

## **Votes and Vetoes: The Political Determinants of Commercial Openness**

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September 23, 2003

## Introduction

Much of the recent literature on the political economy of trade policy emphasizes the role of domestic politics. Societal theories of foreign economic policy stress the importance of domestic interest groups, whereas statist theories focus on the effects of domestic institutions. Debates over the relative merits of these approaches have been fierce, but little systematic empirical research has been brought to bear on this issue. Moreover, most extant research addresses trade policy in stable, mature and wealthy democracies, a tack that places important restrictions on the range of both interest group pressures and domestic political institutions that are analyzed and thereby hampers efforts to assess the usefulness of each approach.

In this paper, we analyze the domestic determinants of commercial openness for democracies and non-democracies at all stages of economic development. Our core argument is that, while societal and statist factors are generally regarded as having independent and competing effects, it is more fruitful to view the influence of each type of factor as conditional on the other. More specifically, as societal explanations contend, deteriorating macroeconomic conditions are a potent source of protectionist sentiment in society. The extent to which such conditions reduce commercial openness, however, depends centrally on the domestic political institutions through which societal pressures must filter to influence policy.

Two institutional features stand out. First, countries vary substantially in the degree to which authority is concentrated within the national government. In states marked by greater fragmentation and more “veto points,” it is harder to change existing policies because any number of actors can block such change. Consequently, we expect the effects of macroeconomic conditions on trade policy to be weaker in fragmented states than in those characterized by a

highly centralized national government. Second, we expect both fragmentation and the societal pressures stemming from the economy to have a more potent impact on commercial openness in democracies than in other regimes. The electoral constraints facing democratic leaders force them to respond to demands made by key segments of society. While autocrats can more easily change policies than democratic leaders, regardless of how concentrated power is in a democracy, autocrats depend on a narrower set of groups for political power than their democratic counterparts. Consequently, in autocracies this set of groups is less likely to base their political support on broad macroeconomic conditions than on distributional choices that the government makes about national income and employment, whatever the overall level or rate of growth of these indicators.

Taken as a whole, we therefore expect deteriorating macroeconomic conditions to impede commercial openness; but the effect of these conditions is likely hinge on the extent of institutional fragmentation. Equally, we expect macroeconomic factors to have a more pronounced influence on trade policy in democracies than other countries. The results of our statistical tests covering more than one hundred countries during the period from 1960 to 2000 strongly support these arguments.

### Societal Interests and Trade Policy

Various studies of trade policy emphasize the role of groups within society.<sup>1</sup> Societal theories focus on how interests groups affect trade policy through demands made on public officials. Such explanations view trade policy as the outcome of competition among coalitions with an interest in foreign commerce. Domestic institutions and policy makers are viewed as

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<sup>1</sup> The classic statement is Schattschneider (1935).

passive actors that supply the trade policies demanded by the most influential segments of society (Ikenberry, Lake, and Mastanduno 1988).

Societal theories frequently infer demands for protection from macroeconomic conditions, contributing to a burgeoning literature that has emerged on the links between aspects of national economic performance and foreign commerce (e.g., Baldwin 1989; Bergsten and Cline 1983; Bhagwati 1991; Bohara and Kaempfer 1991; Cline 1989; Corden 1993; Deardorff and Stern 1987; Destler 1992; Dornbusch and Frankel 1987; Gardner and Kimbrough 1989; Magee, Brock, and Leslie Young 1989). These theories argue that policy makers have reason to respond to demands for protection arising from broad segments of the populace. There is considerable evidence that voters pay attention to overall macroeconomic conditions as well as their own economic circumstances when casting ballots (Colton 2000; Kinder and Kiewiet 1981; Lewis-Beck 1988). Furthermore, survey research indicates that public support for protectionism rises as domestic economic conditions deteriorate (Shapiro and Page 1994). Government officials therefore have reason to raise trade barriers when these conditions worsen in an effort to bolster their prospects of retaining office.

It is widely argued that, among the macroeconomic determinants of trade policy, unemployment is crucial. In fact, as C. Fred Bergsten and William R. Cline (1983: 77) point out, “conventional wisdom suggests that high levels of unemployment are the single most important source of protectionist pressures.” Various studies have arrived at the same conclusion (Hughes and Waelbroeck 1981; Nowzad 1978; Wallerstein 1987).

Heightened unemployment is expected to generate calls for protectionism by making it more difficult for workers to adjust to increases in imports. Workers who lose their jobs due to

rising import competition will find it harder to find alternative employment and are likely to be paid less once they become reemployed. These workers and others who fear that they may soon become unemployed have reason to press for relief from foreign competition (Bradford 2003). So do firms that depend on consumption by these workers. A surge in unemployment serves as a focusing event that stimulates workers, investors and other interest groups adversely affected by open trade to overcome collective action problems and mobilize for protection (Olson 1983).

In addition to unemployment, the extent of economic growth is also likely to reflect societal preferences for trade policy. As Anjaria, Iqbal, Kirmani, and Perez (1982: 10) argue in a study published by the International Monetary Fund, “protectionist pressures tend to increase during periods of cyclical downturn in economic activity and associated rise in unemployment, as industries and workers seek government action to insulate sectors of the economy from import competition.” Lagging growth depresses the demand for goods, placing particular pressure on import competing sectors and creating an incentive for individuals who generate income from these sectors to issue a call for protection. This argument is hardly new: over a century ago, Schmoller (1897; quoted in McKeown 1984) pointed out that “the time of boom, of increasing exports, of new openings of overseas markets, are the natural free trade epochs, while the reverse is true in times of foreign slumps, of depressions, of crisis.”

More recently, McKeown (1984) found that lagging growth stimulated tariffs increases during the second half of the nineteenth century and the period leading up to World War I. Gallarotti (1985) has provided additional evidence of this sort based on a study of Germany, the United Kingdom, and the United States during the nineteenth century. In light of the theoretical links that have been drawn between growth and protection and the particularly widespread

availability of data on economic growth, we use both this variable and unemployment to identify societal preferences for trade policy.

