Policy as Myth and Ceremony: Overview

1. Motivation and Executive Summary
3. Theory: Decoupling in Global Institutional Processes
4. Hypotheses and Methods
5. Findings: Formal Adoption and Vibrancy of Markets
6. Implications and Conclusions

Why Care About This Study?

Institutional Theory
- World Society perspective (Meyer et al., 1997)
  - Countries are like organizations, create formal policies and structures to gain legitimacy, e.g., environmental protection, privatization, democracy
  - Mechanisms: peer nation influence, transnational professionals and agencies
- Institutional decoupling?
  - Implicit assumption that these actions are often ceremonial, i.e. form trumps functioning, due to motives of local actors and misfit with local context
  - But: Almost no empirical work on the consequences of 'institutional' adoption of structures and practices

Economic Development
- Financial market model of economic development (e.g., IMF, WB)
  - Private investments and financial markets solve problems of capital, transparency and governance in development finance, neoliberal logic of development
  - Significant expansion of market-based systems since 1980s ("Washington Consensus")
  - But: Do these markets actually work (in a technical sense)?

Research Question & Answer

Do global institutional processes in the adoption of policies and practices undermine the effectiveness of these practices?
- Are global institutional processes associated with ceremonial adoption?
- Does 'institutional' practice diffusion make for bad (economic) policy?

The master proposition:
- It depends on the mechanism of global diffusion

Study design:
- Data: new national stock markets since 1980 (113 countries, 58 new exchanges)
- Hypotheses: Do predictors of exchange creation also predict vibrancy?
- Survival analysis of exchange creation, panel and spatial econometric analysis of exchange vibrancy (companies listed, market capitalization)

Findings:
- Coercive channels (IMF aid) were associated with more ceremonial adoption
- Competitive, learning and status-based channels led to greater vibrancy
Overview

1. Motivation and Executive Summary
3. Theory: Decoupling in Global Institutional Processes
4. Hypotheses and Methods
5. Findings: Formal Adoption and Vibrancy of Markets
6. Implications and Conclusions

Historical Diffusion of Stock Markets, 1800 - 2005

Historical Spikes in The Diffusion of Exchanges

Prevalence of Stock Markets (Cumulative Adoption)
What Changed In The 1980s?

Stock markets already had high general legitimacy
- First exchange opened in 1602 (Amsterdam)
- Spread widely during industrialization (capital needs, 1st wave of international liberalism before 1914)
- Limited diffusion to former colonies and new states post WWI
- A central institution of the industrialized core of the capitalist world

1980s: Applying the financial market solution to a new problem
- Economic development ideologies since WWI (e.g., Mc Michael, 1996)
- How to foster capital accumulation in poor countries?
  - endogenous accumulation often seen as too slow
  - 1950s-60s: state-to-state lending
  - 1970s: bank-to-state lending
  - 1980s: private-to-private investing (shift due to debt crisis, monetarism)

Stock markets became part of neoliberal development ideology

In Financial Markets We Trust(ed)

The logic of neoliberal development policies
- High private capital stocks in wealthy countries are disconnected from high return opportunities in developing countries
- A win-win proposition: from “third world” to “emerging markets”
- But, governments are inefficient, protectionist and corrupt, see e.g., the collapse of bank lending after the Mexican loan default
- Private financial markets offer several advantages:
  - Transparency and ‘democratic’ (disembedded) access and exit
  - Better governance of firms
  - Opportunity to manage investment risk via larger portfolios

Stock market-based development became a normative ideology
- Role models (Reagan, Thatcher, Pinochet)
- International epistemic community of development experts
- “Washington Consensus” included US Treasury, IMF and WB endorsements

So why is there variance in countries creating exchanges??

The World of Stock Markets, 1980
Sources of Variance in Market Creation and Vibrancy

Economic policy making from an institutional perspective
- Policy makers: includes state officials, civil society and private sector
- Policy process: formal adoption + actual enactment + ongoing development
- Policy impetus: audience legitimation + political interest + technical rationality
- Policy success: motivation + knowledge/resources
- Parallel to organizational level, e.g., TQM, stock buy-backs, recycling

The structure of external influences cause variance
- Many policies and practices originate somewhere else
- Institutional channels (“carriers” – Scott, 2003) expose some policy makers at some stage of the process to more external influence than others
  - Actors outside of a country’s polity serve as idea givers, evaluating audiences, social referents, rivals, professional experts and resource holders
  - Variation in: the “infectiousness” or power of others, the “susceptibility” of policy participants in the country, and the “proximity” or connection between the focal country and potential influencers
    - e.g., China and Vietnam influence Cambodian policy makes more than Namibia

