

FEATURE ESSAY

Preferential Trade Agreements in Hard Times

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Agreements about foreign trade policy have long been key features of the international political economy. Among the most important agreements of this sort are preferential trade agreements (PTAs), which are designed to foster economic integration among member-states by improving and stabilizing the access that each member has to the other participants' markets. PTAs are a broad class of international agreements that include common markets, customs unions (CUs), free trade areas (FTAs), and economic unions. These agreements have marked the global landscape for centuries, but they have proliferated especially rapidly over the past half-century, and hundreds of them currently dot the international system. The spread of PTAs continues unabated and is one of the most significant trends in the international political economy.

Despite the importance of and the widespread interest in PTAs, remarkably little research has been conducted on the sources of these agreements. In a recent study, we attempted to help fill that gap in the literature (Mansfield and Milner 2012). Our focus in that study was on the domestic political influences on preferential agreements. More specifically, we argued that PTAs are especially likely to be ratified by democratic countries and states marked by relatively few "veto players." Here we extend that argument by addressing whether democracies tend to establish these agreements during hard economic times. The argument we advanced in that study suggests as much, but has not been directly tested.

The existing literature implies that countries tend to become more protectionist during economic downturns and less protectionist during expansions (Cassing, McKeown, and Ochs 1986; Magee and Young 1987; Mansfield and Busch 1995; Costinot 2009).¹ The Great

Depression of the 1930s is a particularly widely cited instance of this more general pattern. Kindleberger (1986) and others have pointed out that the depression stimulated a rapidly rising tide of protectionism that engulfed all the major economies and, in turn, deepened the global downturn. In the same vein, observers expressed a keen interest in whether the great recession of 2008-09 would lead to a surge in protectionism. These hard times, which have stretched to the present day for many countries, have been marked by large declines in gross domestic product (GDP), rapid and sizable spikes in unemployment, widespread bankruptcies, stock market declines, and real estate price collapses.² World trade and direct foreign investment flows also dropped precipitously.³ It was thus widely expected that adversely affected countries throughout the globe would respond as states had in the 1930s and erect trade barriers to protect their economies, thus exacerbating the downturn. In fact, some countries have reacted in this manner, and the moribund Doha Round of World Trade Organization negotiations have not helped matters.⁴

Somewhat surprisingly, though, there has been a fairly widespread resistance to protectionism and a resurgence of international trade and investment since 2009 (Bown 2011; Rose 2012; Kee, Neagu, and Nicita forthcoming). Accompanying this development is an ongoing interest in forming PTAs by many countries throughout the world.⁵

(2003).

² On these issues, see <http://www.imf.org/external/pubs/ft/weo/2010/update01/>.

³ World trade dropped at least 12% in 2009 alone. See <http://siteresources.worldbank.org/INTGEP2010/Resources/Overview.pdf> and http://www.wto.org/english/res_e/statis_e/its2011_e/its11_world_trade_dev_e.htm.

⁴ See http://globaltradealert.org/sites/default/files/GTA11_0.pdf.

⁵ In 2011, for example, the US finally ratified

PTAs liberalize trade among their members, but they may or may not divert trade from third parties (Freund and Ornelas 2010). These trade agreements thus are a source of liberalization, but they are not as unambiguously liberalizing as multilateral agreements within the WTO. Nevertheless, for countries to sign and ratify PTAs in the midst of economic downturns seems surprising given the widespread view that protectionism rises in hard times. We are interested in whether economic fluctuations influence how domestic political factors—especially regime type—shape whether and when states decide to form PTAs.

We have argued that national leaders often decide to enter PTAs for political as well as economic reasons (Mansfield and Milner 2012). Faced with special interests that demand protection, particularly when the economy sours, leaders need to find ways to reassure the mass public that they are not being captured by protectionist interests and that they are making sound foreign economic policy. Increasing trade barriers may win leaders support from some import-competing interests, but doing so can also antagonize pro-trade interest groups as well as the general public, which will be harmed if protectionism contributes to slumping economic growth. PTAs provide a mechanism for leaders to manage such societal pressures.⁶

PTAs with South Korea, Panama, and Colombia. It began negotiations on the Trans-Pacific Partnership in 2009. The US is also negotiating a free trade agreement with the EU. Throughout this period, Asian countries and the EU have also been busy negotiating and signing trade agreements.

