Who follows the leaders? Foreign economic policy diffusion 1978-2004

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Draft version, April 2007

Abstract

Foreign economic policy liberalization is marked by remarkable variation across countries. While there has been a general trend towards less restrictive trade and capital account regulations, important differences remain. We present a model of foreign economic policy making in which a country's specific liberalization costs interact with levels of foreign economic policy regulation in other countries. Specifically, by changing opportunity costs of restrictive policies, liberalization steps in other countries change the optimal level of foreign economic policy restrictiveness in a given country. However, changes to current account regulations do not occur automatically. Rather, they are conditioned by domestic costs of liberalization. Diffusion processes, therefore, do not necessarily result in policy convergence. We test the predictions of the model by drawing on a data set that covers policy measures in the area of trade and capital account regulation. The data cover 140 countries in the time from 1978 to 2004. Using an empirical model of conditional policy diffusion, we show that the data match the predictions of uneven patterns of liberalization.

Paper prepared for presentation at the Annual Meeting of the Midwest Political Science Association, Chicago, April 12-15, 2007

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1. Introduction

It is a truism to say that world economic openness has increased dramatically over the last three decades. The value and amount of goods and services traded between nations is unprecedented, and the volume of capital transactions across the border has reached a level that would have seemed unimaginable as little as 20 years ago. Although technological advances are seen by many as the main cause of the surge in global economic integration, a return of laissez-faire thinking, which has found its way into more liberal foreign economic politics, also partly accounts for this remarkable shift. Since the early 1980s governments around the world have opened their current and capital accounts, thus creating opportunities for their economies to integrate further into the emerging world economy.

The "rush to free trade" (Rodrik 1994) has invited some commentators to speculate about the "end of history" and the final victory of capitalism around the world (Fukuyama 1992), the harmonization of social, legal and political cultures through the process of "McDonaldization" (Ritzer 1993) and, more recently, a global convergence of productivity and growth that will ultimately result in a "flattening" of the global economy (Friedman 2005). Conversely, globalization skeptics rather expect that global economic integration, especially in the form preached through the "Washington consensus", had encouraged states to participate in a disastrous race to the bottom that increases inequality and destroys social safety nets (e.g. Stiglitz 2002). This article takes issue with both sides of this globalization pop literature and argues that conflicting expectations of increased regulatory competition and policy harmonization disregard a third possibility, namely that foreign economic liberalization is an uneven process. This alternative interpretation maintains that convergence is rather restricted to regional clubs of liberalizing states and that the spread of foreign economic policies has increased over time. In short, the process to which we still commonly and lazily refer to as "globalization" is less global than the label suggests.

We advance this alternative perspective through a simple model in which countries face different costs of opening up their economies and have to decide simultaneously about the level of regulation. The optimal economic integration policy that can be derived from this model reflects the optimal choices of competing countries, the costs of liberalization and the previous level of regulation. The model implies regulatory competition, convergence and increasing diversity as possible outcomes.

The empirical analysis of the yearly economic openness profiles of 140 states in the period from 1978 to 2004 confirms that the empirical record of either one of the popular globalization conjectures – regulatory competition or convergence – is rather weak. We show in this article that the trend towards more liberal trade and capital account policies has been anything but uniform. Important differences between countries remain, and have, in fact, increased during 1978 to 2004.

Our findings contribute to two strands of research: First, we add to the growing body of literature which emphasizes that globalization is not a destiny but rather the effect of political decisions. In an influential article, Basinger and Hallerberg (2004) have for instance argued that domestic costs prevent policy makers from participating in a "race to the bottom" in order to attract globally mobile capital. Our argument is similar to that of Basinger and Hallerberg in that it recognizes the importance of adjustment costs to global competition. We depart from their argument by emphasizing policy diffusion which is the second strand of research to which our paper is connected. "Diffusion" refers to a transfer of policies across borders. Simmons and Elkins (2004) have adopted this perspective to explain the spread of open market ideas and policies. They argue that both international competition and information gathered abroad have induced countries to liberalize their foreign economic policies. We re-examine this claim and provide an interstate model of policy diffusion which also allows states to form and join convergence clubs.

The remainder of this paper proceeds as follows: We first present a simple model of foreign economic liberalization and introduce the research design. The descriptive and inferential empirical evidence is presented in the fourth section. We summarize our main findings in the conclusion.

2. An Interstate Model of Foreign Economic Liberalization

Our form investigation is based on a two-country model in which two states make their level of economic openness dependent on the policy development in another states. We conceive of foreign economic liberalization as a process that urges states i and j to bear short-term costs in the expectation of long-term growth. In our perspective, world-wide openness O_t is a

good to which the individual states can contribute. Formally, O_t is the sum of nation-level openness so that

$$O_t = \sum_{i=1}^{n} o_{i,t} \qquad (1).$$

We assume that a change in the global level of openness alters the incentives to reform the foreign economic policy of a country. This means for instance that the opportunity costs of a restrictive policy grow with increasing economic integration in the rest of the world. More formally, our model assumes that the national contribution to global openness $o_{i,t}$ depends on the past openness $o_{i,t-1,}$ the own regulatory level $r_{i,t}$ and the level of liberalization $l_{j,t}$ of a reference state with which a country finds itself in a strategic interdependence in the domain of foreign economic policy making.

$$o_{i,t} = f(o_{i,t-1}, l_{i,t}, l_{j,t}) \text{ with } \frac{\partial o_{i,t}}{\partial o_{i,t-1}} > 0, \frac{\partial o_{i,t}}{\partial l_{i,t}} < 0, \frac{\partial o_{i,t}}{\partial l_{j,t}} > 0 \qquad (2)$$

Eq. (2) means that national openness is a positive autoregressive process. States that have contributed in the past have built a reputation for bearing the costs of economic openness and will thus continue to do so in the next period. By contrast, the national contribution to global openness diminishes with a higher level of regulatory integration into the global economy. This means that it becomes easier to integrate more. The international interdependence with reference country j, however, also suffers if it deals with a liberal state. International interactions create, in other words, a collective action problem of the form that it is profitable to be liberal, but to face another liberal state is harmful.