### Domestic Institutions and Trade Policy

Whereas societal approaches point to the importance of influential segments of society in determining trade policy, they give short shrift to the domestic political institutions that filter societal demands and set policy. Crucial in this regard are the extent of fragmentation within a country's national government and its regime type.

The fragmentation of power within a government depends on the number of independent partisan and institutional actors whose agreement is necessary to make policy. These actors include competing branches of government and coalitions within a given branch. As the number of independent actors with such veto power – or veto points – increases, societal groups have greater difficulty pressing for a change in policy (Henisz 2000; Tsebelis 2003). Scholars working in the field of positive political theory have identified veto points as one of the most important institutional elements of policymaking (McCubbins, Noll, and Weingast 1987, 1989; Tsebelis 2003; Wade 1990; Weingast and Moran 1983).

In our context, any single actor with the authority to set trade policy understands that the final policy outcome must lie within a range of policies that satisfies all veto points. To the extent that the preferences of the actors with veto power differ, institutional structures with more veto points limit the range of feasible trade policy choices. As a result, “the potential for policy change decreases with the number of veto players, the lack of congruence (dissimilarity of policy

positions among veto players) and the cohesion (similarity of policy positions among the constituent units of each veto player) of these players” (Tsebelis 2003).

Several cross-national empirical studies that link policy stability to the number of veto points support these theoretical insights. Hallerberg and Basinger (1998), for example, find that in response to tax cuts enacted by the United States in the 1980s, OECD nations with fewer *de facto* veto points lowered their tax rates by a greater amount than did countries with more checks and balances. Analyzing longer term processes, Franzese (1999) and Treisman (2000) conclude that countries with more veto points have more stable (either high or low) government deficits and inflation rates, respectively. MacIntyre (2001) reports that a nonlinear relationship exists between veto points and policy responses to the 1997 East Asian financial crisis: he argues that too many veto points generate overly rigid policies and inhibit policy change during economic crises whereas too few veto players lead to arbitrary or capricious changes in policy rather than a negotiated compromise.

Relatively few studies have addressed the effects of veto points on trade policy. But Lohmann and O’Halloran (1994) find that divided government has impeded trade liberalization in the United States. Unified government, by contrast, has reduced the effective number of veto points and promoted liberalization. In a study of post-communist countries during the 1990s, however, Frye and Mansfield (2003) find that trade reform grows more likely as the number of veto players increase, especially in non-democratic states. This result, they argue, stems from the autarkic trade regimes put in place by these countries during the Cold War and the tendency for an increase in the number of veto players after the collapse of the Berlin Wall to expand the

range of economic interests shaping foreign economic policy, bringing groups with an interest in trade liberalization on to the political stage and leading to more open overseas commerce.

The difference between the effects of veto points in these two studies may be an outgrowth of variations in the status quo policy that the authors consider. In the situation analyzed by Lohmann and O'Halloran (1994), the status quo trade policy is relatively open and was developed by a comparable set of political actors to those currently holding power. A reduction in veto players thus allows a subset of political actors to overcome opposition and push through a change in the status quo policy, leading to trade liberalization. In the case of post-communist countries, by contrast, the status quo trade policy is highly protectionist and nations differ substantially in the extent to which the existing political actors and veto players are the same as or closely related to those that promoted closure. Where veto players are more numerous, political regime change has brought new political actors to the table providing for a new trade liberalization coalition. Where few veto players exist, it is more likely that the same political actors that supported autarky remain in power. This interpretation of these conflicting findings highlights the need to control for the status quo trade policy and to explore the impact of the nature of the political regime and any changes therein.

### Summary

Our analysis adds to the burgeoning literature on the political economy of foreign trade by addressing the combined effects of societal pressure generated by macroeconomic conditions and institutional fragmentation on political actors' incentives to change trade policy. Consistent with societal theories, heightened unemployment or lagging economic growth will stimulate

interest group demands for policies to reduce unemployment or expand domestic output at the expense of cheaper imports, including reductions in commercial openness. Consistent with the literature on positive political theory, however, we also argue that that by constraining the behavior of political actors, policymaking structures with more fragmentation reduce the sensitivity of political actors to such societal pressures. When a large number of veto players exist, there is likely to be some player that is hostile to raising trade barriers and can frustrate the societal demands for protection. As the number of veto players decline, it becomes easier to change the existing trade regime since these veto players are more likely to have relatively homogeneous interests (Henisz 2000). We therefore anticipate that adverse macroeconomic conditions should lead to a larger decline in external trade linkages as countries become more institutionally centralized.

Of course, the need for leaders to respond to such demands differs markedly depending on whether the populace is able to monitor their behavior and penalize them for being unresponsive. In democracies, the populace is able to do so. Indeed, the hallmark of democracy is the existence of regular, open, and fair elections involving candidates who compete for the votes of a large portion of the adult population (e.g., Huntington 1991: 5-13; Przeworski et al. 2000; Schumpeter 1942). Furthermore, a free press and the relatively free flow of information about governmental activities keep constituents apprised of changes in foreign economic policy and leaders' activities. If democratic leaders do not take overt steps to cushion the effects of macroeconomic downturns – including an increase in trade barriers – they face the prospects of being turned out of office by voters.

Non-democratic governments, by contrast, are less susceptible to broad-based societal demands. The absence of electoral pressures and checks on their power by an independent and representative legislature give non-democratic leaders less incentive to respond to demands for protection arising from heightened unemployment and flagging economic growth than their democratic counterparts. Like democratic leaders, autocrats rely on the support of various interest groups to maintain power. However, the segment of society to which an autocrat must appeal to retain office is typically much narrower and therefore less motivated by aggregate macroeconomic conditions than in a democracy. Instead, an autocrat's key constituents tend to focus greater attention on how resources are distributed within society and their share of these resources rather than national economic performance. As a result, despite the absence of veto players, autocrats should also be less sensitive to the societal pressures generated by adverse macroeconomic conditions (Acemoglu and Robinson 2003; Brooker 2000; Wintrobe 1998).

