

Zdzisław W. Puślecki

Adam Mickiewicz University in Poznań (Poland)

Current Trends in Foreign Trade Theory and Policy¹

Abstract: In this research work, Author focus on the current analysis trends in foreign trade theory and policy. Accordance with the foreign trade policy theory further trade liberalisation and improved framework policies would increase trade and promote growth. It must be emphasized that openness to trade is associated with higher incomes and growth and there is the need for new approaches to trade cooperation in light of the forces that are currently re-shaping international business. What indicates the importance and innovativeness of the research is the presentation of the new models of the foreign trade policy and trade interests. First of all, it must underline that in the new theoretical terms in demand for trade policy very important is factor specificity. The low specificity of factors means that factor returns are equalized throughout a region's economy. On the other hand, some factors are stuck in their present uses; therefore, factor returns are not equalized throughout a region's economy but are industry specific. The main objective of the research task is to give a comprehensive analysis of current trends in foreign trade theory and policy and in particular models of foreign trade policy, trade interests indicated by export orientation and import sensitivity, foreign trade policy in different types of authoritarian regimes, protectionist pressures in different political system, the level of protectionist pressures, the tendencies to bilateralism in the foreign trade policy. It should be stressed that free trade in itself is not responsible for economic growth, but more significant are the determining macroeconomic stability and increasing investment.

Keywords: *foreign trade policy; public choice; liberalism; protectionism; authoritarian regimes; bilateralism*

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Introduction

It must be emphasized that there is the need for new approaches to trade cooperation in light of the forces that are currently re-shaping international business. It suggests that the multilateral trading system will need to adjust to developments in trade and the trading environment. The key to trade developments within the broader socio-economic context is especially the rise of global supply chains, the general shift of trade power away from the West towards Asia.

The international trade in the 21st Century has been strongly affected by the force of the economic crisis. The changes are evident in the growing importance of international trade to national economies and domestic groups within those economies, in the close linkages between trade and other international issues. Realistic point is essential trends in the global trade regime during the economic crisis. The growing interdependence and the decline of the United States' trade hegemony have led to increased competitiveness and greater temptations to resort to strategic trade policy.

Materials and Methods

In the paper, it presents the contemporary models of foreign trade policy, trade interests indicated by export orientation and import sensitivity, foreign trade policy in different types of authoritarian regimes, protectionist pressures in the different political system, the level of protectionist pressures, the tendencies to bilateralism in the foreign trade policy. The general theoretical approach will be of broad interest to economists interested in international questions as well as to political scientists. The primary method applied in this research was a method of scientific study. It was used the institutional method, comparative method, and the documentation method. Additionally, it used also, the methods of deductive and inductive forecasting.

The Contemporary Models of the Foreign Trade Policy

Traditionally, political economy models of trade policy have tended to focus on the demand for protection, with factor endowments driving political reactions to exposure to international trade. Such model simply assumed that adversely affected economic agent would organise to seek protection, which would be afforded to them by their elected representatives in the political system. The supply side for trade policy (Jones, 2015) was either ignored or underspecified in most models (Thies & Porche, 2007, p. 172).

In the foreign trade policy theory interesting are the reviews of Alt et al. (1996) and Nelson (1988) about the demand for trade policy in terms of the theoretical importance of factor specificity (Alt et al., 1996, p. 695; Nelson, 1988, p. 806). Factor specificity refers to the ease with which factors (land, labour, and capital) can move from one sector to another in an economy. The two dominant approaches to explaining the demand side of trade policy used radically different assumptions about the specificity of factors. The Heckscher-Ohlin model, used by Rogowski (1989) in his seminal contribution *Commerce and Coalitions*, assumes very low-factor specificity (Rogowski, 1989). The low specificity of factors means that factor returns are equalized throughout a region's economy. Producers should export goods that intensively use their abundant factors and import goods that intensively use their scarce factors, with the result that owners of abundant factors will favour free trade and owners of scarce factors will favour protectionism. Trade policy coalitions will, therefore, be organized along factor or class lines. On the other hand, the Ricardo-Viner assumes that some factors are stuck in their present uses; therefore, factor returns are not equalised throughout a region's economy but are industry specific. Trade policy coalitions should form along the lines of exporting versus import-competing industries.

