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<CT>Three Models of Contemporary Capitalism

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From 1980 to 2006, dozens of countries followed the lead of the United States and Great Britain in implementing free market economic policy ideas. Governments did so largely in the hope that this would lead to sustained high levels of economic growth. The financial shock of 2008-9 imperiled this trend. Emulation of the United States, a driving force of economic policy in both developed and developing countries in the recent past, seems unlikely to be so in the future. The days when economic policymakers worldwide eagerly sought advice from Washington and lionized the likes of Milton Friedman and Alan Greenspan are gone, possibly for good. The question is what comes next.

Where will countries turn now for new ideas about development and models for economic policy? In his book *The End of History and the Last Man*, Frank Fukuyama argued that capitalism and liberal democracy were the only viable systemic choices after the collapse of communism (Fukuyama 1992). Today, alternative models of capitalism are growing in importance. As the influence of free market ideas wanes, countries worldwide will explore other models of capitalist development that promise high growth without periodic collapse or implosion, an unfortunate hallmark of the free market model.

Looking at economic development policy as a search for models is relatively new in economic development theory. Standard analyses of policy choice assume that economic policymakers choose policy rationally, with full information, or that they try to and are prevented by politics. Yet decision makers often follow the herd, using bounded rationality, incomplete information, and emulation of neighboring and peer countries as guideposts of economic policy, or because they are forced, coerced, or encouraged to do so (Simmons, Dobbin, and Garrett 2008; Weyland 2005[A]).

Sometimes emulation brings success, other times disappointment. Models may be (or appear to be) successful in one country or at one point in time, but unsuccessful in another. Since no one economic model has produced development consistently everywhere, most countries tend to try out one model, discover its strengths and weaknesses, and then search for new models of economic development over time as they continue their quest.

The effect is that at different points in time and under different circumstances, certain dominant economic models exert tremendous influence worldwide and then are surpassed by new models that offer seemingly greater promise. Fascism spread during the 1930s in Europe and Latin America, state planning was popular throughout the so-called third world during the 1940s and 1950s, and the 1990s were the heyday of free market capitalism. Today, we are again at a turning point. If emulation is an important part of economic policy choice, the future of economic policy will be determined largely by what models are perceived to be rising and waning in influence right now.

<A>Three Models of Contemporary Capitalism

[A] Weyland 2005 is not in the reference list; please add it there or delete here. Added to references, MAO.

Since the collapse of communism in Europe and Eurasia, three main models of capitalist economic development have competed for influence as sources of economic policy ideas for development: free market liberalism, the European social model, and authoritarian state capitalism. These three models have been adopted by leading countries in the world economy and articulated in expert, academic, and policy discourse. They are models in both a descriptive and a normative sense. On the one hand, they more or less accurately describe the practice of the model leading countries. On the other, they claim superiority as templates in achieving desirable social, economic, and political outcomes.

Not all countries neatly fall into one model or another. While model leading countries tend to adhere most closely to the description, other countries adopt the model only in part. Significant deviations remain, particularly for countries that in a previous period adhered to a different model. Many developing countries are sui generis and tend to be model followers or partial adopters rather than model leading countries. One can no doubt identify additional variants or subvariants of capitalism. Despite these issues of categorization, it is useful to think about models of capitalism, because they are well-established and well-articulated sets of ideas about economic policy that influence policy in multiple countries.

In defining models of capitalism, which are normally distinguished according to the role of government in the economy, social policy, and the structure of labor markets and labor-management relations, I emphasize two additional elements here—the structure of enterprise ownership and the nature of the political regime—which are critical to a proper understanding of the different models of capitalism but are often left aside from standard definitions. In other respects, the definitions employed here follow standard approaches in international political economy (Hall and Soskice 2001; Katzenstein 1978; Schonfeld 1965), and in particular the typology proposed by Schmidt (2002, 107-18).

<B>Free Market Capitalism

Free market capitalism is an economic model in which unencumbered markets are the core element. Free market capitalists claim that markets are superior to states as a mechanism of coordination and allocation of resources, except in cases of severe market failure and provision of certain public goods. Markets are thought to be self-correcting at most times and government regulation is thought to be best when it is minimal or even nonexistent. Advocates of free market capitalism suggest that removal of government regulation and interference in the economy is the best way to achieve growth, investment, and even public welfare. Limited regulation extends also to openness to the world economy, with an emphasis on free trade and capital flows. In free market economies, social policy is geared toward providing minimum guarantees or safety nets to protect people when—and only when—market provision fails. Labor markets typically are lightly regulated to enable flexibility in hiring and firing and wage setting by market forces, rather than rigid pay scales or union pattern bargaining.

