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THE INVISIBLE HAND OF PEACE:
CAPITALISM, THE WAR MACHINE, AND LIBERAL
INTERNATIONAL RELATIONS THEORY

DISSERTATION

Presented in Partial Fulfillment of the Requirements for

the Degree Doctor of Philosophy in the Graduate

School of The Ohio State University

By

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ABSTRACT

The debate over whether and how the spread of democracy, trade, and international organizations enhance peace has long played a central role in international relations theory. My dissertation begins with a simple critique of this literature on the "liberal peace." It has failed to ask whether capitalism extends, limits, or causes this peace. Drawing on classical liberal theory and neo institutional economics, I argue that private property, competitive market structures, and mobile wealth generate additional mechanisms outside the ballot box by which society, and in particular a strong business class, can sanction state behavior and constrain its decision for war.

By exploring the dilemma of resource mobilization, or the process by which the state gains access to private sector wealth and builds domestic coalitions in support of war, I deduce a series of hypotheses about how the institutions of capitalism shape two dimensions of the decision for war. First, the institutions of capitalism alter the *domestic economics of war*. The expansion of private property, competitive markets, and mobile forms of wealth increase both the quantity and price of resources that the state must extract from its citizens to build its war machine and prosecute a war with another state. Second, these same institutions alter the *domestic politics of war*. By limiting the state's

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ability to intervene in the domestic economy, capitalism strengthens the political power of domestic constituencies opposed to war and erodes the state's ability to redistribute income while building domestic coalitions in support of war.

These hypotheses are tested using statistical and historical case analysis. First, I statistically test how variations in domestic economic structure--operationalized as the quantity of private property in an economy and tariff levels--condition the probability of international conflict. Greater levels of private property and lower tariff levels both reduce the probability of military conflict between states. Second, I explore the conditions under which globalization prior to World War I both hindered and supported peace. In particular, I trace how the continental governments used tariffs, capital controls, and state-owned assets to conduct an arms race that ultimately led to the outbreak of World War I.

Dedicated to Deanna

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It is often only with hindsight that we know whether previous decisions were the right ones. For me, the choice of whether or not to go to graduate school and then stick with it often seemed to be a continuous battle. Even if it was not clear throughout the process, being at the end of the tunnel makes it all seem worthwhile. I hope that this dissertation confirms that assessment for others as well.

While most of the people that helped me through this process are no longer at Ohio State, I consider myself tremendously lucky for having been able to cross paths with them. Special thanks goes first to my dissertation committee. If this is a dissertation that extols the virtues of the free market and comparative advantage with respect to international politics, then I know it applies to writing a dissertation as well. They gave me the freedom to let me go where my ideas were taking me and then reigned me in when necessary. Ed Mansfield, John Mueller, Dave Rowe, and Tim Frye challenged me in different ways. Leading often by example, Ed made sure that I had not only thought through all of the implications of my arguments but had carefully defended them as well. By often disagreeing with my primary conclusions, John forced me to rethink big picture issues and "see the forest" continually. Always willing to talk through the mechanics of

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the theory, Dave encouraged me to take risks and had confidence in what I was doing, even when I lacked it. Finally, Tim had the incredible knack of asking new questions and forcing me think over issues that I had yet to consider.

I owe many debts to my graduate student colleagues here at OSU. I remember being told in my first year that a graduate cohort is crucial both during and after the process of earning a degree. I feel fortunate to have been around such a quality group here. Thanks to David Bearce, Paul Fritz, Yoav Gortzak, Andrea Grove, Yoram Haftel, Ted Lehmann, Joe McGarvey, Jon Pevehouse, Chris Scholl, Kevin Sweeney, and Jeff Yankow for their helpful comments and advice along the way. I owe a special thanks to Jeff and Kevin. Jeff was always willing to answer all my questions when I strayed outside political science and into economics. Kevin and I learned early on that graduate school was not a zero sum game among fellow students. Going way beyond the normal call of duty, I think he read and offered comments on just about everything that I wrote while I was here.

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CHAPTER 1

INTRODUCTION

The manner in which the Cold War ended and its aftermath has accelerated a wide range of theoretical revision and adaptation in the study of international relations. The peaceful relinquishment of the Soviet empire challenged many commonly held propositions in the field including the centrality of war as a catalyst of revolutionary change (e.g. Gilpin, 1981, 15). In an attempt to understand both the sources and implications of these dramatic developments, scholars have augmented traditional concentrations on power, anarchy, and great power relations with explorations of how such variables as democracy, culture, ideas, and globalization shape how states interact with each other.

This dissertation continues in this tradition while placing the demise of the Soviet Union within a larger ongoing struggle between political authority and decentralized markets to coordinate productive activities and social behavior on a much grander scale. The collapse of the Soviet empire was more than just a retreat of a great power from the world stage. It marked the defeat of socialism and political authority as an allocation mechanism for scarce factors of production. Initiated during the 1970's and largely ushered in with the Reagan and Thatcher administrations, states around the globe have increasingly adopted conservative neoliberal policies privatizing domestic industry,

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eliminating domestic price controls, and substantially reducing the size of Keynesian fiscal policies. The institutions—such as the embedded liberal compromise (Ruggie 1983) and the social welfare state—that granted governments greater regulatory powers over their domestic economies so as to cushion the extreme dislocations caused by World War I and the Great Depression have either been eliminated or substantially altered. This dissertation seeks to understand the implications of these historic developments for stability in the international system. As markets play an increasing role in the coordination of social behavior and the ability of states to manipulate economic forces is simultaneously minimized, will the international system be marked by more or less conflict? Does the expansion of capitalism cause peace?

Not surprisingly, the paradigmatic benchmarks of international relations offer a number of conclusions with respect to these questions. Relying on mercantilist insights, realism suggests economic reforms that increase national income create a larger resource base from which the state can draw to extend its global interests, by force if necessary. Marxist-Leninist approaches see great power war as the necessary consequence of the inherent contradictions internal to capitalist development. Classical liberal approaches, on the other hand, suggest that globalization and industrialization may promote peace. By transforming the domestic distribution of authority, free markets raise the political and economic costs of aggression and reduce the probability of conflict among states.

Despite these broad claims concerning the relationship between capitalism and conflict, contemporary research on this question has been limited. Its neglect is most surprising within the exploding literature on the sources of a "liberal peace" among

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states. The findings that democracy, interdependence, and membership in international organizations all tend to reduce conflict suggest that the character of interstate relations is in the early stages of a dynamic, but peaceful era.[1] While these series of debates have been marked by substantial empirical progress, questions about the causal mechanisms linking such variables as democracy and trade to the outbreak of conflict remain.[2] I seek to reexamine the prominent explanations for the liberal peace in light of a set of variables largely absent from this debate. Current treatments on the sources of the liberal peace have failed to ask whether the defining elements of capitalism--namely private property and competitive market structures--extend, limit, or cause the outbreak of peace among states.[3]

This oversight is even more surprising given liberal theory's explicit focus on how the expansion of individual freedoms promotes peace. Classical liberal theory recognizes that a number of institutions protect individual liberty--private property, a market-based economy, civil liberties, and competitive elections--and thus regulate the state-society relationship (Doyle, 1983, 207-208). Yet most work on the domestic sources of international behavior focuses almost entirely on only one of these institutions-

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[1] For recent reviews of the democratic peace and interdependence literatures see Chan (1997), McMillan (1997), Stein (1993), and Mansfield and Pollins (2001). On the relationship between membership in international organizations and peace see Russett, Oneal, and Davis (1998); and Mansfield, Pevehouse, and Bearce (1999-2000).

[2] For example, Bruce Bueno de Mesquita, James D. Morrow, Randolph M. Siverson, and Alastair Smith write, "Although these observations about democracy and war are part of an important pattern, they lack a coherent explanation. Several possibilities have been put forward, but none has gained broad acceptance (Bueno de Mesquita et al 1999, 791)."

[3] I will rely on Kornai (2000, 28-30) for a definition of capitalism. For him, three characteristics define such a system. First, the distribution of domestic political power must respect private property or refrain from mass confiscation. Second, property must be predominantly held in private hands. Third, "the main mechanism of economic coordination occurs through the market, through mutual, decentralized adjustments of supply, demand, quantities, and prices."

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-elections. I fill this gap by developing a theory that explains how private property and competitive market structures also impede international conflict. By exploring the dilemma of resource mobilization, or the process by which the state gains access to private sector wealth and builds domestic coalitions in support of war,[4] I deduce a series of hypotheses about how these institutions shape two dimensions of the decision for war. First, the institutions of capitalism alter the *domestic economics of war*. The expansion of private property, competitive markets, and mobile forms of wealth increase both the quantity and price of resources that the state must extract from its citizens to prosecute a war with another state. Second, these same institutions alter the *domestic politics of war*. By limiting the state's ability to intervene in the domestic economy, capitalism strengthens the political power of domestic constituencies opposed to war and erodes the state's ability to redistribute income while building domestic coalitions in support of war.

This focus on the economic institutions that determine the state's ability to intervene and manipulate the distribution of societal resources begins from a simple premise. Due to the fundamental condition of scarcity in human life, the allocation of resources among different components of society is likely to generate conflict and subsequently, demand for mechanisms capable of resolving such disputes. The state plays a crucial role in this process given its capability to define and enforce a series of rules that regulate the distribution of property. But this role also creates a series of

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[4] I will define resource mobilization as the transfer of resources from the private sector to the public sector for the purposes of national defense. Along these lines, I will discuss mobilization in terms of long-term dynamics whereby the state gains the right of access to resources previously owned by society. I do not want to confuse this process with the act of placing a military on high alert or calling up reserve troops, as was the case during the July 1914 crisis. This latter usage simply refers to the rapid utilization of resources already "owned" by the state.

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opportunities for the state to manipulate this distribution for political gain. Douglass North writes of the state's role in governing the domestic economy, "The existence of the state is essential for economic growth; the state, however, is the source of man-made economic decline (North 1981, 20)." A wide variety of literature in both economics and political science has explored how the desire of rational politicians to remain in office can lead to economic policies that reduce economic welfare either for an entire society or components of it.[5] As such, the regulation of an economy becomes an arena of competition and struggle in a domestic polity. This important insight can be extended into the study of war: if political intervention in the marketplace can be employed as an instrument to extend power and shape outcomes in the domestic political system then it should also be capable of serving the same goals in the international system. Conversely, by limiting a government's access to the market, society can generate mechanisms, in addition to elections, by which to constrain and shape public policy and the decision for war.

Drawing on classical liberal theory and neo institutional economics, the framework offered here to understand the links between free markets and conflict focuses on four conditions that empower private actors to prevent war. The first two center on the role of private property in an economy. Has the state made a commitment to respect private property? And what is the scope or quantity property held by the private sector in an economy? The provision and protection of private property reduces the number of

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[5] For a good review of work by economists on this topic, see Keech (1995). One of the classics in political science on how the desire to remain in office can lead politicians to distort economic outcomes is Bates (1981).

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assets that a government directly controls. A government wishing to mobilize privately owned resources for war faces two costly choices. It can simply seize the resource and threaten the long-term commitment to protect private property crucial to investment and economic growth. Or the government could choose to respect society's right of ownership and bargain for the asset. But there are costs to this strategy as well. By granting members of society the right to find alternative buyers of their assets, the government must compete with these societal actors within decentralized markets. On the other hand, if a government possesses substantial public resources that can be used to fund its war machine, it obtains more freedom to act in foreign policy. Instead of being forced to purchase resources from private actors, a state can simply rely on its own wealth to fund its war machine. Domestic constituencies are deprived of a means by which they can bargain for and exchange private assets in return for enhanced influence over public policy.

The structure of domestic markets provides the third element of capitalism that shapes the probability of war. A state wears two hats in the domestic economy. As a participant in competitive markets, the state loses its authority to direct the behavior of societal actors. Competition coordinates social behavior and allows the highest bidder to retain ownership of assets. Within such markets, states are forced to pay higher prices for the factors of production to build their war machines. Second, the state also serves as market maker in the domestic economy. Because it possesses a monopoly on coercion within a polity, private citizens rely on the state to define and enforce property rights necessary for an exchange-based economy to function. Governments can use this

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authority to restrict entry into markets and redistribute wealth toward societal groups that support its policies, including the decision for war. The absence of such regulations necessarily deprives the state of an important tool to build domestic political support necessary to sustain a war effort. As domestic markets become more competitive, it becomes more difficult for the state to pay both the economic and political costs of war.

Finally, the mobility of assets also shapes the state's ability to utilize private sector resources for war. Mobile assets, such as financial capital, tend to oppose war as it increases the potential for confiscation and unfulfilled debt obligations. Because mobile assets can limit these risks simply by relocating to alternative regulatory environments, states traditionally have granted these interests greater influence in the making of public policy in exchange for the right to tax these resources. As widespread capital flight can threaten broader financial stability, mobile wealth also possesses the capacity to punish governments for their policies outside the ballot box. Greater quantities of mobile wealth in an economy constrain the state's efforts to utilize such resources for war and enhance society's ability to punish costly foreign policies.

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The structure of the chapters that follow is built around understanding how these four mechanisms lessen conflict in the international system. The first two chapters lay the theoretic foundations for these arguments by drawing on classical liberal theory and neo institutional economics to critique the current liberal peace literature and then build an alternative set of explanations for how the institutions of capitalism promote peace among states. Chapter 2 argues that the current liberal peace literature has made three

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important oversights. First, it has marginalized foundational attributes of liberal international relations theory, namely the primacy of the individual as the unit of analysis. Second, the literature often neglects the primary liberal insight on the origins of war. States often use war for domestic goals--either to redistribute wealth or political power. Together, these critiques argue that all liberal hypotheses on war must be grounded in the domestic level of analysis. Third, this literature has adopted an overly narrow conceptualization of state-society relations. By not examining how the institutions of capitalism may alter the effects of democracy and interdependence on conflict, current theories of the liberal peace are underspecified. Following this critique, chapter 3 responds to these shortcomings by developing a model of how the structure of domestic economic institutions shape a state's efforts to build a war machine capable of extending its interests in the international system.

Chapters 4 through 6 serve as the empirical section of this dissertation and provide both quantitative and qualitative evidence in support of these claims. The first two chapters conduct a series of tests that examine how attributes of the domestic economy—the commitment to protect private property, the quantity of private property, and level of competitiveness in domestic markets—shape the probability of interstate conflict in the international system. These chapters find robust statistical support across different research designs that liberal economic institutions promote peace in the international system.

Chapter 6 offers further empirical support for these arguments by confronting a series of cases most often cited as contradicting both the claim that capitalism causes

peace and that a liberal peace among states based on trade, democracy, and international organizations exists. Through an examination of the period of globalization confined to the decade leading up to World War I, I illustrate how liberal economic institutions constrained the ability of some governments to mobilize societal resources for war and sustain the costs of crisis diplomacy. However, because liberalization was incomplete across Europe, many states still possessed the capacity to intervene in their domestic economies and build supportive coalitions that could be drawn upon in war. The continental states relied on tariffs, capital controls, conscription, and public property to conduct a series of arms races that culminated in war in July of 1914. In particular, I show how these mercantilist restrictions were crucial in the rebuilding of Russian military strength, perhaps the most destabilizing element in the shifting balance of power in the years before the war. While explicitly challenging the conventional wisdom's characterization of the prewar global economy as the archetype of an open, liberal system, this chapter builds an alternative explanation for the origins of World War I consistent with liberal international relations (IR) theory.

The final chapter concludes and discusses some of the implications of these arguments for IR theory, the study of politics in general, and prospects for peace in the current international system. An examination of the links between capitalism and war necessitates rethinking a foundational question to the study of international political economy, namely what is the relationship between wealth and power in the international system. While most traditions in international relations assume that the pursuits of wealth and power by states are complementary goals—i.e. an expansion in national

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wealth necessarily increases a state's power—this project argues that the relationship is not straightforward. The ability of states to mobilize this expanding pool of societal wealth depends crucially on the structure of domestic institutions that mediate the relationship between a government and its citizenry. Often the policies launched by the state to enhance economic growth simultaneously limit its ability to tap this wealth for public policy. More importantly, the institutions that have traditionally served as the intervening variable between wealth and power, namely democracy and the division of authority among the different institutions of the state, are insufficient to understand all the aspects of this mobilization dilemma. The range of domestic institutions utilized as independent variables in the study of both comparative politics and international relations must be extended to include the institutions of capitalism that often emerge independent of democracy. A focus on how market pressures alter a states mobilizational capacity creates an opportunity to rethink some of the explanations for the democratic peace. Finally, these arguments offer a means to rethink the broader policy of democratic enlargement currently offered as one of the pillars of post-Cold War American foreign policy. While the promotion of democracy is held out as a means of extending American influence and peace, these arguments suggest that political liberalization may not be a sufficient means to prevent the outbreak of conflict. Instead, democracy may need to be reinforced by economic reforms that further constrain government officials.

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CHAPTER 2

RETHINKING THE FOUNDATIONS OF THE LIBERAL PEACE

"We have progressively abandoned that freedom in economic affairs without which personal and political freedom has never existed in the past."

F. A. Hayek in *The Road to Serfdom* (1994 [1944], 16)

Rooted in the work of classical scholars such as Kant, Paine, Montesquieu, Smith, and Cobden, liberal IR theory argues that an expansion of individual liberty from the authority of the state enhances the prospects for peace in the international system. Aided by the tools of game theory and statistical analysis, the last two decades of scholarship have developed and extended this central insight both theoretically and empirically. Largely built around what has been labeled the Kantian tripod (Russett and Oneal 2001), the contemporary literature has found substantial support for the claims that democracy pacifies a country's foreign policy[1] and promotes peace between states; that international commerce reduces conflict among states; and that membership in international organization also reduces the likelihood of war.

But the liberal peace is not without its detractors. Realists point to the unique historical circumstances of the Cold War era and the heavy reliance of liberal peace proponents on this period for empirical evidence as reasons to doubt its validity (e.g.

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[1] This is monadic variant of the democratic peace proposition stating that democracies are less likely to be engaged in conflict with any other type of state in the international system. This point has served as one area of disagreements within the literature with some authors maintaining that peace is restricted only to democratic pairs of states (e.g. Doyle 1997). However, more evidence is building that democracies are more peaceful in general. For examples, see Benoit (1996) and Rousseau et al (1996).

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Gowa 1999). Because the bipolar distribution of power and the presence of nuclear weapons also promoted stability in this period, the independent influence of democracy, trade, and international organizations on peace is suspect. These criticisms are bolstered by the outbreak of World War I. A sustained period of globalization in the decades prior to 1914 failed to prevent the onset of one of the worst conflicts in the history of mankind (Jervis 2002, 6; Mearsheimer 1991, 182; Waltz 1979, 158-160). Game theorists criticize the liberal peace for its failure to place hypotheses within a more general theory of war focusing on the strategic interaction between states (Morrow 1999; Gartzke, Li, and Boehmer 2001,). Statisticians have challenged the empirical conclusions on issues of research design and method (Beck, Katz, and Tucker 1998; Green, Kim, and Yoon, 2001).

In this chapter, I build on these critiques in a different fashion. Instead of attacking liberal international relations theory from outside the paradigm, I challenge it from within. The contemporary literature on the liberal peace has neglected many of its classical roots and suffers from a combination of three fundamental theoretical problems. First, liberal hypotheses on war are often insufficiently grounded in the ontological foundation of liberal theory—the primacy of individuals as the units of analysis in any explanation of social behavior. This foundation demands that liberal explanations of international relations necessarily focus on variation among individual interests and how these conflicting goals get aggregated into social outcomes. Accordingly, liberal explanations of international behavior must take into account how domestic interests and constraints shape a state's ability to make and implement foreign policy. The failure to

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focus on either how domestic pressures constrain foreign policy or how systemic pressures, such as globalization, shift the interests of individuals and thus alter the domestic political game manifests as either an explicit or latent adoption of the state as the primary unit of analysis.

Second, flowing from this insufficient concentration on the centrality of individual behavior, many liberal theories of international relations underemphasize the primary explanation of war that necessarily follows. International conflict is often the product of opportunism created by domestic institutional structures that lead governments to use aggressive external policies in service of a broader set of domestic goals. The decision to launch war is often driven by domestic priorities, which complement systemic goals that have traditionally been the focus of studies of war. Accordingly, liberal explanations of the origins of war must also begin at the domestic level of analysis.

Finally, if the domestic politics provides the starting point for examinations of state behavior, the contemporary literature has too narrowly conceptualized the nature and dynamics of the political relationship between a state and its citizenry. Liberal theory recognizes that a number of domestic institutions enhance the liberty of private actors—democratic elections, civil liberties, private property, and the allocation of scarce resources through competitive markets rather than bureaucratic authority. And yet, liberal hypotheses at the domestic level of analysis have traditionally focused on the presence or absence of elections to differentiate among states. These neglected institutions should also regulate the state's actions within its domestic polity and consequently alter the character of its external relations as well.

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To develop these critiques, this chapter will have three sections. The first outlines the foundations of a liberal theory of international relations and a liberal theory of war. The second reviews the primary components of the contemporary debate, organized around the Kantian tripod of democracy, trade, and international organizations. The final sections develops the three primary critiques of this contemporary literature while pointing to the need to introduce a set of neglected institutions into this debate—those supporting capitalism.

LIBERAL INTERNATIONAL RELATIONS THEORY

A number of authors have noted that liberal international relations theory lacks a coherent and consistent foundation (e.g. Doyle 1986, Keohane 1990, Zacher and Matthew 1995).[2] Much of this may due in part to the eclecticism of liberal approaches in international relations. Liberal hypotheses can be found across the traditional paradigmatic boundaries of the field—namely the relative attention given to structure or agency; and the extent to which structure is composed of ideational or material elements.[3] Focusing on a number of key explanatory variables including international trade, national preferences, democracy, international institutions, and transnational society, these approaches have been fit into a number of classifications--ideational liberalism,

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[2] Keohane (1990, 172-173) writes, "In contrast to Marxism and realism, liberalism is not committed to an ambitious and parsimonious structural theory. Its attempts at theory often seem therefore to be vaguely stated and to yield uncomfortably indeterminate results."

[3] See for example the typology in chapter 2 of Katzenstein (1996).

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republican liberalism, sociological liberalism, commercial liberalism, and regulatory liberalism.[4]

Apart from this variety in explanatory emphasis, the construction of a coherent liberal approach to the study of international politics has also suffered from two additional problems—one external and one internal to the paradigm. Externally, critics of liberal IR theory have often effectively conflated its positive and normative elements by pointing to the failure of national leaders in the past century to realize the progressive goals of Western liberalism such as a stable peace among states (Moravcsik 1997, 514). This has often served to minimize the explanatory successes of liberal theory, such as the identification of zone of peace among democratic states, by characterizing liberalism as utopian and normative rather than positive in contrast with other approaches such as realism (e.g. Carr 1964).

Internally, the variety of purportedly "liberal" approaches has also served to obfuscate the boundaries of liberal IR theory, consequently leaving the content of its theoretical core, crucial for generating hypotheses, unresolved. These differences within liberalism can be seen across what should be the critical components of any theory of social behavior. For example, while the primary ontological foundation of liberalism is its focus on individual goals and actions to understand social behavior (e.g. Arblaster 1984, 15-37; Gray 1995, xii), some liberal approaches have adopted the state or the collective as the primary unit of analysis. Moreover, outside its application to

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[4] For typologies of liberal theory see Hobson (2000), Keohane (1990), McMillan (1997), Moravcsik (1997), Zacher and Matthew (1995). Zacher and Mattew (1995) cast perhaps the broadest view of liberal theory. They also describe additional variants labeled military liberalism, cognitive liberalism, and ecological liberalism.

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international relations theory, there has long been a tension within liberalism over the quality of human nature and its consequences for social cohesion.[5] Tracing back to Hobbes, many liberals--including Kant, Hume, and Bentham--adopt relatively pessimistic assumptions about human nature. Because all individuals are fundamentally selfish and possess acquisitive desires that often curtail the freedom of others, civil society needs to erect constraints, such as the rule of law, to avoid chaos. Alternatively, some variants of liberalism adopt a much more optimistic view that sees human nature as fundamentally good, suggesting that education, trade, and effective government can allow individuals within society to realize their natural harmony of interests. Finally, different conceptions of the primary collective in the modern era, namely the state, can also be found in liberal IR theory. Some approaches have adopted a pluralist conception of the state, treating it is an arena of social conflict in which the state simply responds to and aggregates competing societal interests.[6] Alternatively, Moravcsik (1997) views the state as captured and representative of the dominant group within society.

Moravcsik (1997) has sought to redress these shortcomings by laying out the primary assumptions of a liberal theory of international relations.[7] He argues that this paradigm is defined by three key assumptions identifying the relative role of society, the state, and the international system in explanations of interstate behavior. Private

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[5] For a discussion of differing conceptions of human nature within liberalism see Waltz (1962).

[6] Zacher and Matthew (1995, 118) write, "Liberals view states as the most important collective actors in our present era, but they are seen as pluralistic actors whose interests and policies are determined by bargaining among groups and elections." Krasner (1978, 26-30) also describes liberal IR Theory in a similar fashion. To the extent that it opens up the black box of domestic politics at all, commercial liberalism usually adopts a pluralist conception of the state by assuming that increasing exposure to global markets will increase the domestic political power of trading sectors

[7] One of his goals was to distinguish liberalism from neoliberal institutionalism or regime theory.

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individuals or societal actors are the fundamental actors or units of analysis in international politics. The state serves as a representative institution that seeks to realize the interests of the most powerful groups of society. The degree of compatibility or conflict among state interests then determines the quality and character of international relations. While not relegating systemic goals or pressures to a secondary status, liberal theory suggests that international constraints first alter societal interests, which are then aggregated by domestic institutions to produce foreign policy outputs.[8] Perhaps most importantly, this focus on domestic politics explicitly rejects the assumption that states necessarily define their power and capacity solely with respect to other states in the international system. The state must instead simultaneously act to ensure its power and survival in both the domestic and international arenas. In sum, liberal IR theory concentrates on the relationship between the state and its society to explain the dynamics of interstate relations.

The primacy of individual behavior and the domestic institutions that aggregate societal preferences distinguishes liberalism from other paradigms of international relations. For example, most strands of realism neglect this variety of individual differences, assume away the problem of aggregating these interests, and focus on states as the primary actor in the international system. Robert Gilpin writes, "The fundamental

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[8] A focus on institutions distinguishes liberal theories from both pluralist theories, in which the state is often characterized as an arena where different groups compete for power. In this light, the state simply responds to the most powerful or organized interests within a domestic society. Apart from concentrating on the role that institutions play in generating social outcomes, such an approach also leaves open the possibility that state actors possess their own set of interests that often include remaining in office. This allowance conflicts somewhat from Moravcsik's adoption of the capture theory of the state and suggests a third theory of the state found within liberalism. Because political leaders sit atop a hierarchy of political power that grants them authority over society, they should also possess the capacity to influence social

idea of realism is Aristotle's observation that man is a political animal. Men find their being as members of social groups to which they give their loyalty and for which they are willing to die; human beings are not the solitary individuals assumed to exist in liberal theory" (1996, 7). This assumption imposes a hierarchy upon individual actions and preferences. When national security interests are involved, individuals are treated as if they act in the collective or national interest. The consequences of this assumption for understanding the domestic determinants of international behavior are significant. Apart from failing to allow that a variety of individual interests can shape foreign policy, realism also tends to neglect how differences in domestic institutional structures can shape which interests are reflected in foreign policy. Even for some strands of realism that incorporate domestic constraints on foreign policy (e.g. Mastanduno, Lake, and Ikenberry, 1989; Snyder 1991; Zakaria 1998), national interests are still determined first by external or systemic goals.[9] Domestic pressures are modeled as a constraint on international goals and the possibility that foreign policy actions are driven by solely by domestic goals is ignored.

The Liberal View of War

Couched within this framework, liberal IR theory possesses a different view of the origins of war from other paradigms of international relations theory. Rather than looking to class relations defined by the structure of production or the distribution of

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outcomes so as to realize their own interests. This independence from society allows them to choose, shift, and build supportive coalitions.

[9] Michael Doyle (1997, 303) writes, "Realists hold that the effects of differing domestic regimes (whether Liberal or not) are overridden by the international anarchy under which all states live...Differing domestic regimes do affect the quantity of resources available to the state and the quality of its morale. But the ends

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power in the international system, liberal theory first looks inside the state to understand the origins of war. Given the primacy of the state-society relationship as a determinant of international behavior, war results from an imperfect social contract between a ruler and his subjects that unequally distributes the costs of war within a state. A government wages war for particularistic or selfish reasons that often undermine the broader welfare of society while simultaneously fortifying the domestic political status of the governing political elite. For example, Michael Howard writes:

> By the end of the eighteenth century a complete liberal theory of international relations, of war and peace, had thus already developed...According to this doctrine, mankind would naturally live in a state of perfect harmony if it were not for the vested interests of governments...The whole 'war system' was contrived to preserve the power and the employment of princes, statesmen, soldiers, diplomats, and armaments manufacturers, and to bind their tyranny ever more firmly upon the necks of the people (1978, 31).

Because rulers are able to pass the costs of war onto their societies, they remain unaffected by its consequences and are relatively unconstrained in the decision-making process leading up to war. War can offer the state a relatively costless opportunity to expand its dominion and protect it from threats that emanate from both the international and domestic arenas.

Classical liberals identified a number of benefits that accrued to the state once war broke out. James Mill claimed that war benefited the state and a minority of society by enlarging the former's financial base.[10] Cobden critiqued the balance of power and England's central role in maintaining it as cause of war and a justification to maintain

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that shape policy are determined for the Realist by the fundamental quest for power that shapes all politics or the competitive structure of the international system."

[10] See the discussion of James Mill's views on the origins of war in Silberner (1946, 37-50).