In sum, then, we expect commercial openness to dip as the level of unemployment rises and economic growth stagnates, and we anticipate that the influence of unemployment and growth will grow larger as the number of veto players decline. In addition, while democracies are generally marked by a higher number of veto players than non-democracies, we expect the impact of unemployment and growth to be more pronounced in democratic regimes.

Our analysis departs from the empirical work on the domestic politics of trade policy in various ways. First, very few studies have addressed the effects of political fragmentation on trade policy; none that we are aware of have addressed how fragmentation influences the relationship between societal factors and foreign commerce. In fact, while it is widely recognized that institutional and societal factors are likely to have an interactive effect on trade

policy, little research has explicitly considered this issue (Gilligan 1997; Mansfield and Busch 1995; Milner 1997). Instead, most empirical studies posit that societal demands and policy structures operate independently of each other. Our model, by contrast, explicitly accounts for the intervening role of policymaking structures and political regimes. Second, the vast bulk of the empirical studies of trade policy have focused on democratic, advanced industrial countries. Although there has been widespread interest in whether variations in regime type are linked to patterns of commercial openness, systematic research on this topic has been relatively scarce (Frye and Mansfield 2003; Mansfield, Milner, and Rosendorff 2000, 2002; Milner and Kubota 2001). Equally, the work that has been conducted has not addressed whether the societal influences on trade policy vary between democracies and non-democracies. Our analysis – covering over 100 countries between 1960 and 2000 – will provide some of the first quantitative results bearing on this important issue.

### Model and Measures

To test our argument, we begin by estimating the following model:

$$\Delta OPEN_{i,t} = \beta_{0i} + \beta_1 TIME + \beta_2 SOCIETAL_{i,t-1} + \beta_3 POLCON_{i,t-1} + \beta_4 SOCIETAL_{i,t-1} * POLCON_{i,t-1} + \beta_5 OPEN_{i,t-1} + IGO_{i,t-1} \beta + \varepsilon_{i,t}$$

Our dependent variable is the annual change in trade openness. For each country,  $i$ , openness is defined as its exports plus its imports divided by its gross domestic product (GDP), using data drawn from the World Bank's *World Development Indicators*. The dependent variable is the change in openness from year  $t-1$  to year  $t$ . We have data on this variable for 5,023 country-years involving 176 countries over the 41-year period from 1960 to 2000. The mean value of the

dependent variable is 0.54 percent with a standard deviation of 10.7 percent, indicating both a slight tendency for countries to expand their trade linkages over time and substantial variation in this regard within the sample.

Of course, this measure of trade policy is not ideal since aggregate shifts in openness could reflect various factors other than policy decisions (Leamer 1988; O'Rourke and Williamson 1999). However, the alternative measures that have been developed cover only a fraction of the countries included in our sample. Moreover, they exclude many autocracies and numerous developing countries, rendering them inappropriate for our purposes.<sup>2</sup> It is especially important to include countries with as wide a range of political institutions and macroeconomic conditions as possible, given the arguments being tested in this paper. Furthermore, protectionist trade policies should generally reduce the level of commercial openness and trade liberalization should generally increase this level. Consequently, there is ample reason to focus on explaining  $\Delta OPEN_{i,t}$  in the following analysis.

### Independent Variables

The central variables in our model are two measures of societal interests (*SOCIETAL*) and two measures of domestic political institutions. All of the independent variables are measured in year  $t-1$ , reflecting the fact that trade policy does not respond immediately to either societal pressures or institutional conditions and helping to address the possibility of endogeneity in the model.

As we mentioned earlier, societal theories frequently infer demands for protection from the unemployment rate and the pace of economic growth. The World Bank reports the

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<sup>2</sup> For an overview of these measures, see Edwards (1993).

unemployment rate (*UNEMPL*) that is given by each country's national statistical agency. Using these data introduces some difficulty in making international comparisons; but they cover the widest possible range of countries and years.<sup>3</sup> Unfortunately, even the World Bank leaves substantial missing unemployment data, with coverage for only 1,335 country-years, including 115 countries over the twenty-one years from 1980-2000. As a result and consistent with the arguments outlined above, we also use the annual growth in real per capita GDP (*PERCAPGDP*) as a measure of economic conditions that might create societal pressure for changes in trade policy. Data on per capita GDP are ubiquitous in countries with data on trade openness, thus providing the largest possible sample for our empirical analysis. We will report results using both the unemployment rate and growth in all of our statistical tests.

The key institutional factor included in the model is the extent of the constraints faced by government officials in each country. We measure this variable in terms of the veto points created by the structure of a country's political institutions and the extent of partisan heterogeneity within and across these institutions, using the Political Constraints Index (*POLCON*) developed by Henisz (2000).<sup>4</sup> The first step in constructing this index is the identification of the number of independent branches of government (executive, lower and upper legislative chambers, judiciary and sub-federal institutions) with veto power over policy change in each country. Countries lacking any formal veto points are assigned a score of 0. For all other countries, the majority preference of each of these branches and the *status quo* policy are then assumed to be independently and identically drawn from a uniform, unidimensional policy

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<sup>3</sup> Data from the International Labor Office offers equal coverage to the World Bank dataset and is drawn from the same national sources.

<sup>4</sup> Data and codebook are available from <http://www-management.wharton.upenn.edu/henisz/POLCON/ContactInfo.html>

space [0,1]. This assumption allows for the derivation of a quantitative measure of institutional constraints using a simple spatial model of political interaction.

This initial measure is then modified to take into account the extent of alignment across branches of government using data on the party composition of the executive and legislative branches. Alignment across branches increases the feasibility of policy change, thereby reducing the level of political constraints. The measure is then further modified to capture the extent of preference heterogeneity within each legislative branch. Greater within-branch heterogeneity increases (decreases) the costs of overturning policy for aligned (opposed) branches. The final measure of *POLCON* can take on values ranging from zero (least constrained) to one (most constrained). This measure is available for all countries except microstates (data are missing for only 15 of the countries for which we have data on trade openness) throughout the period from 1960 to 2000. Central to our argument is that the impact of societal forces on trade policy will be moderated as the number of veto points rises. Consequently, we also analyze *UNEMPL \* POLCON* and *GRGDPPC \* POLCON*.