A unique feature of free market economies is their widely dispersed share ownership through highly developed stock markets and minimal or nonexistent state ownership. In the United States and the United Kingdom (along with Australia, Hong Kong, Ireland, Japan, Korea, Mexico, and Switzerland), state ownership of the largest publicly traded enterprises in the country is effectively nil. In most other capitalist countries, the state owns a controlling share of between 10 and 50% of the 20 largest publicly traded enterprises (La Porta, Lopez-de-Silanes, and Shleifer 1999).

Most free market economies are liberal or electoral democracies. Economic and political liberalism both are rooted in a deeper tradition that extends also to the pursuit of science, technology, reason, individualism, and separation of church and state. “Free markets and free people” was one of the slogans of the free market revolution led by Ronald Reagan and Margaret Thatcher. And indeed most, though not all, countries that have achieved a high degree of free market liberalism also attained a high level of democracy during the period from 1980-2006, a period of rapid democratization worldwide.[1]

<B>European Social Model

The European social model has often been defined in contrast to free market capitalism (Giddens 2005). While both rely on capitalist enterprise, free trade, and liberal economic policies to create growth and employment, the European social model leavens these policies with a substantial dose of state direction and regulation. It does so to achieve twin goals of economic and political stability by spreading the benefits of growth more widely and preventing economic crisis. In Europe, these are seen as crucial political imperatives because of its nineteenth- and twentieth-century history of unrest linked to economic uncertainty and struggle. Leading practitioners of the European social model are France, Germany, and Sweden, industrial countries that have long been devoted to different variants of “coordinated market economies” (Hall and Soskice 2001; Pontusson 2005) with sectoral or national wage bargaining and different versions of state planning and economic intervention. Many analysts have pointed out that there are a variety of different European social models (Esping-Andersen 1990) and question whether there is a single one. While there is strong interregional differentiation, most European welfare states remain distinct from the rest of the world and constitute a separate, if very general, set of ideas and practices on economic policy.

According to Giddens (2005), the key elements of the European social model are a developed and interventionist state, high rates of taxation, an elaborate and well-funded welfare system to provide for the needs of not only the poor but also the middle and upper-middle classes, and an institutionalized role for trade unions and other social partners in economic decision making at all levels of policy. In some countries, such as Germany, this extends to enterprise decision making as well. Hall and Soskice (2001) note that coordinated market economies, firms tend to coordinate with one another through strategic interaction, rather than decentralized markets alone. The state plays a much more significant role in economic regulation than in free market economies, with a greater willingness to intervene.

In addition, state ownership and democratic governance are distinctive features of the European social model. In European countries, the median amount of state ownership is a controlling share in 20 percent of the largest companies. This is true of Denmark, Finland, France, Germany, Norway, and Sweden. Some of the more liberal European countries have less state ownership. Others have considerably more. In Austria, fully 83 percent of the leading firms are at least partly state-controlled. This state involvement in enterprise ownership marks a major distinction with free market capitalism, with its characteristic arms-length relations between state and market.

Democratic governance is a core element of the European social model. European social market economies are explicitly intended to protect and ensure the stability of democracy from social unrest that could undermine support for democratic rule, as occurred in the Weimar Republic. Democracy is a large part of their raison d'être. Conversely, democracy is widely seen as a causal factor in the development of the European welfare state, as citizens have demanded greater and greater social rights and protections over time, facilitated by proportional representation voting, coalition cabinets, and other consensus modes of decision making (Lijphart 1999). This emphasis on the democratic nature of the European social model helps us to understand its differences from authoritarian state capitalism.

<B>Authoritarian State Capitalism

Authoritarian state capitalism was once thought in the West to be the most promising path to economic development for less developed countries. In the 1990s, it fell out of favor as scholars determined that democracies on average enjoyed similar growth rates to authoritarian regimes, despite the notable exception of China (Przeworski, Alvarez, Cheibub, and Limongi 2000; Rodrik 1998). However, the authoritarian state capitalist model of development has recently regained its potency in the international marketplace of ideas. It has been adopted by China, the major rising economy in the international system, and by Russia, which has sought to emulate China's development style after suffering a disastrous attempt to build democracy and free markets. Singapore and other East Asian and Southeast Asian countries have also developed under authoritarian state capitalism, as have Middle Eastern countries such as Saudi Arabia, the United Arab Emirates, and Kuwait. Authoritarian state capitalist economies differ in many ways, but they share a few key characteristics: an authoritarian political system, a state that owns, controls, and intervenes to a great extent in the economy, and relatively low welfare state effort, civil society mobilization, and trade union power.

