Social Capital, Democracy, and Trade Liberalization

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Abstract

While ample research has dealt with the effects of democracy on trade, the literature has yielded conflicting outcomes ranging from positive (Milner & Kubota, 2005) to mixed effects (Eichengreen and Leblang, 2008). While this variance in findings is expected, it also implies that existing methodological approaches could suffer from omitted variable bias, namely the exclusion of social capital from the analysis. Classical trade theory suggests that trade barriers benefit uncompetitive domestic producers at the expense of consumers and society at large. We argue that policy-makers in high-trust societies will be less likely to enact trade policies which harm diffuse interests (consumers). Social capital helps consumers achieve greater potential for collective action which, in turn, can translate into pressuring government to pursue welfare maximizing policies such as liberalized international trade. Using Boy and Girl Scout membership data as a proxy of social capital, we systematically explore the hypothesis that higher levels of generalized trust and reciprocity are associated with more trade openness. Combining data for a cross-section of 132 countries over the period 1960-2004, we find strong evidence suggesting a moderating effect of social capital on the relationship between democracy and trade liberalization, especially for high-income countries.

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