Another key aspect of our argument is that the effects of broad societal pressures for protectionism as well as veto points should be qualitatively different in stable democratic nations than in other political regimes. We therefore estimate our model for the democratic states in the sample and again for the non-democratic states.<sup>5</sup> We distinguish between democratic and non-democratic regimes using the POLITY4 dataset (Jagers and Gurr 1995), which contains separate 11-point indices of each state's democratic (*DEM*) and autocratic (*AUT*) characteristics in each year. The difference between these indices ( $DEM - AUT = REG$ ) yields an overall

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<sup>5</sup> In our robustness tests, we further address this issue by pooling the democratic and non-democratic states in the sample and including a democracy indicator variable as described in further detail below.

measure of regime type ranging from -10 to 10. Following much of the existing literature, we define stable democratic regimes are those where *REG* is greater than or equal to 6 or above for five consecutive years. Later, however, we assess the robustness of the results by fluctuating this cut-off point for democracy.

Since our dependent variable is the change in trade openness, it is important to include the level of openness as well. There are practical limits on the extent of openness that countries can achieve. Those that are already relatively open may find it difficult to increase openness much, whereas those that are relatively closed will face strong economic incentives to liberalize their trade regimes. Controlling for initial conditions in this manner will help us to isolate the differing mechanisms that led to conflicting theoretical arguments and empirical evidence regarding the impact of veto players in extant research on trade liberalization (Frye and Mansfield 2003; Lohmann and O'Halloran 1994).

Although our primary interest is in the domestic sources of trade policy, it is obviously important to account for various international factors that might influence foreign commerce too. To this end, we include in the model a number of variables indicating whether a country participates in intergovernmental organizations (*IGO*) that may require, encourage or solicit membership from those countries more likely to expand their external linkages (Ingram, Robinson, and Busch 2003). Time varying indicator variables are included for membership in the World Trade Organization (WTO) (previously, the General Agreement on Tariffs and Trade), the World Bank (WB), the International Monetary Fund (IMF), the International Convention for the Settlement of Investment Disputes (ICSID), the Multilateral Investment Guarantee Agency (MIGA), and the European Union (EU). Further, we include dummy variables indicating

whether each country was a member of the Organization of the Petroleum Exporting Countries (OPEC) or the Council for Mutual Economic Cooperation (COMECON), since a heavy dependence on oil exports and a command economy are likely to influence the evolution of trade policy. Finally, to capture any unmeasured heterogeneity in the data, we include country-specific fixed effects and a time-specific fixed effect for each five-year period covered in the analysis, which spans the period from 1960 to 2000.

### Results

We estimate the model described in the previous section using ordinary least squares. Tests of statistical significance are based on panel-corrected standard errors, which account for any heteroskedasticity, the fact that the data are grouped by country, and, through the estimation of a panel-specific first order autoregressive error structure, by time. Table 1 provides summary statistics and a correlation matrix for the variables included in our analysis.

The least-squares estimates are displayed in Table 2. In Model 1, we enter only the indicator variables. Model 2 adds the initial level of trade openness. Model 3 adds the theoretical variables that are central to testing our argument, using unemployment as a measure of societal interests. Models 4 and 5 replicate the specification of Model 3, breaking the sample into stable democracies and other regime types, respectively. Models 6-8 replicate models 3-5, but use real per capita GDP growth rather than unemployment as a measure of societal interests. Note that since per capita growth and unemployment are negatively correlated, our expectation is that the coefficient estimates for the societal interest variable and its interaction with political constraints should have the opposite sign in models 3-5 than in models 6-8.

Because our argument is that the effects of societal influences are conditional on domestic political institutions, we focus our discussion of these influences on Table 3, which presents the predicted marginal change in external trade linkages for certain combinations of societal factors, veto players, and regime type, holding all other variables constant. The values in the cells do not therefore represent the predicted change in trade policy for a specific or even a hypothetical country. Rather, they represented the predicted marginal change in trade policy openness resulting from varying the societal factors and the level of political constraints as specified in the row and column headings as compared to the value determined by the value of openness arising from all of the remaining independent variables in Table 2 (including the omitted country and time indicator variables) multiplied by their respective coefficient estimates. In order to generate the total predicted change in trade policy one must combine the partial effects displayed in the table with these additional variables for a specific country -year, a task that we do not undertake here.

The results in Table 3 show that *ceteris paribus* both high unemployment and negative real per capita income growth are associated with reductions in the external trade linkages of stable democracies when veto players only weakly constrain decision makers. For example, in a stable democracy where the number of veto players is approximately one standard deviation below the mean (0.3) and the unemployment rate is 10 percent, the predicted change in external trade linkages is 6.2 percentage points lower than if the unemployment rate was 2 percent (a predicted reduction of 7.8 percentage points instead of 1.6 percentage points) and 3.8 percentage points lower than if the unemployment rate was a more realistic 5 percent (a predicted reduction of 7.8 percentage points instead of 3.9 percentage points). Similarly, for the same set of

domestic political institutions, a decline in real per capita income of 4 percent would lead to a predicted decline in external trade linkages 4.0 percentage points greater than were real per capita growth to surge by 5 percent (a 1.8 percentage points decline as compared to a 2.2 percentage point predicted expansion of openness).

Both of these relationships are moderated as the number of veto players increases. For example, if political constraints are held at approximately their mean level for stable democracies (0.6), the impact of having an unemployment rate of 10 percent instead of 2 (5) percent falls from a decline of 6.2 (3.8) percentage points to a decline of 0.8 (0.5) percentage points. Similarly, the effect of having negative real per capita income growth of 4 percent instead of positive 5 percent falls from a decline of 4.0 percentage points to 1.0 percentage points. Finally, in countries that are not stable democracies, we observe no statistically significant relationship between adverse macroeconomic conditions and changes in external linkages.

