Trade Liberalization and Political Instability in Developing Countries[1]

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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.

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 operationalizion 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.

2 FOREIGN ECONOMIC OPENNESS AND DOMES-TIC POLITICAL INSTABILITY: THEORY AND HYPOTHESES

2.1 The long-term effects

No economist is in doubt about the positive effects of trade for the national economy welfare (for example Krugman and Obstfeld, 2000). According to the neoclassical perspective, trade renders the division of labor between states more efficient. States that have opened up to international competition use their comparative advantage, and thus can produce and consume more goods than autarkies. In free trading states, prices approach world market prices. Protectionist measures, by contrast, increase the wedge between the national and the international price of a good. Sachs and Warner (1995) show that economically open developing countries grow faster and can better prevent balance of payments crises than comparable closed economies. Plümper (2001) qualifies this argument but does not deny that reducing trade barriers has a positive effect. In order to benefit from the welfare gains, regulative conditions have to be present for flourishing free trade. The degree to which a state shields its economy against foreign competition largely determines to what extent it can realize welfare gains from free trade.

Free trade can minimize the risk of domestic conflict in two ways. First of all, trade increases the welfare for the general population, and thus reduces factors that can lead to instability, as stated by the theory of deprivation (Gurr, 1971). According to the Stolper-Samuelson theorem of international trade, the abundant factors in a country profit from free trade. In developing countries this is, depending on how factors are divided, either labor or unskilled labor (Wood, 1994). In any case, it is the masses of the population that benefit from trade liberalization. However, the question arises whether economic openness increases income inequality. Here the empirical evidence is split. According to Fischer (2001), income inequality declined after economic liberalization in South East Asia, while at the same time it increased in Latin America. Other studies found either no relationship between the two variables or they arrived at the conclusion that countries experienced a fairer distribution of income through openness (Bourguignon and Morrisson, 1990; Bussmann et al., 2002; Edwards, 1997). If free trade really leads to more income equality, we can expect an additional reduction in the risk of political conflict. Rich and satisfied citizens are, according to the theory of deprivation, less involved in protests than poor and disadvantaged people.

Furthermore, gains from trade increase the interest in maintaining a free trade regime. Violent conflicts would be a hindrance to this commercial spirit.

Thus, it is in a country's interests, as well as in that of its citizens, to guarantee domestic peace and stability. This second line of reasoning is an extension of the liberal and democratic peace literature. In accordance with Immanuel Kant, several researchers argue that democratic states and states that are integrated into the world economy have a lower risk of fighting each other. War disrupts trade flows between countries, and therefore is too costly for a state and its citizens (Russett and Oneal, 2001). In addition, trade enforces liberal norms that are opposite to war and violent conflicts (Kant, 1795 [1987]). This argumentation, as applied to interstate wars, is widely discussed and finds considerable empirical support (Barbieri and Schneider, 1999; Russett and Oneal, 2001; Schneider et al., 2003). The same logic could be transferred to intrastate conflicts. Extreme forms of domestic instability are an obstacle to free trade and reduce potential gains that could be achieved through foreign economic liberalization in the long run. The relevant actors will include free trade in their cost-benefit calculations when they consider domestic strategies. An escalation of quarrels about the foreign economic orientation of a country is thus counterproductive for all participants because it deters foreign investors and trading partners. In case of an escalating domestic conflict, the parties —unions and employers, export-oriented and import-substituting industries— are all in the same boat.

Concerning the long-term effects of economic liberalization, we assume that economic openness helps to enhance economic development. The incentives for political opponents to find a peaceful solution for the conflict will be higher. Besides, liberal norms of conflict resolution are widespread, as postulated by transactionalism for half a century already (Deutsch et al., 1957). Based on the above arguments, we hypothesize that more open states are less susceptible to political instability.

2.2   The short-term effects

Whereas in the long-term the welfare increasing effect of economic openness is important, the distributive effect of the process of liberalization is decisive in the short run. A closed economy's opening up to free trade is a serious interference in existing economic and social relations. This is especially true for developing countries that largely rely on the development strategy of import-substitution. Liberalization might be accompanied by important economic changes that could affect large parts of the population.