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unnecessary high levels of armaments in peacetime.[11] Moreover, he argued that the costs

of war should also be measured in terms of lost individual freedoms. Military conflict

allowed governments to postpone domestic reform (1868, 44-45). Like Mill, Thomas

Paine saw war as a means to increase public taxation. He writes:

> War is the common harvest of all those who participate in the division and
> expenditure of public money, in all countries. It is the art of conquering at home;
> the object of it is an increase of revenue; and as revenue cannot be increased
> without taxes, a pretence must be made for such expenditures. In reviewing the
> history of the English government, its wars and its taxes, a by-stander, not blinded
> by prejudice, nor warped by interest, would declare, that taxes were not raised to
> carry on war, but that wars were raised to carry taxes (1995[1791], 128).

Contemporary literature on the domestic politics of war also finds the potential for

domestic political gains from international conflict. While the empirical record is mixed,

governments can be tempted to launch a foreign war to divert attention from domestic

policy failures, in particular a stagnant or shrinking economy.[12] Studies of public opinion

have identified a "rally around the flag effect" following the onset of an international

crisis (e.g. Brody 1991, Mueller 1973). Societies tend to respond to external threats with

demonstrations of patriotism and internal cohesion that manifest as increasing levels of

support for a government in office.

Liberal theory's focus on the domestic politics of war resembles a broader

principle-agent problem between a state and its citizenry (Downs and Rocke 1994,

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[11] See chapter 3 in the pamphlet entitled *Russia* (Cobden, 1868). He writes (255-6), "Our history may during the last century may be called the tragedy of 'British intervention in the politics of Europe;' in which princes, diplomatists, peers, and generals, have been the authors and actors—the people the victims; and the moral will be exhibited to the latest posterity in 800 million pounds of debt."

[12] For a sample of the empirical and theoretical literature on diversionary war see Bennett and Nordstrom (2000), Dassel and Reinhardt (1999), Downs and Rocke (1994, 1995), Leeds and Davis (1997), Levy (1989), Miller (1999), and Smith (1996).

1995).[13] The state is hired by society to provide security from external threats. Due to the costs of monitoring and control, the state possesses incentives to shirk its responsibilities and use conflict with other states as a means to cement its domestic political power. To prevent war, society needs mechanisms to constrain these selfish goals of political leaders. Classical liberalism argues that the expansion and protection of individual liberties limit the gains that governments can compile from war and consequently make peace more likely. The contemporary literature has focused on three such mechanisms, termed the Kantian tripod, to protect individual freedoms—democracy, international commerce, and international organizations.

THE KANTIAN TRIPOD

Democracy

The democratic peace debate has extensively studied how regular and competitive elections can empower society to constrain abuses of political authority and generate

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[13] Such an approach complements bargaining models that focus on the structural properties of the international system to explain war. While treating the state as a unitary actor, Fearon (1995) argues that rationalist models rely on private information and commitment problems between states under anarchy to explain war. An important assumption of these models is the presence of positive costs of war. States then have an incentive to try to reach a bargaining solution prior to the outbreak of war to avoid these costs of war. Instead of treating the state as a unitary actor, liberalism suggests that the distributional conflicts inherent in domestic politics can also alter the conditions under which war occurs. Even though states and societies together pay positive costs to war, not all domestic groups pay these costs in the same proportion. Consequently, some groups within society may favor war and military conflict can break out even with complete information and the presence of third party capable of enforcing agreements. While structural realists such as Waltz (1979) may argue that it is impossible to explain the outbreak of war without understanding the constraints posed by international structure, liberal or domestic level explanations can offer the converse response. It is impossible to assume that war is costly without understanding the structure of domestic institutions that distributes these costs across both state and societal actors. Finally, it is important to note that Fearon explicitly recognizes this possibility (1995, 379, fn 1) while stating that his emphasis is on the structural origins of war.

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peace among states. The empirical support for this argument appears to be remarkably robust (e.g. Bremer 1992, Dixon 1994, Maoz and Russett 1993, Rousseau et al 1996, Rummel 1983, Russett and Oneal 2001). While numerous theories have been offered to explain the empirical regularities between democracy and conflict behavior, the literature has developed around three primary variants. Two rely on the institutional qualities of democracy; the third on the normative characteristics of such regimes. The first institutional explanation points to such features as regular elections, the separation of powers among an executive, legislature, and judiciary, and the rule of law within democracies as promoting peace. The process of holding regular and competitive elections increases the political costs to a leader for going to war. When the segments of society that pay the real costs of war in terms of higher taxation and death in battle are granted the means to punish the government officials by removing them from office, states use force much more cautiously. A second institutional explanation highlights how democracy helps to increase transparency in the bargaining process between states and adjust informational asymmetries between them. These traits allow democracies to enhance the credibility of their commitments, reduce the dangers of cheating endemic to anarchy, and increase the probability of a cooperative settlement to a dispute (Fearon 1994, Schultz 1999, Smith 1998).

A third set of explanations focuses on the normative aspects of democracy (e.g. Maoz and Russett 1993; Owen 1994; and Risse-Kappen 1996). It argues that the political culture that evolves within democracies helps to promote peace. As the norms of conciliation, compromise, and reciprocity shape the resolution of conflicts within

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democracies, democratic leaders tend to adopt such procedures when negotiating with other democratic states. These norms help to facilitate peaceful dispute resolution.

International Organizations

Immanuel Kant's second foundation for eradicating war lay in a federation among states that eschewed military violence (Kant, 1971). Similar to a social contract whereby individuals escape the potential for conflict inherent in the state of nature, peace in the international system can be strengthened with a voluntary contract among states. Kant's arguments have served as one classical foundation for contemporary work on the ability of international organizations to promote peace (Russett, Oneal, Davis, 1998; Mansfield and Pevehouse 2000; Russett and Oneal 2001). A number of mechanisms linking international institutions and peace have been offered. Some international organizations, such as the UN and NATO, wield coercive power and can punish or deter aggression so as to make conflict less likely. International institutions also provide a mediating forum for bargaining among states that can promote cooperation through issue linkage and facilitate communication so as to reduce uncertainty over the intentions of conflicting parties. Finally, membership in international organization can also promote mutual identities that foster the creation of common interests in peace among states.

Interdependence

The final element in the Kantian tripod focuses on the relationship between commerce and conflict among states.[14] A broad base of empirical tests in the

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[14] The literature reviews of Barbieri and Schneider (1999), Hirschman (1997), Mansfield and Pollins (2001), McMillan (1997), Silberner (1946), and Stein (1993) provide an extensive overview of these propositions.

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contemporary literature across a number of research designs, including differences in operationalizations of the independent and dependent variables, the temporal domain under study, and the unit of analysis, support the hypothesis that international commerce promotes peace among states.[15] These arguments generally take one of three forms and trace their intellectual heritage to a series of developments associated with the Enlightenment and the evolution of a free trade doctrine that challenged longstanding mercantilist propositions on the relationship between trade and national output.[16]

The first, labeled the opportunity cost or deterrence model, is based on the principle of comparative advantage. As economies grow more specialized and the range of goods produced domestically narrows, they simultaneously grow more dependent on international commerce to provide the entire array of goods necessary for consumption and investment by their population. As dependence increases, the costs of severing this trade because of political conflict increase and make war less likely. This dependence is mutual among trading partners. Just as one state may become dependent on another for raw material inputs into manufacturing, its trading partner simultaneously becomes dependent on it for finished manufactured goods.

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[15] Using annual measures of "net conflict" between states from the Conflict and Peace Data Bank (COPDAB), Polachek (1980) found that bilateral trade was inversely related with conflict between states. In a series of studies, Oneal and Russett (1997, 1999a, 1999b, 1999c, 2001) provide substantial statistical evidence that bilateral trade as a proportion of gross domestic product consistently reduced the probability of a militarized interstate dispute within dyads during the period from 1886 until 1992. Mansfield (1994) finds that the relationship holds while using the international system as the unit of analysis. As the ratio of global exports to total production increases, the mean number of wars in the system decreases. At the monadic level, Domke (1988) finds that as a country's exports relative to GDP increase, it becomes less likely to participate in a war. Gartzke, Li, and Boehmer (2001) argue that monetary interdependence and openness to transnational movements of capital, in addition to trade, decrease the probability that a militarized interstate dispute will break out within a dyad.

[16] For a review of the evolution of economic thinking that led to the triumph of the proposition that free trade increases national welfare see Irwin (1996).

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A second argument, what I will term the efficiency mechanism, locates the origins of war in an economy's need to acquire productive resources necessary to survive. States have two means of acquiring these resources—production and spoliation or conquest (Bastiat 1964 [1870], 475-486). As global markets expand and states become increasingly able to acquire these resources through mutually beneficial exchange, plunder or conquest is eschewed because of its relative costliness or inefficiency (Rosecrance 1986).[17]

Finally, flowing from the proposition that the interests of individuals are not inherently conflictual but harmonious, a third variant of the classical tradition argues that trade provides a means to educate individuals about this ultimate compatibility of human interests. By increasing contact and communication with other societies, trade helps to displace national loyalties and establish a broader cosmopolitan identity across societies (e.g. Deutsch et al., 1957). Because governments often start wars in spite of the pacific orientation of society, the strengthening of such a transnational movement allows the pacific interactions across societies to eclipse the competitive relations among governments.

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[17] Associated with this reasoning was the observation that industrialization had so increased the costs of going to war as to render such a policy choice increasingly unlikely (Angell 1933).

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CRITIQUING THE TRIPOD WITH LIBERAL IR THEORY

Reintegrating the primacy of individual behavior: second image dynamics of a commercial peace

Theoretically, commercial liberalism has been challenged on a couple of key issues. Adopting bargaining models of war, game theorists (Morrow 1999; Gartzke, Li, and Boehmer 2001) criticize these hypotheses for failing to be nested in a broader theory about how wars begin. By not accounting for the dynamics of strategic interaction between states, they point that trade can both deter and encourage conflict. Just as dependence on foreign markets raises the costs of severing these relationships (thereby making conflict less likely), this weakness can simultaneously embolden an adversary and make him more likely to initiate a conflict. When accounting for strategic interaction among states, trade's effect on conflict is indeterminate. These approaches argue that links between commerce and conflict cannot be based on the fear of costs imposed on a state after conflict breaks out. Any effect that commerce has on war must be due to its ability to serve as a signaling mechanism in bargaining situations with other states. States can send costly signals of resolve to adversaries in a crisis and commit to an equilibrium bargaining position that prevents war by sustaining policies that threaten societal interests benefiting from international exchange.

Alternatively, commercial liberalism has been faulted for relying on a series of assumptions concerning state-society relations that are rarely discussed or accounted for in empirical tests (Barbieri and Schneider 1999, Mansfield and Pollins 2001, Stein 1993). This failure to examine the microfoundations of a commercial peace manifests in a neglect of two key aspects of state-society interactions: the variety of societal interests

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with respect to trade and the domestic institutions that aggregate these competing claims. For example, both the opportunity cost and efficiency hypotheses suggest that as a state's aggregate exposure to the international markets increases, the economy as a whole should become more dependent as the size of the domestic constituency active and participating in this exchange grows larger (Domke 1988). This expanding trading interest that stands to lose from war should then act as a powerful constraint on the state's decision to go to war.

If society does not hold uniform preferences for trade, it may be less willing to lobby for peace if war threatens this commerce. Standard trade theory has long recognized that even though increasing exposure to foreign competition increases aggregate welfare, it does not do this equally across all segments of an economy. The Heckscher-Ohlin framework argues that the returns accruing to the abundant factors of production in an economy will increase relative to the scarce factors as the barriers to international exchange, either technological or political, decrease (Flam and Flanders, 1991).[18] This approach links international commerce with domestic distributional issues that often lie at the heart of a liberal theory of conflict. Because some groups in society see their relative incomes decrease as a result of foreign competition, they are likely to oppose the opening of domestic markets. For example, scarce factors of production are likely to lobby for protection to prevent the erosion of their income (Stolper and Samuelson 1941). More importantly for the commercial peace hypothesis, these same groups benefiting from protection are also less likely to lobby the state for peace when

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[18]For a review of the political consequences of these price shocks see Alt et al. (1996).

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war threatens to interrupt trade. They may even support more aggressive foreign policies that dampen trade and foreign competition while simultaneously expanding their share of domestic markets. Similarly, work on political or state-owned firms casts doubt on the idea that all enterprises respond to the profit motive that drives the opportunity cost hypothesis.[19] Society lobbies the state for peace because it fears the loss of trade-related income from war. Yet if a substantial amount of firms are publicly owned and possess alternative goals such as maximizing employment, they may be less willing to lobby for peace to prevent such income losses. If the commercial peace hypothesis relies on the ability of those segments of society that benefit from free trade to push the state's foreign policy toward peace, then we need some means of assessing the relative strength of these competing interest groups.

Additionally, the process by which these trading interests translate preferences for maintaining an open economy into foreign policy outputs that include both an open trading system and a more pacific orientation in foreign policy must take into account the structure of domestic institutions that mediate societal conflict, aggregate interests, and determine policy.[20] The opportunity cost hypothesis implicitly adopts a pluralist model

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[19] Thrain Eggertsson writes, "[m]any political firms have as their explicit goal not to sell their output at a price that covers costs" (1990, 150). Similarly, Kornai (1992, 145-148) notes that state-owned firms are weakly responsive to shifts in prices. Consequently, we should expect them to be slow to respond to international shocks, such as war, that shrink supplies and raise the prices of goods purchased on global markets.

[20] The new institutionalism's critique of the open polity literature offers a similar conclusion. Referring to previous research using the open polity approach Garrett and Lange write, "This line of research provides a parsimonious approach to analyzing the impact of integration into the international economy on the preferences and coalitional behavior of domestic actors. It should be noted, however, that scholarship in this vein pays relatively little attention to the relationship between preference change and policy outcomes...The implicit political model is that of "economic pluralism"—in which policy outcomes are a function of political conflict shaped by their preferences of different actors, weighted by their market power

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of domestic politics that fails to acknowledge both that the structure of domestic institutions can privilege portions of society that prefer a closed trading system and that the state possesses an independent capacity to adjudicate among and shape these interests. Even if a majority of society chooses free trade over conflict, we still must know something about the domestic institutions that aggregate these preferences.

One tradition in the interdependence literature has responded to this shortcoming by examining how democracy conditions the effects of commerce on conflict (Gelpi and Grieco 2003; Papayoanou 1999). The ability of commerce to promote peace may be restricted to democratic states because the groups most hurt by interruptions in commerce are able to lobby effectively their governments for more peaceful foreign policies. While regime type provides one means to characterize state-society interactions, it may not capture all of the variation across economies. Democracies have long restricted trade by using tariffs as their primary source of public revenue.[21]

By neglecting the domestic politics of war and commercial policy, much of the empirical support for the commercial peace hypothesis really only tests half of the classical liberal argument.[22] This liberal thesis operates largely at the systemic level of

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and propensity for collective action...There is something missing from this account—institutions" (1996, 48-49).

[21] The United States stands out as an important example to this. Tariffs were the primary source of public revenues until World War I. For a discussion of the relationship between tariffs and taxes in the U.S. case see Hansen (1990). Moreover, the endogenous protection literature that explores the emergence of restrictions on trade generally focuses its analysis on democracies (Hillman 1989).

[22] Moreover, in line with adopting some variant of the unitary actor assumption, most of the subsequent statistical tests of these propositions focus on aggregate national measures of interdependence between states, usually a combination of imports and exports between two states divided by one of their gross national products. Often contrary to the primary assumption of liberal theory, states and not individuals are the primary actors in these analyses. This issue will be taken up in more detail in chapter 5.

analysis because it fails to disaggregate domestic economies into their constituent parts.[23]

It presumes that larger integration in the global economy necessarily enhances the domestic influence of the peace-loving elements of society. Rooted in the broader foundations of liberal theory, all trade is assumed to necessarily enhance individual liberty. Another strand of the classical literature, more squarely rooted in the individualism of liberal theory and the domestic distributional issues of war, does not make this assumption by focusing on an intervening step in the argument that asks whether international commerce actually enhances the liberty of individuals. This intermediate link highlights the structure of domestic institutions that regulate trade and consequently mediate among the state and contending interest groups.

In this fourth and neglected variant of the commercial peace hypothesis, the ability of free trade to alter the institutional context linking state and society provides the crucial input to peace. There are two steps between international commerce and war. The first focuses on the domestic politics of international conflict and is necessarily rooted in broader liberal conceptions of war that see its origins in the privileged benefits of minority of society and the state. The second focuses on the domestic distributional implications of commercial policy. Behind much of the clamor for free trade in the classical literature was a strong opposition to monopolies in the domestic economy. In fact, Adam Smith's case for free trade was driven in large part by his desire to limit the monopolist practices of merchants. He writes:

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[23] Norrin M. Ripsman and Jean-Marc F. Blanchard write, "The debate between commercial liberals and realists has also obscured the impact of domestic political considerations on national security decisions. While other strains of liberal theory, particularly the democratic-peace theory, focus on the domestic sources of international behavior, commercial liberalism is primarily a systemic theory" (1996/7, 5-6).

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Commerce, which ought naturally to be, among nations, as among individuals, a bond of union and friendship, has become the most fertile source of discord and animosity. The capricious ambition of kings and ministers has not, during the present and the preceding century been more fatal to the repose of Europe, than the impertinent jealousy of merchants and manufacturers. The violence and injustice of the rulers of mankind is an ancient evil, for which, I am afraid, the nature of human affairs can scarce admit of a remedy. But the mean rapacity, the monopolizing spirit of merchants and manufacturers, who neither are, nor ought to be, the rulers of mankind, though it cannot perhaps be corrected, may very easily be prevented from disturbing the tranquility of any body but themselves. (1937, 4.3.2.460)

As tariffs tended to shield noncompetitive sectors and shift the distribution of wealth in a society toward these groups and away from consumers, the political motivation behind free trade was just as often domestic as it was international i.e. to promote peace. The elimination of trade restrictions undermined the domestic power of the groups most responsible for war by removing their ability to shift the burdens of public taxation on disorganized members of society that benefited most from open international markets. In this second-image variant of the commercial peace hypothesis, the ability of commerce to promote peace depended crucially on trade's ability to alter the structure of domestic politics. Free trade and not necessarily trade was the key to peace.

Two authors most explicitly identified this series of causal links that focus on the intervening role of the domestic polity between commerce and peace—Richard Cobden[24] and Joseph Schumpeter. Cobden stands out as one of the most important Radical political figures in nineteenth century British history (Taylor 1958). His political activities and philosophy are defined by a number of traditional liberal goals including free trade, the peace movement, non-interventionism in foreign policy, and fiscal

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restraint. His support for free trade carried with it both domestic and international elements. While he argued that free trade would promote peace through the mutual dependence mechanism,[25] he also offered another explanation that was rooted in his hope for the transformation of British society. Cobden saw a tension evolving within societies initiated by the industrial revolution (Cain 1979). He hoped that the emerging economic transformation would alter the distribution of domestic power by undermining the position of the landed aristocracy that was most responsible for the outbreak of conflict.[26] Free trade served as the principle means by which to challenge what he saw as the foundation for aristocratic strength—import protection for landed interests. These ideas can be seen in many of his speeches written during the campaign for the repeal of the Corn Laws. For example, Cobden writes:

> The single and undisguised object of the League is to put down commercial monopoly; but that cannot be done by saddling upon our backs a fixed duty on corn, which means a differential duty on sugar, on coffee, and monopoly in every other article. The Corn-law is the great tree of Monopoly, under whose baneful shadow every other restriction exists. Cut it down by the roots, and it will destroy the others in its fall. The sole object of the League is to put an end to and extinguish, at once and forever, the principle of maintaining taxes for the benefit of a particular class (1870, 1, 78).

> The laws for the encouragement of trade are direct and important; and their tendency is to destroy the privileges of the nobles, by raising up a middle class...(1868, 1, 186).

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[24] A third person could be added to this list, Cobden's counterpart in France, Frederic Bastiat. For one of the few discussions of his work in English see Silberner (1946).

[25] Writing of England's substantial commercial ties with the New World, "England...has by the magic of her machinery, united for ever two remote hemispheres in the bonds of peace, by placing European and American in absolute and inextricable dependence on each other (1868, 1, 193).

[26] He writes, "The middle and industrious classes of England can have no interest apart from the preservation of peace. The honours, the fame, the emoluments of war belong not to them; the battle-plain is the harvest-field of the aristocracy, watered with the blood of the people" (1868, 1, 42-43).

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More importantly, by undermining the position of the aristocracy, which he often treated synonymously with the government because of its dominance in parliament, Cobden argued that one of the primary causes of war would be removed. Only governments benefited from wars and the "war scares" that often provoked them. They allowed governments to postpone domestic reforms that would necessarily expand individual liberty and limit the role of government in domestic life (e.g. Cobden 1868, 1, 44-45; 1870, 2, 429). Moreover, he complained of high public debts stemming from the Napoleonic wars that were eventually paid for through tariffs whose burdens fell on broad segments of British society.[27] Thus, "Free trade would 'snatch the power from the governments to plunge their people into wars'" (Morley 1883, 230-1).

Joseph Schumpeter's (1951) most complete statement on the origins of international conflict shares many of the same themes. He argued that the combination of capitalism and democracy rationalized and eroded the domestic position of the war machine, a group that lay at the source of international conflict.[28] Often contrasted with Lenin's interpretation of imperial expansion as a necessary stage of capitalist development, Schumpeter claimed that the alliance between the state and monopoly interests that produced overseas expansion resulted instead from the financial needs of autocratic rulers.[29] Autocrats restricted commercial activities, including international trade, to generate a tax base that simultaneously created a social class whose standing depended on such regulations. He writes, "This follows from the very fact that trusts and

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[27] Nicholls (1991) compares Cobden's condemnation of the alliance between the aristocracy and the military to Eisenhower's warnings of the military-industrial complex in the United States.

[28] For reviews of this essay, see Doyle (1997), Taylor (1951), and Kautsky (1994).

[29] See especially his discussion from pp. 99-130.

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cartels can attain their primary purpose--to pursue a monopoly policy--only behind

protective tariffs, without which they would lose their essential significance."[30]

Then, similarly to Lenin, he traces the origins of interstate conflict to these

monopolied interests that ally with the precapitalist and authoritarian elements of the

state. While the nascent bourgeoisie favor expansion to establish monopoly holds over

foreign colonies to enhance their competitiveness with foreign producers, the state seizes

on this interest to extract support for its own domestic political position, which in turn

often depends on the perpetuation of conflict to feed the war machine. Most importantly,

in contrast to Lenin, Schumpeter argued that the government captures the capitalist class

rather than the other way around. He writes, "This aggressive economic policy on the

part of a country with a unified tariff--with preparedness for war always in the

background--serves the economy only seemingly rather than in reality. Actually, one

might assert that the economy becomes a weapon in the political struggle, a means for

unifying the nation, for severing it from the fabric of international interests, for placing it

at the disposal of state power" (1951, 102).[31] By eliminating these privileges, free trade

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[30] ibid. pp. 117-118.
[31] Jacob Viner (1951) makes a similar argument in his exploration of the relations between governments that oversee state-controlled economies. He writes, "In almost all of these cases, the capitalist, instead of pushing his government into an imperialistic enterprise in pursuit of his own financial gain, was pushed, or dragged, or cajoled, or lured into it by his government, in order that, in its relation with the outside world and within its own people, this government might be able to point to an apparently real and legitimate economic stake in the territory involved which required military protection against unfair treatment or general misgovernment by the local authorities or against encroachment by other powers" (224-225).

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undermines the state's traditional basis of political support and forces it to be more responsive to the modern industrialized sectors of society that have no interest in aggressive war.

Expanding Conceptions of State-Society Relations: Liberty Through the Market

While democracy provides one potential intermediate link between the pressures of globalization and cooperative foreign policies, this section argues that classical liberalism suggests additional institutions may also protect individual liberty and shape a state's decision for war. Expanding the range of domestic institutional variation necessitates rethinking the foundations of domestic order and second image theories of international relations in general. A central critique of democratic peace theory— elections may often be insufficient to prevent war—provides the starting point for this reexamination.

Despite a wide body of empirical support for the proposition that democracy tends to promote peace, the field has yet to reach a consensus concerning an explanation for this link. Critics of the democratic peace have highlighted the limited role that elections can have on the outbreak of conflict. Democratic states may only be peaceful in their relations with other democratic states (e.g. Chan 1984; Doyle 1983, 1997). Transitions to democracy have been found to increase conflict (Mansfield and Snyder 1995, 2002a, 2002b). Nonmyopic democratic leaders may be able to circumvent electoral constraints and attempts to check their authority by legislators (Gowa 1999). The failure of recently democratizing states to grant constitutional freedoms and civil liberties casts doubt on their ability to join the "zone of peace" (Zakaria 1997). A number of authors have noted

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that the timing of the election cycle within democracies shapes their decisions for war and their relative peacefulness. Gaubatz (1999) argues that while the decision for war places the job security of a democratic leader at risk, electoral periods heighten these risks and increase the possibility that anti-war opinions can influence foreign policy. Consequently, democratic states are more hesitant to pursue war just prior to an election but become more emboldened after it has taken place. Finally, a number of scholars note that the popular support created by external aggression can provide an opportunity for democratic leaders to use war as a tool to counteract failures in domestic policy and revive their political fortunes (Downs and Rocke 1994; Hess and Orphanides 2001; Levy 1989; Smith 1996).

All of these arguments share a common concern. While the granting of voice to society through elections may provide a necessary element to the pacification of foreign policy, it may not be sufficient to prevent the manipulation of the state machinery by a small leadership group to serve its own private goals. This possibility suggests the need to expand the range of domestic institutions that may shape this zone of peace.

The democratic peace debate has been part of a broader renewal of interest in the domestic origins of foreign policy largely developed as a response to the systemic bias of Waltzian neo-realism (Waltz 1979). Questions about the presence or distribution of authority within domestic polities have served as a focal point for second image theories of international relations.[32] While quite general to the field of political science,[33] this

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[32] Realist or statist approaches emphasize how authority concentrated in the hands of government officials and supported by an institutionalized legal order allows these officials to respond to external challenges (Katzenstein 1977, Krasner 1978, Mastanduno et al. 1989, Zakaria 1998). Pluralist approaches instead focus on how state authority serves primarily as an aggregating mechanism, adjudicating among interest

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concentration on authority and the consequent hierarchical social ordering within domestic systems is distinguished from the international political arena, where authority is absent under anarchy. For example, Kenneth Waltz writes:

> The parts of domestic political systems stand in relations of super- and subordination. Some are entitled to command; others are required to obey. Domestic systems are centralized and hierarchic. The parts of international-political systems stand in relations of coordination. Formally, each is the equal of all the others. None is entitled to command; none is required to obey. International systems are decentralized and anarchic. The ordering principles of the structures are distinctly different, indeed, contrary to each other (Waltz 1979, 88).

Second image theories of international relations are largely defined by their challenge to hierarchical conceptions of domestic political systems. Helen Milner argues that the organization of domestic politics is more accurately conceptualized as a polyarchical system in which no one individual or group is able to control the behavior of all others in a society. As a consequence, individuals and groups must share power (Milner 1997, 9-14). More importantly, it is the central premise of the second image tradition that such power sharing arrangements, such as the division between an executive and a legislature or that between a federal and provincial government, lead to bargaining and the search for compromise among competing domestic groups, which alters both the foreign policy of states and the possibility for cooperation among them.

Yet this critique can be extended to explore previously neglected institutions, *marked by the absence of authority*, that also regulate state-society interactions. While the state does hold the capacity to direct the behavior of its citizenry largely because of its

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group pressures emanating from society. Lacking any independent interest or authority, Marxist theory views the state as captured by the interests of a powerful capital class.

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monopoly on coercion, it does not rely on this capacity to coordinate *all* of its interactions with society. In capitalist economies, the state and society also interact within markets on the basis of an exchange relationship in which the price mechanism constrains both sets of actors. When the state makes a commitment to respect private property or agrees to compete with private sector firms for the right to acquire scarce societal resources, it necessarily surrenders some of its authority to direct or control the behavior of society. Competitive markets render both the state and members of society "weak" in the sense that neither can control prices or the terms of their exchange relationship. Within markets, command over societal resources goes to the highest bidder. For example, conscription offers the state a means to set prices in the labor market for soldiers. If conscripted, a citizen must either accept the payment offered by the state or face legal sanctions. However, states that rely on voluntary enlistment to build and sustain their armed forces must compete with the same market pressures faced by firms in the private sector. States that finance spending deficits by selling bonds in international credit markets must pay interest rates that the market offers. Most importantly, these possibilities suggest that society can also acquire liberty and the consequent ability to shape or alter state behavior through such market based institutions as private property and competitive market structures in addition to democracy.

Classical liberal theory has long recognized that the institutions of capitalism, namely private property and competitive markets, serve as powerful constraints on state authority as guarantors of individual liberty. For example, Adam Smith's discussion of

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[33] See for example Harry Eckstein's (1973) delineation of the boundaries of the field.

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the links between commerce and liberty focuses on how the expansion of markets first led sovereigns to grant increasing freedom to cities--creating in effect independent republics--to generate a tax base and foster an alliance that could be used to offset the power and influence of feudal landlords.[34] The spread of commerce within the cities then created opportunities for large landowners to dispose of surplus production and led them to adopt innovations, that included allowing peasants to retain larger portions of their surplus by granting them longer leases, to expand production.[35] These innovations decreased the dependence of the peasants on the landlord for subsistence and would eventually serve to curtail the authority of the latter. He writes:

> [c]ommerce and manufactures gradually introduced order and good government, and with them, the liberty and security of individuals, among the inhabitants of the country, who had before lived almost in a continual state of war with their neighbors, and of servile dependency on their superiors (1937, 3.4.385).

In effect, the greed of the landlords had led them to allow peasants to hold or lay claim to greater quantities of property that then altered the fundamental relationship between the two parties from one based on authority to one governed by decentralized exchange.

