Votes and Vetoes: The Political Determinants of Commercial Openness

WITOLD J. HENISZ AND EDWARD D. MANSFIELD

University of Pennsylvania

Some theories of foreign economic policy stress the importance of domestic interest groups, whereas others focus on the effects of domestic institutions. Debates between advocates of these approaches are longstanding, but little systematic empirical research has been brought to bear on the relative merits of these theories. We argue that while interest group demands and institutions are often 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. As explanations emphasizing societal interests contend, deteriorating macroeconomic conditions are a potent source of protectionist sentiment. The extent to which such conditions reduce commercial openness, however, depends centrally on a country's political institutions, especially the number of veto points in a country's policy-making structure and its regime type. We expect the effects of macroeconomic conditions on trade policy to become weaker as the number of veto points increases. We also expect both veto points and the societal pressures stemming from the economy to have a more potent impact on trade policy in democracies than in other regimes. The results of our statistical tests covering almost 60 countries during the period from 1980 to 2000 strongly support these arguments.

Much of the recent literature on the political economy of trade policy emphasizes the role of domestic politics. Some theories of foreign economic policy stress the importance of domestic interest groups, whereas others focus on the effects of domestic institutions. Debates between advocates of these approaches are longstanding, but little systematic empirical research has been brought to bear on the relative merits of these theories. 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 undertake comparisons of the two approaches.

In this article, 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 interest group demands and institutions are often 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

Authors' note: For very helpful comments on earlier versions of this article, we are grateful to Marc Busch, Mark Hallerberg, David Leblang, Helen Milner, Dennis Quinn, Daniel Treisman, and the anonymous reviewers. We also thank Todor Enev and Matthew Tubin for research assistance, and the Christopher H. Browne Center for International Politics for financial support.

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Published by Blackwell Publishing, 350 Main Street, Malden, MA 02148, USA, and 9600 Garsington Road, Oxford OX4 2DQ, UK.

explanations emphasizing societal interests contend, deteriorating macroeconomic conditions are a potent source of protectionist sentiment. The extent to which such conditions reduce commercial openness, however, depends centrally on the domestic political institutions through which interest group pressures must filter to influence policy.

Two institutional features stand out in this regard. First, countries vary substantially in the degree to which authority is concentrated within the government. In states marked by greater fragmentation of authority and more "veto points," it is harder to change existing policies because any number of actors can block such a change. Consequently, we expect the effects of macroeconomic conditions on trade policy to be weaker in fragmented states (i.e., those with more veto points) than in those characterized by a highly centralized government (i.e., those with fewer veto points).¹ Second, we expect both fragmentation and interest group 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 policy than democratic leaders, regardless of how concentrated authority is in a democracy, autocrats depend on a narrower set of groups for political power than their democratic counterparts. This set of groups is less likely to base their political support on broad macroeconomic conditions than on whether they benefit from the government's economic policy, regardless of the economy's overall performance.

Taken as a whole, we therefore expect deteriorating macroeconomic conditions to impede commercial openness, but the effect of these conditions is likely to hinge on the extent of institutional fragmentation. Equally, we expect macroeconomic factors to have a more pronounced influence on trade policy in democracies than in other countries. The results of our statistical tests—covering almost 60 countries during the period from 1980 to 2000—strongly support these arguments.

Societal Interests and Trade Policy

Various studies emphasize how interest groups affect trade policy by exerting political pressure on public officials.² These studies generally view domestic institutions and policy makers as passive actors that supply the trade policies demanded by the most influential groups in society (Ikenberry, Lake, and Mastanduno 1988). Societal demands for protection are frequently inferred from macroeconomic conditions, a research strategy that has contributed to a burgeoning literature on the links between aspects of national economic performance and foreign commerce (e.g., Bergsten and Cline 1983; Deardorff and Stern 1987; Dornbusch and Frankel 1987; Baldwin 1989; Cline 1989; Gardner and Kimbrough 1989; Magee, Brock, and Young 1989; Bhagwati 1991; Bohara and Kaempfer 1991; Destler 1992; Corden 1993).

Central to this literature is the argument that public officials must respond to demands made by broad segments of the populace in order to ensure their political survival. There is considerable evidence that voters pay attention to overall macroeconomic conditions as well as their own economic circumstances when casting ballots (Kinder and Kiewiet 1981; Lewis-Beck 1988; Colton 2000). Furthermore, survey research indicates that public support for protectionism rises as domestic economic conditions degrade (Shapiro and Page 1994). Government officials

¹ As long as the policy preferences by political actors across "veto points" are not perfectly correlated and they encounter some positive decision costs in reaching a consensus, the response to a given shock or change in environmental circumstance will, on average, be muted for a country with multiple veto points as compared with one characterized by a single veto point.

² The classic statement is Schattschneider (1935).

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 Bergsten and Cline (1983:77) point out, "conventional wisdom suggests that high levels of unemployment are the single most important source of protectionist pressures." Similarly, an International Monetary Fund study concludes that "perhaps the most crucial factor—and the one most likely to influence policy choices toward protection—is the extent and duration of existing unemployment" (Nowzad 1978:35). Various other studies have arrived at the same conclusion (Hughes and Waelbroeck 1981; Wallerstein 1987).

High levels of unemployment are expected to generate calls for protectionism by making it more difficult for workers to adjust to increases in imports. Workers who lose their jobs because of rising import competition will find it harder to obtain 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. High levels of unemployment stimulate workers, investors, and other interest groups adversely affected by open trade to overcome collective action problems and mobilize to press for policies that reduce openness (Olson 1983).

The "dual" of this relationship would be a positive association between the political strength of groups that benefit from free trade and increases in commercial openness. We offer no such prediction because of a lack of internationally comparable, time-varying, and exogenous measures of the strength of the free trade lobby. It is important to recognize, however, that the lack of an explicit measure of the strength of this lobby does not bear on our expectation that an inverse relationship will exist between unemployment and changes in trade openness. The marginal effect of high unemployment on openness (while all other factors are held constant) should be negative, regardless of the unobserved free trade lobby's political potency.

Veto Points and Trade Policy

Approaches that stress the importance of interest groups in shaping trade policy usually give short shrift to the domestic political institutions that filter demands made by these groups and set policy. Crucial in this regard are the extent of fragmentation within a country's government and its regime type (Garrett and Lange 1996).

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, groups in society have greater difficulty pressing for a change in policy (Henisz 2000; Tsebelis 2003).

In the trade policy arena, any actor with the authority to set policy understands that the final outcome must lie within a range of policies that satisfies all veto points. To the extent that the preferences of 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 1995:289). Various cross-national studies that link policy stability to the number of veto points support these theoretical insights (Haggard and Kaufman 1995; Milner 1997; Hallerberg and Basinger 1998; Franzese 1999; Treisman 2000; MacIntyre 2001; Kastner and Rector 2003; Tsebelis 2003; Mansfield, Milner, and Pevehouse 2005).

In a similar vein, we argue that governments will be less responsive to societal pressures as the number of veto points rises in policy-making structures (Frieden and Rogowski 1996:43; Garrett and Lange 1996:66). More specifically, we expect that a high level of unemployment will stimulate interest group demands for policies to decrease unemployment at the cost of more expensive imports, including reductions in commercial openness. However, we also expect that more fragmented policy-making structures will reduce the sensitivity of government actors to such societal pressures. When a large number of veto points exists, there is more likely to be an actor in control of a veto point who is hostile to raising trade barriers and who can use this control to frustrate societal demands for protection. As the number of veto points declines, it becomes easier to change the existing trade regime as the actors controlling veto points are more likely to have relatively homogeneous interests (Henisz 2000). We therefore anticipate that adverse macroeconomic conditions will stimulate a larger decline in external trade linkages as countries become more institutionally centralized.