⁶ PTAs may also help countries increase growth through the exports they stimulate. We do not claim that PTAs have no economic effects or that leaders are not motivated by such economic incentives. But we think that the political effects of trade agreements are also very important, and have not been appreciated

continued on page 10

¹ For an overview, see Bagwell and Staiger

Mansfield & Milner Feature Essay...continued from page 9

For leaders, entering a trade agreement can help to reassure the public that they are making sound foreign economic policy. Leaders, however, also worry about the domestic costs involved in ratifying agreements. Balancing these two forces is a central part of a decision maker's calculations about whether to sign a PTA. A country's regime type and its number of institutional veto players are crucial in this regard. Regime type and veto players are two distinct institutional features. Regime type is linked to the degree of political—especially electoral—competition, while veto players affect the checks and balances on the executive branch.

Our first argument is that the number of veto players in a country affects the transaction costs that governments bear when ratifying a PTA. These costs are greater in countries marked by a large number of veto players, which in turn reduces the incentives for leaders to try to negotiate and ratify PTAs. Consequently, the odds of a state entering a preferential arrangement declines as the number of veto players rises.

Our second argument is that democracies have greater political incentives to enter PTAs than other countries. The free, fair, and regular elections that are the hallmark of democracies motivate leaders in such regimes to sign international trade agreements. Leaders in various types of polities are caught between the pressures of special interest groups and the preferences of voters. Some special interests press for policies—such as protectionist trade policies—that adversely affect the economy. Heads of states may want to satisfy these interest groups in exchange for benefits like campaign contributions or other sources of political support. But giving in to all interest group demands would have very harmful economic consequences and could imperil their hold on office.

Leaders, at the same time, have a hard time convincing the public that they will not accede to special interest

demands. When elections take place in the face of adverse economic circumstances, citizens may blame incumbents for economic problems and vote them out of office. As such, chief executives need to find ways to reassure the public and other domestic groups that economic downturns are beyond their control and are not simply an outgrowth of leaders buckling under to the demands of protectionist groups.

PTAs provide such a political reassurance mechanism. These agreements allow leaders to commit to a lower level of protectionism than they might otherwise desire, and to signal voters that they will not allow trade policy to be dictated by special interests. Voters, if reassured that leaders are generally abiding by the terms of the international agreement, have reason to believe that leaders' policies did not directly cause any hard economic times that come to pass. In turn, these leaders are more likely to remain in office since voters have reason to view them as competent economic stewards, even during recessions. The more electoral competition that exists, the more that leaders have to worry about being ejected from office and the greater their need to reassure the public. Hence, we argue that democratic governments should be more likely to sign trade agreements than other governments.

For autocracies, the calculations differ. Interest group pressures for protectionism in autocracies vest leaders with an incentive to resist entering PTAs that reduce the rents they can provide to supporters. Equally, autocrats have less need to reassure the public that they are competent economic decision makers since electoral competition does not determine their fate. Consequently, autocrats have less incentive to enter into trade agreements than their democratic counterparts.

Our results clearly show that both veto players and regime type strongly influence PTA formation. Based on an analysis of the period from 1952 to 2004, we found that a given democracy is over

50% more likely to establish a PTA than a given autocracy, holding constant various international and domestic factors. We also found that countries with relatively few veto players (which we define as the 10th percentile in our data) are about one third more likely to form a PTA than states with many such players (which we define as the 90th percentile in our data) (Mansfield and Milner 2012: 108-9). These results provide substantial support for our argument. They are also very robust, displaying little change regardless of our modeling and estimation strategies, the lag structure of the key variables, how we measure regime type and veto players, whether we include the European Community/European Union, and other decisions.

