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Abstract

The rapid increase in the number of open developing countries has recently caused a proliferation of arguments concerning the determinants of foreign economic liberalization. In this emerging debate, explanations stressing the importance of economic crises, interest-group competition, international financial institutions, and the increase in political participation can be distinguished. We add a fifth explanation and suggest a model that links foreign economic liberalization to government fragmentation in autocratic countries. The 'trilemma of the protectionist autocrat' describes a situation in which the dominant protectionist fraction in government cannot reach the three goals of high rental income, maintaining a protectionist policy and appeasing the dominated, more liberal faction simultaneously. A two-stage non-cooperative game is developed to show that government fractionalization makes foreign economic liberalization more likely. Since an increase in political conflict between the dominant and the dominated faction increases the likelihood of a revolution, the dominant faction might use policy concessions to stabilize the government. We test this claim with a Cox continuous time survival model with time-dependent covariates. The results suggest in line with our model that economic crises and government fractionalization increase the likelihood of foreign economic opening, while lending by international financial institutions and democratization do not exert a systematic influence.

> ...deheinen rât kond ich gegeben,
> wie man driu dinc erwurbe,
> der deheinez niht verdurbe.
> *Walter von der Vogelweide[1]*

1. Introduction

Economists and political scientists typically have explained the conditions that led governments to implement suboptimal protectionist policies. Recently, the 'rush to free trade' among developing countries, as Dani Rodrik (1994) dubbed the phenomenon, gave rise to an almost complete reversal of the research agenda. Since the early 1990s, the number of articles dealing with the determinants of foreign economic liberalization has grown steadily. Perhaps surprisingly, the literatures on protectionism and on foreign economic liberalization are only weakly linked. The predominant answer to the first puzzle pertaining to protectionism is that there are certain protectionist interests represented in the political arena that may capture the government. If we take this simple but nevertheless convincing answer for granted, how can we explain that this interest became apparently weaker over the last two decades? How can we explain that developing countries have "flocked to free trade as if it were the Holy Grail of economic development"? (Rodrik 1994: 61).

As yet, the literature has given four prominent answers: The first explanation stresses the importance of economic crises. In this perspective, the debt crisis of the 1980s has weakened the pro-protectionist faction in the political arena and coerced governments to liberalize foreign economic policies in order to ensure economic development and thereby maintain political power. A second group of political economy models have moved beyond this view and argued that liberalization results from interest-group competition in crises-ridden countries. A third theoretical strand has brought institutional factors into play. It advances that the conditionality imposed by international financial institutions plays a crucial role. The fourth explanation underlines the (exogenous) increase in political participation in the

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[1]   The quote is from Wolfram´s poem "Ich saz ûf eime steine". It describes a similar "trilemma like the one analyzed in this article.

developing world. Proponents of this theory usually claim that the median voter, who generates an income from labor, has an interest in free trade: Since developing countries have a comparative advantage in labor intense production, and since free trade favors the abundant factor, workers gain and capital loses. An increase in political participation should thus cause a reduction in barriers to trade as well as a reduction of capital controls.

Although we have no doubt that the extant literature capture some important aspects of the political and economic determinants of foreign economic liberalization, they lack a well specified model of the political process and thus rely upon a functional theory of the political process which possibly results in policy reforms. In seeking to fill this apparent gap, we argue that policy reforms result from a "trilemma" in which autocratic governments find themselves as a consequence of their protectionist policies. Over the long run, the trilemma emerges because the ruling elite can only reach two out of three goals simultaneously: the appropriation of rental income, its policy goals, and political stability. Taking this constellation as a point of departure, we argue that foreign economic liberalization emerges a consequence of the "trilemma" and the attempt by crisis-ridden governments to secure their own political survival. In this view, democratization is an unintended consequence of failed attempts to stabilize the government and not a necessary precondition of economic reform.[2] Since the need to stabilize the government crucially depends upon the fractionalization of the government, we suggest that liberalization depends on government fractionalization while democratization may emerge from failed attempts to stabilize a fractionalized government.

Our political explanation of economic opening is accordingly based on a game that models the strategic interactions between three actors: a dominating protectionist faction within the government, a more liberal-minded counter-elite and the domestic constituents, which we represent through the median member of the population.[3] This conceptualization enriches our understanding of foreign economic liberalization since most extant models only conceive of the rush to free trade as the result of a contest between two competing groups,

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[2]   The existence of closed democracies proves that it is neither a sufficient condition.

thereby ignoring the role that the status quo interest of the ruling regime plays (Alesina/Drazen 1991).

The main difference between existing explanations and our model results from the role of the dominant political actors. Whereas both the crises and the democratization theories conceptualize the autocratic government as merely depending on exogenous forces of history, the dominant faction of our analytical framework possess the means to appease possible challenges. Most extant models of political opening focus on the escalation stage during which governments are not able to use such 'carrots', but have to rely on the 'sticks' of repression (Acemoglu/ Robinson 2000, 2001).

The article is structured as follows: We first discuss the recent theoretical developments in analyzing the determinants of economic liberalization. In an attempt to more carefully model the political process, we present a political-economy model of policy-making in autocracies. The formal framework allows us to derive the testable hypotheses that liberalization crucially depends upon government fractionalization. Finally, we test this main hypothesis in a Cox regression analysis of all underdeveloped countries that were both autocratic and protectionist in 1975. The survival model indicates that government fractionalization is a powerful predictor of whether or not a country liberalizes its economy. This result strongly supports our contention that the likelihood of economic reform is not the least a consequence of the power struggle between liberal and protectionist factions within a government. We conclude with some cautionary remarks on the quality of the data used and the possible implications of our results for the literature on democratization and economic development.

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[3]   If the autocracy democratizes, the median member of the population becomes the median voter.

2. The Sources of Foreign Economic Liberalization: Theories and Stylized Facts

If we take the Sachs-Warner Index[4] as a benchmark, we can easily illustrate the 'rush to free trade' and see that the relative number of so-called open countries has doubled between 1985 and 1992:
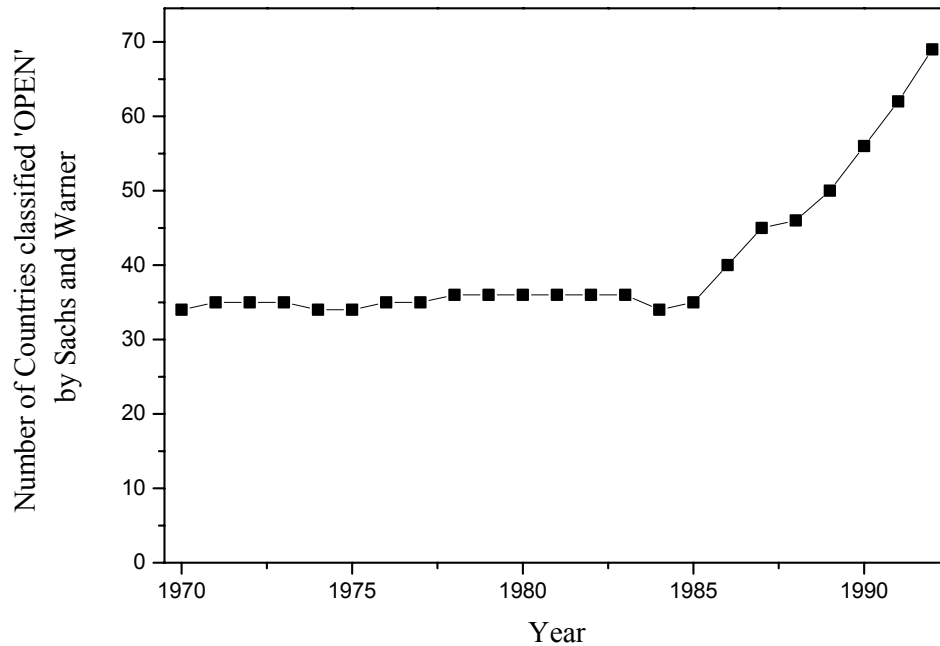

Fig. 2.1 The 'Rush' to Free Trade according to Sachs/ Warner 1995.