The liberalizing policy change that a country undertakes is denoted as δ_{it}. We assume that the costs of liberalizations grow in a linear fashion with the size of a reform. International norms that arise through the membership of a state in the World Trade Organization or the International Monetary Fund take the form of threshold value θ that a country cannot underbid in its eventual attempt to increase the level of protection. We thus include in our model the importance that states have to attribute to international organizations.

The costs of regulation depend on the openness and the adaptation costs of the political system, a factor that we assume to be given for each country.

$$c(o_{i,t}) = o_{i,t} \text{ and } c(\delta_{i,t}) = c_i\delta_{i,t} \text{ whereby } o_{i,t} = o_{i,t-1}(1-l_{i,t})(1+l_{j,t}) \;\; \forall i \neq j \qquad (3)$$

Assuming that both states move simultaneously, we can calculate the optimal level of openness. To this end, we assume that two conditions must hold. First, a country cannot underbid the international norm and, second, the states have to divide the global level of openness among themselves. This leads to the following Lagrangian for country 1 at time 1:

$$L := \frac{O}{2}(1-l_{i,0}-\delta_{i,1})(1+r_{j,0}+\delta_{j,1}) + c_i\delta_{i,1} + \lambda\left[O - o_i - o_j\right] + w\left[-\theta + l_i + \delta_{i,1}\right] \qquad (4)$$

Differentiating equation (4) according to $\delta_{i,1}$, λ and ω allows us to calculate the optimal policy change $\delta^*_{i,1}$.

$$\frac{\partial L}{\partial \delta_{i,1}} = -\frac{O}{2}(1+l_{j,0}+\delta_{j,1}) + c_i = 0 \qquad (5\text{-}1)$$

$$\frac{\partial L}{\partial \lambda} = O - o_i - o_j = 0 \qquad (5\text{-}2)$$

$$\frac{\partial L}{\partial \omega} = -\theta + l_{i,0} + \partial_{i,1} \geq 0\,. \qquad (5\text{-}3)$$

Since the second state faces exactly the same decision problem, the first order condition is symmetric. The optimal liberalization step for state 1 amounts thus to

$$\partial^*_{i,1} = \frac{2\left(c_j - c_i\right)}{O} + \left(l_{j,0} - l_{i,0}\right) + \partial_{2,1} \qquad (6).$$

This equilibrium condition yields a first insight. Under the unrealistic assumption that neither state affects the overall world openness given $l_{i,0} = l_{j,0}$, the difference in the production of additional liberalization depends only on the parameters of the cost functions. If the two states have identical cost functions, they equally share O and we remain in the situation of $t = 0$. If the cost functions differ, the country which has the lower marginal costs will open up, produce a larger amount of δ and take a minor share of O. Another plausible result of equation (6) can be derived if we drop the assumption of equal initial standards. In this situation, the more protectionist country has greater incentives to open up than its counterpart. This implies that we should observe converging foreign economic policies in the industrialized world.

The relationship between the production of additional liberalization for the two countries and different settings is documented in Table 1 from the perspective of the government in state 1. The first column reflects different legal situations and accordingly distinguishes three possible endowments *l* of the two states. In combination with corresponding configurations of the cost parameter *c* in the top row, there are nine possible situations.

	State 1 with higher c ($c_i > c_j$)	Equal costs ($c_i = c_j$)	State 1 with lower c ($c_i < c_j$)
State 1 with higher l ($l_{i,0} > l_{j,0}$)	$\delta_{i,1} < \delta_{j,2}$	$\delta_{i,1} < \delta_{j,2}$	Indeterminate
Equal standard ($l_{i,0} = l_{20}$)	$\delta_{i,1} < \delta_{j,2}$	$\delta_{i,1} = \delta_{j,2}$	$\delta_{i,1} > \delta_{j,2}$
State 1 with lower s ($l_{1,0} < l_{2,0}$)	Indeterminate	$\delta_{i,1} > \delta_{j,2}$	$\delta_{i,1} > \delta_{j,2}$

Table 1: Foreign economic liberalization as a function of current legislation and the costs of reform in a two-country world

The entries in Table 1 are to be interpreted in the following way: The configuration $\delta_{11} < \delta_{12}$ in the second column and the second row indicates that if state 1 is initially more protectionist and faces higher marginal costs in liberalizing, then state two will, relatively speaking, opt for a more liberal course of action.

Extension of the basic model: This basic model can easily be extended to a situation where n states seek to avoid high costs of opening up. The only element that needs to be modified for that purpose is the expression for *o* in (2). In the n-actor case, we require

$$o_{i,t} = o_{i,t-1}\left(1 - l_{i,t}\right)\frac{1}{n-1}\prod_{i \neq j}\left(1 + l_{j,t}\right) \tag{7}$$

The equilibrium condition then becomes:

$$l_i = \frac{n}{O}\frac{1}{n-1}\frac{\sum c_j - c_i}{\sum l_j} + \frac{\prod l_j}{\sum l_j} \quad \text{with } l_i = l_{i0} + \delta_{i1} \text{ and } l_j = l_{j0} + \delta_{j1} \tag{8}$$

In a three-country-world, the optimal amount of foreign economic liberalization can be obtained from equation (8) after some rearrangements:

$$l_1 = \frac{3}{O}\frac{c_2 + c_3 - c_1}{l_2 + l_3} + \frac{l_2 l_3 - 1}{1 + l_2 + 1 + l_3} \tag{9}$$

This extension shows that the relationship between the production of additional liberalization and the costs functions of the different countries remains basically the same as in a situation with two states. Lower marginal costs will accordingly allow a government to introduce more drastic policy changes. The relationship between the different state's production of liberalization, conversely, is more involved. Yet, it becomes clear that protectionist states can faster catch up with a liberalizing trend if the other states are already relatively open.