Neither of these models explains how preferences over trade policies are translated into political action (Alt, Frieden, Gilligan, Rodrik and Rogowski, 1996, p. 695). In a discussion of the endogenous tariff literature, Nelson (1988) notes that the mobility costs of the specific-factors model may be a result of productivity differentials, labour union activity, or individual preferences for membership in a given geographic area, industry, or firm (i.e., some form of solidarity) (Nelson, 1988, p. 806). In all of these cases, one can derive a link to preferences for tariff policy, "but without additional information on why the specific-factor model is chosen, it does not tell us much about political organisation".

Alt et al. (1996, p. 695) suggest that one can begin to understand this process by assuming that rational individuals make cost/benefit calculations. The Heckscher-Ohlin and Ricardo-Viner models tell us the benefits that individuals hope to receive, but the costs of collective action also intervene as they organise to achieve those benefits in the political system. Olson (1985, p. 928–937) argued that small groups with specific interests be easier to organise and more efficient in securing economic rents than large groups with diffuse interests. Small groups are better able to control free riders than large groups, and groups with specific or homogenous interests can more easily coordinate and target their activities than groups with diffuse or heterogeneous interests. This approach is thought to explain the success of agricultural producer groups in developed countries in organizing for protection as well as the inability of agricultural producer group to organize in developing countries (Anderson, 1995,

p. 401–423; Coleman, 1998, p. 632–651; Olson, 1985, p. 928–937; Olson, 1986; Sheingate, 2001, Eagleton-Pierce, 2013).

However, Nelson (1988, p. 807) points out that we should not assume that organised interests will be equally responsive to all issues. Institutionalized interaction among actors may help to explain systematic patterns of action, especially as institutions created for specific historical purposes may outlive those purposes. Alt et al. (1996, p. 696) suggest that if a particular group has paid the fixed costs of establishing collective action and developed well-worn channels of access to public officials, it may defend its trade policy preferences even when the stakes are low because the marginal costs of action are low. It may be the case that “a much more affected but inchoate group does nothing because the start-up costs of the organization are too daunting”. Past strength of an organisation should, therefore, be an important intervening variable predicting group action on trade policy. Further, as Nelson (1988, p. 807) argues, once these institutions exist, supply-side interventions may also affect their usefulness as some are deemed legitimate or illegitimate aggregators of interest. Thus, we must examine the way in which economic institutions and political institutions interact. Most economic models simply assume that a model of the economy is a model of the demand side for trade policy, but Nelson (1988) suggests that we must elaborate the mechanisms by which demand is articulated to the suppliers of trade policy (Nelson, 1988, p. 810). For a good overview of this argument, especially as it pertains to agriculture (Thies & Porche, 2007, p. 172; Eagleton-Pierce, 2013).

If the political systems reward small sectoral groups, then individuals will not pay the costs of organising large intersectoral coalitions. If the political system rewards large mass movements (i.e., majoritarianism), then individuals will have to pay the costs of organising large intersectoral coalitions to achieve any benefits. Collective action costs and political institutions are interactive with factor specificity. They suggest that Rogowski’s (1989) Heckscher-Ohlin framework requires low factor specificity, low collective action costs, and domestic political institutions that favour mass movements (Rogowski, 1989). The Ricardo-Viner framework used by the endogenous tariff literature requires that factors be specific, collection action costs are high, and institutions are less majoritarian, with changes in any of these three variables also affecting the type of coalitions that form.

In the state as a rational dictator model, the state may be seen as either pursuing “good government” goals along a social welfare function or intervening in the economy for their own self-interested model of the state views politicians as offering preferential trade policy to economic actors in exchange for political support (Magee, Brock & Young, 1989; Grossman & Helpman, 1984, p. 833–850). On the other hand, pluralist theory typically views the state as a neutral aggregator of demands from groups in

society. The supply of trade policy is then determined by the balance of power on any given issue. The supply side of trade policy (Jones, 2015) is relatively undeveloped theoretically, and yet a crucial part of the equation. A variety of different characteristics of the political system are posited to affect the supply of trade protectionism, such as politicians incentives to cultivate personal votes, the size of electoral districts, party fragmentation, federalism, presidential versus parliamentary systems, and so on (Nielson, 2003, p. 407–491; Rodrik, 1995; Rogowski, 1987, p. 203–222; Rogowski, 1987, p. 1121–1137).