The assertion that the process of opening an economy to international trade increases the risk of instability can be related to two classical models of international trade theory, the Ricardo-Viner model and the Stolper-Samuelson model. An example of conceptualizing the conflict centering on the free trade orientation is provided by the widely acknowledged work of Rogowski

(1989). In his model, the coalition patterns activate a change of the trading regime in such a way that the society becomes less stable. He distinguishes, based on the Stolper-Samuelson model, the factors *capital*, *labor*, and *land*. In case of a turn to free trade, the holder of abundant factors will benefit, whereas the owners of scarce factors will lose. The losers want to stop this change and the winners are interested in accelerating the reforms in order to enlarge their power. Rogowski derives the lines of conflict for countries that are in transition from protectionism to free trade. The cleavage runs between urban and rural areas in countries where land is the abundant factor, and between labor and capital in countries that have abundant labor.

Frieden (1991) presents a similar model. He argues, based on the Ricardo-Viner model, that sector-specific factors are not completely mobile between the sectors. In this model, the lines of conflict do not run between the different classes but, in case of trade liberalization, between the export-promoting and the import-substituting sectors. The more specific a factor and the more cohesive a sector, the higher is the pressure on politics and thus the larger its political clout.

The political economy of developing countries is determined by state regulation and rent-seeking, both aiming at the enrichment of the elites and the stability of the ruling regime, instead of at the welfare of the population (Tullock, 1980; Weede, 1990). An economy regulated by the government has the goal of earning foreign exchange through the export of resources and agricultural products to raise money in support of the import-substituting industries. Followers of the government manage these industries often inefficiently, rendering them internationally uncompetitive. To save these firms the markets are closed. This way the ruling elites can earn rents and in return they promise loyalty and support to the government. In the medium-term this system is stable because neither the government nor the elites have an incentive to change the existing order. In the long run, however, the national economy suffers, and reforms become eventually inevitable.

Foreign economic liberalization destabilizes the existing social system because the profiteer of a closed economy loses a large share of income. Economic liberalization enhances national welfare, but the distributive effect is immense. Rodrik (1994) estimates that the cost-benefit ratio is larger than five; this means for each currency unit of additional income from liberalization five currency units will be redistributed. A change in trade policy presumably has a direct impact on the income of the import-competing sector which has to bear the total costs while the general population (through low prices) and the export sector are the winners. Until the 1980s the industries in most developing countries were protected from competition; they could produce inefficiently and sell their products more expensively than the world

market price, i.e. with a higher margin of profit. With open markets this is no longer possible. Consequently, the import-competing sector is always opposed to foreign trade liberalization.

The state has to expect losses from liberalization as well. Due to an inefficient tax system, many developing states relied on the income from tariffs and the sale of licenses in order to finance their budget (Rodrik, 1994). Liberalization reduces this source of income. Because taxpayers might fear that the government seeks compensation, they have some reason to oppose the reforms.

Another problem of trade reforms results from the fact that differently structured groups are affected by the gains and losses of the reform. As the general public is the winner, individual gains are small. Because the losers are a small group, which often coincides with the political and economic elite, the individual disutility is large. This divergence creates an important asymmetry. According to Olson (1965), it is much easier for a small homogeneous group to organize itself, whereas a large heterogeneous group suffers from the problem of collective action. Every individual wants to use a public good but has no incentive to contribute to its provision. As a result the public good is not or only insufficiently provided. In the case of trade liberalization, this means that, unlike the small group, the large group is badly organized, and thus not efficient in its fight for the public good "liberalization". The beneficiaries of the previous system, however, could show their resistance to liberalization in order to maintain their privileges. If the government decides to open the country to free trade, it has to expect massive opposition from the import-competing sector but can count on only limited support.

Foreign liberalization is a difficult undertaking, especially because the supporters of the government are potential losers. An additional problem results from the long-term character of the costs of liberalization, as it is not possible for protectionists to seek the rents after the reform. This source of income dries up completely through liberalization. Especially neo-patrimonial governments have increasing difficulties to compensate its followers because they lose a source of income as well.