As we mentioned earlier, it is not possible to observe the corresponding moderating role that veto points have on the positive relationship between the strength of the free trade lobby and changes in openness, as reliable, cross-national data on this lobby are unavailable. Comparing the relationship between the estimated change in openness when the unemployment rate is zero and few veto points exist with this relationship when a large number of veto points exist, however, will be informative in this regard. In the hypothetical absence of unemployment, only the unobserved lobby for free trade should pressure the government over commercial policy. A larger number of veto points should moderate the positive association between the strength of this lobby and the estimated change in openness. We therefore expect that where the unemployment rate is relatively low, the predicted increase in the level of openness will be smaller as the number of veto points grows larger.

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 by the United States. Unified government (i.e., one with few veto points), by contrast, has promoted liberalization. In a study of post-Communist countries during the 1990s, however, Frye and Mansfield (2003) find that trade has reform becomes more likely as the number of veto points increases, 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 during the era since 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 onto 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, the status quo trade policy is relatively open and was put in place by a comparable set of political actors to those currently holding power. A reduction in the number of veto points 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 points are the same as or closely related to those that promoted closure. Where veto points are more numerous, political regime change has brought new political actors to the table, fostering a new coalition that endorses trade liberalization. Where few veto points 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.

Regime Type and Trade Policy

Our analysis adds to the burgeoning literature on the political economy of foreign trade by addressing the combined effects of interest group pressures generated by macroeconomic conditions and institutional fragmentation on political actors' incentives and ability to change trade policy. Of course, the need for leaders to respond to such pressures 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., Schumpeter 1942; Huntington 1991:5–13; Przeworski et al. 2000). 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' behavior. If democratic leaders do not take overt steps to cushion the effects of macroeconomic downturns—by increasing trade barriers among other measures—they face audience costs, including the prospect 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 higher levels of unemployment 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 than on national economic performance. Autocrats, therefore, should be relatively insensitive to the societal pressures generated by adverse macroeconomic conditions (Frieden and Rogowski 1996; Garrett and Lange 1996; Wintrobe 1998; Brooker 2000; Acemoglu and Robinson 2005).

In sum, then, we expect commercial openness to dip as the level of unemployment rises, and we anticipate that the influence of unemployment will grow larger as the number of veto points declines. In addition, while democracies are generally marked by a higher number of veto points than non-democracies, we expect the impact of unemployment and veto points to be more pronounced in democratic regimes.³

Anecdotal evidence points to the effect that veto points can have on trade policy. Consider the cases of Chile and Peru. In Chile, a democratically elected government came to power in 1989 and subsequently cut the tariff rate to 11 percent in 1991 (Lederman 2001:226–227). Based on our data, the number of veto points in Chile rose substantially during the early 1990s. Consistent with our argument, the Chilean government succeeded in warding off demands for protection during this decade despite adverse economic conditions. As Saez, Salazar, and Vicuña (1995:49) point out, in the early 1990s, the government faced "pressures to raise the level of protection" but "these pressures were not fruitful." Nor were such pressures effective at the end of this decade, despite an unemployment rate that rose to almost 10 percent (Lederman 2001). Again, the maintenance of Chile's open trade policy accords with our claim that deteriorating macroeconomic conditions

³ It is important to recognize that regime type and veto points tap different, although somewhat related, aspects of domestic politics. The extent of veto points varies considerably among democracies and non-democracies alike (the mean among stable democracies is 0.60 and the standard deviation is 0.26 while among other nations the mean is 0.09 and the standard deviation 0.20). Furthermore, while democracies tend to have more veto points than other countries, the correlation between regime type and veto points is not overwhelmingly high (0.63 or 0.46, depending on which measure of veto points is analyzed; see Table 1).

are less likely to yield heightened trade barriers in democracies with a wider range of veto points.

In Peru's emerging democracy, unemployment rose dramatically during the early 1980s, reaching a rate of about 60 percent by 1984. During that time, Wise (1989:170) reports, constitutional changes and other developments precipitated a "greater concentration of power in the executive." As such, the number of veto points declined during the first half of the 1980s. Hence, it is not surprising that Peru abandoned its export-led growth strategy and increased trade barriers during these years (Wise 1989:170; Nogues and Gulati 1994:487). We would expect that demands for protection spurred by heightened unemployment would have a greater effect on trade policy as the number of veto points declines.

Of course, these are only illustrations of our argument, but they suggest that the factors we emphasize may have influenced trade policy. To test the argument more fully, we now turn to a set of quantitative analyses. These analyses depart from the existing empirical work on the domestic politics of trade in various ways. First, very few studies have addressed the effects of veto points on trade policy. None that we are aware of have addressed how veto points influence the relationship between interest group pressures and foreign commerce, even though it is widely recognized that domestic institutions and societal pressures are likely to have an interactive effect on trade policy (Mansfield and Busch 1995; Garrett and Lange 1996; Gilligan 1997; Milner 1997; Grossman and Helpman 2002). Instead, most empirical studies assume that interest group demands and policy structures operate independently of each other. Our model, by contrast, explicitly accounts for the moderating role of policy-making 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 (Bliss and Russett 1998; Mansfield, Milner, and Rosendorff 2000; Frye and Mansfield 2003; Milner and Kubota 2005). Equally, the work that has been conducted has not addressed whether societal influences on trade policy vary between democracies and non-democracies. Our analysis—covering almost 60 countries between 1980 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:

$$\Delta IMPORTS_{i,t} = \beta_1 UNEMPL_{i,t-1} + \beta_2 VP_{i,t-1} + \beta_3 UNEMPL_{i,t-1} \times VP_{i,t-1} + \beta_4 IMPORTS_{i,t-1} + \beta_5 REER_{i,t-1} + \beta_6 \Delta REER_{i,t-1} + \beta_7 \Delta TOT_{i,t-1} + \beta_8 RES_{i,t-1} + \beta_9 GPCF_{i,t-1} + PTA_{i,t-1} \boldsymbol{\beta} + COUNTRY_i \boldsymbol{\beta} + YEAR_t \boldsymbol{\beta} + \varepsilon_{i,t}$$

Our dependent variable is the annual percentage change in import penetration. For each country, *i*, import penetration is defined as the value of imports in domestic currency divided by the nation's gross domestic product (GDP) in a given year (*t*), using data drawn from the World Bank's *World Development Indicators*. The dependent variable is the percentage change in import penetration from year t-1 to year *t*. For the period covered in our analysis (1980–2000), the mean value of the dependent variable is 3 percent with a standard deviation of 21 percent, indicating both a slight tendency for countries to expand their imports over time and substantial variation in this regard within the sample.

Of course, this measure of trade policy is not ideal as aggregate shifts in import penetration 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.⁴ To test our argument, it is especially important to analyze a sample of countries with as wide a range of political institutions and macroeconomic conditions as possible. Furthermore, protectionist trade policies should generally reduce imports and trade liberalization should generally increase them. Consequently, while we consider the robustness of our results to an alternative measure of openness that is based on a gravity model of trade and discussed further below (Hiscox and Kastner 2002), there is ample reason to use $\Delta IMPORTS_{i,t}$ in our core specification.

Independent Variables

The central variables in our model are the unemployment rate (*UNEMPL*) and the extensiveness of veto points in each country. 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, existing studies frequently infer demands for protection from the unemployment rate. The *World Development Indicators* reports the unemployment rate that is given by each country's national statistical agency. These data cover the widest possible range of countries and years, rendering them especially useful in light of our objectives.⁵ Prior to 1980, however, unemployment data for developing countries are not compiled using a comparable methodology, making cross-national comparisons very difficult to conduct. As such, our analysis covers the period from 1980 to 2000.

