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Gov 2710
Week 3

Robert O. Keohane and Helen V. Milner eds. <u>Internationalization and Domestic Politics</u>

This volume concentrates on how internationalization affects states' economic policies and institutional forms. Internationalization affects the preferences of domestic policy-makers by altering the opportunities and constraints they face in the international system. Internationalization is taken as the independent variable and used to explain: 1.) national economic policy and the structure of domestic institutions, 2.) policy-makers' preferences regarding national economic policy and the structure of domestic institutions. Milner/Keohane provide an overview, Frieden/Rogowski and Garrett/Lange make the causal argument for each of the dependent variables, and Frieden and Evangelista are empirical tests of the theory.

- Milner/Keohane – "Introduction"

Milner and Keohane define *internationalization* as "the processes generated by underlying shifts in transaction costs that produce observable flows of goods, services, and capital." As evidence of internationalization, Milner and Keohane cite the growth of trade as a percentage of national GDPs and the dramatic increase in international capital flows in the past twenty years. In theorizing about how international changes affect domestic politics, they identity two key factors: the interests of actors, and the structure of domestic institutions. Variation in these factors help to explain why states respond differently to the same external environment.

Milner and Keohane hypothesize that as internationalization increases, states will increasingly integrate their economies into the international economy. As a state becomes more open it will be more vulnerable to externally generated shocks.

- Frieden/Rogowski – "The Impact of the International Economy on National Policies"

Internationalization affects states' preferences through exogenous easing – factors that make it more advantageous to engage in trade, or conversely make it more costly not to engage in international trade. As the terms of trade improve states face increasing opportunity costs to not opening their economies.

Frieden and Rogowski argue that while greater openness improves overall national welfare, the cost and benefits of such strategies are unevenly distributed. Sectors that are internationally competitive will support more open economic policies while those sectors that would be hurt by greater openness will prefer the status quo so as not to have to face international competition. They expect coalitions to form among the winner and the losers from internationalization.

- Garrett/Lange – “Internationalization, Institutions, and Domestic Politics“

Garrett and Lange identify two types of domestic institutions that are consequential to states’ responses to internationalization: socioeconomic institutions – non-state institutions that organize actors with the same preferences, and lobby for its preferred policy choice (example: labor unions); and formal political institutions. The strength of, and coordination between socioeconomic institutions determine the types of policy demands made. The stronger and more cooperative socioeconomic institutions are in their demands, the more likely that their policy preferences will maximize overall gains. The effects of formal political institutions are a function of how they aggregate societal preferences. Political institutions entrench distributional arrangements that advantage specific sub-groups. The extent to which institutions extend leaders’ time horizons and create incentives for leaders to be responsive to preferences of the broadest possible societal spectrum explains their willingness to change economic policies and disrupt the existing distributional arrangement. Thus we should expect states with democratic institutions to be more inclined implement liberal economic policies.

- Frieden – “Economic Integration and the Politics of Monetary Policy in the United States”

Frieden argues that internationalization makes monetary policy a more salient domestic political issue because of the effect of monetary policy on relative prices. This gives rise to divergent, clearly delineated preferences between the tradable and nontradable sectors. In closed economies there are no obvious distributional consequences to monetary policy. In an open economy monetary policy has a concentrated effect on the relative prices of tradable and nontradable goods. Appreciation of currency makes exports more expensive, providing the tradables sector a clear incentive to lobby for a change in monetary policy. The tradables sector will also prefer a fixed interest rate regime so to as to minimize uncertainty. The nontradables sector will be either indifferent or opposed to such measures. Frieden also contends that in open economies monetary policy can be used to alter the circumstances of trade. The tradables sector will pursue trade-motivated changes in monetary policy as it is easier to achieve than direct change of trade policy.

Frieden illustrates the argument by analyzing American monetary policy. He demonstrates that in periods of extensive engagement in the international economy, interest groups formed in response to the appreciation of the dollar. He also highlights the growing linkage between trade and monetary policy in the US Congress in periods of economic openness.

- Evangelista – “Stalin’s Revenge: Institutional Barriers to Internationalization in the Soviet Union”

Evangelista argues that in the Soviet case the institutions of state socialism hindered the perception of changing relative prices by sub-national actors. The state monopoly on foreign trade and central planning system blocked all world price signals and actively prevented a change in domestic prices. Almost all economic assets formally belonged to the state and were controlled by a small ruling elite. This ruling elite was the beneficiary of the existing distributional arrangement. This was not an formal arrangement embodied in formal institutions, rather the elite derived its wealth and power by virtual of their association. Thus, Evangelista finds little evidence of the processes Frieden/Rogowski describe but very strong evidence of the Garrett/Lange argument.

He analyzes the case of the Soviet energy sector as a test of the Frieden/Rogowski hypothesis that those sub-national actors with the greatest incentive to engage in trade should push for greater economic openness. Evangelista contends that the command economy prevented actors in the sector from perceiving an interest in openness and provided no means of acting on those interests. Soviet authorities held oil prices constant during the 1970s oil crisis, providing no incentive to improve efficiency or increase production. He finds some tentative evidence that supports Frieden/Rogowski in the behavior of the Soviet coal sector. Strikes by coal workers can be interpreted as rough coalition-building.