It should be noted that many authoritarian state capitalist countries, including China and Russia, often have been portrayed as free market liberal economies because they have adopted elements of the free market model (Aslund 2007). This approach ignores major areas of departure from economic policies of free market capitalist countries. Authoritarian state capitalist countries can be distinguished from free market capitalist countries in important ways. While they have liberalized trade significantly and allowed some foreign direct investment, their economies are not fully liberalized. The state does not constrain itself to a regulatory role and behaves very differently. While in a free market capitalist country, the state provides a moderately extensive set of welfare guarantees and business regulations, authoritarian state capitalist countries typically provide minimal welfare coverage but are highly interventionist and regulate with a heavy hand, unconstrained by courts and law. Labor tends to be suppressed, while it is free to organize and often moderately powerful in free market economies.

Adding ownership and governance to the definition provides a sharper view of authoritarian state capitalism. Authoritarian state capitalist countries are unlike free market economies in both their degree of ownership concentration and state ownership. While exactly comparable statistics are not fully available, in China the five largest shareholders in the country held 58 percent of all shares in 1995. At that time, a typical publicly traded company was 30 percent owned by the state. The Chinese state continues to own controlling shares of the major banks (despite the much-publicized offering of some shares on the Hong Kong and Shanghai stock exchanges), including three of the largest banks in the world. Despite the large amount of private business in China, the state retains the “commanding heights” of the economy (Yergin and Stanislaw 2002)[B] through ownership of banks and key enterprises. This ownership enables the state to control economic policy and facilitate development in ways that are impossible in free market economies. State ownership is also characteristic of countries such as Saudi Arabia (Aramco), Singapore (Temasek), and United Arab Emirates.

Finally, most state capitalist economies are also authoritarian. Authoritarian rule enables these countries to cut back on wages, welfare state spending, and private consumption in favor of investment and defense, to suppress labor organization, and stop political shocks to the economic development model (Przeworski et al. 2000). Only through authoritarian governance can China, for instance, maintain a nearly 50 percent rate of investment. Authoritarian states do not depend on popular approval in the same ways or to the same extent. They can afford to ignore short-term discontent in the pursuit of long-term objectives. This provides a powerful set of tools for economic development, if used correctly. Authoritarian state capitalist countries differ from one another in important ways, but they share key features, outlined in table 1.1 below.

<Table 1.1 Models of Capitalism about here>

<A>Emulation and Development

Having defined the three main models of capitalism, in the rest of this chapter I begin to develop a theory of the role of emulation in economic development and use the example of the spread of free market capitalism from 1980 to 2006 to frame some propositions about what might come next, after the shock of the 2008-9 world financial crisis.

[B] Yergin and Stanislaw is not in the reference list; please add it there or delete here. Also, please add year of publication. Added, MAO

Most theories of economic development focus on the domestic economic and political context to explain economic policy choices. Economic approaches often emphasize that political leaders do not choose optimal economic policies that can be discovered through the application of economic reasoning. Domestic interest group politics often trumps economic theory as a source of policy choice, except in unusual circumstances. This general approach overlaps in important ways with a dominant approach in political science, which emphasizes historical path dependencies that keep countries on the same developmental path and prevent them from fundamentally changing their model of development. Policies, as Pierson (1994) showed, create their own politics. Constituencies develop to support the benefits provided by existent policies and are often able to defend these policies against future changes. Institutions and politics thus tend to perpetuate existing policy regimes. For instance, Arvind Subramanian in his chapter in this volume entitled, "The Crisis and the Two Globalization Fetishes," notes that interest groups benefit disproportionately from capital account liberalization. It is this fact, rather than the economic merits of the liberalizing reforms, that explains why so many developing countries have liberalized their capital accounts.

While these interest-based theories explain a lot about economic policy choice, they do have shortcomings. One of the main ones is that these theories have an easier time explaining policy continuity than policy change. Since underlying power structures do not change easily, it is easier to use them to explain the way things are than why things change. To explain change, economic theorists often look to exogenous shocks, since these have the ability to shake up prevailing interest group structures. However, while crises create the environment for policy change, the content of change cannot necessarily be determined as interest group politics is reshaped in contingent ways under conditions of uncertainty.

Explaining why a certain policy is suddenly adopted in a crisis rather than another requires attention to the realm of ideas and the construction of interest. Theories, ideas, and models help to generate propositions about how the economy works, general frameworks for policy, and a set of practices for economic policy change that may be implemented at times of crisis. This is why the Chicago school with its emphasis on laissez-faire economic policies has been so important in the spread of free market capitalism worldwide. After the Second World War, U.S. universities became breeding grounds of a coherent ideology of economic development theory that gained influence in think tanks, governments, and international institutions worldwide, changing the way many countries approached economic development theory and practice.