The key institutional factor included in the model is the extent of the constraints faced by government officials in each country (VP). We measure the level of veto points in terms of the structure of a country's formal political institutions and the degree of partisan heterogeneity within and among these institutions. We used two veto points measures: the Political Constraints Index (*POLCON*) developed by Henisz (2000) and the *CHECKS* index developed by Beck et al. (2001).

The first step in the construction of *POLCON* is identifying 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.⁶ 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, one-dimensional policy space [0, 1]. This assumption facilitates 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. Scores for the final

⁴ For an overview of these measures, see Edwards (1993).

⁵ Data from the International Labor Office offer equal coverage to the World Bank data set and are drawn from the same national sources.

⁶ Note that the following results are quite similar when we replace this variant of *POLCON* with one that excludes the judiciary and sub-federal institutions. The data and codebook for these measures are available from http://www-management.wharton.upenn.edu/henisz/POLCON/ContactInfo.html

measure of political constraints can range from zero (least constrained) to one (most constrained).

Countries with the most veto points in the formal policy-making apparatus are federal states with strong independent judiciaries and either presidential regimes or those with proportional representation electoral rules that tend to yield coalition governments, such as the United States, Germany, and Switzerland. Political constraints decrease as the number of veto points declines or as their preferences become more homogeneous, as is the case in moving to a mixed Parliamentary– Presidential system, typified by France and Brazil, to heavily fractionalized Parliamentary systems like those of Belgium, Israel, and the Netherlands, or to Westminster Parliamentary systems with winner-take-all districts, such as the United Kingdom. Non-democratic countries and those with transitional political regimes have the lowest levels of political constraints because the formal institutional structures in these states provide tremendous discretion to policy makers.

The alternative measure—the logarithm of *CHECKS*—"count[s] the number of veto players in a political system, adjusting for whether these veto players are independent of each other, as determined by the level of electoral competitiveness in a system, their respective party affiliations, and the electoral rules" (Beck et al. 2001:170). This index yields a minimum score of 0 when a country lacks an effective legislature. The score then increases linearly with the addition of subsequent veto points whose political preferences are closer to that of the opposition than they are to the average government preference, based on a three-point scale calculated using a different methodology for Presidential and Parliamentary systems.

For Presidential systems, the opposition is defined as the largest opposition party. The index's value increases by one point for each legislative chamber and for the president, unless elections are held under closed lists and the president's party is the largest one in a particular chamber, in which case the president is not considered a check. For Parliamentary systems, the opposition is defined as the three largest opposition parties. The index's value increases by one point for the prime minister and for each party in the government coalition, including that of the prime minister, unless elections are held under closed lists.

In our sample, the correlation between *POLCON* and *CHECKS* is 0.72. The greatest divergence between the two measures is in their treatment of broad coalition governments. As *CHECKS* treats each party as a veto point, countries such as India, Pakistan, Turkey, and France have the highest level of veto points by this measure. Alternatively, *POLCON* indicates that countries such as Germany, Switzerland, Belgium, and the United States have the highest level of veto points.

As our argument is that the impact of societal forces on trade policy will be moderated as the number of veto points rises, we analyze $UNEMPL \times POLCON$ and $UNEMPL \times CHECKS$ in addition to POLCON and CHECKS.

Another key aspect of our argument is that the effects of veto points and broad societal pressures for protection should be qualitatively different in stable democracies than in other political regimes. We therefore generate three sets of parameter estimates: one for the full sample, a second for the stable remaining democratic states in the sample, and a third for the remaining states.⁷ We distinguish between democratic and non-democratic regimes using two different sources of data. First, we use the Polity IV data set (Marshall and Jaggers 2001), 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* = *REGIME*) yields an overall measure of regime type ranging from -10 to 10 (Jaggers and

⁷ 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. We chose to split our data into these two subsamples on the basis of a Wald test that suggested statistically significant (p = .003) differences in the full set of coefficient estimates as opposed to merely a change in the intercept.

Gurr 1995). Following much of the existing literature, we define stable democratic regimes as those where *REGIME* is greater than or equal to 6 for 5 consecutive years.⁸ Later, however, we assess the robustness of the results by fluctuating this cutoff point for democracy, and by using data from Freedom House (2005) on Political Rights and Civil Liberties within a country.

As our dependent variable is the percentage change in import penetration, it is important to include the level of import penetration as well. There are practical limits on the extent of import penetration that countries can achieve. Those that are already relatively open with respect to trade may find it difficult to increase import penetration 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 also help to isolate the differing mechanisms that led to conflicting theoretical arguments and empirical evidence regarding the impact of veto points in earlier research on trade policy (Lohmann and O'Halloran 1994; Frye and Mansfield 2003).

Although our primary interest is in the interaction between societal pressures and domestic institutions, it is obviously important to account for various additional factors that might influence foreign commerce. To this end, we include the following: (1) the level of and change in each country's real effective exchange rate (REER and $\Delta REER$), which alters the relative price of imports and thus demand for them; (2) the change in each state's terms of trade (ΔTOT), which captures relative price movements particular to a country's imports or exports that may not be fully reflected in its exchange rate (e.g., the effect of an oil price shock on oil importers or oil exporters in a fixed exchange rate regime); (3) the government's supply of foreign exchange reserves as a percentage of imports (RES), which is positively associated with its ability to withstand a run on its currency and is negatively associated with the likelihood that it will liberalize trade as part of a multilateral program to restore financial stability; (4) gross private capital formation (GPCF), which plays a role similar to reserves in shaping trade policy; and (5) a vector of time-varying dummy variables indicating whether a country is a member of each of the 50 preferential trade agreements (PTA) that may require, encourage, or solicit membership from those countries that are more likely to expand their overseas economic linkages (Ingram, Robinson, and Busch, forthcoming). Further, we include dummy variables indicating whether each country was a member of the Organization of Petroleum Exporting Countries or the Council for Mutual Economic Cooperation, as a heavy dependence on oil exports and a command economy are likely to influence the evolution of trade policy.

Finally, to capture any unmeasured country-specific but time-invariant or timespecific but country-invariant heterogeneity in the data, we include country-specific and year-specific fixed effects. The inclusion of these fixed effects implies that our coefficient estimates are identified by within-country variation in the independent variables that is not common to all countries in a given year. For example, the inclusion of time-invariant characteristics of a country—such as its land area—would confer no additional explanatory power to our model as variables of this kind are already captured by the country's fixed effect. Similarly, cross-country variation in the mean level of our independent variables—including veto points and unemployment—are also subsumed within the country's fixed effect.

Results

We estimate the model described in the previous section using ordinary least squares (OLS) with panel-corrected standard errors. These standard errors are

⁸ The same country may appear in both subsamples in different time periods. For example, a country that was an autocracy from 1980 to 1990 and then became a stable democracy would appear in the stable democracy subsample after 1995, but in the other subsample from 1980 to 1995.

