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a response to Abiad and Mody**

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**Abstract**

We challenge recent findings by Abiad and Mody (2005) which suggest that financial liberalization has little to do with political variables. This analysis is at odds with some of the established literature, and only with difficulty comes to terms with the considerable cross-national variation in the pace, phasing, and extent of financial reforms over time. Using Abiad and Mody's own index of financial liberalization, but slightly unbundling and refining their measures of 'ideological affinity' and 'regime type', we examine what Abiad and Mody call the 'triggers' of liberalisation and the dynamics of the subsequent 'cumulative transformation'. We demonstrate the role of political variables in relation to initial liberalisation episodes, and as variables affecting the cumulative dynamics and sustainability of ongoing financial reform processes, including those which affect the acceptability and costs of liberalization. These factors include (i) shifts to – as opposed to levels in – Left government; (ii) the incidence of Left governments combined with low levels of democracy; (iii) international voter support for free markets; (iv) the extent of social safety nets; (v) the presence of multilateral and bilateral aid programs. Our empirical investigation confirms these factors as statistically significant determinants of financial liberalization, and reveal what Abiad and Mody identify as 'learning' to be a highly political process.

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## **1. Introduction**

Global financial openness remains a politically fragile and contested dynamic, as the reaction to the current sub-prime crisis clearly demonstrates. It follows that there are sound reasons to enhance understanding of these dynamics through ongoing research into the political economy of financial openness as a key face of economic globalization. A recent and important contribution to this literature is Abiad and Mody's (2005) study of the determinants of financial liberalization, based on a rich new dataset of policy measures, which encapsulate six different aspects of financial reforms. Abiad and Mody's explanation of the timing, pace, and extent of financial reforms and consequent origins of financial liberalization stands out as remarkably apolitical. Their core argument and empirical findings highlight how increasing-returns become locked-in through learning effects. The initial step to liberalization is difficult and is typically sparked by economic shocks, but this policy breakthrough yields information and footholds for deepening liberalization over time which are related to the spatial dynamics of "catching-up" with the most liberalized countries in their region. A number of plausible political factors which previous studies found had played an important role in shaping financial globalization – such as left-right partisanship or democratic institutions – are found to have little influence on the particular measures of financial liberalization in the wide range of countries and time-periods covered by the study.

While Abiad and Mody's conclusions make an important contribution to our understanding of the broad trend towards reform of the past fifteen years or more, we argue that refined and additional variables better explain the cross-national variation within the trend itself. Given that economic shocks and regional-international pressures related to learning usually affect a number of countries simultaneously, their findings appear to contribute less to understanding the considerable cross-national variation in the pace, phasing, and eventual extent of domestic reforms. In turn, analysing the comparative dynamics across national processes is likely to lead to a better general understanding of the longer-run sustainability and political underpinnings of financial openness.

In this paper we seek to re-examine the role that political variables might play in shaping Abiad and Mody's measures of financial liberalization. We demonstrate the role of political variables in relation to initial liberalisation episodes, and as variables affecting the cumulative dynamics and sustainability of ongoing financial reform processes, including those which affect the acceptability and costs of liberalization. In order to deepen the analysis, we employ Abiad and Mody's own methodology, dataset and index of financial liberalisation, while unbundling and refining some of their key variables subsumed under

‘ideological affinity’ and ‘regime type’. We focus on how national policy choices on financial liberalization might be significantly affected by both domestic-national and international political variables relevant to the “input” and “output” sides or ‘phases’ of the processes generating financial openness. Input concerns process: the involvement of and acceptance by stakeholders of the decision to initiate (or continue with/reverse) financial liberalisation. The output side concerns the substantive effects of such policy change on the perceived interests of stakeholders, whatever their involvement and acceptance of initial or ongoing policy change.

Our analysis (see figure 1) reveals that these factors influence significantly and directly the chances that governments may liberalize their financial markets, and the interaction of these factors underpins the domestic learning and catch-up dynamics emphasized by Abiad and Mody. With respect to the input side, we find both domestic and international-level political variables to be relevant to liberalization. The domestic factors are two-fold. First, shifts towards (as opposed to levels of) Left governments significantly decrease chances of liberalization. Second, both changes and incidence of Left government affect liberalization in ways strongly mediated by democratic representation: different levels of democracy affect the policy options and credibility concerns of parties, such that at low levels of democracy, moves to and incidence of Left governments tend to significantly decrease chances of liberalization, while in more democratic settings this negative effect of Left representation disappears. The regional/international factors relevant to the input phase are measures of the overall level of external, international voter and stakeholder support for e.g. free-market enterprise, international openness, and internationalism generally, versus voter support for e.g. (post-) Communist parties, Marxist ideology, and international closure. Liberalization is significantly more likely when the international, extra-national *zeitgeist* and institutions support free-market openness and less likely to the extent that it supports anti-market closure. Finally, both the domestic and international input factors may also mediate the output-side learning-based lock-in and catch-up dynamics Abiad and Mody emphasize – shifts towards left government have fewer negative effects on liberalisation as *ex ante* financial openness increases, and as international voter-support for free markets significantly spurs a catch-up effect.

With respect to the output side, we explore the hypothesis that financial liberalization is more likely when accompanied by domestic and international spending programs that help address the internal distributional costs and risks of financial markets. Once again, there was a domestic and an international dimension. Firstly, while domestic systems of compensation

might increase political support for international openness, we find that not all aspects of social and welfare policy increase the chances of financial liberalization. Specifically, while various measures of total spending are found to have only a modest influence, health spending (which in a developing-country context provides more generalized indemnification of risk than social security expenditures) appears to correlate to liberalization. International sources of compensation – measured as bilateral developmental assistance, multilateral development assistance, and technical assistance – may not only involve conditionality that demands liberalization but may also help address social policy risks beyond domestic capacity. We find that such “social insurance from without” tends to significantly increase liberalization chances. There is some modest evidence that domestic, though not international, sources of compensation may decrease the catch-up effect identified by Abiad and Mody. Catch-up and learning as processes are found to be heavily mediated by political variables.

**Figure One:** input and output/domestic international dimensions

	<b>Input Phase</b>	<b>Output Phase</b>
<b>International Level</b>	<b>International Voter support for</b> <i>Net free-market internationalism</i>	<b>Foreign Aid</b> <b>(multilateral, bilateral)</b>
<b>Domestic Level</b>	<b>Δ Left Government</b> <b>Left Government</b> <b>x</b> <b>Democracy</b>	<b>Social Policy Compensation</b> <b>(e.g. health spending)</b>

We develop these points in three sections, building on and refining Abiad and Mody's study. The first section summarises the basic specification of their study and their findings on political variables. The second section considers alternative specifications, unbundling some of those variables which address domestic left partisanship and democracy, as well as international embrace of free markets, as possible input sources of change. The third section considers output-side specifications focused on domestic spending and international aid as potential sources of sustainability of liberal reforms. Our final section summarises and concludes by highlighting a broader research agenda to explore the long-run political underpinnings of financial liberalization.

