Journal of International Economics 76 (2008) 296–308

Contents lists available at ScienceDirect

Journal of International Economics

journal homepage: www.elsevier.com/locate/econbase

Globalization and domestic conflict ☆

Michelle R. Garfinkel [a], Stergios Skaperdas [a], Constantinos Syropoulos [b,*]

[a] Department of Economics, 3151 Social Science Plaza, University of California-Irvine, Irvine, CA 92697-5100, United States
[b] Department of Economics and International Business LeBow College of Business-Drexel University, 503-N Matheson Hall, 32nd and Market Streets, Philadelphia, PA 19104, United States

ARTICLE INFO

Article history:
Received 1 June 2006
Received in revised form 10 December 2007
Accepted 25 July 2008

Keywords:
Trade openness
Property rights
Enforcement
Insecurity
Civil wars

JEL classification:
D30
D70
D72
D74
F2
F10

ABSTRACT

When a resource like oil is domestically contested, trade patters and welfare can be very different than when property rights are costlessly enforced. Whereas (small-country) importers of the contested resource gain unambiguously relative to autarky, exporters of the contested resource lose under free trade, unless the world price of the resource is sufficiently high. Regardless of what price obtains in world markets, countries tend to over-export the contested resource compared to the absence of conflict. For a wide range of prices, higher international prices of the contested resource reduce welfare, an instance of the "natural resource curse."

1. Introduction

In the debate regarding the effects of globalization, economists often take the rigorous neoclassical paradigm of trade as their starting point.[1] Canonical versions of that paradigm assume that property rights are perfectly and costlessly enforced. Under such conditions, greater trade openness is typically found to be beneficial. However, in many circumstances, property rights either are not well-defined or are costly to enforce. It is, therefore, only natural to ask how such deviations from the canonical paradigm of trade would influence our assessment of globalization.[2]

☆ Previous drafts of this paper have been presented at various seminars and conferences. We are grateful to the participants and others—especially Jonathan Eaton, Bill Ethier, Michael McBride, Gary Milante, Oliver Morrissey, Johannes Münster, Gary Richardson, Ragnar Torvik, Heinrich Ursprung, David Wildasin, Rorden Wilkinson and anonymous referees—for thoughtful comments. Skaperdas' research was supported by a research and writing grant from the John D. and Catherine T. MacArthur Foundation.

* Corresponding author. Tel.: +1 215 895 2792; fax: +1 215 895 6975.
E-mail address: c.syropoulos@drexel.edu (C. Syropoulos).

[1] See, for example, Bhagwati's (2004) multi-faceted discussion of the benefits of globalization. Stiglitz (2002) provides a different view, emphasizing the role of finance and international organizations, such as the IMF and the World Bank.

[2] The specification and enforcement of property rights in a modern economy would seem to require (i) the presence of a state that can define these rights legislatively, (ii) an independent judiciary and non-corrupted power to enforce them, and (iii) the fiscal ability to maintain that infrastructure. Olson (2000, p. 183) dubbed the modern markets that require property rights specification and enforcement, in contrast to the spontaneous markets of much of history that can rely on self-enforcement, as socially-contrived. However, even a near-complete specification of property rights cannot ensure costless enforcement. Given the resources devoted to enforcement by the state, individual parties may need to spend time or money on litigation and related activities to defend their rights.

0022-1996/$ – see front matter
doi:10.1016/j.jinteco.2008.07.005

For the most part, economic analyses of imperfectly enforced property rights have concentrated on open-access resources — fisheries, environmental resources, the commons in general — in which over-exploitation is the main source of inefficiency. With regard to the effects of globalization, Chichilnisky (1994) and Brander and Taylor (1998), among others, have shown how removing the barriers to trade of an open-access resource can further stimulate its over-exploitation and lead to lower welfare.

In this paper, we adopt a different approach, one that enables us to explore an altogether different set of inefficiencies arising from imperfect property-rights enforcement in relation to trade — namely, the costs of enforcement and conflict within a country.[3] Some costs of enforcement, such as those reflected in the resources regularly expended in litigation and related activities, such as rent and revenue-seeking activities stemming from trade restrictions (Krueger, 1974; Bhagwati and Srinivasan, 1980, 1982) or, more generally, "directly unproductive profit-seeking (DUP) activities" (Bhagwati, 1982), as individuals and interest groups try to protect their perceived or actual rights, are observed everywhere, even in high-income countries. Many countries, however, face more severe and costly enforcement problems that manifest themselves in a variety of forms of domestic conflict, including strikes and lockouts, military coups, low-level ethnic, religious or class rivalries, as well as rampant basic insecurity that the state is simply unable to curtail. As Rodrik (1998, 1999) has argued, managing such conflicts is critical for successful economic development. An even more important case of problematic enforcement is simply that of civil wars. The economic costs of civil conflicts have been overwhelming during the post-World War II period. The costs range from the resources allocated directly to arming and those destroyed in the struggle to the indirect losses associated with a reduction in investment and trade due to greater insecurity as well as other allocative effects that can extend well beyond the duration of the war. We briefly review the empirical relevance of domestic conflict in the first section below.

