monetarism to glasnost to "rights talk," that may have little to do with political power or market dynamics.

This book puts these processes under the analytic microscope. The wave-like structure of liberalization's spread around the world suggests that these policy changes are hardly independent events. We are interested primarily in how a given country's policy choices are affected by the prior choices of other countries, sometimes mediated by international organizations and private transnational actors. There is considerable variation in the spread of liberal policies across time and space, which the contributors to this volume exploit to explore the processes underpinning liberalization. Our principal objective is to shed light on the causal mechanisms that explain the timing and geographic reach of liberal innovations. What has caused these new policies to diffuse across time and space? Conversely, what factors put the brakes on such diffusion, and why are some countries willing to take an apparently independent course?

The contending approaches to liberalization we outline share the assumption that national policy choices are at least to some extent interdependent – that governments adopt new policies not in isolation but in response to what their counterparts in other countries are doing. In this introduction, we review four distinct mechanisms through which interdependent decision making may take place – coercion, competition, learning, and emulation. We begin by describing the patterns of liberalization that we seek to explain. We then move on to distinguish *interdependent* decision making by national governments from the null hypothesis of *independent* decision making, which has been for decades the workhorse approach in comparative and international political economy. We then elaborate the four classes of diffusion hypotheses found in the literature, which are subsequently tested alongside one another and developed in the other chapters in this book. We end by previewing the findings of the coming chapters.

The spread of economic and political liberalism

We define liberalism conventionally. Economic liberalism, in the classic rather than the American sense, refers to policies that reduce government constraints on economic behavior and thereby promote economic exchange: "marketization." Political liberalism refers to policies that

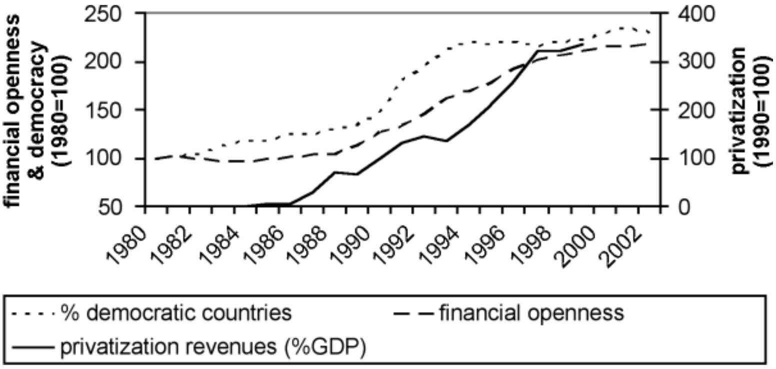

Figure 1.1 Political and economic liberalization around the world

reduce government constraints on political behavior, promote free political exchange, and establish rights to political participation: "democratization."

There is no doubt that both forces have been powerful facets of the global political economy in recent decades. Figure 1.1 documents this trend on three key indicators of liberalization in the 1980s and 1990s. The privatization of state-owned enterprises went from an iconoclastic policy idea in Margaret Thatcher's 1979 British election manifesto to a major element of economic policy in both developed and developing countries over the course of twenty years.[3] At more or less the same time, there was a dramatic opening of national economies to external forces – exemplified by substantial reductions in policy restrictions on cross-border capital flows.[4] But the scope of liberalization was not limited to economic policy. Perhaps the headline political statistic of the late twentieth century was that the proportion of democratic countries in the world more than doubled from under 30% in the early 1980s to almost 60% in the first years of the twenty-first century (while the number of sovereign states in the world also doubled to roughly 200).[5]

Moreover, all three curves in Figure 1.1 follow the classic S-shaped logistic curve associated with the diffusion of innovation, beginning with hesitant early moves to liberalize in only a few countries, followed by a rapid escalation in the trend, and finally a leveling off. In less than a

[3] Brune, Garrett, and Kogut 2004. [4] Simmons and Elkins 2004.
[5] Przeworski *et al.* 2000.