In this situation the state is susceptible to political instability. On the one hand, the government has to improve the economic situation in order to avoid turmoil in the population and to weaken the opposition. On the other hand, the government is afraid that the elite will organize a coup in order to prevent or reverse reforms. These contradictory goals put pressure on the government, what Plümper and Schneider (2000) call the trilemma of the protectionist autocrat. The autocrat has to maximize his own income and that of his followers and simultaneously, in times of crises, he has to make concessions to the liberal opposition or to the population in order to maintain regime stability.

This situation is problematic for the autocrat as he can only achieve two of the three goals at the same time. Thus, it is obvious why a long lasting socio-political conflict often prevents the timely implementation of reforms (Alesina and Drazen, 1991).

In addition to the hypothesis on the long-term effects of economic openness on political stability, we will examine short-term effects. We assume that the liberalization of the economy directly increases the risk of domestic conflict because this process is accompanied by a far reaching redistribution, which polarizes between the economic and political winners and losers. This is especially true in times of reforms, as the welfare gains that the government promises remain uncertain. We expect, in sum, that in the short term the process of foreign economic liberalization increases the risk of instability.

2.3   Control factors

Whereas our focus is on the relationship between economic liberalization or openness and political violence, we will also control for other factors that are spelled out as potential causes of instability. There are essentially two strands of literature that deal with the causes of political violence. One theory emphasizes economic dissatisfaction and the other considers political incentives as root causes of rebellion (Schock, 1996). Representatives of the theory of economic dissatisfaction, also called relative deprivation, start with the assumption that the population's perception of the difference between expectations and actual economic conditions leads to violence (Gurr, 1971). The distinction between absolute and relative deprivation is common. In case of absolute deprivation, a group becomes rebellious if it possesses very little of a certain good (Lipset, 1959), whereas in case of relative deprivation, a group compares itself with another group. Frustration emerges because the group has less of a good than the group with which it compares itself (Gurr, 1970, 1994). A high degree of economic and political inequality within the population leads to these processes. In addition, factors of identification, such as ethnicity or religion, can justify violence against other groups (Ellingsen, 2000).

Identity and frustration are not sufficient factors to start a rebellion; the group needs in addition a good opportunity. The group is accordingly supposed to calculate if the rebellion is likely to be successful (Tilly, 1978). For the representatives of the theory of political opportunity, it is less the economic conditions that are important. The political context and the opportunity to overcome collective action problems are more salient. Factors that contain a potential for violence are present in every society, but only in certain situations will potential violence turn into actual violence (Tilly, 1978; Tarrow,

1989, 1998). Here, especially the characteristics of the political system play a role.

A high level of development is expected to reduce the risk of instability because the population attributes its economic well-being at least partly to the government (Henderson and Singer, 2000). Lipset (1959) showed that economic welfare leads to achievements like education or better access to information which in turn reduces instability. Furthermore, Gurr (1979) considers economic development as a means to reduce political violence without reducing protests because rich countries are predominantly democracies and democracies tolerate non-violent protests. A micro-level version of this explanation is offered by Collier and Hoeffler (1998). According to their study, the costs for a rebellion go up with a higher level of development because a rich individual has more to lose from a rebellion than a poor citizen. We assume that economic welfare renders the conditions that might lead the population to become involved in a rebellion less attractive. Economic welfare is thus expected to reduce the risk of political instability.

Liberalism as a theory within the field of international relations postulates that democracies are especially resistant against violent political conflicts. The two underlying causal mechanisms that this approach puts forward relate to the competitive elections on the one hand and the non-violent norms of conflict resolution on the other hand that shape democratic systems. If the majority of the population is dissatisfied with the government, it can vote for another party in the next election. The threat to be moved out of office functions, in the liberal view, as a deterrent against the use of force. The democratic norms allow for a generally peaceful conflict resolution and a non-violent way of dealing with political questions (Russett, 1993; Gleditsch, 1995; Rummel, 1997). The thesis that democracies are more peaceful political systems is, for the most part, empirically supported. However, we cannot assume a linear relationship between the two variables but rather an inverse U-curved relationship between democracy and political violence (Muller and Weede, 1990; Boswell and Dixon, 1993; Schock, 1996; Auvinen, 1997; Benson and Kugler, 1998; Ellingsen, 2000; Henderson and Singer, 2000; Hegre et al., 2001). This means that the risk of political instability is rather low in democracies as well as in autocracies, whereas it is high in semi-democracies. In contrast to democratic politicians, autocrats are not dependent on the support of the population but are generally backed up by a very small winning coalition. In exchange for their support the group expects to receive rents from the government (Frey and Eichenberger, 1994; Pritzl and Schneider, 1997). The small size of a winning coalition makes the survival of the autocratic ruler relatively independent from the performance of the economy (Bueno de Mesquita et al., 2000). In addition, autocrats have the possibility to

