

**The Social Context in Conditionality:
Internationalizing Finance and Defense in Postcommunist Europe**

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Abstract:

This paper theorizes the conditions under which states are likely to comply with the policy prescriptions of international institutions. Two groups of explanations dominate the literature: 1) that states comply because of the power of incentives and 2) that states comply because they are persuaded by the power of arguments. I provide an alternative ‘hybrid’ approach and suggest that incentives elicit their intended effect only within a specific social context. This context is defined by the uncertainty of domestic actors, the perceived status of international institutions and the credibility of the policies in question. Degrees of uncertainty, hierarchy and credibility imbue incentives with meaning that, from the perspective of domestic actors, make them worthy of compliance or not. Compliance outcomes over time and across countries correspond more consistently to variation in the social context *in connection with* incentives than to incentives taken on their own. In this chapter, I propose to test the argument in four areas: the democratization of civil-military relations, the denationalization of defense planning, the institutionalization of central bank independence and the internationalization of bank ownership. I briefly address outcomes in four countries: Poland, Hungary, Romania and Ukraine.

Introduction:

Cultivating Consensus: International Institutions and a Liberal Worldview

In this chapter, I specify a theory of institutional influence that locates the impetus for state-level compliance in social mechanisms, specifically in the cultivation of a common worldview. That common – liberal - worldview studied here is anchored by a shared perception of where authority lies. For much of central and eastern Europe (CEE) the transition has been marked by a shift from domestic sources of authority, such as historical experience and nationalist striving, to international sources of authority such as the North Atlantic Treaty Organization (NATO), the European Union (EU) and the Bretton Woods institutions – the World Bank and the International Monetary Fund (IMF). The policy manifestations of the liberal world view embraced by these institutions, and to varying extents transferred to CEE, include the democratization of

civil-military relations, the denationalization of defense planning, the institutionalization of central bank independence and the internationalization of bank ownership.

This chapter also specifies three hypotheses to assess the validity of the theory throughout the study. The cultivation of a liberal worldview around specific issues depends on both domestic and international variables. On the domestic side, international institutions are more likely to gain access to reform processes and thereby define what constitutes “optimal” policy under conditions of interest demobilization and uncertainty in the domestic sphere and when target states seek the social recognition of external actors. On the international side, the power of institutions to cultivate support for their policy preferences is heightened further when their prescriptions are normatively consistent with the practices of their member states.

This combination of factors allows international institutions access to domestic reform processes and to cultivate consensus around the policy orientations of a liberal worldview. Whereas realist approaches in International Relations have traditionally argued that it was the distribution of capabilities in international politics that produced particular outcomes, I contend that it is rather the distribution of knowledge that shapes enmities and alliances. In this book, the distribution of knowledge that matters concerns where authority appropriately rests – in international institutions or in domestic claims for national autonomy and tradition.

Although I emphasize the cultivation of “knowledge” and “consensus” around shared understandings of who wields authority in the international system, my theory of institutional influence should not be construed in terms of harmonious volunteerism among actors or even in terms of socialization. Building transnational coalitions that

support the denationalization of defense planning or bank ownership, for example, is often itself a politically charged process in which even formidable domestic players are shamed into embracing policies they believe to be genuinely bad ideas. Moreover, the same transnational coalitions, once constituted, are powerful agents of internationally-inspired agendas. Should subsequent challenges to an initial liberal consensus emerge (and they often have), international institutions can use coalition partners to help orchestrate the isolation of that opposition. Although cultivating consensus around who should wield authority may seem shallower than socialization or persuasion, outcomes resulting from the consensus on authority are no less consequential for international politics.

I begin by introducing a theory of institutional influence. Since this theory is at odds with much recent constructivist literature that recognizes a clear distinction between the logic of consequences and the logic of appropriateness, I make the case for a constructivist-rationalist synthesis and locate it within the International Relations literature. I then detail and operationalize the hypotheses that I use throughout the study. The aim is to assess conditions under which international institutions are able to influence domestic reform processes and to explain variation in the timing and nature of outcomes. In the final parts of this chapter, I set out the rationale for my case selection and consider alternative approaches.

A Theory of Institutional Influence

Under certain rather narrow conditions, international institutions can transform political dynamics and shape choices in transition societies. A particular social context

informed by the uncertainty of domestic actors, their perceived relative status vis-à-vis international institutions and the credibility of the policies in question are more important for securing liberalizing outcomes than new information or incentives taken on their own. Uncertainty, status and credibility allow international institutions to imbue information and incentives with particular meanings and thus power. A radically different social context can likewise render the same information and incentives, provided by the same international institutions, quite meaningless.

Uncertainty among domestic actors, their perceived location in a hierarchy vis-à-vis foreign advisors, and the credibility of international institutions' policies all permit international actors to persuade their domestic interlocutors of where authority appropriately lies. Such persuasion can be based on the merits of an argument or on the affective relationship between domestic and international actors – or both. Alternatively, social influence, in which actors comply with the prescriptions of international institutions because they come to believe that not everyone else can be wrong, may also encourage domestic players to recognize new sources of authority. If international institutions can exert power over policy-making elites, they can influence not just proximate outcomes but also the basic properties of states, where “property” refers to the balance of power among groups in society or the international orientation of states.

Although the consequences of social dynamics have more often been the concern of constructivists than rationalists, this is not a study that pits rationality against norm-governed behaviour as is so often the case in constructivist research. Rather, I argue that instrumentality among actors is central to the construction of normative contexts in which only narrow manifestations of rationality are politically tenable. Thus while actors and

their choices are heavily structured by social practice, I contend that outcomes in this study—and beyond it—are not strictly characterized either by a consequentialist logic or by an obligatory one.¹

In a social context defined by uncertainty, status and credibility, international institutions can cultivate transnational coalitions that strengthen their domestic members—not by virtue of their authority in terms of popular support—but by virtue of their internationally-recognized status. To be clear, the cultivation of a domestic consensus by international institutions is not simply the empowerment of particular pre-existing domestic interests. In this sense, my argument is somewhat different from those who contend that policies make their way into domestic settings largely as a consequence of “goodness of fit” (e.g., Risse, Cowles and Caporaso 2001; Checkel 2001a:187-189). Rather, I argue that consensus evolves via a process of domestic interest mobilization through which policy “fit” takes on the appearance of being “good” in the eyes of reformers and the public alike.