The steep increase after 1985 was mainly driven by a change in the foreign economic policy orientation of developing countries. The significance foreign economic liberalization gained in the developing world has led to a proliferation of competing hypotheses. As we have already pointed out in the introduction, there are four distinct explanations: A first

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[4]   The Sachs-Warner openness dummy is denoted 0 if a country has applied non-tariff barriers to trade to more than 40 percent of imported goods, or if the average tariff exceeds 40 percent, or if the black market exchange rate is more than 20 percent below the official rate, or if a state monopoly for the most important export goods has been implemented (Sachs/ Warner 1995: 22).

literature assumes that a severe economic crisis precedes the decision by governments to open their economy, though the causal chain varies in this literature. A second theoretical strand accepts that the incentive to open the economy becomes more pronounced because of an economic crisis, but replaces the deterministic logic of early crisis theories by more carefully modeling interest group behavior. A third literature places the role of foreign economic institutions such as the International Monetary Fund at the core of explanation. Here, the crisis serves as a window of opportunity for international financial institutions that seek to influence the economic policies of countries troubled by an economic crisis. Finally, a fourth analytical literature mainly concentrates on institutional considerations such as the role of democratic government. We subsume the explanations into two broad categories, crises-driven and politics-driven explanations, and briefly discuss the theories:

Crisis theories: In most existing models deteriorating economic conditions serve as the trigger mechanism starting economic policies reforms such as stabilization and foreign economic liberalization. Tomassi and Velasco (1996:197) even argue that it has become part of the new conventional wisdom on reforms that crises either facilitate or cause economic reforms. Bresser Pereira, Maravall and Przeworski illustrate this point with examples from Latin America:

> "When populist leaders in Argentina, Bolivia, Venezuela, Peru and Brazil adopted non-populist policies it was because the crisis in these countries was so deep that even the cost of sticking to populist became higher than the cost of adjustment." (Bresser Pereira et al. 1993: 57)

Bates and Krueger similarly contend that all reforms have been undertaken

> "in circumstances when economic conditions were deteriorating. There is no recorded instance of the beginning of a reform program at a time when economic growth was satisfactory." (Bates/ Krueger 1993: 454)

Although this interpretation is appealing at first sight, it does not offer a convincing explanation for the occurrence and non-occurrence of reforms. On the contrary, the 'law' borders the tautological and trivial. According to Rodrik (1996: 27), "that reform should follow crisis, then, is no more surprising than smoke following fire."

The tautological nature of the deterministic crisis explanation becomes obvious if one traces the term 'crisis' back to its Greek origins where it had the connotation of change.

It also remains largely unclear whether a crisis is a necessary or a sufficient condition or a combination of those two prerequisites. The assumption of sufficiency renders the hypothesis virtually infalsifiable, because any researcher can easily employ the fallback argument that the problems are not yet severe enough to justify a lack of reform (Rodrik 1996: 27). Hence, one needs to define at least crisis' severity.[5] If we consider the large number of reform delays or preemployed policy changes, the deterministic argument that a crisis necessarily induces a reform turns out to be blatantly wrong (Drazen 2000: 446). The most severe weakness of the hypothesis is, however, that many of its early adherents presented it in a functionalist fashion. This makes it impossible to understand why a country delays reforms that would help to sort out the economic muddle or why some governments resist all pressures to reform and rather do nothing.

Recently, four possible microfoundations focusing on the behavior of interest groups have been suggested (Drazen 2000; Rodrik 1996): A first literature draws on Mancur Olson's (1982) influential work on collective action and contends that powerful interest groups are able to block economic reforms. Proponents of this view contend that, as the problems aggravate, the 'redistributional coalitions' lose so much power that a society is finally able to implement a reform (Nelson 1994). The second analytic strand deals with the policy-makers' perception of the need to reform from a purely informational vantage point. In this view, the autocratic rulers exhibit a status quo bias and misperceive the utility of the current policy (Akerlof 1991). Policy-makers only update their belief in a process of Bayesian learning if a crisis is severe enough (Harberger 1993). The third argument about the role of crisis in the political process addresses the impact of uncertainty more generally, assuming that actors do not know if they will belong to the group of winners or the losers of the reform. In this vein, only a sufficiently large deterioration of the status quo renders a reform feasible (Laban/ Sturzenegger 1994). All explanations do not specify how deep the prob-

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[5]   Drazen and Easterly (2001) define crisis severity simply by the inflation rate. This simple definition helps them to show that with growing severity, the likelihood of reforms becomes larger. They ignore, however, the fact that even without reforms hyperinflation may be unsustainable. Kaminsky, Lizondo and Reinhart (1998) suggest a wide variety of crisis indicators. Hausken and Plümper (2002) use their definition to estimate the crisis severity of countries affected by the Asian crisis by a principal component analysis.

lems have to become until they trigger off a change, of course. Thus, in our view only the fourth argument, which emphasizes the societal distribution of the costs resulting from the implementation of reforms, provides a causal mechanism that is both testable and non-functionalist. These alternative models conceive of reforms as a possible consequence of a contest between two almost equally powerful veto-players. In the influential model of Alesina and Drazen (1991), a 'war of attrition' unfolds over which group has to bear the larger costs of reform. While a crisis provides the incentive for reforms, the final settlement of the conflict is delayed until one of the domestic groups is no longer able to hold out. Apparently, political stalemate is a consequence of the way in which competing groups try to settle their redistributional conflict (Drazen 2000:16).

A number of authors has suggested that the link between crisis and reforms was provided by the International Financial Institutions' (IFIs') conditionality (Harrigan 1996; Taylor 1997). As Sebastian Edwards (1997) has pointed out, between 1985 and 1995 almost 70 percent of the World Bank adjustment operations included at least some conditionality upon trade liberalization. The same holds true for the IMF's lending to developing countries. In Dani Rodriks view (1994), the World Bank and the International Monetary Fund were the clear winners of the 1980s debt crisis. As a consequence of deteriorating economic conditions and a huge demand for capital in the developing world, the IFIs became the principal sources of capital inflows and uncommonly powerful in the negotiations with developing countries' governments.

