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THE POLITICAL ECONOMY OF INTERNATIONAL TRADE

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ABSTRACT

One of the most salient changes in the world economy since 1980 has been the move toward freer trade among countries across the globe. How do existing theories about trade policy explain this puzzle? Three sets of explanations are prominent. First, many focus on changes in trade policy preferences among domestic actors, either societal groups or political leaders. Second, scholars examine changes in political institutions to account for such policy change. Third, they seek explanations in changes in the international political system. Large-scale changes in political institutions, especially in the direction of democracy, may be necessary for the kind of massive trade liberalization that has occurred. But changes in preferences cannot be overlooked in explaining the rush to free trade. Moreover, the influence of international institutions has been important. Finally, the reciprocal impact of trade on domestic politics and the international political system is important. If the rush to free trade is sustained, will its impact be benign or malign?

INTRODUCTION

One of the most salient changes in the world economy since 1980 has been the move toward freer trade among countries across the globe. Countries as diverse as Mexico, India, Poland, Turkey, Ghana, Morocco, and Spain—not to mention Chile, which moved earlier in the 1970s—have all chosen to liberalize unilaterally their trade policies.[1] In addition, the successful conclusion of the multilateral trade negotiations under the General Agreement on Tariffs and

[1]Many of these trade liberalizations occurred within the context of larger economic reform packages. Here I discuss only the trade liberalization component.

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Trade (GATT), the Uruguay Round, in 1994 further liberalized trade among many developed countries and between them and developing ones. This global "rush to free trade," as Rodrik (1994) has called it, is an anomaly politically. As he describes it (1994:62), "Since the early 1980s, developing countries have flocked to free trade as if it were the Holy Grail of economic development.… Together with the historic transformation and opening of the Eastern European economies, these developments represent a genuine revolution in policymaking. The puzzle is why is it occurring now and why in so many countries all at once?" The purpose of this essay is to ask whether and how the existing theories we have about trade policy can explain this puzzle.

The scholarly literature on international trade is vast. Both economists and political scientists have contributed much to it, as recent surveys by economists such as Reizman & Wilson (1995) and Rodrik (1995) and political scientists such as Cohen (1990) and Lake (1993) demonstrate. But their approaches have tended to differ. Economists have focused on explaining trade flows. Why certain countries import and export particular goods or services to certain other countries has been a central question for them. Much theory in international trade addresses this question; for instance, one of the central theorems in trade theory, the Heckscher-Ohlin theorem, explains trade flows. Economists have also devoted attention to the issue of trade barriers. The central theoretical conclusion of the field, of course, has been that free trade is the best policy for most countries most of the time. Thus, economists have puzzled over why, given this finding, countries invariably employ at least some protectionist policies. They have tended to ask why countries protect certain of their industries when free trade would be better economically. By and large, their answer has focused on the preferences of domestic actors for protection. Using the Stopler-Samuelson theorem and other economic theories, they have explored why certain domestic groups would prefer protection and why they would expend resources to lobby for it. This has resulted in a large empirical literature examining levels of protection across industries and, recently, in the development of models of such protection. Ultimately, then, economists have been pushed into studying the politics of trade. How well have they done in modeling such politics? Moreover, have they been able to explain the rush to free trade that has occurred?

In contrast, political scientists have rarely focused on explaining the pattern of trade flows. Only some recent work has explored the political roots of import and export flows among countries. Moreover, political scientists have tended to see protection as the norm and have puzzled over why a country would ever liberalize its trade policy or adopt free trade. Politically, protectionism seems eminently reasonable. Explaining both protectionist and free trade policies and their changes over time has occupied political scientists. Indeed, the prevailing theories of the 1970s and early 1980s would have predicted the opposite of the rush to free trade. As I argue below, many systemic theories, such as hegemonic stability and dependency theory, seemed to forecast growing protectionism in the world economy. For many political scientists, then, the rush to free trade has been unexpected.

Here I explore four sets of issues that are central to understanding trade politics. First, what do we know about the preferences of domestic groups for protection or free trade? Why do some groups favor protection, and some favor free trade? Do these preferences change over time? And if so, why? Can changes in preferences explain the rush to free trade?

Second, how do political institutions affect the ways in which the preferences of actors are translated into policy? How important are institutions in aggregating preferences and supplying policy? How much do changes in institutions affect trade policy, and can they explain the rush to free trade?

Third, what factors at the international level shape trade policy choices? How do relations among countries and the structure of the international system affect domestic choices about trade? Have changes such as the end of the bipolar Cold War system been responsible for the recent trend toward trade liberalization?

Finally, how does international trade itself affect states and the international political system? Do rising trade flows produce important changes in domestic preferences, institutions, and policies?

I examine each of these issues to see if they can provide us with some answers to the most significant aspect of trade policy today: the widespread liberalization of trade policies that has taken place since the early 1980s.

WHAT DO WE KNOW ABOUT TRADE AND TRADE POLICY?[2]

Since World War II, the main instrument of trade policy, tariffs, among advanced industrial countries have been reduced to insignificant levels. After the latest round of international trade negotiations, the Uruguay Round, completed in 1994, the average tariff for the developed countries was reduced from 6.3% to 3.8% [World Trade Organization (WTO) 1996:31]. On the other hand, non-tariff barriers—which include quantitative restrictions, price controls, subsidies, voluntary export restraints, etc—have proliferated, in part making

[2]"Trade policies" refers to all policies that have a direct impact on the domestic prices of tradables, that is, goods and services traded across national boundaries as imports and/or exports. Such policies include not only import tariffs, which are taxes on imports, but also export taxes, which under certain conditions have the same effects as import taxes. Likewise, import and export subsidies count. Exchange rate policy also affects trade flows, but I leave this subject for others to discuss.

up for the decline in tariffs. But again the Uruguay Round slowed or reversed this, helping to reduce quotas, subsidies, and voluntary export restraints across a wide range of industries and to convert these barriers into more transparent tariffs (WTO 1996:32).