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[34] This discussion of the links between commerce and liberty is largely based on book 3, "Of the Different Progress of Opulence in Different Nations," of *Wealth of Nations*. But Smith also notes that commerce can also expand liberty by establishing judicial independence from the executive (book 5). For a discussion of Smith's ideas on the reciprocal interaction between commerce and liberty see chapter 4 of Winch (1978) and Hirschman (1997, 100-113).

[35] Smith (1937, 3, iv, 390) writes, "[t]he merchants and manufacturers soon furnished him with a method of spending upon his own person on the same manner as he had done to the rest. The same cause continuing to operate, he was desirous to raise his rents above what his lands...could afford. His tenants could agree to this on one condition only, that they should be secured in their possession, for such a term of years as might give them time to recover with profit whatever they should lay out in the further improvement of the land. The expensive vanity of the landlord made him willing to accept of this condition; hence the origin of long leases...But if he (referring to the peasant) has a lease for a long term of years, he is altogether independent...The tenants having in this manner become independent, and the retainers being dismissed, the great proprietors were no longer capable of interrupting the regular execution of justice, or of disturbing the peace of the country."

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The links between private property and liberty have long been a theme in liberal theory often dated to Locke's, *Two Treatises of Government* (1988). Locke argued that the need to protect private property was the primary motivation behind the formation of a voluntary social contract that allowed individuals to escape the state of nature and create a civil society. More importantly, private property, justified through natural law granting individuals the right to own property in their selves, created the independence necessary for liberty. John Gray writes:

> Locke's thought brings to the fore a theme absent or denied in the thought of Hobbes and Spinoza—the theme of the links between right to personal property and individual liberty. There is in Locke what is lacking in earlier individualist writers—a clear perception that personal independence presupposes private property, securely protected under the rule of law (1995, 14).

The strengthening of independent decision making is best seen by comparing systems of private property with systems in which all assets are owned by a single person or collective.[36] In the latter arrangement, one individual or collective possesses the authority to direct the lives of other members of society by controlling the means of subsistence. On the other hand, as property diffuses to multiple owners, society is increasingly coordinated by decentralized activities rather than the authoritative decisions of any singly body. This weakening of a central authority necessarily enhances the liberty of individuals in society.

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[36] This comparison is drawn from Gray (1995, ch. 8), who in turn draws from Hayek's writings. Hayek (1994, 115) writes, "What our generation has forgotten is that the system of private property is the most important guaranty of freedom, not only for those who own property, but scarcely less for those who do not. It is only because the control of the means of production is divided among many people acting independently that nobody has complete power over us, that we as individuals can decide what to do with ourselves. If all the means of production were vested in a single hand, whether it be nominally that of society as a whole or that of a dictator, whoever exercises this control has complete power over us."

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The relationship between private property and liberty parallels the connections between decentralized exchange through markets and liberty. Friedrich von Hayek's, *The Road to Serfdom* (1994), provides one of the strongest arguments linking nearly any interference with free and competitive markets to an abridgement of individual liberties and an enhancement of the power of the state.[37] Written as a warning to western societies, Hayek argued the origins of the Nazi totalitarianism lay in the socialist or market-friendly policies first inaugurated by Bismarck.[38] Defined by the absence of private property and allocation of productive resources by a bureaucracy, socialism must rely on coercion to function effectively. Because the implementation of a central economic plan requires both the identification of a central goal, which productive decisions seek to fulfill and a strategy to achieve this end, some means of deciding among completing plans was a fundamental prerequisite to the centralization of economic life. Seeing unanimous consent within society on these issues as impossible, Hayek argued that coercion was necessary to make such collective decisions.

This need to rely on coercion for the plan to succeed inevitably rendered democratic socialism impossible. This claim was rooted in an examination of the difficulties created by administering a central plan to govern an economy. Because democracies cannot debate every aspect of a central plan down to the daily productive decisions of each firm, they must necessarily delegate decision making over the plan to

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[37] I qualify this a bit by noting that Hayek recognized the important role of the state in supplying such public goods as a legal infrastructure, or the rule of the law, and national defense. Thus, it would be incorrect to characterize his arguments as not recognizing any role for authority in social behavior.

[38] He writes, "Few are ready to recognize that the rise of fascism and nazism was not a reaction against the socialist trends of the preceding period but a necessary outcome of those tendencies (1994, 6).

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either a separate governing body or a set of individuals.[39] This act of delegation necessarily removes important components of the implementation of the plan from democratic oversight. In short, Hayek argued capitalism was necessary for democracy to function. He writes, "If 'capitalism' means here a competitive system based on free disposal over private property, it is far more important to realize that only within this system is democracy possible. When it becomes dominated by a collectivist creed, democracy will inevitably destroy itself" (1994, 77-78).

While finding support in the debate linking modernization and economic development to democratic institutions (e.g. Lipset 1994, Przeworski and Limongi 1997),[40] Hayek's claims about the dependence of democracy on capitalism suggest an important critique of the democratic peace research program.[41] By treating democracy as an exogenous variable and not simultaneously examining how political freedoms represented by competitive elections interact with economic freedoms, it is possible that the relationship between democracy and peace is spurious. If capitalism leads to democracy, the peace among democratic states may really be a function of a larger capitalist peace in which private property and competitive market structure serve to enhance individual liberty, create the necessary conditions for democracy to flourish, and

[39] Hayek (1994, 78) writes, "Our point, however, is not that dictatorship must inevitably extirpate freedom but rather that planning leads to dictatorship because dictatorship is the most effective instrument or coercion and the enforcement of ideals and, as such, essential if central planning on a large scale is to be possible."

[40] The findings of Przeworski and Limongi (1997) offer mixed support for modernization theory. They argue that development, the primary indicator of modernization, is correlated with the survival of democratic regimes but not necessarily with transitions to democracy.

[41] For a recent review of the relationship between capitalism and democracy see Diamond and Plattner (1993). In one of the contributions to this volume, Peter L. Berger (3) writes, "Does political democracy require or depend upon a market economy? Here is one question where caution is *not* called for: the

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make it more difficult for states to go to war.[42] At the very least, this possibility suggests that an examination of how the institutions of capitalism strengthen or inhibit a liberal peace among states is long overdue.

CONCLUSION

This chapter has sought to offer a "liberal" critique of the liberal peace literature. Building on and challenging some of the central critiques of this research program, it has argued that contemporary examinations suffer from a combination of three central problems. The liberal peace literature must expand its vision of the manner in which a domestic society constrains the foreign policy actions of its leaders. While returning to the basic liberal insight that the state-society relationship provides a powerful clue in understanding foreign policy behavior, we should incorporate the possibility that the state and society interactions are regulated by a number of institutions in addition to elections. Moreover, studies that examine liberal sources of peace operating at the level of the international system, such as globalization, must explicitly incorporate how these pressures shift the interests of societal actors, refract through domestic institutions, and alter the domestic incentives for war. The next chapter takes up these challenges by developing a theory of how capitalism shapes foreign policy and enhances the potential for peace in the international system.

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answer is a resounding *yes*. The reason for it is strictly empirical: the evidence overwhelmingly suggests it...There has been no case of political democracy that has not been a market economy."

[42] Weede (1995, 1996) makes this very argument, tracing democratization and its consequent effects on peace to the spread of capitalism.

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CHAPTER 3

CAPITALISM AND PEACE

"There cannot be a greater security for the continuance of peace, than the imposing on ministers the necessity of applying to the people for taxes to support a war."
--David Ricardo in *Essay on the Funding System* (1820),
quoted in Silberner (1946, 34-35)

Ricardo's concern over the size of the British public debt in the aftermath of the Napoleonic wars led him to explore links between financing war and the potential for peace.[1] Upon the onset of conflict, the immediate imposition of an income tax rather than a series of public loans to pay the costs of war would provide benefits to both the economy and the polity. Economically, it would force citizens to save for war and eliminate the wartime drag on consumption as soon as military hostilities ceased. Politically, it would prevent the citizenry from passing the costs of war onto future generations while depriving the state of a discretionary reserve that could be tapped for aggressive conquest.

Ricardo's arguments illustrate one of the foundations of the liberal peace. As citizens acquire the means to influence the government, their ability to resist war effectively and the possibilities for peace grow. A government's need and ability to secure private sector resources to finance the construction of a war machine capable of defending its territory, projecting its national interests, and even conquering other states

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critically shape its decision for war. By forcing the state to rely on the private sector for revenue and simultaneously restricting its ability to tax or seize these assets, individuals in society can be empowered to establish a more pacific foreign policy.

While the previous chapter argued that most treatments of the liberal peace have neglected various aspects of the domestic institutional structure that set the terms by which the state gains access to these resources, this chapter fills this gap by developing a theory that explains how capitalism shapes the dynamics of war. Domestically, the quantity of private property in an economy, the competitiveness of domestic markets, and the extent of mobile wealth in an economy determine the domestic economics of war. They set the price that the state must pay private actors for their resources and they determine the quantity of resources a state must purchase. The expansion of private property necessarily reduces the quantity of resources owned by the state and increases its reliance on the private sector to provide them. Because of the difficulties faced by the state in seizing mobile wealth, it must tax this form of wealth at a lower rate than other sectors. Competitive market structures reinforce these trends toward higher costs by compelling states to surrender their capacity to shape domestic prices and compete with other private firms through the impersonal forces of supply and demand.

These institutions also shape the domestic politics of war. When states liberalize their domestic economies, they relinquish many opportunities to redistribute income toward their political supporters. The capacity to determine the prices, quantity, or quality of goods that are exchanged in a domestic economy creates opportunities for the

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[1] For a review of Ricardo's writings on the problem of war, see chapter 2 of Silberner (1946).

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state to generate real economic resources that can be diverted to its supportive coalitions. Consequently, this power can allow the state to generate side payments that can be used to divert war's costs away from these groups. Liberal economic institutions thus limit the state's capacity to build coalitions for war by shifting its costs outside the ruling cadre.

This chapter develops these arguments in the following manner. First, it briefly examines the existing literature on the relationship between capitalism and war. Second, it builds a simple model of state-society relations drawn from neo-institutional economics to illustrate how the institutions of capitalism shape both the economic and political costs paid by the state to go to war. Third, this model is used to derive hypotheses linking variation in institutions regulating the domestic economy to the outbreak of military conflict among states.

CAPITALISM AND PEACE? OR WAR?

Industrialization, the Strengthening of the Middle Rank, and Peace

Contemporary liberal scholarship has generally focused on the economic causes or constraints on war in terms of the relationship between a domestic economy and the broader global economy. Mutual dependence and the strengthening of transnational cultural links through extensive trade helps to raise the costs of war and make it less likely. But classical liberal theory and the socialist precursors to Marx also recognized

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another series of connections between economics and conflict that focused on the consequences of industrialization for the domestic structure of power. Constructing two ideal types of societies, one based on militarism and another based on industrialism and work, these writers viewed history as progressing from the former to the latter.[2] Derived from many concepts that were later the focus of modernization theory, these arguments focus on how industrialization expanded national interests to include nonsecurity goals, such as the expansion and redistribution of wealth, and altered the domestic distribution of power by increasing political participation. These twin effects then promoted peace among states.

The distinctions between military and industrial societies are perhaps most clearly cast in the late nineteenth century writings of Herbert Spencer (1975). Military societies are centralized and hierarchically organized so as to meet their functional objective—to maintain their existence through conquest or the prevention of their own conquest. While the warriors or military class sit atop this hierarchy of social power, the activities and liberties of all other citizens are subordinated to supporting this group and preserving the collective. As individuals are distinguished by performance in battle, military conflict becomes a means to acquire status within society. Consequently, the proclivity toward war takes on a life of its own. To climb the social ladder, individuals need to participate in war. This demand for war as a means to distinction thereby creates an incentive to initiate conflict with other societies. Juxtaposed against the militant society, Spencer

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[2] The writings of such scholars as Jean-Baptiste Say, Herbert Spencer, Richard Cobden, August Comte, St. Simon, and Schumpeter exemplify this approach. For reviews of their arguments see Aron (1980), Cain (1979), Domke (1988), Doyle (1986, 1997), and Silberner (1946).

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argues that industrial societies possess many of the opposite tendencies.[3] Power is decentralized and individuals focus on providing the means for their own survival through productive activities. While society possesses greater individual liberties, the primary function of the state shifts from meeting external threats to meting out internal justice.

Industrialization provokes the transformation of societal organization and peace by changing the very nature of productive activity, which consequently alters the interests of individuals within society. Prior to industrialization, conquering other societies through war served as the only means of acquiring wealth. But industrialization and the capitalist organization of production created an opportunity for large portions of society not only to provide for their subsistence by specialization but also to accumulate wealth. This pursuit of individual wealth did not leave time for diversions of attention to war.[4]

Second, industrialization promoted peace by transforming the domestic balance of power. While status and power was conferred to warriors in militarist societies, the accumulation of wealth became a means to social ascendancy in industrial societies. This then eroded the traditional dominant position of the military and aristocracy. As the political influence of the bourgeoisie rose, it had no interest in foreign wars that would only serve to destroy its wealth. For example, Schumpeter (1951, 87-88) notes that

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[3] While Spencer's distinguishes between military and industrial societies, his arguments discussing the impetus behind the transition are less direct and thus less suggestive of a direct link between industrialization and war. For example, he notes (1975, 606-607) that the absence of military conflict eases the need for collective action that curtails individual liberties and instead allows individuals to focus on providing their own material needs. This logic suggests that peace may instead precede industrialization.
[4] Schumpeter (1951) refers to this as the rationalization of society.

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industrialization raised the demand for labor, which in turn increased this class's income and political power.

Despite these claims, the direct links between industrialization, modernization, domestic sociopolitical change, and conflict with other states remain murky and thus subject to contradictory tendencies. Instead of generating peace, Snyder (1991) notes how the timing of industrialization instead of simply industrialization itself can shape conflict in the international system. Late development tends to concentrate domestic interests, which support war and expansion. Similarly, in a critique of these links between industrialization and peace, Aron (1980) argues that industrialization can also be harnessed by militarist societies to magnify the scale of warfare such as that in World War I and World War II. Moreover, he notes (48-49) that industrialization and economic development ultimately begat two fundamentally opposed styles of organizing production—capitalism and socialism. Instead of promoting peace, the opposition between these systems provided the foundation for the Cold War.

Capitalism, Imperialism, and Conflict

While classical liberals generally hold that capitalism increases prosperity and expands individual liberty, Marxist scholarship takes a much more negative view of its consequences, particularly with respect to the outbreak of war in the international system. Instead of empowering the pacific elements of society, notably a business class, to restrain the state from pursuing an aggressive foreign policy, Marxist-Leninism locates the origins of war in this capitalist sector. As the capitalist system reproduces itself, greater portions of national wealth concentrate in the hands of a few leading holders of

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capital. This dominant domestic coalition then translates control over the forces of production into political influence and encourages policies of protectionism and expansionism, by military force if necessary, to acquire new sources of raw materials and cheap labor. More generally called imperialism, such policies culminate in war between those states with the most developed economies—the great powers.[5]

The classical writers on imperialism, including Luxemburg, Hilferding, Bukharin, and Lenin built on Marx's concentration on capitalist development within economies to examine how these pressures led to the global integration of economies outside of Western Europe.[6] Most of these arguments began from the same dynamic, namely the exploitation of labor by the holders of capital, to explain this expansion. Arguing that wages are set by the costs of subsistence and not labor's productivity, the owners of capital are able to generate a surplus from this divergence. A contradiction then emerges in such a system. By paying labor subsistence wages, the owners of capital constrain labor's ability to consume all the goods produced in an economy. Marked by periods of crisis due to underconsumption and limited investment, these pressures translate into a search for foreign outlets for both investment and unsold goods.

Many of these Marxist arguments, and those of a liberal, Hobson,[7] traced the sources of underconsumption to a series of financial changes across European economies

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[5] Etherington (1982) following on Stokes (1969) argues that classical scholars of imperialism, namely Bukharin, Hilferding, Hobson, Lenin, Luxemburg, Kautsky, and Schumpeter were principally concerned with war among the great powers at the turn of the twentieth century and not with explaining the preceding period of colonial expansion of such European countries as Great Britain and France into Africa and Asia.
[6] For a review of these works see Brewer (1990).
[7] While Hobson was both an activist and theorist for the Liberal party in Great Britain, his early arguments on imperialism were seized on by later Marxist writers to explain the rising great power tensions in the first decades of the twentieth century. However, he later changed his views and moved toward a more standard

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in the latter part of the nineteenth century. Hilferding (1981) noted that as most firms shifted from being owned by single individuals or families to multiple shareholders, the rise of joint stock companies allowed the wealthiest owners of capital to expand their control over smaller investors. Even though the largest capitalists no longer owned all of the capital in a firm, their majority control granted them authority over production decisions. As their ability to control large portions of financial capital increased, they were able to exert greater influence over industrial capital as well. At the center of all these developments, the largest banks actively encouraged the consolidation of industry as a way of minimizing lending risks. While competitive capitalism was marked by a separation between industrial and financial capital, the fusion of these two interests defined monopoly capitalism. Moreover, this centralization tended to feed on itself. Competitive industries were forced to consolidate as a defensive tactic to offset rising costs due to the consolidation in the rest of the domestic economy. The financial sector thus sat at the apex of a domestic economic structure that allowed them to control investment and productive decisions over consolidated industries.

This power then translated into political influence and support for a more aggressive foreign policy. To offset declining interest rates due to a surplus of savings and underconsumption in the home economy, the financial sector sought outlets for their excess capital, many times calling on the military power of the state to protect these investments abroad. Because the supply of foreign outlets was finite, the need for

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position liberal position, namely that interests that stood to gain from expanding international commerce, including finance, tended to support peace. For a review of the evolution of Hobson's ideas on imperialism see Cain (1978).

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military intervention increased as the competition among great powers to divide up the world intensified. Lenin, for example, argued that this competition among the leading capitalist states to secure colonial outlets caused World War I. Moreover, the financial class also encouraged other policies, such as protection, that also intensified conflict among states. While bolstering consolidation by preventing foreign competition in the domestic economy, protection also generated pressures to expand the size of the domestic market through expansion if necessary.

While these writers generally agreed that the trend toward consolidation and monopolization within domestic economies would produce international conflict, they disagreed over its inevitability and thus of the direct links between capitalism and war. Instead of ultimately ending in expansion, Hobson argued that state intervention to redistribute income could enhance the purchasing power of labor and reduce the need to seek foreign outlets for the problems of underconsumption. Kautsky (1970) argued that imperialism was not the necessary result of capitalist development but a deliberate policy choice. As the costs of subjugating colonial territories and arms races with other great powers increased, he argued that it would promote opposing domestic interests that could foster a compromise among the leading industrial powers. In this stage of ultraimperialism, capitalists would collude to divide up the rest of the world.[8] Lenin (1993) instead saw this consolidation and drive to seek out new markets as the inevitable

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[8] While this stage of ultraimperialism would be marked by peace among the great powers, Kautsky did not argue that war would be absent in the whole system. He expected the leading capitalist states to use force to extend their hold over economies in the periphery.

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product of capitalist development. These dynamics would ultimately end in war that would wipe the slate clean for a socialist revolution.

Contemporary Literature

Even though explorations of the links between capitalism and war have been relatively infrequent in contemporary scholarship, it would be a mistake to assert that concepts closely associated with capitalism have been entirely absent from the debate. For example, some maintain that the concept of interdependence defined in terms of extensive trading links between states indicates the presence of liberal institutions regulating the domestic economy. Empirical support for the lateral pressure thesis linking economic growth to the onset of international conflict suggests that capitalism may increase conflict to the extent that it correlates positively with growth (e.g. Choucri and North 1975; Pollins and Murrin 1999).[9] Other scholars focus on the interaction between democracy and such domestic economic characteristics as development and market-distorting rents to explain the origins of peace among democratic states (Brawley 1993; Mousseau 2000; Weede 1995, 1996). Rummel (1983) traces the sources of a pacific foreign policy to a more expansive definition of domestic freedom that includes private property and an exchange based economy in addition to free and competitive elections.

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[9] It is important to note that Choucri and North point out that the effects of lateral pressure on war are not entirely attributable to capitalism. They write, "The demands of a capitalist economy may contribute to lateral pressure in important ways, but capitalism is not a necessary condition for lateral pressure; both pre-capitalist and socialist societies may generate lateral pressure" (1975, 19).

While these arguments are suggestive of a link between capitalism and peace, both theoretically and empirically they provide an insufficient series of tests for the propositions that private property and competitive markets, the linchpins of a capitalist economy, promote peace. In this section, I briefly discuss two reasons why further exploration of the theoretical and empirical links between capitalism and conflict is necessary.

First, with respect to the outbreak of peace, capitalism is rarely afforded a causal role independent of democracy in recent work. Two primary links are generally posited. In the first, capitalism strengthens democratic constraints on foreign policy. For example, Mousseau (2000) argues that as economic behavior becomes regularized over time, norms based on trust and mutual respect for contractual obligations evolve within developed societies helping to resolve disputes through negotiation and compromise. These norms, in turn, support democratic consolidation and societal constraints on executive authority, which unchecked can lead to an aggressive foreign policy. Weede (1995, 1996) argues that the prosperity caused by capitalism leads to democratization, which in turn builds a zone of peace among democratic states. In the second variant, capitalism is instead endogenous to democracy. Brawley (1993) maintains that mercantilist policies associated with imperialism are much less likely to arise in democracies because all economic interests possess access to the political arena.[10] On the other hand, when the ability to capture rents become pervasive in a domestic political

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[10] These ideas find theoretical and empirical support in the recent arguments of Mansfield, Milner, and Rosendorf (2000) that link democracy to the reduction of barriers to international exchange.

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system, states are much more likely to pursue imperialism and eschew free trading strategies as domestic industries are less competitive in international markets.

What are the consequences of this inability to identify an independent effect of capitalism on conflict? Such a focus neglects potential mechanisms by which capitalism may shape the likelihood of conflict in the absence of democratic institutions; and it neglects potentially important sources of variation among democracies.[11] Consequently, these theories provide indeterminate predictions for two classes of states—democratic mercantilists and autocratic capitalists—that have often served as critical cases in the democratic peace debate. For example, many of the democratic states that confound liberal predictions by going to war have maintained important economic regulations restricting competition. Both France and Germany maintained conscription[12] and relatively high tariffs on imported goods prior to the outbreak of World War I.[13] Tariffs served as the primary source of government revenue in the United States, often accounting for more than 50 percent of total annual receipts, until the institution of an

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[11] Mousseau provides a potential exception to this shortcoming. His theory leads him to doubt whether democracy can inhibit conflict in the absence of market norms. He writes, "In the absence of the universal form of trust in the sanctity of contract, the model predicts no basis for the leaders of democracies without supplemental market economies to respect the rules and procedures of the democratic social contract" (2000, 480). However, his statistical evidence contradicts this theoretical claim. He later writes, "[w]e can safely conclude that democracy appears to have a significant pacifying impact among all democracies, rich and poor..." (ibid., 492). Weede offers a similar conclusion. He writes, "[t]he peace promoted by free trade in the long run is confined to stable and prosperous democracies" (Weede, 1996, 159).

[12] Marx and Engels argued that wage or free labor was one of the defining characteristics of capitalist systems. For a discussion of this classification of capitalism, see Gilpin (1987, 15-18).

[13] The classification of Germany as a democratic or an autocratic state has often served as a key point of disagreement in the democratic peace debate. For arguments that historically contingent definitions of democracy should lead to the classification of Germany as at least as democratic as either Britain or France in the period leading up to World War I see Layne (1996) and Oren (1996). Even Doyle (1983, 216), a prominent proponent of the democratic peace, admits that Germany in 1914 possessed many characteristics of a democratic regime.

income tax during World War I.[14] Up until it began a period of liberalization under Rao, India also relied heavily on tariffs to fund public policies.[15] A focus on these illiberal economic policies may shed some light on how these democratic regimes were able to adopt more aggressive foreign policies and bypass electoral constraints on the path to war.

The inability to predict the behavior of capitalist "autocracies" is an important oversight in light of recent historical developments in East Asia and Latin America where economic liberalization has preceded democratization.[16] Solingen (1998) argues that the democratic peace hypothesis offers little explanatory leverage in some of these cases, particularly in Latin America.[17] Moreover, for these cases, the broader body of work on the liberal peace offers contradictory hypotheses. On the one hand, the absence of democratic institutions suggests that these states should be more conflict-prone. On the other hand, the commercial liberal hypothesis suggests that their increasing integration in the global economy should leave them more likely to pursue pacific foreign policies. Assessing the degree of capitalism or the extent of economic liberalization in autocratic states provides an opportunity to reconcile these competing claims and offer insight into

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[14] For data on customs revenue as a proportion of total government revenue in the United States see Mitchell (1998b, 680-688).

[15] For the components of central government revenues in India, see Mitchell (1998a, 916). For an application of the democratic peace hypothesis to the Indo-Pakistani rivalry see Ganguly (1997).

[16] Examples of states that have pursued economic reforms prior to or in the absence of political reforms include Chile, China, Singapore, Taiwan, South Korea, Malaysia, Indonesia, and Thailand. For a discussion of the East Asian cases see Campos and Root (1996).

[17] See especially chapter 4. With respect to the emergence of security cooperation in the Southern cone, she writes, "Democracy, but more so the market, weakened the military and its associated complex to an extent never before seen in the political cycles of the last five decades. The advent of democracy in itself failed to bring about these dramatic changes...Clearly, a changed domestic political status for the military had favorable implications regionally" (Solingen, 1998, 161).

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the foreign policy of a fairly large population of states in the current international system.[18]

Second, studies of economic links between war and peace frequently conceptualize the outbreak of conflict solely in economic terms. In this light, the state itself either assesses the relative economic costs and benefits of war versus alternative policies or it simply aggregates the competing interests of society that are instead derived from these same economic calculations. States adopt imperialist policies that have a tendency to culminate in war to acquire productive resources their society needs for survival. Peace emerges among states as the costs of going to war increase and the benefits of adopting trading strategies increase (e.g. Rosecrance, 1986).[19] Alternatively, Brawley (1993) asserts that as democracies reduce market-perverting policies, they reduce the domestic power of noncompetitive interest groups likely to favor imperial expansion instead of free trading strategies. By adopting pluralist conceptions of state-society relations, such approaches neglect the possibility that states possess a variety of interests other economic gain, which also shape the decision for war.

Economic regulations that restrict competition generally have the state's approval and are instituted as part of a broader effort by a ruling coalition to remain in power. The state's unique monopoly over the legitimate use of violence grants it the ultimate capacity to define and enforce the rules of economic exchange. Consequently, the state can

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[18] This need to expand the range of domestic institutional variation within autocracies is even more important in light of recent evidence for a separate peace among different types of autocratic regimes (Peceny, Beer, and Sanchez-Terry, 2002).

[19] While tangential to the argument offered here, this theoretical mechanism also suffers from an inability to identify the independent role of trade on peace. In this framework, peace could result either from an expansion of trade or a dramatic increase in the costs of war, such as the introduction of nuclear weapons.

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manipulate this power and privilege certain economic sectors through the sale of regulations, such as tariffs, that restrict competition and reduce the level of capitalism in an economy to generate public revenues and political support (e.g. Ekelund and Tollison, 1981, 1997; Grossman and Helpman, 1994). The creation and protection of domestic groups that favor imperialism and push a state to war can emerge as the byproduct of the state's effort to remain its hold on domestic power (Schumpeter, 1951; Snyder, 1991; Solingen 1998). This possibility suggests that an understanding of how such regulations shape the decision for conflict must take into account the nesting of such policies within the broader process of coalition building among competing domestic groups and the state. War is not necessarily driven solely by economic goals of wealth maximization. It can also occur as part of a broader effort by governments to increase their political control over both their domestic society and other international actors.

To deal with these concerns, the following section lays out a series of mechanisms drawn from classical liberal theory and neo-institutional economics by which capitalism tends to promote peace among states. Relying on quantitative and qualitative evidence, the empirical chapters then test these hypotheses by adopting indicators of the institutions of capitalism, including variation in property rights regimes, the competitiveness of domestic markets, and the types of wealth predominantly found in capitalist economies. While the quantitative analysis affords the opportunity to statistically control for and disentangle the effects of capitalism and democracy on conflict, the qualitative section focuses on what has been perhaps the most problematic case for liberal IR theory--the outbreak of World War I.

GETTING FROM ECONOMIC STRUCTURE TO WAR

The Fundamental Problem of Mobilization

Because governments do not own all of the productive resources contained within a state's geographic boundaries, their ability to conduct foreign policy in service of national interests depends on their capacity to draw on the wealth of or simply tax private actors. The dynamics of resource mobilization, or the long-term process of transferring societal resources from the private sector to the public sector for the purposes of grand strategy and national defense, provides the crucial link between economic structure and a state's decision to use military force.[20] As a state's ability to draw on the wealth of its society increases, it should have more freedom to extend its authority in both the domestic and international environments. Margaret Levi writes:

> One major limitation on rule is revenue, the income of the government. The greater the revenue of the state, the more possible it is to extend rule. Revenue enhances the ability of rulers to elaborate the institutions of the state, to bring more people within the domain of those institutions, and to increase the number and variety of collective goods provided through the state (1988, 2).

The terms by which the state gains access to private resources necessarily places domestic interests, coalitions, and institutions that regulate this bargaining process at the center of explanations international or systemic behavior.[21] Fareed Zakaria writes of this

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[20] The explicit mention of long-term dynamics is incorporated here to distinguish such a set of policies that require the transfer of resources from the society to the state. I do not want to confuse this process with the act of placing a military on high alert or calling up reserves, as was the case during the July 1914 crisis. This latter usage simply refers to the rapid utilization of resources already "owned" by the state.

[21] The revival of interest in the domestic politics of international relations has helped facilitate a series of studies examining how mobilizational capacity plays a crucial role in a number of central dependent

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domestic determinant of national power, "Statesmen, not nations confront the international system, and they have access to only that fraction of national power that the state apparatus can extract for its purposes" (1998, 35). Michael Barnett concurs, "[s]ecurity is itself two-faced: it is concerned with the construction of strategies vis-à-vis foreign threats and with the construction of strategies for mobilizing societal resources as well" (1990, 534).