### **1. Abiad and Mody's analysis: a case of disappearing politics**

Abiad and Mody's study employs a new data index of financial openness.<sup>1</sup> That political variables might matter is clearly one of the hypotheses they set out to test, and the approach is not *a priori* likely to generate the finding that political variables play little role. However, their characterisation of political variables, and certainly their empirical analysis, all yield such a conclusion. Their starting point is that breaking the status quo to begin a process of financial liberalization is a difficult and rare event, usually induced under the impulse of exogenous economic shocks such as currency crises, recessions, or IMF-conditionality. Once begun, however, a dynamic process emerges: the early stages of liberalization are marked by increasing-returns that may become locked-in through learning effects, while at later stages liberalization reaches a sort of saturation point, tending towards diminishing marginal returns. They also find that this lock-in learning dynamic is conditioned by a range of other factors, not just the starting point of liberalization but also existing levels of economic development and external conditions such as currency crises. Finally, they follow the lead of other scholars who have given attention to spatial interdependence (Simmons and Elkins 2004; Franzese and Hays 2006), and expect that polities will tend to try to catch up with the levels of financial openness of their region's most open regional polity. Abiad and Mody make sense of these developments in essentially apolitical terms: national reform, in turn embedded in the regional patterns of liberalization in the region, sensitizes policymakers to the economic benefits of financial integration by yielding information and material benefits for deepening liberalization over time.

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<sup>1</sup> Their dataset is a new 18-point composite measure of six areas of financial openness for 35 countries between 1973 and 1997, each capturing liberalization of the following aspects of finance (0-3, with 3 being most open): (1) capital controls/reserve requirements; (2) interest rate controls; (3) entry barriers, pro-competition measures; (4) regulations of securities markets; (5) privatization in the financial sector; and (6) international transactions.

Perhaps contrary to their own anticipations as revealed by the initial inclusion of political variables, Abiad and Mody find a very limited role for the several plausible political factors which previous studies have found important in shaping financial globalization. They consider particularly the role of left, right or centre governments – employing the Database on Political Institutions, where governments are coded based on broad content and rhetoric of government policies with respect to public intervention in their economies. Abiad and Mody anticipate that Left governments might be more opposed to liberalization than right governments because the former should disproportionately represent the likely losers of globalization. But they also anticipate that left governments might also have more political credibility to pursue such reforms than their right-party counterparts because such reform can be more credibly sold as in a national rather than a party’s ideological interest. Their empirical results demonstrate consistently that left, centre or right government tend to matter little in shaping changes in financial openness – either directly influencing change or in interaction with various crisis conditions or with ex ante levels of financial openness.<sup>2</sup>

These findings contrast with those of a number of other studies into financial liberalization, including quantitative studies of capital account liberalization and openness. For example, Quinn and Inclan (1997) found that left partisanship tends to – à la Stolper and Samuelson – interact with levels of economic development, such that left partisanship spurs liberalization in developing countries but thwarts it in richer countries. Abiad and Mody also reach conclusions in contrast to other studies of financial globalization that focus on a range of more or less elite struggles among economic sectors of finance, bureaucratic struggles, historical accidents, and spillovers from other areas of economic and political globalization (e.g. Sobel 1998; Laurence 2001; Garrett 2001; Helleiner 1994).

To be fair, applying the specifications from these other studies to Abiad and Mody’s framework tends to suggest that partisanship matters less in relation to their measures of short-term changes for their set of countries and years. For instance, left partisanship does not interact with various measures of economic development or factor endowments – and we considered a range of measures of capital-labour ratios, labour productivity, capital productivity, and GDP per capita, all as proxies for factor profile that might mediate the influence of partisanship. None of these measures yield consistently significant results. And in fact the consistent pattern is actually in the direction opposite to Stolper-Samuelson expectations, albeit usually statistically insignificant: higher levels of development tend to

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<sup>2</sup> Other political factors, especially institutional characteristics like quality of democracy and legislative fragmentation are also found to be empirically insignificant in shaping liberalization politics.

make left government more rather than less likely to introduce financial liberalization. This pattern, incidentally, holds even if one considers *levels* rather than *changes* in financial openness.<sup>3</sup> But it could be an artefact, again, of the particular measure of financial liberalization, or of the data coverage. In any event, Abiad and Mody's findings on the insignificance of partisanship have a reasonable basis, even beyond their estimation approach.

Abiad and Mody's study therefore raises big and important questions about the role of politics in financial liberalization, with important and counter-intuitive implications for our understanding of the longer-run policy dynamics of liberalisation. If Abiad and Mody are correct, then liberalization is a path which is difficult and often painful to stumble upon, but its positive nature becomes clear once the process has begun, as the benefits of openness are increasingly manifested. Stimulated by shocks, policy-makers taking the correct initial technical decision, to reform through liberalisation, link up with the locomotive of learning and policy is on track.

However, if it were the case that liberalization has its origins in specific *political* conditions (whether or not initially stimulated by economic shocks), then both the explanation of its origins (input) as well as our understanding of the longer-run dynamics of openness (output) must be altered. We know that markets are dynamic and that these dynamics imply a range of differentially-distributed adjustment costs and benefits for agents and constituencies over time. The conditions which initiate decisions to liberalize may not be the same as the conditions which take the policy further or render the policy politically sustainable in the long term. So this apparently simple point - does financial openness have political origins or not? - is central to our broader understanding of the relationship between the openness of financial systems and their governance.

Given the common intuition that political/distributional inputs to decisive changes in policy are likely to prove important, and supported by the findings of other studies, we argue that there are good reasons to delve deeper into the political variables employed in the Abiad and Mody study. Their findings leave little room for the discussion of cross-national variation in political or economic costs and benefits of policy change, yet we know that liberalization may represent a policy solution for some, and a significant disadvantage for others. Moreover, it is not clear from their analysis that all paths leading to liberalisation or

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<sup>3</sup> Abiad and Mody's focus on first-difference changes in, rather than levels of, financial openness is appropriate as a statistical matter, because the measures all show (individually and in composite) strong signs of non-stationarity in the dataset. Even if this narrows the possible focus to more short-term dynamics of liberalization, thus, taking changes on the LHS is pretty much essential, requiring a dynamic model of some form, either their ordered logit with the robust-cluster "sandwich" estimator of standard errors, or an error-correction model, or some other approach able to address panel (country) and temporal correlation, and heteroskedasticity.

even the end result are the same, particularly in distributional terms. Case research reveals that each move along the continuum between financial repression and openness seldom takes place in the same way, even in the wake of the same crisis (Underhill and Zhang 2003, chs. 5-6). Even though similar forces may be at work, there is considerable cross-country variation in the experience of crisis and liberalization and in the pace, phasing and extent of reforms, especially in terms of the political compromises produced, and national experiences of themselves admit of variation over time (Moran 1990; Coleman 1996). Little is said of the longer-run political costs of financial instability which may be linked to openness itself, despite a considerable literature linking market liberalization to increased market volatility (Prasad, Rajan, and Subramainiam, 2007; Bhagwati 1998; Arestis and Demetriades, 1999). Most importantly, the study employs relatively broad and simplified measures of what constitute the most important political variables (essentially left-right orientation of government, and parliamentary vs. presidential regime type) and how they might be employed in the model. There is little attention to the deeper phenomena of constituency rivalry and interest politics, nor to how these might play out in relation to initial liberalisation and over time. We argue that Abiad and Mody's broad notions of politics should therefore be unbundled and applied systematically in terms of the input phase (initial decisions to implement liberal policies) versus the dynamics of the output phase (the dynamics of 'learning' played out among constituencies over time). This in turn raises the question of the longer-run sustainability of financial openness in relation to the broader policy mix.