Formal Policy Adoption vs. Enactment and Vibrancy

Decoupling of formal policy change from enactment
- Compared to effective implementation, formal adoption
  - requires narrower participation, e.g. only government
  - requires episodic rather than sustained effort, e.g. limited program
  - is easier to monitor from the outside, e.g., compliance check lists
  - has fewer repercussions in other policy areas
  - requires less tacit knowledge and experience

Different institutional mechanisms, different outcomes
(Lee & Strang, 2006; Simmons, Dobin & Garrett, 2006)
- Coercion
- Competition
- Learning
- Emulation

Overview

1. Motivation and Executive Summary
3. Theory: Decoupling in Global Institutional Processes
4. Hypotheses and Methods
5. Findings: Formal Adoption and Vibrancy of Markets
6. Implications and Conclusions
Baseline Hypothesis

**Domestic propensity**
- Fit between the new policy and national institutional endowment (North, 1990)
  - Two countries may behave similarly not because they influence each other or are exposed to a same third party, but because they share the same features, e.g., due to a common history that increases adoption propensity
  - Policies are adopted and implemented when they fit domestic institutions
  - In this context, institutions compatible with financial markets:
    - Influence of colonial power (legal system, policy traditions, etc.): France vs. UK
    - Religion: Protestant commercial ethic
    - Political system: Democracy allows self-governing private interests
    - Ruling elite ideology: Socialist party and head of state ideology
- The influence of these factors is pervasive (many actors, durable, tacit)

**H1:** Countries with domestic institutions compatible with stock markets are more likely to create markets, and achieve market vibrancy (less ceremonial).

External Influence Hypotheses

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mechanisms</th>
<th>Adoption Prediction</th>
<th>Vibrancy Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>H2: Coercion</td>
<td>IMF/WB concessional lending</td>
<td>Dependence on lending</td>
<td>+</td>
</tr>
<tr>
<td>H3: Competition</td>
<td>Trade competition with recent adopters (structural equivalence in imports/exports)</td>
<td>Attention and rivalry</td>
<td>+</td>
</tr>
<tr>
<td>H4: Learning</td>
<td>Trade with recent adopters</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>H5: Emulation</td>
<td>World system centrality (compound, trade)</td>
<td>Status-based imitation</td>
<td>+</td>
</tr>
</tbody>
</table>

Data and Analysis

**Population, Sample, Data**
- Population of independent countries without exchanges in 1980 (N=113)
- Adoption event = Legal incorporation with regulation in place for equities trading
- Vibrancy = number of companies listed, market capitalization as % GDP
- Independent & control variables: various sources (UN, IMF, and economic political databases)

**Models and Estimation**
- Proportional hazard models of exchange adoption
- GEE for vibrancy, with conditions in adoption year as predictors
- ML estimation of spatial autoregressive (SAR) models for vibrancy
- AR(1) autoregressive error specifications

Controls And Robustness Tests

**Control variables**
- Country factors: population, former Soviet country
- Time period: pre and post 1989
- Economic: GDP/capita, GDP growth, trade openness, market liberalization
- Development of financial system: capital account balance, domestic credit

**Alternative specifications and sensitivity analyses**
- Selection for being in the risk set, receiving IMF/WB aid and having a professional finance association
- Extension of time period to earlier years, different country samples, jackknifed and bootstrapped estimations
- Shared frailty and cluster by country, alternative lag structures for prior adoption events, infectiousness weights for prior adopters’ economic performance
- Alternative legal and colonial dummies; alternative controls for financial development, economic openness, offshore financial activity
## Overview

1. **Motivation and Executive Summary**
2. **Context: Financial Markets and Economic Development**
3. **Theory: Decoupling in Global Institutional Processes**
4. **Hypotheses and Methods**
5. **Findings: Formal Adoption and Varying Markets**
6. **Implications and Conclusions**

### Panel 3a: Time to Adoption, 75 Country Sample

<table>
<thead>
<tr>
<th>Time strata (1990s = 1)</th>
<th>1.546</th>
<th>1.461</th>
<th>1.256</th>
<th>1.539</th>
<th>1.596*</th>
<th>0.573</th>
<th>0.642</th>
<th>1.730*</th>
<th>1.830**</th>
<th>0.581</th>
<th>0.952</th>
</tr>
</thead>
<tbody>
<tr>
<td>(0.954)</td>
<td>(0.966)</td>
<td>(0.965)</td>
<td>(0.946)</td>
<td>(0.963)</td>
<td>(1.016)</td>
<td>(1.011)</td>
<td>(0.933)</td>
<td>(0.926)</td>
<td>(1.079)</td>
<td>(1.194)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ln(Domestic Credit / GDP)</td>
<td>0.198</td>
<td>0.153</td>
<td>0.10</td>
<td>0.193</td>
<td>0.206</td>
<td>0.082</td>
<td>0.085</td>
<td>0.084</td>
<td>0.042</td>
<td>-0.274</td>
</tr>
<tr>
<td>(0.057)</td>
<td>(0.061)</td>
<td>(0.083)</td>
<td>(0.086)</td>
<td>(0.085)</td>
<td>(0.083)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

