DISCUSSION AND DEBATE

Free Trade, Economic Inequality and the Stability of Democracies in the Democratic Core of Peace

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The democracy–peace hypothesis in international politics is in the process of becoming a widely accepted, near-universal law. With rare exceptions (Faber and Gowa, 1994; Spiro, 1994), few now argue against the notion that stable democracies seldom if ever fight each other, and especially so over the last 50 years. Possibly democracies are no less war-prone when it comes to engaging in conflict with non-democracies, yet even this aspect of conflict relations is undergoing renewed scrutiny (Rummel, 1995).

Increasingly, scholarship has shifted from further empirical testing of the democracy–peace linkage toward two different theoretical directions. One places analytical focus on conditions internal to democracies that may help to account for the persistence of war avoidance between democracies (e.g. Dixon, 1994; Maoz and Russett, 1993; Siverson, 1995). The second focus, a more recent one, is found among both policy-makers and academics — each of these groups is looking at foreign policies aimed at creating dynamics that may promote the development of new democratic polities and sustain the existence of emerging democracies in international politics. US National Security Advisor Anthony Lake, for example, has articulated (1993) the objective of 'growing democracies' as a major US foreign policy plank for the new world order. Likewise, scholars working at the system level of analysis are focusing their scholarship on factors that may increase the number of democratic states, and through such increases, presumably reduce the number of wars in the post-Cold War system.

With the development of GATT, NAFTA and the WTO, one interesting line of inquiry scrutinizes the relationship between global economic policies promoting free trade and the implications of these policies for the growth

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and sustenance of democratic polities. A clear theoretical argument has been forwarded by Weede (1995), who suggests the following causal linkages —

FREE TRADE→PROSPERITY→DEMOCRACY→PEACE

In advancing this model for the importance of free-trade policies to the growth and sustenance of democratic polities, Weede argues that the link between free trade and prosperity is 'as close to common and undisputed knowledge *among economists* as any assertion may even come' (Weede, 1995: 520). He cites extensive evidence regarding the economic benefits of free trade for potential democratic polities — the studies of numerous economists 'strongly support the advantages of a free trade regime for poor countries . . .' (Weede, 1995: 521).

Likewise, Weede (1995: 521) argues that development and maintenance of democracy requires nations to be both 'prosperous and capitalist at the same time.' He argues that it is only under conditions of prosperity and capitalism that elites can accept defeat peacefully at the polls, secure in the knowledge that they will have fair opportunities to regain political power, and opportunities for economic benefit when they are out of power. The empirical evidence appears to support this causal linkage as well — while not all democracies are prosperous or capitalist, the correlations are indeed quite high (although the effects of rising income may have less of an impact on non-European polities; see Londregan and Poole, 1996).

Eventually, Weede concludes that the appropriate policy alternative for advanced democratic polities is to promote free trade with both the emerging democracies of Eastern Europe and the potential democracies of the poorer states of the Third World. Such policies are likely to increase and strengthen the number of democracies, and thus extend the 'democratic zone of peace'. Furthermore, Weede suggests that such policies need not be driven by altruistic concerns but are compatible with goals based on conceptions of the national interest — 'If one defines the (economic) national interest by something related to the greatest good for the greatest number, or by high and growing average incomes, there can be little doubt about the compatibility of free trade and national interest' (Weede, 1995: 526).

The findings of our research come to a different result. They suggest that the causal linkage in the free trade–democratic peace argument is flawed in two fundamental respects for mature, wealthy democracies. Our research indicates the need for a more complex model capable of noting that free trade may create significant *negative* consequences for the sustenance of *stable, wealthy democracies*, and therefore for the ability to maintain the democratic zone of peace among some of the most critical actors in the international system. We offer the following modifications to Weede's model:

Free Trade → Prosperity → Democracy → PEACE
↓ ↘
Increased ↑
labor -
supply → Economic -
Inequality → Democracy
↑
Increased Weakened labor
competition → power

Three caveats should be noted regarding our modifications of Weede's model. First, the model is meant to apply only to stable, wealthy democracies. For other polities — in potential transition to democracies, unstable, or poor democracies — the original model may be more applicable, although recent research suggests that it may be less free trade and more the long-term threat of sanctions that may be more conducive to forcing leaders in non-democratic polities to take the political risks associated with the emergence of democratic processes (Londregan and Poole, 1996: 26).