International institutions—even under the most propitious conditions—are not uniformly successful in shaping domestic political choices, either within countries or across them. Indeed, in postcommunist Europe, where a range of international institutions has been actively trying to direct outcomes, observers have noted a wide degree of variation in political and economic systems (Bunce 2003; Kitschelt 2003: 49). The objective here is to provide a theoretical framework that explains this variation in compliance with international institutions’ policy prescriptions. I argue that both compliance and defection are possible, depending on the presence or absence of

¹ In a similar vein, Frank Schimmelfennig argues that it is through the instrumental application of “rhetorical action” that “community rules” impact the decision to enlarge NATO and the EU, and not the “logic of appropriateness” (Schimmelfennig 2003: 3).

particular social contexts and the degrees of uncertainty, status and credibility produced within them.

When Instrumentality is the Rule: Combining Constructivist and Rationalist Perspectives

There are three core elements to my argument for a constructivist-rationalist synthesis. First, although I do not deny that there are instances in which agents act *either* appropriately *or* consequentially, more often than not they are doing both. NATO officials might think that democratizing civil-military relations is the right thing for postcommunist countries to do. But finally getting them to do it depends on NATO's ability to create a social context in which the failure to democratize is embarrassing. And for something to be embarrassing, actors must share social reference points—which NATO had to create as they did not exist previously. Patterns of compliance show that disgrace can be a more powerful motivator than incentives independent of opprobrium. Second, although actors may be “optimizing” in that they seek to achieve their preferences, this study does not assume a baseline rationality. Rather, I investigate what actors believe is rational in a given context and why what constitutes “rationality” shifts over time. And finally, although incentives are typically construed as regulative rules, the evidence here suggests instead that incentives, when embedded in a social context, can in fact be *constitutive* of actors, or in other words fundamentally shape their preferences.

Three theoretical goals follow from this constructivist-rationalist synthesis. The first is to engage the rationalist literature on transitions, institutions, conditionality and compliance. I argue that the social context in which actors make choices should be at the center of any analysis that seeks to enhance our understanding of why certain outcomes

prevail. Second, I argue that neoliberal and constructivist approaches that attempt to carve out a separate sphere for the role of ideas in politics, distinct from power and interests, ratify an artificial divide between instrumental and obligatory action. Finally, I provide a theoretical framework that specifies the conditions under which the institutionalization of particular ideas at the domestic level is likely to take place.

Rationalist approaches in International Relations that assess the influence of international institutions have tended to focus on the role of incentives—in the form of financial assistance, security, transparency and autonomy—in eliciting particular behaviors from states (see, for the postcommunist states, Wallander 2000; Vachudova 2005; Moravcsik and Vachudova 2003; Kelley 2004a and 2004b; Schimmelfennig 2005; Schimmelfennig and Sedelmeier 2005). This conceptualization of action as a utility-maximizing response to signals in the environment is consistent with neoliberal institutionalism, which is largely concerned with the constraining, regulative and coordinating role that international institutions play in the life of states (Keohane 1984; Goldstein and Keohane 1993; Haftendorn, Keohane and Wallander 1999; Wallander 1999). In building on the assumptions of neorealism rather than radically departing from them, neoliberal institutionalists hold actors' interests, as well as the social contexts in which they find themselves, to be 'pre-existing' and 'exogenous.' These "rationalist" studies therefore elide some of the most important dynamics in explaining the incidence of domestic conformity with burgeoning or prevailing global trends—including, for example, the increasing use of markets as a primary means of resolving political conflict as opposed to authoritative methods of allocation.

Dissatisfaction with rationalist explanations led constructivists to demonstrate that some behavior is not driven by instrumentality, but rather by ‘rules.’ In contrast to the “logic of consequences,” in which actors make a decision based on self-interested and a cost-benefit calculation, in its most pristine form, the “logic of appropriateness,” which is said to underpin rule-based behavior, refers to action that is “taken for granted” and consistent with an actor’s identity (March and Olsen 1989 and 1998)². Such choices are guided by a sense of what one “should” do – for moral or taken-for-granted reasons - in any given situation.

The tendency, first among constructivists, to link sociological approaches in IR to the logic of appropriateness led to a false and counterproductive divide. Because cost-benefit analysis and instrumental action were characterized as features of “rationalist” analysis, obligatory action was categorized as something other than, and possibly less than, rational. Constructivist scholars tried either to show that “culture” operated in some instances where “rationality” might have triumphed instead (e.g., Legro 1996) or that some kinds of political systems allow norms to have constitutive effects while others only allow them to have constraining ones (e.g., Checkel 1997).³ Both kinds of studies conceive of consequential and obligatory action as distinct, with actors responding to incentives in some instances and rules in others.

The methodological challenge posed by constructivism also fuelled the notion that distinctive logics underpinned action. In an effort to distinguish between material and

² Becker (1976) and Rosenberg (1979) debate rationality with respect to the degree to which conscious calculation must inform decision-making in order for it to fall under the definition of “rationality.”

³ Other examples of work that generally corroborate the obligatory/consequentialist divide include: March and Olsen (1989 and 1998); Keck and Sikkink (1998); Katzenstein, Keohane and Krasner (1998); Risse, Ropp and Sikkink, eds., (1999); Börzel and Risse (2000); Checkel and Moravcsik (2001); Checkel (2001 and 2005); and Schimmelfennig (2003).

social causal forces and to avoid overdetermination, some constructivist scholarship focused on issues in which explanations based on national interests, as conceived by the dominant paradigms in International Relations, fail (Katzenstein, 1996). Or, where policies concern questions other than wealth and power—such as human rights—realist, interest-based explanations are arguably not relevant.⁴ But the problem with the obligatory/consequentialist dichotomy is that the insistence on separate logics of behavior upholds the notion that power and interest have meaning and effects independent of social relations - a claim that several scholars have already convincingly dismissed (e.g., Kratochwil 1989; Onuf 1989; Wendt 1999).