For the rest of our formal analysis, we drop the assumption of a constant world economic openness over time. What we keep is that initially at $t = 0$ O is exogenous to the model. In the case of two countries, we have moreover $o_{1t} + o_{2t} = O_t \ \forall t$. As we already noted earlier, contributions of global openness are highly correlated over time. Therefore, we require that O_t depends on O_{t-1}. Further, the degree of liberalization will influence the world openness. We argue that the most protectionist state is determinant for O_t. In general, the functional form looks as follows

$$O_t = f\left(O_{t-1}, \min\left\{L_{it}, L_{jt}\right\}\right) \quad \text{with} \quad \frac{\partial O_t}{\partial O_{t-1}} > 0 \quad \frac{\partial O_t}{\partial \min\left\{L_{it}, L_{jt}\right\}} < 0, \tag{10}$$

what we specify with

$$O_t = \phi\, O_{t-1}\left(\min\left\{L_{it}, L_{jt}\right\}\right)^{\eta} \tag{11}$$

where $\phi > 0$ is a parameter for autocorrelation and $\eta < 0$ can be interpreted as the "elasticity of demand" for openness. Altering l_i allows a state i to affect the share of O_t it has to take, given that state 2 does not change its regime. Whether a new level of s_i influences the magnitude of O_t depends on the level of l_{it-1} relative to l_{jt-1}. Only when the condition $l_{it-1} = \min\{l_{it-1}, l_{jt-1}\}$ holds, does a new level of l_{it} have an impact on O_t.

We further assume quite realistically that each country knows the most protectionist state at time t-1. This changes the decision problem of the two states. Suppose that state 1 is more restrictive than state 2 at time t-1. The optimal strategy of state 1 heavily depends upon its expectations about the decision of state 2. State 1 has to consider three possible situations. First, state 2 does not alter its standard. Second, state 2 raises l_{jt} such that $l_{jt} \leq l_{it-1,}$ and, third, state 2 raises its standard such that $l_{jt} > l_{it-1}$. In the first two situations, state 1 cannot influence O_t by raising its standard. Thus O_t is to be considered as a constant and state 1 faces the same decision problem as in the basic model. The more interesting case is the third situation. The positive aspect for state 1 in this configuration is that without doing anything, O_t will become smaller. But a reversed effect might be equally likely. If state 2 passes the state 1´s level of liberalization of state 1, the latter has to bear a larger share of O_t.

If we consider n states instead of only two, the decision problem becomes even more complex. Since we argued that O_t depends on {min l_{it}} the most liberal country at time t-1 can always influence O_t by the production of additional restriction. For all other countries the possibility to affect O_t is contingent on the decisions of the states with a more protectionist regime at time t-1. Hence, the analysis shows that the forces driving world towards a common liberalizing course or into competing unilateral policies are intertwined in subtle ways.

To sum up, the model suggests that harmonizing foreign economic policies are not necessarily doomed to failure because of the tradeoff between individual and collective interests. On the contrary, if a deteriorating economic situation leads constituents to call liberalization, states are inclined to coordinate their policies implicitly or explicitly. We should thus observe at least a delayed convergence in the way in which the states reacted to the economic problems that were affecting the world economy in the early 1980s. We can, however, also not exclude the possibility that this harmonization is restricted to a subset of the nation states as the initial costs for highly protectionist countries to radically break with the past might be prohibitively high. The model clearly shows that the political dynamics of foreign economic liberalization are much more subtle than the globalization literature implies.

3. Uneven globalization

3.1 Data

Our empirical analysis is based on a data set of foreign economic policies in 140 countries that covers the years 1978 to 2004. The data allow to distinguish between different dimensions of foreign economic policy making; in this paper, we focus on policies that regulate cross-border trade in goods and services. With a total of 2880 observations for the trade dimension, the average number of countries covered per year is around 107.

Data are drawn from the IMF's annual publication "Report on Exchange Arrangement and Exchange Restrictions" (International Monetary Fund 1978-2005). These reports contain detailed information on a variety of aspects of foreign economic policies, including non-tariff trade barriers such as quota regulation and voluntary exports restraints. Unfortunately, the IMF issues its reports only as hard copies. Furthermore, it was only in 1996 that the first report adhered to a standardized form that covered all countries in the same way. Despite these drawbacks, the IMF data contain a wealth of information that was coded into a data set with 51 variables. Some of these variables were used to create a measure of trade restrictions that runs from 0 (most liberal) to 7 (most restrictive) and has eight unique values.[1]

3.2 Visual inspection

Figure 1 shows the global trend in trade policy making for all countries covered by the data. The solid line represents yearly arithmetic means for trade restrictiveness; the dashed lined (right axis) stands for the standard deviation of trade restrictiveness. As is obvious, while average restrictiveness has declined over the time under observation, policies globally have *not* become more alike but, on the contrary, more diverse. Thus, already from this simple picture, we conclude that convergence claims are – to date – unwarranted. Clearly, some countries have liberalized their foreign trade relations, while other countries have not. Hence, functionalist arguments that attribute foreign economic liberalization processes solely to world levels of trade restrictiveness and the opportunities created by liberalization abroad tell not the whole story, to say the least. Rather, we need to distinguish between different

[1] For a more detailed description of the data see Martin (2007). The data set can be downloaded at http://www.polsci.org/martin/data

countries and the costs and opportunities they face in the wake of a world economy that, on average, has become more liberal.

