**Theory**

**Economic reform as a political strategy**

Leaders’ fundamental interest is survival. They inherently want powerful and stable leadership. Leaders generally have two general ways to accumulate power: *repression* and *loyalty* (Wintrobe, 2000). By repression, it means a leader can restrict individuals' rights to criticize against the government or use severe sanctions to punish the organized opposition to the government, including imprisonment, execution, and torture. By loyalty, it means a leader can accumulate political loyalty of interest groups and elites by means of the distribution of rent. In this framework, political rent is the price a leader pays to buy off the loyalty of the oppositions to exchange for political stability. Certain economic policies that create rent and inefficiencies such as state intervention to protect some economic sectors, subsidies and policy support to State-Owned Enterprises (SOEs) are some examples of policies of loyalty.

Oppositions compete for power. Some have independent power to consider certain types of legislation; some can form political parties to compete in office formally, and some may share covert power bases with interest groups in society. Because a leader's power is not absolute, oppositions may defect and overthrow the incumbent government from time to time. Their ultimate goal is to subvert the rule of the current leader. They can choose to form a coalition with the leader or pose a threat to the current regime. We can conceptualize threat as “the demands on a regime by opposition groups” (Regan & Henderson, 2002, p. 122). The demands can take various forms, such as strikes, protest demonstrations, riots, guerillas and civil war. When the demands are sufficiently strong to destabilize the government, the leader is less likely to accede to the demands. The ruler will perceive it as an open challenge from the oppositions and associate them with defecting from the promised loyalty.

Under normal circumstances, leaders and their subjects have mutual signalling and commitment problems. For leaders, to reward the loyalty of the opposition, the leader could promise to implement certain policies that the oppositions benefit. One example is the government’s subsidies to the SOEs or some public financed projects that create rents for the oppositions. The oppositions, benefiting from such an arrangement, offer support for the regime in return. However, what guarantee does each party have that the other party will live up to their commitment? Leaders could potentially see the risks of increasing power of the oppositions who benefit from collecting political rents, so they could stop appeasing the oppositions by but start torturing them. The oppositions may also promise loyalty to the leader on the surface, but they could take part in an assassination plot as soon as the ruler shows his weaknesses. In sum, the so-called Dictator’s Dilemma always exists: “the greater the dictator's power, the more reason he or she has to be afraid” (Wintrobe, 2000, p. 22). Stated differently, a leader never really knows how popular he is and when the promised support stops being delivered. According to Kuran (1991), revolution is unanticipated: a society can come to the brink of a revolution without anyone knowing it, not even those who wish can unleash it. No matter how stable a regime may look, an upheaval may occur any time. The question remains: what prevents the opposition from breaking their promises as often as they wish to overthrow the ruler?

Wintrobe (2000) provides three conditions to prevent actors from reneging on the exchange when no formal contract is written up. One, there is a future interaction between the parties; two, both parties have a reputation for not frequently cheating in the past; and three, the parties receive a premium on the exchange (Wintrobe, 2000, p. 30). I find what is missing here is the punishment mechanism: once one of the two parties reneges, the defector must pay the cost. If the costs of reneging are high, the frequencies of breaking down promises are expected to drop. Severe sanctions raise costs to anti-government actions so that they can deter dissents. Scholars focus on the violent forms of political repression as leader’s main response to deter dissent, but I argue a non-violent form of punishment, economic reform, is also effective for governments to reach one of its end -- to deter dissent.

In this study, secureness shock occurs when opposition poses threatening demands to challenge the current regime. The attempt to overthrow the ruler comes with severe political instability. Under autocratic regimes, the oppositions may overthrow the leader through a coup. Under semi-democratic regimes, the oppositions may mobilize citizens against the leader to displace him. Note that under mature democratic regimes, “all but the most extreme form of oppositions” will be channelled into the formal institutions of government, in which dissents of oppositions can hardly dampen the political stability or cause secureness shock. In such democratic regimes, not only secureness shocks rarely happen but also leader turnovers are generally institutionalized and peaceful. Therefore, I limit the scope of this study in only autocratic and semi-democratic developing countries.

In these regimes, for the opposition, the costs of defection are indeed high: once they fail to remove the current leader, they may face severe punishment after the attempt. What strategy a leader adopts after he survives after a secureness shock is the focus of this study. One route that a leader takes is to torture or murder the oppositions. I argue repression is only one of the tactics a leader can use to punish the defectors. A leader who just experiences a secureness shock may not have the capacity to kill all the revolutionary leaders and the conspirators in the organized opposition groups as he wishes. Even if he has the capacity to do so, all the oppositions today will become his potential threats in the future, so it is not feasible to kill all of them.

I argue, another tactic of punishment is economic reform. This strategy withdraws the promised payoffs and limits the rent-seeking opportunities for the opposition today and tomorrow. Economic reforms, i.e., the privatization of state-owned enterprises and fair competition for the government-funded project can effectively cut off the power sources of the oppositions. It is generally safe to assume that much of the opposition somehow benefits from the distribution of rent prior to the secureness shock. Originally, the rents were promised by the leaders to reward loyal groups. Now, economic reforms come at the expense of the interest groups who previously privileged from the political rent. The structural changes of economies also make the oppositions’ accumulation of future rents and powers harder. Economic reform as a tool of political survival for leaders can punish the current defectors and deters future cheaters by cutting off their potential sources of wealth and resources. Therefore, a leader, after a secureness shock, conceptualized as an open challenge to the leader, implements economic reforms because he wants to punish the elites who break their promises of offering loyalty to his leadership.

