

Chapter 2

Institutions and Trade Policy: A Review

Abstract This analysis examines the impact of institutions on a particular trade policy instrument, i.e. anti-dumping. In doing so, it draws on a body of existing research both from political science and economics. This chapter provides an account of the relevant literature. It explains how the different lines of research interact to establish the theoretical and methodological background, points out remaining gaps in the literature and suggests how this analysis can contribute to address them.

It should be noted that this chapter does not provide a thematic account of the dependent variable, i.e. AD.¹ Instead it starts from a broader perspective and reviews trade policy research. The reason is that trade policy research in general provides the theoretical background against which AD can be analysed. In a way, AD can be considered a subtopic that is of course part of a wider context and to start with trade policy research in general helps put it into perspective. At the same time, the basic insights that can be derived from studying AD hold wider implications for trade policy research in general. In addition, research that addresses the direct link between institutions and AD with a cross-country focus remains scarce.² However, the chapter does include research on AD where it is relevant and informative from a theoretical point of view, particularly in the final section. The chapter starts with a brief account of research examining how institutions, notably democratic rule, affect trade policy. This includes two perspectives: (1) Work from comparative political economy that focuses on countries as the unit of analysis and examines whether democratic rule leads countries to be more or less protectionist.

¹ There is an extensive literature on AD, its history and development. For a comprehensive review see for instance Nelson (2006) or Bloningen and Prusa (2003). Relevant characteristics of AD as well stylised facts will also be addressed in Chaps. 3 and 4 when focusing on the application of theoretical arguments to AD.

² This has several obvious reasons: first, AD had only been used by a small group of countries for a long time, which obviously limited possibilities for cross-country analysis. This only changed relatively recently with AD use spreading and data on use being made available as a consequence. Second, scholars who study institutions and those who study AD often come from different disciplines, hence the development of separate literatures and the lack of connection between institutions, notably democratic rule, as an independent and AD as the dependent variable.

(2) Research from an international relations perspective, which concentrates on interaction between nations and typically conceptualises trade as a problem of cooperation, commitment and/or an issue of conflict among nations. Following this approach, institutions matter because they shape countries' willingness and ability to commit, cooperate or cheat and thereby affect whether trade between countries flourishes or triggers frictions.

The third section introduces a different perspective that can be used to analyse trade policy in general and AD in particular. It conceptualises the imposition of trade barriers as the result of interactions between players. The section presents an emerging body of research that develops this strategic perspective on trade issues to better conceptualise countries' actions and reactions and explains how this view can advance existing research on trade policy and AD in particular.

Before starting with the literature review, a very brief introductory note on AD duties as a specific trade policy instrument is in order (for a more extensive review also see Hoekman and Kostecki 2001; Lindsey and Ikenson 2003; Prusa 2005; Nelson 2006; WTO 2009). This also helps to understand how the different lines of research described above connect to inform this work, and why AD measures offer a particularly interesting option to bring them together.

Technically, AD measures are duties imposed on foreign imports. What distinguishes them from ordinary tariffs is that they are not subject to the most-favoured nation principle that usually prevents WTO members from discriminating against fellow trading partners via differences in tariffs. The fact that AD duties can be levied on specific imports from specific trading partners already suggests that the interaction between trading partners can be very important in this context. It is mostly research from international relations (IR) and the strategic perspective that can help create a better understanding of this component.

AD duties should only be used to counteract dumping, i.e. selling a product cheaper than the price typically charged domestically (Hoekman and Kostecki 2001; WTO 2009).³ This is why it is often referred to as "contingent protection". However, research also suggests that it is frequently used to protect domestic industries from foreign competition and rather used for "ordinary" protection than for keeping trade "fair" (Prusa 2005). Here, the comparative political economy literature as well as research focusing on compliance and commitment, both matter for the assessment of anti-dumping.

AD cases typically start with a request by domestic industries. Domestic AD authorities then determine whether there is evidence of dumping by foreign exporters and whether this causes significant injury to domestic producers (or threatens to do so). Both elements are required in order to impose duties. The

³ The respective legal definition refers to dumping as "(...) a product is to be considered as being dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country." See the Agreement on the implementation of Art.6 of the General Agreement on Tariffs and Trade 1994. Available at http://www.wto.org/english/docs_e/legal_e/19-adp_01_e.htm

investigation process, the data collection, and the assessment involved are typically done by bureaucrats. Therefore in addition to being “contingent protection” it is also “administered protection”.

AD investigations can be fairly technical; involve the gathering of data on prices at home and abroad, possibly production costs, estimations of price differences and an assessment of whether and to what extent practices by foreign exporters cause injury to domestic producers. Precisely because of the technicalities involved there is also some room for judgement. International rules, notably GATT Art.6 and the Anti-Dumping Agreement, do provide a framework and rules for conducting the assessment but at the same time leave room for interpretation.

In any case, the duties that are imposed are typically highly targeted measures, i.e. for particular products from particular countries as suggested by domestic petitioners. They can have strong redistributive effects—both at the domestic level and between countries—and they cause frictions between trading partners. This makes them an issue for both comparative political economy as well as IR research. While the former mostly focuses on domestic determinants, IR focuses on the interaction aspects. Essentially, both are needed to explain AD as an empirical phenomenon. The following sections elaborate on the different lines of research that help inform this study about AD and how they can be integrated for this particular purpose.

2.1 Institutions Shape Countries' Trade Policies

The question how political rules, economic policies and particularly trade liberalization interact is a longstanding issue. Eichengreen and Leblang (2006, p. 4) call it “*one of the foundational topics of the subfield of international political economy*”. The idea that more inclusive institutions and trade openness are intertwined has been at the heart of classical liberalism and still shows in foreign policymaking today (Russett and Oneal 2001). Waves of democratization and liberalization during the 1980s and 1990s helped to renew scholarly interest in the topic and led to empirical studies that examine the effect of democracy on trade restrictions using statistical methods. Most recently, the rise of global economic players such as China or Russia reinvigorates discussions about whether and to what extent political and economic openness really need to go together, and how countries with different domestic institutions can effectively cooperate in a globalised trading system. Finally, the recent economic crisis has reinforced the issue of how domestic institutions mediate countries' reactions to economic shocks, help to maintain openness or give way to protection. Against this background, what do we know about the effect of institutions on trade policy?

2.1.1 Institutions and Trade Policy: Overview of Theoretical Arguments

Why should institutions matter for trade policy? The rationale is simple: They provide the mechanism to aggregate preferences in society. They define access to as well as incentives and constraints for policymakers thereby influencing their actions (McGillivray 2004). Essentially, institutions set the rules of the political game (Myerson 1995, 1996). Whether democratic rules are associated with more trade openness, though, has been subject to considerable scholarly debate. As Garrett (2000, p. 973) notes:

On the one hand, democracy makes leaders more accountable to their citizens, promoting trade liberalization to the extent that this is good for society as a whole. On the other hand, democracy also empowers distributional coalitions with intense interests, making higher levels of protectionism more likely (...).

On balance, the existing literature rather suggests a positive link between democracy and trade openness. Nonetheless the arguments challenging this view still deserve a closer look. They include claims that insulation of policymakers can be conducive to promote free trade, that democracies act less decisively when it comes to trade policy reform and—as mentioned above—that democracy can empower coalitions that oppose free trade.

The insulation argument rests on the premise that leaders basically favour openness but special interests push for protection. Hence, institutions that sufficiently insulate leaders from protectionist pressure should be conducive to establish and maintain trade openness.

Several studies have researched which institutional features provide for insulation and leaders' autonomy and could thus be associated with greater openness. They include institutional characteristics such as larger districts and proportional representation (Rogowski 1987), majoritarian electoral systems (Rogowski and Kayser 2002), as well as the delegation of trade policy competences to the executive (Schattschneider 1935; Destler 2005; Lohmann and O'Halloran 1994) or to decision-making authorities within governments that are more insulated from political pressures (Haggard and Webb 1994; Nelson 2006).⁴ Empirical results on some of these features appear a bit inconsistent though. For instance Mansfield and Busch (1995) find that greater insulation via larger districts and electoral systems

⁴ Notably, delegation is an important issue in the literature on American trade politics. Members of the legislature represent narrower constituencies making them more prone for capture by special interests pushing for protection. Given their narrow constituency focus policymakers may engage in logrolling activities, i.e. they agree to barriers for other products in return for favours for their own constituency, resulting in higher trade barriers across the board—as illustrated by the infamous Smoot-Hawley tariffs (Oatley 2008). "Theories of Presidential liberalism" claim that the president tends to be more pro-trade because he represent a nationwide constituency and can better balance different interests. Hence, delegating powers to the president should help to foster openness. Looking beyond the US, the delegation of trade policy competences to the European Commission at an early stage of integration also reflects a similar logic.

with proportional representation (PR) can even be associated with more protection when focusing on non-tariff barriers. Brawley (2001) finds that Rogowski's reasoning on small districts and proportional rule fits developing countries less well. Roelfsema (2004) presents evidence that majoritarian countries have higher tariffs while Goodhart (2008) finds that PR systems have higher levels of protection (incl. tariffs and non-tariff barriers) when controlling for the number of electoral districts.