One issue that we did not analyze in this study, but which flows from the argument we advanced in it, involves the interaction between democracy and the business cycle. In our model, voters in a democracy consider the state of the economy when going to the polls. Thus, governments are likely to be penalized when the economy performs badly. Voters assume that such downturns are at least partly attributable to the policies enacted in response to interest group pressures. As such, governments face a credibility problem: voters are more likely to remove them from office in bad economic times, even if they did not give in to special interest demands and overprotect the economy. Leaders therefore seek ways to demonstrate to the public that they are not overly solicitous to special interests that demand protection. One way to demonstrate this is to sign a trade agreement.

In political systems where the public cannot vote leaders out of office, this problem is less severe. In systems with competitive elections, by contrast, the problem is acute. The more leaders' fortunes depend on the voting public, the more incentives they will have to find mechanisms to reassure the public that they have not given in to special

continued on page 11

THE POLITICAL ECONOMIST

Mansfield & Milner Feature Essay...continued from page 11

interest demands. Consequently, the more democratic a country is, the greater the incentive for leaders to make a credible commitment to an open trade policy and hence the more likely they are to sign international trade agreements. This dynamic is especially pronounced during hard economic times, when leaders are often suspected of having chosen policies that favored special interests and contributed to the downturn. Leaders thus seek membership in PTAs during downturns to demonstrate that they are not overly influenced by protectionist interests. For the chief executives of countries marked by competitive political systems, these pressures are expected to be especially pronounced. Thus we expect democracies to respond to economic downturns by initiating and ratifying PTAs even more frequently than they do in good times.

In recent research, we have found considerable support for this hypothesis (Mansfield and Milner 2013). In order to test the hypothesis, we added the interaction between regime type and the change in the logarithm of GDP to the base model of PTA ratification in our book (Mansfield and Milner 2012: 96-107). As before, our analysis covered 1952 to 2004. Figure 1 is based on these results. It shows the predicted probability of a given democracy ratifying a PTA for the range of changes in the logarithm of GDP observed in the data. Here we define a democracy as having a score of 21 on the Polity Project's widely used index of regime type, which ranges from 1 for the most autocratic country to 21 for the most democratic state, although relaxing this definition somewhat has little bearing on the results. As shown in Figure 1, the odds of a democracy forming a PTA rise sharply as the economy contracts. In contrast, as shown in Figure 2, reductions in GDP seem to decrease the likelihood of PTA formation for an "anocratic" regime (which we define here as a country with a score of 14 on the Polity Project's index), although it is difficult to assess the nature of this relationship given the size

of the associated confidence intervals. Autocratic regimes (that is, those with very low scores on the Polity Project's index) are even less likely to enter a PTA during economic downturns, results that we do not show to conserve space.

Our data reveal numerous cases where a democracy ratified trade agreements during economic hard times. Japan, for instance, ratified a PTA with Singapore in 2002 (Japan's first) in the face of an economic decline. Israel signed agreements with Bulgaria and Romania in 2001, during an economic slump. Zambia, a new democracy that had just held its first multi-party elections in decades, joined the both Southern African Development Community (SADC) and the African Economic Community during an economic downturn in 1992. From 1991 to 1993, Switzerland concluded a large number of PTAs with East and Central European countries, as well as one with Israel under the EFTA umbrella, a period when it experienced poor economic performance. Finally, as we mentioned earlier, the proliferation of PTAs has continued since 2008. Many of the countries forming trade agreements during the great recession were democracies.

The great recession of 2008-09, which has continued in milder form to the present, raised wide concerns about whether we would see a return to protectionism as happened in the 1930s. So far, while protection has increased somewhat, resistance to it has been coordinated and quite strong. In fact, although the WTO's Doha Round has not advanced, countries have been signing new PTAs at a solid pace. Our argument suggests why this might be the case. Leaders sign PTAs for both economic and political reasons. In democracies, leaders have reason to demonstrate their competence to voters and to reassure the public that they are not captured by protectionist special interests. These political incentives are heightened during hard times, when voters are likely to hold leaders accountable for the slumping

economy unless leaders have taken steps to demonstrate that their policies were not the main culprit. While conventional wisdom might suggest that the leaders should not seek to further open their economies during downturns, our theory and data present political reasons and substantial evidence for the turn to PTAs in hard times by democracies.