For most of the postwar period, less developed countries (LDCs) have used trade barriers extensively, many for the explicit purpose of import-substituting industrialization (ISI). But beginning in the 1980s especially, many developing countries began to liberalize trade and to adopt export-oriented policies [International Monetary Fund (IMF) 1992]. The conclusion of the Uruguay Round promoted this by reducing trade barriers in many areas of key interest to the LDCs, such as textiles and agriculture; it also brought many new developing countries into the international trade organization, the WTO, inducing them to follow its rules. In addition, the transition from communist economies to market-based ones by many countries in the early 1990s further accelerated the trend toward global trade liberalization. All of these changes have resulted in one striking fact about the period since 1980: There has been a far-reaching liberalization of trade barriers across the globe (WTO 1996, Rodrik 1994). Why has this occurred? And will it last?

Concomitantly and in part consequentially, the growth of world trade has surged. For most of the postwar period, the growth of trade has outpaced growth in world output. Also important are changes in the nature of global trade. There has been tremendous growth in intra-industry trade and in intrafirm trade. Intra-industry trade, which involves the exchange of goods from within the same industry, say Toyotas for BMWs, now accounts for between 55% and 75% of trade in advanced industrial countries (Greenaway & Milner 1986:Table 5-3); for the United States, this figure was 83% in 1990 (Bergsten & Noland 1993:66). Intrafirm trade, which involves transfers of goods within one company across national boundaries, has also grown; it now accounts for over 40% of total US imports and 30% of US exports (Encarnation 1992:28). These two types of trade are important because they tend to have different effects than standard, interindustry trade. Generally, they are associated with fewer displacement effects and less conflict. As Lipson (1982:453) argues, "intra-industry trade provides a powerful new source of multilateral interest in the liberal trade regime: diminished adjustment costs in some sectors, and higher net gains from trade as a result." Finally, there has been a significant regionalization of trade. Intraregional trade flows within the European Union, East Asia, North America, and Latin America especially have become more important as a share of total trade. This is partially a result of the regional integration agreements signed by these countries in the past two decades—e.g. the single market in Europe, the North American Free Trade Agreement (NAFTA), the Association of South East Asian Nations (ASEAN), the Asia Pacific Economic Cooperation (APEC), and Mercosur (WTO 1996:17–22).

TRADE POLICY PREFERENCES

Some of the earliest models explaining trade policy have focused on "pressure group politics." That is, they explain the recourse to protection by governments as a function of the demands made by domestic groups. Domestic groups seek protection or liberalization because such policies increase their incomes. The distributional consequences of trade policy thus become the explanation for its causes. Adam Smith (1937 [1776]) may have been one of the first to recognize this when he noted that the subversion of the national interest in free trade is the frequent outcome of collusion among businessmen. Schattschneider (1935) was another early proponent of the view that special economic interests were mainly responsible for the choice of protectionism; he showed how these pressure groups hijacked the US Congress in 1929–1930 and produced one of the highest tariffs in US history, the Smoot-Hawley tariff.

Since then, development of the pressure group model has attempted to delineate more specifically the groups who should favor and oppose protection and the conditions under which they may be most influential. One motive for this has been the observation that the extent of protection and the demands for it vary both across industries and across countries. If all domestic groups favored protection, then such variance should not exist. Explaining this variance has been a key feature of the literature. The main divide has been between so-called factoral versus sectoral or firm-based theories of preferences. In both cases, preferences are deduced as a result of the changes in income that accrue to different actors when policy changes from free trade to protection or vice versa. Factoral theories rely on the Stopler-Samuelson theorem (1941), which shows that when factors of production, such as labor and capital, can move freely among sectors, a change from free trade to protection will raise the income of factors that are relatively scarce in a country and lower the income of relatively abundant factors. Thus, scarce factors will support protection, whereas abundant ones will oppose it. Rogowski (1989) has developed one of the most interesting political extensions of this, claiming that increasing (decreasing) exposure to trade sets off either increasing class conflict or urban-rural conflict according to the factor endowments of different countries.

In contrast, sectoral and firm-based theories of trade preferences follow from the Ricardo-Viner model of trade—also called the specific-factors model—in which, because at least one factor is immobile, all factors attached to import-competing sectors lose from trade liberalization while those in export-oriented sectors gain. Conflict over trade policy thus pits labor, capital, and landowners in sectors besieged by imports against those who export their production. How closely factors are tied to their sectors—i.e. the degree of factor specificity—is the key difference between these two models (Alt et al

1996). A number of studies have tested these two models, sometimes singly and sometimes simultaneously. Irwin (1994, 1996), Magee et al (1989), and Frieden (1990) have found evidence in support of the specific-factors model; in contrast, E Beaulieu (unpublished manuscript), Balestreri (1997), Rogowski (1989), Midford (1993), and Scheve & Slaughter (1998) find support for the Stolper-Samuelson–type factoral models.

In addition to these models of trade preferences, others have looked at how particular characteristics of industries affect patterns of protection. Caves (1976), Pincus (1975), Baldwin (1986), Anderson (1980), Marvel & Ray (1983), Ray (1981), and Trefler (1993) have shown how specific characteristics make an industry more likely not only to desire protection but also to be able to induce policy makers to provide it. These regression analyses tend to straddle the debate between sectoral and factoral models of trade politics. Their comparison across industries suggests a sectoral type of model, but many of their findings do not disagree with those of a more factoral view of the world. For example, they tend to demonstrate that low-skill, labor-intensive industries with high and rising import penetration are frequently associated with high protection. In addition, many show that export-oriented industries and multinationals tend to favor freer trade and to be associated with less protection (Milner 1988). The attention to antiprotectionist groups is particularly interesting given the global move toward trade liberalization; one question is whether this movement has been due to the growth in importance of these types of groups domestically.