Hence, evidence about which institutional features deliver insulation effectively and whether it translates into lower levels of protection remains somewhat inconclusive. In any case, it is important to distinguish between arguments about a certain degree of insulation via institutional features within democratic regimes and fundamental differences between democratic and autocratic rule. Any positive effect that may arise from insulation *within* a democratic framework does not mean that leaders who face very few constraints on decision-making deliver liberal trade policies. In autocratic regimes, leaders may have more personal scope when deciding about policies and can neglect some interest groups, though it is unclear why they would chose to advocate free trade. Most scholars suggest that they tend to be rather more rent-seeking and that provision of protection is one way to privilege cronies. Models that start from the assumption of welfare-oriented leaders therefore appear particularly questionable for autocrats (Milner 2012; Bueno de Mesquita et al. 2003, p. 19; McGillivray and Smith 2008). But any positive effect of insulation on free trade is contingent on leaders' benevolence, i.e. ultimately their desire to promote openness. Without prior assumptions about preferences, insulation simply gives them more leeway to pursue trade policies as they wish (Hiscox and Kastner 2008, Ch. 8). Whether this would give rise to systematic differences in levels of openness across regime types is not clear. If anything, greater heterogeneity in the levels of openness can be expected for autocratic regimes as particularities, be it leaders' beliefs shaped by experience or education or countries' history and geographic characteristics, should become more important for an explanation of their trade policies (Mansfield et al. 2000).⁵

As for regime type and its impact on trade policy reform, it is sometimes argued that democracies face some disadvantage when pursuing liberalising reforms.⁶ One reason is that gains from liberalization materialise unevenly over time. Costs, such as job-losses in import-competing industries occur immediately but benefits often take longer to materialise—a constellation that can prove difficult for policymakers seeking re-election in the short term (Haggard 1990; Haggard and Webb 1993). This may lead policymakers facing the need for re-election to postpone or shy away from liberalising reforms. Decision-makers who face less electoral pressure, on the contrary, can afford to focus on the long term. Examples of successful autocratic liberalisation such as Chile, Turkey, Taiwan, and South

⁵ Haggard and Webb (1993) similarly suggest that any autocratic advantage in terms of pursuing reforms essentially depends on leadership.

⁶ See Haggard and Webb (1993) and Haggard and Kaufmann (1995) for a more extensive discussion.

Korea (Milner 1999, p. 104) are sometimes used to illustrate this point. However, the argument about successful autocratic reforms can be challenged on empirical grounds since the anecdotal case-level evidence presented to support it is ambiguous at best (Verdier 1998; Henisz and Mansfield 2006).⁷ There may be selection effects as autocratic regimes which undertake reforms should be those with better chances to succeed in the first place. Giavazzi and Tabellini (2005) point out that the share of autocratic reformers compared to the total number of autocracies is actually rather low. At the same time, autocratic reformers outperforming democratic ones attract disproportionate attention. As for the theoretical argument: Not having to stand in regular elections does not free leaders from pressures against reform. Again, a major weakness of these claims is that they lack a general explanation of *why* autocratic leaders should actually pursue these reforms—at least without resorting to the assumption of benevolence.⁸

Finally, there is the claim that democracy can empower distributional coalitions that oppose free trade and leaders can hardly ignore interest group demands (Haggard and Webb 1993). While this is certainly a possibility, and interest groups always influence trade policy to some extent, the question of interest remains whether protectionist interests are c. p. more likely to be empowered than under autocratic rule and thereby imply higher levels of protection. Ultimately, this is an empirical matter (see also Sect. 2.1.2) but a number of theoretical arguments also oppose this.

The case for a positive link between democracy and openness is based on the distributional and welfare effects of trade which underpin preferences and are mediated by institutions. Two lines of reasoning can be distinguished: An unconditional link between democratic rule and openness based on welfare effects and a conditional argument which focuses on the distributional effects of trade and their interplay with institutions.

The conditional argument can be simplified as follows: If democracy empowers those groups that benefit from free trade, then democratisation is associated with a reduction in trade barriers. Economic models which base countries' comparative advantages on their factor endowments show that in a relatively labour-abundant economy, owners of labour as a factor of production benefit from free trade (see Krugman and Obstfeld 2006 for an introduction to the Heckscher-Ohlin model and the Stolper-Samuelson theorem). Yet owners of the scarce factor (capital in this case) stand to lose when this country engages in trade with a capital-abundant economy and therefore oppose liberalisation. We also know that capital ownership

⁷ Scholars point out other factors that contributed to the success of liberalizing reforms for particular countries, e.g. American influence in the case of East Asia (Young 1996) or suggest counter examples such as Chile which also enacted tariff cuts under democratic rule (Henisz and Mansfield 2006) or Germany in the 1930s where autocracy went hand in hand with favouring autarky (Verdier 1998).

⁸ Ability, effectiveness and persistence of trade policy reforms then follow as a second step and require thorough theorising and empirical examination. See for instance the analyses by Giavazzi and Tabellini (2005) or Frye and Mansfield (2003).

is typically more concentrated than labour. When combining this setup with the median-voter logic (Mayer 1984), political institutions do make a difference: Democratisation increases the franchise and the identity of the median voter shifts towards labour. As a result, democratisation should be associated with liberalisation in a relatively labour abundant economy. More generally, it means that democratisation promotes liberalisation if institutional change increases the weight of the abundant factor in the political decision-making process (Milner and Kubota 2005; O'Rourke and Taylor 2006).

This logic can nicely account for the wave of liberalization that happened in developing countries after they introduced political reforms (Milner and Kubota 2005). Note, however, that on the flip-side it implies that owners of labour in rich countries (that are capital abundant) have an interest in blocking liberalization. Strictly sticking to this symmetry, democratisation would not always induce more openness. In practice, high levels of openness can nonetheless be observed for many rich and democratic countries. The model logic can still account for this to some extent by replacing capital and labour with high- and low skilled labour as factors of production. Skilled labour tends to be more widely distributed among the population which helps to maintain support for openness. At the same time, support for free trade among low-skilled workers in rich countries is typically lower and in line with the logic of the model. In addition, a number of other factors come into play for "real world" trade politics, too.

The key advantage of this approach is that it combines a clear rationale of preferences about trade policy based on individual factor endowments with a simple model of politics. Studies on public opinion and trade policy show that individuals' preferences with regard to trade openness indeed reflect factor endowments (Scheve and Slaughter 2001; Mayda and Rodrik 2005)—at least to some extent.⁹ At the same time, the assumptions about the underlying economic model (two factor-two sector) as well as the political mechanism imposes some restrictions. Eichengreen and Leblang (2006) argue that when broadening the framework to a three factor-two good model, it becomes increasingly difficult to derive clear preferences about trade policy because effects on incomes depend on the specific factor proportions and endowments of trading partner(s). Also, it should be noted that the economic model focuses on trade driven by differences in factor endowments but today large trade volumes are actually intra-industry or intra-firm. It

⁹ Note that there is a debate in the literature as to what extent factor or sector-based models perform better to explain trade policy preferences. Factor mobility is important in this respect, with higher mobility of production factors across sectors, factor-based models provide a more accurate view and when mobility is low, sector-based models are better suited. Alternatively, the two approaches can be interpreted as short and long-term views. Apart from that, analyses of survey data also reveal that other noneconomic factors such as gender, social status or nationalism play a role in the formation of individual preferences about trade policy (Mayda and Rodrik 2005). Also, Mansfield and Mutz (2009) challenge the view that trade policy preferences are mainly based on income effects and stress the importance "societal effects" based on perceptions of how trade affects the entire country for the formation of preferences.

remains up for discussion whether and to what extent this logic is transferable. Furthermore, O'Rourke and Taylor (2006) show that political outcomes in a more complex framework depend on patterns of coalition formation which are beyond the scope of this approach. One could argue that there is little politics in the model as institutions somewhat mechanically aggregate preferences of voters and policymakers simply implement what the median voter prefers. While parsimonious, this modelling approach has drawbacks when applying it to trade policy: Often, there is no direct voting on trade matters or it tends to be a low-key issue. Most importantly perhaps, a median voter model of politics neglects the role of collective action and interest groups which play an important role for trade policymaking (Krugman and Obstfeld 2006).