On a theoretical level, understanding the choice of trade policies in countries is very important. A survey of economists suggested that one of the few things they agreed on was that, under most conditions, tariffs, and quotas reduce the general welfare (Frey, 1984, p. 986–994). The stubbornness of protectionism in the face of international and academic pressure against it has led economists to seek explanations. These explanations range from the simple ignorance of politicians to arguments about the rationality of protection for ‘infant industries’ and ‘optimal tariff levels’ in developing states. Faced with this frustrating question, scholars have increasingly turned to political answers to explain the choice of what would seem to be an ‘irrational’ policy (Frey, 1984, p. 199–223; Nau, 1989; Nelson, 1988, p. 796–837).

Trade Interests Indicated by Export Orientation and Import Sensitivity

The evidence considered provides substantial support for the argument that the trade interests of their constituents, as indicated by export orientation and import sensitivity of their district, influence policymakers’ behaviour on political and security issues. These effects are mediated by the party and the heterogeneity of the constituency and are consistent in both roll-call voting and sponsorship activity. Export orientation appears to be somewhat more important than import sensitivity. Both have substantively meaningful effects on sponsorships, but only export orientation is a statistically significant predictor of roll-call voting (Kleinberg & Fordham, 2013, p. 615).

About the liberal argument, it is important to underline that trade reduces international conflict and promotes cooperative foreign policies. The first is that the benefits of international trade indeed appear to influence policymakers’ attitudes toward trading partners as the liberal argument suggests (Kleinberg & Fordham, 2013, p. 615). These results complement similar effects it can found in surveys of mass public (Kleinberg & Fordham 2010; Fordham & Kleinberg 2011).

The second conclusion is an essential qualification to the liberal argument, though not one that is at odds with its underlying logic. Because the aggregate benefits of international trade are not shared equally within the trading states, trade’s political

effects do not apply to everyone. The fact that some people can expect their income to decline as a result of international trade is critically important for whether it reduces conflict between trading partners. These people could contribute to demands for a less-cooperative foreign policy as well as for trade protection. In principle, the winners in the trading relationship should be able to remove this motive by compensating the losers out of the aggregate benefits of trade. In practice, such compensation is not always offered (Kleinberg & Fordham, 2013, p. 615).

Foreign Trade Policy in Different Types of Authoritarian Regimes

The interesting question is, which authoritarian regimes are most politically liberal? Among the authoritarian regime types often identified in the literature, multiparty, and to a lesser extent single-party, regimes will tend to have the largest electorates. Therefore it argues that multiparty and single-party authoritarian regimes will have more open trade policies than other authoritarian regime types, other things equal. More specifically in the Wright–Geddes data (Wright, 2008a; 2008b; Geddes, 1999), the coding is divided into four categories: single-party, military, monarchist, and personal regimes (Hankla & Kuthy, 2013, p. 495). In the case using this data, it can expect that single party regimes will tend to have more liberal trade policies than other authoritarian regime types. For the test using the Hadenius and Terrell’s data (2007, p. 143–156), it can expect that multiparty regimes will tend to have more liberal trade policies in comparison with any of the other four regime types (single-party, military, monarchy, and personal regimes) (Hankla & Kuthy, 2013, p. 495).

The second component institutionalisation argument is that regime stability encourages free trade policies in authoritarian systems. More institutionalised autocratic regimes are better able to co-opt dissent and should, therefore, tend to enjoy longer and more stable tenures. As a regime’s stability increases, the time horizons, in turn, produce powerful incentives to enact policies that will benefit the country’s economy in the long run rather than just shore up support for the leadership in the immediate future. As Olson (1993) has argued even kleptocratic dictators have good reason to maintain the health of their national economies if only to provide sources of future loot. By contrast, authoritarian leaders sitting top unstable regimes and fearing removal will not be thinking about the long-term future. Instead, their focus will be providing immediate benefits to their supporters to remain in power. As a consequence, the leaders of more stable autocratic regimes will be more likely to provide the public good of free trade, while those whose hold on power is precarious will tend to rely on particularistic goods such as protectionism to keep their winning coalition intact (Hankla & Kuthy, 2013, p. 495).