<<Figure 1>>

By considering OECD countries, developing countries, and transition countries separately, Figures 2 and 3 take a first cut at such a more differentiated approach. Figure 2 shows the yearly arithmetic means of trade policy restrictiveness in OECD countries, developing countries, and transition economies, respectively, for the years 1978-2004. On average, countries in all three groups liberalized their trade regimes. However, liberalization was much more pronounced in OECD economies than in developing countries. In 1978, mean trade restrictiveness in OECD countries stood at 5.21, while it was 5.74 in developing countries. In 2004, these figures were 2.39 for OECD countries and 4.54 for developing countries. The gap in trade regulation between these two groups of countries has increased fourfold between 1978 and 2004. The average OECD economy has liberalized its foreign trade relations much more than the average developing country, despite the observed "rush to free trade" of poorer countries.

<<Figure 2>>

Even more remarkable are observations that can be drawn from figure 3 which shows yearly standard deviations of trade regulation across the three groups of countries. Only in the "OECD world" have countries become more alike in their foreign trade relations. In both developing countries and transition economies, differences in trade policy making have increased.

<<Figure 3>>

To sum up, three preliminary observations can be drawn from the visual inspection of the data: First, the period from 1978 to 2004 was marked by a decrease of average levels of trade restrictiveness. In this sense, globalization took place, indeed. Second, and more importantly, we were witnessing processes of *uneven* globalization during which some countries liberalized their trade relations while others did not. Third, convergence of trade policies, defined as a decrease in the standard deviation of trade policy measures, took place only in sub-groups of countries. Taking these three observations together, we can conclude that claims of ever increasing levels of integration are empirically unfounded. Theoretically, they

are unwarranted because of their functionalist nature that precludes political economy considerations of governments' incentives and restrictions. The next section, therefore, takes a closer look at interactions between country specific costs and world integration levels.

4. Analysis

We use a regression model in which trade policy restrictiveness is the dependent variable in order to capture the idea that trade policy making depends on domestic costs on the one hand, and incentives that are determined by global openness on the other hand. Recall that our model predicts different reactions to changing foreign economic circumstances depending on the domestic costs of liberalization a policy maker is facing. The appropriate empirical model, therefore, includes an interaction effect that conditions the effects of world openness on domestic costs.

Unfortunately, it is not easy to measure "domestic costs". Cost considerations for an opportunistic government could be manifold, including resistance from special interest groups and subgroups of the populace against a change in foreign economic policy making. Regardless of whether the underlying model of distributional effects predicts winners and losers from trade liberalization across industries or across factors of production, the task of gauging such costs are formidable. We, therefore, opted to employ a simpler model of the governmental cost function. This model relies on institutional factors to distinguish between different cost levels under changing levels of openness in the world economy. We assume that costs of foreign economic liberalization varies across levels of democracy, and include a measure of democracy in our empirical analysis.

The reason for this is straightforward: Democratically elected governments rely on larger proportions of the population to remain in power than do their non-democratic counterparts. Therefore, in a democracy, governments face higher incentives to adopt welfare improving measures. The incentives for trade liberalization created by a more liberal global economic environment should therefore overcome domestic resistance against liberalization more easily than in an autocracy. Assuming a difference between democracies and autocracies with respect to foreign economic relations is in line with a number of findings in the literature (Mansfield/Milner/Rosendorff 2000; Milner/Kubota 2005; Martin 2005) that

contribute the move to more open trade regimes (among other factors) to changes in levels of democracy.

Our empirical model thus includes a multiplicative interaction term between the levels of democracy in a country and average foreign trade restrictiveness. It is hypothesized that varying levels of restrictiveness abroad exert a varying influence on the country under observation, depending on its level of democracy. For democracies, the liberalizing effect of a more open global environment should be more pronounced than for non-democracies.

Data on levels of democracy are based on the variable "polity 2" of the Polity IV data set in its most recent version (Marshall/Jaggers/Gurr 2007). The variable was recoded to a range from 0 (most autocratic) to 20 (most democratic). World levels of trade restrictiveness are averages of trade policy restrictiveness from the point of view of a home country. Assume a ten-country world with 9 countries employing restrictive policies that receive a "7" on our trade policy variable, and one country that has more liberal policies, say "3". From the point of view of the liberal country, world trade restrictiveness is 7, from the perspective of any of the other countries, world restrictiveness is about 6.5. Thus, in line with our model, more protectionist states are facing a less restrictive policy environment than more liberally regulated stated. This variable is lagged by one period to capture the idea that states react to changing policy conditions. Additionally, in model 3, (table 2 below), a variable enters the regression that measures trade restrictiveness in the first observation period to control for initial levels of regulation. Model 4 includes a dummy variable that captures whether a country is a member to the IMF under Article VIII or under the less restraining provisions of Article XIV of the IMF statute. Article VIII puts forward a number of obligations that compel states to adopt open market policies, while Article XIV allows states to use more restrictive policies. This variable is a proxy for the degree to which countries adhere to international standards, thus measuring the influence of norms on an international level.

We include a number of other controls in the regression model: per capita GDP in current international dollars, adjusted for purchasing power parities, GDP measured the same way, inflation, and general government consumption as percentage of GDP. GDP per capita and GDP enter the regression in their logged form, inflation and government consumption are lagged by one year. All data are taken from the World Bank's World Development Indicators 2005.