The remainder of this paper focuses on particular political variables in relation to the input and output sides/phases of financial liberalization and across the domestic/international dimensions (see Figure one again), variables that we believe are relevant to the shorter-term decisions to liberalize as well as to broader issues of sustainability or more complex notions of politics. We employ a relatively simple set of domestic and international factors that we think highly relevant to the political economy of globalization and that we expect and empirically find to be important to shaping financial liberalization.

## **2. Input**

The input side or phase of liberalisation concerns the involvement of and acceptance by stakeholders in policy-making. In the case of financial opening, we posit that this means not just aggregate voter preferences but also the involvement of stakeholders, including firms, workers and other socio-economic groups, in policy "decisions" to liberalize the financial system. As such, we need to find aggregate-level measures as 'proxies' for the involvement

and interests of stakeholders and constituencies. These could for example be captured by broad patterns of domestic democratic representation, implying at least passive involvement of stakeholders. But this might also involve more direct involvement in a policy decision – as opposed to de facto decision-making by bureaucrats unfettered by democratic accountability. The input phase might involve, particularly in democratic settings, less direct and formally protected representation through partisan orientation of governments. Finally, the input side involves the general underlying support for a particular policy change, both domestically within a given polity or internationally in terms of broader world opinion about such change.<sup>4</sup>

In our exploration of the role that political variables might play in shaping financial liberalization, we find that examples of these ‘sinews of input’ have a significant influence on changes in Abiad and Mody’s six-policy measure of financial governance. The results are summarized in Table One. In this and the following table (on issues relevant to output legitimacy), we use as the benchmark Abiad and Mody’s specification from column four of their Table Eight, because this specification is the first of those where lagged levels of financial regulation are interacted with policy measures that might influence the lock-in effects of learning.<sup>5</sup> Column One shows the estimation we will take as the benchmark. The most important results, well discussed in the Abiad and Mody paper, are that there does seem to be an emerging lock-in learning effect that displays increasing returns (linking our input and output phases), captured by the significant positive effect of lagged levels of financial openness and the negative and significant effect of the square term. Also noteworthy is the significantly positive interaction between GDP per capita (on PPP basis) and lagged liberalization, suggesting that desired liberalization is higher among richer countries. Furthermore, the “catch-up” parameter – measured as the difference between the level of financial openness of the region’s most liberalized financial system and the country’s own level of openness – is modestly significantly positive, suggesting that the chance of liberalization increases with the extent that a country lags behind regional liberalizers. Finally, balance-of-payments currency crises positively affect chances of liberalizing, while banking crises and levels of US interest rates tend to reduce such chances (input phase). Key for us, however, is that incidence of left and right governments (with center governments as the excluded category) have no significant influence on chances of liberalization.

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<sup>4</sup> As time goes on, the issue of underlying support takes on the characteristics of the output side as outlined below.

<sup>5</sup> We hasten to emphasize, however, that our own results are robust to the various other specifications in their study – for instance with the cruder measure of lock-in, with the more drawn-out specification with many more interactions, and the estimations without country fixed effects.

[[Table One about here]]

*2.1. Shifts in government.* Our first example of how input conditions might matter more than the ‘benchmark’ suggests concerns the influence of left, right and centre governments and issues of economic intervention on the chances of liberalization. Abiad and Mody’s study only characterises the ‘ideological affinity’ of government as the incidence of left, right or centre parties. Yet, the ideological affinity of governments might also matter to policy changes by virtue of a *change in power* from one party to another. A new government may be freshly empowered, providing extra stimulus to policy change and yielding short-term changes in levels of financial liberalization. Indeed, Abiad and Mody anticipate this possibility when they discuss the “‘new government’ or ‘honeymoon’ hypothesis,” such as Krueger’s finding based on case research that one of the most important conditions for liberalization is that a new government comes to power (see AD, p.72, citing Krueger 1993, p.124). Although Abiad and Mody also cite reasons to think that shifts in power might not spark reform, as new governments delay painful policies until they have consolidated power (c.f. Haggard and Webb 1993), the hypothesis and case histories of “new government” suggest that shifts in government may matter as much as, or at least in ways distinct from, incidence of government. These possibilities lead Abiad and Mody to consider a dummy for first-year-of office of a government, in addition to partisanship of government. But this specification does not address the possibility that different governments might act differently in their first year of office.

Taking account of such developments in the empirical investigation might involve, most simply and minimally, considering how first-differences of partisanship affect first-difference changes in levels of financial liberalization.<sup>6</sup> Our general expectation might be that – possible Stolper-Samuelson effects notwithstanding – a shift to left governments (captured by a positive one in first differences) should decrease the chance of liberalization while a shift away from left governments to either centre or right governments (captured by a negative one in first-differences) should increase the chance of liberalization. One might also hypothesize that the opposite pattern ought to emerge with changes in right government control.

Column one of Table One captures how this is broadly what one finds for changes in left partisanship, though not significantly for changes in right partisanship – both, as in the

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<sup>6</sup> We remove from the RHS dummy for first-year-of-rule, though leaving this in yields virtually the same results.

incidence models, having effects that can be discerned relative to a shift to centre governments. The shift to left governments, in particular, significantly decreases the chances that a polity will liberalize. Substantively, this effect can be captured by counterfactual estimates of how moving from no left government to a shift to left government affects predicted changes in openness, holding other parameters at their means. Such a shift increases the likelihood of a reduction of openness by 5.6 percentage points (from a probability of .024 to a probability of .08), and of there being no change by 6.7 percentage points (from probability .795 to .862), and *decreases* the chance of liberalization (a little or a lot) by 11 percentage points (from a probability of .177 to .067).

Column (3) suggests, further, that the shift to left governments might have effects mediated by *ex ante* levels of financial openness. In particular, the individual coefficient for first-difference in left government suggests that at levels of full closure of financial markets (a score of 0 on the Abiad and Mody scale), a shift to left government predicts a significant reduction of chances of liberalization, on a scale roughly double for that just reported for column (2). But as financial openness becomes greater, this negative effect significantly declines – becoming insignificant once a country reaches a level of financial openness equivalent to .52 liberalization on the rescaled 0 to 1 measure of openness (0 being full closure and 1 being full openness).

*2.2. Left government and Democracy:* Columns (4) and (5) consider a second aspect of input legitimacy, where the incidence of left government appears to significantly interact with levels of democracy in shaping chances of liberalization. As Abiad and Mody report, levels of democracy as well as partisanship generally appear to be insignificant predictors of liberalization. But levels of democracy might well alter the calculations of specific political parties in the kinds of policies they pursue, and this alteration might play out differently for left than for right or centre parties – all net of economic development and other conditions.<sup>7</sup> It is also possible that democratization might play out differently in different partisan settings – though government colour tends to vary more than levels of democracy as an institution.