Second, we do not contest the linkage between democracies and the absence of war between them. The literature and findings on this linkage are sufficiently overwhelming at this point to require little more in the way of re-analysis.

Third, we are not necessarily in agreement with Weede that the linkage between free trade and peace cannot occur more directly than in his model. Considerable controversy exists regarding the linkage between trade and conflict (e.g. see Barbieri, 1996, vs Oneal et al., 1996), regardless of regime type. At the dyadic level, trade seems to be both negatively and positively related to conflict, depending on the temporal focus of the study and the nature of the research design. Our focus here is on the extent to which the free trade–prosperity–democracy linkage itself may be flawed. This is not a trivial concern, especially since free trade is articulated in the model as a prescription for greater peace through democratization.[1]

The modifications to Weede's model proposed here are meant to suggest that while free trade *may* lead, through increased prosperity, to more democracy and therefore to less war, this causal linkage is overly simplistic. In fact, free trade may lead to other consequences that can be quite negative for the sustenance of wealthy democracies. Open free-trade regimes may act to increase the domestic labor supply through the labor contained in imported products. In addition, international competition can lead to a weakening of worker power. These two forces in turn may create increased economic inequality within the domestic economy. Increased economic inequality then may have significant negative consequences for the health and success of established democratic polities.

The proposed model applies to the present 'democratic zone of peace.' It focuses on the established, older, wealthier democratic polities. While there is considerable controversy over the effects of free trade on emerging democracies and over the claim that increased prosperity in poor countries may indeed lead to democratization, here we raise only the issue of whether and the extent to which global-free trade regimes may weaken and ultimately destroy the stability of wealthier, democratic polities, and thereby potentially shrink the democratic zone of peace in the new world order.

Free Trade and Prosperity

We hypothesize that an aggressive policy of global free trade for the system's democratic polities has two fundamental, potentially negative effects. First, for countries such as Germany, France, the United States or Japan to compete successfully with each other and with less wealthy countries in the global arena, they have to reduce the costs of production, manufacture and/or the provision of services in order to attain a profitable competitive position in the global market. To achieve such cost-effectiveness, one strategy managers and owners in wealthy democracies may attempt is to create work environments where workers receive lower wages and/or benefits relative to their actual productivity. Alternatively, enterprises may move to those locales of the global economy where the costs of production are lower, and thus create significant unemployment problems at home. Both of these 'cost reduction' strategies are likely to be fought by organized labor. As a result, in countries where organized worker power is strong, enterprises may fail to become competitive in the global arena. It is just as likely, however, that enormous political pressures will grow in the domestic arena to reduce the power of workers over economic policies. Tests of the social contract between workers and managers are undergoing scrutiny in France and Germany. In Japan, corporate philosophy toward workers is changing substantially. In the automobile industry, Japanese car producers have relocated major manufacturing facilities to lower-cost labor markets elsewhere, at the cost of increased unemployment in Japan. In the United States, tremendous successes in the global market (doubling exports and imports) have been accompanied by the virtual disappearance of worker power.

An aggressive free-trade policy for wealthy, democratic European states, one that is competitive with the United States, may require the same changes in domestic economic relations as evidenced in the United States (Faux, 1994). Yet, the US experience may not bode well for the economic well-being of most Europeans. With weak worker power (at an all-time low for the post-World War II period) and minimal increases in labor costs, the numbers of jobs created in the United States have grown in tandem with US free-trade policies, but the wages of workers have steadily declined, including a 13% fall on average since 1973 for all production workers, who comprise three-quarters of the workforce (Volgy et al., 1996).[2]

Domestic and International Labor Supply, Worker Power and Wages

The free market, in theory, is based on self-interested maximization of profit. In an unconstrained free-market environment, owners of firms, if profits are increasing, have few reasons to reward their employees with higher wages unless their enterprises are affected by one of two conditions. The first condition has to do with worker bargaining strength (Cameron, 1984; Golden, 1993). Where workers are organized effectively to press claims and/or have legal power to participate directly in the governing of enterprises, their activities ought to affect how wages change.