### Panel 4a: Domestic Companies Listed

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ln(GDP/capita)</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
</tr>
<tr>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
</tr>
</tbody>
</table>

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

### Panel 4b: Market Capitalization

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ln(GDP/capita)</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
</tr>
<tr>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
</tr>
</tbody>
</table>

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

### Panel 5a: Time Series Analysis of Exchange Rates with AIC

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ln(Domestic Credit / GDP)</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
</tr>
<tr>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
</tr>
</tbody>
</table>

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

### Panel 6a: unreasonable models of exchange variation with AIC

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ln(Population)</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
</tr>
<tr>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
</tr>
</tbody>
</table>

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

### Panel 6b: Market Capitalization

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>std. Error</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ln(Domestic Credit / GDP)</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
<td>0.208***</td>
</tr>
<tr>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
<td>(0.038)</td>
</tr>
</tbody>
</table>

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.

---

**Notes:**
- *Significant at 10%.
- **Significant at 5%.
- ***Significant at 1%.
Interdependence, Common Descent, Common Shock

Galton’s Problem

- We want to distinguish similarities in outcomes due to correlated domestic factors (e.g., population size), common ancestry (e.g., common colonial history), similar stages of development (e.g., GDP/capita), parallel adaptations to common exogenous influences (e.g., IMF programs) or mutual influence and interdependence (e.g., trade diffusion)
- It is statistically difficult to attribute similarities to causes in comparative designs, and standard panel regression models are likely to yield biased estimates
- Spatial lag autoregressive models offer one solution (Franzese et al., 2006-8)
  - Specify N x N matrices of interdependence between countries (spatial proximity, such as region, trade, competition, etc)
  - Test the significance of these spatial weights together with other variables
  - Similar approach to heterogeneous diffusion models (Strang & Tuma, 1993) but allows for time-varying spatial structure
  - Assumption: spatial dimensions are exogenous (stock markets do not affect regional membership or trade)

Summary of Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mechanisms</th>
<th>Adoption Prediction</th>
<th>Vibrancy Prediction</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1: Domestic Institutions</td>
<td>Protestantism, French colonial legacy, liberal democracy, ruling party ideology</td>
<td>Fit with existing domestic institutions</td>
<td>+</td>
</tr>
<tr>
<td>H2: Coercion</td>
<td>IMF/WB concessional lending</td>
<td>Dependence on lending</td>
<td>+</td>
</tr>
<tr>
<td>H3: Competition</td>
<td>Trade competition with recent adopters (structural equivalence in imports/exports)</td>
<td>Attention and rivalry</td>
<td>+</td>
</tr>
<tr>
<td>H4: Learning</td>
<td>Trade with recent adopters (enforced similarity in imports/exports)</td>
<td>Ongoing, broad relations</td>
<td>+</td>
</tr>
<tr>
<td>H5: Emulation</td>
<td>World system centrality (compound, trade)</td>
<td>Status-based imitation</td>
<td>+</td>
</tr>
</tbody>
</table>

Ongoing social influence

<table>
<thead>
<tr>
<th>Common origin, parallel adaptation</th>
<th>t-coef. now isolate conditions at founding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Capitalization: GEE</td>
<td>SAR region</td>
</tr>
<tr>
<td>Period 1-5</td>
<td>Period 1-5</td>
</tr>
<tr>
<td>Common origin, parallel adaptation</td>
<td>t-coef. now isolate conditions at founding</td>
</tr>
<tr>
<td>Market Capitalization: GEE</td>
<td>SAR region</td>
</tr>
</tbody>
</table>
Overview

1. Motivation and Executive Summary
3. Theory: Decoupling in Global Institutional Processes
4. Hypotheses and Methods
5. Findings: Formal Adoption and Vibrancy of Markets
6. Implications and Conclusions

Conclusions

Institutional Theory:
- Not all “institutional” diffusion leads to ceremonial compliance
  -> evidence only for coercive channels
- Expanded model of policy making process
  -> distributed, multi-stage process of “adoption”

Economic Development Policies:
- Global financial institutions face problems in deploying policy programs
  -> IMF/WB projects effective for formal adoption, not vibrancy
  -> greater role for non-state actors in policy implementation
- Regional cooperation and international professional networks are the most effective carriers of “world society” type global integration
  -> similar to lessons from ‘nation building’ efforts in political institutions