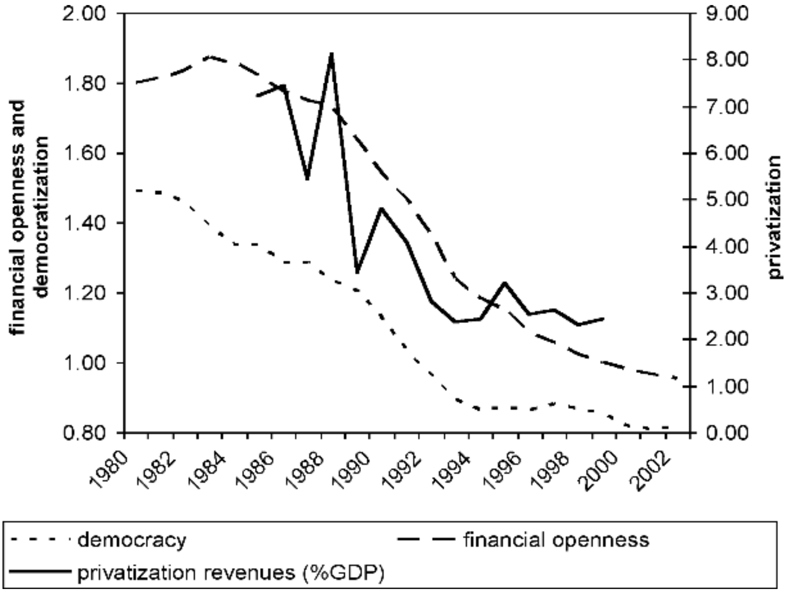

Figure 1.2 Variations in liberalization around the world (std. deviation/ mean)

generation a new equilibrium level of much more liberalism appears to have been established in each realm.

Figure 1.2 demonstrates that in addition to this broad trend toward political and economic liberalism, there was considerable convergence in national trajectories.[6] Cross-national variation, defined in terms of coefficients of variation (the standard deviation of each distribution divided by its mean) declined substantially in each of the three areas of privatization (representing domestic economic liberalization), capital account openness (external economic liberalization), and democracy (political liberalization).

It is important to note, however, that these broad global trends toward liberalism belie substantial variations in the paths pursued by countries in different parts of the world. Figures 1.3 to 1.5 break down the global averages presented in Figure 1.1 by geographic region. As students of democracy know well, there have been three waves of democratization in recent decades (see Figure 1.3). Latin American countries began to

[6] For recent reviews of the "convergence" literature see Heichel, Pape, and Sommerer 2005; Knill 2005.

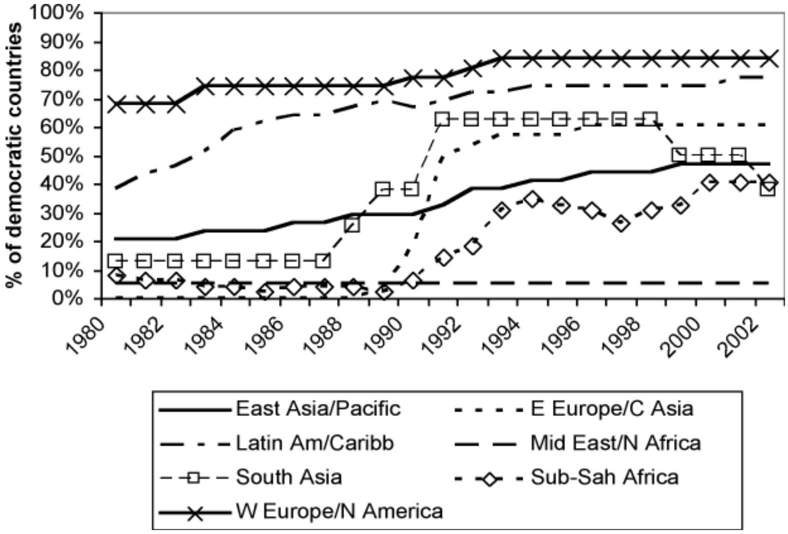

Figure 1.3 Regional variations in democracy

democratize in the 1970s, to the point where today the region is almost as democratic as North America and Western Europe. The same kind of pattern, though less pronounced, was apparent in East Asia and the Pacific. A second wave of democratization centered around the fall of the Berlin Wall and the subsequent velvet revolutions in the former Soviet bloc between 1989 and 1991 – but it should also be noted that the pace and extent of democratization was almost as great, and began just a few years earlier, in South Asia. The number of democracies in Sub-Saharan Africa also began to increase in 1989, though that region still lags behind Eastern Europe and Central Asia. Only the Middle East and North Africa saw no significant democratization in the 1980s and 1990s.