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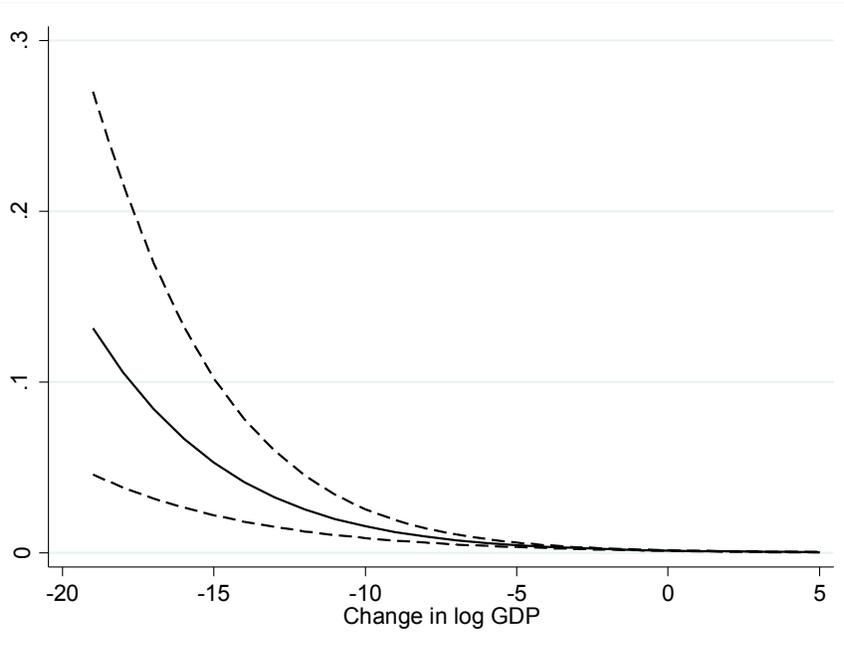
continued on page 12

Mansfield & Milner Feature Essay...continued from page 11

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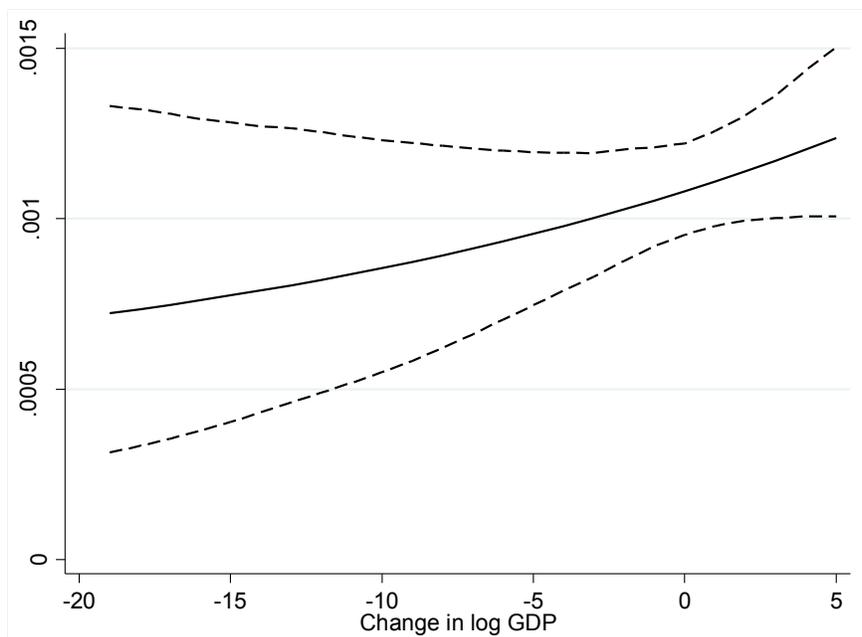
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Figure 1. Predicted probability of a democracy ratifying a PTA under various domestic economic conditions, 1952-2004.



Note: Dashed lines represent 95% confidence intervals.

Figure 2. Predicted probability of an anocracy ratifying a PTA under various domestic economic conditions, 1952-2004.



Note: Dashed lines represent 95% confidence intervals.