As estimation method, we employ a Prais-Winsten regression with panel corrected standard errors and an AR1 error correction process.[2] Table 2 shows the results.

	Model 1	**Model 2**	**Model 3**	**Model 4**
Trade restrictiveness t0			0.504*** (7.62)	0.489*** (7.57)
Average trade restrictiveness (lag1)	0.777*** (8.62)	0.371*** (3.07)	0.339*** (2.79)	0.240** (1.97)
Democracy	-0.005 (-0.94)	-0.163*** (-4.60)	-0.166*** (-4.53)	-0.173*** (-4.72)
Average trade restrictiveness (lag1) X Democracy		0.031*** (4.46)	0.031*** (4.34)	0.032*** (4.58)
Per capita GDP (log)	-0.677*** (-11.08)	-0.670*** (-12.12)	-0.406*** (-5.35)	-0.356*** (-4.75)
GDP (log)	0.184*** (4.23)	0.187*** (4.40)	0.108** (2.53)	0.104** (2.47 =
Inflation (lag1)	-0.00002 (-1.03)	-0.00001 (-1.02)	-0.00002 (-1.09)	-0.00002 (-1.09)
Government consumption (lag1)	0.002 (0.32)	0.002 (0.40)	0.005 (1.01)	0.006 (1.07)
Article VIII				-0.332*** (-4.86)
Constant	2.03** (2.14)	4.014*** (3.88)	1.175788 (1.13)	1.641 (1.56)
Nobs	2099	2099	2099	2099
Countries	120[3]	120	120	120
Years	1979-2003	1979-2003	1979-2003	1979-2003
R2	0.5186	0.5260	0.5443	0.5503
Wald Chi2	265.64***	305.46***	520.25***	694.23***
Dependent variable is trade restrictiveness. Prais-Winsten regression with panel corrected standard errors and AR1-process. z-values in parentheses. *** significant at p<0.01; ** significant at p<0.05				

Table 2: Regression results for determinants of trade restrictiveness

In model 1, our measure of world integration levels enters the regression with the correct sign and highly significant. A more restrictive global environment induces the focal country to adopt more restrictive policies. In that sense, there appears to exist a diffusion effect by which policies abroad impact on domestic policies. Interestingly, the democracy variable without an interaction effect is not significant: different levels of democracy, in this specification, do not seem to impact on trade policies. Both GDP per capita and GDP appear

[2] Alternative specifications, including fixed effect models do not change the results substantially.

[3] For a list of the countries included in the estimates, see the appendix.

with the expected sign and at significant levels: richer countries employ less restrictive trade policies, while larger countries are more restrictive. The two other controls are estimated at insignificant levels.

Turning to model 2, we observe a highly significant impact of the variables that make up the interaction effect and the interaction effect itself. Figure 4 graphically represents the joint effect of the three variables graphically. As can be seen, in a liberal global environment, democratic countries reduce their trade policy restrictiveness to a much higher degree than non-democratic countries. We attribute this to the different cost-benefit-ratio of democratic governments as opposed to their non-democratic counterparts. Democratic governments face higher incentives to open their trade regimes if trade policy conditions in other countries are liberal. This finding could also explain why democracy did not exert a significant influence in model 1: Given the time span from 1979 to 2003 and the general trend towards more liberal policies, global trade policy levels may initially simply not have been liberal enough to compel democratic governments to open their current accounts. Of course, this does not answer the question why any state moved to more liberal policies in the first place. But it sheds some light on the debate whether democracies unconditionally liberalize their foreign trade relations. In our view, democracy is neither a sufficient nor a necessary condition for trade liberalization. But due to the different costs of liberalizing foreign economic policies, governments in democracies follow the lead of trade liberalizations abroad more readily than non-democratic governments.

Model 3 includes a variable that captures initial levels of trade policy restrictiveness. This variable exerts a positive and significant influence on trade policy making. Countries that started out at low levels of trade restrictiveness will continue to follow a liberal trade policy, while countries that were more restrictive initially tend to continue their restrictive practices. In model 4, the variable that captures IMF membership under Article VIII of the Agreement is estimated significantly and with a negative sign. Countries willing to sign Article VIII indeed adhere to the norms put forward in this article, i.e. they follow more liberal trade policies than countries that are members under the provisions of Article XIV.

Summing up these findings, we can see that global levels of trade policy restrictiveness interact with domestic conditions in determining a country's trade policies. Countries with

initially high levels of restrictiveness tend to follow these restrictive policies, while international norms exert a liberalizing influence.

5. Conclusion

This paper has argued that "globalization", so far, has been anything but a truly global process. While, on average, trade policies today are more liberal than they used to be almost 30 years ago, important differences between countries remain, and are, in fact, today more pronounced than at the beginning of our observation period. Instead of becoming more alike in their foreign economic policy making, the variance in policies have increased. "Convergence" of trade policies can only be observed in sub-groups of the sample, most clearly in the rich, democratic countries of the OECD world.

We have attributed this finding to the interaction between domestic costs of trade policy liberalization and incentives to liberalize from global trade policy conditions. In a liberal trade policy environment, opportunity costs of closure are higher than if restrictive conditions prevail. This, however, is only part of the story. Costs and incentives systematically interact to create patterns of uneven globalization.

We have tested this assertion by empirically analyzing trade policy making in 120 countries from 1979 to 2003. To capture varying costs of trade policy liberalization across countries, we have employed "democracy" as a proxy for the domestic costs governments are facing. The results show that democracies react more readily to the incentives created by a liberal global trade policy environment. To the extent that democracy adequately captures domestic costs, the hypothesis derived from our model is not rejected.