Ultimately states face two options while attempting to secure this transfer of private resources. First, they can choose to rely on the coercive power of the state and simply seize the assets. However, this strategy is not without its costs. A long literature in economics recognizes why it is rational for leaders to privatize resources and then commit not to seize these assets in the future (e.g. Smith, 1937, book 3; North 1981). Through promising to regularize and limit their seizure by taxing only a portion of the returns that accrue to such resources, leaders can stimulate investment and increase total national production. On the other hand, repeated seizure of assets and violation of commitments to respect private property ultimately impede long-term economic growth and weaken a ruler's foundation for national power. Perhaps more significantly, the expropriation of private assets restricts consumption and often provokes societal opposition to the government's rule.

Governments alternatively can choose to enter into a contractual relationship with private actors whereby the latter turns over a portion of its wealth in exchange for the

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variables in the field including alliance decisions (Barnett, 1990; Barnett and Levy 1994; Morrow 1993), victory in war and arms races (D'Lugo and Rogowski 1993; Schultz and Weingast 1998), great power expansion (Zakaria 1998), and the decision to pursue conciliatory policies or go to war (Maoz and Russett 1993; Rowe 1999, 2001).

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provision of public goods such as a functioning domestic legal system and protection from external threats. Despite society's demand for these goods, their public nature creates distributional conflict among different actors in society. Even though all citizens receive the benefits of these public goods, the costliness of restricting any member's consumption creates a free-riding problem (Olson, 1965). All individuals prefer that they be exempted from paying for the good and receive its benefits for free while the other members of society contribute to its production. Under these conditions, the good tends not to be provided or rather a centralized state fails to form. Alternatively, when a centralized state does form, it must rely on a blend of coercion and particularized benefits that generate sufficient resources to provide such public goods.[22] Likely to alter the distribution of income with society, such policies may also carry spillover effects that serve to isolate and punish potential opposition to the government's authority. Conflicting interests within society over the nature of public goods provision thus generate opportunities for the state to build supportive coalitions and remain in power.

Given this bargaining problem created by divergent interests within society and between private actors and the state, the structure of domestic institutions plays a crucial role in aggregating these interests and determining the extent to which private actors will surrender resources to the state for public policies. The international relations literature traditionally relied on the concept of state autonomy or state strength first developed in the comparative politics literature to characterize this bargaining relationship. As states

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[22] For example, Bueno de Mesquita et al (1999) construct a general model of war that focuses on the divergence between particularistic benefits provided by the state to members of its coalition and public goods provided to all members of polity. Tilly (1990) discusses this blend between carrots and sticks as the capitalized-coercion mode of state formation.

grow more autonomous from societal pressures, they are more able to mobilize more resources from society. Greater autonomy pushes foreign policy outputs closer to the ideal preferences of the state, often defined in terms of influence over actors in the international system, and further from the particularistic interests within society. A number of variables have been cited as contributing to the "relative strength" of either the state or society.[23] The centralization of state authority marked by the absence competition among branches of government tends to enhance state strength relative to society. Insulation from multiple and competing societal pressures generated by large selectorates or bureaucratic isolation allows the state to focus on the "national interest" and increases its strength over society. An expansion in the scope of state authority increases state strength by providing it with more policy instruments by which to influence society. As the structure of society becomes less cohesive and unable to overcome the collective action problem, state strength is likely to increase as well.

An Alternative Approach

Another way to conceptualize this exchange relationship between the state and private actors to provide military security from external threats can be built by drawing on the conceptual tools of neo institutional economics (e.g. North 1981; Eggertsson 1990). Relying on the rudiments of price theory, this exchange or contract can be seen as an example of a more general principle-agent problem. The principal (society) hires an agent (the state) to supply a public good that private actors are incapable of supplying

[23] Examples from this literature include Krasner (1978, 1984), Katzenstein (1977), Rogowski (1987), Ikenberry, Lake, and Mastanduno (1988, 1989), Migdal, (1988), Barnett (1990), Mansfield and Busch (1995), Desch (1996), and Zakaria (1998).

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themselves. Drawing on Weber's (Gerth and Mill 1958, 78) classic definition, I simply refer to the state as a subset of individuals that possess a monopoly on the legitimate means of coercive authority over all other members within a territorial unit. Its primary interest is to remain in power domestically. To this end, the state must build a supportive coalition composed of both its own agents such as the military or the administrative bureaucracy--responsible for enforcing its laws and collecting taxes--and subsets of society that at a minimum refrain from opposing its rule and at a maximum actively seek to limit the political influence of opposing groups. Unless this coalition possesses a set of interests that are perfectly congruent with the policies employed by the state, the latter offers its supportive coalition a set of private benefits such as a reduced taxation levels in addition to such public goods as order and external security to remain in power.

Society is composed of a number of groups, often possessing highly divergent interests. Because of the difficulties of collective action, individuals within society need a centralized authority structure capable of delineating and enforcing the rules of exchange so that they can reap the gains of specialization and the division of labor. However, by ceding such powers to the leviathan, society necessarily grants the state the capacity to extend this authority and abuse these privileges. In order to realize their own goals, individuals also seek to place limits on the state's ability to abuse its authority.

The structure of this relationship between state and society is determined largely by the unique nature of supplying a good, defined here as military protection from external threats. The absence of multiple suppliers of coercive authority in society begets a monopoly position to the state. By restricting output, the state can alter the price of a

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unit of security. This can be seen in Figure 3.1. In this standard diagram of monopoly market structure, the price of a good is reflected by the vertical (Y) axis, while the horizontal (X) axis reflects the quantity of military security supplied. Determined largely by societal preferences, societal income, and the availability of substitute producers of security, the demand for military security is reflected in the downward sloping curve labeled D.[24] This demand curve is the aggregation of all the individual demand curves for each member of society.

The costs incurred by the state to supply this good is reflected in the marginal cost curve, labeled MC. The marginal cost curve indicates the costs the state must pay to produce each additional unit of a good. While originally sloping downward to reflect the declining proportion of fixed cost expenditures in the production of a single unit of security, its slope eventually becomes positive and continues to increase. The state's production decision is reflected by the intersection of the marginal cost curve and its marginal revenue curve (MR), defined as the additional revenue received by the state for producing an additional unit of output. The state will continue to produce more units of security until the cost of the most recently constructed unit exceeds the marginal revenue generated by the sale of the final good.

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[24] The downward slope of the demand curve thus assumes that external security is subject to the law of demand, namely that the quantity demanded will decrease as the price increases. While the demand for security is often inelastic (not very responsive to changes in price), the possibilities of exiting from a government by overthrowing a ruler or moving to another territory suggest that substitutes do exist, even though costly.

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The state's cost functions reflect both input prices and its production techniques.[25] Because the state does not own all resources within an economy, it must induce private actors to allow their property to serve as an input into the production of national defense. In other words, the state must purchase the inputs to national defense. Included in its total costs are the prices commanded by the factors of production within markets, the quantity of resources the state must mobilize from society to produce security, and the infrastructural costs incurred to establish an administrative bureaucracy capable of collecting taxes and more generally managing the productive decisions of the firm.

The demand curve reflects a crucial dynamic of the market for security. Because the state is the sole producer of military security within the polity, the market for this good closely approximates a monopolistic structure. Rather than facing a completely horizontal demand curve in which any change in output by the state would not alter the price of a unit of security, the state's output decision shapes the price of security. By restricting output, the state can raise prices above the levels produced by a market in which a number of producers supply these goods. Accordingly, the state can extract a rent or supernormal profit that does not exist in competitive markets from supplying security from external threats to its society (e.g. Tullock 1980).

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[25] For the rest of this exercise, I will hold production techniques constant. Given my focus on how the institutions of capitalism alter rent-seeking abilities of the state and its conflict propensities, some may object to this choice because capitalism tends to reward efficiency and punish any reluctance to adapt. Thus capitalism's productive efficiency may reward it by building a more effective or qualitatively better war machine. An alternative view, which focuses on the ability of command economies to focus all production on defense-related goals, suggests this may not be the case. Even though a number of inefficiencies in the command style of the Soviet economy introduced significant problems in the quality of production, centralized control allowed the Soviet state to divert goods of the highest quality into the defense sector while inferior goods were left for consumption. For a discussion of the issues of production quality with respect to the defense sector in the Soviet Union see Gaddy (1996, 40-43).

I conceptualize rents as a political asset that can be used both internally and externally as a means of serving the state's ultimate goal: to remain in office. If secure in office, rents can be retained by members of the ruling coalition so as to increase their personal income. Alternatively, facing challenges to their domestic position, rents can be diverted either to coopt or punish societal groups outside the ruling coalition. Larger rents accordingly facilitate a government's efforts to remain in power. As its rents increase, the state can afford to expend more resources on the tools of coercion to disband opposition or increase side payments to opposition groups, in effect increasing the size of its supportive coalition. Additionally, if a government is secure domestically, its leaders can also choose to invest these profits in its military so as to facilitate the conquest of other societies. Enhanced possibilities of conquest offer the opportunity to replace other governments as monopoly suppliers of security and extract more rents. Thus, larger rents signify not only a regime whose domestic position is secure, but also a regime possessing more autonomy to pursue expansionist policies abroad. In Figure 3.1, the size of the political rent is determined by the box created by connecting points A,B,C, and D.

Systemic pressures enter this model through shifts in the demand curve. As the international environment becomes more threatening i.e. as other states begin to balance or increase their military spending, we should expect that society's demand curve for security shifts outward. At each quantity of security provided by the state, private actors are willing to pay higher prices in a more threatening international environment. For example, students of the arms race on land prior to World War I (e.g. Krumreich 1984; Herrmann 1996; Stevenson 1996) point to the important role played by the action-

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reaction dynamic of increasing levels of defense spending. Increasingly large military outlays in rival states increased perceptions of external threat and eased domestic constraints on longer terms of conscription and greater armaments spending. Tilly (1990 esp. ch. 3) argues that war helped to create the modern state by generating the demand and willingness to pay the state for this service. Desch (1996) suggests that peaceful environments tend to decrease the cohesion and thus the extractive capacity of the state. Christensen (1996) argues that the decline in international threat immediately after World War II forced American leaders to overexaggerate the threat posed by the Chinese revolution in 1949 so as to reduce the difficulties of mobilizing resources for defense from a war-weary population.

The tendency for threats from the international environment to shift the demand curve to the right along with the existence of supernormal profits for providing security together illustrate the basic classical liberal insight about war. As the demand for security increases, the state's rent will increase, *ceteris paribus*. Even if war is costly in terms of destroying productive resources, the state can redistribute these costs away from itself and its domestic allies. In short, just as the classical liberals argued, the intense game of rivalry and competition in the anarchic international order provides domestic benefits to governments that enhance their ability to remain in power.[26]

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[26] The tendency for rent-seeking on the part of states to lead to an increased probability of war can also be illustrated through the logic of the security dilemma. The desire for states to increase their rents can lead them to encourage another state to behave aggressively toward them so as to increase their society's demand for security. Unless the other state recognizes these goading invitations as primarily aimed at the domestic audience, they may feel threatened and set off a spiral of hostility that culminates in war. But it is important to note that here the difference between rent-seeking, derived from each state's monopoly on the production of security, and the size of rents, which I will shortly argue to be the product of domestic

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Most importantly, the size of these rents captured by the state provides the crucial link between the state's role as monopoly producer of security from external threats and the origins of war with another state. Larger rents make war more likely by enhancing a government's ability to counter domestic opposition that builds as the costs of preparing for and sustaining the war effort increase. Rents can be used in one of two fashions. States can choose to enhance the size of their supportive coalition by coopting certain opposition groups thereby enhancing the size of its supportive coalition (the carrot approach). Alternatively, a government can choose to maintain the size of its supportive coalition and simply increase the resources it spends on internal policing and disband any opposition through coercion (the stick approach). Lower rents decrease the available resources to the state and limit its ability to make side payments that are sometimes necessary to build supportive coalitions and sustain an unpopular policy, such as war.

Second, apart from enhancing a domestic regime's ability to remain in power, these rents also become an asset over which states compete. If a state's domestic hold on power is secure, these rents can instead be invested in resources for conquest to capture the rents received by neighboring regimes from their own domestic societies. Larger domestic rents allow a government to enhance military spending and increase the probability of successfully conquering another state. Greater expectations of victory in war make the outbreak of military conflict more likely.

Lake (1992) argues that the costs of monitoring and punishing the state for its rent-seeking activities help explain why democracies are less likely to go to war with

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institutional variation. In this case, the source of war is rent-seeking that is endemic to all states and not the

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each other. Arguing that greater rents encourage states to pursue imperial expansion, democracies contain mechanisms to limit these supernormal profits and offset these pressures thereby promoting peace. Competitive elections reduce the costs of political participation and substantiate society's threat to remove politicians from office if their rent-extraction activities become too excessive. Society can also punish the state through exit or political emigration by depleting the resource base of the state.

These arguments draw on Hirschman's (1970) differentiation between voice and exit as the most basic manifestations of political and economic behavior. Voice is simply interest articulation or the expression of dissent or support for a public policy. Regular and competitive elections serve as the primary vehicle for conveying these opinions and ensuring that an organization is responsive to the demands of the groups it serves. Exit induces change in organizational behavior in a different fashion. Organizations reform themselves after observing customer dissatisfaction through the latter's pursuit of alternative suppliers of a good. Hirschman writes, "[a]ny recovery on the part of the declining firm comes by courtesy of the Invisible Hand, as an unintended by-product of the customer's decision to shift" (1970, 16). Fundamentally shaped by the existence of choice, exit is the most basic manifestation of the competitive process at work.

Yet Lake's application of these conceptual tools to this more general problem of war and the liberal peace still requires two amendments. First, by focusing on emigration as the primary expression of exit, he only explores one input or factor in the basic

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size of the rents.

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production process.[27] The labor and human capital lost due to political emigration only partially constitute the resource base of a state that also includes large components of industrial and financial capital. Recent scholarship has noted how capital mobility can constrain both domestic economic policy and military conflict with other states.[28] Classical liberal theorists argued that a dependence on mobile wealth would pacify foreign policy.[29]

Second, productive resources do not need to leave a set of territorial boundaries to constrain the foreign policy of a state. Like any other public policy, war consumes scarce resources in an economy. States need industrial and financial capital to build armaments and a ready supply of labor to utilize these instruments of war. The "exit" of assets from the public economy to the private sector also constrains the ability of the state to prepare for war by allowing markets rather than the central authority of the state to allocate scarce societal resources. The state must then compete with the private sector to secure the right to control these resources. If a government is not willing to pay market prices, the holder of that resource can simply seek higher returns elsewhere in the private economy. However, if the state chooses to expropriate societal resources in preparation for war, it risks undermining the credible commitment to protect private property that is crucial for long-term economic growth.[30] Either scenario suggests that the widespread presence of

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[27] It should be noted that Lake also suggests that territorial secession is also a form of political exit.
[28] For a review of how capital mobility constrains domestic economic policy see Goodman and Pauly (1993). On the relationship to conflict behavior, see Gartzke, Li, and Boehmer (2001).
[29] For a review of this literature see Hirschman (1997).
[30] For the theoretical explanations of the argument linking credible commitments to private property and growth see North (1981). For some examples of empirical work supporting this proposition see Knack and Keefer (1995, 1997) and Barro (1997).

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private property in an economy raises the costs paid by the state to mobilize societal resources for war.

Integrating these critiques allows the introduction of the institutions of capitalism into principle-agent models of international conflict. The crucial intervening variables between such market-based constraints and war are the domestic institutions that regulate conflicting interests among societal and state actors and help determine both the state's and a potential conqueror's capacity to mobilize private resources for national defense. While the literature on the domestic sources of war has traditionally focused on such variables as democracy, bureaucratic autonomy, and societal cohesion to understand this institutional relationship, I argue that four characteristics of the domestic economy, which also serve as the defining institutional characteristics of capitalism, condition this mobilization problem as well. These traits are a credible commitment made by the state to protect private property, the quantity of private property within an economy, the extent to which competitive prices rather than bureaucratic authority allocates scarce societal resources, and the dominant types of wealth in an economy.[31] Next, I turn to a discussion of how these institutions alter the framework of state-society relations just constructed.

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[31] I would like to add a fifth characteristic but this instead will be saved for future work. This is the degree of competition among states to provide secure property rights regimes. Based on the tools discussed so far, I hypothesize that as the number of states capable of providing this commitment increases, the price that any one state can charge for supply this good necessary decreases (this is reflected in a shift in the slope of the demand curve). In other words, as the number of producers of public goods such as stable property rights increases, the rents of all states should decrease. Consequently, this could provide another mechanism whereby globalization promotes peace. Additionally, it could also serve to distinguish today's era of globalization to that which preceded World War I.

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THE INSTITUTIONS OF THE INVISIBLE HAND

Private Property: Commitment and Scope

The state must make credible commitments to protect private property to encourage productive investment necessary for long run economic growth. Combined with realist theories of international relations asserting a long-run congruence between a state's wealth and its power, these arguments suggest that credible commitments to respect private property should increase a state's military power.[32] As an economy grows larger, the state should be able to harness an expanding pie of societal resources to extend its influence in the international system.

Yet these arguments neglect the fundamental nature of these commitments by the state. To be credible, they must provide a guarantee to the holders of private assets that a state will suffer penalties if it expropriates these assets. When states recognize private property, they simultaneously cede their authority over how these assets might be allocated. In terms of preparing for war, this relinquishment of authority is a tacit acknowledgement that the state must compete with other firms or private actors to secure the right to control the terms by which an asset is used. Consequently, holding all else equal, credible commitments to protect private property necessarily raise the state's costs of expropriating assets to prepare for war.

Contemporary studies of the mobilization problem acknowledge this fundamental tension faced by states between creating the necessary institutional infrastructure to

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[32] The classic statement on the long-run complementarity is Viner (1948). Interestingly, in addition to realist scholars, a number of contemporary liberal scholars make this claim as well. For a critical review of this assumption see Rowe and McDonald (2001).

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support economic growth and maintaining the capacity to utilize these resources for foreign policy. Differentiating between mobilization--the state's attempts to stimulate economic growth through such measures as creating more efficient property rights--and extraction--or the seizure of wealth from society--, Mastanduno, Lake, and Ikenberry (1989, 462-463) note that the tradeoffs between these strategies shape a state's ability to meet its international goals. While necessary to purchase military resources, extraction undermines the incentives for investment and generates substantial costs by reducing the present and future economic potential of a state. When implementing strategies to prepare for war, Barnett (1990, 538) argues that the state must respect the interests of the capitalist class because of the latter's responsibility in generating long-run economic growth, society's consumption policies, and the state's tax base. As positive assessments of government performance often hinge on the ability of business and the interests of capital to supply goods such as employment and growth, a government must protect the interests of these groups and respect its commitment to protect private property (e. g. Lindblom 1977, Block 1977, Przeworski and Wallerstein, 1988). Often, policies that might threaten business profits, such as expropriating private assets, do not even find their way to the public agenda.[33] Because business interests are in a better position to

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[33] Charles Lindblom (1977, 172) writes, "In short, in any private enterprise system, a large category of major decisions is turned over to businessmen...They are taken off the agenda of government. Businessmen thus become a kind of public official and exercise what, on a broad view of their role, are public functions. The significant logical consequence of this for polyarchy is that a broad area of public decision making is removed from polyarchal control...Businessmen generally and corporate executives in particular take a privileged role in government that is, it seems reasonable to say, unmatched by any leadership group other than government officials themselves."

lobby against policies that threaten their interests,[34] increasing levels of taxation, whether in the form a direct tax or the expropriation of societal resources, that are part of the mobilization process for war may consequently provoke the opposition of this privileged domestic interest and increase the state's difficulties in mobilizing societal resources for war.[35]

In short, the pursuit of wealth and power on the part of states often conflict. The costs of expropriating societal assets increase as the state's commitment to respect private property becomes more credible. By serving as a promise to an important constituency in the domestic polity, namely business, to protect or not seize its wealth, credible commitments to protect private property shrink the pool of resources or components of society upon which the state can rely to fund its war machine. Consequently, the state faces a series of more costly options once this commitment has been made. It can choose to suffer the costs of revoking such a promise measured in terms of damage to long-term investment and business confidence. Or it can choose to offer side payments to this constituency for its support that can include tax breaks or the payment of market prices for their assets. Either way, a commitment to suffer some punishment following the expropriation of private assets forces the state to pay higher costs for the inputs in the production of this security and reduces the rents that accrue to a state for supplying it.

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[34] For an argument that links the growing capacity of business interests to lobby for peace as exposure to international markets increases see Domke (1988, 46-51).

[35] This is not to say that there are not any businesses, which profit from war. These industries, such as armaments manufacturers, are likely to support aggressive foreign policies. The crucial distinction, to be discussed shortly, lays in the dependence of business on the state for protecting property rights, which can include preventing entry so as to create noncompetitive market structures, and providing regular sources of demand for industrial goods. As the dependence of business on any one state for these services decreases, I

These dynamics can be reflected in an upward shift in the marginal cost curve shown in

Figure 3.2[36] and suggests the following hypothesis:

H1: As a state's commitment to respect private property becomes more credible, that state should be less likely to become involved in a conflict.

In addition to this initial commitment made by the state to respect private property, property rights regimes also differ according to the relative distribution of private and public assets in an economy. The quantity or scope of private property in an economy determines the size of the mobilization effort that the state must undertake to go to war. If a state owns all of the resources within an economy, it can simply shift resources to the defense sector, as the manager of a firm may adjust budget priorities in favor of some activities over others.[37] In this light, public property can serve as a revenue

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argue that business is much more likely to oppose any policy, most importantly war, which carries heightened risks that assets will be seized or new market opportunities will be shut off from future pursuit.
[36] Additionally, the quantity of external security supplied decreases from q* to q*'. Assuming that the quality of security is held constant, this suggests that the state must retrench from its international commitments (if the quality of security is not held constant, a state may attempt to provide security over the same territory or populace with fewer resources. Consequently, it would appear overstretched and look weak, potentially inviting challenges from adversaries). This retrenchment can also provide another means by which any institution that increases the marginal costs of security increases the prospects for peace. By minimizing interests that states are willing to protect abroad, retrenchment reduces the potential for conflicts of interests with other states. Garfinkel (1994) makes a similar argument to explain the democratic peace. She argues that the election uncertainty inherent to the competition among political parties in democracies creates a negative bias on defense spending. Conceptualizing defense spending as a costly insurance policy that allows states to acquire greater quantities of global resources at the cost of current consumption, democratic leaders are less willing to sacrifice current consumption for future benefits that they may not capture if removed from power. This bias then may serve as a device whereby democracies can commit to reduced defense expenditures so as not to threaten other states. Her argument suggests that other mechanisms capable of reducing defense expenditures may also reduce conflict among states. By raising the costs of building the war machine, credible commitments to protect private property may provide one such signal.
[37] It would be wrong to assert that the state does not suffer some set of opportunity costs by moving public industries from civilian to military production. However, I think it is fair to assume that these opportunity costs are less than the costs that would be incurred by maintaining civilian production in public industries and then purchasing additional assets to augment defense industries from the private sector. Moreover, this assumption finds support in recognizing that publicly owned firms are "political firms" and thus do not possess the same utility function as privately held firms. Along these lines, the state is less concerned

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source for the state that is acquired independently of societal oversight. Privatization necessarily reduces the amount of resources owned by the state. As public property decreases, the state must undertake a broader mobilization effort and run greater risks of alienating societal support as consumption is sacrificed to prepare for war.

A number of authors have noted how the state's bargaining position vis-à-vis society is strengthened when it does not rely on the wealth of private citizens within its polity to fund public policies such as war. For example, Barnett (1990) writes:

> Because the state is institutionally separated from organized production, it does not produce its own source of revenue. Therefore, all state managers must be attentive to and are constrained by the flow of resources upon which the deployment of the state's means depends. The state's ability either to develop alternative sources of financial means or to loosen its dependence on the capitalist class substantially increases its autonomy (538).

Kiser (1986/87) argues that relative distribution of resources between public and private actors is the crucial determinant of state autonomy. Examining the absolutist era in European history, he notes that an expansion in public property increased the independence of monarchs in formulating policy. As monarchs simply did not need to call parliaments into session to approve new taxation policies, both the landed aristocracy and the rising merchant class that populated these legislative bodies were deprived of opportunities for political influence created by threatening to withhold their financial support.[38] States that rely heavily on natural resource endowments, such as oil and minerals, are often able to derive substantial revenues from these assets and avoid

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about the relative profitability of military versus civilian production while it pursues other goals like maximizing employment.

[38] He examines how the Reformation allowed the Tudors, and in particular Henry VIII, to confiscate church lands. These church lands then reduced the monarch's dependence on parliament to appropriate funds.

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societal resistance and the demands for accountability following from the imposition of taxes.[39] Levi (1988, 19) echoes the logic of these arguments by noting the relative bargaining power of a ruler attempting to raise revenue is enhanced as its dependence on the economic resources of its constituents is reduced. Examining the Cold War, Weede (1996) argues that the United States was able to shift some of the burdens of hegemony away from its own citizens and onto other states because the dollar was the primary reserve currency in the international economy. By getting its allies to accept overvalued dollars prior to the closing of the dollar window, the U.S. in effect imposed an inflation tax on holders of the dollar around the world.[40] In short, the ability of the state to rely on sources of wealth that its citizenry does not own increases the state's autonomy or mobilizational capacity.

In light of these arguments, an expansion in state-owned assets can serve as an independent source of finance and reduce the state's need to rely on revenue from its own society to fund public policies such as war. This fiscal independence limits its production costs for security. Greater quantities of public property reduce the quantity of privately held assets that need to be purchased as inputs into the production process. In terms of the basic model presented above, this is perhaps best reflected by a downward shift in the state's total cost curve in Figure 3.3. As total input costs reflect both the price and quantity of resources purchased from society, these costs will necessarily decline as the

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Kiser also characterizes Henry VIII as the most violent, in terms of fighting wars, of the English monarchs and correlates this war propensity with the autonomy created by confiscated church property.

[39] These are the some of the general conclusions from the literature on the 'rentier' state, which has traditionally focused on how substantial natural resources decrease the likelihood of democratization. For a recent review of this literature, see Ross (2001). For an argument that links the rentier state to the problem of war in the Middle East see Anderson (1995).

state purchases fewer private assets to produce the same quantity of security from external threats. More importantly, while holding the demand for military protection constant, these lower costs translate into greater profits, defined as the difference between total revenues and total costs for a given quantity of production.[41] These shifts thus suggest a direct relationship between private property and conflict:

H2a: As the quantity of public property in an economy increases, a state becomes more likely to be engaged in military conflict.
H2b: As the quantity of private property in an economic increases, a state becomes less likely to be engaged in a military conflict.

Allocation Through Competition or Authority?

A second defining element of capitalist systems that also determines the state's mobilizational capacity draws on the extent to which competitive prices or bureaucratic authorities determine the allocation of scarce societal resources. Market structure shapes the state's capacity to capture rents while providing security in two ways. The first focuses on the state as a market maker; the second on the state's role as a consumer in the domestic economy.

Because the state possesses a monopoly on coercion and the consequent ability to define the basic structure of property rights, and in particular monopoly rights, it also possesses the capacity to restrict entry into domestic markets and regulate the terms of exchange between buyers and sellers. This function creates two opportunities for the

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[40] Weede (1996, 166, fn 1) cites Mayer (1991) as also making this argument.
[41] In terms of Figure 3.3, the profits received at the initial total cost curve equal the total costs reflected at B subtracted from the total revenues at A. An increase in public property, reflected in the downward shift of the total cost curve, increases profits to the difference between A and C. The state's highest profits are achieved at a quantity of output that maximizes the difference between its total revenue and total cost curves. This point occurs when the slope of the total cost curve equals the slope of the total revenue curve.

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state to sell these rights in exchange for revenue. The first follows from the willingness of industries to pay the state either through direct payments or campaign contributions that strengthen the government's support coalition (e.g. Stigler, 1971; Grossman and Helpman, 1994) for the right to gain privileged access to markets. For example, Ekelund and Tollison (1981, 1997) argue that an important source of revenue that funded European wars of the seventeenth and eighteenth centuries was the sale of monopoly rights within domestic economies.[42] Second, because entry into markets is often restricted by the imposition of a tax, governments derive revenues by collecting those taxes from domestic groups that are hurt by such regulations. As shown in Table 2.1, prior to World War I, many governments relied heavily on tariff revenues to fund public policy. In Germany and the United States, tariff revenues made up at least forty percent of total avenue revenues for much of the nineteenth century. In short, governments can generate revenues and political support by restricting competition within their domestic economies. However, as markets become more competitive, the state also surrenders the capacity to extract these rents.

This ability to extract revenue from protected industries can also be seen in another light. The sale of economic regulation by a state is unique in that this asset or property right—the right to sell goods at noncompetitive prices—is not transferable to another economy or regulatory regime. In the language of transaction cost economics, such a right can be regarded as a specific asset (e.g. Williamson, 1985). If a firm wishes

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[42] Between 1662 and 1683, over half of the French government's revenues came from granting monopoly privileges (Ekelund and Tollison 1997, 5). For another argument that stresses how the French state prior to the revolution was largely dependent on market intervention for revenue that consequently shaped decisions for war see Root (1994).