suppress resistance by force. The risk of instability is assumed to be higher in semi-autocratic regimes than in democracies or autocracies. An economic crisis weakens the government in many ways making a country more susceptible to rebellions. Reduced income from taxes limits the abilities to silence a potential opposition (Plümper and Schneider, 2000). Second, an economic crisis increases dissatisfaction among the population who has to bear the main burden and holds the government responsible. In a democracy the government counts on losing the next elections; in a dictatorship political violence might erupt if the government can no longer distribute rents to its supporters who might consider overthrowing the government by force. As Collier and Hoeffler (2000) point out, an economic crisis increases the risk of a domestic conflict but not because certain groups in the population feel deprived of their rents. Instead, a bad economic situation reduces the costs of recruitment for the rebels because they can offer higher incomes to potential members than the wages to be earned on the regular labor markets. Economic growth should reduce the risk of political instability.

The size of the population needs to be taken into account, especially in connection with foreign economic liberalization. The assumption is that large states are more susceptible to conflict. Populous states are more heterogeneous which increases the probability that individual groups expect an advantage from successions (Collier and Hoeffler, 1998: 564), a relationship that a broad literature supports (i.e. Rothgeb, 1990; Collier and Hoeffler, 1998, 2000; Zanger, 2000). In addition to a direct effect of a country's size, there is an indirect effect. Large countries are less strongly integrated into the world economy because they can satisfy the need of the population within the domestic market, whereas for small states integration in the world economy gives access to a larger market (Alesina et al., 1997; Alesina and Wacziarg, 1998). This advantage comes at the price of higher cultural heterogeneity which minimizes the efficiency of political institutions. We can easily deduce from this argument that in small countries economic liberalization will be more welcomed in the population because it brings more direct benefits to the citizens. In large countries the advantages of liberalization are less pronounced. In these countries economic liberalization might provoke a strong reaction and thus increases the risk of instability.

3   RESEARCH DESIGN

We examine the hypotheses of a relationship between political instability and foreign economic openness and liberalization with data for 90 developing countries for the time period from 1978 to 1997. As *protest*, *political violence,*

and *state failure* are dichotomous dependent variables, we choose logistic regression as method of estimation. This statistical approach estimates the probability that an event occurs, i.e., the probability that the dependent variable takes the value 1. We conduct all tests with White-corrected standard errors in order to deal with the problem of heteroscedasticity; this releases the condition that the single observations, at least within a state, have to be independent. The panel structure of the data set bears another problem, the problem of temporal dependence, and thus an additional violation of the assumption of independence of observations. We controlled for temporal dependence with the approach taken by Beck et al. (1998) of adding a variable that measures the stability in the past. Stability in the past is calculated as the number of years since the last outbreak of instability with the program Binary Time-Series-Cross-Section Data Analysis Utility Version 4.0.4. (Tucker, 1999). What follows is the description of how we operationalized the individual variables and of the corresponding sources of data.

3.1   Dependent variable: Political instability

Our dependent variable is political instability which we operationalize in three different ways: as *mass protests*, *political violence*, and *state failure*. By using different indicators of instability we want to ensure that our results are robust to the operationalization of the dependent variable, especially in light of the lacking consensus in the research community on how to measure political instability (Auvinen, 1997; Kimenyi and Mbaku, 1993; Boswell and Dixon, 1993; Sidell, 1988).