As expected, the estimate for the initial level of openness is large and negative, indicating that relatively open countries are less likely to expand their external trade linkages than countries that are relatively closed. In addition, there is evidence that international organizations influence changes in openness. Members of the OECD and the EU are more likely to expand their external trade linkages, as are signatories to ICSID. When we work with the larger sample that is created by using growth in real per capita GDP rather than unemployment to measure societal interests, membership in OPEC is also positively associated with external trade linkages for countries that are not stable democracies and MIGA membership replaced ICSID membership in its positive association with openness for countries that are not stable democracies.

### Robustness Checks

Having generated some initial estimates of the model, it is important to assess the robustness of these results. To begin, we split the group of non-democracies by analyzing separately stable autocracies (countries where *REG* remained at or below -6 for five consecutive years); stable anocracies (countries where *REG* remained between -5 and 5 for five consecutive years); transitional democracies (countries where *REG* is currently 6 or above but where it has been at that level for less than five years); transitional autocracies (countries where *REG* is currently -6 or below but where it has been at that level for less than five years); transitions from democracy to anocracy (countries where *REG* is currently between -5 and 5 that were classified as stable democracies in the past five years); and transitions from autocracy to anocracy (countries where *REG* is currently between -5 and 5 that were classified as stable autocracies in the past five years). Table 4 provides the distribution of country-years across all of these regime types. Note that while correlated with checks and balances, the nature of the political regime is an independent construct. There is substantial variation in political constraints for each type of regime except autocracies, as the large standard deviation of political constraints for every other regime category in Table 4 indicates. Unfortunately, the small sample size of some of these subsamples and heterogeneity among the stable autocracies not captured by the POLITY4 measure hampers our ability to more fully explore the implications of regime type and regime change. We therefore leave this topic for subsequent research and retain the dichotomous comparison between stable democracies and other regimes for the purposes of this analysis.

Though we did not posit a specific relationship between regime type and changes in trade policy, we can explore this relationship in a preliminary way so as to compare our results to the

broad literature that has focused on this topic. Specifically, we pool the democratic and the non-democratic country-years, forming a single sample, and then introduce an indicator variable for stable democracies into our model. The results are broadly corroborative with prior analyses. Democracy has a positive and statistically significant influence on change in openness. Its effect is also fairly large: *ceteris paribus* the predicted change in openness for a stable democracy is 6 percentage points higher than for other countries. Once again, the pooled sample generated no statistically meaningful distinctions among the various types of non-democratic countries.

In addition, recall that we defined democracies as countries where *REG* is greater than or equal to 6 over the past five years. However, we also experimented with different thresholds for democracy, increasing it by a point (to 7) and then decreasing by a point (to 5). The results are qualitatively similar to those reported earlier.

Next, we examine a range of macroeconomic variables and country characteristics suggested by the literature as potential determinants of openness. We include the logarithmic transformation of population (*LPOP*) to capture the negative relationship between country size and external trade linkages. Once we include country-specific fixed effects, the level of population is not a significant determinant of changes in external trade linkages. This result highlights the power of our statistical tests, which identify results from within country changes in the independent variables rather than cross-sectional variation, since such variation is absorbed by the country-specific effects. This specification alleviates much of the concern regarding unobservable country-specific factors that could be correlated with both our independent and dependent variables.

We also considered a broader set of independent variables suggested by the literature. While the coefficient estimates of some of these variables are statistically significant, we did not include them in our primary specification because doing so led to a considerable dip in the sample size, the coefficient estimates of these variables often varied depending on the model's specification, and including them had no bearing on the core results reported above. The additional independent variables that we considered include value added in the manufacturing sector, changes in the real effective exchange rate, the level of real GDP, the size of the government as measured by the share of government spending in GDP, the size of the government budget deficit, the inflation rate, a series of indicator variables to capture the existence or risk of hyperinflation, the current account balance, the magnitude of multilateral lending from the World Bank, IMF, regional development banks and other sources, and indicator variables for the presence of external or civil war. Taken as a whole, the tests described in this section offer considerable evidence that our results are quite robust.

### Discussion

The results of this paper have various implications for research on the political economy of trade policy. First, social scientists have long debated the merits of societal and statist approaches. While many studies have privileged one approach over the other, our findings indicate the importance of acknowledging their interdependence. As many societal theories emphasize, changes in macroeconomic conditions influence the preferences of the populace at large. These preferences have a considerable bearing on foreign economic policy. At the same time, however, statist factors are also important in this regard. Both the number of veto points in

a government and a country's regime type heavily influence its responsiveness to demands for change in its trade orientation.

Moreover, there is ample evidence that the interaction between societal and statist variables are central to shaping trade policy. Various studies have raised this issue, but remarkably little empirical research has directly confronted it (Gilligan 1997; Mansfield and Busch 1995; Milner 1997). The effects of unemployment and per capita income growth depend heavily on the number of veto players that constrain decision makers and whether a country is democratic or not. Both high unemployment and negative real per capita income growth lead to reductions in openness of stable democracies marked by few veto players. As expected, however, the magnitude of these relationships becomes attenuated as the number of veto players rises, making it more difficult to change the existing trade regime and increasing the heterogeneity of the players' interests. Equally, macroeconomic fluctuations have a much more pronounced influence on the trade regime in democracies than other countries, reflecting the need for democratic leaders to be more responsive to demands made by the general population than their non-democratic counterparts.

Second, our results bear heavily on recent debates about the relationship between regime type and economic reform. Consistent with previous studies, we find that democracies tend to be less protectionist than other regimes (e.g., Nelson 1994; Bliss and Russett 1998; Mansfield, Milner, and Rosendorff 2000). However, virtually all of this literature ignores the effects of institutional variations within both democracies and non-democracies. Such variations are crucial to explaining changes in commercial openness, especially in democracies. Holding macroeconomic conditions constant, the trade regime changes less within democracies as the

number of veto players increases. Furthermore, as macroeconomic conditions worsen and societal calls for protectionism become louder and more widespread, reductions in openness are more likely to occur as the number of veto players declines. When a country's economy is thriving – marked by very low levels of unemployment and rapid growth – thereby creating a substantial constituency for expanding openness, such an expansion is most likely to occur in countries with few veto points. Not only do these results indicate that regime type is just one aspect of the institutional influences on trade policy, they also point to the importance of veto points, a factor that has been underemphasized in existing studies of trade policy.