An additional drawback of the obligatory/consequentialist conceptualization is that it leaves the misimpression that constructivists have little systematic to say about core issues of our field—war, capabilities, power and interest. Because rarely do we find instances of pure “sociological” phenomena in our highly instrumentalized world that do not also illustrate the centrality of deliberation, and with it, optimization. But this fact should do nothing to diminish the salience of sociological approaches. Our ability to “calculate” stems precisely from our capacity as individuals and collectivities to imbue events with particular meaning (Kratochwil 1989: 11; Ruggie 1998: 861; Kratochwil in Byers 2000: 56). Irrespective of this key insight, rationalists tend to suppress the social dynamics inherent in many political processes or to understate their causal and constitutive significance (Walt 1987 and 1996; Schweller 1998; Schweller and Wohlforth

⁴ Klotz (1995), Keck and Sikkink (1998), Risse, et al. (1999), and Checkel (2001) have used human rights to illustrate this logic at work. Morgenthau (1948) and Waltz (1979) provide the classical and structural realist analyses on what constitutes state interests. Frieden (1999) discusses three methods for inferring preferences.

2000; Wallander 1999 and 2000). This study is an attempt to make these underlying social forces explicit and central—with actors behaving rationally.⁵

Another problem for constructivists derives from the notion that certain norms have constitutive effects while others are basically regulative. This suggests that regulative rules do not affect the properties of actors and that constitutive norms do not regulate behavior.⁶ Neither claim endures under empirical scrutiny. For example, as CEE political parties adopt the policy prescriptions of international institutions, even if only nominally in response to incentives, they are implicitly recognizing a new authority. In postcommunist Europe, such recognition is accompanied by more general changes in the underlying goals of states. In this study, recognizable changes of this kind include shifts from preferring executive authority over the armed forces and high levels of military autonomy to securing civilian oversight; from seeking territorial integrity against historic rivals to supporting an alliance pursuing “out-of-area” (e.g. foreign) missions; and from preserving national power through the control over domestic credit allocation to accepting high levels of foreign investment in banking.

I develop a theoretical framework that specifies the conditions under which such shifts in the distribution of knowledge in the international system are likely to occur. I argue that international institutions provide incentives attached to conditions because that is the language in which international institutions speak. International institutions apply conditionality as though it were a consistently proven method of winning compliance, even though many studies have reached more ambiguous conclusions (Killick 1996;

⁵ “An action, to be rational, must be the final result of three optimal decisions. First, it must be the best means of realizing a person’s desire, given his beliefs. Next, these beliefs must themselves be optimal, given the evidence available to him. Finally, the person must collect an optimal amount of evidence—neither too much nor too little” (Elster 1989: 30).

⁶ Wendt also questions the viability of such a claim (1999: 165).

Collier 1997; Hunter and Brown 2000; Stone 2002; Hughes, Sasse and Gordon 2004; Jacoby 2004; Kelley 2004b; Sasse 2005; Weyland 2005). Incentives are only the tip of the iceberg however, in so far as money or membership - or even—as previously noted, instrumentality—are meaningless outside the context of how the parties to an interaction constitute and interpret money, membership or instrumentality.

In the case studies presented throughout this book, I trace a series of causal and constitutive episodes in which international institutions denationalized the frames through which central and east European politicians perceived their interests. This in turn affected how politicians structured their domestic political institutions. Instrumentality pervades the story. But so too do the social processes through which a certain kind of instrumentality -in which Western rewards were exchanged for compliance with Western norms - became the rule.

Accounting for Variation

I propose three hypotheses for understanding the circumstances under which international institutions will be able to generate domestic support for a particular idea. The hypotheses are based on measures of uncertainty, status and credibility that vary over time, across sectors and countries and help account for fluctuating levels of compliance. International institutions can maximize their influence over domestic reforms under the following conditions:⁷

- 1) When sectoral or regime discontinuity demobilizes interest groups and leaves domestic actors uncertain about how to make policy.

⁷ Similar conditions have been specified, although separately and in different form, by constructivists and liberals. See Ikenberry and Kupchan 1990; Ikenberry 1992; Finnemore and Sikkink 1998; Checkel 2001; Johnston 2001; Kindleberger 1975 and Risse 2000.

- 2) When domestic actors seek the social approbation of the international institutions that are undertaking policy transfer.
- 3) When purveyors of policy are normatively consistent in the ideas they promote and the policies they prescribe.

The presence of these variables renders domestic actors relatively more open to adopting foreign advice and definitions than their absence. Uncertainty, status and credibility give international institutions the power to assign positive meanings to information and incentives, making them worthy of compliance for domestic actors.

In this study, I operationalize each of these variables for postcommunist conditions. Regarding the first hypothesis, in the course of breaking with communism, states had to create some entirely new institutions around which domestic interests had yet to coalesce (H1). I argue that when policy areas are new, domestic actors are more dependent on foreign expertise and their policies become “functional” by virtue of their association with internationally-respected opinion. This is especially true when domestic actors have little understanding of the consequences of different policies.

I operationalize “interest demobilization” (i.e. the disorientation and dislocation of interests) by assessing both sectoral and regime discontinuity. Interest demobilization is stronger in sectors where the state-socialist system was all-controlling. In finance, for example, price liberalization and the creation of two-tiered banking systems created entirely new environments. International institutions therefore had more intellectual access to processes of financial reform than they did, for example, to military reform early on in the transition because the functioning of the armed forces was not peculiar to the state socialist system and interest demobilization was correspondingly weaker.

Regime discontinuity also varied. Whereas Poland and Hungary experienced interest demobilization at the outset of transition when opposition movements came to power, the same cannot be said of Romania and Ukraine until later.

Regarding the second hypothesis, international institutions can imbue ideas with status—i.e., as being desirable or undesirable—if domestic actors seek their social affirmation when engaged in promoting domestic reform (H2). They may confer social recognition through partnership agreements, by providing public praise or by awarding membership. When domestic actors solicit social affirmation they seek association with the values extolled by an international institution.

The salience of international opinion in domestic policy debates corresponds closely to the quality of political competition and to the public support for the institution facing reform.⁸ When political competition is robust, the salience of international opinion is higher for the domestic desire to win international approval also increases – especially among communist successor parties. I argue that this is a result of such parties using international opinion to rebuild their post-Cold War image. This variable changes over time. In Romania and Ukraine the desire for international approbation was initially low but grew over time as political competition intensified. International opinion is also more powerful where the public has confidence in the domestic institution undergoing reform. Poland and Romania were in some ways more sensitive to NATO's scrutiny than Hungary because relatively poor military-society relations in Hungary dampened NATO's social power there.