David Greenaway and Oliver Morrissey (1996) observe four channels of influence: In their view, IFIs have the ability to persuade and encourage governments to implement reforms aiming at the liberalization of foreign economic policies, the may monitor the implementation of reforms, they can lend some credibility to the reform packages by signaling additional financial support in case of a reform crisis, and they may reduce the expected costs of reforms by giving technical assistance to governments willing to implement reforms.

The fact that almost all developing countries had to accept conditional lending from IFIs should make clear that we ought to be careful to formulate deterministic theories of the regulatory impact of IMF and World Bank conditionality. If conditional lending caused foreign economic opening, we should observe a much more general trend towards the liber-

alization of trade and capital flows. Edwards (1997) therefore believes that the rush to free trade was not driven by IFIs' intervention into the political decision-making process, but by changing views of the politicians and governments in the developing countries. He thus concludes that the World Bank has contributed somewhat, but not much to the liberalization of trade policies.

Although these advanced models are more explicit about the political process than the functionalistic crisis-literature, they suffer from a couple of disadvantages. Firstly, they do not pay sufficient attention to the role political institutions play in the policy formation process. In contrast to the earlier rent-seeking literature, these models do especially not include the government and thus the actor who can strategically decide on the initiation and design of the reforms. Hence, governments are treated as choiceless agents, which have to adjust more or less immediately to changes in the economic environment. And secondly, in the absence of an easy and convincing way to test interest group models, it is hard to believe that a war of attrition between competing interests keeps a government from implementing economic policy reforms.

Political Institutions and Reforms: All variants of the crisis theory treat the political system of the reforming country as constant. Reforms are triggered by an exogenous economic shock that has the same impact on all countries. However, some authors convincingly doubt that a crisis is a sufficient condition for reforms. In their view, 'veto-players provide a major obstacle for governments wanting to implement economic reforms (Tsebelis 1995; Hallerberg/ Basinger 1998). With a growing number of veto-players, the dominant party in governments must convince more actors to agree upon economic policy reforms. The more the preferences of the relevant actors vary, the less likely becomes the timely adjustment to economic crises. Zielinski (1999) stresses that "liberalization proper is likely to be preceded by a power struggle within the dictatorship" (Zielinski 1999: 223). Valerie Bunce even goes further and states that newly democratized states are less likely to open up economically than autocratic states. She maintains that young democracies "in which power is deconcentrated, institutions new, and politicians fearful of public anger and limited in their temporal

horizons" are particularly hard to reform (Bunce 2000: 719). Although these models have moved us far-away from the vagueness of general theories on revolution or democratic consolidations, they exclusively focus on the sticks that the authoritarian government possesses. This one-sidedness is insofar detrimental as protectionist autocracies typically possess sufficient leverage to employ the "carrot" of economic opening.

An almost contrarily institutional explanation of foreign economic liberalization has highlighted the impact of democratization. A growing number of observers seem to believe that democratization and international economic integration do not only coincide, but the former process causes the latter. This is at least the main thrust of a unpublished studies by Kubota and Milner (2000) and Mansfield, Milner and Rosendorff (2001). These authors argue that the growing influence of the median voter drives the political elite to opt for economic openness. In the Kubota-Milner model of domestic policy making, constituents profit from liberalization because of their factor endowment. The model assumes in line with the Stolper-Samuelson theorem that in developing countries labor benefits from the welfare gains that the abolishment of tariffs generates (Mayer 1984). Kubota and Milner (2000) find some support for this argument in their pooled cross-sectional analysis.

Yet, a closer look at the empirical record suggests that the interpretation that 'democracy moves first' does not correspond to the path that has been chosen in a plurality of the protectionist autocracies of the 1970s. We will demonstrate this based on the Sachs Warner criteria that we have used in Fig. 2.1 and the evaluation of the level of democracy (DEMOC) of the widely used Polity dataset (Jaggers/ Gurr 1995). Our examination only refers to those states that were not economically closed in 1970 and simultaneously not sufficiently democratic. While economic opening is coded as a switch from 0 to 1 on the Sachs-Warner dummy variable, democratization refers to an increase in DEMOC exceeding 4 points. If we use this double set of criteria and only believe that one form of opening has to follow the other form of opening within five years, we are able to order the countries within four categories. Table 1 presents this evidence.

	Not liberalize (within five years)	Liberalize
Democratize	Argentina (1983), Brazil (1986), Dominica (1978), Ecuador (1979) El Salvador (1984), Uruguay (1985) Honduras (1982), Peru (1980), Pakistan (1988), Nigeria (1979) Congo (1992), Madagascar (1992) Bangladesh (1991), Haiti (1991) Zambia (1991)	Bolivia (1982/1986) Guatemala (1986/1990) Nicaragua (1990/ 1992) Nepal (1991/1992) Philippines (1987/1990)
Not demo-cratize	Iraq, Jordan, Syria Egypt, Yemen, Myanmar Angola, Central African Republic Chad, Ethiopia, Gabon Ivory Coast, Kenya, Malawi Mozambique, Niger, Rwanda Senegal, Sierra Leone, Somalia Tanzania, Togo	Chile (1976), Mexico (1987) Paraguay (1990), Peru (1992) Guayana (1989), Indonesia (1971) Benin (1990), Ghana (1986) Guinea Bissau (1987), Guinea (1987), Mali (1991) Morocco (1985), Tunisia (1989) Uganda (1988)

Table 1: Categorization of countries along two dimensions.

All in all, 22 autocratic countries abstained from opening up both the political and the economic system, and 14 opted first for economic reform without experiencing a democratization within the next five years. By contrast, at least 15 countries only democratized, but did not open their economy five years after the corresponding constitutional change. Among these countries, Argentina, Brazil, Ecuador, Honduras and Uruguay opened the economy later on. If we do not count these late-liberalizers as examples for the Kubota-Milner hypothesis, only five countries have chosen to democratize first and opted afterwards, but within five years for economic opening.[6]

The multitude of outcomes suggests that the two forms of opening a country to the outside world are perhaps related, but that they are rather the consequence of a common cause than determinants of each other. Before we suggest a theory that combines both phenomena, we briefly discuss the extensive literature on economic reforms. As we find none of these ap-

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[6]   If we stretch the definition to eight years, two other countries, Argentina and Brazil, could be included. This does not change the results of the statistical analysis (see section 4).

proaches fully satisfactory, we proceed to present an approach that more carefully models the underlying political processes.

3. The Model with Analysis

Foreign economic liberalization is the consequence of the rational decision by a ruling elite which tries to survive politically. The trilemma game that we present in this section models decisions of a protectionist government that may ultimately result in economic reform, if the government is fragmentized and the dominant protectionist faction has to appease the dominated, more liberal faction in an attempt to stabilize the government. We start the analysis be first introducing the main actors and assumptions.

Assumptions: We consider three actors in our model of foreign economic liberalization in protectionist autocracies. Actors i and e are the dominant and dominated factions of the government representing the interests of the import- and export-competing sector while Actor c represents the domestic constituent represented by the median voter. The two government factions have power q_i and q_e, $q_i+q_e=1$, $q_i>q_e$, determined exogenously by the current state of affairs (either by taking the relative decision power of the government factions into account or by assessing the influence that the competing lobbies can exert on them). The dominant faction i has to make two strategic choices. First, based on rental income r determined exogenously by the state of the economy, it determines how much of the spoils it can keep for itself and how much the export sector will receive. While it obtains a fraction α of r, 1-α goes to e. Actor i chooses policy p_i from an interval $0\leq p_i\leq 1$, itself preferring $p_i=0$ (protectionism). Actor e, conversely, prefers $p_i=1$ (economic liberalization). I.e., actor i prefers $(\alpha,p_i)=(1,0)$, and actor e prefers $(\alpha,p_i)=(0,1)$. Actor c has to decide how large it revolutionary effort s shall be, with $0\leq s\leq 1$.