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to locate to another economy, it necessarily loses this right and must repurchase it from another government. Levi (1988, 37) recognizes this aspect of regulatory assets by noting that the relative bargaining position of the state vis-à-vis these sectors will increase as producers become dependent on the government for tariff protection and regulated factor markets. Consequently, we should expect that noncompetitive industries relying on the state for either subsidies or protection are more likely to support its general set of policies including the decision for war, fearing that these particularistic benefits might be withdrawn.[43]

In terms of the general model under discussion, this increasing reliance of producers on the state is reflected in an outward shift in the demand curve for security for the members of the protected economic sectors. As it grows more costly to move production to another state, the cost of substitute producers of military security increases as well. Seen in Figure 3.4, this outward shift also increases the rents that the state captures for producing security.[44]

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[43] Moreover, by conceptualizing economic regulations, like tariffs, as a good that is sold by the state to domestic groups in exchange for revenue, this approach suggests the conditions under which a powerful domestic constituency—big business—supports war or peace. Marxist and liberal theories have long disagreed over the role of commercial groups in foreign policy. While Marxist-Leninism holds that business interests capture the state and push it toward a more aggressive foreign policy to secure raw materials and markets abroad, liberal theory generally views these same groups as bulwarks for peace. The degree of business dependence on state regulation for market share should provide the crucial dynamic for understanding business preferences with respect to foreign policy. When businesses purchase regulation from the state, their profits simultaneously depend on the state's ability to prevent entry by competitors. Unlikely to be competitive in international markets, these protected groups benefit from a contraction in the size of domestic markets caused either by restrictions on foreign competition through tariffs or conflict that decreases international commerce. Conversely, when looking at businesses that are competitive in international markets, their revenues do not depend on state protection. Seeing a decline in profits due to market contraction that is likely to follow the outbreak of conflict, they are consequently more likely to support policies that are consistent with peace and exposure to the competition of international markets.
[44] This outward shift also increases the optimal quantity of external security produced (from q* to q*'). As Lake (1992) argues, this increase in demand may also increase the optimal size of the polity and encourage a state to expand, also making conflict more likely.

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Second, it is important to note that the state does not solely act as a market maker within a domestic economy. It also purchases assets within an economy. Consequently, the structure of markets determines the price that the state must pay to mobilize resources. As a state attempts to acquire labor and capital within competitive markets it necessarily loses market power or the capacity to set or influence the price of an exchange and must then outbid other private actors. Increased competition thus raises the economic prices that the state must pay to acquire resources for national defense. Rowe, Bearce, and McDonald (2002) show that competitive labor markets restricted the British government's ability to raise an army in the period prior to World War I. Because Great Britain was alone among Great Powers in its reliance on voluntary enlistment to supply its army with soldiers, it was forced to compete with private firms and pay market wages to maintain the quality and size of its military. When parliament refused to increase soldier pay, the army failed to meet recruiting targets and was forced to adjust quality standards and recruit less capable soldiers. A similar dynamic plagued the United States during the recent economic boom of the 1990's. As civilian wages steady increased as a consequence of sustained growth, it became more difficult for recruiters to induce qualified individuals to serve in the military.

These cost dynamics can be seen by an upward shift in both the state's marginal cost curve similar to the private property effect noted in the previous section (Figures 3.2). As the state's input costs increase, its rents derived from providing military security decrease. Together with the market making dynamics discussed above, these input cost pressures lead to the following hypothesis:

H3: As domestic markets become more competitive, a state is less likely to become involved in a military conflict with another state.

Mobile Wealth: Reducing the Costs of Exit

Holders of mobile wealth possess a unique advantage over other private actors within the domestic economy. Because the costs of moving these assets to another regulatory environment are less than for fixed assets such as natural resource wealth, rulers face more difficulties in taxing or confiscating such forms of wealth.[45] Consequently, the holders of mobile wealth have generally enjoyed disproportionate influence within a domestic political system. Montesquieu (1966), for example, argued that the invention of mobile forms of wealth forced restraint on princes and their desire to seize that wealth.[46] Bates and Lien (1985) and Rogowski (1998) trace democratization to an expansion of mobile wealth in an economy. To generate revenues by taxing such wealth, leaders are forced to grant concessions in the form of power sharing arrangements or legislative oversight. The literature on the rentier state, or states that derive a substantial portion of revenue from external sources while neglecting domestic production, argues that the converse relationship also holds. Economies that rely heavily on less mobile forms of wealth tied to land, such as oil and mineral resources, are less likely to be democratic (e.g. Ross 2001).

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[45] Mobile wealth is a nonspecific asset in the sense that differences between the value of an asset in its optimal use and a second best alternative use are small. It suffers fewer costs by moving to its second best allocation. For example, moving a factory to another state necessarily requires first its sale and then the building of another factory. Unless there are developed secondary markets in which there exist many individuals or groups that wish to purchase factories, the first step in this transaction is likely to be difficult. For an argument linking capital mobility to the development of secondary markets see Verdier (2001).

[46] These arguments are discussed in chapter 23 of book 20 and chapter 20 of book 21.

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Apart from possessing a significant level of political influence within a domestic society, these holders of mobile wealth also often possess strong interests in maintaining peace in the international system. Because war tends to increase the risks of expropriation and destroy economic resources that holders of financial capital rely on as income bearing investments, these interests tend to support peace. For example, financial interests worry that governments will erect capital controls and halt the payments of domestic firms to international creditors once war breaks out in order to secure its access to hard currency for purchasing additional armaments. Moreover, the possibility of being defeated in war tends to raise uncertainty over a government's credit, which in turn shapes the prices of its debt and affects the value of government bonds in secondary markets. Holders of such assets often see their wealth decline as the threat of war increases.

Polanyi (2001 [1944]) traced the stable functioning of the balance of power from the defeat of Napoleon until the outbreak of World War I to the decisive role of financial interests in preserving peace. Because of its transnational position and independence from any government, *haute finance* strongly supported peace knowing that a war among the great powers would devastate the stable and highly profitable international monetary system.[47] Kennedy (1983) argues that the structural shift from being the world's

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[47] It is worth quoting at length one long passage from Polanyi. He writes, "Haute finance, and institution *sui generis*, peculiar to the last third of the nineteenth century and the first third of the twentieth century functioned as the main link between the political and economic organization of the world. It supplied the instruments for an international peace system, which was worked with the help of the Powers, but which the Powers themselves could neither have established nor maintained. While the Concert of Europe acted only at intervals, haute finance functioned as a permanent agency of the most elastic kind. Independent of single governments, even of the most powerful, it was in touch with them all...There was intimate contact between finance and diplomacy; neither would consider any long-range plan, whether peaceful or warlike,

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industrial center to its financial center constrained British military strategy in the decades prior to World War I. Because war would bring the threat of halted payments to British creditors, the financial sector in Britain needed peace to avoid huge losses and continue functioning.[48] The logic of these worries was born out by the financial crisis that erupted throughout Europe during the July crisis in 1914. Equity prices and the value of governments bonds plummeted and halted trading in the London, Paris, and Berlin stock exchanges on July 31. Despite its failure, the London banking community desperately lobbied the British government to remain neutral in the event of a general European war.[49]

In terms of the basic model presented in this chapter, this political influence and desire for peace can be conceptualized in terms of the ability of mobile capital to secure alternative providers of security from external threats.[50] Because mobile capital can simply exit out of economies threatened by war with minimal losses, it is less willing to pay monopoly rents to any one state. If a state taxes mobile financial capital too heavily, it shifts to a more profitable investment in an alternative economy. These reduced relocation costs are reflected in a downward shift in the demand curve for security by holders of mobile wealth. This shift reflects a reduction in the price of a substitute good, in this case an alternative provider of military security, created by lower exit costs. Because mobile wealth can easily move to less war-like economies, they are unwilling to

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with making sure of the other's goodwill. Yet the secret of the successful maintenance of general peace lay undoubtedly in the position, organization, and techniques of international finance" (2001, 10).

[48] These arguments also find empirical support in the statistical findings of Gartzke, Li, Boehmer (2001) that link fewer capital controls to a reduced probability of militarized disputes between states.

[49] For a discussion the financial panic and the efforts by the London banking community to lobby the government and secure British neutrality during this crisis see pp. 189-197 in Ferguson (1998).

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pay more for each unit of security than are holders of fixed assets. States are able to extract less rent from this economic interest group. The market for security faced by all the holders of mobile wealth in the global economy is thus more competitive than for other interest groups. As the size of this constituency within a domestic economy increases, the aggregate demand curve for security shifts inward indicating a decline in the state's ability to capture rents.

The converse argument can also be made of land-based or fixed wealth sectors and finds support in one variant of the commercial peace hypothesis that focuses on the distinction between trading and mercantilist/military states. Rosecrance (1986, 1999) argues that variations in the foreign policy of states can be attributed to the degree to which economies rely on land as factor of production and growth. The economies of military states traditionally depend on resources, such as agriculture and natural resources, fixed to their territory. Derived from mercantilist principles, such an economic structure offers the possibility of generating growth by simply conquering new territories. On the other hand, the economies of trading or "virtual" states depend less on the size of the territory or the assets within this territory and more on intangible assets such as knowledge and management skills that are less easy to seize by a conquering state. As states depend less on land and more on trading strategies, the benefits of conquest and the likelihood of war decrease. Moreover, the gains from attacking such economies that do not rely on land as a factor of production decrease because of the difficulty of extracting such resources by a conquering power.

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[50] This proposition is the same as that made in Rogowski (1998).

Because of the relative ease of extracting land based-resources and the incentives this creates for conquering powers to attack, the holders of such resources are particularly vulnerable to the seizure of assets following defeat in war. As a consequence, they should be willing to pay higher prices for military security than other economic interests.[51] This can be reflected in an outward shift of their demand curve for security (see Figure 3.4), which correspondingly increases the rents that accrue to the state for providing protection.

Together, these arguments about the differences between mobile and fixed forms of wealth suggest the following hypotheses:

H4a: As the quantity of mobile wealth in an economy increases, that state should be less likely to become involved in military conflict with another state.

CONCLUSION

The ability of the institutions of capitalism to inhibit conflict has been surprisingly neglected in contemporary examinations of a liberal peace among states. Rooted in the arguments of classical liberalism, which stress the domestic benefits received by the state for going to war, and the conceptual tools of neo-institutional economics, which focus on the state's unique role as monopoly provider of such collective goods as internal justice and protection from external threats, this chapter has developed a series of hypotheses

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[51] They also face higher costs for substitute providers of external security. Because they cannot move their assets to another state, they need to build and support a revolution from within their own society to find an alternative supplier.

linking capitalism to peace among states. While private property and competitive markets increase the state's real economic costs of war, they simultaneously shrink the state's capacity to divert resources to aggressive expansion in the international system and build supportive domestic coalitions that can offset rising opposition to war. Increasing levels of mobile wealth further constrain the state by limiting its ability to tax these sectors. Faced with threats to their wealth as the risk of war increases, holders of mobile wealth simply exit to alternative regulatory environments and punish the state by depleting its total resource base. The next two chapters turn to a statistical examination of these hypotheses.

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	1850-2	1862-4	1876-8	1892-4	1911-13	1992[c]
Belgium	10.6	9.6	7.1	7.3	9.3[a]	0.0
France	10.0	7.9	7.3	12.6	15.2	0.0
Germany	--	--	42.2	35.8	43.9[a]	0.0
Italy	--	11.3	12.2	13.0	10.8	0.02
Russia	14.6	9.8	12.4	15.2	10.6	--
Spain	12.9	9.7	9.3	18.4	16.7	0.54
The Netherlands	8.8	7.4	5.8	5.1	9.8	0.0
United Kingdom	38.8	34.0	25.4	20.3	17.5	0.08
United States	91.5	94.2[b]	49.1	49.0	44.6	1.55
Canada	--	--	71.7	70.1	82.9	2.84

Notes:
[a] 1910-12
[b] 1859-61
[c] Measured as taxes on international trade--includes import duties, export duties, profits of export or import monopolies, exchange profits and exchange taxes.

Table 3.1: Share of customs revenues in total central (or federal) government revenue (in percentages) for selected countries. Sources: Bairoch (1989,59); The World Bank (1998).

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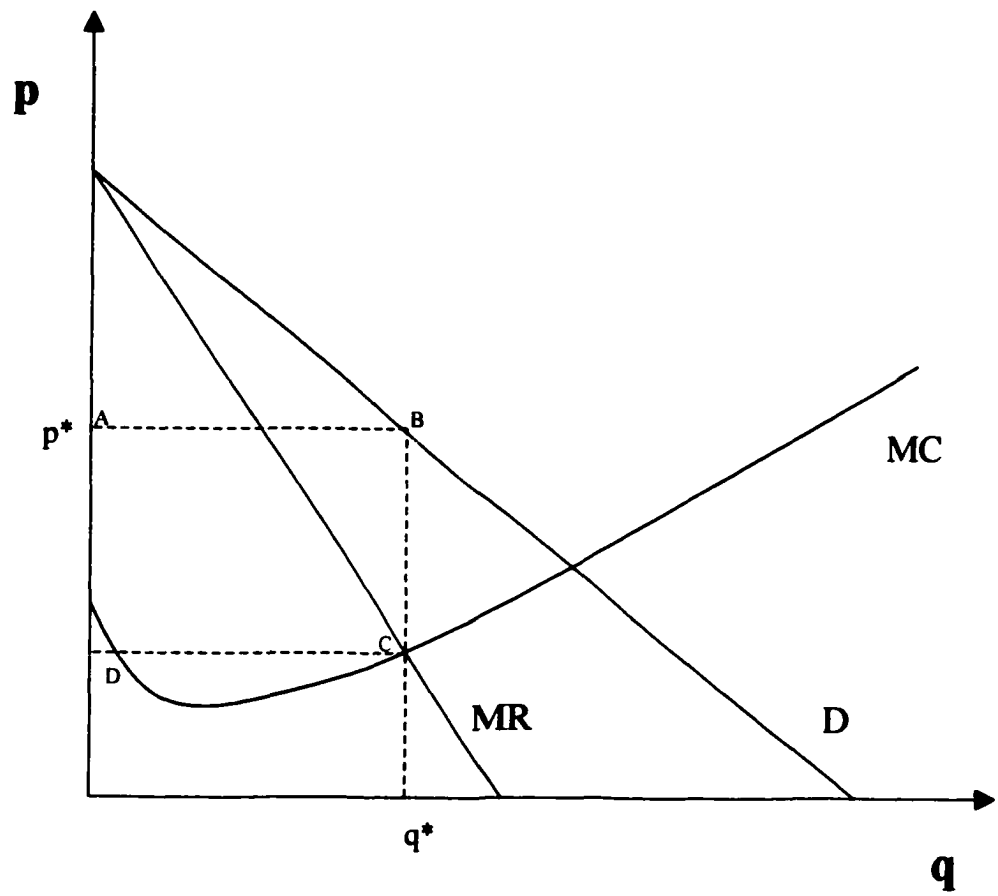
Figure 3.1: Monopoly structure of production

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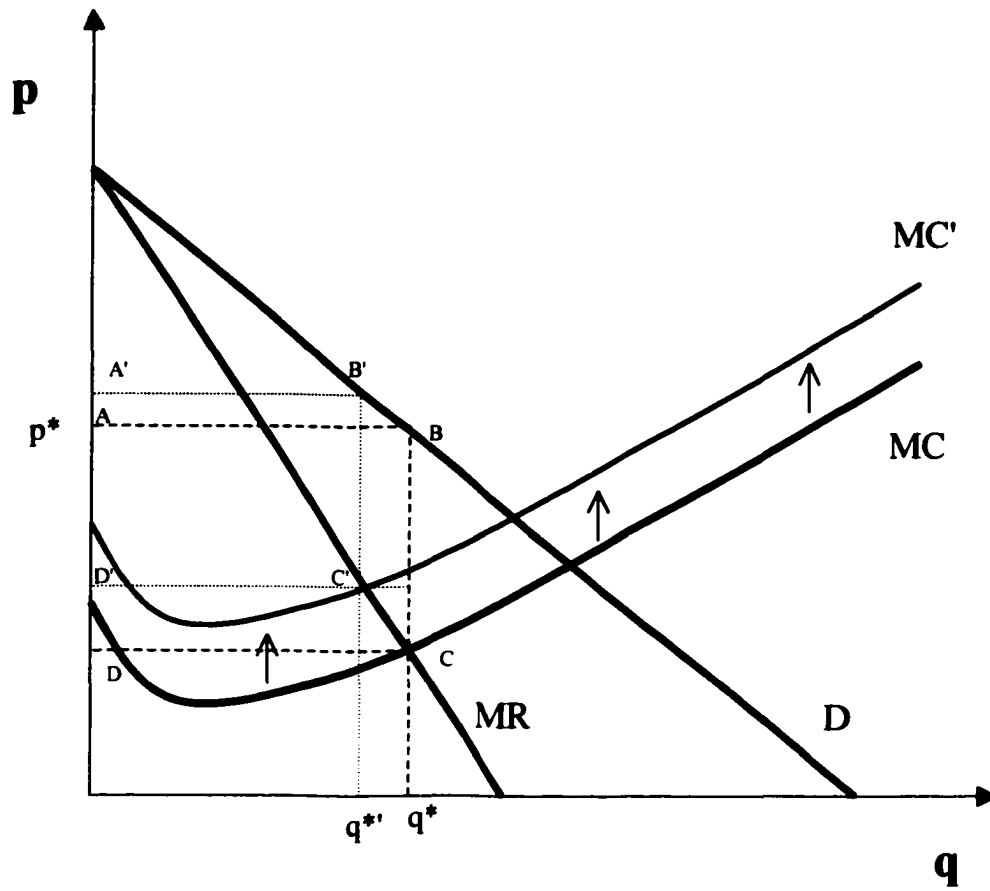
Figure 3.2: Monopoly structure of production; upward shift
in marginal costs

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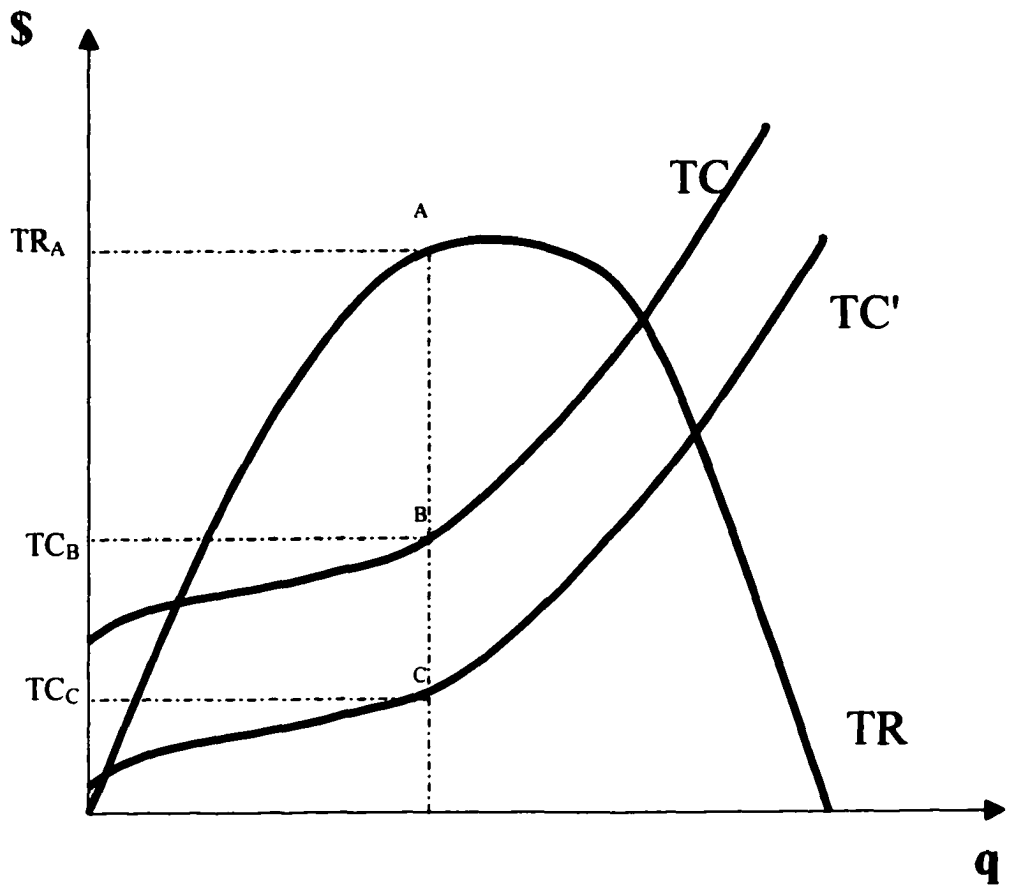
Figure 3.3: Monopolist's profits given decrease in total costs of production

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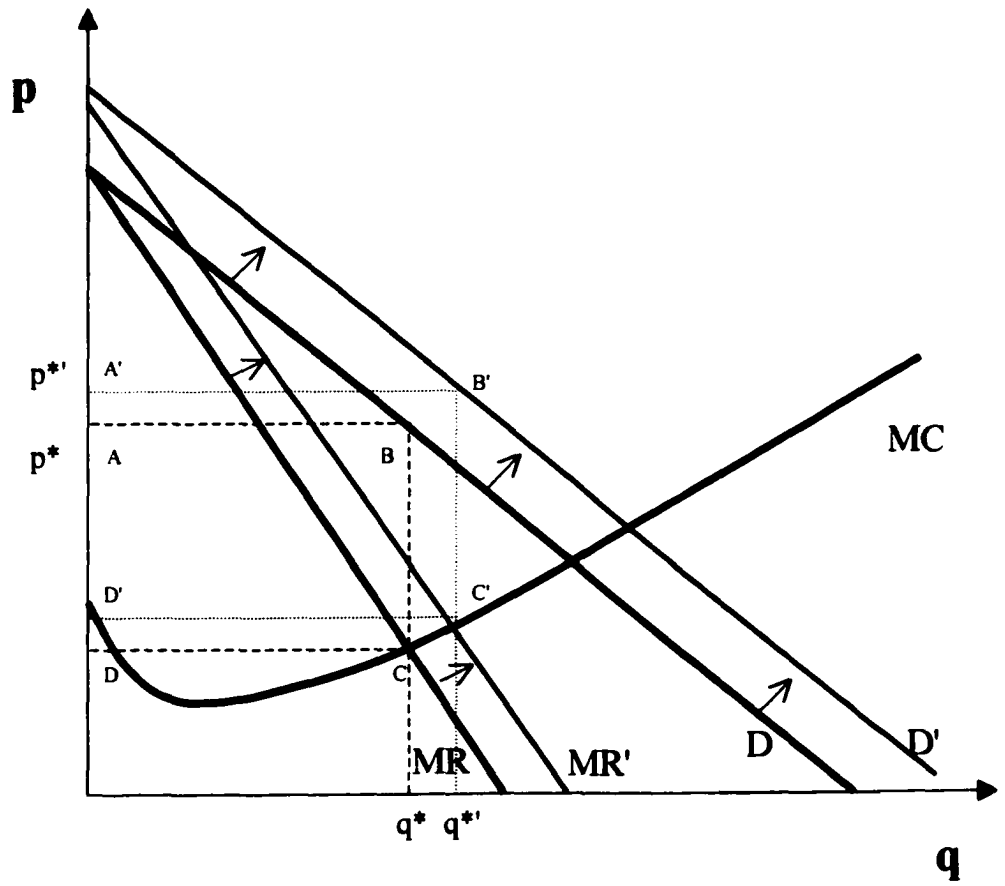
Figure 3.4: Monopoly production; increasing demand

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CHAPTER 4

PRIVATE PROPERTY AND INTERNATIONAL CONFLICT

The previous chapters have argued that theoretical treatments of the liberal peace suffer from an important deficiency. While concentrating on how the presence or absence of electoral institutions shape state-society relations and alter the foreign policy of states, this literature has simultaneously neglected how one of the defining institutions of capitalism, namely private property, also extends individual liberty and can consequently shape these same public policy decisions. By removing a potentially potent source of revenue for the war machine, the expansion of private property increases the quantity of resources that a state must mobilize or collect from society for war. Because this mobilization process is inherently conflictual and consequently costly for the state to undertake, private property grants society another lever by which to constrain its foreign policy. Society is much more likely to oppose war if they directly bear the burdens of conflict through such measures as higher taxation levels and the direct expropriation of assets that are made necessary by the absence of extensive public property.

This chapter explores how variations in property rights regimes—defined by the quality of the state's commitment to protect private property and the relative quantity of private assets to state-owned assets—alter the state's propensity to threaten or use force

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in international relations. It tests these hypotheses across a number of variations in both research design and the operationalization of the primary independent variable. Strong and robust statistical support for the arguments that credible commitments to protect private property and greater quantities of private property are found at both the dyadic and monadic levels of analyses.

To defend these claims, the rest of the chapter proceeds as follows. The first section describes the operationalization of the independent and dependent variables. The second section tests how variation in property rights regimes alters the likelihood of military conflict between pairs of states. The third section tests the monadic variant of the broader hypothesis: as the level of private property in an economy increases, that state is less likely to be involved in international conflict irrespective of the traits of potential adversaries in the international system. These tests draw on both the state-year and directed dyad-year as the units of analyses. A final section concludes.

RESEARCH DESIGN

To test the hypothesis that variations in the structure of the domestic economy affect the likelihood of interstate conflict, I adopt many of the standard techniques utilized in the vast empirical literature on the liberal peace. The sample of cases under examination is all interstate dyads from 1950 until 1992. The dyad year, or a grouping of two states in a year, serves as the initial unit of analysis.

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Dependent variables

The primary dependent variable is the onset of a militarized dispute, MIDON, in year *t* between dyad members, *i* and *j*.[1] It takes on a value of 1 in the first year of a new dispute and 0 at all other times. However, additional regression models utilize the presence of dispute, DISPUTE, as the dependent variable. DISPUTE takes on a value of 1 every year in which a dispute between two states is either initiated or ongoing. The source of this data is the recently revised dyadic MID data version 1.1 constructed by Maoz (2001).

Independent variables—property rights regimes

This study departs from others of the liberal peace by focusing on how the structure of the domestic economy conditions the outbreak of international conflict. This chapter focuses on how variation in property rights regimes conditions the outbreak of conflict. As discussed in the theoretical chapter, this variation needs to be assessed along two dimensions—respect for private property and scope or the quantity of private property. Respect for private property captures the credibility of the commitment made by a state to refrain from expropriating private assets. If a government has not made that commitment, the domestic costs of expropriating social assets and violating business confidence in preparation for war are likely to be less than after this commitment is made. A state therefore pays lower mobilization costs to prepare for war if it has not made a credible commitment to private property holders that it will not expropriate their assets.

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[1] A Militarized interstate dispute refers to "historical cases in which the threat, display or use of military force short of war by one member state is explicitly directed towards the government, official representatives, official forces, property, or territory of another state" (Gochman and Maoz 1984; Jones, Bremer, and Singer, 1996).

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Scope, on the other hand, refers to the quantity of private property in an economy and is related to but not dependent on the initial commitment made by the state to respect private property. The differences between these characteristics is perhaps best demonstrated by comparing the more laissez faire style of capitalism found in the United States and Great Britain following the Reagan and Thatcher revolutions with other developed economies in Western Europe. While all of these states possess established independent judiciary systems capable of defending private property from seizure both by the state and other private actors, there exists substantial variation in the degree to which governments intervene and attempt to direct economic life. In particular, these economies are marked by substantial divergence in the quantity of public holdings and the bundle of social welfare goods provided by the state. Thus apart from examining whether the commitment to protect private property is related to the incidence of military conflict, the size of public and/or private holdings sheds light on the scale of the mobilization effort necessary to prepare for war. If a state owns few assets, the size of the mobilization effort needed to conduct a more active foreign policy increases. Consequently, as the scale of mobilization increases, societal opposition to war is likely to increase as well.

The rapidly expanding literature on economic growth provides a reasonable place from which to begin the search for indicators of variation in property rights regimes. One of the consistent empirical findings from this literature is that institutional quality-- defined by such characteristics as credible commitments to protect private property, the rule of law, and contract enforceability--is positively related to economic growth (e.g.

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Barro 1997; Keefer and Knack 1995, 1997; Kaufman, Kray, and Zoido-Lobaton, 2002). While initial research on this question employed such proxies as violent regime change (coups and assassinations) and the Gastil indices of political and civil liberties, recent work has turned to a series of private sector surveys and investor risk services to measure institutional quality.[2]

My first measurement of the credibility of commitment made by the state to respect private property draws on one of the more common measures of institutional quality in the growth literature. This variable, labeled BERI, is an additive index of four traits of institutional quality measured by Business Environment Risk Intelligence, a private investment research service headquartered in Geneva, Switzerland. These traits--contract enforceability, infrastructure quality, nationalization potential, and bureaucratic delays—are rated on a scale of 0 to 4 with higher values corresponding to greater institutional quality. I employ the composite score of this rating service, which can range from 0 to 16, as an indicator of the commitment to respect private property. Adopting the weak-link assumption common in the liberal peace literature that the lesser constrained state within a dyad drives the conflict potential of that relationship, I include the lower BERI score, labeled $BERI_L$, measured at time t in the statistical models of conflict. I expect that $BERI_L$ is negatively related to both the onset and presence of international conflict.

For the present question under investigation, reliance on this literature is not without its disadvantages. Cross-country studies of economic growth typically employ

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[2] For a discussion of the advantages of employing survey and investor risk data over other alternatives see

an average growth rate over a period of many years as the dependent variable and consequently throw out a substantial amount of within group variation. Because most studies of international conflict generally use the dyad year as the unit of analysis and utilize this within-group variation,[3] a wide range of alternative measurements and aggregations of institutional quality indicators found in the growth literature were not used because of their limited availability for a number of years. One of the benefits of the data from BERI is its longer temporal domain than other measurements. For the period under investigation in this study, data is available from 1972 to 1992. This contrasts with Knack and Keefer's (1995, 1997) alternative measurement that provides data from 1982 to 1992 and a series of other sources that are largely limited to two or three year periods.[4]

The second set of measurements of domestic economic structure attempts to capture the scope or size of private and public ownership in an economy. While a true measure of the scope of private property would measure the relative distribution of private and public assets, I rely on a measurement of the relative size of these sectors in annual economic activity as a proxy for this division. Measurements for public sector size are created from the components of annual gross domestic product found in the Penn World Tables version 5.6 (Summers and Heston, 1991) and the World Bank's *World Development Indicators*.[5] The first such variable, GOV, is simply the annual size of real

Knack and Keefer (1995).
[3] Benoit (1996) is an exception to this.
[4] For a comprehensive list of the sources of domestic institutional variation including BERI employed in the growth literature see Kaufmann, Kraay, and Zoido-Lobaton (1999).
[5] Regression models were run in three ways. First, only data from the Penn World Tables was used. Second, only data from the World Bank development indicators was used. Finally, models were run using

government consumption divided by real gross domestic product of an economy.[6] A larger government sector is treated as a proxy for the quantity of public assets relative to the private sector. Higher levels of public property reduce the constraints to mobilizing resources for national defense. When bureaucratic officials replace the market in determining the allocation of scarce societal resources, the state does not need to compete with other private actors to acquire such resources for war. An expansion of government holdings or public property should increase the likelihood that a state will enter into a dispute. The value for GOV of the state with the larger government sector, GOV_H, is the less constrained member of the dyad and included in the regression models. I expect that GOV_H should be positively related to interstate conflict. This variable is measured at time t-1 to account for the possible endogeneity problem created by a rise in government spending in response to a militarized dispute.