To help understand the future of economic development theory, it is therefore helpful and interesting to look at the spread of free market capitalism worldwide from 1980 to 2006. Since we have little available data about previous episodes of economic policy emulation, the spread of free market capitalism offers a unique set of clues to understand the ways that emulation works as a source of economic development policy.

This section uses a global database on economic, as distinct from political, liberalization created by the Fraser Institute of Canada, a liberal think tank, to show how and how much policy emulation has affected countries around the world in the hope that observing these patterns can help to shed light on future directions.

The Fraser Institute Liberalization Index is based on 42 indicators divided into five areas of policy: (1) size of government; (2) legal structure and security of property rights; (3) access to sound money; (4) freedom to trade internationally; and (5) regulation of credit, labor, and business (Gwartney and Lawson 2008, xxi). These data are imperfect and may reflect subjective judgments, but in the absence of better data, we assume that they present a generally accurate picture of the spread of free market liberal economic policies worldwide, though results on individual countries may be suspect.

The first thing that jumps out of the Fraser Institute data is how widespread the trend toward free market liberalism has been. Out of 141 countries studied, 110 liberalized between 1980 and 2006, while only 12 went in the opposite direction (Gwartney and Lawson 2008). The others exhibited no distinct trend. Only a handful of countries like Myanmar (Burma), Venezuela, and Zimbabwe were seriously out of step with global trends during this period. The sheer enormity of the trend and the fact that most countries of the world could not or did not ignore it without risking international isolation suggest that emulation—voluntary or coerced—is a powerful force in economic policy choice.

While most countries adopted free market capitalist policies from 1980 to 2006, the extent of liberalization differed greatly. Exhibiting considerable path dependency based no doubt on domestic interest group politics and institutional rigidities, most countries liberalized only incrementally. However, there were some notable exceptions. Some countries liberalized by leaps and bounds, utterly transforming the nature of their economic system, somehow freeing themselves from interest groups and institutions that had dominated policy in the past.

<B>Incremental Liberalization

Model leading countries—those that are strongly identified with a particular model of capitalism—tended to liberalize only incrementally from 1980 to 2006 both in terms of absolute changes in the index and relative to other reforming countries. This held true for the ten leading free market liberal economies in the world (Hong Kong, Singapore, New Zealand, Switzerland, the United Kingdom, Chile, Canada, the United States, Australia, and Ireland) that were already relatively liberal in 1980 and remained so in 2006. Few changes occurred in their global rankings during this period (see table 1.2 below). Only a few exceptional countries joined their ranks.[2]

Similarly, while the leading European social model countries liberalized significantly between 1980 and 2006, few liberalized enough to outpace the free market economies whose policies they emulated. Several, however, did exceed the degree of liberalism that free market economies attained in 1980. Calculating the rates of liberalization measured by the Fraser Institute, we find that France, Germany, Sweden, Denmark, Finland, the Netherlands, and Norway all liberalized at a rate that was within one standard deviation below the average rate of change for the entire sample (mainly because the size of government in these countries remained comparatively high). Path dependency matters and countries emulate policy from an existing baseline (Pierson 1994). Yet, the absolute level of liberalization did increase significantly in these countries, nonetheless.

<Insert Table 1. 2. Fraser Institute Rankings of Liberalism about here>

The leading authoritarian state capitalist countries also liberalized incrementally. China, which is often portrayed as an example of radical liberalization, did not advance as quickly as one might expect in the Fraser Institute ranking. While its overall score increased from 4.42 in 1980 to 6.17 in 2006, its world ranking actually decreased from 80 to 88 as other countries outpaced it in liberalization. China remains a heavily state-dominated economy, with a large state sector, government control of credit, and poor legal structure and property rights protections. Interestingly, both Iran and Russia liberalized more than China did. Iran's score increased from 3.82 in 1980 to 6.69 in 2006, 67th place in the world ranking, making it one of the world's most radical liberalizers. Russia increased from 4.09 to 5.91 between 1995 and 2006. Hong Kong did not increase its score at all during the period, but remained the most liberal economy in the world. Singapore increased modestly to the number two spot. Kuwait increased its score more dramatically, reaching number 20 in the global ranking by 2006. With the exception of Iran, none of the leading authoritarian state capitalist countries liberalized at a rate greater than one standard deviation above the norm for the rest of the world.