Can these models of societal preferences explain the rush to free trade? As Rodrik (1994:78) points out, "Focusing on the distributional consequences of trade policy provides one potential key to the puzzle. Perhaps the powerful interests that benefited from protection and had successfully blocked reform were weakened by the debt crises of the 1980s, which would explain the general move toward liberal policies." He concludes that such evidence would be difficult to find. But others have argued that the distributional politics of trade can explain this change in policy.

Frieden & Rogowski (1996:40), for example, argue that exogenous changes have brought about a reduction in the costs of trade and have thus made trade more important relative to any domestic economy, increasing the costs of protection. They then point out that this

> exogenous easing of international trade [i.e. internationalization] increases potential benefits to capitalists and skilled workers in the advanced countries, to skilled and unskilled workers in the NICs [newly industrializing countries], and to unskilled workers in LDCs—all of whom are predicted to mobilize on behalf of liberalization. At the same time, easier trade threatens unskilled workers in advanced economies, local capitalists in NICs, and owners of both physical and human capital in LDCs—all of whom will

> heighten their demands for protection or compensation. Wood (1994) has argued that we observe exactly this in the economic history of the last twenty years. (Frieden & Rogowski 1996:40)

Reductions in the costs of trade have thus heightened the opportunity costs of protection, creating new pressures for freer trade. Exactly why and how the proponents of trade liberalization have gained political advantage over those demanding protection is less clear. Indeed, as Rodrik (1994:66–67) notes, "the prospect of too much redistribution may be the central political difficulty in trade reform.… Taking income away from one group is rarely easy for a politician to accomplish." Why did policy makers around the globe choose to do this, and how were they able to overcome opposition to the sizable income redistribution wrought by embracing freer trade?

One argument made to explain this is that various exogenous conditions created new actors who preferred freer trade, thus shifting the balance of power in their favor. Many LDCs began their experiment with trade liberalization as part of a package of reforms designed to pull their economies out of severe economic crises. The crises themselves helped decimate sectors of the economy and created government budget crises, which in turn meant an end to subsidies for some domestic industries. Both of these changes eliminated many import-competing firms and put a premium on creating exporting firms that could generate foreign exchange (Haggard 1995:16–19). Thus, in many LDCs, the crises may have not only created new groups with preferences for freer trade but also eliminated supporters of protection. For the advanced industrial countries, such changes in the nature of the actors and in their influence may have come from a different source. Frieden & Rogowski (1996) claim that exogenous change, often in the form of technological change, may have altered the interest group politics of trade. Here one could cite the growing component of intra-industry trade among the developed countries and the new support for trade liberalization it might generate. In any case, interest group explanations of the rush to free trade remain incomplete unless they can somehow specify how an exogenous force shifted political influence away from protectionists and in favor of those preferring free trade.

The preferences of other domestic actors have also received some attention. Many authors assume that individual voters take their preferences from their role as consumers. Because consumers gain from free trade, they should favor it (e.g. Grossman & Helpman 1994). Other models of individual preferences contradict this. Mayer (1984), for example, introduces an electoral component into the determination of trade policy. Trade policy is determined by the median voter's preferences, which depend on his factor endowments. The better endowed he is in the factor used intensively for production of import-competing goods, the more protectionist he will be. Scheve & Slaughter (1998) add a new component by asking how asset ownership is affected by trade policy.

They show that the preferences of individual voters depend on how trade affects their assets. Individuals living in regions with a high concentration of import-competing industries tend to favor protection because, as imports rise, economic activity in the region will fall, causing their housing assets to fall in value. Some surveys have also shown that voters respond positively toward protection out of sympathy for workers who lose their jobs because of import competition. Thus, whether individual voters favor protection or free trade is an area demanding further research, especially in democracies where elections are often linked to trade policy decisions. Moreover, understanding changes in these preferences may help us account for the recent rush to free trade.

A number of scholars have argued that the preferences of interest groups and voters are less important in determining trade policy than are those of the policy makers themselves. Bauer et al (1972) were among the first to make this point. From their surveys, they concluded that constituents rarely had strong preferences about trade policy and even more rarely communicated these to their political representatives. Trade policy depended much more on the personal preferences and ideas of politicians. Baldwin (1986) and Goldstein (1988) have also argued that it is the ideas of policy makers about trade policy that matter most. Rather than material factors determining preferences, ideational factors are paramount. Interestingly, Krueger (1997) argues that "ideas with regard to trade policy and economic development are among those [factors] that have changed most radically" from 1950 to the 1990s and that help explain the rush to free trade. A key example of this change is Fernando Henrique Cardoso. As coauthor of one of the most important books on dependency theory in the 1970s, he argued for the continuation of ISI policies to shelter LDCs from the capitalist world economy (Cardoso & Faletto 1979). In the 1990s, however, Cardoso was elected president of Brazil and initiated a major economic reform program, including extensive trade liberalization. How could his ideas about the proper policies for LDCs have changed so much? What factors explain this dramatic change in ideas among political leaders in the developing world?

Given that belief in the superiority of free trade has existed for centuries among economists, it is also important to question why this change occurred when it did. Krueger appears to retreat to more material factors to explain its timing; the failures of ISI and the success of the relatively open NIC economies convinced policy makers that new trade policies were necessary. Others focus on the economic crises of the early 1980s and the growing influence of international institutions and the United States.

Although Krueger and others, such as Rodrik (1995), Haggard & Kaufman (1995), and Bates & Krueger (1993), attribute trade policy reform to crises and economic downturns, another strand of literature on the macroeconomics of trade policy concludes in the opposite direction. Many scholars consider bad economic times a prelude to rising demands for protection and increasing levels of protection. Takacs (1981), Gallarotti (1985), Cassing et al (1986), Magee & Young (1987), and Wallerstein (1987) all found that declines in economic growth or capacity utilization and/or increases in unemployment and imports tend to increase the demand and supply of protection. This earlier literature saw policy makers responding increasingly to the rising demands for protection from domestic groups in bad economic times.