⁸ Democratic opposition under communism is Milada Vachudova's central hypothesis in explaining success in economic and democratic transition (2005). Building on Vachudova's argument, political competition in general affords international institutions access to domestic reform processes. See also Vachudova and Snyder (1997); Fish (1998); Orenstein (2001); and Grzymała-Busse (2002).

As for hypothesis three, assessing normative consistency requires measuring the extent to which international institutions take the technical correctness or political desirability of a policy for granted. “Taken-for-grantedness” is high where a particular policy prescription is the outcome of a political battle already fought and settled in Western industrialized states. Central bank independence and democratic civil-military relations are two such examples (Epstein 2005a and 2006). But a low level of policy contestation in Western states does not mean the distributional consequences of a particular policy are negligible. All economic arrangements produce winners and losers—even those portrayed as Pareto optimal.⁹ The question is whose interests deserve protection at the expense of others.

Where there is strong international consensus, international institutions will more easily be able to undermine the legitimacy of the losers’ claims in target states, thus suppressing domestic political debate about the policy. But where the existing (Western) member states of international institutions behave inconsistently, space is created for target actors to question the credibility of a policy. A high level of taken-for-grantedness among promoters of a policy powerfully conveys to target actors who does and does not have legitimate claims.

The presence of the three conditions—the uncertainty of domestic actors, their desire for social affirmation from international institutions, and the credibility of international institutions’ policy prescriptions—enhances the power of international institutions to build transnational coalitions in support of their ideas and policies.¹⁰ By imbuing ideas with elevated status, international institutions mobilize support for

⁹ “Pareto optimality” refers to an equilibrium in which no one can become better off without at least one actor becoming worse off.

¹⁰ On the role that social coalitions play in policy diffusion, see Jacoby (2001a).

particular practices. The status of policies is crucial: their origins, their uses, their supporters and even their detractors will determine the chances of compliance or defection. Incentives that bolster a county's wealth, security, and independence are not autonomous from perceptions of whether and how certain incentives make such contributions. Moreover, wealth, security and independence are not entities in and of themselves but rather depend on the answers to value-laden questions concerning wealth for whom, security from what, and given that no country is literally autonomous, "independent" in what sense. International institutions, where they had access, weighed in on precisely those value-laden questions, usually promoting the liberalizing or internationalizing perspective.

I use these hypotheses as reference points when evaluating alternative explanations in the spirit of maximizing the utility of my work to others. I fully acknowledge the eclecticism of claiming that social forces are central to any explanation of political outcomes while also adopting a positivist epistemology of hypothesis-testing to demonstrate that this is the case. The difficulty, of course, as at least two scholars have lucidly explained, is that the intersubjective nature of the concepts that populate our social world make them inextricably linked to us and thus not subject cause-effect processes.¹¹

Equally, I recognize that my hypotheses, stated in their general form, are not readily falsifiable. Although my efforts to identify falsifiable proxies with "concrete" measures in the real world may suggest a strong commitment to the hypothesis-testing

¹¹ Because their existence depends upon the meanings we attach to them, social concepts' position relative to us is not separate in the way that causal reasoning demands that they be (Ruggie 1982; Kratochwil and Ruggie 1986). For a discussion on the problems of "eclecticism" in social science theorizing, see Kratochwil (2000: 79-80).

epistemology, in fact it signals an awareness of the kind of intractable backward reasoning that is impossible to operationalize for which some constructivist work has justifiably been criticized (Moravcsik 1999). And although I refer to the hypotheses throughout my empirical analysis - engaging in comparisons between what a hypothesis would predict and observable outcomes - I am also telling a story in which perspectives compete for dominance, an avowedly interpretative exercise.

Dealing with such inconsistencies is daunting, but not prohibitive. Ultimately, research is a social enterprise in which deliberation among many scholars adjudicates the utility of competing approaches (see Vasquez 1997: 900). I have therefore chosen a strategy that I believe speaks to warranted mainstream anxieties about methodology as well as to constructivist concerns about the importance of social forces for understanding politics.

Case Selection

Sectors

I devote a chapter each to the democratization of civil-military relations, the denationalization of defense and foreign policy, the institutionalization of central bank independence and the internationalization of bank ownership. The focus on financial sectors and military-security apparatuses for the study serves a number of purposes. First, as proxies for democratic consolidation and capitalist development, outcomes in defense and finance are critical for measuring the extent of transition from authoritarian rule and central planning. Just as subordination of the armed forces to democratically-accountable civilian officials has become a cornerstone of democratic governance, so has the erosion

of state power over domestic capital allocation become a lodestar of free market enterprise.

Second, finance and security are hard cases for constructivists. For all of the constructivist discussion about the unique human capacity to attach particular meanings to concepts and therefore to deliberate about them, finance and security would seem to come awfully close to being features of a material base that exist independent of any meaning we might assign them (Wendt 1999). I therefore use these cases to demonstrate that rationalist approaches are not only incomplete on a case-by-case basis (Katzenstein 1996) but also to show that constructivist analyses can explain recurring patterns that have social and ideational sources—even in the difficult cases of money and security.

Finance and defense are also empirically important cases both in terms of domestic distribution and in terms of how the international system functions. Banking, for example, is one determinant of the state's role in the economy (Gerschenkron 1962; Zysman 1983) and may shape institutional complementarities (Hall and Soskice 2001) according to which other domestic political and economic institutions develop. Defense planning—another example—has ramifications for the military's role in society and consequent modes of governance (Ralston 1990). Both sectors also bear on the functioning of the international system in so far as they signal the willingness of states to embrace interdependence or preserve relative autonomy (Adler and Barnett 1998).

The range of sectors also provides variation on the first and third variables concerning the demobilization of domestic actors' interests and the credibility of international institutions' policies. Interest demobilization initially gave international institutions more access to some areas of reform than others (H1). Militaries across

central and eastern Europe were reluctant to embrace NATO's standards of democratic civil-military relations in large measure because their legacies and traditions endured through the transition.¹² Interest demobilization was comparatively greater in banking where price liberalization rendered state-socialist bankers uncertain about what policies would best serve their interests.