<A>Radical Liberalization

Some countries liberalized so radically between 1980 and 2005 or 2006 that they effectively jumped categories, breaking free of their previous models of economic development and historical path dependencies. This list encompasses Ghana, Israel, Uganda, Jamaica, Peru, El Salvador, Hungary, Iran, Nicaragua, Tanzania, Iceland, Turkey, Chile, Bangladesh, and Mauritius. These countries liberalized more than one standard deviation beyond the average for countries in the Fraser Institute sample between 1980 and 2005.[3] Note that radical changes in most cases did not completely erase past legacies of state-directed economic policy. However, the change in these countries was simply greater than most. Add to this list several radical liberalizers among the post-communist countries that the Fraser Institute only began to track starting in 1990: Romania, Lithuania, Albania, Estonia, and Latvia. What do these radical liberalizing countries have in common? What factors account for their adoption of more radical policy change?

While there are undoubtedly multiple factors having to do with domestic politics and economics and external shocks (particularly in the case of the post-communist countries), one obvious commonality between this group is their level of development and their positioning vis-à-vis the core of the international system. For the most part, they are neither very rich nor very poor, but rather semi-peripheral[C] countries in the world economic system – not at the core of the system, but not entirely peripheral either.

The majority of radical liberalizers are classified by the World Bank as middle-income developing countries. Only four are low-income countries. The remaining ones are high-income countries like Estonia, Hungary, Iceland, and Israel—all relatively small, semi-peripheral European or European-style states. Notably, the high-growth East Asian miracle countries do not appear on the list of radical liberalizers. Another important fact: most of the radical liberalizing countries, with the exception of Iran, democratized during the same time period, ending in 2006 as electoral democracies.

Why are semi-peripheral countries (encompassing both middle-income and small, semi-peripheral high-income countries) seemingly more prone to emulate dominant economic policy trends? There are several reasons one could point to. First, semi-peripheral countries may have greater opportunity to reform. Because of their semi-peripheral status, domestic groups may be more likely to support risky policy changes that hold out the promise of joining the core of the international system. Compared with richer more centrally positioned countries, majorities may not view their country and its policies as already highly successful and be prepared to depart from the status quo. Second, as relatively wealthy states, they may have the slack resources and state capacity necessary to enact major changes that poor countries do not. Third, these countries may be better placed to benefit from radical change. With factor endowments and education

[C] Will the average reader know this term? I hope so, seems self-evident.

levels that are more similar to their developed country rivals, they may benefit more than others from free trade and other forms of liberalization. In sum, middle-income, semi-peripheral countries may have greater chances to take advantage of the benefits of reform and the political and economic resources to deal with its costs. Compared with most wealthy incremental reformers, the political obstacles to emulation may be lower and prospective benefits higher in middle-income countries.

Other factors are no doubt at work. Neighboring countries tend to emulate one another to a greater extent, perhaps partly because of knowledge-sharing but also because of competition for comparative advantage. Thus radical liberalization tends to be concentrated in certain regions of the world where neighboring and peer countries compete to emulate one another. Radical liberalization is highly correlated with political democratization. Democratization may make countries more open to emulating foreign economic models through the opportunity structures created by a more open political system. Specific domestic political and economic factors may also explain a propensity to radical emulation and a lack of strong path dependency.

<B>Deliberalization

If radical liberalizers tend to be semi-peripheral countries from regions with liberalizing and democratizing neighbors, what about those countries that have bucked the liberalization trend and opposed global influences?

Countries that truly have gone against the grain are very few in number. Of the 12 deliberalizing countries in the Fraser Institute sample, nine decreased only marginally in their liberalization scores. Interestingly, the United States (since 2000) falls into this group,[4] together with Belgium, Haiti, Luxembourg, Hong Kong, Malaysia, Nepal, Niger, and Bahrain.

The only countries to move more than marginally away from liberalism during the 1980-2006 time period were Venezuela, Zimbabwe, and Myanmar (Burma), three countries with strong dictatorships that have determined to resist influence from the international community. This suggests that bucking the trend toward economic liberalization has been politically difficult and incredibly costly. Domestic politics can trump international influences, but only if governments are willing and able to incur high costs for their citizens (Garrett and Lange 1996, 69).

Overall, the spread of free market capitalism shows that emulation is a powerful cause of economic policy change. When a particular model of capitalism is dominant, as the free market model was between 1980 and 2006, countries emulate its success. Most countries move incrementally toward the dominant policy regimes. Others undertake radical transformations. Only a relatively small proportion of countries buck the trend altogether. Path dependency is a powerful force in keeping countries within their traditional economic models, but policy emulation helps to explain why so many countries move within the constraints of the past toward the models of the future.