The more recent literature, however, implies that bad economic times allow policy makers more freedom to maneuver so that they can overturn existing protectionist policies by blaming them for the bad times. For example, Rodrik (1992:88–89) finds it "paradoxical that the 1980s should have become the decade of trade liberalization in the developing countries. Thanks to the debt crisis, the 1980s have also been a decade of intense macroeconomic instability. Common sense would suggest that the conventional benefits of liberalization become muted, if not completely offset, under conditions of macro instability." But he claims that "a time of crisis occasionally enables radical reforms that would have been unthinkable in calmer times" (1992:89). Rodrik argues that the prolonged macroeconomic crises of the 1980s were so bad that "the overall gain from restoring the economy's health [in part via trade liberalization] became so large that it swamped distributional considerations [raised by such reforms]" (1994:79).

On the other hand, others, especially Haggard (1995), have argued that crises reduce the maneuvering room of political leaders. They suggest that in the 1980s these leaders were almost forced to liberalize trade (and make other reforms) because of the lack of options and international pressures. Noting the difference between the 1930s and 1980s crises, Haggard (1995:16–19) points out that

> why external shocks and corresponding macroeconomic policy adjustments might also be associated with trade and investment liberalization…is puzzling. In the 1930s, balance of payments and debt crises spurred the substitution of imports…and gave rise to a more autarchic and interventionist policy stance. In the 1980s, by contrast, an inward-looking policy seemed foreclosed.… The opportunities for continued import substitution were limited, and ties to the world economy had become more varied, complex and difficult to sever.

The effect of economic crises on countries' decisions to liberalize trade, then, seems contingent on other factors, such as the prevailing ideas about trade, the extent of openness existing at the time, and the influence of international factors.

A similar debate seems to exist concerning the exchange rate. Appreciation of the exchange rate may increase protectionist pressures because it increases imports and decreases exports, thus affecting the balance of trade preferences domestically (Mansfield & Busch 1995). Others suggest that the effects of an exchange rate change may have little impact. For instance, Rodrik (1994:73) shows that a devaluation, which is the opposite of an appreciation, increases the domestic price of all tradables—imports and exports—thereby allowing both import-competing and export-oriented sectors to benefit. But under certain conditions, e.g. when foreign exchange is rationed, devaluations can work just like trade liberalization, prompting demands for new protection from import-competing sectors. Some studies reveal such an association between periods of currency devaluations and rising tariffs; Simmons (1994) points out that many, though not all, of the same conditions that drove states to devalue also pushed them to increase tariffs in the interwar period. Both policies were intended to increase demand for domestic output, thus counteracting the effects of the depression. Much debate continues over the macroeconomic conditions that produce increasing pressures for protection and/or that induce policy makers to relent to or resist such pressures.

Can these preference-based theories explain the rush to free trade we have witnessed recently? As noted above, large changes in relative factor endowments or increasing exposure to international markets could perhaps explain changes in preferences in liberalizing countries. But relative factor endowments do not seem to have changed much; and greater exposure to international markets, which Frieden & Rogowski (1996) cite as paramount, has had more effect on the developed countries, since over the prior 30 years many LDCs have actually reduced their exposure to trade through their ISI policies. Frieden & Rogowski would counter that the opportunity costs of such closure have been increasing nevertheless and should have propelled greater demands for liberalization. Moreover, various exogenous changes may have created new actors who favor free trade, shifting the domestic balance of power in favor of liberalization. Numerous studies, however, suggest that many interest groups in LDCs opposed trade liberalization and few supported it (e.g. Bates & Krueger 1993, Haggard & Webb 1994). Nonetheless, many scholars recognize that the support of societal groups favoring free trade is an essential element of the reform process, if not for its initiation at least for its implementation. "Governments seeking to liberalize trade clearly gain by building ties to private sector organizations with export interests and by weakening institutions that provide access for firms in the import-substituting sector" (Haggard & Webb 1994:19).

The changing preferences of policy makers may have played a greater role. But our models of such preferences seem the most underspecified and post hoc. There are few theories about the conditions under which policy makers will abandon ideas that produce "bad" results and what ideas they will adopt in their stead. Furthermore, such theories suggest that the recent liberalization process may not be long-lived; changes in leaders or their preferences, or the onset of bad economic conditions, may lead to the revival of protectionism. In sum, theories of trade preferences seem to provide only poor explanations for the major change in trade policy that has occurred globally in the past decade.

POLITICAL INSTITUTIONS

Can theories that focus on the supply side of trade policy do any better? What role do political institutions play in trade policy making? And are changes in them responsible for the rush to free trade?

A number of scholars have argued that political institutions, rather than preferences, are crucial in explaining trade policy. Although preferences play a role in these arguments, the main claim is that institutions aggregate such preferences and different institutions do so differently, thus leading to distinct policies. Understanding institutions is necessary to explain the actual supply of protection, rather than simply its demand (Nelson 1988). On the domestic side, different institutions empower different actors. Some institutions, for example, tend to give special interest groups greater access to policy makers, rendering their demands harder to resist. For example, many scholars believe that the fact that the US Congress controlled trade policy exclusively before 1934 made it very susceptible to protectionist pressures from interest groups (Destler 1986, Haggard 1988, Baldwin 1986, Goldstein 1993). Other institutions insulate policy makers from these demands, allowing them more leeway in setting policy. Thus, some authors argue that giving the executive branch greater control over trade after the Reciprocal Trade Act of 1934 made trade policy less susceptible to these influences and more free-trade oriented. In general, concentrating trade-policy–making capabilities in the executive branch seems to be associated with the adoption of trade liberalization in a wide variety of countries (e.g. Haggard & Kaufman 1995:199). As Haggard & Webb (1994:13) have noted about trade liberalization in numerous LDCs, "In every successful reform effort, politicians delegated decisionmaking authority to units within the government that were insulated from routine bureaucratic processes, from legislative and interest group pressures, and even from executive pressure."