The pressure for protectionism in an attempt to gain short-term support in new unstable regimes is likely to be even higher for authoritarian governments than for those in a democracy. Additionally, genuinely stable authoritarian regimes tend to have individual leaders with very long time horizons (far beyond those of stable democratic leaders), providing them with stronger incentives to choose policies, like free trade, that may contribute to long-run economic growth (Hankla & Kuthy, 2013, p. 495).

Protectionism Pressures in Different Political Systems

It is important to indicate, that the role of trade unions in different political systems may be, to a high degree, different. In authoritarian systems, it is, as a rule, smaller than in democratic systems. It would seem that if protectionistic pressure on the part of trade unions is weaker, the situation for economic growth is much better. Following that line of reasoning, we could conclude that the authoritarian system is better for the effectiveness of the labour market. The examples of Chile, South Korea, Singapore and Turkey from the seventies and early eighties could confirm that point of view. In many cases, during those two decades, the authoritarian regimes persecuted trade unions and put restrictions on basic labour rights. During that period of oppression, South Korea, Singapore and Turkey experienced spectacular growth in the sector of processing industry and the growth of demand for labour. Growing profits and the demand for labour in a processing industry caused a general growth of prosperity of the employed. Although similar results were not noted immediately during the authoritarian phase of development in Chile, some observers express the opinion that the reforms introduced at that time helped to reorganise Chilean economy in the nineties. The application of democratic rules, on the other hand, may lead to lower productivity of labour force. In some years, different democracies had to use significant financial resources for the employment of those who belonged to trade unions like for example in the European Union.

A different point of view says that government legislation concerning the labour market may be applied more efficiently in an authoritarian system than in a democratic one. There are, however, some democracies among the industrialised countries where an effective labour market exists. There are also democracies with effective labour market policy among the developing countries. Similarly, in the countries in which the transformation from the authoritarian regime towards democracy is taking place, avoiding unfavourable phenomena in a labour market is often a priority. For example, the Chilean government moved towards democracy and to free trade unions without home income growth. The end of oppression in South Korea, in 1987, started the partnership relations in full of conflicts industry (Banerji & Ghanem, 1997).

It is worth considering which of the two points of view presented above should be given support, that is, which of them is the proper one. The analysis of that problem may be based on the Grossman and Helpman model (Grossman & Helpman, 1994). This model describes economic development by two sectors – urbanised, regulated processing sector, and rural, unregulated agricultural sector. The protection of the labour market, especially of minimum wages, is usually applied to bring the benefits for the employees of the regulated sector since the sector of unregulated employees does not come under the legislation concerning the labour market.

The sector of classified employees, and also the owners, demand from the government that it leads an economic policy that is favourable to them. The employed demand high minimum wages, while capitalists demand high profits. Both groups demand the restrictions on the degree of economic openness. In a closed economy, higher market minimum wages and higher profits are usually connected with higher prices for home consumers, and this is not easy when those consumers are free to buy the substitutes in the form of imported goods. Thus, incomes in an economy may be created by protection and later divided among the employees of the regulated sector and the capitalists, although sometimes the government itself takes a part of those incomes (Banerji and Ghanem, 1997).

A government conducting an economic policy takes into account some factors. Firstly, it has to decide the degree of obtaining the resources, that is, how much of those resources it wants to obtain. Hence the importance of investments and future economic growth, and also of defining the possibilities for keeping the power it is currently holding. Secondly, the government should define the scale of support from each of the pressure groups that can influence the situation. The position and importance of each group for the development of political processes should be considered. For example, in the country where the regulated labour market is divided and politically weak, only the capitalists may have a deciding voice in political processes. Moreover, the contrary also happens - in the societies where the labour market is organized, it may play an important role in mobilising voters.