					TABLI	E 1. Sun	ımary S	tatistics									
Variable	#	I	2	n	4	ŕ	9	7	8	6	01	11	12	13	14	15	16
N		4,368	2,620	4,489	2,703	5,108	3,280	1,173	1,162	1,512	1,437	4,105	2,856	3,033	4,275	3,843	4,533
Mean		0.03	0.01	34.21	30.58	0.26	0.62	8.17	4.53	32.77	0.01	0.01	13.09	3.48	0.11	52.42	59.17
Standard deviation		0.21	0.12	22.74	10.39	0.33	0.67	5.71	3.93	984.30	0.26	0.15	34.37	2.93	0.13	540.07	623.42
Minimum		-0.69	-1.00	0.69	0.00	0.00	0.00	0.10	0.00	0.18	-1.00	-1.13	0.00	-0.09	0.00	-13.05	-29.17
Maximum		3.54	2.55	223.64	66.27	0.89	2.89	42.20	18.72	37,969	7.92	3.20	688.64	24.66	1.71	23,773	26,762
Change in import penetration	-																
Change in Hiscox/Kastner indicator	0	-0.25															
Level of import penetration	3	0.24	-0.15														
Level of Hiscox indicator	4	-0.10	0.10	-0.55													
Political constraints	5 C	-0.10	-0.12	0.23	-0.32												
Log checks	9	-0.03	-0.04	0.13	-0.16	0.67											
Unemployment rate	1-	-0.08	0.17	-0.14	-0.13	0.04	0.11										
Political constraints × unemployment rate	×	-0.10	-0.06	0.03	-0.14	0.83	0.62	0.44									
Real effective exchange rate index/1,000	6	-0.23	0.35	-0.28	0.24	-0.25	-0.31	-0.10	-0.23								
Change in real effective exchange rate index	10	-0.40	-0.08	0.07	-0.14	0.07	0.02	0.09	0.09	0.03							
Change in terms of trade/GDP	Ξ	-0.11	-0.02	-0.03	-0.31	-0.11	-0.07	-0.04	-0.21	0.06	-0.12						
Gross private capital formation/GDP	12	-0.13	0.13	0.10	-0.36	0.16	0.15	0.16	0.13	-0.10	0.08	0.10					
Gross international reserves/imports	13	-0.09	0.02	-0.43	0.07	0.24	0.15	0.10	0.32	0.03	-0.06	-0.03	0.22				
Gross international reserves/GDP	14	-0.05	-0.13	0.24	-0.35	0.43	0.24	0.03	0.35	-0.16	0.07	-0.01	0.38	0.72			
Inflation (CPI)	15	0.63	-0.09	0.36	-0.18	-0.13	-0.02	0.04	-0.08	-0.33	0.17	-0.26	-0.06	-0.16	-0.01		
Inflation (GDP deflator)	16	0.76	-0.08	0.35	-0.18	-0.14	-0.02	0.02	-0.10	-0.31	-0.02	-0.22	-0.06	-0.16	-0.04	0.96	
Log inflation (CPI)	17	0.47	-0.03	0.34	-0.23	-0.08	0.05	0.10	-0.01	-0.41	0.27	-0.28	0.03	-0.12	0.04	0.94	0.89
Log inflation (GDP deflator)	18	0.49	-0.02	0.35	-0.23	-0.09	0.04	0.10	-0.01	-0.41	0.22	-0.27	0.03	-0.12	0.02	0.93	0.90
Inflation indicator ($\geq 33\% < 100\%$)	19	-0.07	0.05	-0.02	-0.14	0.30	0.32	0.10	0.34	-0.33	-0.09	-0.10	0.26	0.12	0.08	-0.06	-0.06
Inflation indicator ($\geq 100\% < 1,000\%$)	20	-0.02	-0.03	-0.11	-0.09	0.04	0.12	0.02	0.05	-0.16	0.03	0.13	0.06	0.09	0.01	-0.01	-0.01
Inflation indicator $(\geq 1,000\%)$	21	0.43	-0.01	0.40	-0.19	-0.13	-0.03	0.09	-0.07	-0.31	0.29	-0.30	-0.02	-0.18	0.01	0.91	0.87
Log real gross domestic product (\$b)	22	-0.19	-0.03	-0.38	0.60	-0.09	-0.03	-0.06	-0.04	0.21	-0.14	-0.04	-0.04	0.24	0.04	-0.43	-0.41
Log real gross domestic product per capita (\$)	23	-0.13	-0.01	0.04	-0.51	0.56	0.31	0.24	0.48	-0.18	-0.07	0.24	0.44	0.50	0.64	-0.28	-0.27
Gross foreign direct investment/GDP	24	-0.06	-0.17	0.45	-0.31	0.34	0.23	-0.10	0.15	-0.18	-0.04	0.23	0.27	-0.04	0.34	-0.17	-0.16
Net foreign direct investment/GDP	25	-0.06	-0.13	0.50	-0.29	0.37	0.26	-0.09	0.17	-0.14	-0.01	0.23	0.19	-0.08	0.31	-0.15	-0.15
Portfolio investment/GDP	26	-0.04	-0.03	-0.08	0.04	0.14	0.17	0.05	0.18	-0.09	-0.02	-0.14	0.60	0.27	0.23	-0.02	-0.02
Government budget balance/GDP	27	-0.31	0.08	-0.16	-0.13	0.17	0.08	0.14	0.20	-0.01	-0.28	0.25	0.18	0.30	0.20	-0.64	-0.53
Debt service/GDP	28	-0.10	0.11	0.27	-0.33	0.21	0.00	0.28	0.21	-0.08	0.16	0.05	0.38	-0.11	0.17	-0.07	0.00
Debt service/exports	29	-0.09	0.24	-0.17	-0.09	-0.03	-0.09	0.36	0.07	0.10	0.16	-0.01	0.23	-0.02	-0.07	-0.07	0.00
Stable democracy—Polity (0,1)	30	-0.06	0.02	-0.24	-0.03	0.63	0.46	0.20	0.66	-0.09	-0.03	-0.21	0.03	0.23	0.05	-0.13	-0.13
Stable democracy—Freedom House (0,1)	31	-0.08	0.01	-0.22	-0.21	0.66	0.60	0.16	0.64	-0.15	-0.03	0.03	0.13	0.30	0.15	-0.14	-0.14

Variable	#	17	18	61	20	21	22	23	24	25	26	27	28	29	30	31
N		9 049	1 2 9 9	1101	10.11	1071	4 465 4	1465 6	300 (3000	0 664	0 2 40	9649	0.900	и 0,1 1	110 1
		0,040	1,000	0,447	0,447	0,411	1,103		4,04U	0,000	4,004	210,2	7,010 7,017	000017	0,447	0.08
Mean		4.78	4.78	0.07	0.03	0.01	23.30	1.44	2.41	1.42	000	20.6-	12.0	15./5	0.32	62.0
Standard deviation		0.38	0.41	0.25	0.17	0.09	2.16	1.60	3.86	2.88	0.03	6.12	5.30	14.73	0.47	0.42
Minimum		4.48	4.26	0.00	0.00	0.00	18.54	4.34	0.00	-25.78	-0.30	-64.49	0.00	0.00	0.00	0.00
Maximum		10.08	10.20	1.00	1.00	1.00	29.79	10.87	56.01	39.86	0.45	58.71	107.45	180.85	1.00	1.00
Change in import penetration	-															
Change in Hiscox/Kastner indicator	61															
Level of import penetration	3															
Level of Hiscox indicator	4															
Political constraints	5															
Log checks	9															
Unemployment rate	4															
Political constraints × unemployment rate	8															
Real effective exchange rate index/1,000	6															
Change in real effective exchange rate index	10															
Change in terms of trade/GDP	Π															
Gross private capital formation/GDP	12															
Gross international reserves/imports	13															
Gross international reserves/GDP	14															
Inflation (CPI)	15															
Inflation (GDP deflator)	16															
Log inflation (CPI)	17															
Log inflation (GDP deflator)	18	1.00														
Inflation indicator $(\geq 33\% < 100\%)$	19	0.07	0.08													
Inflation indicator $(\geq 100\% < 1,000\%)$	20	0.07	0.07	-0.05												
Inflation indicator $(\geq 1,000\%)$	21	0.97	0.97	-0.08	-0.02											
Log real gross domestic product (\$b)	22	-0.51	-0.51	-0.17	-0.06	-0.47										
Log real gross domestic product per capita (\$)	23	-0.22	-0.22	0.25	0.19	-0.32	-0.03									
Gross foreign direct investment/GDP	24	-0.20	-0.20	-0.03	-0.13	-0.18	0.16	0.30								
Net foreign direct investment/GDP	25	-0.20	-0.20	-0.06	-0.12	-0.17	0.15	0.28	0.92							
Portfolio investment/GDP	26	0.00	0.00	0.24	0.01	-0.03	0.09	0.13 -	-0.01	-0.04						
Government budget balance/GDP	27	-0.47	-0.44	0.14	0.08	-0.47	0.10	0.44	0.22	0.17	0.04					
Debt service/GDP	28	0.08	0.11	0.03	0.02	0.14	-0.13	0.25	0.12	0.10	0.05	0.27				
Debt service/exports	29	0.09	0.13	-0.04	0.06	0.14	-0.08	- 60.0	-0.16	-0.18	-0.03	0.26	0.80			
Stable democracy—Polity (0,1)	30	-0.07	-0.07	0.22	0.15	-0.15	-0.07	0.38	0.06	0.05	0.08	0.23	-0.01	0.08		
Stable democracy—Freedom House (0, 1)	31	-0.06	-0.06	0.37	0.14	-0.16	-0.13	0.46	0.09	0.07	0.12	0.23	-0.01	0.05	0.73	