A second condition is related to the available labor pool. Wages in a free market are expected to vary with the supply of labor. High unemployment signifies a labor surplus. With high unemployment, wages should fall; the reverse is expected when unemployment is low and there is a shortage of labor. An extension of the labor supply available within a nation is the global market. Outside the industrialized nations, the global market consists of an enormous supply of labor available at wages substantially below those prevailing in the domestic markets of the wealthier nations. Viewed in this perspective, a policy decision to pursue free-trade competition in the global economy, all other things being equal, in effect augments the labor supply and can have a negative effect on wages, if labor power at home is weak, that is similar to a rise in unemployment in the domestic economy.

In countries with weak worker power, success in international trade ought to be negatively rather than positively associated with real wage growth, as will the level of domestic unemployment. In countries with stronger worker power, the effects of both international trade and unemployment should diminish, and the effect of these variables should be displaced by other factors, such as productivity and even inflation as labor can effectuate bargains for increased wages.

According to this line of argument, public policies designed to increase global free trade will likely have the effect of negatively impacting the wages of workers in economies where worker power is weak, since global free trade will have consequences similar to rising domestic unemployment. This pattern will not occur initially in economies with strong worker power, but even there increased competition in a global free-trade regime ultimately may also force wealthy democracies to alter the conditions of the social contract and to reduce the role of worker power in economic decisions. Corporate leaders in Japan are now articulating this approach to global competition. The leader of Japan's employers' organization has publicly declared

> There is no doubt the Keynesian approach does not apply here any more. We will have to move more towards Adam Smith and a more market-oriented approach. (Dawkins, 1996: 6)

Japan is by no means the only wealthy economy looking to make structural changes similar to the United States. Recent developments in Germany, for example, are beginning to look suspiciously like those in America that have increased US competitiveness in the global market-place. One illustration comes from Grundig, which has shifted from 40,000 to 8400 employees over two decades, and is expected to take further measures to reduce its 'uncompetitive cost base' compared to others in the market (Munchau and van de Krol, 1996).

International Trade, Unemployment and Inequality

More than anecdotal evidence exists concerning the relationship between worker power, unemployment, trade and wages (Burtless, 1995; Freeman and Katz, 1994). Our analysis of the relationship between changes in real wages, unemployment, productivity, inflation and international trade, while controlling for worker power, has underscored the importance of worker power in mediating between trade, domestic labor supply and the real wages of workers. In order to test these relationships, we created separate regressions for 10 wealthy, democratic nations over a 30-year period (see Tables 1 and 2).[3] In these regressions, we lagged changes in real wages behind measures of productivity, inflation, unemployment and exports. For the five nations identified as weak in worker power, the evidence is consistent — neither productivity nor inflation had any significant effect on wages. By contrast, the level of unemployment had a consistent, significant, and negative effect on real wages for all five countries. Moreover, in the United States, the country weakest on our measure of worker power, changes in the level of global trading predicted as well to changes in real wages as did level of unemployment. As expected, the relationship between global trade and real wage change was negative. Thus, the empirical results of 30 years of experience in these countries provide strong supporting evidence that available labor supply, whether domestic or global, is a primary predictor for changes in real wages in countries with weak worker power.

For the five nations with strong worker power,[4] the relationships were clearly different from the weak worker power countries. In these economies, productivity increases and even inflation were significantly related to increased real wages, consistent with the successful bargaining position of workers.[5] For nations with strong worker power, the relative power balance between owners and labor seems to mitigate the negative effects of domestic and international labor supply on real wages. In none of these countries is there the relationship found in the earlier group between unemployment and real wages. Yet, as expected, in three of the five strong worker power countries (Germany, Sweden and Austria) there are demonstrable effects between changes in productivity and wages. It is precisely in these countries, such as Germany and Sweden, however, where increased global free-trade regimes will create strong competitive pressures from highly industrialized but weak worker power countries (as well from poor countries with plentiful, inexpensive labor markets), pressures that may force economic and political actors to seek reductions in labor costs, and to challenge the prevailing power of workers.[6] If such strategies become successful in reducing costs and making national exports more competitive, the experience of weak worker power democracies would indicate that this group of nations will also begin to experience negative impacts on real wage levels, as wages will respond more directly to domestic unemployment and reliance on successful external trade policies underscored by competitive positions (i.e. lower labor costs) in the international market.