I also measure the size of the private sector directly from the same components of GDP. PRIV is simply the proportion of the real annual gross domestic product accounted for by consumption and investment. Again drawing on the weak link assumption, $PRIV_L$, is the quantity of PRIV found within the member of dyad possessing the smallest such proportion. This variable is also measured at time t-1 to account for the possible endogeneity problem created by a decrease in private sector activity, particularly

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the Penn World Tables data with the World Bank data serving as supplement to fill in missing observations. Results were the same across all iterations. The results that follow utilize the Penn World Tables data that is supplemented with the World Bank data. This method was chosen to maximize the number of cases under analysis.

[6] For the primary operationalization of GOV, I have chosen only to focus on government consumption while excluding public investment from a total measure of government activity because the Penn World Tables only distinguish between public and private investment for a small number of cases. However, as

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consumption, in response to a militarized dispute. I expect $PRIV_L$ to be negatively related to interstate conflict.

For a third measure of the size of the public sector and more generally of the level of state intervention in the economy, I draw on the POLITY II database (Gurr, 1997). Although not included in subsequent updates of this dataset, the first two versions contained an indicator, with data available from 1950 to 1986, entitled Scope of Government Action. The codebook defines this variable in the following fashion:

> Scope is an operational version, applicable to the state, of Directiveness. It is a continuum which refers to the extent to which all levels of government combined—national, regional, and local—attempt to regulate and organize the economic and social life of the citizens and subjects of the state. The Scope dimension does not refer to the regulation or restriction of political activity, which is registered in the Political Participation variables 2.6 and 2.7.

Scope is subjectively defined along a continuum ranging from one (totalitarian) to nine (minimal), with higher values indicating less state control of social and economic life. The codebook outlines five categories along with four intermediate groups within each of the categories. Figure 4.1 describes each of these categories, their corresponding interval measures, and some examples of coding decisions. Drawing on the weak-link common to dyadic tests of the liberal peace, I define the variable, $SCOPE_L$, as the lowest scope score or the least constrained member of the dyad in terms of the structure of the domestic economy measured at time t. Thus, given the hypotheses that government intervention in the domestic economy should be positively related to conflict, a negative relationship should exist between $SCOPE_L$ and the onset of a militarized dispute.

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discussed shortly, I did run a series of regression models that added public investment to consumption for a

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One benefit provided by using SCOPE$_L$ stems from its ability to counteract a specific type of endogeneity problem centering on the role of defense spending in the public economy. An increase of the government's role in the domestic economy measured in the three ways suggested so far could simply be a response or an effect of heightened international tensions. As the possibility of conflict increases, a state becomes more likely to increase defense spending. Conversely, as the possibility of international conflict decreases, the demand for defense spending decreases as well.

The explicit coding practices of the Polity II project for the SCOPE variable provide some protection against this danger. While drawing on the size of the government in the domestic economy as a starting point in the identification of a SCOPE score, the coding procedures attempt to minimize the distortions caused by wartime mobilizations. The codebook states, "Discount the short-term impact of rapid militarization during large-scale conflict on Gexp/GDP ratios. Such ratios typically increase immediately before/during war, then decrease after. Change the scope coding only if they remain high thereafter" (Gurr, 1997, 17).

In sum, while each of these four measurements has its own shortcomings, the inclusion of the additional operatizionalizations should help to compensate for any of these individual problems. For example, while the data for the BERI$_L$ is quite limited, particularly in a dyadic design, these sample sizes are offset by the much larger data availability for GOV and SCOPE. Data up to 1992 for GOV compensates for the absence of data after 1986 for SCOPE. Given high investment levels in the socialist

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small number of cases. Its inclusion did not change any of the primary results.

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states and the inability to distinguish between public and private investment in the Penn World Tables, the SCOPE scores counteract for an underestimation of government size in these cases by explicity coding them at the most heavily regulated end of the continuum. Significant statistical findings on all of these indicators should bolster confidence that the combination of these operationalizations provides a reasonable indicator for variation in property rights regimes.[7]

Independent variables--controls

The set of additional independent variables used in the following statistical tests are standard controls in the liberal peace literature. Extensive support has been offered for the proposition that democratic states are less likely to go to war with each other (e.g. Maoz and Russett 1993, Chan 1997, Oneal and Russett 1997). As such, I include two independent variables in the regression models. Drawing on the Polity 3 data set, a democracy value for each state is constructed by subtracting the autocracy score from democracy score of regimes (Jaggers and Gurr 1995).[8] These scores range in value from 10 to −10. With these values, two democracy variables are specified in the equation. The first control variable, $DEMOCRACY_L$, refers to the score of state that is the least democratic in the dyad i.e. lower score; while $DEMOCRACY_H$ equals the democracy score for the state that is the most democratic in the dyad.

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[7] Additionally, low correlation coefficients among these four indicators suggest that they are individually measuring different aspects of property rights regimes. These can be seen here:

	$PRIV_L$	$SCOPE_L$	$BERI_L$
GOV_H	-0.425	-0.136	-0.151
$PRIV_L$	.	0.025	0.119
$SCOPE_L$	.	.	-0.097

[8] The democracy scores were constructed from version 2.0 of the Eugene program created by Bennett and Stam (2000a).

A second critical finding in the liberal peace literature is that increasing levels of international commerce between states tends to reduce the onset of military conflict. Two variables, $DEPEND_L$, $DEPEND_H$, are included in the regression models to control for this hypothesis. These variables measure the proportion of exports and imports between the two states in a dyad divided by their relative gross domestic products. DEP_L is the smaller of one of the following two proportions: the sum of state i's exports to state j plus i's imports from j divided by i's GDP; or the sum of state j's exports to i plus j's imports from i divided by j's GDP.[9] DEP_H is the value of the state possessing the higher proportion of trade as a percentage of GDP. Exports, imports, and GDP figures are all measured in thousands of 1985 U.S. dollars at time t-1. The data is taken from Oneal and Russett (1999a), which draws on the IMF's *Direction of Trade Statistics*.

Because of the limited quantity of trade data, Oneal and Russett code missing observations of trade data between IMF members as having no commerce. To control for these coding changes, I also add another dummy variable, IMPUTE, that takes on a value of 1 when missing trade data is coded as being equivalent to no commerce in a year.[10] Given that countries possessing no trade have nonexistent commercial interactions with each other, their limited political interactions may contribute to a smaller likelihood of any disagreement escalating to the use of military force.

Following Mansfield and Pevehouse (2000), I include the higher and lower values of gross domestic product, GDP_L and GDP_H, of each member of the dyad for two

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[9] The following equation illustrates how the DEPEND scores are calculated:
$$DEP_i = (EXPORTS_{ij} + IMPORTS_{ij})/GDP_i.$$
[10] This method of dealing with missing data is discussed in Appendix A of King et al (2001).

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reasons. First, their inclusion controls for potential interaction effects between trade and GDP as well as between GOV and GDP. Any relationship between openness and the size of the government sector to militarized disputes may largely be the result of economic size. Larger states tend to have more resources to devote to national defense and as a consequence tend to be more powerful and prone to military conflict. Second, these variables also control for a realist critique of the primary hypotheses under investigation. If economic liberalization fosters economic growth, it may actually increase the total quantity of mobilizational output while the state paradoxically harnesses a smaller piece of a growing pie. This growing level of mobilization may embolden a state to pursue a more aggressive foreign policy and confound any relationship between liberal economic institutions and conflict. Like GOV_H, the primary source of this data is the *Penn World Tables* with missing values filled in from the *World Bank Development Indicators*. These values are measured at time *t-1* in thousands of 1985 U.S. dollars.

A control is added for the diversionary war hypothesis that suggest governments may deliberately initiate a conflict with another state to shift societal attention away from lingering domestic troubles accompanying political scandals and downturns in the domestic economy (Levy 1989). To account for the possibility that these incentives to initiate conflict are less likely during periods of domestic tranquility, a measurement of the short-term trajectory of the national economy, $GROWTH_L$, is included.[11] Employing the weak-link assumption, it equals the percentage change in per capita GDP measured in 1985 U.S. dollars over a three-year period prior to time *t*. Similar to GOV_H, the primary

source of this data is the *Penn World Tables* with missing values filled in from the *World Bank Development Indicators* when available. A negative relationship to conflict is expected.

Critics of the liberal peace hypotheses, and its democratic variant in particular, argue that similar political interests, or the absence of a motivation for war, explain peace within dyads (Gartzke 1998; Gowa 1999). I control for these arguments with two variables. First, employing codings from the Correlates of War project (Singer and Small 1968), I code a dummy variable, ALLY, that takes on a value of one when both states in a dyad are members of the same alliance.[12] The second control for similar political relations between states, AFFIN, is created from correlations of roll call voting in the United Nations General Assembly to operationalize interest similarity (Gartzke, Jo, and Tucker, 1999). As the level of interest or preference similarity between two states in a dyad increases, the likelihood of military conflict between those states should decrease. Both of these variables are measured at time t.

Numerous arguments suggest that differences in capabilities between states account for the outbreak of conflict between states (e.g. Kugler and Lemke 1996). Preponderance proponents argue that as the dyadic balance of capabilities between two states increasingly favors one side, peace should be more likely. The weaker state has no incentive to initiate a conflict that it is sure to lose. A stronger state has no incentive pay the costs of going to war when it can simply extract concessions from a weaker state that

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[11] Like the control for national income, GROWTH$_L$ also controls for the possibility that liberalization eases the mobilization burdens on the state by creating a larger pool of resources from which it can draw.
[12] The alliance codings were drawn from version 2.0 of the Eugene program (Bennett and Stam, 2000a).

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will prefer to concede an issue at stake rather than lose the dispute and pay the additional costs associated with going to war. On the other hand, balance of power theory suggests that peace is more likely as two states approach parity in capability with each other. To control for these possibilities, I include CAPRATIO. Taken from the Correlates of War project (Singer and Small 1993), this variable is the natural log of the ratio of the stronger state's capability index to the weaker state's index.[13]

I also include two variables to control for geographic conditions that might contribute to the onset of a dispute. As states become closer to each other, they have more opportunities for interactions that can become conflictual. First, a dummy variable, CONTIGUITY, takes on a value of one when both members of a dyad are geographically contiguous by land. Second, given that the sample under investigation includes all potential dyads in the international system, many of which may have limited diplomatic interactions and consequently diminished opportunities for conflict, I include the logged distance in miles between capital cities, defined as DISTANCE, to control for this possibility. As the distance between two states increases, the likelihood of conflict between them should decrease. Data for these variables is taken from Eugene version 2.0 (Bennett and Stam, 2000a).

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[13] The COW project's capability score for a state is an aggregation of that state's share of the total quantity of population, urban population, iron or steel production, energy consumption, military personnel, and military spending in the international system. Data for this variable was again taken from version 2.0 of the Eugene program (ibid.).

ESTIMATION AND RESULTS

Due to the dichotomous nature of the dependent variable, a series of models designed to test for any relationship between domestic economic structure and interstate conflict were estimated using logistic regression. Drawing on the arguments of Beck, Katz, and Tucker (1998), which suggest that ordinary logit leads to improperly estimated standard errors in times-series—cross-sectional analysis of binary dependent variables, a natural splines function of the number of years since i and j were last engaged in a militarized dispute was included to account for the temporal nature of the data. The size and coefficients of these parameters were excluded from each of the following tables, but the base of this function and each knot is always statistically significant. Finally, to account for the possibility that observations are independent across groups (dyads) but not independent within dyads, robust standard errors, clustering on each dyad, were estimated.

The results of the baseline regressions model can be seen in Table 4.1. In this table, MIDON serves as the dependent variable. All four operationalizations of property rights regimes are statistically significant and in the predicted direction. Measuring the scale of private property by GOV_H, $PRIV_L$, or $SCOPE_L$ yields the same result: as the size of private sector activity increases in the less constrained state, conflict within a dyad becomes less likely. In other words, as a state attempts to intervene in and direct economic activity, international conflict becomes more likely. As demonstrated in model four of table 4.1, this general finding also applies to the second dimension of property

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rights, namely the credibility of the state's commitment to protect private property. As commitments to respect private property become more credible, the probability of military conflict within a dyad decreases.[14]

Moreover, as can be seen in Table 4.2, these results also hold with the alternative definition of the dependent variable (DISPUTE).[15] When all years of a dispute are coding as having conflict present, all four measures of these measures exhibit the same predicted relationship with respect to interstate conflict. Taken together, these series of regression models indicate that the structure of the domestic economy matters for international relations. As governments intervene less in the domestic economy and private sector activity becomes a larger portion of gross domestic product, the likelihood

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[14] I also conducted a series of tests (not shown) that disaggregated the four components of the BERI score. These results show that two of the components, contract enforceability and nationalization potential, appear to be largely responsible for the negative and significant relationship between the composite score and MIDON. While all four individual measures are negatively related to conflict, only contract enforceability ($p<0.057$) and nationalization potential ($p<0.014$) are statistically significant (two-tailed tests). Moreover, these two components also exert much larger substantive effects on the probability of a new dispute breaking out. A one standard deviation increase in the score of each of the components has the following effect on the probability of MIDON:

bureaucratic delays   -8%
contract enforceability   -27%
nationalization potential -29%
infrastructure quality   -8%

I chose to report the component indicators to follow what appears to be the standard approach in the growth literature and due to the high correlation across the four components shown below:

	bureaucratic delays	contract enforceability	nationalization potential
contract enforceability	0.8484		
nationalization potential	0.7728	0.8292	
infrastructure quality	0.8059	0.8053	0.6679

[15] I also ran a series of models to see if these results held across different severity levels of a militarized interstate dispute. Disputes receive a hostility score of 2 if there is a threat to use force; 3 if there is a display of force; 4 if there is the use of force; and 5 if it escalates to war. Following Reed (2000), I estimated a censored probit in which MIDON served as the dependent variable in the first stage of the regression equation. The dependent variable in the second stage of the equation was a dummy variable indicating whether or not the militarized interstate dispute had escalated to war. Both GOV_H and $PRIV_L$ were statistically significant (at least $p<0.10$) in both the selection and outcome equations.

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of conflict within a dyad decreases. As a government's commitment to respect private property becomes more credible, conflict becomes less likely.

Apart from demonstrating a statistically significant relationship between domestic economic structure and conflict, it is also important to examine the substantive significance of liberal markets for peace. To do this, Figures 4.2 through 4.4 provide predicted probabilities of the onset of a militarized interstate dispute as the level of either size of the private sector or commitment to protect private property varies. For each of these figures, all control variables were held at their mean except ALLY, CONTIGUITY, and IMPUTE, which were coded at their modes i.e. zero.[16] Figure 4.2 demonstrates how the probability of MIDON changes as GOV_H increases. In this sample of 201,747 dyad years, the scores of GOV_H range from a minimum of 4.1 to a maximum of 64.8. The probability of MIDON increases by over 35 percent when moving from one standard deviation (14.7) below the mean score of GOV_H (22.8) to one standard deviation greater than the mean (30.9).

Figure 4.3 demonstrates how the probability of MIDON changes as $SCOPE_L$ increases. Adding 1 to the mean value of $SCOPE_L$ (4.18) decreases the probability of conflict by 17 percent. Adding one standard deviation to its mean decreases the probability of conflict by 28 percent. And if one were to treat the Soviet Union and then the United States, the two respective exemplars of socialist and capitalist systems during

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[16] Summary statistics for variables included in the baseline models found in table 4.1 can be seen in Appendix 1.

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this period, as having the lowest scope scores in a dyad, the probability of the onset of conflict would be reduced by over 53 percent.[17]

The impact of BERI$_L$ on the probability of MIDON can be seen in figure 4.4. Moving from a score that is standard deviation below (5.6) the mean (7.6) to a score of one standard deviation above (9.6) the mean reduced the probability of conflict by approximately 43 percent.

Further demonstration of how the probability of conflict change as the commitment to protect private property becomes more credible can be demonstrated by examining representative scores on BERI from the United States, Singapore, and Iran in 1986. These cases illustrate how relying on democracy scores alone can fail to capture the entire range of domestic institutional variation among states. While the United States scored high on both Polity (10) and BERI (13.0), Iran scored low on both Polity (-6) and BERI (3.3). Singapore's scores on these two characteristics did not exhibit the same degree of correlation. While it received a Polity score similar to a number of other authoritarian regimes (-2), its BERI score was in the range of states that provide the strongest commitment to private property (13.1). In terms of predicted probabilities, moving from a dyad containing Iran to a dyad in which Singapore's score provides the low value for BERI$_L$ reduces the probability of conflict by nearly 75 percent.

The results on the rest of the independent variables are largely similar to previous studies. While the alliance term always fails to achieve statistical significance, the

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[17] Throughout the sample, the Soviet Union received a score of 1. The United States split its time between a score of 5 and 4 (which followed the Great Society period until Reagan was elected). For this example, I treated the United States as possessing a score of 5.

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coefficient on CONTIGUITY is always positive and highly significant. The negative and generally significant coefficient on CAPRATIO supports the proposition that a preponderance of capability promotes peace within a dyad. Apart from the models run with constrained samples due to the limitation of data available for $BERI_L$, the commercial liberal hypothesis, which states that increased trade facilitates peace, receives relatively strong support as DEP_L is negative and statistically significant. The consistently negative and significant coefficient on IMPUTE also implies that it should be included when assigning values to missing trade data. An increase in economic size increases the probability of a dispute. The coefficients on both GDP_H and GDP_L are positive and significant.[18] Additionally, an increase in the similarity of political interests, defined by UN roll call votes, within a dyad decreases the probability of a dispute.

Finally, the relationship between democracy and conflict receives somewhat mixed support. Though in the predicted direction, DEM_L fails to achieve standard levels of statistical significance when $SCOPE_L$ or $BERI_L$ are included in the models. To check and see whether these results were the result of a sampling bias because of the lack of data on SCOPE past 1986, I ran a regression that excluded the SCOPE variable.[19] Although not listed in the tables, DEM_L was negative and significant at $p < 0.1$ suggesting that the links between democracy and peace may be less robust when domestic economic structure is controlled for in the model. Free markets may be a more powerful restraint

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[18] Similarly, I also ran a series of models that included standard measures of development (GDP per capita) as a proxy for any wealth effect on war. When substituting for GDP, development had a positive effect on military conflict and was generally significant. It did not alter any of the findings between property rights regimes and conflict. When including variables for development and GDP, GDP remained significant while development was insignificant. Again, its inclusion did not alter the direction or significance of the property rights variables.

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on conflict than free elections. However, caution must be observed before drawing too strong a conclusion from these results. When GOV and PRIV are used as indicators of domestic economic structure, the relationship between dyadic democracy and either the onset or presence of a MID is again negative and significant. Yet at the very least, this series of issues deserves further attention because it asks a foundational question to the study of both politics and economics: does exit (competitive markets) or voice (elections) provide a more efficient means of solving the principle-agent problem?

Robustness Checks

To assess the relative strength of these results, I ran another series of statistical models that examined their robustness with respect to concerns for problems created by missing data, measurement error, multicollinearity, and omitted variable bias. These results can be seen Tables 4.3 through 4.6.

Missing data and measurement error. One of the problems plaguing many statistical studies in international relations stems from limited data availability on a number of key independent variables. Data for GDP, trade, and growth serve as perhaps the most prominent illustrations of this problem. Generally, scholars have proceeded through listwise deletion, or simply dropping those cases in which data for all of the independent variables in the model is not present.[20] Gleditsch (2002) recommends another option. In a forthcoming research note, he has sought to lessen the dangers of drawing inferences from samples that systematically exclude certain types of states (e.g.

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[19] The sample was the same as that in which SCOPE data was available (n=148,158).

[20] King et al (2001) warn against the dangers of this approach and instead recommend using a program that imputes missing data. The size of the data set in this nondirected dyad design from 1950 to 1992 precluded this possibility. I could not find a computer capable of imputing the missing values in this data set.

socialist states) by providing reasonable imputations of missing data. Through such steps as expanding the list of data sources beyond the *Penn World Tables* and *Direction of Trade Statistics* of the IMF, inferring missing values for some states based on data from a set of reference countries, he has constructed a complete data set of GDP and bilateral trade values for all interstate dyads between 1948 and 1996.

To examine the robustness of my findings, I substituted the GDP, growth, and trade scores in his data set for GDP_L, GDP_H, $GROWTH_L$, DEP_L, and DEP_H values found in the first set of results and ran a series of regressions utilizing MIDON as the dependent variable.[21] As shown in Table 4.3, the use of this alternative data generates very similar results to those already found.[22] All of the coefficients of the various indicators of property rights regimes are statistically significant and retain their predicted direction.

A second question that may result from these statistical models is the extent to which the population of communist states is driving these results. Is the positive relationship between GOV and MIDON the result of high levels of government direction of the economy in the Communist World; and consequently, are these results simply driven by the larger struggle between the United States and the Soviet Union? To try and control for this possibility, I interacted GOV_H with a variable labeled SOC. It takes on a value of 1 when the member of the dyad possessing the higher GOV score is a socialist state.[23] The results can be seen in model 1 of Table 4.4. In this regression, the value and

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[21] When using Gleditsch's data, I also dropped the IMPUTE term from the statistical analysis.

[22] The benefits of using this data in terms of expanding the sample size is somewhat minimal when relying on GOV or PRIV to assess relative private sector size because the data set does not contain component measurements of GDP. The number of observations increases to 180,875 from 148,158 when $SCOPE_L$ provides the operationalization for size of the private sector in the Gleditsch data set.

[23] I relied on the codings of Kornai (1992, 6-7) to designate socialist states.

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sign of the coefficient on GOV_H now represents the relationship between the size of the public sector and the onset of a MID when SOC equals zero. Thus a positive and statistically significant relationship between GOV_H and the onset of MID exists even in the sample of non-Communist states.[24] The positive and statistically significant relationship between size of the public sector and international conflict is not driven entirely by the inclusion of communist states in the sample.

A third potential data problem emerges from the inability to distinguish between public and private sector investment throughout the entire period. Apart for a small set of states over a period of less than a decade, the proportion of investment in GDP from the *Penn World Tables* includes both public and private sector contributions. This carries the possibility of underestimating public sector size in socialist states when only relying on government consumption to assess it as I have done here. The inclusion of the models utilizing SCOPE provides one set of insurance against this danger. While beginning with government consumption as a baseline to generate SCOPE scores, Polity II then recoded socialist states at the end of high government direction of the economy on its continuum. As a second check, I also added public sector investment to GOV when the *Penn World Tables* distinguished between private and public investment.[25] These results can be seen in model 2 of Table 4.4. The primary finding is unchanged. An increase in the size of the public sector is still statistically significant and positively related to conflict.

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[24] Somewhat surprisingly, while the presence of a socialist state in a dyad increases the probability of conflict (as indicated by the positive coefficient on SOC), the size of GOV is negatively related to conflict within the socialist sample. This is a curious result and suggestive of the need for future research.
[25] This changed the GOV score for 442 state years, which corresponded with 27,365 dyad years in this sample. The mean GOV score increased from 20.32 to 24.34 when adding public investment to these cases.

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Fourth, I also ran a series of robustness checks necessitated by the particular coding rules of SCOPE.[26] As these rules focused on concerted government direction of the economy, the provision of public goods such as basic economic infrastructure, education, and social welfare spending were also taken into consideration. If public goods provision was minimal, as in some less developed countries, this was coded as indicating lower levels of government direction of the economy. These coding decisions carry the potential of inaccurately capturing the key concept at issue--the degree of freedom present in the domestic economy—for some of these economies. This danger is most pronounced in highly corrupt states, such as Haiti under Duvalier. Such cases were given a value of 9 on the SCOPE scale, seemingly indicating less government direction and a more liberal domestic economy.

Consequently, these coding rules necessitate asking whether the results presented here depend on the inclusion of such questionable cases in which there may be a disjuncture between the theoretical concepts at issue and this choice of operationalization. To check for this possibility, I ran a series of regressions that simply dropped these states from the analysis.[27] Model 3 of Table 4.4 was run on a sample that excluded all states in which at least one member of the dyad possessed a score of either 8 or 9 on SCOPE.[28]

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[26] See Figure 4.1 for some examples of these codings.

[27] Additionally, I also ran three additional regressions that added a dummy variable to the model if the scope score of either state first equaled 7, 8, or 9. In the second, the dummy variable equaled one if either of the scope scores equaled 8 or 9. In the final check a dummy was included if either of the scope scores equaled 9. The inclusion of each of these variables in separate regression models only slightly altered the coefficients on any of the independent variables. SCOPE was still negative and significant ($p \leq 0.001$) in all three models.

[28] SCOPE remains negative and significant in three such regressions. The first simply excluded all states given a score of 9. The second model, shown in column 5 of table 2, dropped all scores of 8 or 9. The third model dropped all scope scores of 7, 8, or 9. Not until dropping cases in which scope was coded at 6 did the results fail to achieve statistical significance. However, this is not surprising as such a coding

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Again, the coefficient on SCOPE remains negative and statistically significant strengthening confidence that the results linking economic structure to conflict do not depend on coding corrupt regimes as having a liberal domestic economy.

Politically relevant dyads. Because many tests of the liberal peace have been conducted on the "politically relevant" set of cases, it is fair to ask whether the results here depend on including cases that are not politically relevant. The politically relevant sample includes all dyads that are either contiguous or have at least one Great Power as defined by the COW project. Because these dyads are the most likely to have some form of political and/or economic exchange, they have opportunity for conflict and thus comprise the "at-risk" group of dyads in the international system (Lemke and Reed 2001). Without controlling for this important subgroup of cases, it may be that the relationship between domestic economic structure and interstate conflict depends on the inclusion of cases in the sample that really have no opportunity or reason to use military force against each other. I examine this possibility in models 1 and 2 of Table 4.5. Here I run regressions with GOV_H and $SCOPE_L$ on the politically relevant subsample of cases.[29] While GOV_H retains the predicted positive direction with respect to international conflict, it loses some of its statistical significance ($p<0.12$).[30] Although the level of

decision would require dropping states such as Canada and Switzerland, the very cases that should be consistently coded as more liberal with respect to the rest of the world.

[29] States are coded as contiguous if they possess a common border on land.

[30] Lemke and Reed (2001) warn that measurement error and/or selection bias can occur as a result of restricting the sample to only politically relevant dyads. With respect to the sample run with GOV_H as the primary indicator of size of the private sector, I find that the ordinary logit does produce misspecified results. Lemke and Reed recommend using a censored probit model as a diagnostic check for selection bias. In this two-stage procedure, the first model determines whether or not the dependent variable in the second stage is observed. In this case, the dependent variable in the first or selection stage is simply a dummy variable indicating whether or not a dyad is politically relevant. Following Lemke and Reed, I regress this dichotomous variable on the following independent variables: the power of side A, the power

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significance declines somewhat, SCOPE$_L$ is still found to have a negative relationship on the onset of a militarized dispute.

Omitted variable bias. Model 3 of Table 4.5 checks for the possibility that these results suffer from omitted variable bias. First, I simply added a dummy variable (MAJPOW) indicating whether or not at least one member of the dyad is major power as defined by the COW project. Its inclusion does not change any of the primary findings. The coefficient on GOV$_H$ is still positive and statistically significant.

Although not show in the tables, additional regression models were also run with the following alterations to the right-hand side variables. First, alliance portfolios were substituted for UN roll call voting as a proxy for interest similarity. Second, controls for international institutions--operationalized as intergovernmental organizational membership (Oneal and Russett 1999b) and as membership in the same preferential trade agreement (Mansfield and Pevehouse 2000)--were included in the baseline regression models found in Table 4.1. None of these changes altered the relationship between the various measurements of domestic economic structure and the outbreak of international conflict.

Multicollinearity. As a final set of diagnostics, I also checked the baseline models for problems of multicollinearity.[31] This problem is particularly important given the

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of side B, the natural log of the distance between capital cities, and DEM$_L$. The second stage of the model is simply the baseline model from which I have been working (for the politically relevant case, it is that shown in model 2 of table 5). Using a censored probit, I find that GOV$_H$ is positive and statistically significant (p≤0.034 with a two-tailed test). Moreover, the value of rho, or the correlation between the error terms in the first and second stages of the censored probit, is negative and significant (p<0.001), which is consistent with the existence of selection bias.

[31] The presence of collinearity among independent variables (or the ability to predict the value of one independent variable based the value of one more other independent variables) can weaken the inferences

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nature of the theoretical claims made here about the need to separate the effects of democracy and capitalism on the outbreak of international conflict and the possibility that political and economic freedoms may be highly correlated. Initially, I examined the bivariate correlations between DEMOCRACY$_L$ and the property rights indicators. All of these correlations are fairly modest suggesting that multicollinearity might not be a problem.[32]

However, because bivariate correlations provide an imperfect diagnostic for collinearity,[33] I also examined the condition indices for the samples of data matricies of independent variables created by the property rights indicators (Belsley, Kuh, and Welsch, 1980). Gujarati (1995, 338) suggests that a condition index between 10 and 30 implies moderate to strong multicollinearity; while a score greater than 30 indicates severe multicollinearity.