Similarly, we find that, within democracies, changes in the trade regimes are more likely to occur as the number of veto points declines. However, whether such changes lead to greater protection or liberalization hinges on the demands being issued by societal groups. When the economy is faltering, giving rise to calls for protection, a small number of veto points tend to promote greater closure; when the economy is flourishing, a small number of these points foster greater openness. Our results offer important qualifications to studies making unconditional comparisons between either domestic political concentration and fragmentation or democracy and autocracy on commercial openness and economic reform (Haggard 1990; Haggard and Kaufman 1995; Wade 1990). Just as the effects of societal forces depend on domestic institutions, the effects of institutions are contingent on societal forces.

Third, our focus in this paper has been on the domestic sources of overseas commerce. However, our results indicate that in addition to such sources, international organizations shape states' trade policy. For example, members of the OECD and the EU are more likely to expand their trade linkages than states that do not participate in these organizations. These findings are

hardly surprising, but in light of the emphasis that contemporary studies of foreign commerce place on domestic forces, they do serve as a useful reminder that such studies need to account for international forces as well.

The observed effects of some international organizations are particularly interesting. More specifically, we find that membership in the International Monetary Fund, the International Convention for the Settlement of Investment Disputes, and the Multilateral Investment Guarantee Agency (MIGA) provides a large and significant impetus to expand foreign trade for non-democracy, but has relatively impact on the trade regime of democracies. It is widely argued that non-democratic leaders are more prone to rent-seeking and other forms of economic predation than their democratic counterparts (e.g., Olson 1993; Schultz and Weingast 2003). For non-democracies with an interest in signaling their intention to follow a market-oriented path, participating in the IMF (which binds signatories to capital controls, currency convertible, and other market-oriented measures), ICSID (which is a branch of the World Bank that provides arbitration over investment disputes to members), and MIGA (which is another branch of the World Bank that provides a form of political risk insurance) are useful ways of making a credible commitment not to deviate from this path. After all, defecting from these agreements is costly and non-democracies that plan to do so have little reason to bear these costs. Democracies, by contrast, have less difficulty making credible commitments to eschew rent-seeking activities and thus have less need to signal their intentions by participating in these international institutions.

## Conclusions

The remarkable expansion of global trade since World War II has stimulated a large and important literature, much of which stresses the effects of domestic politics on trade policy outcomes. This literature, however, has miscast certain aspects of the domestic determinants of trade policy. Whereas societal and statist factors are usually viewed as having independent and competing influences, these factors actually have an interactive effect on trade policy.

Deteriorating macroeconomic conditions give rise to societal demands for protectionism. But the extent to which these demands are met and barriers to trade are put in place depends on the domestic political institutions through which societal pressures are filtered.

Furthermore, while a rising number of studies emphasize that democracy promotes open trade, the trade policy of democracies hinges on the extent of the constraints placed on leaders and the underlying societal pressures that these leaders face. When leaders face a greater number of veto players, it becomes harder to change policy. When unemployment soars and real per capita growth stagnates, leaders face increased incentives to restrict openness. Consequently, whether spreading democracy throughout the world will promote prosperity and free trade – as many observers have argued – depends on institutional factors within democracies, global and local macroeconomic conditions, and the patterns of domestic interest group competition. A better understanding of these factors and how they operate is crucial to improving our understanding of the political economy of trade policy.