For the first two indicators we use information on various forms of political instability from the Cross-National Time-Series Database (CNTS Archive 2001). All variables in the CNTS database count the events per year. The combination of different events into an additive index is problematic because the ordinal character of these variables is questionable. Instead we use indicators that take the value 1 if one or more of the described events happened and 0 otherwise. This means the indicator variable *mass protest* takes the value 1 if a country experienced one or more demonstrations, general strikes and/or revolts within a given year. Revolts are violent demonstrations. General strikes and anti-government demonstrations are peaceful and are aimed against government policies. The variables are 0 if none of these events happened. We calculate *political violence* similarly, using the CNTS-data about revolutionary wars, guerilla wars, and political assassinations. Revolutions are instirred with the goal of overthrowing the government. Guerilla wars account for activities of illegal rebel groups. Political assassinations are killings or attempted killings of high ranking civil servants or politicians.

In addition to *mass protests* and *political violence*, we examine *state failure* with data from the State Failure Task Force (Esty et al., 1998; King and Zeng, 2001). The State Failure Project divides the variable *state failure* into revolutionary wars, ethnic wars, and genocides. In order to be classified as a civil war, a conflict has to break out between the state and a rebel group of at least 1000 members and the conflict has to have a threshold of at least 100 victims per year. Revolutionary wars aim at overthrowing the government, whereas in ethnic wars the dispute occurs between the government and an ethnic group that wants to change its status, for example seceding from the state. Genocides are mass killings organized by the state and that last at least six months. State failures are abrupt and violent changes in the state's structure or a change to an autocratic regime. They are defined by a change of at last three points on the Polity-scale or through a long period of missing state institutions. As before, we use state failure as a 0-1 indicator.

3.2 Independent variables

3.2.1 *Foreign economic openness and liberalization*

We distinguish between economic openness and economic liberalization. The former variable stands for the extent to which the state is actually integrated into the world economy; the latter concept is the process with which the government creates the regulative conditions for free trade. In order to estimate the long-term effects of economic openness we rely on a measure that calculates the sum of exports and imports divided by GDP with data from the Penn World Tables version 6.0. A problem with this measurement is that trade flows do not necessarily provide information about trade policy (Martin et al., 2001: 3).

Foreign economic liberalization denotes the regulations that are necessary for free trade, i.e., the absence of tariffs, quotas, import and export limitations, and a freely convertible currency. Liberalization signifies the withdrawal from regulative obstacles for free trade. For a country to benefit from the advantages of trade, the political conditions favorable for free trade have to be present. In order to investigate the short-term effects of the process of economic liberalization, we will use the CACAO-indicator of Martin, Plümper and Schneider (Martin et al., 2001). This indicator of openness measures trade institutions and barriers on an ordinal scale from 0 for open to 7 for closed. This index is based on a combination of trade policies and institutional arrangements taken from the IMF's *Report on Exchange Arrangement and Exchange Restrictions*. The process of liberalization will be measured as the CACAO's difference to the previous year.

3.2.2   Level of development

The negative relationship between the level of development and political instability or civil war was empirically supported in several studies. The GDP per capita is a standard variable in every regression on this topic (Auvinen, 1997; Collier and Hoeffler, 1998, 2000; Elbadavi and Sambanis, 2000; Fearon and Laitin, 2003; Henderson and Singer, 2000; Zanger, 2000). Others arrived at the same result by using the energy consumption per capita (Jagodzinski, 1983; Ellingsen, 2000). We add the GDP per capita in logarithmic form to our regressions to account for the skewed distribution of this variable.

3.2.3   Economic growth

Few studies have tested the influence of economic crises on instability. Jagodzinski's (1983) study revealed a negative or no effect of economic growth. Auvinen (1997) found a positive relationship between inflation and political conflict and a negative effect of economic growth per capita. Based on GDP per capita, economic growth will be measured as $(GDP_t - GDP_{t-1})/GDP_{t-1}$.

3.2.4   Level of democracy

We operationalize, as indicated, the type of regime with the widely used Polity IV-index (Marshall and Jaggers, 2000). Polity combines various institutional characteristics of a political system—openness and competitiveness of executive recruitment, constraints on the chief executive, regulation and competitiveness of political participation—to an index ranging from -10 for autocracies to +10 for democracies. We add the index of regime type to our model of instability in its linear form as well as its squared term to examine whether the relationship has the form of an inverted U-curve.

3.2.5   Population

To account for the size of the population we use data from the World Bank (1999). The variable will be used in its logarithmic form.