It is not an anomaly that the country with the least worker power and an aggressive policy toward free trade — the United States — has also exhibited a steady decline in worker wages and the largest increases in economic inequality among Western, industrialized democracies. To the extent that European and Japanese firms (and governments) feel obligated to copy the American model in order to compete in the global free trade market-place,[7] either growing unemployment or reduced worker power and its attendant effects on income inequality can be predicted as a likely consequence.

Inequality and Democracy

Weede argues for the linkage between prosperity and democracy. By contrast, another view (e.g. Muller, 1995a, b) holds that a strong negative linkage exists between economic inequality and democracy, arguing that the

Table 1
Regression Equations for 10 Democratic Countries on Selected Variables Predicting to Changes in Real Wages, by Types of Worker Power, 1960–90

	Moderate to Weak Worker Power					Strong Worker Power				
	US	CAN	FRA	JPN	HOL	GER	SWE	GB	AUS	ITA
Variables										
CHPROD						.514*	1.28*		.841*	
						(.233)	(.432)		(.303)	
CHINFLAT										.078*
										(0.23)
CHTRAD	–2.007*									2.135*
	(.817)									(.804)
UNEMPLY	–.536*	–1.215*	–.566*	–3.825*	–.349*					
	(.253)	(.197)	(.155)	(1.754)	(.162)					
Standard Error	.017	.019	.021	.023	.031	.018	.036	.038	.030	.053
Q(to lag 5)[2]	4.08	1.17	2.27	19.46*	3.03	4.01*	6.98*	4.77	5.01	4.89
R^2	.472	.660	.450	.717	.378	.596	.396	.061	.367	.543
Adjusted R^2	.384	.601	.354	.670	.274	.529	.295	.010	.261	.447
F	5.35**	11.62**	4.71*	15.19**	3.65*	8.06**	3.95*	.38	3.47*	5.64**

*$p < .05$; **$p < .005$.

[1] Values are shown only for those variables that meet statistical tests of significance in the equation.

[2] Modified Box-Pierce test. Results for Japan are shown with model corrected for AR(1). The corrected Rho for Japan is –.008. Results for Germany and Sweden are shown with model corrected for AR(1) and AR(3), respectively, since diagnostics show significant autocorrelation at lag 1 for Germany and lag 3 for Sweden. The Rho for the corrected model for Germany is .095; for Sweden is –.018.

Table 2
Number of Accurate and Inaccurate Predictions from Model

	Number accurately predicted[1,2]	Number inaccurately predicted	Not Applicable[3]
Weak/moderate worker power countries	16	0	
Percent	80		
Strong worker power countries	11	1	4
Percent	69		

[1] Accuracy refers to the following for weak and moderate worker power countries — significant relationships in the direction anticipated by the model for unemployment and trade; the absence of relationships for inflation and productivity.
[2] Accuracy refers to the following for strong worker power countries — significant relationships in the direction anticipated by the model for productivity and inflation; the absence of relationships for unemployment and trade.
[3] Major changes occurred in worker power relationships for Great Britain through the temporal domain of this analysis. The relationships for Great Britain, in the aggregate, were insignificant.

development and sustenance of democratic processes are incompatible with high levels of economic inequality in society.

In the United States, massive infusions of new jobs, a so-called 'healthy' economy, strong successes in international trade, increased profit taking among corporations, and low unemployment nevertheless has resulted in lower wages and ever increasing economic inequality. In turn, the public reaction has ranged from the deterioration of 'social capital' (Putnam, 1996) to a broad assault on government and the status quo. The Bush administration was dismissed from power in 1992, the new Democratic administration sustained crushing losses in the congressional elections of 1994, and the anger, alienation and frustrations of the public were exhibited from radio talk show programs to Republican caucuses. Pat Buchanan, an extremist candidate in American political terms, challenging for the Republican nomination, was the surprise in the Iowa caucuses, and in the New Hampshire primary eked out a victory over a well-financed and well-known Senator Dole, in part on a platform dedicated to radical economic nationalism in response to falling wages and job insecurity. Buchanan's initial successes forced the eventual nominee to give at least lip-service to the growing inequalities between owners and workers.