Figure 1.4 presents data on the openness of national economies to international financial flows with respect to: foreign direct investment (FDI); the buying and selling of stocks, bonds, and currencies across national borders; and international bank lending. The most dramatic feature of this figure is the rapid march among the countries of North America and Western Europe toward complete financial openness. The same general trend, though muted, obtained in Central Europe, East Asia, and Latin America. There were small moves toward capital mobility in Sub-Saharan Africa, but only in the mid and late 1990s. Financial policy remained relatively closed in the Middle East and in South Asia in the 1980s and 1990s.

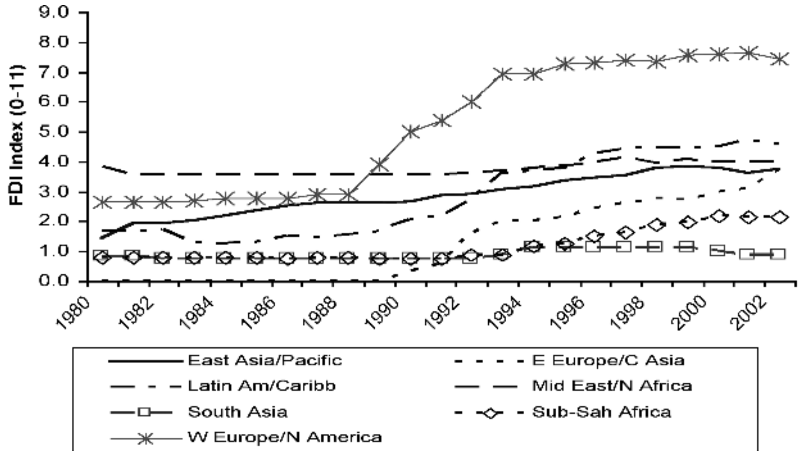

Figure 1.4 Regional variations in financial openness

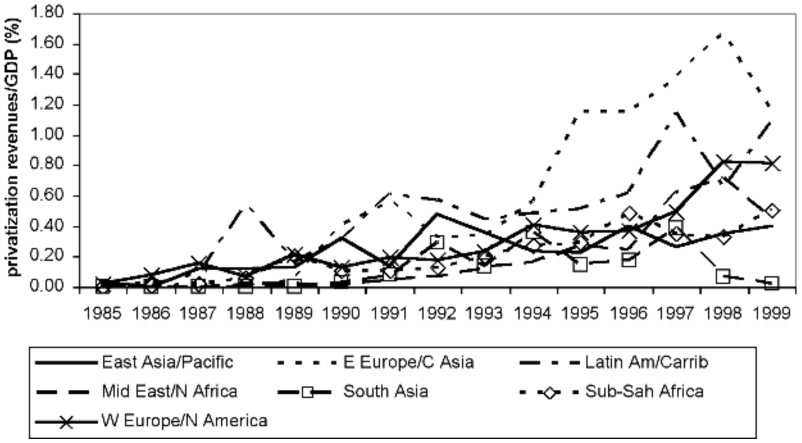

Figure 1.5 Regional variations in privatization

Finally, Figure 1.5 presents data on regional variations in privatization. Given that the data are measured in terms of the prices at which state-owned assets were sold (relative to GDP), it is not surprising that these curves are less smooth. Nonetheless, it is clear that privatization took off earlier and was more pronounced in Eastern Europe and Central Asia, Latin America and North America, and Western Europe than elsewhere. The radical and thoroughgoing nature of the velvet revolutions in the former Soviet countries is readily apparent in the case of privatization, no doubt in large measure because these countries had the most state-owned assets to sell in the 1990s.

Figures 1.3 to 1.5 demonstrate that despite the global trend toward liberalism, there were important differences in the trajectories of different parts of the world – differences across regions, over time, and among different dimensions of liberalization. The Middle East and North Africa did not liberalize much, if at all, in the 1980s and 1990s. Latin America democratized and marketized gradually over the whole period, whereas the shift from state socialism to capitalist democracy was much more abrupt in Eastern Europe.