Our general expectation is not strong here, since intuition and previous theory suggests offsetting possibilities. On the one hand, if left governments are more likely to oppose

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<sup>7</sup> Stolper-Samuelson considerations might predict that left governments decrease liberalization in non-democracies but be less so inclined in more democratic settings, since the sample is skewed to non-OECD developing countries, where democratization might make left parties more inclined to act for their (presumably) working-class constituencies. We might thus expect left government to become less negative and more positive with democratization. But there is no evidence of general Stolper-Samuelson effects, as discussed above. And limiting the sample to democracies shows patterns that, if anything, go against such effects: right parties support liberalization in labor-abundant settings and become less inclined to do so as factor profiles shift to capital-abundant. In any event, factor-profile difference is partly controlled-for with the GDP-per-capita parameter.

liberalization to help constituents (a pattern that holds for the shifts to left governments), then one might expect democratization to reinforce the electoral incentives thus to act because democratic governments are more likely to be held accountable for their actions. Left governments might also tend to oppose financial liberalization because of state control over finance and financial institutions, in which case the effects of democratization ought to be more neutral. There is however a further and offsetting possibility that democratization will *reduce* left parties' incentives to protect financial markets. Democratization brings with it accountability to a broad range of constituents, beyond traditional left or right coalitions of interests. Parties positioning themselves to attract the median voter may consciously aim outside their traditional clientele, unleashing new ways of thinking about and serving both traditional and 'new' constituents. For example, a left government might seek to broaden its constituency by promoting 'national interest' policies aimed at non-working class constituencies, while simultaneously strengthening and targeting compensation provisions to their traditional working-class clients. As levels of wealth change, constituents may reinterpret their perceived interests and governments seeking to bridge gaps among constituents may use policy to stimulate this realignment, shifting from policies of subsidized rental 'social housing' to home ownership and the financial products which go with them. On another tack, the contracting and transaction-costs literature (as well as some case studies) suggests that left parties in more democratized setting may be more successful in supporting liberalization than their right counterparts. The argument here is that the left will have more credibility than the right in the face of entrenched opposition to market opening (Cukierman and Tommasi 1998), and a range of circumstances may also render left liberalisation proposals easier to achieve. On the one hand, the left may face lower aggregate levels of opposition from right or centre parties, and these parties' traditional (business) constituencies are rather unlikely to seriously oppose left-government financial liberalisation proposals. On the other hand, were a right government to propose it the left would most certainly mount serious opposition. The left may be able to count on the support of their traditional constituencies despite the opposition of the latter to financial liberalization (they have nowhere else to go), and may be more successful at persuading opposing constituencies to acquiesce, not least because of a willingness to employ policies of compensation. Finally, left governments may seek to enhance their macroeconomic policy credibility in the international domain by embracing various forms of liberalization despite the opposition of their traditional supporters (who are unlikely to defect from them in the absence of serious alternatives).

Both columns (4) and (5) consider the various possibilities focusing on levels of democracy interacted with simple levels, or incidence, of left and right governments (center governments as the excluded category). Column (4) specifies democracy by taking the Polity IV measure of 10-point autocracy and 10-point democracy, with levels of democracy ranging from complete autarchy (-10) to complete democracy (10). Column (5) specifies democracy more roughly, taking a value of 1 for all country-years where the above Polity score is above 0. As both specifications make clear, democratization significantly mutes the tendency of left governments to oppose financial liberalization. Net of levels of economic development as well as all other controls, low levels of democracy creates conditions under which left governments tend to significantly oppose liberalization, and as levels of democracy rise this negative effect becomes weaker, such that at medium to high levels of democracy left parties are no longer associated with less financial liberalization or more closure.

Focusing on the substantive effects suggested by the estimation in column (5), in non-democratic settings (with a polity score of 0 or negative) moving from a year without left government to a year with left government leads to an increased chance of some degree of financial closure (negative change in financial openness index) by 4.6 percentage points (from .0138 to .0313 probability), and of zero change in financial openness by 12.8 percentage points (from a predicted probability of .697 to .825), and lowers the chance of financial liberalization by 14.6 percentage points (from a probability of .29 to a probability of .143). However, under more democratic settings (where polity scores are higher than zero), moving from non-left to left government predicts in the net a decrease in the chance of reversal by 11.2 percentage points (from a predicted probability of .123 to .026) and of no change by 2.5 percentage points (predicted chance of .824 to .804), and an increase in the chance of liberalization by 13.7 percentage points (from a probability of .034 to .171). Such conditionally positive effects of left government, however, are only significant for the middle third of the full distribution of country-year variation in incidence of left government.

In any event, these patterns suggest that democratization – perhaps the most obvious and general measure of the input side – will tend to diminish left government opposition to liberalization. Even if partisanship and democracy appear to have few direct effects, thus, their *interaction* in input-phase processes is good news for the chances of liberalization. These results are robust to all the Abiad and Mody specifications and to a range of alternative estimators and specifications, including an error correction model where RHS variables, including the interactions between democracy and partisanship, are taken in first differences and lags.

2.3. *International support for free-market internationalism versus protectionist closure.* The final set of estimations in Table One concern the broad subjective embrace versus rejection of free market openness or internationalism, versus support for anti-capitalist regulation or closure. Both the domestic and *international* level of such embrace and rejection affect the domestic thinking of a polity relevant to its subjective acceptance or rejection of financial liberalization in particular. These all capture the possible input phase elements of financial reforms being explained – net of the kinds of institutional and partisanship conditions relevant to input. Although domestic measures are the most obviously relevant to input, international voter support for or rejection of free market ideas is also relevant because it captures general influences on the domestic ideological climate which in turn likely influence a polity's tastes for financial liberalization – the tastes of the broad public as well as elites. Indeed, a recent study by Quinn and Toyoda (2007) finds that international levels of voter support for (post-) Communist parties tends to significantly decrease the chances that a polity introduces capital account liberalization, while international voter support for free-enterprise capitalism tends to increase chances of liberalization.

Unfortunately, we have insufficient information to measure the levels of citizen support for free-market internationalism versus regulatory intervention and protectionism – not least because a number of country-years in the sample are non-democratic where polls or party information are lacking – something further research may partially redress. But building on the technique Quinn and Toyoda use to gauge the influence of international ideology, we can find measures of international levels of voter support for free-market internationalism versus anti-capitalist closure. Such voter support can be gauged using the Comparative Manifesto Project (CMP) dataset, which provides salient measures of party “support” for a range of substantive policy issues, based on content analysis of the party programs of political parties on a range of substantive policy issues for 25 countries since 1945.<sup>8</sup> Based on the share of a party's program supporting or opposing free markets or capitalism, one can then judge what this means for voters by multiplying the platform scores by the percentage of votes the relevant party received in the election. One can then take the yearly averages for the inferred voter positions for all the countries in the sample to gauge the

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<sup>8</sup> The dataset provides salience measures of position-taking on a range of issues, where the level of support or opposition to a policy principle is gauged as the number of sentences or sentence fragments addressing such support or opposition, as a percentage of the total number of sentences or sentence fragments in the party manifesto. Higher values represent higher salience and/or support for a particular policy position

general international climate on issues – position-taking that gauge input legitimacy from without.<sup>9</sup>

Relevant to the input phase of financial liberalization are a number of parameters in the CMP dataset. Providing a more encompassing measure of support for markets than Quinn and Toyoda develop, we focus on a measure of net support for international free markets, representing a composite of the following elements:

*Free enterprise* (per401 in the CMP dataset):

Favourable mentions of free enterprise capitalism; superiority of individual enterprise over state and control systems; favourable mentions of private property rights, personal enterprise and initiative; need for unhampered individual enterprises”

*Protectionism: Negative* (per407):

Support for the concept of free trade; otherwise as 406, but negative.