The threats to American democracy — the loss of social capital, large defections from the two political parties, substantial alienation from government and politics, and in 1996 the lowest voter turnout in over a century — are substantial, and are due to a variety of causes. Yet, each of these problems parallels decreases in the power of workers, reductions in the wages of most Americans and a growing economic inequality second to none among modern democracies.

Potential threats to the stability of a democratic polity from growing income inequality are by no means confined to the American experience. Data on the relationship between income inequality and democracy strongly support the notion that democracies exist in the context of relative income equality. A substantial majority of democracies exist below a threshold of 45% of societal income controlled by the top 20% of society (Muller, 1988; Muller and Seligson, 1994). An examination of 33 democracies has shown that 80% of those with the top 20% of society holding above 50% of the income experienced a breakdown of democracy, while the mortality rate for democracies below the 50% threshold was only 4% (Muller, 1995b). Another empirical effort to test the relative effects of income inequality on level of democracy for 27 nations found a strong negative relationship between income inequality and level of democracy, which, when entered into the appropriate regression model, also effectively eliminated the relationship between GDP per capita (prosperity) and level of democracy (Muller and Seligson, 1994: 643). It seems that it is not prosperity but income inequality that seems to be most associated with democratic stabilization. Furthermore, the relationship is quite strong — the authors found that an 'increase of 10 percentage points in the size of the upper-quintile income share is associated with a decrease of 16 points in the level of democracy' (Muller and Seligson, 1994: 646)[8].

Thus, the empirical evidence documents a strong negative relationship between income inequality and the level of democracy in society. Even if global free-trade policies create more overall prosperity in the societies of stable democracies, they lead to negative effects on real wages in weak worker power countries with the result that income inequality is likely to rise. To the extent that countries that are presently stable democracies with strong worker power will be forced to compete with 'low labor cost democracies' by reducing the power of workers in economic decisions, the effects of free-trade policies ultimately are likely to lead to lower wages and greater income inequalities in these countries as well.

All five of the weak worker power countries in our sample have demonstrated the sensitivity of real wages to fluctuations in labor supply. To date, the US, as the weakest worker power country in the sample, and the one most aggressively pursuing a policy of vigorous external trade, demonstrates as well the effects of this policy on wages and growing economic inequality. Clearly, the evidence is limited, but strongly suggestive of trends that may accelerate for other stable, wealthy democracies, as they begin to aggressively pursue international trading policies in the aftermath of GATT and the evolution of the WTO.

It may be tempting to dismiss the potential negative effect of growing income inequality for stable democracies, by arguing that even though the empirical evidence argues for such negative linkages, there is little evidence that growing income inequality has actually destroyed any stable democracy in the democratic core of peace. Two responses should be noted in this regard. First, while the trend in low worker power democracies is toward increasing inequality, none of them, including the United States has yet reached the threshold identified by Muller's research on this linkage. Unfortunately, the trend is in that direction, and since worker power, in decline, seems to mitigate further decline in worker wages, there is little hope demonstrated in the data we reviewed that further income inequality will not occur under pressures to increase successful global free-trade objectives.

Second, the pressures for increasing global free trade, while not new, are being acted out with a different set of groundrules today than at any other time since the establishment of the post-World War II global order. The rules established at Bretton Woods struck an implicit agreement between states and their respective societies to ensure that gains from economic liberalization 'would be used to compensate the losers in the interests of political stability' ensuring that 'equity and growth went hand in hand' (Kapstein, 1996: 21, 20). Even Churchill, a conservative Tory, was committed to a major expansion of the role of the democratic state to protect elements of society hard hit by liberal economic policies (Ikenberry, 1996: 86). Today, these very same states are under enormous political and fiscal pressures to reduce or eliminate their role in maintaining equality in society. Some governments are in the process of voluntarily surrendering some of their capabilities to intervene in social welfare, or see their abilities to continue social welfare policies greatly hampered by the resources available to them. Thus, while the post-1945 democracies in the core of peace have not destabilized, such history is not sufficient proof that further political movement towards inequality may not destabilize these polities in the future.