**Table 1: Summary Statistics**

	Variable #	1.00	2.00	3.00	4.00	5.00	6.00	7.00	8.00	9.00	10.00	11.00	12.00	13.00	14.00	15.00	16.00
N		5023	5214	5288	5202	5411	1335	7270	3904	1762	5390	5101	2845	4474	7560	7560	7560
Mean		0.54	70.06	0.26	-0.17	1.64	8.59	15.22	14.70	0.01	5245	15.87	-3.61	46.67	0.05	0.02	0.01
Std. Dev.		10.74	44.76	0.33	7.64	6.46	5.94	1.97	8.13	0.24	8278	7.07	6.00	501	0.22	0.14	0.08
Minimum		-99.07	1.12	0.00	-10.00	-52.09	0.10	10.61	0.10	-1.00	0	1.37	-64.49	-100	0.00	0.00	0.00
Maximum		130	439	0.89	10.00	79.70	43.50	20.94	45.97	7.92	52711	76.22	58.71	23773	1.00	1.00	1.00
Change in Openness	1	1.00															
Openness	2	0.13	1.00														
Political Constraints	3	0.00	0.09	1.00													
Political Regime	4	0.01	0.06	0.86	1.00												
Real Per Capita Growth	5	-0.03	0.07	0.09	0.05	1.00											
Unemployment Rate	6	-0.02	-0.05	0.02	0.07	-0.04	1.00										
Log (Population)	7	0.01	-0.57	0.10	0.07	-0.02	-0.19	1.00									
Value Added Manufacturing	8	0.02	-0.02	0.31	0.30	0.01	-0.35	0.36	1.00								
% Change in Real Effective Exchange Rate	9	-0.20	-0.02	0.00	0.02	0.00	-0.02	-0.01	0.04	1.00							
Real per Capita Income (GDP)	10	-0.01	0.12	0.58	0.47	0.04	-0.25	0.04	0.18	-0.01	1.00						
Government Consumption / GDP	11	0.01	0.32	0.12	0.08	-0.09	0.12	-0.33	-0.16	0.07	0.18	1.00					
Government Budget Balance / GDP	12	0.02	0.13	0.07	0.03	0.08	-0.16	-0.03	0.06	-0.09	0.16	-0.24	1.00				
Inflation	13	0.05	-0.02	-0.03	0.01	-0.12	-0.05	0.04	0.06	0.05	-0.04	0.01	-0.07	1.00			
hyperinf1	14	0.02	-0.06	-0.02	0.00	-0.06	0.02	0.08	0.05	-0.04	-0.09	-0.07	-0.01	0.00	1.00		
hyperinf2	15	0.01	-0.04	-0.03	0.02	-0.17	-0.11	0.08	0.19	0.17	-0.05	0.01	-0.03	0.07	-0.03	1.00	
hyperinf3	16	0.07	0.02	-0.02	0.02	-0.17	-0.06	0.05	0.07	0.06	-0.04	0.02	-0.07	0.66	-0.02	-0.01	1.00
Multilateral Lending from World Bank / GDP	17	0.02	0.00	-0.18	-0.14	-0.04	0.10	-0.01	-0.18	-0.05	-0.22	0.01	-0.22	-0.02	0.20	0.03	-0.02
Multilateral Lending from IMF / GDP	18	0.08	0.04	-0.03	0.00	-0.06	-0.04	0.02	0.01	0.02	-0.04	0.00	-0.02	0.01	0.09	0.09	0.02
Multilateral Lending from Regional Dev. Bank / GDP	19	0.02	0.05	0.00	0.04	-0.02	0.09	-0.05	-0.09	0.00	-0.08	0.04	-0.02	0.00	0.13	0.00	0.00
Multilateral Lending from Other / GDP	20	0.02	0.09	-0.10	-0.10	-0.05	0.07	-0.13	-0.12	-0.03	-0.14	0.15	-0.20	0.00	0.05	0.01	0.00
At War	21	-0.01	-0.04	-0.08	-0.08	-0.09	-0.06	0.08	-0.01	0.03	-0.05	0.07	-0.03	-0.01	-0.02	0.03	-0.01
At Civil War	22	-0.01	-0.14	-0.16	-0.07	-0.13	0.05	0.11	-0.05	0.15	-0.16	-0.05	-0.07	0.12	0.10	0.07	0.08
WTO member	23	0.00	-0.07	0.35	0.36	0.03	-0.10	0.30	0.13	0.01	0.28	-0.09	0.04	0.00	0.06	0.02	-0.01
OECD member	24	0.01	-0.07	0.63	0.56	0.07	-0.15	0.22	0.22	-0.01	0.75	0.11	0.02	-0.04	-0.04	-0.05	-0.03
IMF member	25	0.01	-0.03	0.16	0.18	-0.01	0.00	0.28	-0.04	-0.01	0.04	-0.02	-0.05	0.01	0.13	0.06	0.05
IBRD member	26	0.00	-0.08	0.15	0.17	-0.02	0.01	0.29	-0.06	-0.01	0.04	-0.04	-0.07	0.01	0.12	0.07	0.04
ICSID member	27	0.01	0.13	0.17	0.14	-0.02	-0.10	0.14	-0.06	-0.05	0.20	0.05	-0.02	-0.03	0.03	-0.02	0.00
MIGA member	28	0.02	0.15	0.25	0.23	-0.02	0.08	0.13	0.11	0.02	0.10	0.07	0.07	0.03	0.07	0.05	0.08
EU member	29	0.01	0.08	0.40	0.36	0.04	0.05	0.14	0.19	0.00	0.49	0.16	-0.03	-0.03	-0.05	-0.03	-0.02
OPEC member	30	-0.01	-0.03	-0.15	-0.20	-0.06	0.09	0.08	-0.17	-0.01	0.06	0.01	0.16	-0.01	0.02	0.01	-0.01
COMECON member	31	0.01	-0.02	-0.18	-0.20	0.03	-0.05	0.12	0.12	0.00	-0.06	-0.03	0.08	-0.01	-0.03	-0.01	-0.02

**Table 1: Summary Statistics**

	Variable #	17.00	18.00	19.00	20.00	21.00	22.00	23.00	24.00	25.00	26.00	27.00	28.00	29.00	30.00	31.00
N		7073	7242	7242	7560	4920	4920	7520	7520	7520	7520	7520	7520	7520	7560	7560
Mean		0.00	0.00	0.00	0.00	0.03	0.10	0.46	0.13	0.73	0.72	0.37	0.17	0.05	0.06	0.04
Std. Dev.		0.01	0.00	0.01	0.01	0.16	0.30	0.50	0.33	0.45	0.45	0.48	0.38	0.22	0.23	0.20
Minimum		-0.04	-0.03	-0.02	-0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum		0.17	0.12	0.37	0.22	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Change in Openness	1															
Openness	2															
Political Constraints	3															
Political Regime	4															
Real Per Capita Growth	5															
Unemployment Rate	6															
Log (Population)	7															
Value Added Manufacturing	8															
% Change in Real Effective Exchange Rate	9															
Real per Capita Income (GDP)	10															
Government Consumption / GDP	11															
Government Budget Balance / GDP	12															
Inflation	13															
hyperinf1	14															
hyperinf2	15															
hyperinf3	16															
Multilateral Lending from World Bank / GDP	17	1.00														
Multilateral Lending from IMF / GDP	18	0.16	1.00													
Multilateral Lending from Regional Dev. Bank / GDP	19	0.42	0.06	1.00												
Multilateral Lending from Other / GDP	20	0.34	0.01	0.07	1.00											
At War	21	-0.03	0.00	-0.02	-0.04	1.00										
At Civil War	22	0.04	-0.01	0.00	0.00	0.11	1.00									
WTO member	23	0.06	-0.02	0.01	-0.02	-0.12	-0.14	1.00								
OECD member	24	-0.13	-0.02	-0.05	-0.09	-0.07	-0.11	0.39	1.00							
IMF member	25	0.20	0.03	0.08	0.14	-0.02	0.01	0.48	0.20	1.00						
IBRD member	26	0.20	0.03	0.08	0.13	-0.02	0.01	0.48	0.20	0.96	1.00					
ICSID member	27	0.18	0.01	0.04	0.09	-0.10	-0.08	0.48	0.24	0.46	0.46	1.00				
MIGA member	28	0.11	0.07	0.11	-0.02	-0.04	-0.06	0.24	0.09	0.28	0.27	0.38	1.00			
EU member	29	-0.08	-0.01	-0.03	-0.06	-0.04	-0.09	0.25	0.61	0.14	0.15	0.22	0.12	1.00		
OPEC member	30	-0.07	0.00	-0.03	-0.05	0.13	-0.02	-0.07	-0.09	0.11	0.12	-0.03	0.00	-0.06	1.00	
COMECON member	31	-0.05	-0.01	-0.02	-0.05	-0.01	-0.07	-0.04	-0.08	-0.19	-0.23	-0.10	-0.08	-0.05	-0.05	1.00