A revolution becomes more likely if p_i differs considerably from the policy p_c preferred by actor c, and if the observed level of conflict between actors i and e is considerably large. Actor c has the power of exerting revolutionary effort if actor i inadequately solves what we call the "trilemma" of the protectionist autocrat. This triple tradeoff arises as a conse-

quence of the need to transfer rental income r to actor e through the manipulation of α, choosing policy p_i to satisfy actor e's preference of $p_i=0$, and choosing p_i to satisfy actor c's preference of $p_i=p_c$. We model the conflict between actors i and e over r and p_i as

$$
c_r = \begin{cases} \left(\dfrac{\alpha - q_i}{1 - q_i}\right)^a & when \quad q_i \leq \alpha \leq 1 \\ 0 & when \quad 0 \leq \alpha \leq q_i \end{cases} \quad , \quad 0 \leq c_r \leq 1,
$$

$$
c_p = \begin{cases} \left(\dfrac{1 - p_i - q_i}{1 - q_i}\right)^a & when \quad q_i \leq 1 - p_i \leq 1 \\ 0 & when \quad 0 \leq 1 - p_i \leq q_i \end{cases} \quad , \quad 0 \leq c_p \leq 1,
$$

(1)

where a is a parameter that weighs the impact of deviations of α and $1-p_i$ from q_i on c_r and c_p. If $\alpha=q_i$ which means allocation according to relative power, we assume no conflict $c_r=0$ over rental income since this is the best actor e can reasonably hope for. Analogously, $1-p_i=q_i=1-q_e$ does not lead to a policy conflict $c_r=0$ since this is the best actor e can reasonably hope for. Division with $1-q_i$ occurs to ensure $0\leq c_r$ and $c_p\leq1$. Observe that $c_r=1$ when actor i chooses its most egoistic $\alpha=1$, which yields maximum conflict between i and e over rental income. Analogously, $c_p=1$ when actor i chooses its most egoistic $1-p_i=1$. We observe maximum conflict between i and e in this instance. When $a>1$ large deviations of α and $1-p_i$ incite larger c_r and c_p than small deviations. Using c_r and c_p from (1), we model the probability $0\leq\beta\leq1$ of revolution as

$$
\beta = \beta_a s = \left[\gamma c_r + \xi c_p + (1 - \gamma - \xi)\left(\frac{|p_c - p_i|}{p_c}\right)^a \right] s,
$$

(2)

where $0\leq\gamma,\xi\leq1$ are weights actor c assigns to the conflict between actors i and e over rental income r and policy p_i, respectively. The remaining weight $1-\gamma-\xi$ is assigned by actor c to the conflict between actors i and c over policy p_i, where actor c hopes for $p_i=p_c$ which yields no conflict. The absolute value is taken to avoid negative conflict where actor c is

assumed to be equally opposed to positive and negative deviations of p_i relative to its preferred p_c. Division with p_c ensures a maximum conflict probability of 1 when actor i chooses its most egoistic $p_i=0$. Multiplication with s is necessary because a revolution does not occur ($\beta=0$) if actor c does not engage into a revolutionary effort (s=0). Conversely, if actor c´s revolutionary effort is maximal (s=1), a revolution occurs with probability β. The expected utilities of actors i and e are modeled with the Cobb-Douglas functions[7]

$$u_i = (1-\beta)(\alpha r)^b (1-p_i)^{1-b}, \quad u_e = (1-\beta)((1-\alpha)r)^b (p_i)^{1-b}, \tag{3}$$

with utility 0 if a revolution occurs with probability β, where $0 \le b \le 1$ is a parameter. To avoid the two corner solutions $\alpha=1$ or $p_i=0$, we set a>1. Large deviations $\alpha=1$ or $p_i=0$ by actor i are thus rendered less likely since these would make revolutionary effort by actor c more likely. Interior solutions become, in other words, more likely if a>1. Equation (3) assumes that r is scaled appropriately relative to $1-p_i$. If r increases (decreases), rental income becomes more (less) important than policy in actor i's utility. Assume that actor c has an effort capacity of 1 which can be allocated into revolutionary effort s, and non-revolutionary effort (e.g. production or leisure) 1-s.[8] The latter gives a guaranteed utility 1-s. The revolutionary effort is "sunk cost" which exclusively impacts upon β in (2). The expected utility of actor c is

$$u_c = 1-s+(1-\beta)(1-|p_c-p_i|)+\beta(r+1) = 2-|p_c-p_i|+s[\beta_a(|p_c-p_i|+r)-1] \tag{4}$$

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[7]   The Cobb-Douglas function is frequently used in economics (e.g. Varian 1999:64) to model actors' preferences over bundles of goods. For our case the two bundles are rental income and policy quantified as $1-p_i$ for actor i and p_i for actor e.

[8]   A similar conception is common in economic theories of conflict. See e.g. Grossman (1991:913,915) where "a large number of family units <contemplating insurrection> can divide the labor time of its family members among a nonnegative fraction l devoted to production, a nonnegative fraction s devoted to soldiering, and a nonnegative fraction i devoted to participation in an insurrection," where l+s+i=1.

A revolution does not occur with probability 1-β which gives a policy utility $1-|p_c - p_i|$.
I.e., if actor c gets its preferred policy $p_i=p_c$, its policy utility is 1, declining as p_i departs from p_c in positive or negative direction. If a revolution occurs with probability β, actor c receives its preferred policy utility 1 and the rental income r. This ensures that c possesses an incentive for revolution.

The strategic choice of actor e in this analysis is constantly to push for its preferred $(\alpha,p_i)=(0,1)$. If actor i does not pay sufficient heed to the interests of actors e and c, a revolution occurs. Since the three utilities depend on the conflict between actors i and e over r and p_i, and on the probability β of revolution, this allows us to analyze a two-stage game. Actor i moves in the first stage choosing α and p_i. Taking α and p_i as given, actor c moves in the second stage choosing s. As is common for two-stage games, we start the analysis by considering the decision of actor c in the second stage. Equation (5) gives that actor c chooses

$$
\begin{aligned}
s = 0 \quad & when \quad \beta_a(|p_c - p_i| + r) < 1, \\
0 \le s \le 1 \quad & when \quad \beta_a(|p_c - p_i| + r) = 1, \\
s = 1 \quad & when \quad \beta_a(|p_c - p_i| + r) > 1.
\end{aligned}
\tag{5}
$$

The equation $\beta_a(|p_c - p_i| + r) = 1$, where actor c is indifferent between engaging into revolutionary action and staying with the status quo, is solvable w.r.t. p_i as a function of α. Fig. 3.1 demonstrates this for r=5, $q_i=0.6=1-q_e$, γ=0.1, ξ=0.4, $p_c=0.85$, a=2.