Alternative approaches suggest an unconditional positive relationship between democratic rule and openness motivated by argument with the positive welfare effects of trade. The bottom line is that voters favour free trade because it is associated with higher levels of consumption, economic growth and less rent-seeking.¹⁰ It is special interests that push for protection in this setup. Against this background, the idea of the Grossman–Helpman model (1994) is that policymakers try to maximise the joint support of interest groups that provide contributions to them and social welfare. Notably, this approach takes both the role of voters and interest groups into account.

Institutions can be included in this setup as they even influence the relative importance of the two groups for policymakers' considerations. Using a Grossman–Helpman type approach, higher levels of democracy can simply be modelled as increasing voters' weight in the decision-making calculus of policymakers.¹¹ Because greater relevance of voters is a characteristic of democracies and voters have a preference for welfare-enhancing policies, democratisation goes hand in hand with liberalization according to the model (and is not contingent on factor endowments). This approach illustrates how policymakers balance different interests and how institutions matter in this respect but it does not explicitly model the dynamics of political competition (Grossman and Helpman 1994, p. 835) which are also part of the explanation why democratic institutions induce greater openness.

More inclusive rule is associated with greater accountability of leaders due to for instance regular elections, separation of powers but also a free press, etc. All these factors make it easier to challenge incumbents and remove them from office if they don't deliver. This helps ensure that voters' preferences are reflected in policy choices and provides for continuous monitoring (Bueno de Mesquita et al. 2003; McGillivray and Smith 2008). Instead of focusing on shifts in constituencies as a consequence of institutional changes, Aidt and Gassebner (2010) emphasise the

¹⁰ On the link between trade and growth see for example Sachs and Warner (1995), Dollar and Kraay (2001), and Wacziarg and Welch (2003). Wintrobe (1998) suggests that democracy helps to reduce rent-seeking. Verdier (1998) focuses on trade policy in industrialized countries in the nineteenth century and similarly argues that democratic leaders are less likely to use trade barriers to extract economic rents.

¹¹ See Kono (2006) for an example.

role of accountability and monitoring for trade openness. They argue that democratic rule limits rent extraction associated with trade distortions and also reduces bureaucratic inefficiencies, such as cumbersome or even corrupt customs, that constrain trade. Accountability essentially induces incentives for leaders to invest in better policies and ensures that they deliver. The results are direct differences in trade policy, but also changes in other areas that can help additionally boost trade.¹²

Bueno de Mesquita et al. (2003, 2008) share the view that institutional rules fundamentally shape policymakers' focus. They also take up the idea of leaders' balancing special interests vs. welfare that is at the heart of the Grossman–Helpman approach. Bueno de Mesquita et al. add to the literature on trade policy by combining the public vs. special interest idea with a consistent logic of how institutional rules define different dynamics of political competition and thereby impact on leaders' choices. Unlike other analyses where effects of institutions depend on claims about preferences, they do not assume that leaders differ with respect to preferences or patience across regime types (Bueno de Mesquita et al. 2003, p. 26; McGillivray and Smith 2008). Regardless of institutional rules, they share a desire to remain in power. But leaders adopt different strategies to achieve this goal contingent on the political rules in place. With more inclusive institutions, leaders advocate public goods because political survival requires broad public support. Because openness can be regarded a public good, this means greater support for free trade. On the contrary if rulers only have to please a narrow clientele, they chose private goods, such as trade protection, to privilege them. This logic emphasises fundamental differences in political competition that also map into differences in trade openness. While Bueno de Mesquita et al.'s logic yields a familiar conclusion, i.e. that democracies are linked with greater openness, it should be noted that their theory diverges from other analyses with respect to the classification of institutions. Instead of traditional regime types such as democracy and autocracy their classification is based on the size of the winning coalition and the selectorate (for a brief account of selectorate theory also see Chap. 3).

By and large, a number of theoretical arguments suggest a positive link between more inclusive institutions and economic openness. The next section reviews studies that test this connection empirically.

2.1.2 Institutions and Trade Policy: Empirical Studies

While the theoretical debate about institutions and their impact on trade policy is a longstanding one, large-N empirical work is fairly recent. Case studies and

¹² While Aidt and Gassebner focus on reductions in bureaucratic inefficiencies, better protection of property rights—a characteristic typically associated with democracies—is another example with possible positive repercussions on trade. Better protection of property rights is conducive to FDI (Jensen 2003), which can help encourage trade as recent research suggests that both are complementary (Busse and Hefeker 2006).

arguments based on historic observations,¹³ such as the repeal of the Corn Laws in nineteenth century Britain following the extension of the franchise (O'Rourke and Taylor 2006) are increasingly complemented by statistical analyses that look at variation across countries and over time. Altogether, most empirical analyses corroborate a positive link between inclusive institutions and trade openness. Using different analytical approaches, studies by Dutt and Mitra (2002), O'Rourke and Taylor (2006) and Milner and Kubota (2005) provide support for the median-voter logic (Mayer-Heckscher-Ohlin framework). Dutt and Mitra (2002) examine the impact of inequality on trade restrictions. They argue that voters are endowed with capital and labour and that the median voter's endowment is decisive for policy outcomes. Because he owns less capital in more unequal societies, policies that benefit labour will be more popular. This leads to more free trade in labour abundant economies than in labour-scarce ones—a proposition for which the authors find empirical support estimating OLS regression for twentieth century data. Dutt and Mitra basically assume democracy as an implicit condition for the median-voter logic to apply. However, part of their analysis also examines different samples and finds that the model performs better for democracies. Similarly, they note that demand for redistribution in favour of labour tends to be more pronounced in democracies. O'Rourke and Taylor (2006) focus on the late nineteenth and early twentieth century period to examine whether extensions of the franchise led to liberalisation in labour abundant countries. Their empirical strategy tests for the interaction of an institutional variable and land/labour ratios. It should be noted that their institutional indicator not only contains information on domestic institutions but O'Rourke and Taylor also incorporate information about countries' ability to independently determine their trade policies to avoid distortions arising from colonial ties existent at that time. While the results support the interaction between institutions and factor endowment, the authors do not find a "raw effect" of their institutional variable on trade openness. One key take-away from O'Rourke's and Taylor's analysis is, however, that the median voter two-factor logic clearly has limits when explaining "real world politics" before World War I and that understanding of coalition formation is crucial. For example, in Great Britain extensions of the franchise led to liberalisation because labour successfully formed coalitions with capital to support liberalisation against the interests of landowners. This contrasts with the situation in Southern and Eastern Europe where gradual extensions of the franchise had less of an impact because industrialists and landowners joined forces and labour was lacking a coalition partner.

Milner and Kubota (2005) examine the impact of the late twentieth century wave of democratisation on developing countries, the key argument being that the need to gain support by a larger group reduces politically optimal levels of protection.

¹³ Rodrik (1994, p. 69) for example makes a general claim based on historic observations: "*Indeed, historically sharp changes in trade policy have almost always been preceded (or accompanied) by changes in the political regime. (...) Not all political transformation result in trade reform, but sharp changes in trade policy are typically the result of such transformations.*" Verdier (1998) also starts from a historical approach examining trade liberalization in nineteenth century Europe.

Using cross-country time series regression, they provide empirical evidence that democratization is indeed associated with liberalisation. For their sample of developing countries, the results in fact provide support for both the median voter model and a general link between democracy and trade openness. Milner and Kubota are careful to control for country effects but also for a number of alternative explanations for liberalisation such as the impact of economic crises, external pressure or ideational factors.

Milner and Kubota also address endogeneity issues as part of their analysis and conclude that causality runs from democracy to trade policy rather than the other way round. Eichengreen and Leblang (2006) and Milner and Mukherjee (2009) similarly consider endogeneity problems. While the first study finds some support for a two-way relationship, Milner and Mukherjee argue for a stronger effect of democracy on trade. Giavazzi and Tabellini (2005) take a somewhat different approach as their analysis examines the interplay of political and economic reforms. They support a positive link between political and economic liberalisation¹⁴ in general and provide some evidence that the chain of causality rather starts with the former. However, they caution that this result may be driven by the most recent wave of democratisation at the end of the twentieth century. They also note that the actual impact of liberalizing reforms—both economic and political—is more complex and that the sequencing of policy reforms matters for actual outcomes such as trade volumes.

In terms of data coverage, Eichengreen and Leblang (2006) provide perhaps the most comprehensive study on the interplay between democracy and globalization and they examine openness to trade as one particular feature. Their analysis covers data from 1870 to 2000 and includes more than 150 developed and developing countries.¹⁵ Their findings further support the notion that democratic countries are more open and trade more compared to autocratic regimes. However, the results on the interaction between factor endowments and institutional rules are more mixed and vary depending on empirical specifications and time periods for the analysis.