The credibility of policies also varies across sectors, largely in keeping with the degree of international consensus underpinning a policy (H3). There was strong (albeit new) international consensus in support of central bank independence and low inflation orthodoxy by the early 1990s, even if this came at the expense of national monetary autonomy. By contrast, at least at the outset of transition, there was a relatively weaker consensus on the wisdom of selling state-owned banks mostly to foreign interests given that the majority of OECD states had proven unwilling to follow a similar course themselves. The denationalization of defense planning was similarly problematic in states that had suffered from inadequate security guarantees in World War II.

Finally, the range of sectors necessitates coverage of several international institutions. The inclusion of NATO, the EU, the International Monetary Fund and the World Bank, among others, helps me address alternative explanations predicated on the power of markets, incentives and membership independent of any social context. Similarly situated countries respond quite differently to the same incentives (Killick 1996; Stone 2002; Jacoby 2004; Vachudova 2005). At the same time, international institutions may offer the same rewards for quite different levels of compliance (Hughes et al 2004; Sasse 2005; Sissenich 2007). Uneven application of incentives and

¹² Jacoby (2004) points to a similar variable to explain the resistance of CEE militaries to NATO norms: the density of actors.

inconsistent responses to them highlight the extent to which social forces come into play, thus undermining a strictly rationalist interpretation of events.

Countries

Poland, Hungary, Romania and Ukraine provide additional variation, principally in terms of sectoral or regime continuity (H1) and the salience of international opinion, measured according to the quality of political competition (H2). Because it is both representative and exceptional, Poland, the central case in the study, is particularly appropriate for studying the effects of international institutions on postcommunist domestic policy making. It is representative in that Poland faced an array of challenges common to all states in the post-Soviet bloc - the result of decades of authoritarian central planning and rule and the economic and political crises they precipitated. From the standpoint of embedding liberalism, however, Poland is exceptional. Episodes of democracy in Polish history have repeatedly given way to internal strife, foreign domination and domestically-generated authoritarianism. Even Solidarity, the most commonly cited of Poland's anticommunist credentials, has an ambiguous relationship with liberal economic reform given its origins as a movement fighting for the expansion of workers' rights rather than market ideals (Cox and Powers 1997; Orenstein 2001; Ost 2005). Analysts made the most pessimistic forecasts for Poland in 1990 precisely because of its turbulent past, nationalist proclivities, and the severity of its economic collapse. Those fears appeared to materialize in 1993 when Poland joined Lithuania as the first countries in which communist successor parties ambivalent about Western institutions returned to power.¹³

¹³ Lithuania did so in 1992.

And yet within a decade of transition, liberal political and economic reforms had clearly prevailed in Poland. Despite volatile turnover in governing coalitions, the country had consistently stayed the liberalizing course. Poland joined NATO and became an essential player in the first round of EU enlargement. In the same period, central bank independence was enshrined in the 1997 constitution and Polish politicians, albeit reluctantly, opened the banking sector to substantial foreign investment. In 2003, the United States chose Poland to lead the third stabilization zone in post-war Iraq.

Hungary, Romania and Ukraine are to varying degrees comparable and contrasting. Hungary most resembles Poland in terms of both explanatory factors and liberalizing outcomes in the economic sphere. Having had a vibrant democratic opposition to communism over decades, international institutions had broad access to domestic reform processes in finance and, to a lesser extent, in defense. An elite political class borne of that opposition identified with the values embedded in a range of Western policy prescriptions spanning from economic liberalization to military reform. Hungary was an obvious candidate for EU membership and ultimately - even though it was not geographically contiguous with the alliance - persuaded NATO that it should be included in the alliance's first post-Cold War enlargement. Important for all those developments was the communist successor party's eventual co-optation of Western reform ideas as it sought to create a political image more appropriate for the postcommunist era in opposition to the more conservative center-right and nationalists.

Romania, by contrast, had quite different starting conditions. Owing to the highly repressive nature of its communist regime, economic backwardness, the lack of democratic opposition, and the ability of members of the communist apparatus to

“manage” the revolution and govern in its aftermath, in sharp contrast to Poland, Hungary and Czechoslovakia, those in power initially had little concern for social recognition from the West. But in a case of telescoped transformation, although international institutions initially lacked access to Romanian reform processes, by the early 2000s, international institutions had helped transform the political context such that everything from democratic civil-military relations to central bank independence was on the reform agenda and moving towards Western models. Whereas the potential benefits of both EU and NATO membership *failed* to elicit Romanian compliance in the first half of the 1990s, both major political groupings—including, crucially, the direct communist successors—were competing for international approval by the end of that decade.

Ukraine provides a different kind of variation. While formerly part of the Soviet Union, the EU and to a lesser extent NATO have held the country at arm’s length. Although similar in some ways to Romania in its starting conditions, the divergence between the two countries since Romania’s embrace by both NATO and the EU illustrates the difference that international institutions can make. Despite the presence of a Ukrainian Westernizing elite, the country has only sporadically embraced those reform strategies most often associated with Western norms—the democratization of civil-military relations, the institutionalization of central bank independence, or the denationalization of commercial banks through privatization with foreign capital. The EU’s reluctance to categorize Ukraine as a potential candidate for membership has no doubt diminished the salience of Western influence on Ukrainian reform. The inclusion of the Ukraine case helps address the best practice argument in which observers claim that, market pressures would have forced CEE states to adopt liberalizing reforms even in

the absence of international institutional influence. Because market pressures have evidently not been decisive in Ukraine, it is not clear why they should have been elsewhere either.

In no postcommunist country was there an unproblematic adoption of liberal policies in critical sectors such as finance and defense—the first because free markets impose social costs and perceived vulnerability, the second because multilateralism impinges on military tradition and national autonomy. Nevertheless, across a range of states and issue areas, because international institutions have weighed in on the side of financial and defense interdependence, policy convergence around liberalization is the putative goal if not yet the universal reality. Indeed, as I will argue throughout the book, the degree of convergence we currently see, even among countries with as diverse starting conditions as Poland and Romania, would be inexplicable without taking the role of international institutions into account.