Other aspects of political regimes may make them more or less insulated from societal pressures. Rogowski (1987), for example, has argued that policy makers should be most insulated from domestic pressures for protection in countries having large electoral districts and proportional representation (PR) systems. Mansfield & Busch (1995), however, find that such institutional insulation does indeed matter but often in exactly the opposite direction—greater insulation (i.e. larger districts and a PR system) leads to more protection. Similarly, D Rodrik (unpublished paper) shows that "political regimes with lower executive autonomy and more participatory institutions handle exogenous shocks better," and this may include their response to shocks via trade policy. Thus, it is not clear that greater insulation of policy makers always produces policies that promote trade liberalization; the preferences of those policy makers also matter.

The administrative capacity of the state is also seen as an important factor shaping trade policy. It is well established that developed countries tend to have fewer trade barriers than do lesser developed countries (Magee et al 1989:230–41; IMF 1992; Conybeare 1982, 1983; Rodrik 1995:1483). Part of the reason is that taxes on trade are fairly easy to collect and thus, in LDCs where the apparatus of the state is poorly developed, such taxes may account for a substantial portion of total state revenues (between a quarter and a half, according to Rodrik 1994:77). As countries develop, their institutional capacity may also grow, reducing their need to depend on import taxes for revenue.[3] For example, the introduction of the personal income tax in 1913 in the United States made trade taxes much less important for the government, which permitted their later reduction. Thus, changes in political institutions may help explain changes in trade policy.

Large institutional differences in countries' political regime types also may be associated with different trade policy profiles. Some scholars have argued that democratic countries are less likely to be able to pursue protectionist policies. Wintrobe (1998) claims that autocratic countries are more rent-seeking and that protection is simply one form of rent-seeking. Mansfield et al (1997, 1998) also show that democratic pairs of countries tend to be more likely to cooperate to lower trade barriers and to sign trade liberalizing agreements than are autocratic ones. On the other hand, Verdier (1998) argues that, because of the political conflict engendered by trade, democracies may be less likely to pursue free trade and more likely to adopt protection against each other, except when intra-industry trade dominates their trade flows. "The postwar democratic convergence among OECD countries did not hurt trade because similarity in endowments, combined with the presence of scale economies, allowed these countries to engage in intra-industry trade—a form of trade with few, if any, wealth effects…. The current wave of democratization endangers trade. Only in the presence of scale economies [and thus intra-industry trade] can democratic convergence sustain trade" (Verdier 1998:18–19). Haggard & Kaufmann (1995) are more circumspect, arguing that the presence of crises and the form of autocracy may influence the ability to adopt economic reforms (such as trade liberalization) more than does regime type alone. Debates over the impact of regime type on trade policy have just begun.

[3]Political leaders may also favor trade liberalization simply because it increases government revenues. Liberalization may generate more revenues because of the increased economic activity and higher volumes of trade it produces, even at lower tariff rates.

The structure of the government and the nature of the party system have also been seen as important institutional factors shaping trade policy. Parties very often take specific stands on trade policy, and their movement in and out of government may explain trade policy changes, as many authors have contended about the United States (e.g. Epstein & O'Halloran 1996). If so, then countries with highly polarized party systems, in which the main parties are separated by large ideological differences, may experience huge swings in policy and generally produce unsustainable trade reforms. On the other hand, countries with large numbers of parties may frequently experience coalition governments, which may be unable to change the status quo. Haggard & Kaufman (1995:170) predict that countries with fragmented and/or polarized party systems will be unable to initiate economic policy reforms, including trade liberalization, let alone to sustain them. In general, these perspectives suggest that fragmented political systems are similar to ones with many veto players, and like them are resistant to change (Tsebelis 1995).

Party systems also interact with the structure of the government. For example, Lohmann & O'Halloran (1994) and O'Halloran (1994) have argued that when government in presidential systems, such as the United States, is divided—i.e. when one party controls the legislature and the other controls the executive branch—protectionism is likely to be higher. Milner & Rosendorff (1996) also argue that divided government in any country is likely to make the lowering of trade barriers, either domestically or internationally, harder in most cases. In sum, "political systems with weak executives and fragmented party systems, divided government, and decentralized political structures responded poorly to crises" and were unable to mobilize the support necessary for the initiation of economic reforms such as trade liberalization (Haggard & Kaufman 1995:378). In all of these cases, however, the trade policy preferences of the parties matter for the outcome. Political institutions tend more to affect which preferences, if any, will become dominant in policy making.

Many of these institutional arguments thus depend on prior claims about actors' preferences. For instance, many of the arguments about insulation assume that the policy makers (usually executives) who are insulated from societal demands are free traders. But, as Mansfield & Busch (1995) show, they may actually be protectionists, in which case insulation allows greater protection. The arguments about divided government, party systems, and democracies also rest to some extent on assumptions about each actor's preferences. Divided government matters most when preferences of the parties differ, and differences in the preferences of autocratic leaders and democratic ones may be important for the implications of different regime types. Thus, theories that incorporate both preferences and institutions seem most valuable, since we know that both matter. Very few studies, however, try to bring together theories of preference formation and institutional influence; Gilligan (1997) and

Milner (1997) are examples. Moreover, the matter of which comes first, preferences or institutions, is far from settled. Scholars who focus on preferences tend to argue that institutions are often shaped by the preferences of those in power; those who emphasize institutions argue that institutions may actually shape actors' preferences. The growing consensus is that both matter and are jointly determined, but parsimoniously modeling and testing this is an area for future research.

Do these arguments about the role of institutions help explain the recent rush to free trade across the globe? They suggest that large institutional changes should have preceded this change in policy. Have trade-policy–making institutions become more or less insulated across a variety of countries in the past two decades? Compared with the monetary area, where independent central banks and currency boards have sprung up widely, there is limited evidence for such a change in trade. Although Haggard & Webb (1994:13) point to such evidence for some LDCs, little evidence exists that developed countries have changed their trade policy structures much in the past 20 years. Moreover, it is unclear whether more or less insulation of policy makers induces trade liberalization.