Based on these guidelines, a severe multicollinearity problem seems to be present in the baseline model with GOV$_H$ serving as the indicator or property rights.[34] This data matrix produced a condition index score of 48.87.[35] However, in order to determine whether GOV$_H$ was the source of this collinearity problem, I examined the condition index scores for fourteen separate data matrices that took turns eliminating one of the independent variables in the baseline model. These results suggest that the control for

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drawn from the regression model because it increases the difficulty of distinguishing the separate influences each of the offending independent variables has on the dependent variable. For an extended discussion of this problem see Belsley, Kuh, and Welsch (1980).

[32] The bivariate correlations between DEM$_L$ and the property rights indicators are as follows: with GOV$_H$ (-0.1941); with PRIV$_L$ (0.2473); with SCOPE (0.0320); and with BERI$_L$ (0.3822).

[33] An offending independent variable may also be correlated with a combination (instead of just one) of the other independent variables.

[34] Similar results were obtained using the other operationalizations of property rights regimes.

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distance is source of this problem. While excluding all the other independent variables provided only a modest improvement in the condition index,[36] the exclusion of the control for distance decreased its score to 11.97. Finally, to determine whether the results on GOV_H were sensitive to the inclusion of the distance term, I ran a separate regression that excluded this control (results not shown). The coefficient on GOV_H was still positive and statistically significant ($p<0.001$). In sum, this set of diagnostics helps to demonstrate that the primary inference--namely that an increase in public sector size is positively correlated with international conflict--drawn from this series of statistical models is fairly robust with respect to the problem of collinearity as well.

IS THERE A MONADIC EFFECT?

The broad base of support found for the dyadic findings linking both state regulation of the domestic economy and the size of the public sector with respect to GDP begs another empirical question. Is there a monadic capitalist peace? Are liberal economies less likely to become involved in military conflict irrespective of the regime type or domestic economic structure of a dyadic partner? This monadic hypothesis was tested in two ways. First, rather than employ the dyad year as the unit of analysis, I assessed how state level characteristics alone shaped the probability of that state being involved in a MID by utilizing the state year as the unit of analysis. Second, I also tested

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[35] I excluded the splines variables because they are highly correlated with each other.
[36] The best improvement in scores outside of that gained by excluding the distance term came by dropping the alliance term. It dropped the condition index from 48.87 to 44.26.

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the monadic hypothesis with a directed dyad design. Again, the results produced by both of these designs support the central conclusions of this project. More liberal property rights regimes are negatively related to the onset of international conflict.

State-year design. Many of the characteristics of this design are similar to those discussed with respect to the series of statistical models employing nondirected dyads. While the sources of the data are the same as described above, the variables in this next series of models differ because of the inability to include dyadic traits such as the distance between a pair of states or the lowest democracy score of the two states. I thus estimated the following baseline model:

$$\text{MIDON}_{i,t} = \beta_0 + \beta_1 * \text{ISLAND} + \beta_2 * \text{CAPABILITY}_i + \beta_3 * \text{OPEN}_{i,\,t-1} + \beta_4 * \text{GROWTH}_i +$$

$$\beta_5 * \text{DEMOCRACY}_i + \beta_6 * \text{GDP}_{i,\,t-1} + \beta_7 * \text{PROPERTY RIGHTS} + \beta_{8,9,10,11} * \text{SPLINES} + \varepsilon_{i,t}.$$

The dependent variable, MIDON, is dichotomous and takes on a value of one in the first year in which a state is involved in a new militarized interstate dispute. The variable, ISLAND, attempts to control for contiguity. Because contiguity is a dyadic variable and thus cannot be included in the present analysis, I coded ISLAND to indicate the absence of neighboring countries on land. It takes on a value of 1 if a state is not bordered on land by any other state in the system. CAPABILITY is simply the composite capability score for a state created by the COW project. To control for the commercial liberal hypothesis, OPEN is drawn from the Penn World Tables and is the sum of a state's exports and imports divided by current gross domestic product measured at time *t-1*. GROWTH is the average per capita economic growth in the three years prior to time *t*. Like the dyadic tests, DEMOCRACY values are drawn from the Polity 3

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project and simply subtract a state's autocracy score from its democracy score. GDP is annual gross domestic product measured in time *t-1*. PROPERTY RIGHTS refer to the same definitions of GOV, PRIV, and SCOPE discussed in the previous section. Finally, SPLINES refers to four control variables added to the model to account for temporal correlation in the dependent variable (Beck, Katz, and Tucker, 1998).[37]

The results of the baseline regression utilizing GOV, PRIV, and SCOPE as the property rights indicators can be seen in models one through three of Table 4.6. All of the property rights coefficients are statistically significant while retaining their predicted directions. In terms of substantive significance, moving from one standard deviation below the mean score of GOV to one standard deviation above the mean increases the probability that a state will be involved in the first year of a militarized dispute by approximately 32 percent. The control variables share some traits from the dyadic design. Again, contiguity is an important determinant of conflict. Often viewed as determining a state's opportunity for conflict, the negative and significant coefficient on ISLAND indicates that the absence of neighboring states decreases the probability that a state will enter a MID. While negative, the DEMOCRACY term is not significant suggesting support for the argument that the democratic peace is a dyadic phenomenon. Contrasting with this, the monadic version of the commercial peace hypotheses receives support here. The negative and significant coefficient on OPEN demonstrates that as the

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[37] These variables are excluded from the ensuing tables. While all of these variables are less consistently statistically significant in the state year design, at least one of them is always statistically significant suggesting the need to keep them in the models.

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role of trade in a state's gross domestic product increases, it becomes less likely to become involved in a conflict.

In order to assess the strength of these monadic results, I also conducted some of the same robustness checks employed on the dyadic design. The first two attempt to control for omitted variable bias. In model 4 of Table 4.6, I add a dummy variable for major power status to the baseline model. While MAJPOW is in the predicted direction, it does not achieve standard levels of statistical significance ($p < 0.12$). Moreover, the coefficients on the rests of the other variables remain largely unaffected. ISLAND, CAPABILITY, OPEN, and GOV all maintain their levels of statistical significance and their predicted directional effect on the outbreak of conflict.

Model 1 in Table 4.7 attempts to control for the possibility of omitted variable bias created by the panel design in this study. Up until this point, all of the statistical models have presumed that each of the separate units (states in the monadic design; pairs of states in the dyadic design) possesses a common intercept. Yet numerous scholars have noted that a failure to control for group-specific unobservable effects can lead to biased estimates of the remaining coefficients in the model (e.g. Stimson 1985; Green, Kim, and Yoon, 2001).

While Beck and Katz (2001) strongly discourage the use of fixed effects models (or the addition of a dummy variable for each group), in the standard dyadic design, one of the more pernicious effects of such a modeling strategy is not present in the state year design. They argue that modeling fixed effects in the dyadic design unnecessarily throws away too much information as it eliminates all the observations for which panels display

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no variation in the dependent variable (many dyads exhibit no conflict during the time periods under investigation).[38] However, because most states are involved in at least one MID during the period under study, the elimination of cases is much less severe in the state level design.[39] The results for a fixed effects model in the state level design can be seen in model 1 of Table 4.7. The coefficient on GOV remains positive and significant.

I also undertook a final robustness check that utilized the Gleditsch (2002) data. Its ability to increase the number of cases in the sample was modest and the primary results again were largely unchanged. Model 2 of Table 4.7 demonstrates the results for the GOV sample; and model 3 of table 7 has the results for the sample created by using SCOPE to operationalize property rights regimes.

Directed dyad-year design. Finally, I also tested the monadic hypothesis with directed dyads (Bennett and Stam 2000b). Instead of using the dyad-year as the unit of analysis as in nondirected samples, directed dyads make the country-year within a dyad the unit of analysis. Each member of a dyad enters the sample once in every year. For example the US-USSR dyad has two entries in the directed sample for 1956. One observation has all the country characteristics--such as regime score (DEMOCRACY$_A$), gross domestic product (GDP$_A$), and size of government spending (GOV$_A$)--of the United States and the other observation has the country characteristics of the Soviet Union. The sample size is at least doubled from the nondirected sample. While such a procedure

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[38] It also eliminates independent variables that are time-invariant from the model. In this case, ISLAND drops out of the analysis.

[39] Only nine states were omitted from the available sample run in the baseline model (1) of table 6. For GOV, the number of cases went from 4,101 to 3,933.

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artificially decreases estimates of the standard errors, clustered standard errors on a variable that identifies each dyad alleviates this problem. [40]

The use of directed dyads also offers another potential benefit. By treating the country-year as the unit of analysis, it allows the inclusion of missing information from the nondirected sample. For example, because the data on Soviet GDP and trade is not available in 1956, all of the information contained in the US-USSR dyad for that year--a year in which a new dispute broke out--is excluded from nondirected analyses. However, because a directed dyad design generates two observations, one for each state in a dyad, the domestic characteristics of the United States can enter the sample for the US-Soviet dyad in 1956. This inclusion of "half cases" is particularly important in light of the paucity of economic data available on the socialist states during the Cold War and presents itself as another reasonable approach to dealing with a missing data problem that is only recently beginning to receive more attention in the field (King et al 2001).

The results of these models can be seen in columns 1, 2, and 3, and 4 of Table 4.8. All four primary indicators of domestic economic structure are in their predicted directions and highly significant. Again, the consequences of capitalism for war do not appear to be restricted to a zone of capitalist states. Rather capitalist states seem to be more peaceful with all other states regardless of their opponent's "level" of capitalism.

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[40] For an example that uses directed dyads to test for monadic effects of country characteristics on conflict see Mansfield and Snyder 2002b.

CONCLUSION

Taken together, these results suggest a strong relationship between the neglected institutions of capitalism and the outbreak of conflict between states in the international system. Credible commitments to protect private property and the expansion of private property were both found to reduce the level of conflict at both the dyadic and monadic levels of analysis across four different operationalizations of property rights regimes. More broadly, as the state's ability to intervene in the domestic economy, or put more simply, as the domestic economy becomes more "free," the likelihood of international conflict decreases. The next chapter will augment these statistical results by exploring how the second institution of capitalism—competitive markets—also shapes the conflict propensity of states.

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Variable	Model 1	Model 2	Model 3	Model 4
ALLY	0.079 (0.188)	0.014 (0.189)	0.382 (0.236)	0.147 (0.249)
CONTIGUITY	2.321*** (0.301)	2.317*** (0.297)	2.181*** (0.300)	0.799** (0.371)
CAPRATIO	-0.102* (0.055)	-0.088 (0.056)	-0.104* (0.060)	-0.568*** (0.183)
DEPEND$_L$	-48.518** (22.929)	-47.489** (22.303)	-54.837** (28.014)	-36.342 (22.321)
DEPEND$_H$	1.535 (1.836)	0.929 (1.800)	1.421 (2.143)	-0.930 (3.048)
IMPUTE	-0.747*** (0.159)	-0.810*** (0.164)	-0.572*** (0.167)	-0.568 (0.358)
GROWTH$_L$	-1.023 (1.286)	-0.764 (1.281)	-2.180 (1.454)	-5.081** (2.438)
DEMOCRACY$_L$	-0.027** (0.013)	-0.025** (0.012)	-0.015 (0.014)	-0.022 (0.020)
DEMOCRACY$_H$	0.015 (0.011)	0.019 (0.012)	0.009 (0.012)	0.012 (0.036)

(continued)

TABLE 4.1: Baseline dyadic tests of effects of private property regime on ONSET of militarized interstate dispute (MID). Robust standard errors are listed in parentheses. Each model also includes a natural spline function (not shown) with a base and three knots. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 4.1: (continued),

Variable	Model 1	Model 2	Model 3	Model 4
AFFINITY	-0.994*** (0.264)	-0.998*** (0.261)	-1.193*** (0.262)	-0.233 (0.536)
GDP$_L$	$2.03*10^{-9}$*** $(4.96*10^{-10})$	$1.98*10^{-9}$*** $(4.88*10^{-10})$	$1.91*10^{-9}$*** $(6.10*10^{-10})$	$-3.83*10^{-10}$ $(1.25*10^{-9}$
GDP$_H$	$5.79*10^{-10}$*** $(1.10*10^{-10})$	$5.80*10^{-10}$*** $(1.09*10^{-10})$	$5.11*10^{-10}$*** $(1.24*10^{-10})$	$8.76*10^{-10}$*** $(2.43*10^{-10})$
DISTANCE	-0.440*** (0.130)	-0.478*** (0.134)	-0.464*** (0.128)	-0.801*** (0.189)
GOV$_H$	0.019** (0.008)			
PRIV$_L$		-0.013*** (0.005)		
SCOPE$_L$			-0.191*** (0.046)	
BERI$_L$				-0.141* (0.084)
CONSTANT	-0.181 (1.059)	1.519 (1.237)	1.423 (1.000)	5.313*** (1.626)
N	201,747	194,429	148,158	16,692
Log likelihood	-2784.164	-2695.0369	-2256.8275	-380.18444

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Variable	Model 1	Model 2	Model 3	Model 4
ALLY	0.164 (0.174)	0.088 (0.176)	0.480** (0.217)	0.081 (0.234)
CONTIGUITY	2.114*** (0.302)	2.117*** (0.297)	1.998*** (0.299)	0.993*** (0.353)
CAPRATIO	-0.098* (0.056)	-0.084 (0.058)	-0.116* (0.064)	-0.376** (0.162)
DEP$_L$	-50.194** (23.670)	-50.198** (23.160)	-60.559** (29.474)	-32.498 (25.422)
DEP$_H$	1.815 (1.680)	1.219 (1.657)	1.849 (1.995)	-1.787 (3.080)
IMPUTE	-0.672*** (0.160)	-0.718*** (0.165)	-0.447*** (0.164)	-0.187 (0.247)
GROW$_L$	-1.126 (1.277)	-1.146 (1.285)	-1.579 (1.410)	-6.150** (2.559)
DEM$_L$	-0.029** (0.012)	-0.028** (0.012)	-0.015 (0.014)	-0.018 (0.018)
DEM$_H$	0.009 (0.011)	0.012 (0.012)	0.004 (0.012)	-0.029 (0.035)

(continued)

TABLE 4.2: Dyadic tests of effects of private property regimes on presence (DISPUTE) of MID. Robust standard errors are listed in parentheses. Each model also includes a natural spline function (not shown) with a base and three knots.
*** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 4.2: (continued),

Variable	Model 1	Model 2	Model 3	Model 4
AFFINITY	-1.192*** (0.256)	-1.183*** (0.254)	-1.404*** (0.256)	-0.473 (0.497)
GDP_L	$1.95*10^{-9}$*** $(5.17*10^{-10})$	$1.86*10^{-9}$*** $(5.11*10^{-10})$	$1.59*10^{-9}$*** $(6.09*10^{-10})$	$-1.71*10^{-10}$ $(1.29*10^{-9})$
GDP_H	$5.60*10^{-10}$*** $(1.03*10^{-10})$	$5.62*10^{-10}$*** $(1.03*10^{-10})$	$4.84*10^{-10}$*** $(1.21*10^{-10})$	$7.67*10^{-10}$*** $(2.19*10^{-10})$
DISTANCE	-0.501*** (0.145)	-0.539*** (0.146)	-0.526*** (0.138)	-0.830*** (0.182)
GOV_H	0.022*** (0.001)			
$PRIV_L$		-0.011** (0.005)		
$SCOPE_L$			-0.211*** (0.041)	
$BERI_L$				-0.137* (0.082)
CONSTANT	0.996 (1.130)	2.625** (1.296)	2.797*** (1.061)	6.148*** (1.526)
N	201,747	194,924	148,158	16,692
Log likelihood	-2888.0178	-2799.3528	-2325.6755	-380.43684

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Variable	Model 1	Model 2	Model 3	Model 4
ALLY	0.135 (0.187)	0.063 (0.195)	0.305 (0.204)	0.556** (0.268)
CONTIGUITY	2.464*** (0.287)	2.424*** (0.292)	2.296*** (0.247)	0.709** (0.350)
CAPRATIO	0.099* (0.052)	-0.078 (0.054)	-0.089* (0.048)	-0.607*** (0.179)
DEPEND$_L$	-31.583* (18.705)	-32.680* (19.200)	-46.450* (25.270)	-30.014* (16.661)
DEPEND$_H$	1.288*** (0.388)	0.871 (0.685)	1.163*** (0.393)	2.658 (1.918)
GROWTH$_L$	0.493 (1.465)	-0.387 (1.365)	0.064 (1.587)	0.629 (2.574)
DEMOCRACY$_L$	-0.032** (0.013)	-0.026** (0.013)	-0.021 (0.013)	-0.056*** (0.019)
DEMOCRACY$_H$	0.018* (0.011)	0.021* (0.011)	0.011 (0.011)	0.006 (0.028)
AFFINITY	-1.003*** (0.267)	-0.984*** (0.276)	-1.033*** (0.208)	-0.466 (0.497)

(continued)

TABLE 4.3: Robustness checks with Gleditsch data--dyadic tests of effects of property rights regimes on ONSET of MID. Each model also includes a natural spline function (not shown) with a base and three knots.

*** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 4.3: (continued),

Variable	Model 1	Model 2	Model 3	Model 4
GDP_L	$1.74*10^{-12}$*** $(5.44*10^{-13})$	$1.97*10^{-12}$*** $(5.26*10^{-13})$	$2.19*10^{-12}$*** $(6.22*10^{-13})$	$-1.74*10^{-12}$ $(1.11*10^{-12})$
GDP_H	$6.73*10^{-13}$*** $(1.04*10^{-13})$	$6.40*10^{-13}$*** $(1.11*10^{-13})$	$6.98*10^{-13}$*** $(9.89*10^{-14})$	$8.26*10^{-13}$*** $(2.24*10^{-13})$
DISTANCE	-0.433*** (0.122)	-0.484*** (0.126)	-0.458*** (0.100)	-0.842*** (0.177)
GOV_H	0.019** (0.008)			
$PRIV_L$		-0.010** (0.005)		
$SCOPE_L$			-0.146*** (0.037)	
$BERI_L$				-0.243*** (0.069)
CONSTANT	-0.601 (1.015)	0.925 (1.163)	0.715 (0.768)	6.436 (1.488)
N	209,199	196,508	180,875	17,159
Log likelihood	-3012.0889	-2766.6104	-3032.7161	-465.93955

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Variable	Model 1	Model 2	Model 3
ALLY	0.096 (0.192)	0.081 (0.188)	0.660*** (0.192)
CONTIGUITY	2.244*** (0.265)	2.321*** (0.301)	1.830*** (0.206)
CAPRATIO	-0.103** (0.052)	-0.101* (0.055)	-0.080 (0.066)
DEPEND$_L$	-49.343** (22.666)	-48.732** (22.925)	-52.876* (30.698)
DEPEND$_H$	1.521 (1.805)	1.524 (1.834)	0.952 (2.269)
IMPUTE	-0.767*** (0.162)	-0.748*** (0.160)	-0.333* (0.174)
GROWTH$_L$	-1.376 (1.290)	-0.987 (1.281)	-1.743 (1.666)
DEMOCRACY$_L$	-0.026** (0.012)	0.027** (0.013)	-0.021 (0.013)
DEMOCRACY$_H$	0.014 (0.011)	0.015 (0.011)	-0.006 (0.014)

(continued)

TABLE 4.4: Robustness checks for measurement error--dyadic tests of effects of property rights regimes on ONSET of MID. Each model also includes a natural spline function (not shown) with a base and three knots.

*** $p \le 0.01$; ** $p \le 0.05$; * $p \le 0.1$. Two-tailed tests for all estimates.

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TABLE 4.4: (continued),

Variable	Model 1	Model 2	Model 3
AFFINITY	-1.008***	-0.993***	-1.457***
	(0.265)	(0.264)	(0.273)
GDP$_L$	$1.90*10^{-9}$***	$2.02*10^{-9}$***	$1.97*10^{-9}$***
	$(4.80*10^{-10})$	$(4.96*10^{-10})$	$(6.03*10^{-10})$
GDP$_H$	$5.94*10^{-10}$***	$5.77*10^{-10}$***	$4.32*10^{-10}$***
	$(1.08*10^{-10})$	$(1.10*10^{-10})$	$(1.31*10^{-10})$
DISTANCE	-0.476***	-0.437***	-0.444***
	(0.102)	(0.130)	(0.135)
GOV$_H$	0.025***	0.019**	
	(0.008)	(0.008)	
SCOPE$_L$			-0.192***
			(0.047)
SOC	0.914*		
	(0.507)		
GOV$_H$*SOC	-0.046*		
	(0.023)		
CONSTANT	-0.004	-0.222	1.463
	(0.878)	(1.060)	(1.014)
N	201,747	201,747	112,589
Log likelihood	-2778.268	-2783.606	-1784.045

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Variable	Model 1	Model 2	Model 3
ALLY	-0.026 (0.182)	0.139 (0.215)	0.071 (0.200)
CONTIGUITY	1.251*** (0.206)	1.323*** (0.207)	2.376*** (0.304)
CAPRATIO	-0.272*** (0.053)	-0.261*** (0.051)	-0.202*** (0.059)
DEPEND$_L$	-49.197*** (15.423)	-48.803*** (15.334)	-55.448** (23.472)
DEPEND$_H$	2.607** (1.071)	1.024** (0.429)	0.326 (1.758)
IMPUTE	-0.188 (0.167)		-0.614*** (0.161)
GROWTH$_L$	-0.903 (1.143)	-0.337 (1.505)	-1.476 (1.247)
DEMOCRACY$_L$	-0.036*** (0.013)	-0.028** (0.013)	-0.027** (0.013)
DEMOCRACY$_H$	0.046*** (0.010)	0.036*** (0.001)	0.016 (0.012)

(continued)

TABLE 4.5: Robustness checks for measurement error, politically relevant dyads, and omitted variable bias--dyadic tests of effects of property rights regimes on ONSET of MID. Each model also includes a natural spline function (not shown) with a base and three knots. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 4.5: (continued),

Variable	Model 1	Model 2	Model 3
AFFINITY	-0.391*	-0.569**	-0.762***
	(0.224)	(0.224)	(0.265)
GDP_L	$9.67*10^{-10}$***	$9.71*10^{-10}$***	$1.22*10^{-9}$***
	$(3.11*10^{-10})$	$(3.96*10^{-10})$	$(4.00*10^{-10})$
GDP_H	$2.60*10^{-10}$**	$3.09*10^{-10}$***	$3.38*10^{-10}$***
	$(1.04*10^{-10})$	$(1.08*10^{-10})$	$(1.19*10^{-10})$
DISTANCE	-0.120**	-0.137***	-0.449***
	(0.052)	(0.053)	(0.125)
GOV_H	0.012		0.024***
	(0.007)		(0.008)
$SCOPE_L$		-0.086*	
		(0.046)	
MAJPOWER			1.504***
			(0.235)
CONSTANT	-1.225***	-0.434	-0.405
	(0.476)	(0.428)	(1.045)
N	20,397	17,028	201,747
Log Likelihood	-1800.945	-1581.655	-2741.467

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Variable	Model 1	Model 2	Model 3	Model 4
ISLAND	-0.717***	-0.728***	-0.654***	0.682***
	(0.183)	(0.187)	(0.229)	(0.193)
CAPABILITY	24.941***	26.357***	41.714***	23.040**
	(7.931)	(8.674)	(10.989)	(8.696)
OPEN	-0.004***	-0.004**	-0.003	-0.004***
	(0.002)	(0.002)	(0.002)	(0.002)
GROWTH	0.636	0.210	-0.473	0.658
	(0.836)	(0.830)	(0.942)	(0.839)
DEMOCRACY	-0.002	-0.001	-0.013	-0.003
	(0.009)	(0.009)	(0.009)	(0.009)
GDP	$7.95 * 10^{-11}$	$-9.96 * 10^{-11}$	$-7.56 * 10^{-10}$	$9.33 * 10^{-12}$
	$(4.57 * 10^{-10})$	$(4.60 * 10^{-10})$	$(5.76 * 10^{-10})$	$(4.20 * 10^{-10})$
PRIV		-0.013***		
		(0.005)		
SCOPE			-0.075*	
			(0.038)	
GOV	0.025***			0.025***
	(0.009)			(0.009)

(continued)

TABLE 4.6: Baseline monadic tests of effects of property rights regimes on ONSET of MID. Each model also includes a natural spline function (not shown) with a base and three knots. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 4.6: (continued),

Variable	Model 1	Model 2	Model 3	Model 4
MAJPOWER				0.394
				(0.251)
CONSTANT	-0.399*	1.141***	0.438	-0.387
	(0.210)	(0.389)	(0.294)	(0.209)
N	4,101	4,101	3,252	4,101
Log likelihood	-2043.9056	-2048.7587	-1601.0049	-2042.792

Variable	Model 1	Model 2	Model 3
ISLAND		-0.717*** (0.189)	-0.654*** (0.229)
CAPABILITY	-3.684 (14.589)	23.590*** (7.391)	44.728*** (11.204)
OPEN	-0.001 (0.003)	-0.004*** (0.002)	-0.001*** (0.003)
GROWTH	-0.674 (0.990)	0.614 (1.080)	-0.638 (1.104)
DEMOCRACY	0.002 (0.011)	-0.001 (0.009)	-0.015 (0.009)
GDP	$-7.20*10^{-10}$ $(4.41*10^{-10})$	$5.45*10^{-14}$ $(4.23*10^{-13})$	$-8.21*10^{-13}$ $(5.98*10^{-13})$
SCOPE			-0.069* (0.038)
GOV	0.026*** (0.010)	0.024*** (0.009)	
CONSTANT		-0.368* (0.211)	0.282 (0.256)
N	3,933	4,133	3,278
Log likelihood	-1619.9539	-2069.7516	-1621.1972

TABLE 4.7: Robustness checks—monadic tests of effects of property rights regimes on ONSET of MID. Robust standard errors are listed in parentheses. Each model also includes a natural spline function (not shown) with a base and three knots.
*** $p \le 0.01$; ** $p \le 0.05$; * $p \le 0.1$. Two-tailed tests for all estimates.

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Variable	Model 1	Model 2	Model 3	Model 4
ALLY	0.053 (0.168)	0.017 (0.170)	0.289 (0.201)	0.246 (0.170)
CONTIGUITY	2.374*** (0.252)	2.372*** (0.248)	2.340*** (0.243)	1.334*** (0.296)
CAPRATIO	-0.147*** (0.051)	-0.144*** (0.051)	-0.157** (0.059)	-0.322*** (0.042)
$DEPEND_A$	2.531** (1.216)	2.172* (1.200)	2.482 (1.608)	1.245 (1.532)
IMPUTE	-0.830*** (0.148)	-0.847*** (0.148)	-0.660*** (0.151)	-0.704*** (0.174)
$GROWTH_A$	-0.803 (0.812)	-0.847 (0.836)	-1.306 (0.853)	-2.625* (1.357)
DEM_A	-0.010* (0.006)	-0.007 (0.006)	-0.013** (0.006)	-0.015* (0.009)
GDP_A	$6.84*10^{-10}$*** $(7.12*10^{-11})$	$6.68*10^{-10}$*** $(7.25*10^{-11})$	$7.01*10^{-10}$*** $(1.02*10^{-10})$	$6.76*10^{-10}$*** $(8.47*10^{-11})$
AFFINITY	-1.512*** (0.210)	-1.521*** (0.209)	-1.615*** (0.205)	-1.507*** (0.321)

(continued)

TABLE 4.8: Directed dyad tests of effects of property rights regimes on ONSET of MID. Robust standard errors are listed in parentheses. Each model also includes a natural spline function (not shown) with a base and three knots.

*** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 4.8: (continued),

Variable	Model 1	Model 2	Model 3	Model 4
DISTANCE	-0.366*** (0.096)	-0.384*** (0.096)	-0.361*** (0.087)	-0.507*** (0.121)
PRIV$_A$		-0.011*** (0.003)		
GOV$_A$	0.017*** (0.005)			
SCOPE$_A$			-0.170*** (0.031)	
BERI$_A$				-0.183*** (0.037)
CONSTANT	0.087*** (0.779)	1.495** (0.868)	1.220* (0.704)	4.260*** (1.047)
N	500,759	491,483	385,859	118,687
Log likelihood	-7099.3329	-6990.2066	-5888.1034	-1966.3585

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1. TOTALITARIAN: Governments that directly organize and control almost all aspects of social and economic life.
Examples: Soviet Union 1950-1986, Cuba 1961-1986, East Germany 1950-1986, China 1950-1977, Vietnam 1960-1986

2. Intermediate variable
Examples: Poland 1950-1986, Angola 1977-1985, Libya 1977-1986, Egypt 1970-1986

3. SEGMENTAL PLUS: Governments whose activities are intermediate between segmental and totalitarian. These governments that provide almost all basic services for their populations, and/or control large economic sectors, directly through state ownership or indirectly through detailed planning and regulation.
Examples: Mexico 1972-1986, France 1952-1980, West Germany 1976-1986, Italy 1975-1986, Israel 1970-1986

4. Intermediate variable
Examples: United States 1964-1980, Australia 1971-1986

5. SEGMENTAL: Public authorities provide a wide range of basic services plus close regulation of significant segments of social and/or economic activity, but leave large sectors free of direct state involvement.
Examples: United States 1950-1963, 1981-1986, Austria 1957-1986, Japan 1952-1977

6. Intermediate variable
Examples: Canada 1950-1970, Switzerland 1966-1986

7. SEGMENTAL MINUS: Public authorities provide limited basic services, e.g. public education, postal service, communication and transport facilities, and use state regulatory powers to ensure provision of some basic social services.
Examples: Switzerland 1950-1965, Lebanon 1950-1977, Thailand 1955-1986

8. Intermediate variable
Examples: Uganda 1962-1986, Haiti 1974-1986

9. MINIMAL: Governments whose operations are largely or wholly limited to such core functions as maintenance of internal security and administration of justice. "Extractive," or "predatory" governments which exploit a population primarily for the benefit of the elite are also coded here.
Examples: Ethiopia 1950-1963, Yemen Arab Republic 1950-1977, Afghanistan 1950-1972, Philippines 1950-1971

Figure 4.1: Description of SCOPE codings. Source: Gurr (1997[1989],15).