Fig. 3.1 Actor c's choice of revolution vs. no revolution when

r=1, q_i=0.6=1-q_e, γ=0.1, ξ=0.4, p_c=0.85.

In Fig. 3.1, actor i prefers the lower-right corner $(\alpha,p_i)=(1,0)$, while actor e prefers the upper-left corner $(\alpha,p_i)=(0,1)$. Although actor c is indifferent along $\beta_a(|p_c - p_i|+r)=1$, actor i is not. Actor i's problem is that she prefers $\alpha=1$ and $p_i=0$ which should clearly result in a revolutionary effort at level s=1. Actor i can be expected to choose α and p_i so as to bring actor c as close up to choosing s=1 as possible, without actually choosing s=1. A question is which "safety margin" actor i should choose. Although real life is characterized by uncertainty, incomplete information (Harsanyi 1967/68), and bounded rationality limiting the capacity for processing information and preferences (Simon 1955) pertaining to the safety margin, our objective here as a benchmark is to determine the exact point with zero safety margin. The minimal safety margin amounts to a value of p_i which lies $\varepsilon>0$ above player c's indifference curve $\beta_a(|p_c - p_i|+r)=1$. Player i cannot be expected to choose $\alpha<0.6$, which gives the horizontal line in Fig. 3.1. The choice $\gamma=0.1$ means that actor c assigns low weight to how actor i allocates rental income r between the dominant and dominated government factions. Hence in Fig. 3.1 actor i can even choose its egoistic $\alpha=1$ and avoid revolution as long as its policy concession exceeds $p_i>0.5$. On the other hand, the choices $\xi=0.4$ and $1-\gamma-\xi=0.5$ mean that actor c assigns high weight to actor i's choice of

and 1-γ-ξ=0.5 mean that actor c assigns high weight to actor i's choice of policy. Even with α<0.6 actor i needs to choose the relatively high p_i>0.35 to avoid revolution, where we have earlier described p_i=1-q_i=0.4 as the best actor e can reasonably hope for given the power distributions between actors i and e. Since actor i prefers α>0.6, it can be expected to make a policy concession beyond p_i=0.35. Straightforward numerical maximization for b=0.5 of actor i's Cobb-Douglas utility u_i in (2.3) w.r.t. α and p_i gives the optimal values α=0.91 and p_i=0.43, where u_i=1.61. Especially the choice α=0.91 is an egoistic one for actor i. The choice p_i=0.43 is better than actor e can reasonably hope for, justified by the high weight 1-γ-ξ=0.5 assigned to actor c's preferred policy p_c=0.85. Fig. 3.2 plots the three utilities u_i,u_e,u_c, and β_a as functions of p_i for α=0.91 and α=0.71.
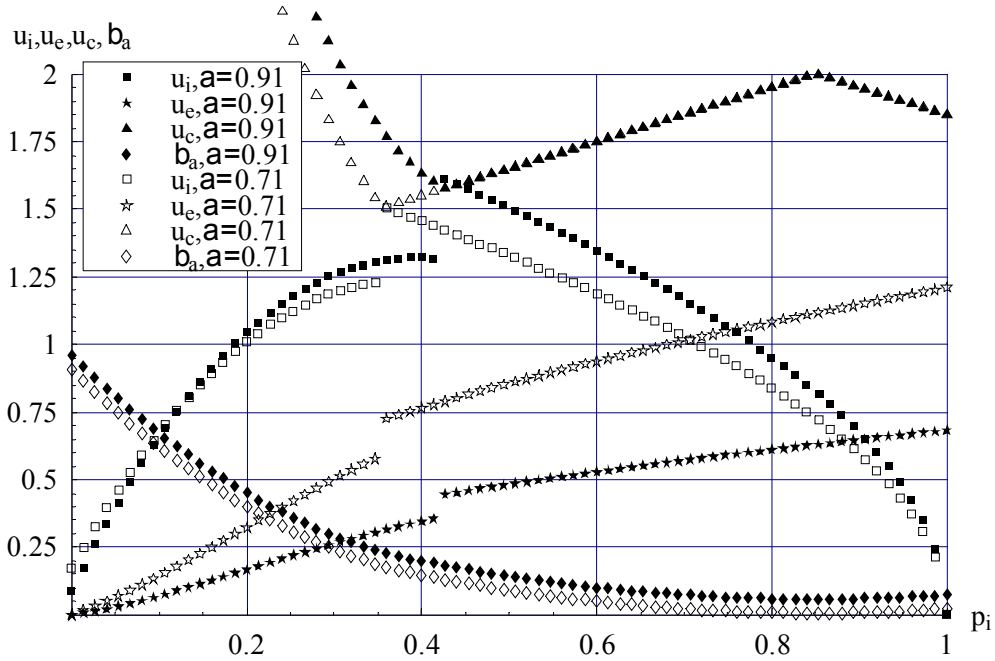

Fig. 3.2 Actor utilities u_i,u_e,u_c, and β_a when

r=1, q_i=0.6=1-q_e, γ=0.1, ξ=0.4, p_c=0.85, α=1 and α=0.6.

In the event that α=0.91, u_i for player i increases from 0 when p_i=0, to 1.32 when p_i=0.43, and makes a jump to 1.61 when actor c can be convinced not to cause a revolution. There-after u_i suffers a decrease as p_i gets removed from the preferred p_i=0. The dominated gov-

ernment faction, actor e, has a moderate increase in u_e as p_i increases from 0 to 0.43, but enjoys an increase after the jump towards its preferred $p_i=1$. For those values of p_i where actor c invests in revolution (s=1), actor c's expected utility u_c is highest when the probability β of a successful revolution is highest, which in Fig. 3.2 is the case when $p_i=0$. u_c for actor c decreases to a minimum for $p_i=0.43$ with indifference between s=1 and s=0. As p_i increases above $p_i=0.43$ and a revolution does not occur, u_c increases to a maximum for actor c's preferred policy $p_i=p_c=0.85$, and declines thereafter. For $\alpha=0.71$, the structure of the three utilities is similar. Actor i's max utility is $u_i=1.5$, which is lower than $u_i=1.61$ described above. In this case actor i prefers to transfer rental income according to the relatively egoistic $\alpha=0.91$, while making a considerable policy concession $p_i=0.43+\varepsilon$, where ε is arbitrarily small above the safety margin. Thus, this example resembles a case in which the dominant faction maintains the major share of the rental income r for itself and stabilizes the government by making policy concessions to both the dominated faction and the median member of the population.