**Table 2: Regression of Change in Openness as a Function of Level of Openness, Fragmentation and Societal Conditions By Regime Type**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Openness		-0.265*** (0.033)	-0.518*** (0.070)	-0.709*** (0.089)	-0.368*** (0.067)	-0.298*** (0.042)	-0.486*** (0.082)	-0.275*** (0.038)
Political constraints			-1.955 (2.703)	-17.108*** (4.681)	3.979 (3.894)	-1.751 (0.948)	-7.533** (2.475)	-0.778 (1.322)
Societal indicator (see note)			-0.420* (0.166)	-1.466*** (0.425)	-0.132 (0.118)	0.070 (0.126)	0.783* (0.344)	0.028 (0.044)
Societal indicator X Political Constraints			0.641** (0.218)	2.272*** (0.524)	-0.444 (0.346)	-0.114 (0.126)	-1.118* (0.554)	-0.151 (0.216)
WTO	-0.510 (0.687)	-0.610 (0.759)	1.132 (1.246)	1.252 (1.546)	3.934 (2.866)	1.311 (0.786)	-0.034 (0.975)	1.558 (1.079)
OECD	2.157* (0.952)	3.410*** (1.043)	9.134*** (1.760)	11.704*** (1.696)	13.977*** (2.558)	3.947*** (1.057)	2.156 (1.273)	13.556*** (2.250)
IMF	-1.296 (2.038)	2.246 (2.246)	2.001 (6.593)	5.271 (8.964)	15.529 (8.399)	2.660 (2.605)	-1.326 (6.802)	4.268 (2.998)
IBRD	0.184 (1.968)	-1.154 (2.116)	-5.245 (5.075)	-5.478 (7.598)	-10.593 (7.518)	-3.121 (2.931)	-5.224 (6.617)	-1.608 (3.506)
ICSID	0.602 (0.642)	1.204 (0.662)	3.687*** (0.870)	2.183 (1.472)	5.352** (1.884)	1.806** (0.669)	1.958 (1.043)	1.339 (0.874)
MIGA	0.394 (0.731)	0.735 (0.778)	-0.472 (0.877)	-0.661 (0.930)	3.614 (2.228)	1.523 (0.831)	0.787 (1.203)	3.077*** (0.922)
EU	0.901 (0.650)	2.240** (0.722)	3.184** (1.206)	4.132*** (1.250)	n/a n/a	2.527*** (0.770)	2.521** (0.913)	-13.711*** (2.501)
OPEC	0.825 (1.889)	20.208*** (3.187)	-126.420 (135.898)	29.837 (23.698)	3.620 (5.318)	16.121*** (3.110)	11.289 (4.982)	15.116*** (2.811)
COMECON	2.067 (3.096)	-0.576 (2.693)	n/a n/a	n/a n/a	n/a n/a	-4.973 (2.718)	11.910 (7.498)	0.297 (2.811)
N	5023	5023	1120	774	346	4204	1561	2643
Countries	180	180	99	69	54	154	91	110
R2	0.046	0.174	0.462	0.606	0.528	0.202	0.376	0.208

Notes: Coefficient estimates for country and year indicator variables not reported.  
Panel-corrected standard errors are reported in parantheses below coefficient estimates.  
\* p ≤ .05, \*\* p ≤ .01 and \*\*\* p ≤ .001.  
"societal indicator" is unemployment in models 3-5 and real per capita GDP in models 6-8

**Table 3: Predicted Change in Openness for a Given Level of Unemployment or Real Per Capita Growth and Political Constraints**

	<u>Political Constraints</u>	<u>0</u>	<u>0.3</u>	<u>0.6</u>	<u>0.8</u>
<i>Full Sample</i>					
	unemployment				
	2	-0.84	-0.46	-0.07	0.19
	5	-2.10	-1.14	-0.18	0.46
	10	-4.20	-2.28	-0.35	0.93
	25	-10.50	-5.69	-0.89	2.32
<i>Sub-sample of Stable Democracies</i>					
	unemployment				
	2	-2.93	-1.57	-0.21	0.70
	5	-7.33	-3.92	-0.51	1.76
	10	-14.66	-7.84	-1.03	3.52
	25	-36.65	-19.61	-2.57	8.79
	Real Per capita Growth				
	-4	-3.13	-1.79	-0.45	0.45
	-1	-0.78	-0.45	-0.11	-0.11
	2	1.57	0.90	0.22	-0.22
	5	3.92	2.24	0.56	-0.56
	8	6.26	3.58	0.90	-0.89

**Table 4: Distribution of Countries by Political Regime with Summary Statistics for Political Constraints**

	<u>N</u>	<u>Mean Political Constraints</u>	<u>S.D. Political Constraints</u>
Stable Democracies	1802	0.60	0.26
Other	3486	0.09	0.20
--Transitions to Democracy	261	0.40	0.28
--Stable Anocracies	497	0.23	0.25
--Transitions from Democracy to Anocracy	243	0.17	0.22
--Transitions from Autocracy to Anocracy	255	0.10	0.21
--Transitions to Autocracy	522	0.01	0.05
--Stable Autocracies	1708	0.01	0.07

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