For the variables *economic development*, *economic growth*, *democracy*, *openness*, and *liberalization* we take the values from the previous year in order to avoid that the variables are influenced by instability. For *population* this is not necessary because this concept does not vary greatly over time. Table 3.1. summarizes our basic models and indicates the signs that we expect for the independent variables.

Table 3.1. Expected influence of different variables on political instability

Independent variable	Expected influence on political instability
Openness	-
Liberalization	+
Economic growth	-
Level of development	-
Democracy	+
Democracy squared	-
Population	+

4 RESULTS

As a first approach to the research questions we will examine whether economically open countries are more stable than closed states by looking at a simple cross tabulation of *openness* and *instability* (see Table 3.2.). For this purpose *openness* is divided into three categories: from closed (0 to 2 on the CACAO-openness scale) over an intermediate category (3 to 4) to open (5 to 7). As *instability* we use collective protests and political violence.

Table 3.2. Cross-tabulations of trade openness and instability

Protest	Trade openness			
	1 - closed	*2*	*3 - open*	*total*
0 – no protest	831	97	49	977
	67,18%	62,58%	70,00%	66,83%
1 – protest	406	58	21	485
	32,82%	37,42%	30,00%	33,17%
Total	1237	155	70	1462

Pearsons Chi-Quadrat (χ^2)=1,65 df(2)

Political Violence	Trade openness			
	1 - closed	*2*	*3 - open*	*total*
0 – no violence	749	101	52	902
	63,69%	69,66%	88,14%	65,36%
1 – violence	427	44	7	478
	36,31%	30,34%	11,86%	34,64%
Total	1176	145	59	1380

Pearsons Chi-Quadrat (χ^2)=16,15** df(2)

We can detect a significant χ² difference between the categories only in the case of political violence. This means open countries experience less instability. For the closed and intermediate categories the proportion of non-violence and violence is about 2:1, whereas for the open states this proportion is 9:1. In the case of protests the differences could happen by chance. Here we can see that the distribution for all categories of openness is throughout about 2:1. A simple bivariate examination leads us thus to conclude that *openness* is not related to *protests* but does vary systematically with *political violence*.

In our multivariate regression analyses we examine the relationship between *openness* and *instability* while holding other influences constant. For the tests we use different indicators of instability.

The first column in Table 3.3. shows the long-term effects of *openness* on *mass protests*, i.e., the incidence of demonstrations, strikes, and/or unrests. *Openness* is negatively related to *mass protests* at a level of statistical significance of .06. The null hypothesis of no relationship between the two variables cannot be rejected. In the second column, we substitute the long-term variable of *openness* with *liberalization*, the variable measuring the short-term effects of the process of opening an economy. We can observe a negative relationship but it is clearly not significant. In our tests, we could not confirm short-term effects of foreign economic liberalization on the protest behavior in developing countries.

In both models the control variables have the expected direction. The results of *economic development* indicate that the hypothesis of rich countries having fewer conflicts than poor countries is not warranted, at least not concerning protests. Instead, we can observe that protests are more likely in rich countries, a result that is statistically significant. The variable *economic growth* as indicator for economic crises points, as predicted, to a conflict reducing effect. It seems that economic crises can significantly destabilize a country. The lacking significance of the squared term of *democracy* suggests a linear relationship between *protests* and *democracy*. In democracies we can observe more protest behavior, which has to do with lower levels of repression and more freedom of expression in democracies. This is consistent with Prezeworski et al.'s (2000) findings. *Population* shows a highly significant and positive relationship with *instability*; this means that large countries are less stable than small countries. This finding is in agreement with the hypothesis that large countries are more heterogeneous and thus have a higher potential for conflict. The variable accounting for the history of protests is, as expected, highly significant. The more years without protests a country experienced, the less likely it will undergo a protest now.

Table 3.3. Foreign economic openness and liberalization and various indicators of political domestic instability, 1978-97.