To illustrate sensitivity to parameter variation we increase γ to $\gamma=0.7$, which means that actor c assigns high weight to how actor i allocates rental income r between the dominant and dominated government factions. We further choose $\xi=0.1$ which implies $1-\gamma-\xi=0.2$ which means that actor c assigns low weight to actor i's policy choice. Fig. 3.3 illustrates these choices.
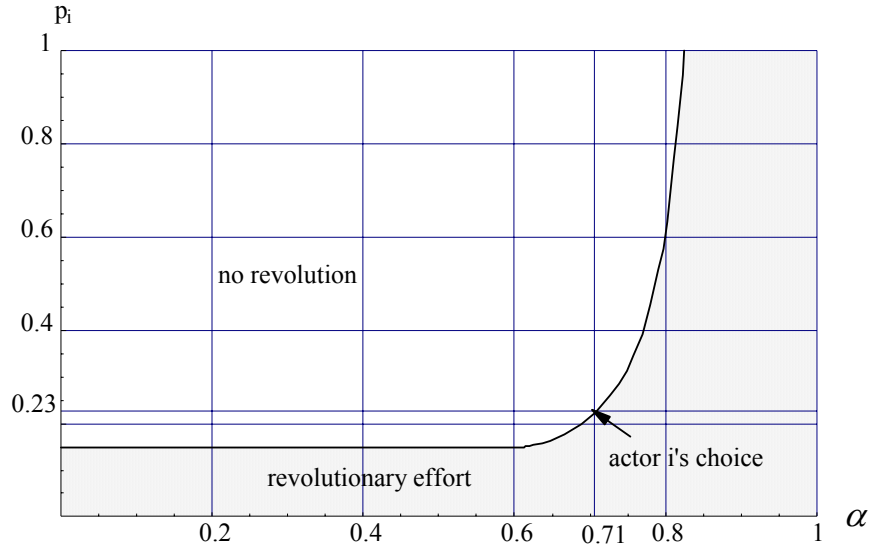
Fig. 3.3 Actor c's choice of revolution vs no revolution when

r=1, q_i=0.6=1-q_e, γ=0.7, ξ=0.1, p_c=0.85.

The high weight γ=0.7 forces the protectionist actor to transfer more rental income r to actor e. For α>0.83 actor c is guaranteed to exert revolutionary effort even when actor i makes the most extreme policy concession p_i=1. On the other hand, the low weights ξ=0.1 and 1-γ-ξ=0.2 allow actor i to be considerably more recalcitrant w.r.t. policy concessions. For α<0.6 actor i avoids revolutionary effort by choosing the low and preferable p_i>0.15. Numerical maximization for b=0.5 of u_i in (2.3) w.r.t. α and p_i gives the optimal values α=0.71 and p_i=0.23, where u_i=1.65. Fig. 3.4 plots the three utilities u_i, u_e, u_c, and $β_a$, as functions of p_i for α=0.91 and α=0.71.
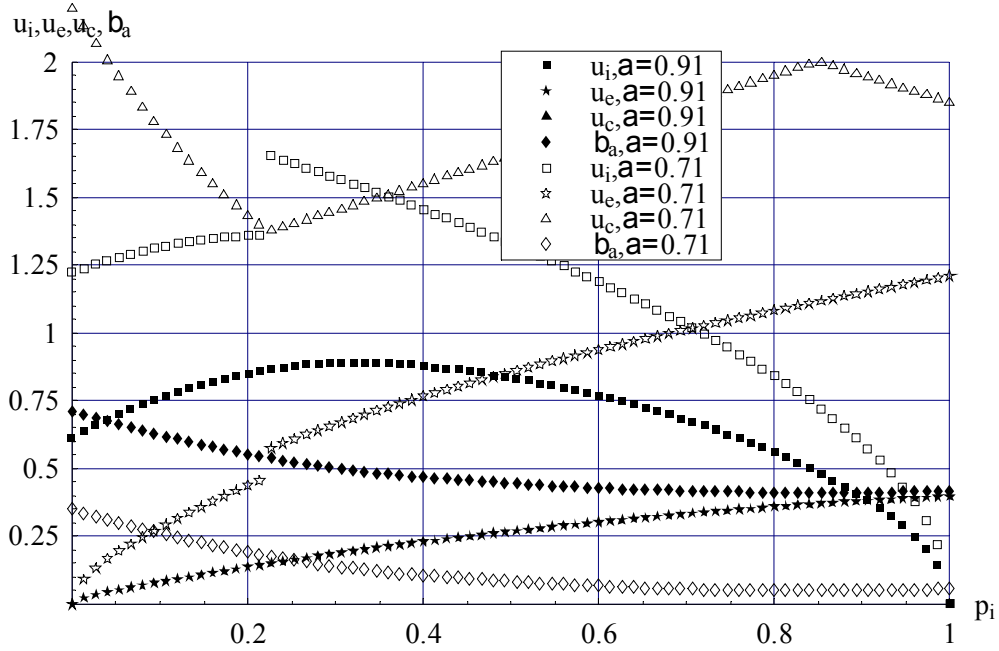
Fig. 3.4 Actor utilities u_i, u_e, u_c, and β_a when $r=1$, $q_i=0.6=1-q_e$, $\gamma=0.7$, $\xi=0.1$, $p_c=0.85$, $\alpha=1$ and $\alpha=0.74$.

In Fig. 3.4 actor i's maximum utility is $u_i=1.65$ when $\alpha=0.71$ and $p_i=0.23+\varepsilon$, which is larger than e.g. $u_i=0.89$ which is the maximum that can be attained when $\alpha=0.91$ and $p_i=0.33$. Hence in this case actor i prefers to transfer more rental income, but to make a smaller policy concession.

Let us define the policy under government fractionalization as $p_i=p_{ig}$. Government fractionalization is expressed by the sizes of c_r and c_p, where a convenient measure is $c_r c_p$. The equation $\beta_a(|p_c - p_i|+r)=1$ determines the value of p_i where actor c is indifferent between engaging into revolutionary action and staying with the status quo. Inserting $p_i=p_{ig}$ into this equation gives

$$\left[\gamma c_r + \xi c_p + (1-\gamma-\xi)\left(\frac{|p_c - p_{ig}|}{p_c} \right)^a \right] \left(|p_c - p_{ig}| + r \right) = 1. \tag{6}$$

We define the absence of government fractionalization as $c_r = c_p = 0$, and the associated policy as $p_i = p_{iw}$. Inserting into $\beta_a \left(|p_c - p_i| + r \right) = 1$ gives

$$\left[(1 - \gamma - \xi) \left(\frac{|p_c - p_{iw}|}{p_c} \right)^a \right] \left(|p_c - p_{iw}| + r \right) = 1. \tag{7}$$

Proposition: $p_{ig} > p_{iw}$ when $p_c > p_{ig}$, which means that government fractionalization makes foreign economic liberalization more likely (high p_i) when the median voter also has a high preference for foreign economic liberalization ($p_c > p_{ig}$).

Proof. Comparing (6) and (7), equation (6) has an additional term $\left[\gamma c_r + \xi c_p \right] \left(|p_c - p_{ig}| + r \right)$ on the left hand side, where $c_r c_p > 0$. It thus follows directly that $p_{ig} > p_{iw}$ when $p_c > p_{ig}$. QED.

Inserting the parameter values used in Figs. 3.1-3.2, i.e. r=5, $q_i = 0.6 = 1 - q_e$, $\gamma = 0.1$, $\xi = 0.4$, $p_c = 0.85$, a=2, into (7) gives $p_{ig} = 0.34$, where actor i chooses its preferred $\alpha = 1$. I.e., the absence of government fractionalization gives $(\alpha, p_{iw}) = (1.00, 0.34)$, in contrast to $(\alpha, p_{ig}) = (0.91, 0.43)$ with government fractionalization. Inserting the parameter values used in Figs. 3.3-3.4, i.e. r=5, $q_i = 0.6 = 1 - q_e$, $\gamma = 0.7$, $\xi = 0.1$, $p_c = 0.85$, a=2, into (7) gives $p_{ig} = 0.06$, actor i choosing $\alpha = 1$. The absence of government fractionalization gives $(\alpha, p_{iw}) = (1.00, 0.06)$, in contrast to $(\alpha, p_{ig}) = (0.71, 0.23)$ with government fractionalization. We test this hypothesis in the following section.