WITOLD J. HENISZ AND EDWARD D. MANSFIELD

calculated assuming that the disturbances in the cross-sectional time series data are heteroscedastic across panels (i.e., grouped by country) and autocorrelated within panels (i.e., disturbances in a given country in a given year are correlated with disturbances in that country in the previous year) (Beck and Katz 1995). The procedure involves generating Prais–Winsten coefficient estimates conditional on the estimated autocorrelation parameter. The variance–covariance matrix of these coefficients is then estimated using feasible generalized least squares (FGLS). In the presence of incorrectly specified covariance structures, Prais–Winsten estimates improve the efficiency of both the coefficient estimates and their variance–covariance matrix when compared with FGLS (Beck and Katz 1995). We assume that the autocorrelation parameter (ρ) is constant across panels. 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 the first three columns, we use *POLCON* as a measure of veto points; in the last three columns, we use *CHECKS*. Within each set of findings, we give the results for the full sample, the subsample of stable democracies, and the subsample of other countries. When using *POLCON* as our measure of veto points and analyzing the entire sample, we find a negative relationship between the unemployment rate and the change in import penetration that is moderated by the extent of veto points. The coefficient estimate of *UNEMPL* is negative, the estimate of *UNEMPL* × *POLCON* is positive, and both are statistically significant (although the estimate of *UNEMPL* is only marginally so). As expected, the effects of these variables are both stronger and quantitatively larger when we focus on non-democratic states. We find a similar pattern when using *CHECKS* as our measure of veto points, although the coefficient

	-				,	
	(1)	(2)	(3)	(4)	(5)	(6)
N	731	587	144	723	583	140
# countries	58	44	26	58	45	25
R^2	0.72	0.39	0.90	0.72	0.38	0.90
Sample	All	Stable	Other	All	Stable	Other
		democracies	countries		democracies	countries
Source of democracy data		Polity ≥ 6	Polity<6		Polity ≥ 6	Polity < 6
Level of import penetration	-0.007	-0.009	-0.013	-0.007	-0.010	-0.012
	0.000	0.000	0.000	0.000	0.000	0.000
Veto points	-0.136	-0.273	-0.055	-0.048	-0.061	-0.015
	0.014	0.000	0.628	0.047	0.060	0.751
Unemployment rate	-0.005	-0.023	-0.001	-0.005	-0.010	0.005
	0.087	0.001	0.749	0.160	0.086	0.433
Veto points \times	0.012	0.034	-0.013	0.006	0.009	-0.008
unemployment rate	0.007	0.000	0.235	0.029	0.019	0.231
Real effective exchange rate	0.000	-0.001	0.000	0.000	-0.001	0.000
	0.000	0.164	0.000	0.000	0.067	0.000
Change in real effective	-0.031	-0.102	0.027	-0.034	-0.104	0.018
exchange rate	0.450	0.117	0.586	0.416	0.118	0.731
Change in terms of trade	0.721	0.626	1.247	0.662	0.636	1.500
	0.001	0.007	0.004	0.002	0.007	0.010
Gross private capital	0.001	0.001	-0.002	0.001	0.001	-0.002
formation/GDP	0.013	0.026	0.479	0.009	0.012	0.412
Gross international	0.014	0.012	0.026	0.012	0.010	0.027
reserves/imports	0.000	0.001	0.003	0.000	0.003	0.002

TABLE 2. Effects of Unemployment and Veto Points on Trade Policy, 1980-2000

Notes: Entries are ordinary least-squares coefficient estimates above corresponding p-values, based on panel-corrected standard errors. Coefficient estimates for PTA, country, and year indicator variables are not reported to conserve space. As we included PTA, country, and year indicator variables, we do not include a constant term.



FIG. 1. How Political Constraints Moderate Societal Pressures for Protectionism

estimate for the unemployment rate is only marginally significant (p = .086) when stable democracies are analyzed. Further, regardless of the measure of veto points, in the hypothetical case where the unemployment rate equals zero, openness to trade is lower where more veto points exist, suggesting that extensive veto points moderate the ability of the unobserved free trade lobby to secure greater trade openness.

To address the substantive significance of these results, Figure 1 plots the predicted marginal effect of a given level of unemployment on the change in import penetration for a stable democracy having a given level of veto points, based on the results in the second column of Table 2 (i.e., the coefficient estimate of *UNEMPL* multiplied by the unemployment rate plus the coefficient estimate of *UN-EMPL* × *POLCON* multiplied by the unemployment rate and the level of veto points). The figure does not show the predicted impact of unemployment on changes in openness for a specific or even a hypothetical county. In order to generate the total predicted change in trade policy, it is necessary to combine the partial effects displayed in Figure 1 with the other relevant variables for a specific countryyear, including the omitted country, PTA, and time indicator variables, a task that we do not undertake here.

The downward-sloping schedules in Figure 1 show that, *ceteris paribus*, higher unemployment is associated with a reduction in import penetration and hence increased protectionism. Consistent with our argument, this effect becomes stronger as the number of veto points declines. For example, in a stable democracy where the number of veto points is approximately one standard deviation below the mean for stable democracies (0.3) and the unemployment rate is 10 percent, the predicted change in external trade linkages is 10 percentage points lower than if the unemployment rate was 2 percent (a predicted reduction of 13 percentage points instead of 3 percentage points) and 7 percentage points lower than if the unemployment rate was a more realistic 5 percent (a predicted reduction of 13 percentage points instead of 6 percentage points). This relationship, however, is influenced by the number of veto points. 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 10 (7) percentage points to a decline of 2.1 (1.3) percentage points.

As expected, the estimate for the initial level of import penetration 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 preferential trade agreements are positively associated with changes in import penetration (although we do not present these parameter estimates to conserve space). Increases in the terms of trade, the availability of local capital, and the stock of reserves are each associated with rising import penetration. So, too, is a higher real exchange rate, although changes in this rate have little effect on openness. Finally, the year-specific and country-specific indicator variables are jointly significant. Note that the use of these fixed effects is a less restrictive means of capturing the impact of a time trend, national size, coastline, or distance from other countries, variables that, if entered independently, would impose linear or other functional restrictions on each of the effects.

