

Chapter 3

Trade Liberalization and Political Instability in Developing Countries¹

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1 INTRODUCTION

When in spring 2002 thousands of Argentineans protested against their government's economic policy, their anger was directed against, amongst other issues, the economic liberalization of the 1990s. After decades of protectionism, the Latin-American state followed the recommendation of the IMF, as did its neighbors, and systematically opened its markets of goods and capital. Critics of globalization considered the Argentinean crisis as an affirmation of their skepticism towards the "Washington consensus", namely the recipes of liberalization and deregulation. According to their interpretation, economic integration instigates socio-political conflicts because of the redistributive effects of liberalization. While capital owners and multinational firms profit from the renunciation of import substitution and other protectionist measures, the working population and the local industry are, in this perspective, the losers of the new policy.

This view suggests that increasing social and political instability will accompany the "Rush to Free Trade" (Rodrik, 1994) onto which many developing countries have embarked within the past two decades. Although this thesis plays a central role in the debate on globalization, it was not systematically tested until now. The majority of the economic literature deals with the *causes* but not with the *consequences* of economic interdependence. The increasingly professional research on the causes of civil war refers only partially to economic conditions as potential explanations of intrastate conflicts.

¹. We would like to thank the participants of the workshop on "Computer-Aided Methods for International Conflict Resolution and Prevention" at the Austrian Research Institute for Artificial Intelligence, Vienna 25-26 October 2002, for comments. Margit Bussmann and Gerald Schneider gratefully acknowledge the German Foundation for Peace Research for financial support of this project. In this chapter, we present a translated and slightly revised version with complementary analyses of Bussmann, Scheuthle, and Schneider (2003).

The availability of natural resources deserves special mention (Collier, 2001; de Soysa, 2002). However, a state's interlacing with the world economy is attributed at the most the role of a control variable. This is in sharp contrast to the dependency school, which was prominent in the 1970s and 1980s. Their representatives repeatedly pointed at the destabilizing effect that foreign direct investment allegedly has.

Academic research has dealt with the economic causes of protests since a long time already (e.g., Jagodzinski, 1983). However, the relationship between economic openness and political instability was ignored, although Ronald Rogowski (1989) raised the issue already some fifteen years ago. He showed with a standard trade model how free trade may affect class differences and conflict. Other researchers also find a connection between trade liberalization and regime change or economic crises (Fernandez and Rodrik, 1991: 1147), whereas Alesina and Drazen (1991) point out how the "war of attrition" in which contending social groups engage because of their unwillingness to pay the adjustment costs delays necessary reforms.

Although they are hardly inspired by these findings, opponents of globalization have repeatedly emphasized the destabilizing effects of economic integration. According to their point of view, a state that undergoes socially painful reforms such as trade liberalization significantly runs the risk of increased political instability. In principle, economic openness can influence the unity of a society in the long and in the short run. In this study, we distinguish between the two effects and examine them separately. A society possibly experiences social and political unrest shortly before and after measures of economic liberalization are implemented. In the long run, conversely, the economic growth resulting from economic openness might render exactly these conflicts harmless. For a better understanding of how measures of openness work, we will differentiate between various forms of instability, namely non-violent mass protests, political violence, and state failure.

Our chapter will be organized as follows. Based on foreign economic policy, we will first portray under which conditions and in which time frame measures of economic liberalization could meet domestic resistance. For this purpose, we will derive hypotheses on the long-term and short-term effects of openness from recent research in the field of political economy. The hypotheses will be compared to alternative explanations from the literature on the causes of civil war. In the description of our research design, we will lay out the operationalization of the variables and introduce our method of estimation. We present our bivariate and multivariate results in section 4. The article concludes with a summary and suggestions for further research steps.