4.   A Cox Regression Analysis of the Fractionalization Hypothesis

The objective of the following survival analysis is to investigate the asserted causal relationship between government fragmentation and foreign economic liberalization. We assume that inter-factional conflict is only one of the factors determinant of economic open-

ing and that we have to control for some other factors. Other observers have addressed the importance of democratization and political participation (Kubota/ Milner 2000), the number of veto players (Tsebelis 1995, Hallerberg/ Basinger 1998), IMF conditionality (Harrigan 1996; Taylor 1997) and the seriousness of the economic crisis (Tomassi/ Velasco 1996).

The statistical model estimates the impact of these variables on the likelihood of economic reform. Our sample consists of all countries that have been closed autocracies in 1975 (OPEN=0 and DEMOC<5) and for which the necessary data could be collected. All basic economic data are from the Penn World Tables (Mark 5.6, revised December 1997, University of Toronto, Canada). We obtained the natural growth rate of per capita income (NGDPC), the share of trade as part of the gross domestic product (OPENPWT), and the government share of the economy (G) from this data source. The natural growth rate enters the regression with a lag of five years because we rely on the functionalist logic as a baseline model that a crisis typically precedes the opening (NGDPC5). We therefore expect a negative sign (a hazard rate below 1) and hypothesize that the better the state of the economy was five years ago, the lower the incentive to open the economy. We also expect a negative sign (a hazard rate below 1) for G because an increasing government share of the economy allows the dominant faction to distribute more rental income and to lessen the degree of conflict within the government. OPENPWT, however, should enter the regression with a hazard ratio above 1, since a high trading share of the economy indicates a higher potential for gains from trade.

We obtained the political variables from the data sets of Keefer (Beck et al. 2000). We include the number of veto players (CHECK1) and GOFRAC into the regression. GOFRAC measures the likelihood that two randomly drawn members of the parliament will belong to different parties. Specifically, the index is one minus the Herfindahl index of the government. The Herfindahl index is a concentration measure. The value of the index, *H*, is the sum of the squares of the shares of all units q:

$$H = \sum_{i=1}^{N} q_i^2. \tag{8}$$

H approaches 1 if there is complete concentration and 0 if there is complete fractionalization. GOFRAC, therefore, approaches the value 1 if the government under observation is extremely fractionalized.

Keefer et al. have coded GOFRAC as missing values if the country under consideration is a pure dictatorship with no parliamentary involvement in political decision-making. We have re-coded these cases to 0, claiming that we observe no fractionalization. The dictatorships are then indistinguishable to countries with a single party government. This procedure would be unacceptable if we were to measure democracy or political participation. However, since GOFRAC represents government fragmentation in our empirical model and since we control for the level of democracy, we see no reason to isolate non-fragmentary autocracies from non-fragmentary democracies. Quite to the contrary, if we would not re-code our main variable in the described manner, GOFRAC would be largely indistinguishable from other levels of democracy, such as Polity's DEMOC. Admittedly, GOFRAC measures the potential for conflict among government factions rather than the level of conflict itself. But the reliance on institutional attributes rather than behavioral indicators is a common second-best solution in macroquantitative research. GOFRAC is definitely not the best proxy one can imagine, but the best that is currently available to distinguish different levels of fragmentation within autocracies.

The variable CHECKS counts the number of veto players in a political system. The variable is adjusted for whether these veto players are independent of each other, as determined by the level of electoral competitiveness in a system, their respective party affiliations, and the electoral rules. The inclusion of this variable clearly requires some explanation, since the notion of a veto player does not fit into the common and correct understanding of autocratic political systems. We therefore follow the appropriate coding schema of Beck et al. (2000) and set CHECKS equal to 0 if the Legislative Index of Electoral Competitiveness is less than four. The idea is that "regardless of the formal constitutional arrangements, where legislative elections are uncompetitive, constitutional checks on officials are unlikely to be binding" (Beck et al. 2000: 27). In all other cases, CHECKS is increased by one in presi-

dential systems and one for each legislative chamber. If, however, a country conducts its elections under closed list rules *and* the president's party holds a majority in a particular chamber, then we can expect that the president exercises substantial control over the chamber. Again in accordance with Beck et al. (2000) we do not count such constellations as an additional check. For parliamentary systems, CHECKS is increased by one for the prime minister and the number of parties in the government coalition, including the prime minister's own party. The interpretation of CHECKS is straightforward: Autocracies are indistinguishable characterized by the lack of veto-players. Countries are only able to introduce veto players to their political systems if they democratize. The more veto players are present, the more is a government constrained and the more does the policy depend on the status quo. We therefore expect the likelihood of a foreign economic liberalization to decrease with a rising number of veto players.

DEMOC and dDEMOC are taken from the Polity 98 data set. While DEMOC measures the level of democratization at a given time t, dDEMOC measures the first difference of this level compared to the level of democracy five years ago. See Gurr (1990) and Jaggers and Gurr (1995) for an in-depth discussion of the variables. GOFRAC, CHECKS and DEMOC co-vary, but the bivariate correlation only amounts to .321 (GOFRAC, CHECKS), .302 (GOFRAC, DEMOC), and .291 (CHECKS, DEMOC). We therefore expect no serious estimation problems caused by the multicolinearity of the independent variables.

A number of authors has, as outlined, argued that the rush to foreign economic liberalization was mainly driven by the IMF conditionality (Harrigan 1996; Taylor 1997). We have tested this hypothesis using various operationalization: a) the cumulated amount of IMF credits (IMFC), b) the number of IMF credits within the previous five years (IMFCSUM) and c) IMF credits divided by national GDP (IMFCGDP).

Finally, our dependent variable, opening, is a change from 0 (closed) to 1 (open) in the Sachs-Warner (1995) dummy variable. Their proxy is denoted 0 if a country has applied non-tariff barriers to trade to more than 40 percent of imported goods or if the average tariff exceeds 40 percent or if the black market exchange rate is more than 20 percent below the

official rate or if a state monopoly for the most important export goods has been implemented (Sachs/ Warner 1995: 22).

We apply a Cox regression model with time-dependent covariates (Cox 1972, 1975) to explain the event of economic opening. Continuous-time models apply partial likelihood estimation and yield the flexibility that one can assume time dependency without being forced to specify the functional form (Yamaguchi 1991: 101).

The empirical evaluation distinguishes between five models: Model 1 represents the baseline argument that attributes the likelihood of economic opening to the occurrence of an economic crisis. It equally specifies the national political system and includes measures of the number of veto players, the government share of the GDP, and the government fractionalization index. Models 2 to 4 add DEMOC, dDEMOC, and finally both of these variables simultaneously to test the hypotheses put forward by Kubota and Milner (2000). Model 5 and 6 regresses the democracy variables without the variable of our main interest, GOFRAC.