Robustness Checks

Having generated some initial estimates of the model, it is important to assess the robustness of these results to alternate measures of the key variables, alternate approaches to modeling time series cross-section error structures, the use of changes in unemployment instead of levels, and potentially omitted independent variables. To conserve on space, the following tests rely on Henisz's measure of veto points, although it should be noted that the results rarely change much when Beck et al.'s measure is used instead.

First, we analyze a different measure of trade policy that was constructed by Hiscox and Kastner (2002). This measure involves using estimates of fixed country-year effects in a gravity model of trade flows to assess each state's trade policy in a given year.⁹ In Table 3, we replicate our initial results after replacing our original dependent variable with Hiscox and Kastner's measure. In interpreting these results, it is important to recognize that higher values of their measure indicate greater protectionism, whereas larger increases in import penetration indicate greater liberalization. As such, we expect the signs of the coefficient estimates in our model to be reversed when focusing on Hiscox and Kastner's measure, an expectation that is borne out by the results in Table 3. Indeed, the effects of unemployment and veto points in all countries and in stable democracies do not depend in any significant way on which measure of trade policy we analyze, even though there is a substantial reduction in the sample size (particularly among non-democracies) when Hiscox and Kastner's measure is used.¹⁰

Second, we assess whether our results depend on how stable democracies are defined and measured. Recall that we have coded a country as democratic if the value of *REGIME*—the 21-point Polity index that ranges from -10 to 10—for this country is 6 or higher for the past 5 consecutive years. To begin, we redefine stable democracies as those country-years where this index is greater than or equal to 7 for the past 5 consecutive years. These results, which are reported in Table 4 (models 1 and 2), are qualitatively similar to the base specifications in Table 2 (models 2 and 3). Next, we redefine stable democracies using the average of the Freedom House (2005) score for political rights and civil liberties. Following Freedom House's procedures, we code each state for which this average is less than 3 as

⁹ More specifically, they regressed the ratio of annual imports by country *i* from country *j* to *i*'s annual GDP on *j*'s annual GDP, *j*'s annual GDP, *j*'s annual GDP, *j* is annual GDP, *j* is annual GDP, *j* annual GDP, *j* is annual GDP, *j* a

¹⁰ Our results are also unchanged when we replace the percentage change in import penetration with the absolute change in import penetration or with the percentage or absolute change in overall trade openness (i.e., the sum of a country's imports and exports divided by its gross domestic product).

	(1)	(2)	(3)
N	375	299	76
# countries	38	30	11
R^2	0.37	0.37	0.78
Sample	All	Stable democracies	Other countries
Source of democracy data		Polity ≥ 6	Polity < 6
Level of Hiscox and Kastner Residual	-0.023	-0.027	-0.018
	0.000	0.000	0.000
Veto points	0.186	0.769	0.165
	0.099	0.025	0.028
Unemployment rate	0.008	0.033	0.005
	0.010	0.106	0.014
Veto points × unemployment rate	-0.038	-0.076	-0.028
	0.005	0.016	0.015
Real effective exchange rate	0.000	0.001	0.000
	0.671	0.155	0.542
Change in real effective exchange rate	-0.021	-0.164	0.005
	0.349	0.086	0.728
Change in terms of trade	-0.013	-0.077	-0.357
	0.960	0.839	0.259
Gross private capital formation/GDP	0.000	0.000	-0.001
	0.878	0.876	0.727
Gross international reserves/imports	-0.001	0.003	-0.191
	0.725	0.592	0.234

TABLE 3. Effects of Unemployment and Veto Points on the Hiscox and Kastner Measure of Trade Policy, 1980–2000

Notes: Entries are ordinary least-squares coefficient estimates above corresponding p-values, based on panel-corrected standard errors. Coefficient estimates for PTA, country, and year indicator variables are not reported to conserve space. The value of the Hiscox and Kastner measure is inversely correlated with the degree of trade openness.

a "free" country or stable democracy (models 3 and 4). We also analyze the entire sample of countries and enter an indicator variable for stable democracies using both the original (6 and greater) and modified (7 and greater) Polity thresholds as well as the Freedom House threshold (less than 3). Doing so yields no substantive changes in the results of theoretical interest (see Table 4, models 5–7). These results suggest that democracy's effect on changes in import penetration is conditional on the structure of a nation's political institutions and societal pressures.

Third, to address the possibility that our earlier results are driven by the endogeneity of our independent variables, we undertake two additional tests. To begin, we conduct a variant of the Granger causality test designed for panel data (Marvell and Moody 1996) to assess whether unemployment is endogenous. This might be the case if rising trade openness leads to a reallocation of capital and labor from those sectors that are relatively uncompetitive in international markets to sectors that are more competitive and if it takes time for individuals who lose jobs in uncompetitive sectors to become reabsorbed into the workforce.¹¹ The results indicate that we can reject the null hypothesis that unemployment does not Granger cause changes in import penetration (F[3,518] = 3.84, p = .01; $\chi^2[3] = 13.58$, p = .004). However, we are unable to reject the null hypothesis that changes in import penetration do not Granger cause unemployment (F[3,518] = 0.51, p = .68; $\chi^2[3] = 1.80$, p = .62). Consequently, there is no evidence that unemployment is endogenous.

¹¹ We are grateful to an anonymous reviewer for raising this point.

	(1)	(2)	(3)	(4)	(5)	(9)	(2)
N	570	161	571	160	731	731	731
# countries	40	28	43	25	58	58	58
R^2	0.37	0.88	0.36	0.88	0.72	0.72	0.72
Sample S	Stable democracies	Other countries	Stable democracies	Other countries	ЧI	IIV	All
Definition of democracy	$Polity \ge 7$	Polity < 7	Freedom House<3	Freedom House > 3	Polity ≥ 6	Polity ≥ 7	Freedom House
Level of import penetration	-0.010	-0.010	-0.008	-0.009	-0.007	-0.007	-0.007
c c	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Veto points	-0.320	-0.151	-0.280	-0.057	-0.143	-0.138	-0.121
4	0.000	0.173	0.001	0.655	0.011	0.014	0.036
Unemployment rate	-0.033	-0.001	-0.026	-0.005	-0.005	-0.005	-0.005
	0.001	0.797	0.008	0.153	0.082	0.087	0.083
Veto points × unemployment rate	0.045	0.005	0.039	0.007	0.012	0.012	0.012
	0.001	0.629	0.004	0.442	0.007	0.007	0.006
Real effective exchange rate	-0.001	0.000	0.000	0.000	0.000	0.000	0.000
	0.218	0.000	0.766	0.000	0.000	0.000	0.000
Change in real effective exchange rate	-0.119	-0.005	-0.134	-0.001	-0.029	-0.031	-0.032
	0.079	0.919	0.034	0.984	0.468	0.452	0.439
Change in terms of trade	0.620	0.933	0.525	1.349	0.702	0.715	0.733
	0.009	0.025	0.029	0.000	0.001	0.001	0.001
Gross private capital formation/GDP	0.001	0.003	0.001	-0.001	0.001	0.001	0.001
	0.034	0.287	0.015	0.810	0.015	0.013	0.013
Gross international reserves/imports	0.012	0.027	0.010	0.026	0.013	0.014	0.014
	0.001	0.002	0.005	0.001	0.000	0.000	0.000
Stable democracy—(0, 1)					0.033	0.010	-0.026
					0.123	0.659	0.335

204

Votes and Vetoes

To further address the possibility of endogeneity in the model, we implement the dynamic panel estimator of Arrelano and Bond (1991). Caselli, Esquivel, and Lefort (1996) argue that OLS estimators, such as the ones we use in our primary specification, are biased and inconsistent for two reasons. First, the country-specific effects—including any omitted variables—are necessarily correlated with the other independent variables. Second, the control variables are likely to be endogenous to some extent. Ignoring this relationship will lead to upwardly biased coefficient estimates because the endogenous variable, in reality, appears on the right-hand side of the estimating equation. Furthermore, the estimators will be inconsistent as the regressors are correlated with the error term.