In addition to the results on institutions and trade openness, what deserves a closer look is the operationalisation of independent and dependent variables in large-N studies. The reason is that some interesting nuances can be discerned: For example Milner and Kubota (2005) use different measures of democracy including a polity-based democracy index, a dummy measure to broadly distinguish autocratic and democratic regimes, dummies for single party, military and personalistic regimes and a measure that allows distinguishing between different types of autocratic regimes based on the nature and extent of the groups that support the

¹⁴ Economic liberalisation is not limited to trade policy in this case. Rather, the authors start from a broader concept of reforms and then assess as part of their analysis to what extent policy reforms translate into changes in outcomes such as trade volumes.

¹⁵ The actual number of countries varies from 14 to 156 for the different regressions and increases over time.

respective leaders.¹⁶ Results with tariffs as the dependent variable suggest that a broad distinction of regimes can fail to capture important nuances, as the dummy measure does not have an effect while the more fine-grained ones do. This suggests that it is worthwhile to further distinguish between different types and levels of democracy and autocracy. In addition, Milner and Kubota assess the effect of different types of regime categories (military, single party and personalistic regimes) while controlling for overall levels of democracy. They find that single party regimes have lower tariffs compared to personalistic ones which they attribute to larger selectorates in single-party regimes. Again this points to the importance of variation within and across regime type (Milner and Kubota 2005, p. 127).

Divergences within and across regime types are not only interesting from an empirical perspective. They rather reemphasise a theoretical question the literature on institutions and trade policy has struggled with for a long time, namely what it is about democracy that actually promotes free trade and how the mechanism works. Other studies emphasise the need to look beyond traditional regime categories and/or rethink them. These include Garrett (2000) who does not find a significant effect of democracy on trade policy but for other political variables and Henisz and Mansfield (2006), who argue that regime type in combination with political fragmentation affects the extent to which countries change their trade policies as a response to economic shocks. Frye and Mansfield (2003) examine trade policy liberalisation during the 1990s in post-communist countries. While they consider regime type as one important factor that drives trade policy reform, given that it improves accountability and monitoring, they also argue that additional institutional factors and their interaction with regime type matter and point to fragmentation of power. The reason why fragmentation matters is that greater fragmentation helps to challenge (incumbent) protectionist interests. The authors test for the effect of democracy and fragmentation using an ordered probit model to measure the extent of reform and control inter alia for temporal dependence, macroeconomic conditions, economic size and relationships with the EU. Results suggest that regime type and fragmentation matter both separately and jointly. Democracies are somewhat more likely to undertake liberalizing trade policy reforms. For autocracies, fragmentation creates a big difference: With low fragmentation, autocracies are less likely to liberalise while non-democracies with some fragmentation can be quite open. For democratic regimes, their greater accountability in combination with dispersion of power can help promote liberalisation.

The works by Bueno de Mesquita et al. (2003, 2008) provide a different perspective on the issue of variation in trade openness within and across regime type. As mentioned above, their theory has a different starting point and classifies political institutions based on the size of the winning coalition and the selectorate, rather than traditional regime type categories. Bueno de Mesquita et al. (2003, 2008) find a strong positive effect of winning coalition size on trade openness for a large sample of developing and developed countries. Notably, they try to

¹⁶ See Milner and Kubota (2005, p. 120).

disentangle the effects of coalition size from other aspects of democracy (even though it can be argued that this is easier done theoretically than empirically). While their results confirm a positive effect for the size of the winning coalition on democracy, they do not find a positive effect for other aspects associated with democracy. This may indicate that their theory has identified a particular feature that actually drives the positive link and disentangles the sometimes contradictory arguments and effects associated with measures of regime type.

Another point that can be inferred from an overview of existing studies on institutions and trade openness is that most of them focus on trade volumes, aggregate measures of openness or tariffs. Table 2.1 provides a short summary showing the operationalization of dependent and independent variables for key large-N studies:

Trade flows, aggregate openness indices and tariffs certainly provide suitable measures to test for the effect of institutions. However, the set of previously used measures also have some shortcomings. Taking trade flows as a measure means to look at outcomes rather than trade policies. These outcomes can be influenced by other factors such as geographic conditions and only reflect policy choices indirectly.¹⁷ At the same time, the argument that institutions shape policymakers' choices is essentially about policies –hence looking at trade barriers would be a closer test. Tariffs as measure of protection face other drawbacks: they have been gradually reduced and bound as part of multilateral trade negotiations, and other types of trade barriers have become more important (Balassa 1978; Hoekman and Kostecki 2001). Tariffs as a policy measure therefore provide an increasingly less accurate picture of countries' actual stance on trade. To that effect, other measures of protection warrant a closer look all the more when considering more recent periods. Finally, aggregate indices such as the Sachs–Warner measure or the KOF economic globalization measure contain information about openness and policies but—by their very nature—in a composite form. On the one hand, using a comprehensive indicator that reflects several dimensions is highly valuable for cross-country comparisons. On the other, it is often not clear what is actually driving the variation and how the different components interact with the independent variables. In addition, indices are of course sensitive to specification, i.e. which components are included, how they are coded, weighted, etc. For example, the measure developed by Sachs and Warner (1995) has been criticised for being heavily influenced by values for the black-market premium and state monopolies that do not capture trade policy in the narrow sense (Rodriguez and Rodrik 2001). A more disaggregated approach may therefore help assess their logic and ensure that different components are adequately reflected. This is not only important from a methodological point of view: if certain countries prefer trade policy instruments

¹⁷ Gravity models which include geographic distance in their estimation solve this problem only to some extent because distance does not equal accessibility which may be promoted or hindered by geographical conditions (e.g. coastline, high mountains).

Table 2.1 Empirical studies examining the impact of institutions on trade

Study	Independent variable: institutions	Dependent variable: trade
Garrett (2000)	– Democracy score based on Polity (values for 1980s)	Tariff-based measure: – Average trade taxes in the 1990s
Dutt and Mitra (2002)	– Freedom house democracy measure for political rights ^a	Tariff- and non-tariff-based measures, openness based on trade volumes: – Duties/imports – Average tariff rate – ntb-coverage ratio – (IM+EX)/GDP
O'Rourke and Taylor (2006)	– Based on Polity score to measure breadth of franchise – By construction, democracy measure also controls for trade policy autonomy, i.e. countries unable to set trade policy independently are treated as non-democratic	Tariff-based measure: – Duties/imports
Milner and Kubota (2005)	– Various democracy measures: Polity index ^b , regime type dummy ^c , dummies for single party/military/personalistic regimes, and variable to better distinguish different types of autocracy based on the size and composition of groups that support the leaders	Tariff-based measure and openness index: – Average tariff rates – Dichotomous openness indicator based on Sachs/Warner and Wacziarg/Welch; – Includes information on tariffs, non-tariff barriers and the black market exchange rate
Giavazzi and Tabellini (2005)	– To measure political liberalisation: dichotomous and continuous measure based on Polity (countries with positive values qualify as democratic) – To measure economic liberalisation: dichotomous economic liberalisation indicator (based on Sachs and Warner, i.e. includes information on tariffs, non-tariff barrier coverage, black market exchange rate, whether exports are controlled by state monopoly and whether the country has a socialist economic system; updated by Wacziarg and Welch)	Openness based on trade volumes: – (IM+EX)/GDP ^d
Eichengreen and Leblang (2006)	– Dichotomous measure of democracy, focus on elections (Przeworski et al. 2000, extended coverage by Boix and Rosato and Cheibub and Gandhi) – For robustness checks: age of democracy as measured by the number of years a country has been democratic and democracy dummy measure based on Polity values	Openness based on trade volumes and openness indicator: – (IM+EX)/GDP – Dichotomous openness indicator for robustness check based on Sachs and Warner and Wacziarg and Welch; – Includes information on tariffs, non-tariff barriers and the black market exchange rate

(continued)

Table 2.1 (continued)

Study	Independent variable: institutions	Dependent variable: trade
Milner and Mukherjee (2009)	– Polity measure of democracy (lagged and normalised)	Openness based on trade volumes: – (IM+EX)/GDP
Aidt and Gassebner (2010)	– Dichotomous measure of democracy, focus on elections (Przeworski et al.) – Polity based democracy measure – Freedom House index, focus on political rights and civil liberties	Openness based on trade volumes and openness index: – Bilateral imports volumes – KOF-globalization index as openness measure ^e
Frye and Mansfield (2003)	– Regime type and political fragmentation. – Dichotomous measure based on Polity scale to measure regime type (various thresholds used as cut-off points). Freedom house measure of political liberty used for robustness checks. – Fragmentation measure intends to capture competitiveness of government and how many actors are necessary to block policy change (5-point scale based on Frye, Hellman, Tucker)	Trade policy liberalisation indicator: – Extent of trade liberalisation measured on a three point scale, includes information on existence of state monopolies in trade as well as barriers to exports and imports based on EBRD
Bueno de Mesquita, et al. (2003, 2008)	– Size of the winning coalition ^f – Size of the winning coalition relative to selectorate size in alternative specifications. – Controls for other effects of democracy	Openness based on trade volumes: – (IM+EX)/GDP