There is one area where change has occurred that may be linked to this rush to free trade. Many of the countries that have embraced trade liberalization have also democratized. Mexico is a prime case. The growth of political competition and the decline of the hegemonic status of the governing party, the PRI, seem to have gone hand in hand with the liberalization of trade policy beginning in the 1980s. However, trade reform in many LDCs occurred before the transition to democracy and was often more successful when it did occur this way (Haggard & Webb 1994). Chile, Turkey, Taiwan, and South Korea all began their trade liberalization processes before their democratic transitions. Rodrik argues more generally that any change in political regime is likely to induce trade reforms. "Historically sharp changes in trade policy have almost always been preceded (or accompanied) by changes in the political regime.… Not all political transformations result in trade reform, but sharp changes in trade policy are typically the result of such transformations" (Rodrik 1994:69). Although strong evidence has not yet been presented, at this point changes in political regimes, and specifically the spread of democracy, may be the institutional change that best helps explain the rush to free trade.

INTERNATIONAL POLITICS

Trade policy is not only affected by domestic forces. A number of factors in the international system have been connected to countries' trade policy choices. A favored argument among Realists has been that the distribution of capabilities in the international system has a fundamental effect on trade. The so-called theory of hegemonic stability (HST) posited that when the international system or economy was dominated by one country, a hegemon, then free trade would be most likely (Krasner 1976, Gilpin 1987, Lake 1988, Gowa 1994). Many critics have challenged this claim both theoretically and empirically (Lake 1993, Keohane 1997). Conybeare (1984) has shown that large countries should favor optimal tariffs, not free trade, even if others retaliate; Snidal (1985) and others have claimed that small numbers of powerful countries could maintain an open system just as well as a single hegemon could. The theory has also faced empirical challenges implying that a hegemon is neither necessary nor sufficient for an open trading system (e.g. Krasner 1976, Mansfield 1994). In light of these results, HST has been modified as scholars examine more closely the dynamics of interaction among countries in the trading system.

Perhaps the most interesting point about this theory is that it tries to explain change over time in the overall level of openness in the trading system; that is, it looks at the sum of countries' trade policy choices. In terms of our puzzle of explaining the rush to free trade, HST seems to hold much potential. Changes in the distribution of capabilities over time should provide clues to this puzzle. In the 1980s, however, many political scientists argued that the decline of American hegemony from its zenith after World War II would lead to a rise in protectionism and perhaps the fragmentation of the international economy into rival blocs (e.g. Gilpin 1987). This prediction does not seem to explain the rush to free trade witnessed since the mid-1980s.

One possible retort, however, is that US hegemony has risen, not declined, since 1980, as Russett (1985) and Strange (1987) have argued. Thus, the renewal of American preeminence in the international system explains the turn away from protectionism. This argument fits well with a broader claim concerning the dominance of American ideas about free markets and trade, and the impact of those ideas on other countries' trade policy choices. After all, the package of market-oriented reforms, including trade liberalization, that has been proposed for the LDCs and ex-communist countries is called the Washington consensus. Finally, Haggard (1995) argues that changes in US trade policy in the 1980s help explain the move toward free trade. The United States began exerting strong bilateral pressure on LDCs to liberalize their economies or face closure of the American market to their exports. American hegemony and the renewed will to exert influence may help account for the rush to free trade.

Other scholars have felt that aspects of the international security environment best explain the pattern of trade. Gowa (1994) has argued that countries that are military allies trade more with each other, and that this is especially true of countries within the same alliance in bipolar system. That is, when countries are allies in a system featuring one other major opposing alliance group, as was the case during the Cold War, they tend to trade the most freely among themselves. The security externalities of trade drive their behavior, inducing them to help their allies while punishing their enemies. Gowa & Mansfield (1994) and Mansfield & Bronson (1997) provide strong evidence for this effect. How would this argument deal with the rush to free trade? Unlike other arguments, it directly links trade policy to the end of the Cold War and the dissolution of the Eastern bloc. Unfortunately, however, the argument suggests that protectionism should rise, not decline, with the demise of bipolarity. Predictions from this model seem to be inaccurate or at least incomplete. A description of the current structure of the international system might be one of either multipolarity, in which case the model is inaccurate, or unipolarity, in which case Gowa has no prediction.

Another aspect of the international system that scholars have noted for its effect on trade policy is the presence and influence of international institutions. Although a long debate has occurred over whether international institutions matter, many scholars conclude that the willingness of states to set up and participate in such institutions implies that they do matter (e.g. Ruggie 1983, Keohane 1984). In the trade area, a number of institutions provide support for an open, multilateral trading system; these include the GATT and its successor, the WTO, as well as the IMF and World Bank. Although regional trade institutions may have a more ambiguous effect on the multilateral system (E Mansfield, H Milner, unpublished manuscript), some of them, including the European Union (EU), NAFTA, and ASEAN, seem to have positive effects on lowering trade barriers and reinforcing unilateral moves toward freer trade.

These institutions are postulated to have a number of different effects on countries' trade policy choices. Some authors suggest that their main role is to provide information about other countries' behavior and compliance with the rules of the game (e.g. Keohane 1984). Others see these institutions as providing a forum for dispute resolution so that partners in trade can feel more secure and thus more likely to trade (e.g. Yarbrough & Yarbrough 1992). Still others view such international institutions as encapsulating the norms by which countries agree to play the trading game, which again provides a common framework for sustaining trade flows (e.g. Ruggie 1983). All of these arguments hypothesize that the presence of these institutions should be associated with a freer trade environment; moreover, they imply that the depth and breadth of these institutions should be positively related to trade liberalization and the expansion of trade. Can these arguments help explain the rush to free trade since the 1980s?