Alternative Approaches

Four kinds of alternative approaches serve as points of comparison to my own explanation for liberalization in finance and defense in postcommunist Europe: domestic politics, neoliberal institutionalism, conditionality and socialization. Although I borrow from each of these approaches, I depart with them in significant ways, as well. Domestic political explanations tend to downplay the role of international institutions. Neoliberal institutionalism and conditionality take a strictly rationalist view in which the properties of agents do not change. Socialization captures an understudied cause of political change, but also in my view too narrowly defines the scope of constructivist claims.

Domestic Politics

A number of studies understand democratic and economic outcomes in postcommunist Europe as primarily the consequence of domestic actors making decisions solely in reference to national factors (Vachudova and Snyder 1997; Fish 1998; Bunce 1999 and 2003; Reiter 2001; Orenstein 2001; Grzymała-Busse 2002 and 2003). I concede that domestic politics can indeed trump international forces and point to the conditions under which this is likely to occur. I also argue, however, that an exclusively domestic approach omits international pressures as a crucial source of reform.

An important theme in the comparative literature is the degree to which political competition facilitates the development of democratic institutions and free market enterprise. Fish (1998) argues that the first electoral outcomes of the transition set the stage for liberalizing and privatizing trajectories thereafter. Where communist rulers were replaced with reformers, the result was more aggressive economic reform in the short run and greater medium-term reform sustainability (Fish 1998). In separate studies, Vachudova (2005) and Grzymała-Busse (2002) theorize that two prior conditions were essential to a victorious opposition and a subsequent high quality of political competition: the existence of a democratic resistance movement under communism and a communist party that reformed itself prior to the collapse of state-socialism.¹⁴ Comparativists argue that political competition ensures greater transparency in the political system,¹⁵ and

¹⁴ Vachudova (2001 and 2005) uses domestic variables to explain outcomes in the early years of transition, but then also examines the leverage of the European Union in eliciting greater liberalization and later conformity with its policy prescriptions. She argues that the EU was influential because it improved the quality of political competition in illiberal states by providing information and a focal point of cooperation for opposition parties. Grzymała-Busse (2002) analyzes the reform of communist parties in the region.

¹⁵ Orenstein argues that political competition, in combination with government strategies and elite learning, explains democratic and economic policy outcomes. He does take international factors into account as well, but as a constraining condition rather than as a core variable in the analysis (2001).

encourages consensus rather than polarization, equity rather rent seeking, and the emergence of future-oriented constituencies that trump detractors focused on the past.

I borrow from these approaches while also providing an alternative to them. As noted, domestic conditions are central to my own analysis. Indeed, I argue that at least early in the transition, the ideational appeal of Western international institutions to east European reformers can be mapped onto democratic opposition under communism. The presence of dissident movements and an opposition takeover during transition are powerful indicators of early postcommunist compliance with liberal norms. But a purely domestic explanation for political and economic outcomes raises two set sets of issues.

First, comparative studies take the objective of liberalization for granted without exploring the political origins of the reform agenda—the uniformity of which constitutes a significant puzzle.¹⁶ Few scholars are concerned with questions about “why liberalism and why now,” because they typically assume that liberal objectives amount to ‘best practice.’¹⁷ Given the historical context in which central and east Europe “had mimicked fascism in the 1930s and socialism in the 1950s,”¹⁸ it is also not surprising that the region should once again provide a microcosm of global trends.¹⁹ But the strong correlation between political trends external to central and east Europe and developments within it points to processes of international diffusion that in all likelihood facilitate such

¹⁶ An exception is Stark and Bruszt (1998) who argue that the conventional understanding of reform outcomes are oversimplified and misunderstood.

¹⁷ To the extent scholars do raise this question it is about economic reform rather than democratic governance (Szacki 1995; Amsden, Kochanowicz and Taylor 1994). Preteasa (2002) even notes the lack of debate beyond what she calls “neoliberal discourses” in Romania by the late 1990s.

¹⁸ Orenstein (2001: 3).

¹⁹ Valerie Bunce (1999: 9) writes: “Central to the story of regime and state collapse in the eastern half of Europe is what has become a familiar set of developments the world over. . . Indeed what is significant. . . is that [the postcommunist cases] represent a remarkably efficient summary, if you will, of global trends.”

convergence. These are nevertheless conspicuous by their absence in comparative studies of transition.²⁰

A second weakness of cross-national comparisons that depend on country-level variables is that they have trouble explaining sector-level variation *within* countries. The fact that cross-national studies “necessarily do violence to detail and fine distinctions” is in my view a perfectly acceptable price to pay for the significant advances such generalizations bring to our understanding of macro trends.²¹ But to the extent that we can refine theories over time to reduce such “violence,” we should. Moreover, although efficient, the claim that political competition alone explains initial patterns of liberalization and democratization is somewhat reductionist in suggesting that desirable characteristics from a liberal point of view – i.e. democratization and cross-sectoral liberalization – will all cluster together in “good” countries and not emerge in the “bad.”

The political competition thesis thereby elides several important facts about the region that contradict its expectations. Otherwise liberal regimes could be “illiberal” when they wanted to: Poland and Hungary had real trouble democratizing civil-military relations; Slovenia has insisted on maintaining significant state control over its banking sector; and Latvia was decidedly illiberal when it came to citizenship and linguistic rights for all of its citizens. As for “illiberal” regimes, Bulgaria ultimately institutionalized central bank independence, and Ukraine may yet do so. In the medium term, liberal and illiberal policies may not conform to the democratic starting conditions that initially resulted in high or low quality political competition. It is only by addressing the

²⁰ But see Bloom and Orenstein, eds., forthcoming.

²¹ Fish (1998: 32).

international dimensions of transition and how they affect domestic politics that such apparent anomalies can be explained.

Neoliberal Institutionalism and Conditionality

Neoliberal institutionalism, which takes its assumptions and insights from contractual economics, is also relevant to understanding how international institutions affect state behavior (Keohane, 1984; Haftendorn, Keohane and Wallander, 1999). According to this approach, international institutions arise out of uncertainty and insecurity and the desire of states to counter both by institutionalizing the rules, norms and procedures that create transparency. The rationality assumption on which this approach is premised suggests that actors' interests are exogenous. This means that rules, norms and procedures have only regulative effects, not constitutive ones (Wallander 1999). Institutions can thus change how actors behave, but not who or what they are.