*Protectionism: Positive* (per406):

Favourable mentions of extension or maintenance of tariffs to protect internal markets; other domestic economic protectionism such as quota restrictions

*Controlled Economy* (per412):

General need for direct government control of economy; control over prices, wages, rents, etc; state intervention into the economic system.

*Nationalisation* (per413):

Favourable mentions of government ownership, partial or complete, including government ownership of land.

(CMP Appendix III).

From these elements we construct a composite representing support for free-market internationalism in the net:  $net\ free-market\ internationalism = (per401 + per407) - (per406 + per412 + per413)$ . We then multiply the party-year scores by the percentage of votes gleaned in the relevant election, to generate each polity’s support for net free-market internationalism per country-year. Since elections are not held yearly, we construct a 5-year moving average for each country-year to ensure that every country is in the estimates of yearly-varying voter positions. The final step is to calculate the average for the whole international system by taking the unweighted average for all 25 countries per year. This

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<sup>9</sup> One might also consider regionally-specific trends in voter support for free market openness, on the assumption that there are significant regional differences. But the CMP data’s coverage does not fully allow this possibility. For instance, there are no African countries in the dataset.

gives us the average international support for net free-market internationalism that we can then merge with the Abiad and Mody dataset. Figure Two shows how this measure of voter support is volatile across years, but tends in general to rise – broadly in line with rising levels of financial openness in the net.<sup>10</sup>

[[Figure Two about here]]

We also considered a range of alternative measures of support or opposition to free markets and/or internationalism using the same technique applied to other elements of the CMP dataset. These include: each of the above components separately; support and opposition to international organizations and internationalism, without making explicit reference to political-economic openness (per108-per109); support for Marxist ideology (per404); and support for post-communist parties. We also considered alternative measures of international support for or opposition to free-market internationalism, including use of raw scores of party proportions on these issues; or weighting the scores by share of parliamentary seats rather than votes.

Although the results are virtually identical regardless of the particular measure one uses, columns (6) through (8) in Table One show the results for *net free-market internationalism*. Columns (6) and (7) show how this measure of international voter support for free-market internationalism – measured first in the net (as specified above) and as absolute support for free enterprise and free trade (per401+per407) – correlates significantly positively with changes in financial openness. Importantly, we can also see in both specifications that these external voter sentiments also tend to reduce the influence of the catch-up dynamic emphasized in the Abiad and Mody study. And column (8) in any event shows that the international voter support for free-market internationalism also interacts significantly with this catch-up dynamic: at low levels of support for free-market internationalism, countries that lag far behind the regional leader in financial openness are not likely to be significantly spurred to pursue financial liberalization; but at high levels of such internationalism, the urge to catch up becomes significantly more positive.

Substantively, the effects of international voter embrace of free-market internationalism are quite modest. If we consider the model in column (6), and

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<sup>10</sup> Tracking *net free-market internationalism* with changes in financial openness yields clear correlation amidst volatility of the former, and is stronger if one takes lagged values of internationalism (not shown but available upon request).

counterfactually predict the change in chance of liberalization as we move from the 25<sup>th</sup> to the 90<sup>th</sup> percentile in the sample-distribution's variation in *net free-market internationalism* (from a score of -2.66 to 33.6), we see a decrease in the chance that a country reverses course on financial openness by 1.3 percentage points (from .03 to .017 probability of reversal), and a decrease by 7.5 percentage points in the chance of no change in openness (from .82 to .745 probability), and an increase of 8.7 percentage points in the chance of liberalization (from a probability of .15 to a probability of .24). All these effects, however, are significant at a .05 level throughout the sample distribution. And they are also robust to alternative estimators in the Abiad and Mody study, and to the exclusion of the US interest-rate dummy (another annually-changing variable) or the inclusion of yearly dummies. And the same holds for the other measures of support or opposition to free market internationalism.

### **3. Output**

The output phase concerns the substantive and ongoing affects of initial input-phase policy change on the perceived interests of stakeholders, whatever their involvement in or acceptance of the policy change. This is often more relevant than the input phase to our understanding of the longer run sustainability of the outcomes produced by liberalisation. But it is also relevant to shorter-term policy decisions towards financial liberalization (or reversals) as discrete triggers in a cumulative dynamic. In other words, the output phase is central to what Abiad and Mody characterise as 'a learning process that shaped and sustained reforms' (p. 67). Relevant to the output side are all the downstream effects, real and perceived, of the successive levels/reversals of financial openness actually implemented as policy – hence, the relevance of levels of growth, unemployment, inequality, poverty, and the actual or perceived degree to which these are affected by financial openness. In our reckoning, however, a range of policy conditions interact with financial openness/closure to shape the sustainability of a policy trend in the output phase – most obviously government and social policies that address the distributional and/or equity concerns of stakeholders potentially affected by financial liberalization. The point builds on the well-established hypothesis that the provision of some forms of policy compensation can help foster support for international economic openness (Polanyi 1944; Ruggie 1983; Rodrik 1997). Studies of international trade openness have most fully investigated this hypothesis principally in the context of public opinion surveys, but also through work on party manifestos (Hays et.al. 2005; Burgoon 2007; Rodrik, Mayda and O'Rourke 2006). But there is also some qualitative work to support the claim with respect to financial openness (e.g. Bordo et.al. 1999). Our

final set of estimations on the political economy of financial liberalization considers how and whether both national and international sources of such compensation make a difference to financial openness. Table Two summarizes the results.

[[Table Two about here]]

*3.1. Domestic social policy compensation.* Columns (1) through (4) consider the role of various measures of domestic government spending on financial liberalization. Although some have argued that all faces of the public economy are relevant to addressing the social risks to individuals and constituencies of economic openness, others have argued that not all faces of government spending are equally relevant to such risks (c.f. Rodrik 1997; Burgoon 2001). The four estimations consider these possibilities by focusing on four measures of government spending, more or less targeted at particular issues relevant to the risks of openness. All are measured as spending as a share of national GDP, and all are lagged by one year to address the time it takes for polities to respond to the potential insurance-effects of such “compensation” and to adjust for possible endogeneity (given that financial liberalization or reversals plausibly influence spending levels).

Column (1) focuses on government consumption, a measure that has the best coverage, but excludes the many social transfer programs clearly relevant to the risks of openness (Penn World Tables 6.1). Perhaps this is why the effect is insignificant, though positively signed as expected. A somewhat better measure is total government spending or revenue, which includes such transfers, but also includes many other government spending programs many of which are irrelevant to – or perhaps even likely to undermine – support for financial liberalization (POFED database 2003).<sup>11</sup> Although the results are not shown, this measure also yields positive but statistically insignificant results.