Certainly the presence of institutions like the GATT and IMF have added leverage to arguments for trade liberalization; the IMF and World Bank, for instance, have often made loans conditional on trade policy reform. But these institutions have existed since the 1940s, and thus their mere presence cannot explain the current move toward liberalization. The fact that many countries have been in severe economic crisis and needed external financing may help explain the added influence that these institutions have exerted since the 1980s. As Rodrik (1992:89) points out, “The 1980s were a decade of great leverage for these institutions [i.e. the IMF and World Bank] vis-à-vis debtor governments, especially where poorer African governments are concerned. The trade policy recommendations of the World Bank were adopted by cash-starved governments frequently with little conviction of their ultimate benefits.” But he also notes that, once the crisis is over, governments may return to their old protectionist ways. Others tend to argue that international institutions help lock in such domestic reforms. For example, Mexican unilateral trade liberalization seems much more secure now that Mexico is part of NAFTA and the WTO.

Finally, the creation of the WTO out of the GATT Uruguay Round represents a step toward the deeper institutionalization of an open trading system. This change could be associated with growing pressure for domestic trade liberalization. But the WTO’s birth occurred in the wake of changed preferences for freer trade, not as a precursor to them. By the early 1990s, many countries were already convinced that trade liberalization was the right policy. In sum, the growing influence of these international institutions seems to have depended either on the desperation of debtors or on changing domestic preferences and ideas about trade. Although there is little doubt that these institutions helped support trade liberalization globally, it is less certain that they provided the crucial impetus for this liberalization process (Haggard & Kaufman 1995:199). But, as with domestic political support, these institutions may be necessary for the reforms to be long lasting.

One might presume that international-level explanations would better account for a global movement like the rush to free trade. But the main political-economy arguments reviewed here have an awkward time explaining this trend. The distribution of capabilities certainly has changed since the early 1980s, but the direction of this change does not account for the trend in trade policies. If we have witnessed a move away from American hegemony or from bipolarity to multipolarity, then we should see a decrease in the openness and extent of trade. Only if we argue that American hegemony has returned to its postwar levels can we explain the rush to free trade more confidently. The constant presence of international institutions to guide trade, such as the GATT and IMF, is also a poor explanation for the global change in policy that has occurred since the 1980s. The increased influence that these institutions had in the 1980s because of the economic crises that many LDCs underwent may account for some of the change, but again, this combination had been present before the 1980s and had not led to such a U-turn in trade policy. These international institutions, however, may help to ensure that this liberalization process is not easily reversible.

EFFECT OF TRADE ON COUNTRIES AND THE INTERNATIONAL SYSTEM

A final area of interest in the political economy of trade policy is the reciprocal effect of international trade on domestic and international politics. Once countries have liberalized or protected their economies, what might be the effects of such choices? Scholars have examined this question with attention to at least three aspects of the domestic political economy. First, some have argued that trade liberalization can change domestic preferences about trade. As countries liberalize, the tradables sector of the economy should grow along with exposure to international economic pressures. Rogowski (1989) has argued that this should lead to greater or new political cleavages and conflicts between scarce and abundant factors domestically. These new cleavages in turn will alter domestic politics, as for example new parties arise to represent these groups or new coalitions form. Milner (1988) also argues that increasing openness to trade changes preferences domestically. Openness raises the potential number of supporters of free trade as exporters and multinational firms multiply; it may also reduce import-competing firms as they succumb to foreign competition. Hathaway (1998:606) presents a dynamic model showing that trade liberalization "has a positive feedback effect on policy preferences and political strategies of domestic producer groups. As industries adjust to more competitive market conditions, their characteristics change in ways that reduce the likelihood that they will demand protection in the future." James & Lake (1989) suggest an ingenious argument that repeal of the protectionist Corn Laws in the United Kingdom created the necessary conditions for the creation of a successful coalition for free trade in the United States. Each of these arguments in distinct ways suggests that increasing exposure to trade leads to increasing pressure against protection, thus creating a virtuous cycle of rising demand for freer trade. As an explanation for trade policy in the advanced industrial countries over the past few decades, this type of argument seems very plausible. The abrupt rejection of ISI and protectionism by developing countries seems less explicable in these terms.

A second aspect of domestic politics that increased trade may affect involves the character of national political institutions. Among the advanced industrial countries, Cameron (1978) long ago noted the relationship between those that were very open to international trade and those with large governments. He and Katzenstein (1985) attributed this correlation to the need for governments with open economies to provide extensive domestic compensation to the losers from trade and to employ flexible adjustment strategies for their industries. Rodrik (1997) has found strong evidence of this relationship around the globe. He claims that greater exposure to external risk, which trade promotes, increases the volatility of the domestic economy and thus that "societies that expose themselves to greater amounts of external risk demand (and receive) a larger government role as shelter from the vicissitudes of global markets" (1997:53). Increasing exposure to international trade may thus create demands for more government intervention and a larger welfare state, which in turn are necessary to sustain public support for an open economy.

Rogowski (1987:212) has argued that as countries become more open to trade, they will find it increasingly advantageous to devise institutions that maximize "the state's insulation, autonomy and stability." For him, this implies parliamentary systems with strong parties, proportional representation (PR), and large districts. He finds a strong relationship especially between openness and PR systems. Haldenius (1992) also finds that trade may have effects on domestic institutions. He argues that exposure to international trade brings higher rates of economic growth, which, through the development process, may translate into better conditions for the emergence of democracy. Thus, trade liberalization may over time foster conditions conducive to political liberalization. This again suggests a virtuous cycle—trade liberalization fosters democratization and democracy in turn may promote more trade liberalization, and so on.