	Protest		Political violence		State failure	
	Model 1	*Model 2*	*Model 3*	*Model 4*	*Model 5*	*Model 6*
Openness $_{t-1}$	-0.0072*	-	-0.0062*	-	-0.0073	-
	(0.0038)		(0.0037)		(0.0058)	
Liberali-zation $_{t-1}$	-	-0.071	-	-0.0031	-	-0.065
		(0.122)		(0.164)		(0.389)
Economic development $_{t-1}$	0.405***	0.308*	-0.046	-0.044	-0.223	-0.151
	(0.127)	(0.119)	(0.116)	(0.123)	(0.206)	(0.212)
Economic growth$_{t-1}$	-2.17*	-3.77*	-0.946	-1.13	-1.84	1.56
	(1.06)	(1.23)	(1.01)	(1.36)	(1.22)	(1.72)
Democracy $_{t-1}$	0.042***	0.030*	0.045***	0.048***	0.067***	0.076*
	(0.011)	(0.012)	(0.013)	(0.014)	(0.021)	(0.056)
Squared Democracy $_{t-1}$	-0.0019	-0.001	-0.0084*	-0.0061*	-0.012*	-0.0075
	(0.0024)	(0.0029)	(0.0034)	(0.0037)	(0.0053)	0.0057
Population	0.32***	0.38***	0.093	0.13*	0.39***	0.211*
	(0.08)	(0.07)	(0.08)	(0.06)	(0.10)	(0.12)
Years since last Instability	-0.818***	-0.801***	-1.25***	-1.207***	-1.89***	-2.00***
	(0.141)	(0.155)	(0.156)	(0.181)	(0.21)	(0.22)
Constant	-7.69***	-8.33***	-0.011	-1.06	-2.44	-0.026
	(1.61)	(1.29)	(1.65)	(1.51)	(2.26)	(2.42)
N	1442	1052	1345	988	1445	1052
Wald Chi^2	208.34	166.69	176.97	138.13	347.31	276.55
Prob. > Chi^2	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001
Pseudo R^2	.20	.21	.20	.20	.56	.66

Note. The first numbers in each cell are the coefficients, the number in parentheses are the semi-robust standard errors. The asterixes are the level of significance (* $P < .05$; ** $P < .01$; *** $P < .001$).

In models 3 and 4 we substitute *protests* with *political violence* as indicator for instability. As expected, in autocracies and democracies the risk of instability is smaller, whereas in semi-autocratic regimes the risk is higher. The *democracy* variable in its simple form has a positive sign and the squared democracy term has a negative coefficient, thus referring to the relationship of an inverted U-curve. Both variables are jointly significant at the .001 level. In model 4, we can detect a positive relationship between *population* and *political violence* as well. The variable for the violence history is again significant. Between *openness* and *political violence* we have a negative relationship with

a probability of less than 10 % that this relationship occurred by chance. On the other hand, foreign economic liberalization has no effect on political violence in model 4.

Finally, we consider instability operationalized as *state failure*, a dependent variable that is based on data from the State Failure Project. The inverted U-curve between level of *democracy* and *state failure* can be confirmed; both variables are jointly highly significant. We find, with a high level of significance, that large countries are more susceptible to instability. The level of development has the expected negative sign but is not statistically significant. Economic growth also turns out to be insignificant. The variables *openness* and *liberalization* have both a negative coefficient without statistical significance.

To sum up, we can conclude from the tests so far that in the long term an open economy is related with political stability, a finding for which we detect some support. In the short term, the process of liberalization does not appear to affect instability.

4.1   Tests of robustness

In the next series of tests, we examine additional control variables that were emphasized in the literature. We want to reduce the omitted variable bias and to ensure that our results are robust to the model specification. The following analyses are based on the model of political violence, the variable we are primarily interested in. The literature frequently mentions income inequality as a possible cause of political violence. The predominant and widely spread opinion is that an unequal distribution of income increases the risk of political instability (Muller and Seligson, 1987; Boswell and Dixon, 1993; Alesina and Perotti, 1996). Poor people perceive inequality as unfair and demand a more just distribution of resources. Therefore, we examine the additional hypothesis that an unequal distribution of income increases the risk of political conflict by using the Gini coefficient to measure the income distribution. Data are available from Deininger and Squire (1998). Theoretically, this control variable is very important; however, our results show that it is statistically not significant. With the inclusion of the Gini index the number of observations drops to 589 in our model. Its addition has no impact on the trade variables.