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Figures

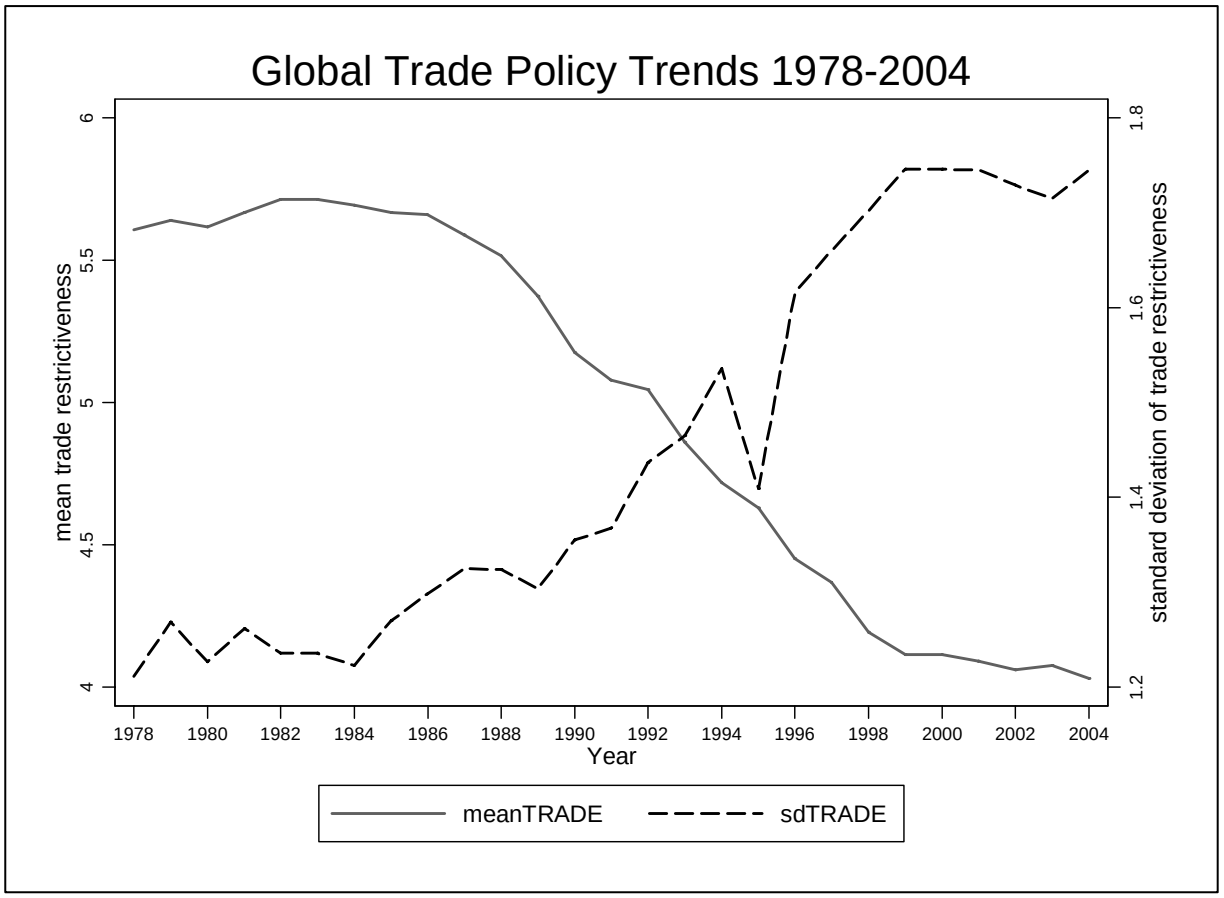

Figure 1: Yearly arithmetic means (solid, left axis) and standard deviations (dashed, right axis) of trade policy restrictiveness. Note the different scales on the Y and R axis.