Columns (2) through (4) consider measures of the spending that come somewhat closer to the social policies thought most relevant to the social risks of openness. Unfortunately, measures of social policy with reasonable coverage of the country-years in the Abiad and Mody dataset are hard to find, and we can only unearth quality measures for social security transfers and for public health expenditures. The former might be expected to have

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<sup>11</sup> For instance, this measure includes military expenditures. Such expenditures may play a social insurance role, but may also capture the military priorities, or conflict footing, of polities, tending to decrease chances of financial liberalization or openness. As an empirical matter, measures of military expenditure actually tend to statistically and substantively significantly decrease chances of liberalization (results not shown but available upon request).

direct relevance for risks of economic openness, but in developing countries such transfers are often heavily skewed to public pension programs and targeted at employees in the formal, public economy. As such, they often do little to indemnify more generally vulnerable workers in more exposed sectors from the risks of financial or other kinds of economic openness. Column (2) shows the effect of such transfers, and following expectation we can see that the effects are positive but statistically insignificant.

Health spending, on the other hand, has often provided stronger and more evenly dispersed benefits for workers in both developing countries, but also developed countries (as the current debate in the US lays bare). Higher public spending on health, hence, might have a more meaningful compensatory effect for workers facing the vagaries of open financial markets. Columns (3) shows that measures including such health expenditures do, indeed, significantly increase the chances of financial liberalization. And column (4) shows that the positive effect of combined spending on health and social security transfers tends also to statistically significantly increase financial liberalization. The substantive effects of such spending, based on the model in column (3), appear to be rather substantial. Moving from the 25<sup>th</sup> to the 75<sup>th</sup> percentile in the sample distribution of health spending – the equivalent of moving from a setting where a country spends 0.7 percent of GDP on health benefits to one where it spends 2.5 percent of GDP on such benefits – decreases the chance that a country will undergo a reversal of financial openness by 3 percentage points (probability of .051 to .022), and also decreases the chance by 8.6 percentage points of there being no change in such openness. And such an increase in health spending predicts an increase of 11.5 percentage points in the chance that a government will liberalize (probability .103 to .218).

*3.2. Foreign Aid received:* Finally, columns (5) through (8) suggest that the role of compensation in increasing the sustainability of the output phase of financial liberalization may extend not only to some domestic social spending, but also to the levels of aid assistance that a country might receive from international sources. Such aid may come with strings attached that might be relevant to financial openness regardless of their substantive, compensatory effects: if aid is made conditional upon economic changes such as financial market opening, then we would expect the effect of aid to be positive. But it is also plausible that international aid of various kinds, whether or not it comes with conditionality, may well play some compensatory role, as it were substituting for the shortcomings of domestic social policy compensation in less developed countries. Both bilateral initiatives of many Northern economies, particularly European countries, and multilateral-aid initiatives channelled through the European Union or World Bank auspices, have explicitly focused on a range of

programmes that provide direct (health programs) and indirect (infrastructure programs) social insurance role for those facing risks of economic openness. If so, one might hypothesize that, net of conditionality conditions, such compensation from without might also increase chances of financial liberalization.

Columns (5) through (7) show that due either to the compensatory or other roles such aid might entail, higher levels of bilateral aid (Column 5), multilateral aid (Column 6), and combined-multilateral-bilateral aid (Column 7) tend to significantly contribute to cumulative and sustainable phases of financial liberalization. All three measures are expressed as shares of GDP, and all are lagged by one year to try to address possible endogeneity and (even harder to address) the possibility of policy conditionality in the granting of aid. As can be seen from the coefficients, all three have a positive, modestly statistically-significant effect on changes in financial openness. And as can be seen by the coefficients, which can be directly compared because they are in the same units, this effect is strongest for multilateral aid. Substantively, however, the effects are quite modest. Moving from the sample's 50<sup>th</sup> to the 90<sup>th</sup> percentile in multilateral aid received – equivalent of moving from a level of aid at .07 percent of GDP to a level of 12.6 percent of GDP – decreases the chance of reversal by .8 percentage points (from .025 to .017 probability) and of no change by 4.5 percentage points (from .84 to .796 probability), and increases the chance of liberalization by 5.3 percentage points (.135 probability to .188 probability of liberalization).

Interestingly, such positive effects of foreign aid received for liberalization appear not to be mediated by varying levels of *ex ante* financial openness or of catch-up dynamics (degree to which a country lags-behind lead-liberalizer of its region). As was also clear from the previous columns in Table Two, foreign aid also does not tend to have effects at the expense of the general catch-up effect, suggesting simply that this aspect of foreign influence might matter more than the spatial effects of lagging-behind regional leaders. But as Column (8) shows, foreign aid received does not significantly interact either the catch-up parameter or with *ex ante* liberalization. Higher aid levels do tend to diminish rather than increase the catch-up dynamic, though not significantly. And the interaction with lagged financial openness is virtually nil. What this all suggests is that foreign aid may well be a significant force in spurring liberalization, though not in ways sensitive to either existing openness or other regional influences. These reported effects, again, are robust to the other estimation specifications in the Abiad and Mody study, and also to a range of other controls – including, for instance, domestic compensation measures also on the RHS.

#### **4. Conclusion**

This paper provides new evidence on how domestic and international dimensions of both the input and output phases of economic globalization help explain financial liberalization across countries and time. Our findings challenge the Abiad and Mody (2005) conclusion that such liberalization has little to do with political variables. In particular, our account proves more sensitive to explaining the substantial observable cross-country variations in the extent, phasing, and pace of financial liberalisation over time. It does so by unpicking the somewhat general political variables employed in the Abiad and Mody study (ideological affinity, regime type), applying more subtle and interactive measures to their index of financial liberalisation. Our own investigation suggests that political variables representing the domestic and international dimensions of both the input and output phases of financial liberalization matter significantly, statistically if not always substantively, to the short-term decisions of polities to undertake financial reforms (the triggers). The domestic and international input elements that appear to matter empirically include: (i) shifts to left partisanship and (ii) the interaction of left partisanship and democracy (iii) international voter support for free-market internationalism, as opposed to anti-capitalist closure. Sources of output legitimacy that are empirically important include: (i) some targeted social policies, particularly in the area of health spending, and (ii) multilateral and bilateral aid. The latter might not only spur liberalization through the conditionality sometimes attached to such aid, but may also serve a compensatory role that constitutes important international sources of output legitimacy.

In the narrowest sense, our findings are meant to provide a partial corrective to the conclusions reached by the Abiad and Mody's study. Our message, in this sense, is simply that political variables matter more and differently than their empirical findings would have us believe. However, we argue in addition that our study into the input and output phases of policy reform constitutes a sound framework in which to understand the political economy of both liberalisation episodes and their longer-run sustainability. In this sense, our approach is also a reminder of a larger research agenda into the politics of globalization than the present study allows. We believe that understanding the political economy of governance under conditions of financial liberalisation requires an account of the complex power-political interactions of a wide range of state and market actors in both formal-institutional and more informal, public-private settings – well beyond the kinds left-right partisan conditions which we discussed above. Much financial sector policy-making is elite policy making where decisions are taken in relatively closed forums involving a limited community of public and

private institutions in the financial sector. In this sense further work should focus not just on broader institutional-electoral or partisan specifications as they interact with policy change, but also on these more back-room settings with their potential for mutual clientelism and policy capture.