	Model 1	Model 2	Model 3	model 4	model 5	model 6	model 7
NGDPC5	0.0002	0.0001	0.0001	0.0005	0.0008	0.0002	0.0002
	-8.474	-8.788	-8.438	-7.578	-7.1647	-7.676	-7.616
	(8.242) ***	(10.680) ****	(8.010) ****	(7.854) ***	(6.825) ***	(7.838) ***	(7.518) ***
G	0.925	0.927	0.928	0.912	0.933	0.915	0.914
	-0.077	-0.076	-0.075	-0.093	-0.069	-0.089	-0.090
	(4.241) **	(4.175) **	(3.774) *	(7.288) ***	(5.453) **	(6.596) ***	(6.409) **
OPENPWT	1.021	1.026	1.020	1.022		1.022	1.020
	0.020	0.025	0.020	0.022		0.022	0.019
	(2.931) *	(5.192) **	(2.920) *	(3.537) *		(3.613) *	(2.662) *
CHECK1	0.541		0.558	0.531	0.477	0.520	0.531
	-0.614		-0.583	-0.634	-0.741	-0.654	-0.633
	(4.540) **		(3.824) *	(4.845) **	(6.799) ***	(5.104) **	(4.940) **
GOFRAC	172.334	71.593	133.678	295.907	148.267	301.524	271.061
	5.149	4.271	4.895	5.690	4.999	5.709	5.602
	(14.524) ****	(12.241) ****	(11.108) ****	(22.080) ****	(20.665) ****	(21.978) ****	(21.706) ****
DEMOC	1.060	1.072	1.087				
	0.058	0.070	0.083				
	(0.514)	(0.820)	0.669				
dDEMOC			0.956				
			-0.044				
			(0.162)				
IMFC	1.539	1.575	1.555				
	0.431	0.454	0.442				
	(0.765)	(0.884)	(0.789)				
IMFCSUM						1.000	
						0.000	
						(0.271)	
IMFCGDP							1.000
							0.000
							(0.584)
-2LL	112.90	117.567	112.704	114.281	117.407	113.898	112.618
CHI²	36.030 ****	31.364 ****	36.106 ****	35.244 ****	39.217 ****	35.033 ****	34.683 ****
time at risk	800	800	800	800	800	800	800

Dependent Variable: OPENEVENT (Sachs/ Warner 1995) line 1: exp(b), line 2: b, line 3: Wald (in parenthesis)
* significant at the 10% level, ** significant at the 5% level, *** significant at the 1% level, **** significant at 0.001 level.

Table 2: Determinants of Foreign Economic Liberalization: A Cox Regression Analysis, 1970-1992.

The first column presents the baseline Cox-regression-model as specified above. All beta coefficients turn up with the expected sign. A high share of trade to GDP, low levels of government fractionalization and increasing growth rates in subsequent years, a large number of veto players, and a high ratio of government consumption to GDP reduce the likelihood of economic opening. Although GOFRAC is not an optimal operationalization for political conflict between government fractions, the results nevertheless highlight the astonishingly large importance of government fractionalization for foreign economic liberalization in accordance to our model. Ceteris paribus, countries with extremely fractionalized governments are about six times more likely to open their economy compared to states without government fractionalization. We therefore tend to interpret these results as a first confirmation of our theoretical model. An equally sized effect results from an economic crisis. Moreover, adding one veto player to a political system reduces the relative likelihood of an economic opening by approximately 20 percent.

Models 2 to 4 show that *adding* the democracy index or the first derivative in the level of democracy does not improve the model. The variable DEMOC enters the regressions with the sign expected by Kubota and Milner, but the impact of democracy on the relative likelihood of economic opening is small and remains insignificant. The estimated coefficient for DDEMOC has the wrong sign and remains far from reaching a conventional level of significance. However, if we suppress GOFRAC from the model, DEMOC as well as DDEMOC enter the regression significantly, though DDEMOC preserves its negative sign, thus falsifying the Kubota-Milner hypothesis.

As models 1-3 and 6 and 7 demonstrate, none of the operationalizations of the IFI's variable turned out to be significantly correlated with our dependent variable. The only impact of IMF lending seems to result from the amount of money the IMF transfer to the debtor country. Since this variable tends to be highly correlated with crisis' severity, an interpretation of the results remains difficult. We may therefore conclude our discussion on IMF conditionality by borrowing a quote from Dani Rodrik, who claimed:

> "That the world bank and the IMF became uncommonly powerful in their dealings with the governments in developing countries during the 1980s is indisput-

able. Yet it would be a mistake to picture the process of policy reform as one in which orthodox economic policies were externally imposed on unwilling policymakers. (…) More often than not, reform has had a significant homegrown component." (Rodrik 1994: 75)

5. Conclusion

This paper has analyzed the impact of the domestic political processes between the dominant protectionist faction and a pro-liberalization faction in autocratic regimes on the likelihood of economic opening. It has shown that the intensifying contestation between competing élites is a major driving force in what Dani Rodrik called 'the rush to free trade' in autocratic regimes. We have shown formally in a game model and statistically with Cox regression analysis that the emergence of conflict between competing factions in an authoritarian government exerts a positive impact on the liberalization process.

This result and the accompanying evaluation of competing hypotheses have several theoretical implications. First, our model of the decision making process strongly suggests that examinations of economic opening should move beyond the functionalist logic that economic crises is a sufficient condition of liberalization. The empirical analysis supports the political economy hypothesis that the internal power allocation of a country affects the possibility that it will open up. We move, however, beyond the standard interest group competition hypotheses that is the base of Alesina and Drazen's (1991) pioneering contribution. In contrast to their 'war of attrition' model, our model includes the government as a strategic actor and conceives of economic opening as the consequence of concessions of the protectionist to the liberal faction in an authoritarian regime.

A second contribution of this article is some tentative support for the argument that can be derived from the veto player literature. According to this important theoretical strand in Comparative Political Economy, economic opening becomes less likely, the more veto players a country possesses. We show that this does not hold true.[9] Despite the mere statistical regularity, one should be aware that such arguments are too for-

malist as long as they do not come up with a sensible measure of the veto players' attitude towards economic reform.

Third, this paper shows that democratization is not a necessary precondition of economic opening. On the contrary, democratization seems to become more likely, the more divided an authoritarian government is. The government fractionalization of authoritarian regimes, in other words, seems to be a major link in the possible relationship between political institutions and economic development. The relative power of liberal interest groups is therefore key for our understanding of transformation processes in the developing world.

Future work has to show whether the findings reported are stable once we move to other research designs or rely on other indicators to measure the relative power of competing élites. We acknowledge that our main indicator exhibits some weaknesses, most notably that it measures an institutional variable while we are rather interested in elite behavior. These drawbacks do, however, not too much impinge on the general thrust of this study that the political economy models should rely on a more focused conceptualization of the domestic political process to account for the sources of economic opening. As this analysis shows, dichotomizing between democracies and autocracies is simply not enough to understand the 'rush to free trade'.

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[9]   Similar results have been obtained by Bodenstein/ Schneider (2001) and Mattli/ Plümper (2002).

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