<B>Financial Crisis and the Free Market Model

The 2008 world financial meltdown was more than a hard landing at the end of a business cycle: it precipitated a political and ideological crisis of free market capitalism. A few large banks were not the only things that died. Much of the justification for the idea of free market capitalism as a world-leading and world-beating economic model was also discredited. Former

U.S. Federal Reserve Bank Chairman Alan Greenspan famously stated “I was wrong” about many of the fundamental assumptions of the free market approach. The crisis will have a global historic impact because it punctured the ideas that underpinned economic policy in much of the world.

There are four fundamental reasons for this collapse in confidence. First, the crisis had a traumatic effect on Western economies, destroying some of the leading institutions of contemporary capitalism. Banks such as Bear Sterns, Lehman Brothers, Bank of America, Citibank, and Merrill Lynch lost between 80 and 100 percent of their share value in 2008-9 and were swallowed up by their healthier competitors, forced into the arms of the state, or closed. Whereas in 2007, three of the top five banks in the world by market capitalization were American, in mid-2009, the top U.S. bank was ranked fifth.[5] In 2009, three Chinese state banks—ICBC, China Construction Bank, and Bank of China—stood astride the global top ten, moving ahead of many traditional Western banking giants from London and New York.[6] As a result, America lost stature in the eyes of the world.

Second, the 2008 crisis was so obviously self-inflicted. Most developing country economic crises are caused by external shocks beyond the control of the affected countries, but the 2008 crisis seemed to be caused by shortcomings of free market capitalism itself. Failures of financial self-regulation, improper and irrational behavior of market actors, short-term incentives on the part of executives, and a lack of effective state oversight all seemed to indict the free market model. The 2008 crisis looked like something torn from the pages of Karl Marx’s *Das Kapital*: unhinged speculation driven by capitalist greed ruining the employment prospects of the average worker.

Third, the U.S. response was so clearly hypocritical given its prior advice to the rest of the world. While U.S.-backed international financial institutions had advised countries to undertake austerity programs in the face of financial panics in the past, cutting budgets and increasing interest rates in an effort to stabilize economies at a considerable cost of unemployment, the United States turned its back on these policies when faced with a similar crisis. The country suddenly embraced Keynesian demand-management policies, expanding budget deficits to stimulate the economy, bailing out failing financial institutions and major firms and even nationalizing some industry, such as the once leading U.S. car maker General Motors. If the United States did not follow free market policies during its crisis, how could it continue to advocate them to the rest of the world?

Fourth, when the crisis hit, the free market model was already in decline worldwide. The collapse in New York was not the first straw, but the last one. A reaction against free market economic policies had already begun in the 2000s. Free market economic policies had failed to fulfill the promise of economic development in Latin America. After two decades of neoliberal reforms, Latin American countries experienced patchy growth and a sharp rise in income inequality, which seemed to be responsible for, not an antidote to, economic underdevelopment. Latin American countries began to turn, one by one, to leftist leaders (of different types) to adopt more growth-oriented economic policies.

The meaning of the 2008 global financial crisis has been the subject of much discussion. Interpretations are inherently controversial, since "what emerges as the dominating narrative of the crisis will have a profound impact"[D] on the balance between state and market in economic policy.[7] Daniel Yergin, founder of a prominent Cambridge energy consultancy, noted 11 possible interpretations in an October 2009 article in the *Financial Times.* The top three explanations are

[D] What is being quoted here? Yergin as note 7 indicates? Yes, MAO.

(1) too much leverage in the financial system, (2) rapid innovation in financial instruments that created unforeseen systemic risk, and (3) failure of regulation to cover the “shadow banking” sector.

In fact, these three points are part of a single dominant narrative that has developed about the crisis: it was caused by an excess of financial risk and a dearth of prudential regulation. Financial companies had a growing amount of risky obligations on their books, overborrowed in general, and did not face adequate supervision. When the U.S. mortgage crisis began in 2007, panic soon spread into other financial markets and in 2008 the whole house of cards collapsed, leaving financial companies with trillions of dollars in toxic assets and bankrupting those institutions controlling the commanding heights of the economy. Tighter government regulation of banks and other financial companies could have averted the crisis. The solution to the crisis appears to most people not to be more of the same policies. Rather, leaders around the world will be forced to explore alternative models of economic policy.

<A>Exploring Alternative Models

Based on the above analysis of the spread of free market capitalism worldwide and the devastating effects of the Great Recession of 2008-9, it is possible to generate several hypotheses about the directions of economic development policy in the years ahead.