^aNote that institutions are not the main independent variable—this is “inequality” (as measured by the Gini coefficient and the median quintile’s share in income/expenditure and the capital labour ratio) - but included as controls and in extensions of the basic model (assessment of performance in different samples and interaction with capital labour ratio)

^bThe polity index captures five components: (1) Competitiveness for selecting countries’ chief executives, (2) Openness of this process, (3) Institutional constraints that limit the chief executive’s authority, (4) Competitiveness of political participation, and (5) the extent to which binding rules govern political participation. Also see Polity IV data series at www.systemicpeace.org

^cThe measure focuses on existence of free and contested elections (based on Alvarez et al. 1996, Przeworski et al. 2000)

^dThe authors use several dependent variables to assess the effect of liberalization on economic performance in a broader sense with openness as measured by imports and exports relative to GDP being the main trade policy measure

^eThe indicator combines data on hidden import barriers, mean tariff rate, taxes on international trade (percent of current revenue) and capital account restrictions. On the KOF-Index also see <http://globalization.kof.ethz.ch/>

^fThe measure is based on information on regime type, competitiveness of executive recruitment, openness of executive recruitment and competitiveness of political participation. See Bueno de Mesquita et al. (2003)

that are (not) included in indices, this biases cross-country comparisons. The same holds true for analyses that only focus on tariff measures.

In this respect, some scholars have argued that institutions not only affect the level but also the type of trade barriers that countries make use of. Kono (2006) explicitly links the choice of trade policy instruments to institutional rules. He argues that democratic countries have indeed lower tariffs but rely more heavily on other trade policy measures that are harder to discern for voters instead. By resorting to non-tariff barriers (NTB's) and regulations they practice "optimal obfuscation".¹⁸ Kono claims that differences across different types of barriers result from the dynamics of political competition: high visibility measures are easily challenged (and are consequently reduced) in democracies whereas more complex ones are harder to discern and therefore remain in place and/or can even be used as substitutes for more obvious barriers.¹⁹ Giavazzi and Tabellini (2005) argue along these lines as they do not find a pronounced positive effect on trade levels for countries that democratized first and then introduced economic reforms. Their interpretation is that trade barriers are indeed abolished following democratisation but some might then be replaced with different ones—hence no sweeping effect on overall levels.

Given that existing empirical analysis mostly examines the impact of institutions on trade policy by looking at openness or tariffs and that there is some theoretical discussion about the effects of institutions on different types of trade barriers, taking a closer look at specific manifestations of trade policy and barriers other than tariffs can contribute fresh insights to the literature (also see Milner and Mukherjee 2009, p. 172).

So far, the focus has been on the interplay of domestic institutions and trade policies from a "traditional" comparative political economy perspective. Researchers look at countries as units, identify domestic factors such as institutions and examine how their variation maps into differences in trade policies.

Research from international relations starts from a different perspective and views trade policy as the result of *interaction* between states. The conceptual starting point is different as trade is analysed as an issue of cooperation and/or conflict among nations. Institutions play an important role here as well because they affect countries' willingness and ability to cooperate.

¹⁸ Kono is careful to demonstrate that higher NTB's in democracies are not the result of policymakers being simply more responsive to public concerns, e.g. for higher product safety standards. He backs his argument by examining how the level of NTB's is affected by several proxies measuring consumer demand for high quality regulation as well as interest group pressure and concludes that it is not consumer demand proxies but rather interest group pressure that explain NTB's.

¹⁹ Additional evidence for this logic is provided by examining whether high tariffs prompt frequent challenges to protectionist policies in the domestic political arena. Kono finds that high tariffs are associated with parties more frequently denouncing protectionism in election manifestos.

2.2 Institutions and Countries' Interaction on Trade Issues

International approaches typically frame trade liberalisation as a cooperation problem (Axelrod 1984; Oatley 2008). According to this logic, two states share an interest in liberalization but unilaterally reducing barriers would leave them worse off. Hence barriers persist which is actually the most disadvantageous outcome for both. Terms of trade arguments or different abilities of domestic interest groups to push for protection are two ways to motivate a prisoner's dilemma-type payoff structure (Krugman and Obstfeld 2006; Oatley 2008). A question scholars investigate against this background is how domestic institutions affect countries' ability to enter cooperative arrangements and maintain them successfully.

Numerous analyses suggest that democratic regime type is generally associated with higher levels of cooperation: pairs of democratic states are reluctant to fight wars against each other (Oneal and Russett 1997), they exhibit more similar voting patterns in the UN (Oneal and Russett 1999) and cooperate more within international organisations (Russett et al. 1998). With regards to trade, scholars have used different proxies to assess cooperation between states.

For instance, studies examine trade volumes and test whether particular pairings trade more with each other. Empirical evidence is often based on gravity-models to estimate bilateral trade volumes controlling for a number of additional political and economic factors. A number of analyses conclude that pairs of democracies trade more with each other (Dixon and Moon 1993; Morrow et al. 1998, 1999; Bliss and Russett 1998; Mansfield et al. 2002; McGillivray and Smith 2008; Aidt and Gassebner 2010). With respect to cooperation between autocratic and mixed dyads, findings remain more limited and less consistent due to studies' empirical designs.²⁰ Mansfield et al. present evidence that mixed dyads trade less than democracies and find that autocratic pairs in fact trade more than mixed ones (2000, pp. 316–3177). Likewise, McGillivray and Smith (2008) argue that democratic pairs trade the most but mixed dyads have the lowest trade levels. The reason is that private actors in democracies prefer to trade with other democratic trading partners because they value stability of cooperation. This creates trade diversion effects at the expense of mixed dyads.²¹ Aidt and Gassebner (2010) conversely find empirical evidence that autocratic dyads trade the least compared to other pairings.

²⁰ For example, Bliss and Russett (1998) use a dummy to distinguish democratic dyads from all other categories and therefore differences between pairs of autocracies and mixed dyads cannot be discerned. Dixon and Moon (1993) exclusively look at trade relationships of the US with other countries and hence no inference about autocratic pairs is possible.

²¹ See McGillivray and Smith (2008, p. 121): [...] *“but if all else is equal on this dimension, the trader strongly prefers to trade with another large coalition system because of the stability of cooperative relations between large coalition systems. Traders in large coalition systems disproportionately trade with other traders from large coalition systems. This diverts trade by merchants in large coalition systems away from small coalition systems toward other large coalition systems.”*

Differences in bilateral trade volumes can reflect differences in policymakers' decisions, i.e. barriers for some trading partners are lower than for others, and private actors' choices (McGillivray and Smith 2008). For instance, even with similar levels of trade restrictions, traders in a democratic country would prefer to trade with other democracies. Reasons for this could be that traders appreciate higher general levels of cooperation between democracies, including for instance low probabilities of militarised conflicts and joint membership of international organisations. Mutually familiar business practices, a common understanding of how to settle disputes, limited ability to provide rents through protection, less red-tape and greater accessibility of information about the general state of affairs in other countries can all contribute to a "democratic difference" in trade (Morrow et al. 1998; Aidt and Gassebner 2010). In addition, traders may value monadic properties associated with democracy such as better protection of property rights (Bliss and Russett 1998; Morrow et al. 1998). Hence, there are a number of features which can boost trade among democracies even without assuming differentiated treatment of trading partners concerning explicit trade barriers.

However, there are also a number of arguments that suggest differences in countries' actual trade policies, contingent on regime type. The conjecture that democracies are more likely to enter cooperation, make more credible commitments (Leeds 1999) and are better at maintaining higher levels of cooperation in general (McGillivray and Smith 2008) should map into greater support for multilateral trade cooperation, deeper commitments to trade liberalization and efforts to promote bilateral trade cooperation. Note that a greater propensity of democracies to take part in multilateral trade cooperation can also lead to lower barriers for democratic pairs on average as the most favoured nation principle applies for all members.