The rationality assumption is problematic because it understates the potential power of international institutions and leads to logical inconsistencies between theory and evidence. For example, in explaining the post-Cold War preservation and adaptability of NATO, Wallander uses a transaction costs approach to develop hypotheses about when states adapt rather than dissolve institutions in response to altered geostrategic conditions. She argues that if it is less costly to change old institutions than to create new ones, then "states will choose to sustain existing arrangements rather than abandon them" (2000: 706). She goes on to take stock of NATO's specific and general assets and the efficiency gains they produce, arguing that the cost-efficiency of its preservation was linked to the adaptability of its risk-management assets to post-cold war security concerns (2000: 70-712).

Although Wallander concedes that the “objectives, beliefs, and roles” of particular states are relevant to institutional adaptation, she maintains that structural incentives and opportunities are more important.²² The concession is noteworthy, however, for throughout her presentation of evidence, Wallander repeatedly points to political processes and motivations that fall outside the ontological assumptions of a transaction costs approach, such as the importance of NATO in the post-war period for bolstering public support for Germany’s semi-sovereign status, for cultivating ‘trust’ among alliance members, and for “enmeshing” Turkey and Greece in a “web of relations” (2000: 716). In the post-Cold War period, NATO did the same for the central and east European states. The alliance’s denationalizing, democratizing efforts most certainly had regulatory effects. But they also surely changed these states, their polities and policies (a constitutive effect), especially regarding the balance of power among groups in society and their international orientation. Moreover, as Wallander also points out, NATO officials often talked about the primacy of creating solidarity in this process, rather than the need to produce “efficiencies” (2000: 726-727).

Neoliberal institutionalism poses two, related problems. The first is ontological inconsistency. It is difficult to sustain the argument that transparency is the putative objective of an international institution but that it is only through solidarity that transparency is achieved. For while transparency may exist independent of our competing perceptions of it (and I am skeptical even on this point), solidarity certainly does not. This means that in order for NATO to have the effects that neoliberal institutionalists

²² “Derived from economic transaction-costs approaches, the argument is dependent on structural incentives and opportunities and how they affect strategic choice. However, the argument does not require—and I am not arguing—that the objectives, beliefs, and roles of individual states are irrelevant to institutional adaptation” (Wallander 2000: 712).

attribute to it, they must assume something different about the nature of institutions and actors than they acknowledge. Indeed, implicit in Wallander's analysis is an assumption concerning the centrality of intersubjective social forces that in turn contribute to outcomes—and not just on the margins.

The second problem is the language of “costs.” I would never dispute the claim that states work to preserve institutions when the costs of losing them are higher than those of keeping them. But then the argument hinges on what constitutes cost—a judgment that I argue is informed by actors' interests that can readily change over time. Both problems—ontological inconsistency and the indeterminacy of costs—stem from the rationality assumption. My rejection of it does not mean that on the whole I think people are irrational. It simply means that we have to understand the terms of rationality and where they come from in order for discussions about costs to have any meaning or measurability.

Research on EU conditionality also tends to view states' choices about whether to comply in terms of costs (e.g., Kelley 2004a and 2004b; Schimmelfennig and Sedelmeier 2005; Schimmelfennig 2005; Moravscik and Vachudova 2003; Vachudova 2005). To be sure, assessing the costs of compliance is a logical first step in light of the fact that all of the former Soviet satellites would in theory have been equally eligible to the join European institutions but responded differently to that uniform incentive. But again in the conditionality literature, “costs” are normally not well enough specified in the hypotheses to tell us in advance whether we could expect compliance or not.

Schimmelfennig argues, for example, that between 1994 and 1998, Slovakia failed to comply with EU and NATO prescriptions concerning minority rights legislation

because the domestic power costs for Mečiar would have been too high—i.e., his nationalist coalition partners would have brought down the government (Schimmelfennig 2005: 849). As it turned out, however, the costs of *not* complying were also quite high for Mečiar: his party lost power in the next elections in no small measure because Slovak opposition parties and groups were able to rally the Slovak public that strongly favored European integration (Vachudova 2005: Chapter 6). The theoretical point here is that had Mečiar made the opposite calculation—to advance Slovakian compliance in the short term with an eye toward longer-term political viability—Schimmelfennig would still be right. In other words, hypotheses premised upon costs are generally not falsifiable because most policies imply some cost and it is usually not obvious what actors should prefer except in retrospect.

More important for my purposes, however, is the fact that conditionality arguments do not normally investigate the origins of interests. More interesting than the fact that Mečiar appeared to be trapped in a nationalist coalition that was unwilling to comply with Western minority rights prescriptions, is the fact that Mečiar's governing partners apparently perceived the right to continue discriminating against minorities to be more valuable than EU or NATO membership. Rather than dismiss this preference as irrational, my own theoretical framework systematically investigates its origins—by measuring the interest demobilization of actors, the perceived relative status of international institutions and the credibility of their policies in terms of Western practice. On at the least the third of these variables my own theoretical framework would anticipate such problems with compliance based on the uneven adherence to any codified minority rights policy in Western Europe (Grabbe 2005; Sasse 2005).

My aim is not to dismiss the power of conditionality or to argue that a social context informed by uncertainty, status and credibility independent of incentives explains outcomes more of the time. Rather, the purpose is to specify why conditionality is compelling in some instances but apparently meaningless in others. The attention to social context is meant to shed light on exactly that question.

Socialization

The recent attention to socialization in International Relations is a welcome innovation that has expanded our understanding of what drives political and institutional change (Checkel 2001b and 2005; Johnston 2001 and 2003; Kelley 2004a; Gheciu 2005a and 2005b). The variables presented here (uncertainty, status and credibility) overlap with those that others have also used for theorizing the impact of persuasion (Johnston 2001; Checkel 2001b; Gheciu 2005a). But important points of intellectual convergence notwithstanding, there are two, related ways in which my own theoretical framework departs from this literature. First, socialization is too narrow to capture the full range of outcomes this study examines; and second, as already noted above, I disagree with the insistence on distinctive - instrumental and obligatory - logics of actions.