First, we can expect less emulation of the free market capitalist model in coming years. Global emulation of the free market model was driven by perceived success of the U.S. and UK economies in beating average economic growth rates of other model leading countries. The crisis damaged perceptions of the relative success of the free market model. It is unlikely that countries will continue to emulate policies that are widely believed to have failed. Even countries like the

United States and the United Kingdom appear to be moving away from their core policy approach and borrowing from other models, increasing the scope of the welfare state dramatically in the United States with health insurance reform and increasing state intervention and ownership of the economy.

Second, the leading free market capitalist countries have little ability to force their preferred policies on the rest of the world. The disrepute of the free market model is so great that it is difficult to imagine that countries would adopt many free market policies even if they faced significant coercion or incentives. Some of the leading institutions promoting free market capitalist worldwide, such as the International Monetary Fund, have a reduced ability and mandate to induce countries to adopt policies such as bank privatization or elimination of capital controls since requiring a new round of capital increases partly from the developing world.

Third, since countries always face incentives to emulate the policies of seemingly successful model countries, it is likely that in future years countries around the world will look toward the major alternative models: the European social model and authoritarian state capitalism. Because authoritarian state capitalist currently appears to be most successful, as China has pulled out of the crisis more quickly than other model leading countries, we should expect in particular a new era of influence for authoritarian state capitalism.

Fourth, the influence of both authoritarian state capitalism and the European social model will be incremental. Countries will not rush headlong toward the full adoption of these models, but starting from a particular baseline, will gradually, over time, choose to implement policies modeled on those of successful model leading countries. The result will be a gradual, but potentially long-term and significant trend toward both of the major alternatives to free market capitalism. This prediction is also underpinned by public opinion surveys, which show that most respondents in most countries wish to reform, but not to replace the free market capitalist system.

Fifth, neither alternative model may be as dominant as free market liberalism was in its heyday. This is because both the European social model and the authoritarian state capitalist models have limits to their acceptability in some countries. The European social model may be increasingly relevant to wealthy and middle-income countries, while the authoritarian state capitalist model will have its greatest effect in poor and low-middle income countries that are already nondemocratic, hybrid, or poorly performing democratic regimes (see Larry Diamond's chapter in this volume for further evidence on this point).

<A>The Pull of the European Social Model

Significant anecdotal evidence supports the view that wealthy and upper-middle-income countries already are emulating the European social model, in an incremental fashion, as a means of restraining the excesses of capitalism. U.S. economic policy after the crisis clearly has moved incrementally in the direction of social market capitalism, with significantly increased state control over leading enterprises, from AIG and Citibank to Bank of America to Chrysler and General Motors, where the government currently owns a 60 percent stake. Trade union ownership and involvement in corporate governance is also on the rise with the handover of 55 percent of Chrysler and 17.5 percent of GM shares to the United Auto Workers. Government regulation of the financial and other sectors has increased and will continue to do so, as has public employment as a percentage of overall employment. The government has sought to restrain income inequality by restricting executive pay. At the same time, it has sought to increase social guarantees by extending health insurance to all Americans. Some of these measures may be temporary, but together they mark a substantial shift toward the European social market model, with its emphasis on government ownership of leading enterprises and social equity.

Government spending and intervention also increased dramatically in Europe in the immediate aftermath of the crisis, as states bailed out failing banks and enterprises and the "automatic stabilizers" of the European social model came into effect: unemployment benefit spending and social supports of all kinds. Yet, this strong initial response caused a swift reaction from those advocating a new phase of austerity. European leaders imposed a severe austerity program on Greece after its 2010 debt crisis and the Tories under David Cameron have imposed deep cuts in government in the UK as well. The outcome of these countervailing trends is unclear. The result is most likely to be a continued commitment to social welfare, but within the bounds of fiscal sustainability. This compromise is evident, too, in Central and East European states that initially moved rapidly in the direction of free market capitalism. After gaining European Union membership, many have maintained the European social model's emphasis on welfare state spending and have acted to protect industries, regions, sectors, and groups affected by globalization and European Union accession. The extension of the European Union's Common Agricultural Policy (CAP) to Central and Eastern Europe played an important role in this, subsidizing agricultural incomes in Poland and Romania, where more than 20 percent of the population still works in agriculture. In many former communist countries, it has proven difficult to slash social spending. Most new member states have failed to fully transform themselves into free market capitalist countries, with the exception of Estonia.The European social model remains locked in a continuous process of transformation, attempting to balance goals of social protection and fiscal sustainability. European leaders want to maneuver between the Scylla of Greece, where social spending spiraled out of fiscal control, and the Charybdis of the United States, where homelessness, hunger, obesity, violence, and other social ills are tolerated as a matter of course. Europe's struggle will be mirrored by other developed and some middleincome developing countries where democratic pressures cause governments to rethink adherence to free market norms.