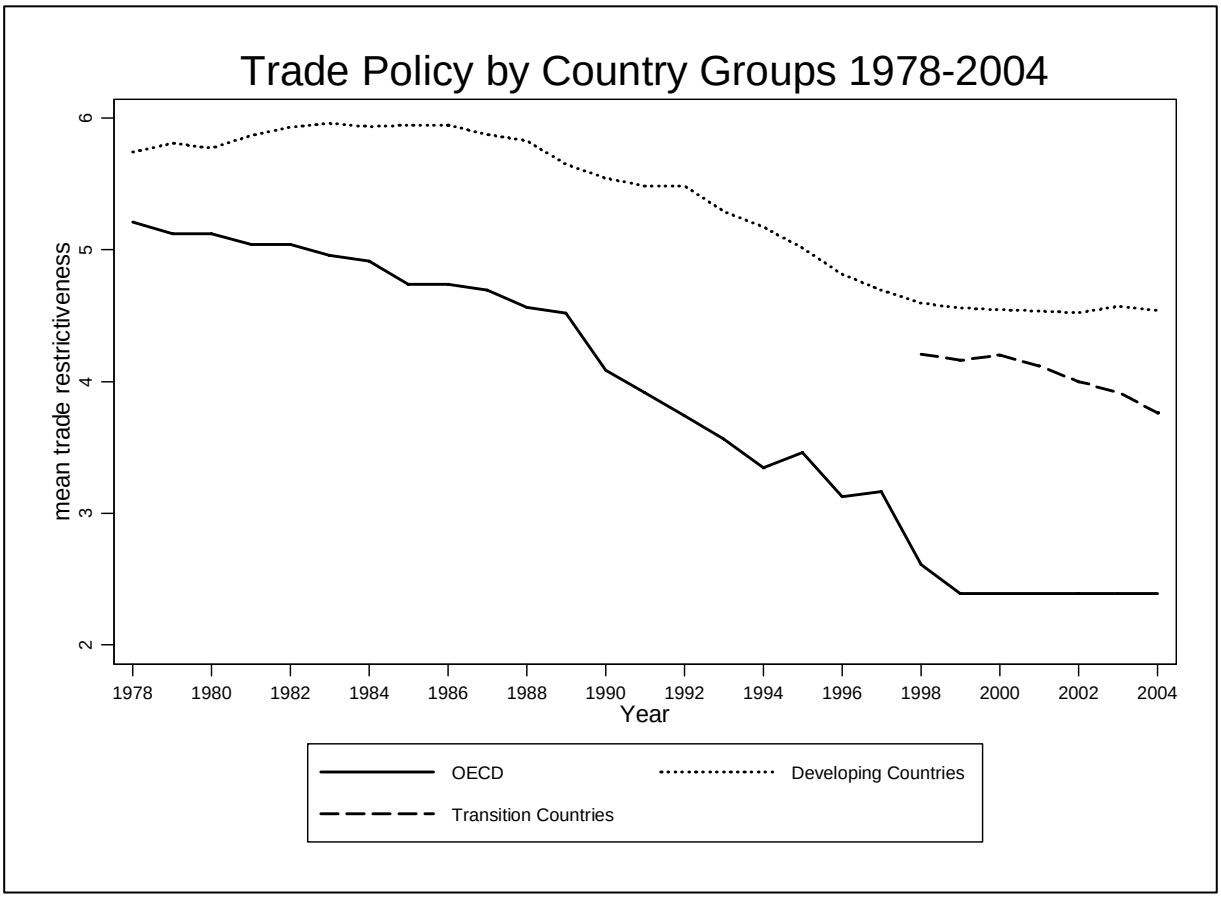

Figure 2: Yearly arithmetic means of trade policy restrictiveness for OECD countries (solid), developing countries (dot), and transition countries (dash)

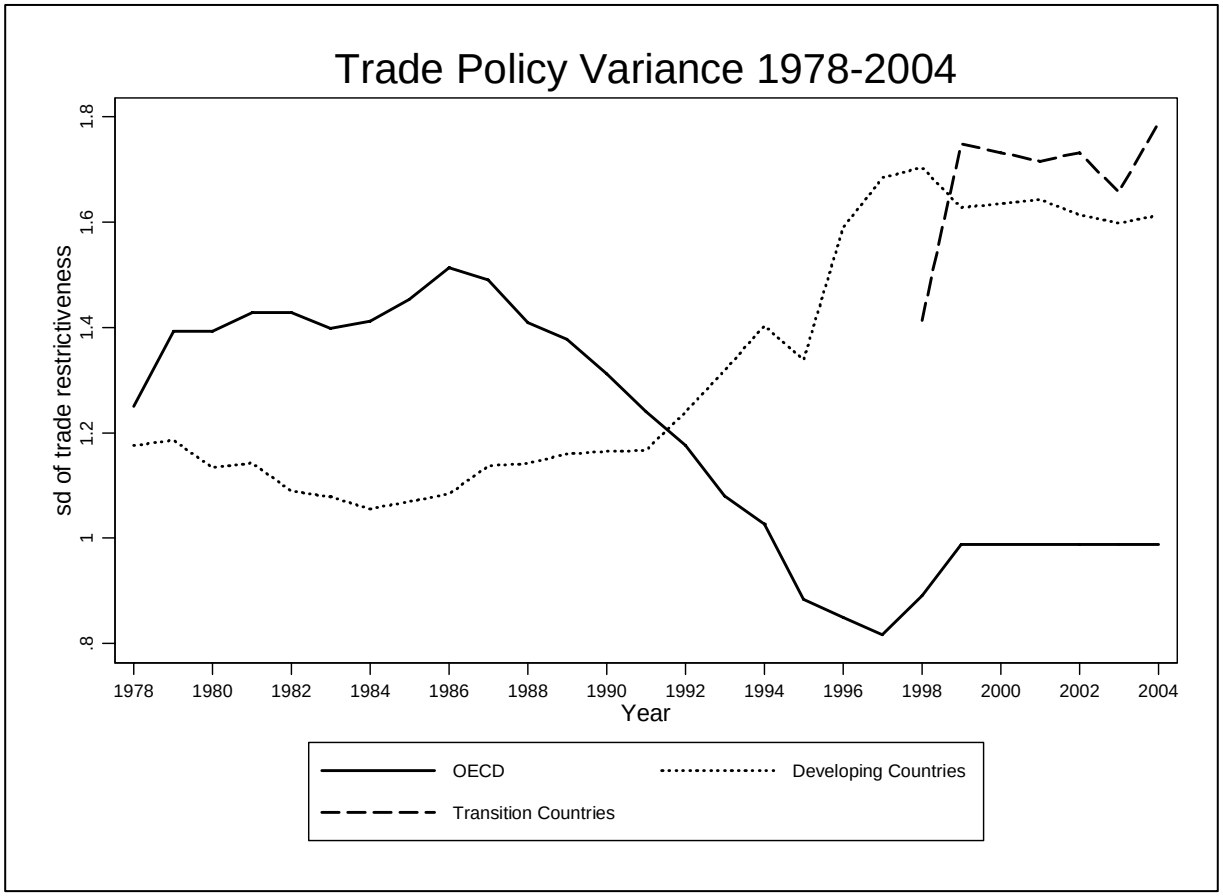

Figure 3: Yearly standard deviations of trade policy restrictiveness for OECD countries (solid), developing countries (dot), and transition countries (dash)