A common practice in the literature is to use lagged variables as an instrument for potentially endogenous regressors in a three-stage least-squares regression. While this procedure addresses the endogeneity problem discussed above, it neglects the bias and inconsistency generated by the omitted variable or fixed effect. Nor does it take into account any time-specific shocks or time trends.

By contrast, Casseli et al. (1996) demonstrate that a generalized method of moments (GMM) estimator is consistent if three identifying assumptions are satisfied: (1) there is no second-order serial correlation, (2) "stock" variables in the model are predetermined at time t-2, and (3) "flow" variables are not predetermined at time t-2 but are predetermined at time t-1. The process involves first differencing the data to remove random effects and using lagged levels and differences of the dependent and strictly exogenous independent variables to construct a large instrument matrix. To calculate the GMM estimator, we follow the two-step process suggested by Arellano and Bond (1991). A first-step estimate is generated using the assumption of independently and identically distributed error terms. Consistent but inefficient (assuming heteroscedasticity) estimates of the error terms are computed and then used in a second-stage regression in which the assumption of homoskedasticity imposed in the first stage is relaxed.

Using the GMM two-step estimator, the Sargan test statistic fails to reject the null hypothesis that the overidentifying restrictions are valid, and we similarly fail to reject the null hypothesis that there is no second-order autocorrelation. In the full sample, the Sargan test statistic is weakly significant, suggesting potential heteroscedasticity. But once we divide the sample into stable democracies and other countries, the test statistic is not significant, providing an additional reason to focus our analysis on these two subsamples. As shown in Table 5, the results for stable democracies are largely unchanged, indicating that these results are quite robust. In the pooled sample and the subsample of non-democratic countries, there are some noticeable differences in the results. Nonetheless, consistent with our argument, we continue to find that the influence of unemployment on trade policy grows larger as the number of veto points declines in stable democracies, but that these factors have relatively little bearing on commercial policy in other regimes.

Fourth, our use of country-specific fixed effects implies that the identification of the coefficients of *UNEMPL* and *UNEMPL* × *POLCON* is driven by within-country changes in unemployment. Nonetheless, it is still possible that the structural rate of unemployment across countries varies substantively in our sample across time, and that we should therefore focus on either the change in unemployment or on both the level of and the change in unemployment. Models (1) and (2) of Table 6 present these results. After replacing the level of unemployment with the change in unemployment, we continue to find support for our hypotheses, as the estimate of $\Delta UNEMPL$ is negative, the coefficient estimate of $\Delta UNEMPL \times POLCON$ is positive, and both are statistically significant (see model 1). However, when we include both the level of unemployment and the change in unemployment, we find that the coefficient estimate of the former variable and its interaction with veto points remain significant, whereas that of the latter variable and its interaction with veto

	(1)	(2)	(3)
 N	661	550	111
# countries	53	42	21
Log likelihood	4.437.01	6.353.74	6.307.80
Sample	All	Stable democracies	Other countries
Level of import penetration	-0.007	-0.009	-0.015
1 1	0.001	0.000	0.015
Veto points	-0.189	-0.331	-0.021
1	0.082	0.000	0.912
Unemployment rate	-0.005	-0.034	0.001
1 /	0.318	0.000	0.875
Veto points × unemployment rate	0.012	0.048	-0.033
· · · ·	0.093	0.000	0.078
Real effective exchange rate	0.000	-0.001	0.000
-	0.000	0.244	0.000
Change in real effective exchange rate	-0.025	-0.153	0.056
	0.765	0.011	0.490
Change in terms of trade	0.798	0.648	1.047
5	0.004	0.000	0.031
Gross private capital formation/GDP	0.001	0.001	0.005
	0.141	0.125	0.806
Gross international reserves/imports	0.013	0.012	0.026
-	0.008	0.008	0.031
Sargan test of over-identifying restrictions	p = .072	p = .916	p = .999
H0: no 2nd order autocorrelation	p = .607	p = .153	p = .455

TABLE 5. Effects of Unemployment and Veto Points on Trade Policy, 1980–2000, Using a Dynamic Panel Estimator

Notes: Entries are ordinary least-squares coefficient estimates above corresponding *p*-values, derived using Arellano and Bond's (1991) dynamic panel estimator. Coefficient estimates for PTA, country, and year indicator variables are not reported to conserve space.

points are not significant.¹² As such, in a specification like ours that includes country-specific fixed effects, the change in unemployment provides no additional explanatory power in predicting trade policy beyond that furnished by the level of unemployment.

Finally, we examine a range of macroeconomic variables and country characteristics suggested by the literature as potential determinants of openness to ensure that they do not account for the observed effects of unemployment and veto points on trade policy. First, we use an alternate normalization for international reserves, the ratio of these reserves to GDP instead of imports. Second, we analyze five different measures of inflation: (1) as derived from the consumer price index (CPI), (2) as derived from the GDP deflator, (3) the logarithm of the CPI-derived measure, (4) the logarithm of the GDP deflator-derived measure, and (5) indicator variables for inflation levels in excess of 33 and 100 percent, respectively. High levels of inflation could signal an impending financial crisis, stimulating commercial reform (Krueger 1993; Rodrik 1996). Third, we analyze real GDP. Economically large states may have the ability to impose an optimal tariff and they are likely to produce

 $^{^{12}}$ We also explored the possibility that the effect of the level of unemployment on changes in import penetration could be nonlinear and found some evidence in support of this hypothesis. The magnitude of the change in the predicted value of the dependent variable generated by this nonlinearity, however, is relatively small. For example, at an unemployment rate of 5 percent for political constraint scores of 0.3 and 0.6, the predicted changes in import penetration using the linear specification are -6.4 and -1.3 percent, respectively. Using the nonlinear specification, the corresponding figures are -8.7 and -3.2 percent. Increasing the unemployment rate to 15 percent yields predicted changes in import penetration of -19.2 and -3.9 percent in the linear specification, and -22.1and -4.9 percent in the nonlinear specification.