The Level of Protectionist Pressures

The above arguments show that the policy is defined by political factors (including the type of the government and the burdens resulting from obligations towards employees and capitalists), and by economic factors (wages, prices, the structure of production and consumption). By the present discussion, we can present two equations, one about the level of protection, and the second about the national economy and deformation of wages.

- 1) $\pi = f(e, l, k, R)$
- 2) $\phi = f_1(\pi, e, l, k, R)$,

The level of protection (π) depends on the economic parameters (e), a relative political importance of urbanised employees and capitalists (l and k , respectively), and on the type of the government (R). Deformation of wages is, on the other hand, the function of π and of e, l, k and R . In case of a small economy, economic parameters that can influence π and ϕ include flexible consumer and producer prices, demand flexibility, wages and the demand for labour force, and also the price of goods on an international market.

One can expect, a priori, which the growth of π is dependent on l and k . If interest groups become stronger, the pressure to form incomes based on protectionism may become stronger. The influence of R , that is, the influence of a political authoritarianism on the level of protectionism, that is, π , depends on the fact whether the opinion that the level of protectionism depends on the effects of democratization is correct. It is also thought that the increase of the deformation of wages depends on π and l , while its decrease depends on k . As long as the incomes are obtained from trade protections, those incomes can be handed over to urbanised employees. An important problem in case of urbanized labour force as an interest group with growing strength is the fact that urbanized employees may gain a big share in the division of incomes but the growth of political importance of the capitalists may cause that the shared incomes, handed over to the labour force in regulated sectors of economy will become smaller (Banerji & Ghanem, 1997).

There is no doubt that it is easier for wealthy rather than poor societies to choose democracy (Helliwel, 1992). Since those wealthier societies at the same time tend a bigger openness, the direction of cause-result events may run from the openness of society to the political system, and not, as was suggested earlier, in the opposite direction. The research also showed that the level of education plays an important role in this respect. The countries with a higher level of education of labour force are more open.

By the earlier considerations, one can conclude that authoritarian systems have a tendency towards a broader application of protectionism than democratic systems, and that, in turn, the trade restrictions accompany significant deformations of wages on the labour market. This opinion may be justified by the observations of the situation in some countries.

Freedom of association is one of the elements of proper management and the necessary condition for development. The authoritarian governments do not respect, however, the freedom of association, which is connected with the policy of trade restrictions and with the deformations on the labour markets. One cannot state,

however, that inappropriate or ineffective policy on the labour market belonged exclusively to authoritarian regimes or that authoritarianism automatically generates this kind of policy. There are some examples of authoritarian countries which do not conduct policies of that kind. The works of such authors as Fields or Freeman show that the repressions against the labour force are not necessary if one wants to achieve a required economic growth (Fields, 1994; Freeman, 1993).

Finally, it should be pointed out that there exists a close relation between democracy and economic growth. There are well-known examples of open societies that stimulate the economic growth. It is true mainly in case of highly developed and strongly urbanised countries. In the countries with a developed democracy, the pressure groups have a bigger opportunity for acting. The research shows that the presence of trade unions helps to accelerate the economic reforms (Devarajan, Ghanem & Thierfelder, 1997). The benefits resulting from the liberalisation of the international trade are more prominent when the trade unions exist in the sector of the economy under protection. The growth of import abilities leads to the decrease of wage pressures, and when the trade unions agree to that, such a situation allows for a better allocation of the labour force in the economy. It is true both in the case of active and passive trade unions, although the effects are better in case of active trade unions.

The Tendencies to Bilateralism in the Foreign Trade Policy

The tendencies in foreign trade policy development can create changes in domestic markets, placing pressure on political actors to obtain aid from the government especially during the economic crisis (Krist, 2013); (Jackson, 2013; Ravenhill, 2014). There are also the groups which want to coordinate activities and change foreign trade policy. Government justify protection of the domestic market to response to global competition. Primarily, the government appears to supply protection for affected parties; yet, the overall impact on consumers, producers, and foreign competition is negligible (Thies & Porche, 2007). Significant government ownership of the productive resources of a country hurts trade liberalisation, while fragmentation of decision-making authority, expressed as fragmentation within the government and pluralism in society, has a positive impact on the liberalisation of trade policy (Kennedy, 2007; Krist, 2013).