As for bilateral trade agreements, Mansfield et al. (2000) develop a bargaining model which shows that veto threats by the legislature induce the executive in democracies to push for lower trade barriers when negotiating with another democracy that similarly faces domestic veto threats. As a result, pairs of democracies can negotiate lower barriers.²² Mansfield et al. (2002) find that pairs of democracies are in fact twice as likely to form a preferential trade agreement as mixed pairs. This pattern is consistent with earlier tentative evidence by Remmer (1998, p. 39) who looks at trade agreements in the Mercosur region between 1947 and 1985. Mansfield et al. (2002) provide an additional motivation arguing that democracies' higher probability to enter trade cooperation originates from domestic politics²³: concluding trade agreements is a signal to imperfectly informed domestic voters which value cooperation and will reward this activity at the ballot box. McGillivray and Smith (2008) argue that cheating on existing cooperation negatively affects

²² See however Dai (2002) for a critique of the model.

²³ While this is a monadic argument, the authors argue that the probability to join a trade agreement for A is independent of B and therefore the probability of two democracies to cooperate is highest.

domestic political survival. With office removal being easier in democracies, this should make democratic leaders more cautious and renegeing on commitments less likely.

However, Tomz (2002) questions the claim about democracies' greater universal propensity for (trade) cooperation. He argues that voters may occasionally prefer non-compliance on some issues²⁴ and also points out that voters' level of information is crucial. If they don't know or learn about non-compliance, it becomes more difficult to hold leaders accountable and the "disciplining mechanism" works less smoothly. This seems particularly important for "low politics" such as trade, that often attract less public attention and general knowledge is limited at best (Guisinger 2009)—all the more where less obvious forms of protection are concerned. Similar to the comparative political economy literature reviewed above, this at least prompts the need to extend empirical analyses beyond the most obvious trade policy measures and to carefully think through the assumptions underpinning our theoretical claims with respect to regime type and trade policy.

This seems all the more warranted when considering arguments about democracy and flexibility and the literature on trade disputes. In their seminal article about the institutional design of trade policy institutions, Milner and Rosendorff (2001) theorise about the role of flexibility provisions for trade cooperation. They argue that institutional features such as escape clause provisions can make cooperation more stable and facilitate commitment in the first place. They provide insurance against unexpected shocks and allow for manoeuvring room without having to terminate cooperation. Rosendorff and Milner mention AD in this context and argue that it can also be interpreted as a sort of flexibility mechanism. Notably, they also suggest that democracy is associated with a greater need for flexibility because leaders loose office more easily.²⁵ Democratic rule could therefore be associated with more frequent use of flexibility provisions. Kucik and Reinhardt (2008) are more interested in examining the role of flexibility provisions for institutional design and their results point to interactions between the existence and use of flexibility provisions such as AD, GATT/WTO membership and countries' willingness to agree to far-reaching tariff reductions and stick to it. At the same time, some of their findings suggest that democracy is associated with a higher probability of initiating AD actions.

The bottom line is that while democratic rule tends to promote cooperation and commitment in many respects, it can also create the need for greater responsiveness. While theoretical models can clearly distinguish between compliance, flexibility and breach of commitments, there is a thin line between (il)legitimate use of escape clauses empirically. The literature on litigation under GATT/WTO shows

²⁴ Tomz (2002) provides evidence for this logic examining the case of Argentina and the link between popular attitudes, debt repayment and electoral success.

²⁵ Henisz and Mansfield (2006) similarly suggest that trade openness in democracies is more responsive to shocks and present empirical evidence for this but their argument is more general and not limited to the use of specific flexibility provisions.

this, as the use of AD provisions has frequently been subject to disputes (Bown 2009a).

At the same time, research on trade disputes illustrates that trade relations between democracies are certainly not frictionless. Some empirical studies about trade disputes and regime type rather suggest that democracies are more frequently involved in trade disputes (GATT and WTO)—both as complainant and defendant (Reinhardt 2000; Davis and Blodgett-Bermeo 2009; Bernauer and Sattler 2011). On the one hand, this may simply result from deeper commitments, more extensive trade relations and greater availability of information about trade policies in democratic countries (Vreeland and Rosendorff 2006). Johns and Rosendorff (2009) argue that it is more promising to challenge democracies via dispute settlement because litigation can be used as a tool to alert domestic opposition about non-compliance. In addition, trading partners can leverage heterogeneous domestic interests more effectively in a democracy, where there is the possibility of a critical and public debate and it is easier to challenge government positions also “from within” than in a non-democratic regime. Finally, there may also be a tendency to solve disagreements through adjudication which would be in line with support for and trust in international organisations.²⁶

The trade dispute literature also suggests that regime type affects patterns of dispute escalation and settlement. Busch (2000) analyses how litigation progresses through different stages of the dispute settlement process and finds that cases between democracies are more likely to proceed to the panel stage. He argues that greater trust in adjudication and the possibility to externalise disagreement drives democracies to escalate their disputes to the formal panel stage (p. 430). Guzman and Simmons (2005) qualify this reasoning and suggest that escalation is affected by regime type and the issue at stake. Distinguishing between different stages of a trade dispute, Busch (2000) finds that democracies are more likely to settle with concessions at the consultation stage but not more likely once a panel has been established. He attributes this difference to increasing audience costs that make it harder for democracies to back down at later stages of the process. Focusing on the outcome of disputes Reinhardt (2000) observes that democracies are less likely to end their disputes cooperatively, i.e. with full concessions. Finally, Guzman and Simmons (2005) provide some evidence that regime type of complainants may also affect whom they pursue in a dispute. The authors suggest that greater responsiveness to interest groups leads democracies to pursue different types of defendants and some of their empirical results indicate that *ceteris paribus* democratic complainants tend to pursue defendants with lower GDP *pc*.

On balance, the research on trade disputes provides some valuable insights for this study as it sheds light on different forms of trade barriers and practices that prove contentious and may be at odds with commitments under GATT/WTO. It

²⁶ It could be argued that trade disputes are “hybrids” in the sense that they include both elements of cooperation and conflict. On the one hand, they involve disagreement between nations. On the other, disagreement is addressed within a cooperative forum and subject to adjudication.

also reemphasises the point that many remaining barriers take more complex forms. There are also some restrictions, which suggest a cautious interpretation—particularly with regard to results on the impact of institutions. The distribution of disputes is special because a large amount of cases involve only a small number of countries as complainants and defendants (particularly the EU and the US). In addition, the number of autocracies participating in litigation has been rather modest, which makes it more difficult to draw inference about “typical dynamics” of cases.²⁷ Most importantly though, the literature on trade disputes epitomises a deeper methodological challenge: it implicitly assumes that countries have a similar probability of encountering restrictive measures. But what researchers observe, could only be “the tip of the iceberg” and we lack precise information on the number of cases a country “should” pursue (Bown 2009a, p. 94). Obviously, a country that suffers more frequently from WTO inconsistent policies by trading partners should file more cases.

At the same time, studies find that countries are more likely to impose new trade restrictions on partners that are less likely to challenge them (Bown 2005, 2009a; Blonigen and Bown 2003). Hence, it can be argued that the imposition of barriers is subject to a strategic calculus.²⁸ Without a better understanding of this logic and the underlying dynamics and selection processes, it is difficult to interpret the outcomes that we see correctly and make inferences about the effects of independent variables such as institutions. The recent literature on strategic models may therefore help complement existing trade policy research.

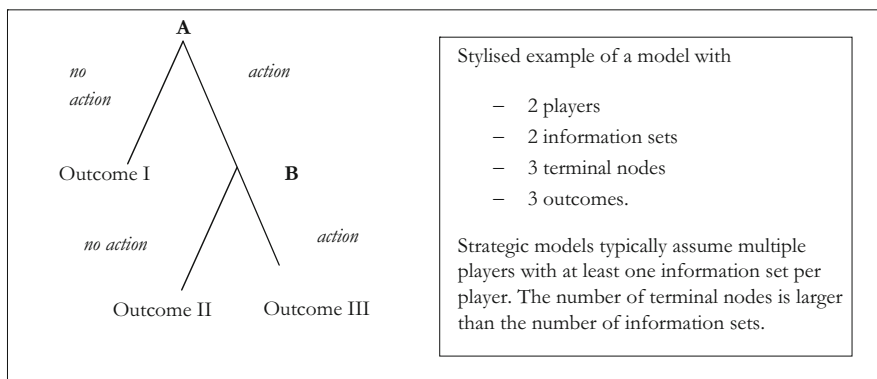
2.3 A Strategic Perspective for the Analysis of Trade Policy

Trade policy obviously involves the interaction of different players and multi-stage decision-making processes. Governments, for instance, negotiate trade agreements and reduction of barriers, interest groups try to advance their positions and change current policies and leaders weigh the pros and cons of doing so considering domestic and international repercussions. Signorino’s (1999, p. 279) general claim that “*strategic interaction is the defining characteristic of international relations*” therefore certainly holds true for trade relations as well.

Applying a strategic perspective means to start with an explicit structure of players’ interaction to understand how the outcomes we see came about. First, this suggests a different interpretation of the data points we see, such as trade barriers imposed or trade disputes initiated. The strategic rationale acknowledges that what

²⁷ Given some recent evidence of China becoming a more active player in dispute settlement, this may change somewhat in the future.