	(I)	(2)	(3)	(4)	$(\tilde{2})$	(9)	(2)	(8)	(6)	(01)	(11)	(12)	(13)	(14)	$(\overline{15})$	(91)	(11)
Ν	558	558	587	585	587	585	587	587	587	587	581	557	581	557	538	555	549
# countries	43	43	44	44	44	44	44	44	44	44	44	43	44	43	41	43	42
R^2	0.40	0.41	0.37	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.40	0.40
Level of	-0.010 .	-0.010	-0.010.	- 00.00-	-0.009	- 600.0-	- 600.0-	-0.010 -	-0.010	-0.010	-0.010	-0.011	-0.010	-0.011	-0.009	-0.009	-0.010
import penetration	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Veto points	-0.081 -	-0.275	-0.258 .	-0.274 -	-0.261	-0.274 -	-0.254 -	-0.265 -	-0.246	-0.249	-0.245	-0.304	-0.244	-0.306	-0.251	-0.293	-0.268
4	0.124	0.000	0.000	0.001	0.001	0.000	0.001	0.000	0.001	0.001	0.001	0.000	0.001	0.000	0.001	0.000	0.000
Unemployment rate		-0.213	-0.022 .	-0.022	-0.021	-0.022 -	-0.021 -	-0.022 -	-0.022	-0.022	-0.021	-0.027	-0.021	-0.027	-0.024	-0.021	-0.023
		0.005	0.001	0.002	0.005	0.002	0.004	0.002	0.002	0.001	0.002	0.000	0.002	0.000	0.001	0.003	0.001
Veto points		0.032	0.033	0.033	0.033	0.034	0.032	0.034	0.032	0.031	0.032	0.040	0.032	0.040	0.037	0.033	0.034
× unemployment rate		0.002	0.000	0.001	0.002	0.001	0.001	0.001	0.001	0.002	0.001	0.000	0.001	0.000	0.000	0.001	0.000
Real effective	-0.001	-0.001	-0.001 .	-0.001	-0.001	-0.001 -	-0.001 -	-0.001 -	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001	-0.001
exchange rate	0.063	0.135	0.161	0.169	0.187	0.170	0.231	0.237	0.105	0.179	0.099	0.184	0.101	0.176	0.072	0.165	0.100
Change in real effective	-0.126 -	-0.132	-0.103 ·	- 0.099	-0.106	- 660.0-	-0.108 -	- 060.0-	-0.088	-0.096	-0.091	-0.119	-0.092	-0.117	-0.088	-0.107	-0.088
exchange rate	0.068	0.058	0.124	0.134	0.109	0.134	0.103	0.130	0.190	0.190	0.179	0.070	0.176	0.070	0.186	0.067	0.215
Change in terms of trade	0.729	0.762	0.653	0.624	0.624	0.624	0.622	0.629	0.684	0.649	0.697	0.755	0.712	0.733	0.700	0.702	0.628
	0.003	0.001	0.006	0.008	0.008	0.008	0.008	0.007	0.005	0.010	0.005	0.003	0.005	0.005	0.005	0.002	0.008
Gross private	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001
capital formation/GDP	0.060	0.063	0.030	0.023	0.027	0.023	0.029	0.034	0.043	0.025	0.099	0.007	0.106	0.004	0.090	0.009	0.011
Gross international	0.013	0.014		0.012	0.012	0.012	0.012	0.012	0.012	0.012	0.012	0.012	0.012	0.012	0.012	0.009	0.012
reserves/imports	0.001	0.000		0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.001	0.002	0.001	0.001	0.011	0.001
Rotated variables	-0.037 -	-0.018	0.200	0.000	0.000	0.002	0.025	0.029	0.000	0.000	0.000	0.000	0.001	-0.003	0.000	-0.002	-0.050
(see notes)	0.025	0.274	0.022	0.967	0.739	0.960	0.461	0.282	0.384	0.157	0.966	0.407	0.768	0.444	0.685	0.867	0.078
	0.046	0.019						0.038				0.090		0.080		0.001	-0.185
	0.041	0.402						0.331				0.623		0.669		0.961	0.366
																	0.002
																	0.938
Motos: Entries are ordinary leas	serenos-t	coefficien	t estimated	or above of	puousera	ulev- <i>h</i> nui	pesch se	-lanen no	corrected	etandard	errore	hefficient	ectimates	for DTA	Connerv	i near ju	ndicator
variables are not reported to c	onserve s	pace. In 1	model nui	mber (1),	we use th	ie change	in unemp	oloyment i	instead o	f the level	of unem	ployment	. In mode	el number	rs $(2)-(17)$), we rotal	e in the
following variables in the noted	model ni	umber: (2) change i:	n unempl	oyment ar	nd its inter	raction wit	th veto poi	ints; (3) g	ross inter	national r	eserves/G	DP (4) inf	lation, CP	I; (5) infla	ation, GDI	; (6) log
inflation, CPI; (7) log inflation inflows; (14) net FDI inflows a	and portf) inflation olio flows	i indicator i: (15) gov	variables; /ernment	: (9) real (hud <i>a</i> et h	(10); (10) alance: (1	real per o	capita GD	F; (11) g1 is lot or	oss FDI 1	ntiows; (1	2) gross F	,	s and poi	rttolio mfi	lows; (13) 	net FDI

WITOLD J. HENISZ AND EDWARD D. MANSFIELD

representation, or close list proportional representation.

domestic alternatives to many imported goods, thereby impeding trade liberalization. Fourth, we analyze real per capita GDP. Heightened economic development could enhance liberalization as a country increasingly trades in differentiated industrial products.¹³ Next, we address four measures of inward capital flows: (1) gross foreign direct investment (FDI), (2) gross FDI and portfolio investment, (3) net FDI, and (4) net FDI and portfolio investment. We also analyze the government budget balance. These are additional measures of financial stability that should promote trade liberalization. Finally, we consider the ideology of a country's chief executive and its type of electoral system, factors that some recent research has linked to trade policy (Milner and Judkins 2004).¹⁴

Models (3)–(17) of Table 6 report the results from these supplementary analyses for the subsample of stable democracies. The findings indicate that, with the exception of the alternate measure of gross international reserves, none of these variables is statistically significant. Nor does their introduction into the primary specification substantively alter the empirical support for our hypotheses. Taken as a whole, then, the tests described in this section offer considerable evidence that our results are quite robust.

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. This literature, however, has miscast certain aspects of the domestic determinants of trade policy. Whereas interest groups and political institutions 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 institutions through which interest group pressures are filtered.

Various studies have raised the possibility that the interaction between societal demands and institutions is central to shaping trade policy, but remarkably little empirical research has directly confronted this possibility (Mansfield and Busch 1995; Garrett and Lange 1996; Gilligan 1997; Milner 1997; Grossman and Helpman 2002). Our findings indicate that the effects of unemployment depend heavily on the number of veto points that constrain decision makers and whether a country is democratic or not. High unemployment leads to protectionist trade policies in stable democracies marked by few veto points. As expected, however, the magnitude of this relationship becomes attenuated as the number of veto points rises, making it more difficult to change the existing trade regime and increasing the heterogeneity of the points' interests. Equally, macroeconomic fluctuations have a much more pronounced influence on the trade regime in stable democracies than other countries, reflecting the need for democratic leaders to be more responsive to demands made by the general population than in other countries.

Our results also bear heavily on recent debates about the relationship between regime type and economic reform. Virtually all of the literature on this topic ignores the effects of institutional variations within both democracies and nondemocracies alike. Such variations, however, are crucial to explaining changes in trade policy, especially in democracies. Holding macroeconomic conditions constant, the trade regime changes less within democracies as the number of veto points increases. Furthermore, societal calls for protectionism precipitated by

¹³ In the same vein, we also excluded members of the Organization for Economic Cooperation and Development (OECD) from the sample and reestimated the model. The results were virtually unchanged.

¹⁴ Data on these variables are taken from Beck et al. (2001).

adverse macroeconomic conditions are increasingly likely to be met as the number of veto points declines. Equally, a thriving economy—marked by very low levels of unemployment—creates a substantial constituency for expanding commercial 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 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 import penetration 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 interest groups. When the economy is faltering, giving rise to calls for protection, a small number of veto points tends 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 of foreign economic policy that make unconditional comparisons between either domestic political concentration and fragmentation or democracy and autocracy (Haggard 1990; Wade 1990; Haggard and Kaufman 1995). Just as the effects of societal forces depend on domestic institutions, the effects of institutions are contingent on societal forces. Our findings also suggest that 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.

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