Besides its effects on preferences and institutions, trade may constrain the policy choices available to decision makers. The recent literature on internationalization, or globalization, suggests this constraining influence. Rodrik (1997) provides some of the most direct evidence that greater openness may force governments to relinquish the use of various policy instruments. In particular, he notes that openness often makes governments cut spending on social programs and reduce taxes on capital. In order to maintain competitiveness, governments are prevented from using many of the fiscal policy measures they once could.[4] Whether such constraints are good or bad depends on the value one places on government intervention in the economy. For some, like Rodrik (1997), this constraint is worrisome because it reduces the government's ability to shelter its citizens from external volatility and thus may erode the public's support for openness. Here the impact of trade liberalization may not be benign. It may produce a backlash, creating pressures for protection and closure.

In terms of international politics, trade liberalization may also have important effects. As countries become more open to the international economy, it may affect their political relations with other countries. In particular, scholars have asked whether increased trade promotes peace between countries or increases their chances of conflict. Several scholars, such as Polachek (1980),

[4]Many scholars have noted that in the presence of high capital mobility—another condition of globalization—governments also lose control of their monetary policy, especially if they desire to fix their exchange rates (e.g. Garrett 1998).

Gasioworski (1986), and Russett et al (1998), have found that increases in trade flows among countries (or between pairs of them) decrease the chances that those countries will be involved in political or military conflicts with each other. Others, such as Waltz (1979) and Barbieri (1996), argue that increased trade and the interdependence it creates either increase conflict or have little effect on it. One way the rush to free trade might affect the international political system, then, is by increasing or decreasing the level of political-military conflicts. The different arguments, however, imply different feedback mechanisms. If trade promotes pacific relations among trading nations, then such a pacific environment is likely to stimulate further trade liberalization and flows; on the other hand, if trade produces more conflict, then we might expect more protectionism and less openness in the future.

These more dynamic models of how international trade and domestic politics interact are an important area of research. They may tell us a good deal about what the rush to free trade, if sustained, may mean for the future. Will the global liberalization process bring increasing pressures for more openness and for democracy? Or will it undermine itself and breed demands for closure and a backlash against governments and the international institutions that support openness? Will openness produce a peaceful international system or one prone to increasing political conflict? The answers to these questions will in turn tell us much about the future direction of trade policy globally.

CONCLUSION

The question that I set out to address was why nations around the globe have liberalized their trade policies since 1980. I examined the preeminent theories of trade policy to see if they could help explain this monumental shift in policy. In this section I assess how well they have done and where future research might be useful.

Why have trade barriers been declining globally since 1980? Existing theories suggest at least three plausible answers. The first involves changing preferences about trade policy among domestic actors. Clearly, in the 1980s, many political leaders and some societal groups in countries around the globe changed their views on what their best trade policy choice was. Political leaders in the LDCs launched ambitious, unilateral economic reforms that included massive trade liberalization, while leaders in the advanced industrial countries undertook large-scale, multilateral efforts to reduce trade barriers. For the latter group, it is hard to pinpoint changes in political institutions or democratization as playing a major role. Instead, the virtuous cycle—growing trade creating more groups in favor of trade liberalization, which in turn created more impetus for greater liberalization and more trade—seems to be a key factor. For the LDCs, on the other hand, changes in leaders' preferences and in political institutions appear more important. The failure of ISI, economic crises, the success of the relatively open Asian NICs, and the demise of a socialist alternative all combined to make leaders favor economic reforms that included trade liberalization. Democratization in some countries also fostered this process. Large-scale changes in political institutions, especially in the direction of democracy, may be necessary for the kind of massive trade liberalization that occurred in some LDCs. But changes in preferences cannot be overlooked in explaining the rush to free trade.

One might think that international factors would play a major role in this global change in policy. But it is harder to argue this. Certainly, the collapse of socialist and communist economies, which was part and parcel of the end of the Cold War and the demise of the Eastern bloc, had an effect. Leaders could no longer plausibly appeal to such models to justify their protectionist policies. But it is important to remember that many of the unilateral reforms toward liberalization began in the early or mid 1980s, before the collapse of the Eastern bloc. They also began at a time when many observers thought American hegemony was long past, especially economically. Perhaps most important was the role of international institutions. For the advanced industrial countries, the GATT allowed countries to design wide-ranging packages of reciprocal trade concessions that fostered broad liberalization; in addition, the EU helped promote liberalization within an ever-growing Europe. For the LDCs, the role of the IMF and World Bank may have played a larger role. Economic distress forced countries to turn to these institutions for help, and part of the price was a prescription of trade liberalization. Although for some leaders this prescription fit with new trade preferences, for others it was a bitter pill to swallow and one they would not have taken without external pressure.

Thus, changing preferences among political leaders and societal groups, institutional changes (especially democratization), and the increased influence of international institutions that supported trade liberalization may best explain the global rush to free trade witnessed since 1980. Research on this puzzle is certainly not complete, however. None of our existing theories by itself seems to do very well in explaining this movement, the most important change in trade policy globally since the end of World War II, and none appears to have predicted it. A better understanding of how political leaders form their trade preferences and how these preferences are connected to societal ones is essential. Moreover, theories about the relationship between democracy and trade are in their infancy. Knowledge of the conditions under which international institutions are able to exert greater (or less) influence over countries is necessary.

Finally, we need to know whether the rush to free trade will be sustained or reversed. Will trade barriers remain as low as they are and keep declining, or will protectionism return? Again, I suspect that the factors that are responsible for the initial change may have some bearing on this. If leaders' or social groups' preferences for free trade are maintained or grow, then we might expect liberalization to remain in place. Factors, such as economic crises, that cause actors to question these preferences will limit their sustainability. We might also expect that the return of authoritarian governments would be associated with the return to protection, but democracy itself is not a sufficient condition for liberalization. Finally, the role of international institutions seems to be heightened by the severity of domestic economic crises. This suggests that, as good times return, political leaders who do not favor free trade may reject the policies forced on them by their lenders and turn protectionist. These and other factors will be important for understanding the sustainability of trade liberalization. Our existing theories are perhaps even less helpful in explaining sustainability than they are in explaining why countries liberalized in the first place.

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