²⁸ See also Bown (2009a, p. 94): “*Governments that feel the need to implement new import protection will try to do so against trading partners through the use of policies with the lowest costs of implementing such protection.*”



Graph 2.1 A simple strategic model

we see is the result of an underlying selection process (see Graph 2.1 below). Instead of focusing on levels of protection (which would translate how many restrictions of a particular type are imposed, e.g. by counting outcome II) or the occurrence of conflict between pairs of states (i.e. focusing on outcome III), the strategic perspective tries to capture several stages, different options and the dynamics of the decision-making process. In doing so, it suggests a different interpretation of outcomes and accounts for how the things we see came about while also considering what did not happen.²⁹

In addition to this conceptual point, applying a strategic perspective to study trade policy involves rethinking empirical strategies. Game-theoretic models nicely capture the structure of strategic interaction, but standard statistical approaches such as logit or probit are inadequate to capture these dynamics (Signorino 1999, 2003). Strategic situations imply that there is censoring and interdependence in the data (Smith 1999). Censoring arises from anticipation effects, i.e. if theory suggests that players interact in sequence and condition their behaviour on others' possible actions, player A won't take a particular action such as imposing a new trade restriction, if B's potential reaction is a credible threat that can deter him. If deterrence works, neither B's reaction, nor new barriers by A will be observed. Interdependence of actions also means correlation of errors and hence causes issues for standard models which assume independence (Smith 1999).³⁰

Moreover, standard statistical models cannot adequately deal with the possibility of non-linear relationships between independent variables and outcomes that arise due to strategic interaction (Signorino 1999). For example, in a two-stage game with two players, a weak challenger may abstain from conflict with a defendant, becoming more daring as his capabilities grow, hence the probability of conflict

²⁹ As Smith (1999, p. 1256) notes: "*Strategic choice is the explicit study of counterfactuals.*"

³⁰ While there are approaches to take particular types of interdependence into account, e.g. for cross-sectional time series data (Beck et al. 1998), the type of interdependence in strategic models is different as it directly arises from the structure of interaction between the two players.

Table 2.2 Statistical discrete choice models: an overview

	Players	Information sets	Terminal nodes	Outcomes	Model
Non-strategic models	1	1	2	2	Standard logit or probit
	1	1	≥ 2	= number of terminal nodes	Multinomial logit or probit
	1	> 1	= number of information sets	> 1	Sequential logit or probit
	1 or 2	2	3	3	Heckman selection model
Strategic models	> 1	$\geq$ number of players	$>$ number of information sets	> 1	Strategic logit or probit

Source Adopted from Signorino (2002, 2003)

would increase. But once he becomes excessively dominant relative to the defendant, the latter may choose to avoid open conflict and therefore the probability of conflict decreases. Hence, the effect of an independent variable on probabilities for outcomes can be non-monotonic or contingent and shaped by the interaction of the two players.³¹ Standard statistical models cannot properly account for these features and have problems capturing the theoretical structure. Applying a non-strategic model to a situation characterized by strategic interaction can produce misleading results (Smith 1999; Signorino 1999; Signorino and Yilmaz 2003). In any case, it would be a second-best solution because if the data-generation process is assumed to be strategic, the empirical approach should be consistent with this (also see Table 2.2 for an overview).

Yet translating a strategic structure into an empirical model involves additional challenges. Solution concepts for game-theoretic models are typically deterministic but maximum likelihood estimation requires non-zero probabilities for all outcomes in order to estimate players' utilities (see Signorino 1999 for a review of the zero-likelihood problem). The solution is to add a stochastic element, which can either be due to agent error, i.e. players make mistakes, or private information.³² While players still play best responses, the addition of the random utility component ensures that all actions in the game are chosen with positive probability and non-binary choice probabilities can be derived. Following this approach, the theoretical model actually *is* the empirical model (Signorino 1999).

³¹ While non-linearities can be modelled to some extent with interaction effects or squared terms, a simple logit or probit with an interaction effect would still not properly account for the interaction between two players, which is at the heart of a strategic model.

³² The game-theoretic solution concept with agent error is the Quantal Response Equilibrium (McKelvey and Palfrey 1995, 1998). Here, the distribution over outcomes basically comes from wrong decisions. With private information, players are observationally equivalent but hold preferences that are only privately known (Kenkel and Signorino 2014). For a discussion of the different sources of uncertainty also see Signorino (2003).

Strategic models estimate players' utilities for all the different outcomes in the game and derive probabilities for action on this basis (Kenkel and Signorino 2014). By means of specifying utilities based on theory, the approach also allows one to combine variables from different strands of the trade policy literature (including for instance economic conditions, institutions and characteristics of trading partners) and to assess their interaction. Empirical applications of the strategic approach to international relations and economic policy issues are still somewhat rare, but in recent years analyses using strategic models have become more frequent. Notably, they have been used to analyse a number of different problems in international relations such as deterrence (Signorino and Tarar 2006), government crises in Latin America (Helmke 2010), and compliance with EU legislation (König and Mäder 2014). With respect to economic policy issues, Leblang (2003) uses a strategic model to examine currency crises and the decision to defend a fixed exchange rate or devalue. Finally, McLean and Whang (2010) analyse the imposition of economic sanctions from a strategic perspective.

Trade policy provides a promising area for further application of strategic models in general but AD is particularly well suited. Unlike some other measures of protection, it can be targeted bilaterally, which already suggests one particular type of strategic interaction, i.e. between the investigating country and the target.³³ Likewise, existing research on AD already seems to acknowledge the importance of strategic interaction for AD conceptually. For instance researchers have repeatedly noted that retaliation matters as a motive for adopting AD legislation (Prusa and Skeath 2002) as well as for the decision to target trading partners (Prusa and Skeath 2004; Feinberg and Reynolds 2006). In turn, if (possible) retaliation matters, this also implies that players try to anticipate the behaviour of others and condition their behaviour accordingly. Along these lines, Busch et al. (2008) suggest that:

Interestingly, while it is not terribly difficult for a domestic producer(s) to secure an AD duty, the positive decisions that governments render are often more selectively targeted at a few countries, rather than at many countries. Why? The conjecture advanced in the literature is that governments tend to avoid naming countries that can credibly threaten retaliation. . . (p. 3)

A number of studies have looked at retaliation (or the threat thereof), examining how it impacts on anti-dumping patterns. While these studies not necessarily include a game theoretic model and/or use strategic models for statistical estimation they do hint at a strategic logic inherent in anti-dumping.

Blonigen (2000) presents a theoretical model and argues that industries are less likely to file AD cases the greater their exposure to retaliation by trading partners.³⁴

³³ Another type of strategic interaction would be suggested by (anti)dumping models that focus on the activities of firms to engage in dumping practices. However, this is not the primary focus of this analysis which focuses on the decision-making processes associated with AD that involve government (re)actions.

³⁴ Two factors that affect retaliatory capacity are the industry's export share to the trading partner and whether the target country has an AD mechanism.

Bown's (2001) model focuses on the decision by government agencies to impose a measure and argues that the threat of legal retaliation impacts on the decision to impose a measure or not. Blonigen and Bown's joint work (2003) combines these two channels in a two stage model (stage 1: industry names trading partners in AD cases, stage 2: government authorities decide about the imposition of measures) and examines whether threats of retaliation reduce the probability of being named in investigations by industry as well as imposition. The authors test this logic for US AD cases between 1980 and 1998 using a nested logit model. At the first stage, they consider product (and sector) specific retaliatory capacity of trading partners that may dampen industry activity and in the second stage they assess whether countries' ability to retaliate via dispute settlement reduces possibilities for a positive finding.³⁵ Their results suggest that the threat of retaliation deters industry to name trading partners as a target in investigations and that possible litigation makes it less likely that measures are imposed too.

Busch et al. (2009) examine a very similar two-stage setup with industries deciding about naming petitioners and government authorities about the imposition of measures. The authors are primarily interested in examining legal deterrence; they test for a product/industry-specific threat of retaliation for firms and the threat of litigation for governments. Like Blonigen and Bown (2003), they consider US AD cases. While they use a somewhat different sample (AD investigations between 1978 and 2001), econometric model, and controls,³⁶ their core results point into a similar direction: both channels of retaliation dampen AD activity. The threat of product-specific retaliation negatively impacts on industries' decision to name targets in petitions while the threat of legal retaliation reduces both the probability for being named in petitions and getting an affirmative decision. Busch, Raciborski and Reinhardt emphasise that the legal deterrence effect not only works in combination with retaliatory capacity but also independently. However, it should also be noted that overall US export dependence—not only in combination with litigation capacity but also separately—shows strong negative effects. This suggests that there is a wider notion of retaliation, spanning beyond legal measures but also beyond specific products, that affect AD patterns.