We also believe that the features of democratic involvement or subjective support for more or less open markets that are key to understanding the input side go well beyond the still simple measures of broad democracy and international voter attitudes discussed above. More obviously, the dimensions of the output phase and of the legitimacy and sustainability of liberalisation are much more complicated than the simple role of compensatory social and aid provisions highlighted above – involving the gamut of policies and informal practices that might diminish the distributional costs and system risks of open markets. These policies and practices are particularly relevant if we wish better to understand the eventual long-term stability of openness and not just the relatively short-term perspective the present paper has investigated. Research into this long-run political economy of financial liberalisation is central to developing a better understanding of the ongoing process of cross-border economic integration and its governance.

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Table One: Input Legitimacy and Financial Liberalization

(DV=Change in Financial openness ( $\Delta FL_{it-1}$ ))

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Benchmark	$\Delta$ Government	$\Delta$ Government* finance.open.	Government* Democracy.	Governmentt* Democ.dummy	Voter Net free- market Int'lism	Voter market Int'lism	Free- Catchup* Net free-mrkt.
Leftist Government <sub>it</sub>	-0.092			-1.561	-2.467	-0.226	-0.100	-0.239
	(0.26)			(1.98)**	(3.13)***	(0.65)	(0.28)	(0.69)
Rightist Government <sub>it</sub>	-0.091			0.122	-0.090			
	(0.26)			(0.31)	(0.16)			
$\Delta$ Left government <sub>it</sub>		-1.261	-2.266					
		(3.07)***	(4.58)***					
$\Delta$ Right government <sub>it</sub>		-0.569	-0.778					
		(1.34)	(1.28)					
$\Delta$ Left * FL <sub>it-1</sub>			3.498					
			(2.96)***					
$\Delta$ Right *Financ.openness <sub>t-1</sub>			1.638					
			(1.35)					
Democracy (PolityIVscore) <sub>it</sub>				-0.022				
				(0.77)				
Left * Democracy (Polity) <sub>it</sub>				0.183				
				(1.93)*				
Right * Democracy (Polity) <sub>it</sub>				-0.011				
				(0.25)				
Democracy dummy (1=Polity>0) <sub>it</sub>					-0.896			

	(2.43)**		
Left * Democracy dummy <sub>it</sub>	2.681		
	(3.18)***		
Right * Democracy dummy <sub>it</sub>	0.241		
	(0.37)		
Net free-market internationalism <sub>t</sub>		0.016	-0.001
		(3.30)***	(0.07)
Free-market internationalism <sub>t</sub>			0.015
			(2.00)**
Net free-market intlsm. *			0.039
Catchup <sub>it</sub>			(2.08)**

Financial openness (FL <sub>it-1</sub> )	6.662 (4.21)***	6.485 (4.02)***	6.373 (3.74)***	6.876 (4.23)***	7.371 (4.34)***	5.568 (3.26)***	6.129 (3.65)***	5.689 (3.44)***
Financial openness sq. ((FL <sub>it-1</sub> ) <sup>2</sup> )	-9.763 (3.70)***	-9.974 (3.86)***	-9.850 (3.83)***	-9.745 (3.74)***	-10.100 (3.93)***	-9.452 (3.61)***	-9.555 (3.63)***	-8.981 (3.37)***
FL <sub>it-1</sub> * Y <sub>it-1</sub>	0.000 (2.40)**	0.000 (2.43)**	0.000 (2.50)**	0.000 (2.29)**	0.000 (2.32)**	0.000 (1.97)**	0.000 (2.21)**	0.000 (2.03)**
Catch-up (Reg.lead_FL <sub>it-1</sub> - FL <sub>it-1</sub> )	2.070 (1.67)*	1.871 (1.47)	1.899 (1.50)	2.416 (2.03)**	2.698 (2.26)**	1.033 (0.79)	1.599 (1.20)	1.201 (0.92)
Currency Crisis <sub>it</sub>	0.454 (1.95)*	0.442 (1.82)*	0.434 (1.77)*	0.425 (1.84)*	0.432 (1.82)*	0.405 (1.64)	0.442 (1.87)*	0.401 (1.63)
Banking Crisis <sub>it</sub>	-1.014 (2.95)***	-1.054 (2.92)***	-1.057 (2.92)***	-1.076 (3.00)***	-1.096 (3.02)***	-0.999 (2.92)***	-0.973 (2.85)***	-1.001 (2.95)***
Recession <sub>it</sub>	-0.035 (0.09)	0.051 (0.14)	0.004 (0.01)	-0.056 (0.15)	-0.077 (0.20)	0.005 (0.01)	-0.029 (0.08)	0.014 (0.04)
High Inflation <sub>it</sub>	-0.429 (0.68)	-0.432 (0.67)	-0.457 (0.72)	-0.274 (0.43)	-0.239 (0.38)	-0.466 (0.72)	-0.455 (0.70)	-0.581 (0.87)
First Year in Office <sub>it</sub>	0.250 (0.92)			0.260 (0.93)	0.263 (0.93)	0.251 (0.93)	0.279 (1.01)	0.267 (1.00)
IMF program <sub>it</sub>	0.370 (1.39)	0.379 (1.45)	0.390 (1.51)	0.372 (1.42)	0.369 (1.45)	0.325 (1.18)	0.356 (1.32)	0.321 (1.14)
US Interest Rate <sub>t</sub>	-0.089 (2.04)**	-0.098 (2.31)**	-0.092 (2.11)**	-0.104 (2.13)**	-0.106 (2.24)**	-0.085 (1.96)**	-0.096 (2.22)**	-0.088 (2.02)**
Openness <sub>it</sub>	0.010 (1.02)	0.011 (1.07)	0.011 (1.06)	0.01 (0.94)	0.09 (0.85)	0.010 (1.06)	0.010 (1.04)	0.011 (1.09)

Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	805	805	805	794	794	805	805	805
Log likelihood	-730.1	-725.9	-721.1	-723.1	-721.7	-726.5	-728.5	

*Notes:* The dependent variable is the change in the Financial Liberalization Index. Robust *t*-statistics are in parentheses, adjusted for clustering by country. Fixed effects for 35 countries not shown.

\*\*\* denotes significance at the 1-percent level; \*\* denotes significance at the 5-percent level; \* denotes significance at the 10-percent level.