**Why negotiating a PTA with major liberal powers?**

Suppose a leader perceives economic reform as a tool to punish the oppositions and announces his decision to conduct an economic reform domestically without a PTA negotiation. Earlier on, we have discussed the commitment problem among the leader and opposition is acuter in autocracies and immature democracies. The domestic oppositions are sceptical about the leader’s credibility and capacity to implement such a policy. Especially after the secureness shock, a leader needs time to restore the status quo ante yet strong enough to implement the reform unilaterally. Failure to implement economic reform will not only by no means serve as a punishment to the opposition and deter future dissent, but also diminishes the credibility of leaders’ future policy changes.

PTAs with major liberal powers mitigates the commitment problem highlighted above. The negotiation of PTA sends a credible signal to the foreign investors that economic reforms will be more likely to be enforced. Recall, PTAs are binding international agreement: governments cannot constantly violate or arbitrarily pull out of the agreements without retaliation. PTAs by design have some coercive mechanisms of influence to make the costs of defection higher than the costs of conformity. In plain words, the expected values of the preferential trade agreements are conditional on the implementation of economic reforms. If leaders fail to implement the provisions, they will pay costs. Therefore, leaders in the developing countries approach to those in the developed countries to negotiate a stringent PTA implies that leaders have anticipated complying the provisions of economic reforms. PTA negotiation sends a credible signal of leaders’ commitments to the reforms.

PTAs negotiation also sends a signal to the opposition that the current leader has won support from the international community, especially from the major powers. Because both the leader and the opposition are assumed to be office-seeking, so they all hold a value from holding power or seeking power. The opposition cannot perfectly observe the power of a leader holds and how much he has recovered from a secureness shock. While a leader’s announcement of economic reforms probably induces backfiring by the oppositions, the successful negotiation of a treaty sends a strong signal to indicate the power of the current leader. This can reduce the possibility of the opposition’s further attempts to overthrow the leader in the short run. In short, leader’s strategic choice of negotiating the PTAs with the provision on economic reforms provides a credible and enforceable mechanism to implement such policy.

Now let us turn to explain why PTAs can help leaders to implement economic reforms. The PTAs are expected to increase trade volumes and the flow of foreign direct investment, and hence increase tax revenues. As a result, the leader has more resources at their disposal, furthering their hold on power to recover from the secureness shock. The promising trade benefits also expect to increase national income. Leaders can claim credit for the improvement in welfare, so the citizens’ loyalty to the leadership will be higher. The oppositions, who mainly lose from the liberalized economic reforms, can be pacified by the values of the PTAs. With the PTAs in place, the oppositions benefit from the increasing welfare of the trade as a citizen and operate in a more efficient economic institution to accumulate wealth as a business operator. They can rebuild their power bases by building up substantial connections with foreign traders, or even gain political support from the foreign governments in the evolving relations of business. Oppositions, depending on where their power sources base, may be affected by the trade liberalization unevenly. Oppositions whose power bases are in the exporting sectors with comparative advantages can reap the most benefits from the opening market. They are the potential winners from the PTAs, whose benefits offset or outweigh their loss in the pre-reform period. In contrast, those in the previously protective sector are forced to compete with foreign producers, are hit with a double-whammy: structural economic adjustment process and net losses in trade.

The main argument in the previous section is economic reform punishes disloyal oppositions who deviate from the promises of offering support to the leader. However, economic reforms may inevitably hurt the elites who are in fact the government supporters. Recall, political rent is a tool that a leader uses to gain loyalty. Economic reforms will stimulate dissent and decrease loyalty, so the leader has to re-buy loyalty from the oppositions after both parties recover from the secureness shock. After reestablishing their pro-government credentials, a leader can use the increased revenue from trade as a side payment to compensate the loyal oppositions, so they can restart their rent-seeking cycles to accumulate wealth and power. Alternatively, leaders carefully crafted the economic reforms to increase rents for the potential winners of the trade liberalization to coalesce a coalition (Schamis, 1999). A leader can use economic reform to not only target the disloyal oppositions responsible for the secureness shock, but also reestablish a coalition with loyal oppositions to consolidate his power.

**Summary**

The puzzle to explain is what motivates a leader in the developing country to negotiate one of the most costly and stringent trade agreements with the developed country. One of the most important features of these PTAs is the provision of economic reforms, whose implementation will ignite domestic opposition. My argument, in brief, is the following: a leader strategically negotiates PTA when he is insecure. I argue after a leader is hit by a secureness shock, he can choose economic reforms to punish the disloyal oppositions responsible for the outbreak. Leaders are more likely to implement economic reform when the PTAs negotiation is in place. The PTAs with major economic powers send positive signals to mitigate commitment problem that a leader has, and offers material benefits to facilitate the reforms. This argument has a main empirical implication that can be used to test its validity in the next section. My prediction is: The presence of secureness shocks in a regime is associated with higher probabilities of its leader’s PTA negotiation.