Clearly, some countries and even entire regions seem exempt from the general liberalizing trends. How do we understand these variations? Growing literatures in political science and sociology point to different dynamic explanations for such policy clustering, which we dub "diffusion." Let us now define diffusion and distinguish it from alternative causal processes.

Policy diffusion – and its alternatives

International policy diffusion occurs when government policy decisions in a given country are systematically conditioned by prior policy choices made in other countries (sometimes mediated by the behavior of international organizations or private actors and organizations). Theories of diffusion have pointed to diverse mechanisms ranging from Bayesian learning to rational competition through hegemonic domination to unthinking emulation of leaders. Theories of diffusion encompass a wide array of assumptions about who the primary actors are, what motivates their behavior, the nature and extent of the information on which they base decisions, and their ultimate goals.

But what theorists of diffusion explicitly *reject* is the notion that processes of policy and political change can adequately be understood by conceiving of national governments as making decisions independently of each other. Policy independence is thus the null hypothesis that motivates our inquiry.[7] Most cross-national social science research focuses on variants of this null hypothesis, developing explanations based on the specific conditions governments encounter. For example, differences in economic development,[8] social cleavages,[9] national institutions,[10] and elite interactions[11] have all been argued to play important roles in democratization.

[7] Compare for example Lenschow, Liefferink, and Veenman 2005.
[8] Przeworski *et al.* 2000. [9] Collier 1999. [10] Linz and Stepan 1996.
[11] O'Donnell, Schmitter, and Whitehead 1986.

Students of the spread of democracy, and of market institutions, frequently presume that decisions to democratize are made in isolation.

A small literature has developed that takes seriously the international diffusion of democracy,[12] but theoretical development and empirical testing are still at a very early stage. Perhaps more surprisingly, the political economy literature is also dominated by research that assumes independent policy choice across countries. Political economists have analyzed restrictions on cross-border capital flows as tools of economic repression[13] or reasoned that such controls could be explained by partisanship, domestic cleavages, and governments' desires for seigniorage.[14] Recent work on the choice of monetary and exchange rate institutions also focuses on the null hypothesis, as amply demonstrated by a recent special issue of *International Organization*, which focused on domestic political pressures,[15] domestic veto players,[16] federalism,[17] coalition governments,[18] and domestic policy transparency[19] as determinants of national monetary institutions and policies.

In the past twenty years, an important strand of research in political economy has linked domestic policy choice with constraints, pressures, and opportunities generated by the international economy. Peter Gourevitch studied the impact of position in the international economy on domestic responses to economic crisis.[20] Ronald Rogowski analyzed trade policy coalitions in comparative advantage terms.[21] Jeffry Frieden hypothesized that the preferences of domestic groups vis-à-vis financial liberalization and exchange rate policy were the function of their specific endowments.[22] But these studies tend to reduce "external influences" to simple exogenous factors, notably changes in relative prices around the world.[23] None explicitly explores the possibility of interdependent decision making – the impact of policy choices in other countries on the behavior of governments at home.

Frieden and Rogowski posited the simplest possible argument to explain economic liberalization in recent decades. They contend that "exogenous easing," such as declining transport and communication costs, has greatly increased the opportunity costs of closure.[24] Over time, these costs have mounted on governments, increasing the incentive to open their economies. As Geoffrey Garrett and Peter Lange were quick

[12] See Huntington 1991; Markoff 1996; O'Loughlin, Ward, Lofdahl, Cohen, Brown, Reilly, Gleditsch, and Shin 1998; Starr 1991.
[13] Giovannini and De Melo 1993.
[14] Epstein and Schor 1992; Grilli and Milesi-Ferretti 1995; Quinn and Inclan 1997.
[15] Clark 2002. [16] Keefer and Stasavage 2002. [17] Hallerberg 2002.
[18] Bernhard and Leblang 2002. [19] Broz 2002. [20] Gourevitch 1986.
[21] Rogowski 1989. [22] Frieden 1991. [23] Keohane and Milner 1996.
[24] Frieden and Rogowski 1996.

to note, however, the pace and extent of liberalization have varied substantially across countries.[25] Garrett and Lange argued that it was critical to take seriously this variation, rather than dismissing it as "noise," as theorists of exogenous easing tended to do. They proposed a framework for analyzing how constellations of domestic interests and institutions mediate between lower costs of international movements and national policy liberalization. Their focus, however, was still squarely on domestic institutions, with no serious thought given to external policy influences.