In the area of foreign-policy analysis has focused on “three I’s”: interest groups, international structure, and ideas (Kennedy, 2007). In the interests groups literature, government policy is viewed as the outcome of competition between groups for trade policies that benefit their industry (Nau, 1989; Milner, 1995; Milner & Yoffie, 1989; Schattschneider, 1935). International structure suggests that freer trade was

a reflection of U.S. interests and its hegemonic status after World War II (Krist, 2013; Kirshner, 2013), while a decline in free trade is a reflection of the U.S.'s hegemonic decline (Krasner, 1976; Krist 2013; Kirshner, 2013). The literature on ideas suggests that policy beliefs are reflected in laws and institutions (Jones, 2015). These laws and institutions, in turn, carry a type of inertia that continues to influence policy outcomes long after changes in international and domestic structure would predict policy change (Jones, 2015). The institutional problems suggest that the current WTO system cannot create the conditions to deliver consensus on multilateral trade liberalisation (Jones, 2015). In contrast to these explanations government interests in the economy and in maintaining stability also play a large role in trade policy (Kennedy, 2007; Jackson 2013).

At one end, a multilateral forum with near universal membership offers maximisation of gains from trade and reduced transaction costs. However, a single state cannot expect to have much control over trade partners or liberalisation agendas at the multilateral level (Jackson, 2013). At the other end, a bilateral FTA (Krist, 2013; Jones, 2015) often yields very small gains from trade and usually increases transaction costs by producing idiosyncratic sets of rules. However, at the same time, a large state can acquire a high level of control regarding partners, issues and agenda selection, and sectoral exclusions or inclusions based on domestic political needs (Pekkanen, Solis & Katada, 2007). One can contend that industrialised states seek aggregate economic gains in the interest of national welfare (largest in multilateral forums) or seeking control over rules in line with political interests (most significant in bilateral forums) (Krist, 2013; Jones, 2015).

The liberalising rules on agriculture and other less competitive sectors are no longer an acceptable political price for the economic gains bundled across sectors (Jackson, 2013). Such policies, they contended, allow farm products to be sold at artificially low prices, thus undermining the sales of products from poorer regions. Farmers in developed countries have had considerable success blocking trade reforms in agriculture before and the WTO has been less successful lowering barriers in this field than in others (Jackson, 2013). Yet, this sort of vague statement fosters uncertainty for domestic actors at home in uncompetitive sectors like agriculture (Eagleton-Pierce, 2013) and several cases like for example in Japan and China trade officials need to show that they have more concrete control for political reasons—an element more credible in a bilateral setting (Krist, 2013; Jones, 2015) than a multilateral one (Pekkanen, Solis & Katada, 2007; Jones, 2015). This situation may also indicate the back from globalisation to the neo-mercantilist tendencies in the foreign trade policy (Krist, 2013; Jackson 2013).

Conclusion

The trade policy plays a vital role in the maintenance of both economic and political liberalisation. Weakened has, the impact of multilateral trade agreements on the processes of liberalisation of international trade in the framework of the WTO and increased the importance of bilateral agreements and regional agreements. This point of view is essential for the theory and practice of the contemporary international business.

The former two effects include mostly static from international trade in goods, services and factors of production, while the latter entails dynamic growth effects. Significant static and dynamic efficiency gains could be reaped through further multilateral trade liberalisation while global welfare gains from regional agreements are much more limited due to trade diversion.

The need for firms to organise their supply chains across different countries has led to a demand for regional agreements that cover more than preferential tariffs. The harmonisation of standards and rules on investment, intellectual property and services have become a standard part of new trade agreements. The differences among firms involved in the trade are also crucial for the future development. The picture that arises from the trade is that even if many firms are indirectly involved in trade-related activities, only relatively few are exporting or importing and these firms tend to be larger and more productive than others. Such firms also have a role in technology advancement and the diffusion of know-how through supply chains.

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Author

Professor Dr Hab. Zdzisław W. Puślecki

Adam Mickiewicz University in Poznań, Department of International Economy. Contact details: ul. Umultowska 89A, 61–614 Poznań (Poland); e-mail: zdzislaw.puslecki@amu.edu.pl.