In a world of global free trade, it is possible that poorer countries may prosper. It is possible as well that in the aggregate, the stable, wealthier democracies will prosper as well, allowing Weede to conclude that such policies constitute a positive sum game. Yet, within such aggregate prosperity in society may lie the seeds of greater income inequality, auguring ill for the stability of the democratic zone of peace. For decades, the democratic zone of peace has been crucially located in North America and Europe, the geographical location of the strongest countries in International Relations. While policy-makers worry about the emerging democracies of Eastern Europe and the former Soviet Union, equal attention should be paid to the consequences of free-trade policies for the level of worker power, growing wage inequality and their impacts on the stability of democracies in the core of the democratic zone of peace.

Notes

1. The Oneal et al. (1996) and Barbieri (1996) findings are based on extensive research involving trade and conflict, at the dyadic level of analysis. However, comparing dyadic findings with findings on global trading patterns is difficult at best. Presumably, a set of political strategies govern the trade between two nations (e.g. see Pollins, 1989), strategies that are continuously evaluated in the political realm, and political corrections can be made in the direction of trade. A strategy of aggressive, global free trade is more market based, and through the removal of tariffs and other governmental controls, takes the trading relationship out of the political realm and more into the economic realm. The extent to which global market dynamics have a positive or negative effect on the political/military relations of states, seems to be a different question than managed trade strategies between politically active dyads.
2. Declining wages do not automatically equate with growing inequality, although that is in fact the case in the United States. The most recent evidence (Kolbert and Clymer, 1996) from official US sources finds that while the top 5% of income earners increased their incomes by about 15% over the 1990–4 period, the bottom 80% consistently lost real wage earnings during the same period.
3. The 10 democracies are Canada, United States, France, Holland, Japan (weak worker power countries); Germany, Italy, Sweden, Austria (strong worker power countries); and Great Britain (in transition from strong to weak worker power). The analysis covers the period 1960 to 1990. While the 10 countries in this sample are by no means the only stable, wealthy, democratic polities in international politics, they were the only ones for which data were consistently available for the 30-year period under analysis (see Volgy et al., 1996, for a more extensive discussion of the data used and the methodology involved in classifying states according to worker power).
4. Great Britain was the only nation in the sample that did not conform to any of the predictions; however, it was also the only country in the sample that underwent a major transformation from strong to weak worker power, confounding a longitudinal analysis based on a bivariate classification. For other reasons which may make Great Britain an exception, see Volgy et al., 1996.
5. Successful bargaining may occur either through strong union organization, political/legal arrangements bringing worker participation to the tables of policy-

makers and/or through legal requirements mandating worker participation in firms.

6. The Italian case in the sample provides an interesting illustration of a deviant case that may underscore the importance of worker power. Italy is the only country in the sample that shows a significant *positive* effect flowing from trade to real wages. Of course, Italy is also in the strong worker power group, and it perhaps indicates that a successful export policy can actually increase wages *if* a country can remain competitive and can maintain *strong* worker power. However, since it is the only case in the sample that exhibits this relationship, we hesitate to draw this conclusion.
7. In a global survey of over 2400 business leaders, most have concluded that the US is the most competitive nation in today's world (Associated Press, 1996). The US has led in the competitiveness survey since 1994. Consistent with our suggestions about the 'attractiveness of the American model', business leaders in Germany and Japan placed their own competitiveness far below the rankings assigned to them by business leaders outside of those countries (17th vs 4th, and 27th vs 3rd, respectively).
8. A third analysis on a sample of 58 countries found similar results (Muller, 1995a) with some suggestive evidence regarding the negative effects of income inequality for sustaining established democracies. Muller (1995b) argues on the basis of his data that income inequality's effects on democracies should be 'much stronger regarding change from democracy to nondemocracy than it is regarding change from nondemocracy to democracy' (Muller, 1995b: 994). His data and arguments seem consistent with our assertion that while the trade–prosperity–democracy linkage may be relevant for emerging democracies, the causal relationships may be substantially negative for established, wealthier democracies, once increasing income inequality is entered into the equation.

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