<A>The Rise of Authoritarian State Capitalism

In developing countries, authoritarian state capitalism is making a comeback. These countries typically do not have access to the resources and governance capacity required by the European social model, and authoritarian state capitalism offers a more secure route to economic growth.

In large part, the appeal of authoritarian state capitalism is tied to the Chinese model and its status as one of the fastest growing economies in the world and one of the first to come out of the recent recession. China, in particular, has come out of the crisis relatively unscathed with its state-owned banks having taken a more conservative approach to risk than their Western counterparts. The same is true of Singapore, Hong Kong, and several other leading state capitalist economies.[E] In real terms, China began to grow earlier, shaking off the recession more quickly than the liberal countries. As the Chinese Chief Economist of the World Bank Justin Yifu Lin pointed out at the conference upon which this book is based, China has grown for 20 years—without a major economic crisis of the type the advanced Western countries are suffering. This achievement will count for much in the years ahead. The authoritarian state

[E] Hong Kong a country OK? Changed, MAO.

capitalist model also gains from the fact that the crisis of 2008-9 was not of its making and that significant state intervention in the economy appears to have dampened the effects of the crisis.

At the same time, the appeal of the authoritarian state capitalist model will primarily be felt in the developing world. Authoritarian state capitalism will not be a relevant or important model in developed countries with well-established democracies. Instead, its relevance will be restricted primarily to poorer developing countries with weak, unconsolidated democracies. For democratic states, the model of an oppressive state mobilizing resources for economic development will remain unappealing. The end result of the crisis of free market liberalism may be greater differentiation in economic policy regimes between adherents of the different models, particularly over the issue of governance.

<A>Conclusion

Emulation is a powerful force in economic development. Country leaders are often uncertain about how to pursue economic growth and development. Development paradigms change and countries have different experiences with similar policies. In conditions of uncertainty, policymakers tend to choose economic policies that appear to work in neighboring or model countries.

The financial crisis of 2008-9 marked the end of the intellectual dominance of the free market capitalist model worldwide. Signs of its waning were apparent before the crisis. Latin American countries that had been among the most vigorous adopters of free market policies soured on them in the early 2000s and began to pursue more social market oriented or authoritarian statist policies in countries from Chile to Venezuela. However, the severity of the current crisis, its obvious and embarrassing roots in the failure of regulation of the free market system, its destruction of some of the key institutions of free market capitalism, and the shocking scandals that went along with it, have drawn attention to the weaknesses of the free market model.

Economic policymakers in free market capitalist countries must find ways to address the legitimacy crisis that has shaken the free market model. This will be a difficult, but vital, project for those concerned with the future of liberalism. It will mean admitting the weaknesses of previous embodiment of the free market model. It will mean addressing the reasons why people believe that the free market model has failed, such as inequality, poor public infrastructure, weakening human capital development, environmental degradation, and fraying social bonds (Manzi 2010). It will mean finding solutions to these issues, without threatening the ability of the free market countries to generate growth.

Until the free market capitalist model receives an overhaul in ideology, perceptions, and practice, we can expect economic policy in developing and developed countries to be shaped by a process of lesson-drawing from the crisis and the rise of alternative models. To some extent, this will mean a strengthening of state regulation and welfare state institutions, consonant with the social market model in Europe. Meanwhile, developing countries will be drawn to authoritarian statism as a way of constraining the excesses of markets in countries without the state capacity to implement a European style of economic development. Political, as well as economic, freedom will continue to be threatened in countries around the world, particularly in those not structurally connected to Western alliances. None of this is particularly good news, but it will take many years for supporters of the free market model to rebuild confidence in this system, create new successes, and articulate them to the world.

<ECH>Notes

1. The exceptions are Hong Kong, Singapore, and Kuwait, which I categorize as authoritarian state capitalist countries not only because they lack democratic rule but also because of the state's large ownership and regulatory role in the economy. Hong Kong had a strong democracy movement prior to its transfer to Chinese authority in 1997 and probably would have democratized under independent rule.

2. Estonia, ranked 11 in the Fraser Institute ranking, is one prominent case of radical liberalization.

3. This list was calculated from the Gwartney and Lawson (2008) data and includes those countries whose increase in liberalization scores between 1980 and 2005 were more than one standard deviation above the mean of all countries included in the study.

4. According to the Fraser Institute, liberalization increased in the United States under Presidents Reagan through Clinton and decreased under the second President Bush.

5. See Kirchfield 2008.

6. Thomson Reuters. Datastream. Figures from July 8, 2009. Available at www.thebanker.com/cp/57/T1000_Top25.gif.

7. Yergin 2009.

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