Our intention is not to deny that relative prices and other factors exogenous to the decision-making environment in any one country affect policy choice. But from our perspective, the critical analytic point is that exogenous shocks – such as changing world prices – are a commonly experienced phenomenon to which governments must decide how to respond. Their responses are no doubt influenced in a "bottom-up" fashion by conditions and institutions within their own countries.[26] But they are surely also affected by the decisions and behavior of other countries. The challenge facing theorists of international policy diffusion is first to demonstrate that domestic political and economic factors cannot alone predict when governments adopt new policies, and then to develop and test hypotheses that distinguish among the several possible mechanisms of diffusion. We argue that government decision making in these critical areas has in fact been highly interdependent and that the mechanisms of diffusion can potentially be teased out in empirical analyses.

Mechanisms of global diffusion

There is an affinity between the recent "strategic turn" in the social sciences and attention to international policy diffusion.[27] But diffusion processes are characteristically uncoordinated[28] and cannot always easily be subsumed under the umbrella of fully informed, rational decision making. Indeed, diffusion is a much broader phenomenon whose study long predates the influence of game theory.

Anthropologists in the first half of the twentieth century "laid primary stress on diffusion, that is, the process of adopting or borrowing by one culture from another various devices, implements, institutions, and beliefs."[29] More recently, sociologists have argued that nations mimic

[25] Garrett and Lange 1995.
[26] See for example Gilardi's study of the diffusion of independent regulatory agencies; Gilardi 2005.
[27] Lake and Powell 1999. [28] Elkins and Simmons 2005. [29] Malinowski 1944: iii. 17.

their successful peers almost ritualistically.[30] Economists debate whether there is a rational/material base to international financial crises, or whether they result from "contagious" herd behavior.[31] Political scientists have incorporated the diffusion of ideas into their accounts of the choice of economic policies.[32] Students of organizational behavior model international networks among people and firms that are said to drive the diffusion of technology and management practices.[33]

But which of these processes is the most important, and under what circumstances does each operate? How can we distinguish among them, both theoretically and empirically? This introduction distinguishes among four causal mechanisms of international diffusion: *coercion*, *competition*, *learning*, and *emulation*. In practice, of course, the diffusion mechanisms we discuss are sometimes commingled and the lines between them are not always sharp. Nonetheless, we believe that clearly staking out the theoretical terrain is a precondition to social scientific progress on a critical dynamic in world politics that is all too often shrouded in imprecise thinking by scholars who talk past each other while preaching to the converted.

Coercion

One prominent explanation for the spread of economic and political liberalism involves a distinctly anti-liberal mechanism: coercive power. It can be exercised by a range of actors: governments, international organizations, and even non-governmental actors.[34] Coercion can be applied in various ways from the subtle to the overt: through the threat or use of physical force,[35] the manipulation of economic costs and benefits, and even through the monopolization of information or expertise. The underlying logic of coercion thus involves power asymmetries that strong actors exploit to impose their preferences for policy change on the weak. Coercion theorists suggest that policies diffuse from the "center" both actively through "conditionality" and passively through "unilateralism" by more powerful actors.[36] Essentially, coercion involves the (usually

[30] Thomas, Meyer, Ramirez, and Boli 1987. [31] Kaminsky and Reinhart 2000.
[32] Hall 1989; McNamara 1998.
[33] Goolsbee and Klenow 1999; Keller 2002; Powell 1990.
[34] Private banks, for example, in IMF conditionality. See Edwards 1997; Gould 2003.
[35] We would expect physical coercion to be rare in the diffusion of economic policy in the latter half of the twentieth century, but it has been used repeatedly historically and contemporaneously by powerful countries to influence domestic institutions in weaker countries. See Owen 2002.
[36] Essentially hierarchical in nature, coercion is a form of "vertical diffusion" discussed in much of the literature on federalism and European regionalism. See for example Daley and Garand 2005; Gilardi 2005.