Although I refer to “consensus” in this study, I am not primarily interested in the causes of socialization in the strictest sense of that term. Nor do I make strong claims about how the political processes I examine alter privately held beliefs. The growing literature on argumentation, persuasion and socialization rightly emphasizes that the “distribution of knowledge” in the international system bears on political outcomes. I take the position here, however, that community-held norms about what constitutes an appropriate belief, as expressed either in language or action, is the more relevant measure

on liberalizing outcomes in postcommunist Europe. The reasons for this are two-fold. First, while beliefs are not observable, language and action are. Second, since language and action can readily belie beliefs, I argue that it is language and action, rather than beliefs, which must have proximate effects on outcomes. This is particularly salient to my argument when one considers the power of social pressure to shape conflicts and their resolution in the political sphere.

Given my emphasis on where actors believe authority lies based on their language and actions, Checkel's analysis might appear to subsume the processes in my study under what he calls "Type I socialization" (Checkel 2005: 804). Checkel defines Type I socialization as the perfunctory adoption of rules that does not require actors' reflexivity but that does necessitate a shift from the logic of consequences to the logic of appropriateness. It is doubtful, however, that perfunctory adherence to rules actually constitutes socialization since Checkel stipulates on the same page that socialization implies an internalization of new rules. More important for my argument, however, is that the shift from a logic of consequences to a logic of appropriateness is not only unobservable but that under most circumstances actors are not adhering to either one logic or the other—they are rather drawing on both. Rules emerge as a consequence of social interaction, to be sure. But a failure to adhere to social rules can undoubtedly carry costs—a fact not lost on the generals and bankers responsible for weighing national autonomy and tradition against international pressures.

Attention to socialization in international politics narrows the scope of constructivist claims by insisting that we show that a shift away from the logic of consequences and that actors have internalized new rules. With such evidentiary

requirements, social forces risk being relegated to that rare category of events in which actors are persuaded of the rightness of an idea and implement policy on that basis.

Indeed, the either/or approach in which international institutions have *either* persuaded domestic actors *or* pressured them into complying has unjustifiably limited the salience of constructivist insights and social forces.

Judith Kelley for example, argues in reference to minority protection and language policies in four postcommunist countries that conditionality appears to be the most powerful mechanism in assuring legislative compliance with the policy prescriptions of the Council of Europe (CE), the EU and the Organization for Security and Cooperation in Europe (OSCE) (Kelley 2004a and 2004b). She presents three propositions which, when tested against the evidence, seem to show that only in very few cases does socialization register an independent effect and only when domestic opposition is low. Kelley concedes that it is difficult to separate the effects of socialization from conditionality because there are few cases in which European institutions apply conditionality without also making some effort to persuade target states of the desirability of a policy (2004b: 439). She nevertheless concludes that the absence of socialization would probably not have seriously undermined the power of conditionality to encourage states to adopt liberal legislation, even where domestic opposition was high (Kelley 2004b: 449-453).

I have no doubt that Kelley's claims are generally correct, but her conceptualization of socialization, which is consistent with Checkel's, is too narrow to infer anything about the constructivist-rationalist debate. Normative pressure, as Kelley defines it, "occurs when an institution advises a government on the direction a policy

should take, offering no reward other than the approbation of the institution” (2005a: 3). Because the definition limits the possible constructivist scope of explanation to instances in which target actors are persuaded by the power of arguments alone, it understates the degree to which social forces could be at play.²³ Social processes that might contribute to an explanation of why states respond variably to EU minority rights prescriptions include the degree to which West European states follow such prescriptions, the perceived value of EU membership as weighed against national autonomy and the prior politicization of ethnic differences. These alternative variables roughly correspond to credibility, status and uncertainty—the presence or absence of which I argue explains whether international institutions can embed liberal policies in transition states.

Conclusion

Although I specify the processes through which international institutions cultivate consensus around the policy manifestations of a liberal worldview, the argument is more broadly applicable to contemporary global politics. Capitalist and democratic cultural forms increasingly animate societies’ understandings of our world.²⁴ Technology in all of its applications—transport, communication and international economic flows—may well shape the material bases that in turn make the global spread of particular cultural forms possible. But material bases and the technology that structures them are both underdetermining in so far as neither bears on the central issue of “why *these* particular cultural forms.” By addressing this critical question in the context of postcommunist

²³ For a fuller explanation of this critique, see Epstein 2005b.

²⁴ For an explanation of why political or economic systems constitute “cultural forms,” see Dobbin (1994); Smelser and Swedberg (1994); and DiMaggio (1994).

transition, I hope to contribute to more general debates about how knowledge is transmitted in the international system and with what political consequences.

That uncertainty, status and credibility are all core elements of my analysis of what makes incentives salient distinguishes my approach from studies premised on stable interests or the rationality assumption. However, my simultaneous insistence on the role of instrumentality in assigning meanings to concepts also distinguishes my theory of institutional influence from constructivist work that is dedicated to specifying the conditions under which competing logics of action—consequential and obligatory—obtain. By detailing how the initial establishment and further embedding of a liberal world view takes place, I also demonstrate that incentives embedded within a social context have both regulative and constitutive effects. Where international institutions have had the power to delineate “what kind of capitalism” and “what “kind of defense,” they are also defining “what kind of state.”

Where the social context allowed it in postcommunist Europe, international institutions limited the range of policy options politicians could pursue and also circumscribed the kinds of arguments that they could use to cultivate public support. The result in finance and defense has often, though not always, been denationalization, such that governments have opted for market-oriented economic policies and multilateral security strategies. Limiting policy options and discourses to denationalization transforms previously contested ideas into commonly held assumptions. Denationalization in finance and defense has distributional consequences domestically. But it also signals a state’s willingness to engage in interdependence or defend relative levels of autonomy.

As the evidence will show, the distribution of knowledge in these cases is not about convergence around economic best practice or optimal strategies for security maximization. It is rather about convergence around what constitutes rational political action in a particular social context, a perhaps even more profound manifestation of a state's intention to signal its solidarity with a particular community. The role of international institutions in cultivating support for liberalism brings us closer to understanding processes of reconciliation or alienation between national politics and our increasingly integrated international system.