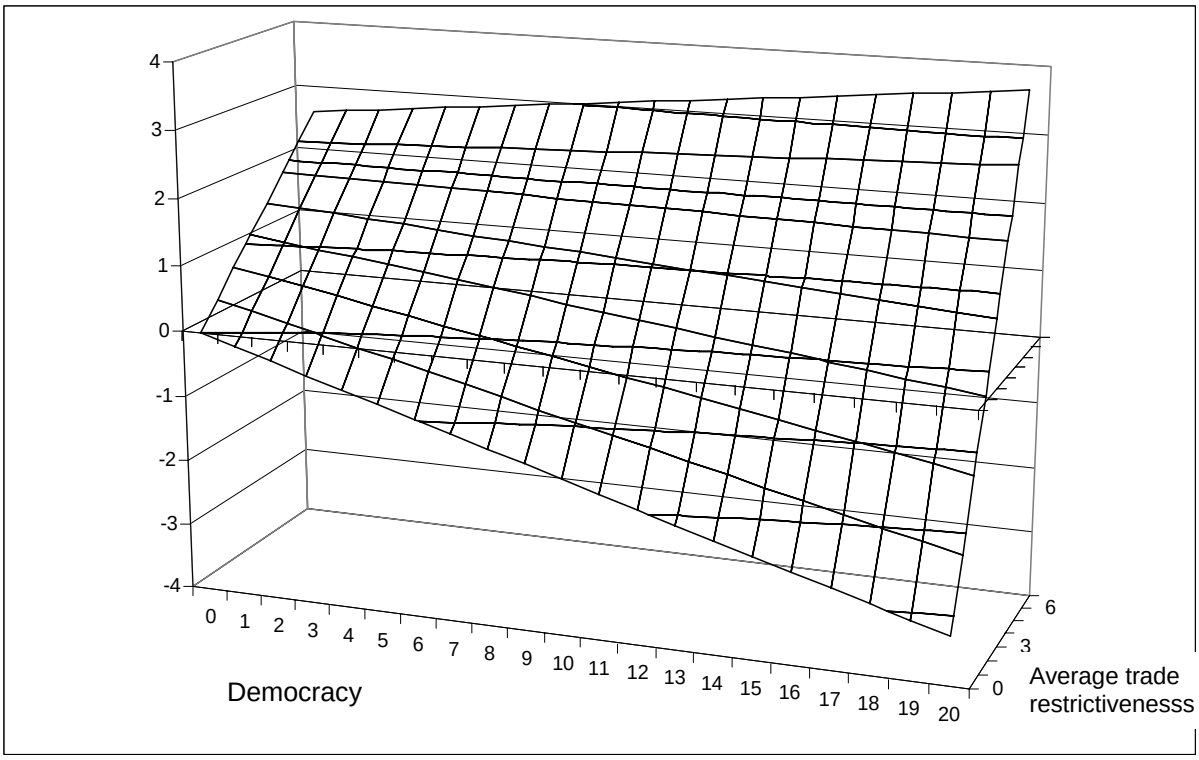

Figure 4: Graphical representation of interaction effect

Appendix: List of countries included in models 1-4

ALBANIA
ALGERIA
ANGOLA
ARGENTINA
ARMENIA
AUSTRALIA
AUSTRIA
AZERBAIDJAN
BANGLADESH
BELARUS
BELGIUM
BENIN
BOLIVIA
BOTSWANA
BRAZIL
BULGARIA
BURKINA_FASO
BURUNDI
CAMEROON
CANADA
CENTRAL_AFRICAN_REPUBLIC
CHAD
CHILE
CHINA
COLOMBIA
CONGO, DEMOCRATIC REPUBLIC
CONGO, REPUBLIC
COSTA RICA
CROATIA
CZECH REP
DENMARK
DOMINICAN REPUBLIC
ECUADOR
EGYPT
EL SALVADOR
ESTONIA
FINLAND
FRANCE
GABON
GAMBIA,THE
GEORGIA
GHANA
GREECE
GUATEMALA
GUINEA-BISSAU
HAITI
HONDURAS
HUNGARY
INDIA
INDONESIA
IRAN
IRELAND
ITALY
JAMAICA
JAPAN
JORDAN
KENYA
KOREA
KYRGYSTAN
LAO,PDR
LATVIA
LESOTHO
LITHUANIA
MACEDONIA
MADAGASCAR
MALAWI
MALAYSIA
MALI
MAURITANIA
MAURITIUS
MEXICO
MOLDAVIA
MONGOLIA
MOROCCO
MOZAMBIQUE
NAMIBIA
NEPAL
NETHERLANDS
NEW ZEALAND
NICARAGUA
NIGER
NIGERIA
NORWAY
OMAN
PAKISTAN
PANAMA
PAPUA_NEW_GUINEA
PARAGUAY
PERU
PHILIPPINES
POLAND
PORTUGAL
ROMANIA
RWANDA
SAUDI_ARABIA
SENEGAL
SIERRA_LEONE
SLOVAKIA
SLOVENIA
SOUTH_AFRICA
SPAIN
SRI_LANKA
SUDAN
SWEDEN
SWITZERLAND
SYRIAN_ARAB_REP
TANZANIA
THAILAND
TOGO
TRINIDAD_AND_TOBAGO
TUNISIA
TURKEY
UGANDA
UKRAINE
UNITED KINGDOM
UNITED STATES
URUGUAY
VENEZUELA
ZAMBIA
ZIMBABWE