We suppose that a potentially tradeable natural resource, like oil, is contested by different domestic groups. The degree of openness to international markets faced by the contending parties affects not only the stakes of the contest (the value of the disputed resource), but the opportunity costs of contestation and conflict as well. To highlight the ways in which openness matters, we examine conflict in a small country under two polar regimes: autarky and free trade. One possibility is that free trade induces less arming and less domestic conflict, in which case free trade unambiguously yields higher welfare. The other possibility is that free trade induces more arming and conflict; in this case, the familiar gains from trade must be balanced against the increased costs of arming and conflict.[4] Some of our main findings are summarized below.

First, countries that are net importers of the contested resource under free trade unambiguously gain relative to the autarkic regime. In addition to realizing the regular gains from trade, such countries also experience a reduction in their costs of conflict. To be more precise, because the price of the contested resource is lower in global markets, its price under free trade is lower than it would be under autarky. As such, removing the barriers to trade with other nations reduces the conflict at home, thereby increasing welfare by more than it would were property rights perfectly and costlessly enforced.

Second, exporters of the contested resource under free trade could lose in comparison to autarky. The closer the international price of the contested resource is to its autarkic price, the more likely is such an outcome. At the autarkic price, there are no gains from trade, and the levels of conflict under the two regimes are identical. But, as the international price of the contested resource rises above its autarkic level, a shift to free trade intensifies domestic conflict so that its costs are higher than the gains from trade. Only when the international price of the contested resource rises above some threshold are the gains from trade sufficiently high to compensate for the (still increasing) costs of conflict, so that trade becomes preferable to autarky.[5]

Third, an increase in the international price of the contested resource could reduce the exporting country's welfare. More likely when the international price is especially close to its value under autarky, this effect could be viewed as an instance of the "natural resource curse"—that is, the tendency for natural-resource abundant countries to have weak economic growth (for example, see Sachs and Warner, 1995; Ross, 2003).[6] The reduction in welfare reflects an increase in the intensity with which groups contest the

[3] Skaperdas and Syropoulos (1996, 2001, 2002) have adopted this approach to explore the welfare consequences of greater openness in the presence of conflict between nations who possibly trade with the rest of the world. See Barbieri and Schneider (1999) for a review of the recent scholarship, produced largely though not exclusively by political scientists, on trade and conflict. This scholarship has resulted primarily in two opposing views: (i) the liberal view, that trade between nations would promote peace; and (ii) the realist view, that the effect of trade would have a negative effect or, at best, no effect.

[4] As pointed out by a referee, were we to consider intermediate trade regimes in which trade flows are conditioned by quotas or tariffs, other outcomes would be possible. Krueger (1974), Bhagwati and Srinivasan (1980, 1982) and others have shown that an important feature of such policy interventions is that they often give rise to rent-seeking over quota rents or revenue-seeking over tariff revenues, and in the process absorb productive resources. Our analysis could be extended to incorporate this additional source of inefficiency, but at the cost of added complexity. Depending on the policy instrument(s) considered and the nature of technology in rent-seeking and/or tariff revenue-seeking activities, we expect controlled trade regimes to be associated with higher or lower welfare as compared with autarky or free trade. This ambiguity is expected because trade restrictions can either exacerbate or mitigate the enforcement costs relative to the deadweight losses they typically generate in competitive environments, as suggested by the theory of the second best.

[5] An analogous result is obtained by Hotte, Long and Tian (2000) in the context of a model of endogenous property rights over a renewable resource that may be subject to appropriation ("poaching"). Specifically, they find that a discrete move from autarky to free trade that may "transform an open-access regime into exclusive private property" could nonetheless be welfare-reducing, as it induces greater private property rights enforcement that causes GDP net of exclusion costs to fall. A similar result is also obtained in Margolis and Shogren (2002), who show, in the context of a North-South trade model with lumpy enclosures, that free trade can hurt the South for a set of world price configurations. These studies share a common objective with ours, and that is to explore the implications of enforcement costs. Our model differs from theirs, however, in that insecure property is actively contested by groups in a strategic environment that is trade-regime-dependent and in which the degree of insecurity assumes a central role.

[6] See Robinson, Torvik, and Verdier (2006) for an overview of this literature.