Table Two: Output Legitimacy and Financial Liberalization  
(DV=Change in Financial openness ( $\Delta FL_{it-1}$ ))

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Government consumption $_{it-1}$	0.010 (0.24)							
Social security transfers $_{it-1}$		10.764 (1.17)						
Health expenditures $_{it-1}$			49.310 (3.29)***					
Total social transfers $_{it-1}$				25.329 (1.97)**				
Bilateral aid received $_{it-1}$					2.971 (1.87)*			
Multilateral aid received $_{it-1}$						3.140 (2.40)**		5.504 (3.59)***
Total aid received $_{it-1}$							2.612 (3.09)***	
Multil.aid $_{it-1}$ * Catch-up $_{it}$								-4.150 (1.17)
Multil.aid $_{it-1}$ * FL $_{it-1}$								-1.635 (0.53)
Leftist Government $_{it}$	-0.085 (0.23)	-0.074 (0.15)	-0.177 (0.34)	-0.263 (0.47)	-0.298 (0.67)	-0.220 (0.49)	-0.288 (0.64)	-0.229 (0.51)

Rightist Government <sub>it</sub>	-0.079 (0.22)	0.196 (0.42)	0.223 (0.51)	0.148 (0.31)	-0.098 (0.23)	-0.018 (0.04)	-0.057 (0.13)	-0.015 (0.03)
Financial openness (FL <sub>it-1</sub> )	6.601 (4.19)***	8.123 (3.51)***	8.569 (3.45)***	8.629 (3.61)***	5.598 (2.84)***	5.374 (2.88)***	5.007 (2.62)***	5.245 (2.60)***
Financial openness sq. ((FL <sub>it-1</sub> ) <sup>2</sup> )	-9.720 (3.75)***	-9.899 (3.43)***	-10.186 (3.39)***	-9.995 (3.48)***	-7.970 (3.02)***	-7.699 (2.93)***	-7.838 (2.94)***	-7.600 (2.89)***
FL <sub>it-1</sub> * Y <sub>it-1</sub>	0.000 (2.37)**	0.000 (1.89)*	0.000 (0.73)	0.000 (0.95)	0.000 (2.42)**	0.000 (2.41)**	0.000 (2.46)**	0.000 (2.33)**
Catch-up (Reg.lead_FL <sub>it-1</sub> - FL <sub>it-1</sub> )	2.063 (1.67)*	3.318 (1.99)**	3.369 (1.94)*	3.354 (2.07)**	3.426 (2.40)**	3.343 (2.41)**	3.035 (2.18)**	3.424 (2.42)**
Currency Crisis <sub>it</sub>	0.447 (1.93)*	0.536 (1.59)	0.412 (1.17)	0.474 (1.37)	0.297 (1.08)	0.364 (1.29)	0.346 (1.25)	0.382 (1.33)
Banking Crisis <sub>it</sub>	-1.017 (2.94)***	-1.069 (2.47)**	-1.180 (2.80)***	-1.219 (2.97)***	-0.991 (2.47)**	-0.976 (2.36)**	-1.000 (2.43)**	-0.979 (2.38)**
Recession <sub>it</sub>	-0.022 (0.06)	0.524 (1.41)	0.498 (1.44)	0.534 (1.51)	0.310 (0.75)	0.300 (0.72)	0.327 (0.78)	0.294 (0.70)
High Inflation <sub>it</sub>	-0.450 (0.75)	-1.099 (1.39)	-1.215 (1.37)	-1.117 (1.35)	-0.925 (1.02)	-0.940 (1.04)	-0.829 (0.91)	-0.953 (1.05)
First Year in Office <sub>it</sub>	0.254 (0.94)	0.088 (0.27)	0.091 (0.28)	0.071 (0.22)	0.287 (0.87)	0.302 (0.91)	0.273 (0.83)	0.289 (0.87)
IMF program <sub>it</sub>	0.362 (1.33)	0.004 (0.02)	0.036 (0.14)	-0.010 (0.04)	0.339 (1.09)	0.346 (1.13)	0.296 (0.94)	0.353 (1.16)
US Interest Rate <sub>t</sub>	-0.089 (2.03)**	-0.069 (1.51)	-0.052 (1.05)	-0.061 (1.28)	-0.108 (2.06)**	-0.104 (1.99)**	-0.107 (2.04)**	-0.100 (1.90)*
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	805	550	550	550	626	626	626	626

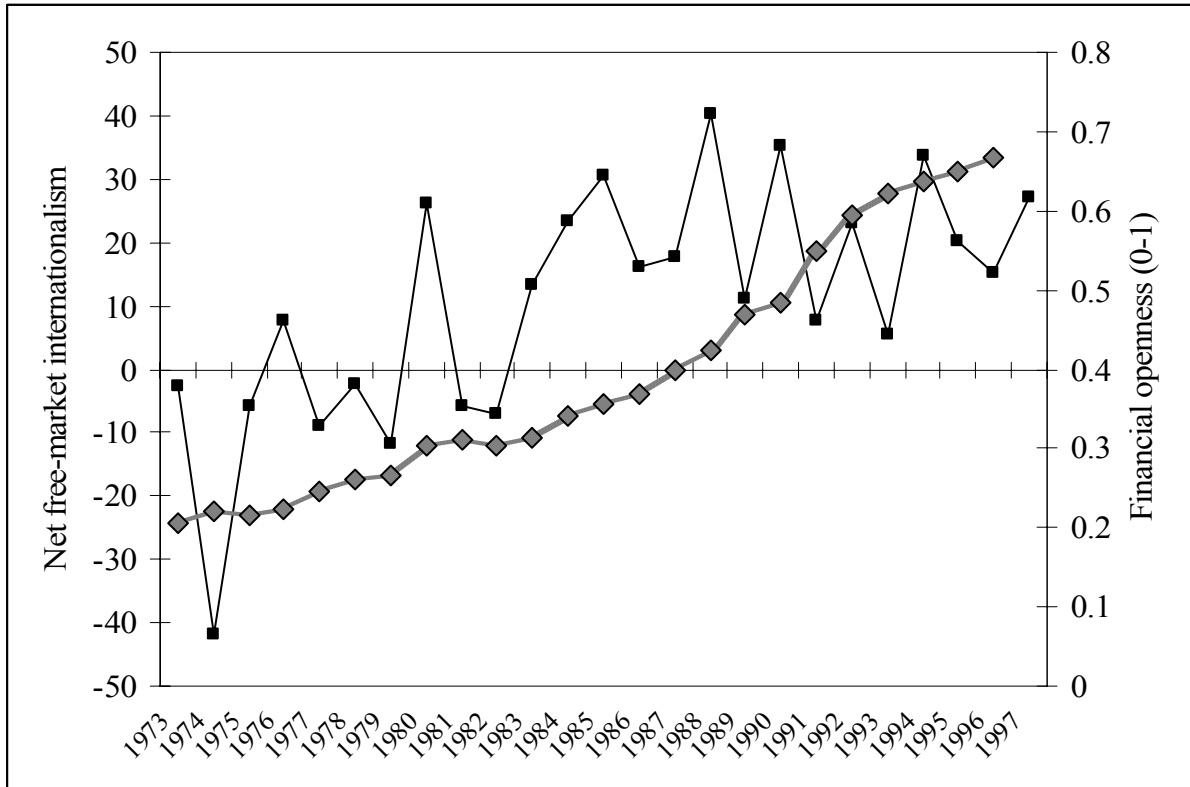
Log likelihood	-730.1	-498.7	-494	-495.5	-520.1	-520.3	-518.8	-520.1
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*Notes:* The dependent variable is the change in the Financial Liberalization Index. Robust *t*-statistics are in parentheses, adjusted for clustering by country. Fixed effects for 35 countries not shown.

\*\*\* denotes significance at the 1-percent level; \*\* denotes significance at the 5-percent level; \* denotes significance at the 10-percent level.

Figure Two:

*Net free-market internationalism of voters, and Financial openness*



Source: Comparative Manifestos Project dataset (own calculations); and Abiad and Mody (2005)