While Blonigen and Bown (2003) and Busch et al. (2009) focus on the domestic part of the AD process, Busch et al. (2008) look at the interaction between the AD

³⁵ The authors use interaction terms to construct variables for retaliatory capacity. For the first stage, they use product specific export shares of industry to the potential target country and interact this with a dummy variable for having an AD law. The scope of the export component is broadened from product to sector level as part of robustness checks to capture the possibility that firms export multiple products. For the second stage, Blonigen and Bown interact US export shares to the target with several measures to proxy legal capacity (whether a country has brought a case against the US before, whether it has ever been a plaintiff and whether it is a GATT/WTO member).

³⁶ Busch, Reinhardt and Raciborski examine US AD cases from 1978 to 2001 using a Heckman probit selection model. Note that both Blonigen and Bown (2003) and Busch, Reinhardt and Raciborski rely on hypothetical control cases, i.e. they try to identify a set of suppliers that could have been named in investigations but where no cases were ultimately initiated.

investigating country and the target. They present a two-stage logic, with the investigating country deciding about the imposition of measures and the target deciding to challenge them via dispute settlement. In turn, they hypothesise that a target's greater capacity to litigate translates into less measures being imposed. Busch, Reinhardt and Shaffer test this logic for a cross-country sample of AD cases from 1995 to 2005 using two separate sets of probit models, estimating the probability for complaints for the set of cases for which measures were imposed, as well as the probability for imposition for their total sample of investigations.³⁷ The main interest of the authors is with litigation and they present a new measure to assess countries' legal capacity.³⁸ Their results suggest that countries with greater legal capacity are indeed more likely to file complaints against AD measures imposed against them and that this also reduces the probability of seeing measures imposed in the first place. Estimates also suggest that higher export dependence of the investigating country makes complaints more likely—which makes sense given that as the target has higher leverage to retaliate in this case—but get somewhat inconsistent results for export dependence in the investigation decision. Busch, Reinhardt and Shaffer also find that larger countries are more likely to impose measures—which would be in line with a power-centric explanation. That size has less of an impact on litigation could be interpreted in two ways: it may either imply that countries are relatively equal before the law or that powerful countries also consider other measures for retaliation.

This possibility is also addressed by Bown (2005). He analyses factors that determine the probability of legal challenges to US AD measures imposed between 1992 and 2003. Bown argues that trading partners' decision simply follows a cost-benefit logic, i.e. they weigh the probability of winning and the gains (restored market access) against the costs of litigation. However, Bown also points out that litigation is not the only option for countries targeted by US AD measures. They may also pursue "vigilante justice", i.e. launch AD measures on their own to retaliate. In his empirical analysis, he finds that targets' capacity to resort to direct retaliation³⁹ reduces the probability for pursuing litigation. At the same time, his findings suggest that overall US exports to targets decrease the probability of having measures imposed in the first place.

These analyses suggest several directions for further research. First, they indicate that retaliatory capacity is relevant and affects AD imposition. Notions of retaliation, whether it works at the product, industry or at a more aggregate level, remains an area for further discussion. Notably, some evidence suggests that a product-specific focus may be too narrow (Blonigen and Bown 2003, also Feinberg

³⁷ Their total sample includes 1,321 cases with 17 investigating countries and 33 targets. The sample for the second set consists of 849 measures.

³⁸ They construct a measure to capture bureaucratic quality and litigation capacity based on survey data. Not combined with export shares.

³⁹ For direct retaliatory capacity, Bown considers the value of US export shares at industry level to the target. The higher they are, the larger the target's capability for retaliation.

and Reynolds 2006) as trading partners may retaliate in other product/sectoral categories. If this is the case though, the notion of retaliation should be broader; its impact should not only be analysed with a view on particular industries only. It should be of broader relevance for the economy at large and reflected in AD authorities' decisions accordingly.

Second, retaliation via legal challenges has so far been researched more extensively. However, Bown's findings as well as policy discussions about AD strongly suggest that "vigilante justice" is another option and does get used but retaliation via legal channels has been researched more intensively. Case-level evidence illustrates a tit-for-tat logic. For example American duties against steel products from Canada followed by Canadian cases on US steel products in 1992 and 1993 (Blonigen and Bown 2003) or Indian investigations against steel products from Canada in 2002 following investigations of similar products by Canadian AD authorities (Feinberg and Reynolds 2006, p. 882). With AD use spreading, the chance for retaliatory episodes also increases. Retaliatory AD action may in fact be more popular than legal disputes because it is quicker and provides direct and certain benefits to petitioners (Bown 2005). In addition, "vigilante justice" is more problematic from a systemic perspective because it is clearly at odds with the rules and spirit of an open multilateral trading system and it is an area where power disparities possibly come (even) more to the fore than for litigation.⁴⁰ This calls for further analyses to examine retaliatory AD actions—Bown examines *capacity*—and how this possibility affects AD patterns. Given the spread of AD, it is clearly worthwhile to involve countries in addition to the US for this purpose. In light of the existing trade policy literature, research conducted on the interplay of democracy and liberal trade policy, considering the impact of institutions as part of this process seems like an obvious choice.

Finally, analyses of AD already suggest a strategic dynamic, i.e. that players condition their behaviour on other players (re)action, but hardly address this explicitly through theoretical modelling and empirical strategies. Existing analyses do account for a number of issues that may give rise to selection effects but they do not consider expected utility calculations of players as a strategic rationale would actually suggest (Smith 1999; Signorino 2002) and we know that this particular characteristic of the interaction is not really captured when using selection models other than strategic methods (Signorino 2002).

⁴⁰ Busch et al. (2009) propose the argument in reverse as they argue that dispute settlement and "the rule of law" can (better) deter protection against members lacking the ability to retaliate via other means.

2.4 Summary

This chapter has provided a review of the trade policy literature with a particular focus on the impact of institutions. This is essentially about which rules are conducive to sound economic policies and it remains subject to intensive scholarly research accordingly.

Considering the different arguments about democratic and autocratic rules and trade, the chapter has pointed out the need for theories that provide a clear theoretical link between institutions and policies rather than ultimately basing differences in policies on differences in preferences. Selectorate theory may offer a promising approach for further research in this respect because it explains how institutional rules affect leaders' choices and map into policies while leaders share a universal desire to remain in office. In addition, selectorate theory shifts the focus away from traditional regime type classification and proposes a different concept to classify institutions based on the size of the winning coalition and the selectorate. By departing from traditional regime type categories it can help clarify remaining ambiguities associated with the impact of democracy on trade policy and openness.

While empirical analyses about institutions and trade clearly advanced during the past two decades and help us understand the impact of institutional rules on trade openness better, the review has also pointed out that our knowledge about their effects on specific trade policy instruments remains more limited. Learning more about specific trade policy instruments and what drives their patterns of use, seems all the more warranted given the rising importance of more complex trade barriers.

The review has also pointed out that there is a need to better incorporate "structure" into the analysis of trade barriers. Comparative research often focuses on levels of existing barriers and assesses factors that influence imposition. Typically they do not conceptualise the decision to impose barriers as being based on expected utility calculations and thereby affected by trading partners' possible reaction. They rather focus on the barriers that have been imposed and compare their levels across countries, thereby masking the selection processes involved. Analyses from international relations, meanwhile focus on the occurrence or absence of conflict or cooperation between states. This is often the case when barriers have already been imposed and countries disagree about their legitimacy. However, these two stages are analysed separately most of the time, even though they are often inherently interconnected. This is where the strategic perspective can provide a link and contribute to a more thorough understanding of trade policy decision-making and the interpretation of outcomes.

Finally, the chapter has connected these three points derived from the general trade policy literature to AD specifically. AD provides new empirical ground to test for the impact of institutions and it is a specific trade policy instrument that has become increasingly more relevant. It can therefore add new insights to the trade policy literature while at the same time considering the impact of institutions can help enrich existing AD research. Finally, AD ideally provides for the possibility to

consider different perspectives for the theoretical and empirical analysis. While it can be approached from a “traditional” perspective comparing countries and their use of AD it can also be analysed from a strategic perspective in order to better take the underlying rationale for the decision to impose measures into account.

The following analysis takes up these points: Chap. 3 looks at the impact of institutions relying on a traditional country-level approach and examines the impact of institutions. Instead of contrasting democracies with autocracies, it draws on selectorate theory as the conceptual framework to classify institutions. Subsequently, Chap. 4 then examines the dynamics at the case level and explicitly considers the strategic interaction taking place there. It develops a theoretical model of AD use that is then tested empirically.

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