Besides income inequality, ethnic fractionalization is frequently pointed out as a reason for political instability. The research community does not yet agree which form this relationship has. On the one hand, there is the assumption that the danger of conflict is highest when there are two equally strong groups because each one of them believes that it will be the winner in a conflict but also because the costs of coordinating and founding a rebel group are

smallest. (Henderson and Singer, 2000; Collier and Hoeffler, 1998). The other side argues that a group's ethnic dominance is most dangerous because the group has an incentive to take advantage of its strength and to exploit other groups (Auvinen, 1997; Collier, 2001). We examine the hypothesis that ethnic fractionalization increases the risk of political conflicts.

Ethnic fractionalization is constructed as the Herfindahl-index by summing up the squared proportions in the population and subtracting it from 1. Small values stand for homogenous and large values for heterogeneous societies. We use data from Collier and Hoeffler (2000). Changes in the ethnic composition of a population are very small and therefore, we took the last values for all the years until 1997 to avoid missing values. The variable has in both models a negative sign but is not significant and does not influence the results of the other variables. *Openness* remains marginally significant and *liberalization* insignificant.[2]

We examined our basic model of political violence for collinearity of *openness* or *liberalization* with any of the control variables to see if this influences our results. For example, one could expect that the variable *democracy* influences the effect of *openness*, because democratic states presumably have a higher involvement in free trade (Bliss and Russett, 1998). Excluding the level of development and economic growth does not affect the results of *openness* or *liberalization*. However, when suppressing the *democracy* variables from the equation, *openness* loses its significance. The violence reducing effect is thus not completely independent from the regime type.[3] If *population* is excluded, the level of significance rises dramatically ($p < .001$). In this case however, *openness* accounts for the fact that small countries are more open.

5 SUMMARY

In this study we examined, with a dataset of 90 developing countries for the time period 1978-97, the two questions of whether free trade reduces the risk of political instability and whether the process of liberalization increases this risk. We wanted to shed light on the long-term and short-term effects of free trade with regard to instability in form of mass protests and political violence. Neither long-term openness nor short-term measures of liberalization

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[2.] We also added the squared term of ethnic fractionalization in order to account for Ellingsen's (2000) argument. Both variables had the expected signs but were insignificant.

[3.] The inclusion of an interactive term between openness and democracy does not provide further insight as it is insignificant.

seem to have an impact on the protest behavior in a population. With regard to political violence, free trade has a conflict reducing effect in the long term but no effect in the short term. The suspicion that countries on their way to a more open economy are more susceptible to instability cannot be supported. The results of our regression analyses rather lead to the conclusion that countries that are more open economically seem to be more stable. This supports the basic idea that integration into the world economy reduces the risk of domestic conflicts. In this regard our results are supplementary to the findings of the liberal peace on the interstate level. The results suggest that free trade has a conflict reducing effect especially for political violence and that it can affect the preferences and norms of conflict regulation. The second important result of our study is that the process of foreign economic liberalization does not increase the risk of instability.

High economic growth, interpreted here as an absence of an economic crises, reduces the risk of mass protests. In democracies and large countries we can observe a higher probability that protest will happen. The inverted U-curve effect of democracy, which postulates that democracies as well as autocracies are less susceptible to political violence, can be confirmed.

This work was a first attempt to make the debate on the effects of globalization more objective. We laid a bridge between the literature on economic openness and reforms and the research on conflict and civil war. The influence of foreign economic liberalization on instability was not systematically examined yet in the empirical social sciences. In this regard our work is a contribution to this shortcoming. It introduces a new potential cause of conflict into the theoretical debate and, at least partly, confirms this effect empirically.

A major problem with our empirical tests was the quality and incompleteness of the data. Missing values result in the complete exclusion of some countries and years. This impairs our results and does not allow us to draw generalizations as the missing values are not random. New and more complete data have to be collected. In particular an extension of the data set on income inequality would be very valuable with regard to the causes of political instability. Case studies can help to clarify the causal relations in a next step. In addition, international factors, such as interstate conflicts, have to be included in an analysis. We are confident that by extending our research, the central finding will be maintained: Foreign economic liberalization has triggered in many countries what could be called the "peace dividend" of globalization.

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