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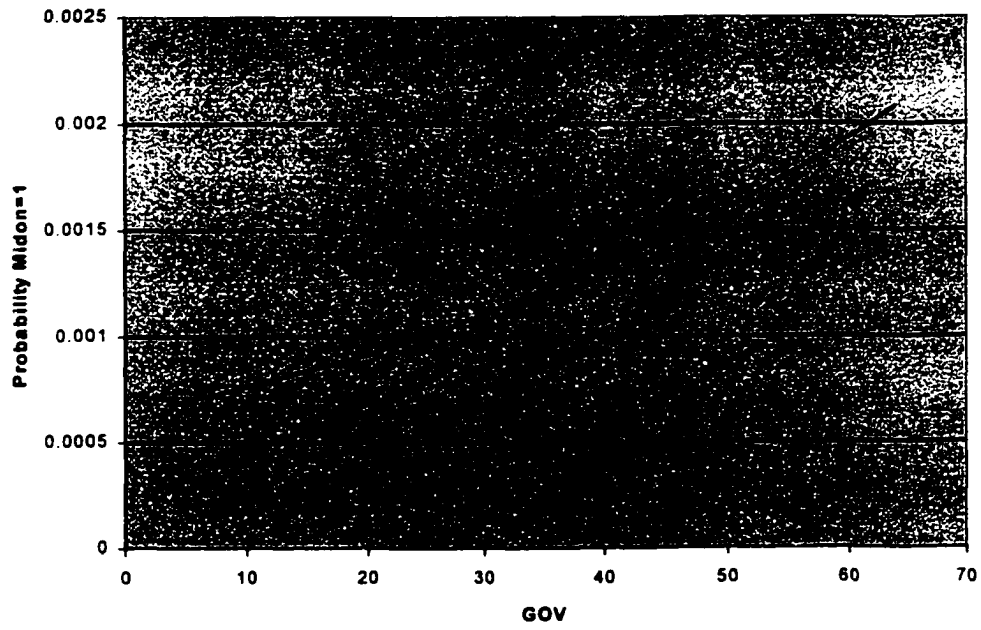
Figure 4 2   Quantitative effects of changes in GOV_H score on probability of MIDON

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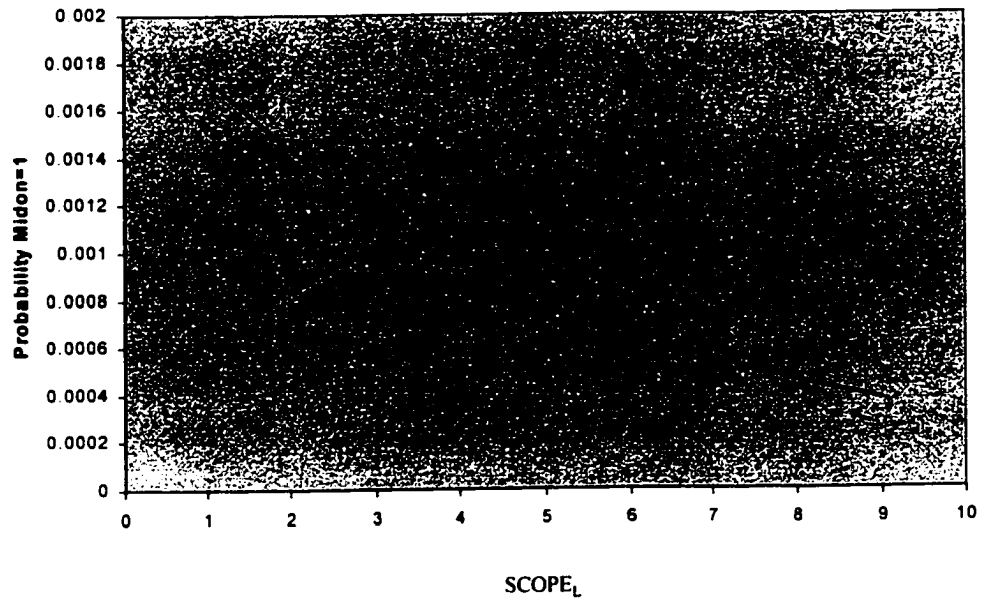
Figure 4.3: Quantitative effects of changes in Scope on probability of MIDON in a year.

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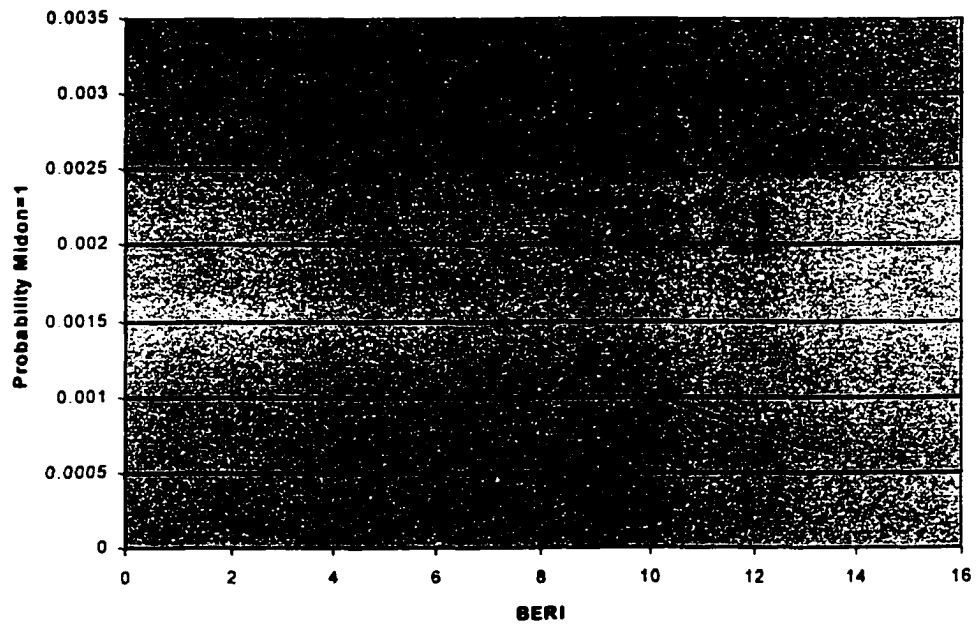
Figure 4.4: Quantitative effects of changes in BERI score on probability of MIDON

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CHAPTER 5

PEACE THROUGH TRADE OR FREE TRADE?
COMPETITIVE MARKETS, TARIFFS, AND INTERNATIONAL CONFLICT

By equilibrating the forces of supply and demand, the allocation of scarce societal

goods through competitive markets and the price mechanism rather than bureaucratic

authority serves as one of the defining elements of a capitalist economy. Chapter 3 laid

out a theoretical argument for why competitive market structures might alter the foreign

policy of state, particularly its decision for war. When a state is forced to purchase

societal resources within competitive markets, it necessarily surrenders some of its

authority to control their allocation. Competition with private sector actors raises the

price that a state must pay to mobilize resources from society. Moreover, because

protected sectors of the domestic economy rely on state-sanctioned regulations to remain

profitable, they possess a vested interest in supporting the current government. These

sectors are more likely to back that regime, even if it pursues costly foreign policies like

war. An important opportunity to build domestic coalitions of support through the sale of

economic regulation is therefore lost within competitive markets. These constraints limit

the state's ability to mobilize political and economic resources for its war machine and

consequently reduce the likelihood that a state will become involved in conflict. This

chapter seeks to support these propositions by statistically testing how one measure of

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domestic economic regulation--import tariffs--alters a state's probability of entering into a militarized dispute.

The nature of this test also offers the opportunity to explore a series of debates that have gained renewed prominence in the fields of international security and international political economy--the questions of whether and how international commerce fosters peace between states. Despite substantial empirical support for the proposition that increasing levels of cross border economic flows--defined either in terms of trade or capital movements--decrease the probability of conflict, scholars have yet to approach a consensus concerning the precise nature of this link. This chapter tests the theoretical critique of this literature advanced in chapter 1.

Free trade, and not just trade alone, promotes peace by removing an important foundation of domestic privilege—protective tariffs—that props up non-competitive producers, taxes disorganizes consumers that would gain from reduced international prices, and simultaneously provides a revenue source for the state often used to fund the war machine. Empirical evidence for this hypothesis is provided by a series of statistical tests that substitute measurements of import tariffs for international trade in the data set first used in chapter 4. Because most of the statistical tests of the commercial peace rely on highly similar aggregate measures of trade that generally conflate trade with free trade, they do not account for the variation among states in their ability to intervene and shape this commerce.[1] This distinction is important as many classical liberals specifically identified free trade and not necessarily just trade as a source of peace.

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Consequently, we need to question the role of trade in reducing conflict and examine whether its pacifying effects are conditioned by the state's ability to regulate such economic flows.

TESTING THE PACIFYING EFFECTS OF FREE TRADE

The theoretical distinction between trade and free trade suggests two different tests of the commercial liberal hypotheses. The first, which has been the traditional standard in the literature, has simply relied on aggregate measures of trade with respect to gross domestic product to capture such concepts as the size of the commercial class, a state's dependence or the costs of severing its trading links, and the extent of transnational social ties among citizens of different states. The second begins from the argument that aggregate trade flows provide an imperfect proxy for the level of free trade. Standard statistical tests of the commercial peace hypothesis must instead include an indicator of the state's ability to regulate international commerce.

To test statistically the hypothesis that free trade and not just trade decreases the probability of interstate conflict, I adopt similar baseline models to those of chapter three. Two sets of tests will be conducted. The first tests a dyadic version of the hypothesis by utilizing the dyad year as the unit of analysis. The second tests the monadic version of the hypothesis by adopting the directed dyad year as the unit of analysis. Two important differences separate these tests from ones conducted earlier. First, because of data

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[1] For exceptions to this see Mansfield, Pevehouse, and Bearce (1999/2000); Mansfield and Pevehouse

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limitations, the temporal domain under investigation will span from 1970 (rather than 1950) to 1992. Second, I substitute a measure of free trade—import tariffs—for the traditional measurements of interdependence in the literature relying on aggregate levels of some combination of imports and exports.

Some of the strongest evidence linking tariff levels to the onset of international conflict can already be found within a recent literature linking the expansion of Preferential Trading Agreements (PTAs) to a reduction in military conflict among states (Mansfield, Pevehouse, and Bearce 1999/2000, Mansfield and Pevehouse 2000, Mansfield 2003). These studies criticize much of the literature in question for failing to account for how the international institutional structure within which this exchange occurs rather than trade itself may alter the conflict behavior of states. Mansfield and Pevehouse write, "[w]e maintain that heightened commerce is more likely to inhibit conflict between states that belong to the same preferential grouping than between states that do not" (2000, 775). Such a concentration on trade institutions among states is important for these agreements require the signatories to reduce trade barriers. While these institutions alter the bargaining context within which states interact, they simultaneously alter the domestic bargaining environment by removing the fountains of privilege on which monopoly interests rely and by empowering those segments of society most likely to support peace. As an operational indicator, membership in a PTA suggests that a state has lower tariff levels than nonmember states. Consequently, these studies

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(2000) and Polacheck et al (1999).

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can also offer a preliminary set of tests of the second image version of the commercial liberal hypothesis.

And yet such an indicator of tariff levels has its own set of limitations as well. Apart from its ability to increase the number of states under observation in a sample, the measurement is unable to distinguish variations in tariff levels among states. This variation in tariff levels is particularly important when examining states that are not members to the same PTA. Even though a pair of states may not discriminate against each other's goods, there is still the possibility that tariffs against nonmembers constitute a sizeable portion of either of the governments' revenue streams.[2] This possibility suggests the need to expand work focusing on PTAs by looking directly at the level of import tariffs a government levies on goods entering its economy from all of its trading partners.

I rely on measurements of import tariffs for a number of additional reasons. First, the depth of tariff protection provides an indicator of the quantity of free trade in an economy--as tariffs increase, the quantity of free trade should decrease.[3] Instead of assuming that a strong negative correlation between tariff levels and trade, this indicator recognizes that there are a number of costs captured in the price of a traded good, including input costs, transportation costs, insurance, foreign exchange contracts, and

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[2] Joseph Chamberlain's campaign for a system of imperial preference to counteract British decline prior to World War I is one example of such a system. While his proposal would have eliminated tariffs on imports from the colonies, it simultaneously would have increased tariffs against the rest of the world. For a brief discussion with respect to this issue see O'Rourke and Williamson (1999, 108).

[3] This is not to say that tariffs are the only sort of barriers to international trade. However, for the period under study, they provide a measure that offers more observations and thus a wider sample both temporally and spatially.

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tariffs.[4] All of these costs can affect the price of a traded good and consequently the size of aggregate trade flows. However, only one such cost explicitly focuses on the state's role in regulating this trade—import duties.

This focus on the level of regulation in an economy to assess its institutional structure avoids a questionable assumption often adopted in empirical tests linking capitalism or interdependence with peace. By operationalizing free trade or capitalism in terms of aggregate flows, some studies tend to infer institutions from outcomes. Capitalism and economic dependence are presumed to exist given that heightened bilateral trade or economic growth should generally follow from laissez faire policies. For example, by suggesting that GDP per capita serves as reasonable indicator of "the intensity of economic norms of contract," Mousseau (2000, 484) necessarily adopts such a view of the processes and institutions that generate economic growth.[5] Studies of the long wave too attribute periods of global economic growth as evidence of capitalist expansion (e.g. Wallerstein, 1983).[6]

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[4] Economic historians examining the prewar period of globalization argue that this correlation did not emerge until the Bretton Woods area. More importantly, the expansion of trade in the latter part of the nineteenth century was largely the result of technological developments that dramatically reduced transportation costs (O'Rourke and Williamson 1999).

[5] He does note that such a measurement does have validity problems for socialist states and oil exporting states that have high development levels without established norms of market based contracting. However, because he is interested in the interaction between development and democracy, such states have lower interactive scores because they are generally autocracies. This suggests that such an operational choice may have trouble testing any independent effect of what I more generally refer to as capitalism on conflict. Furthermore, Mousseau's empirical results must also be viewed with skepticism in light of his use of GDP per capita as an indicator of the primary concept in his model—intensity of economic norms of contract within nations—to the neglect of a large number of alternative operationalizations of contract enforcement, rule of law, and institutional quality commonly used in the growth literature (e.g. Knack and Keefer, 1995, 1997).

[6] Perhaps more importantly for the substance of this project, these periods of economic growth are positively correlated with conflict. For a review of this literature see Pollins (1996).

These perspectives assume that liberal economic institutions such as private property, competitive markets, and limited government are *necessary* for prosperity and neglect the variety of paths an economy may take on the path toward growth. For example, some economists attribute the tremendous growth of socialist states in the immediate postwar period to an authoritarian structure that allowed governments to suppress consumption and integrate previously idle factors of production into their economies.[7] The fact that many socialist states achieved high rates of economic growth and increased their levels of economic development illustrates how difficult it is to infer the presence of capitalist institutions from such indicators.

Moreover, the same logic can be found in the interdependence and conflict literature where an expansion of trade between two countries is presumed to indicate a reduction in trade barriers and/or an increase in the level of capitalism in an economy.[8] And yet it is clear that that an increase in trade can follow from price shifts in any one of a number of components of the total price of a traded good including transportation costs, input costs, productivity improvements, insurance costs, tariffs, etc. Only one of these costs captures the level of political intervention or freedom in the economy—barriers to trade.

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[7] These claims have their origins in growth accounting, which attempts to distinguish the sources of economic growth between those attributable to an increase in inputs and those due to productivity gains. While input led growth is ultimately subject to decreasing returns, growth in productivity is in theory not. For a discussion of these arguments see Krugman (1994).

[8] The assumed links between capitalism, open markets, trade, and interdependence can be seen in the followng quote. Russett and Oneal write, "Almost all democracies, though varying to a degree in the role played by the state, have capitalist economic systems that involve extensive competition in free markets among economic agents, including those in other countries. Consequently, democracies tend to trade extensively with one another. Because of the correlation between democracy and open markets, we need to reconsider the consequences of democracy through tests in which we control for interdependence" (2001, 125).

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Second, as discussed earlier, the second-image commercial peace hypothesis demands a different set of measurements because it does not assume that all segments of society necessarily benefit from free trade. The size of tariff levels provides one measurement of the relative domestic strength of groups within society that either benefit or are hurt by free trade. Higher tariff levels suggest that import-competing sectors have already paid the necessarily lobbying costs to purchase regulations from the government that redistribute income toward them. As the size of this sector grows, we should expect that larger portions of the domestic polity benefit from a contraction in international markets that tends to follow military conflict. Higher tariff levels imply greater domestic pressures for war. On the other hand, lower tariff levels indicate that free trade lobbies and consumers have been more successful in defeating protectionist interests in the domestic political game.

Third, a measurement of import tariffs also provides a crude means by which to examine the level of competition within domestic markets and tie these statistical results to the broader arguments linking capitalism and peace. Because indicators of competition or market structure are generally industry specific, a proxy for the overall level of competition in a domestic economy is hard to find. One of the benefits of focusing on government regulation of imports flows directly from the principle of comparative advantage. Specialization suggests that states import a more diverse bundle of goods than they export. An examination of import regulations should provide a reasonable indicator of regulation across a number of industries. Additionally, by restricting the entry of foreign goods, import tariffs decrease the size of domestic markets

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and increase the ability of domestic firms to influence prices (Varian 1996, 418-19). If a domestic monopoly exists prior to free trade, the elimination of trade barriers will allow foreign competitors to erode the market position of the domestic monopolist (Bhagwati 1991, 110-115). Finally, the relationship between tariffs and monopoly can be examined by exploring the case of a competitive domestic market. What incentive would these producers have for expending costly resources to lobby the government for protection from foreign producers? Any benefit that they receive from import protection will be eroded by competition among domestic producers. For these reasons, domestic monopolies cannot exist without barriers to international competition. Consequently, the absence of trade barriers suggests the presence of competitive domestic markets. Conversely, as trade barriers increase, the probability that domestic markets will be monopolistic increases as well.

Dyadic Design

To test the argument that free trade is negatively related to international conflict, I rely on a measurement of import tariffs drawn from the World Bank Development Indicators (1998). It measures the size of import duties as a percentage of a country's imports.[9] Utilizing this indicator, labeled here $IMPDUTY_H$,[10] I specify first the following baseline model[11] in the dyadic set of tests:

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[9] Import duties are defined in the following manner: Import duties comprise all levies collected on goods at the point of entry into the country. They include levies for revenue purposes or import protection, whether on a specific or ad valorem basis, as long as they are restricted to imported products. Data are shown for central government only.

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$$MIDON_{ij} = \beta_0 + \beta_1 * ALLY + \beta_2 * CONTIGUITY + \beta_3 * CAPRATIO + B_4 * GROWTH_L$$
$$+ \beta_5 * DEMOCRACY_L + \beta_6 * DEMOCRACY_H + \beta_7 * GDP_L + \beta_8 * GDP_H$$
$$+ \beta_9 * AFFINITY + B_{10} * DISTANCE + B_{11} * IMPDUTY_H + \varepsilon.$$

This model was estimated using logistic regression and the Beck, Katz, and

Tucker (1998) correction for time series cross sectional analysis with a binary dependent

variable.[12] The first set of results can be seen in model 1 of table 5.1. Here I substitute a

new measure of free trade—import tariffs—for the standard indicator of bilateral

dependence in the literature—total imports and exports within a dyad divided by GDP.

The positive and statistically significant sign on IMPDUTY$_H$ indicates that as the level of

import duties increases, the probability of the onset of a militarized interstate dispute

increases as well. Given import duties as one means of assessing free trade (as import

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[10] I employ the weak-link assumption common in the empirical literature on the liberal peace. Because the member of the dyad possessing the higher level of import tariffs is less constrained domestically than the other dyad member, its value is included in the model.

[11] The variable descriptions are written in more detail in chapter three. Here is a brief summary. MIDON indicates the onset of a militarized interstate dispute in year t. ALLY is a dummy variable that takes on a value of 1 when both states in the dyad are members to a common alliance as defined by the COW project in year t. CONTIGUITY is a dummy variable that takes on a value of 1 when states i and j share a common border on land. CAPRATIO is the natural log of the stronger member's capability score (taken from the COW project) within the dyad divided by the weaker member. GROWTH$_L$ is the lower economic growth rate of either state i or state j in year t defined as the percentage change in per capita GDP measured over a three-year period prior to year t. DEMOCRACY$_L$ is the lower total democracy score (the democracy score minus the autocracy score in the Polity project) of one of the members of the dyad, while DEMOCRACY$_H$ is the higher score. GDP$_L$ and GDP$_H$ are the higher and lower values of each member's gross domestic product measured at time t-1. AFFINITY is a measure of the correlation of each state's roll call voting patterns in the United Nations General Assembly. DISTANCE is the natural log of the total distance in miles between the capital city of state i and the capital city of state j.

[12] Because observations are likely to be temporally dependent and lead to standard errors that underestimate the variance of a coefficient, a natural splines function of the number of years since i and j were last engaged in a militarized dispute was included. The value of these coefficients are not reported in the table but the base of the function is always statistically significant. Additionally, Huber standard errors were used by clustering on each dyad.

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duties increase, the level of free trade decreases), the likelihood of military conflict within a dyad decreases as the level of free trade increases. Additionally, an examination of the predicted probabilities of this model indicates that while holding all values at their means except CONTIGUITY and ALLY, which are held at their modes (zero), a movement from the mean tariff level (17.5% of imports) to one standard deviation from the mean (26.4%) increases the probability of the outbreak of a military dispute within a dyad during a year by 25 percent.

The next results in model 2 of Table 5.1 examine how an inclusion of the standard measurements of interdependence, total bilateral imports and exports divided by each state's gross domestic product, alters the results. Three variables are included. The first, DEP_L, is the lower proportion of either total dyadic trade divided by state i's GDP or total dyadic trade divided by state j's GDP.[13] It is the standard dyadic measure of mutual dependence in the interdependence literature. As bilateral trade constitutes a larger portion of the more weakly constrained member's GDP, the likelihood of conflict within that dyad should decrease. The second variable, DEP_H, is simply the higher ratio. IMPUTE is a dummy variable included because of the nature of the trade data as used in Oneal and Russett (1999a). It takes on a value of one when they code missing trade in the IMF's Direction of Trade Statistics as being equivalent to no commerce in a given year. Although the inclusion of these variables slightly decreases the confidence of the coefficient on IMPDUTY ($p<0.1$), it still indicates that an increase in import duties is positively associated with the onset of a MID.

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[13] Trade and GDP numbers are both annual figures measured at time t-1.

The last two models of table 5.1 provide the same data robustness checks as were conducted in the previous chapter. They substitute the Gleditsch data on trade, GDP, and growth for the Oneal and Russett data. The results slightly improve as the confidence of the import duty term increases (p<0.05) when controlling for standard measures of interdependence (model 4). Again, tariff rates are positively related to the onset of military conflict between states.

Table 5.2 provides another series of robustness checks on these results. The first model simply adds a dummy variable (MAJPOW) if either member of the dyad is a major power as defined by the COW project. While its inclusion reduces the statistical significance on the coefficients for GDP, the positive and significant coefficient on import duties remains. Model 2 adds one of the indicators for the size of public property, GOV_H, from chapter 4. Again, import duties are still positively related to the onset of a MID.[14] The third model slightly alters the operationalization of the dependent variable. In contrast to MIDON (which only treats the first year of a militarized interstate dispute as an instance of conflict), the dependent variable in this model is DISPUTE, which codes the first year of a MID and every consequent year as having conflict present i.e. it takes on a value of one. This specification of the dependent variable does not alter the primary findings of this chapter. Import duties are still positively related to the presence of military conflict between two states.

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[14] While GOV_H fails to retain either its hypothesized direction or statistical significance in this model, it appears that these results are the product of a reduced sample due to the tariff data. I ran another model (whose results are not included in this table) that excludes the variable for import duties but includes GOV_H. GOV_H failed to achieve statistical significance or the hypothesize direction in this model as well. Similar results were obtained with the other primary operationalizations of private sector size from chapter three—$PRIV_L$ and $SCOPE_L$.

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Monadic tests—the directed dyad sample

Table 5.3 displays a third set of results that allow exploration of the monadic version of the hypothesis suggesting that a state with higher import duties is more likely to engage in international conflict regardless of the characteristics of other states. Utilizing the directed dyad year as the unit of analysis, this research design includes two observations for each dyad year. The first observation includes the observed unit-level traits for one member of the dyad (like its democracy score) while the other observation contains the unit-level traits of the other member of the dyad. While another potential design would treat the state-year instead of the directed dyad year as the unit of analysis for a monadic test, the latter offers the opportunity to include dyadic traits, such as contiguity, distance, or the correlation of UN roll call voting patterns—all of which have been repeatedly shown to have strong effects on the likelihood of conflict—in the model.[15]

The first column of table 5.3, similar in specification to the first column of table 5.1, serves as the baseline model of this directed design. Again, import duties are positively related to the onset of a militarized interstate dispute. These positive and significant findings remain when including the ratio of bilateral exports and imports divided by state a's GDP (DEPEND$_A$ in column 2).

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[15] As noted earlier, the directed research design offers another benefit. When observations for the unit level traits of either member of the dyad are missing, the entire observation is thrown out of the analysis. If Soviet import tariff is missing in 1965, then its interactions with all other states in the international system are excluded for that year. However, say if France has import data available for 1965 then its interactions with the Soviet Union can be included in the analysis. Only the observation from the dyad that has the

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The last two columns of the table test a different variant of the basic commercial liberal hypothesis. The dependent variable here is the initiation of a dispute by one specific member of the dyad rather than just the onset of a conflict within a year. Higher tariff levels also increase the probability that a state will initiate military conflict as evidenced by the positive and significant coefficient on the import duty term. These results support the broader claim that mercantilist policies foster a more aggressive foreign policy.

Finally, it is important acknowledge the need for caution with these results. This data set possesses some limitations. A focus on tariffs neglects nontariff barriers such as quotas and quality restrictions. Additionally, this measurement cannot capture the regulation caused by a restrictive tariff in which no exchange occurs and the state does not collect any revenues. However, in spite of these limitations, the theoretical need for focusing on tariffs combined with the widespread tendency in the literature to conflate trade and free trade demands that such variables, even though imperfect, should be included in standard tests of the commercial peace hypotheses. The combination of dyadic and monadic results offer confirming evidence linking increased tariff levels to the outbreak of military conflict. At the same time, they support the claim that a second image variant of the commercial peace hypothesis offers some additional explanatory leverage over a number of the more popular explanations that focus on the mutual dependence or transnational social ties generated by commerce.

Soviet unit-level characteristics would be excluded. Thus the directed dyad design offers the opportunity to

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CONCLUSIONS

This chapter has sought to accomplish two empirical goals. First, by employing one measure of the level of regulation in a domestic economy, it has found statistical support for the broader arguments linking capitalism with a reduction in military conflict between states. As markets become more competitive, states become less likely to become involved in or initiate a military dispute with another state. Second, this chapter has provided empirical support for the theoretical critique advanced in chapter one of the contemporary literature linking interdependence and peace. Scholars like Cobden and Schumpeter recognized that while international commerce may offer the potential to establish mutual ties of dependence of among states that made war less likely, free trade also simultaneously transformed the domestic distribution of power by eliminating economic regulations that favored monopoly interests likely to support war. While more solidly grounded in the foundations of liberal theory that focus on how individual incentives and domestic institutions alter the foreign policy of states, such arguments do not conflate trade with free trade and recognize that the structure of domestic institutions provides a crucial filtering variable between commerce and peace. Free trade reduces the probability of conflict between states by undermining the domestic political power of interests that benefit from conflict and by limiting the state's ability to use economic regulations to build domestic coalition in support of war. The next chapter applies these

include in the sample a number of "half-cases" that are otherwise thrown out in a dyadic design

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theoretical and empirical insights to the case often held out as contradicting the

commercial peace—the origins of World War I.

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Variable	_Model 1_	_Model 2_	_Model 3_	_Model 4_
ALLY	0.083	0.124	0.031	0.015
	(0.314)	(0.312)	(0.313)	(0.308)
CONTIGUITY	1.986***	1.926***	2.040***	2.095***
	(0.534)	(0.516)	(0.522)	(0.523)
CAPRATIO	-0.032	-0.085	-0.043	-0.054
	(0.099)	(0.099)	(0.098)	(0.097)
DEPEND$_L$		-51.041		-22.249
		(31.200)		(30.409)
DEPEND$_H$		0.246		-2.330
		(2.928)		(3.089)
IMPUTE		-1.039**		
		(0.320)		
GROWTH$_L$	-3.214	-4.179**	-6.141**	-5.977**
	(1.993)	(2.017)	(2.613)	(2.638)
DEM$_L$	-0.025	-0.020	-0.025	-0.018
	(0.019)	(0.171	(0.019)	(0.018)
DEM$_H$	-0.009	0.000	-0.008	-0.006
	(0.019)	(0.021)	(0.018)	(0.019)

(continued)

TABLE 5.1: Dyadic tests of effects of market competition on ONSET of militarized interstate dispute (MID). Robust standard errors are listed in parentheses. Each model also includes a natural spline function (not shown) with a base and three knots.
*** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 5.1: (continued),

Variable	Model 1	Model 2	Model 3	Model 4
AFFINITY	-0.813	-0.727	-0.809	-0.630
	(0.504)	(0.532)	(0.505)	(0.536)
GDP$_L$	$1.89*10^{-9}$**	$2.52*10^{-9}$***	$1.87*10^{-9}$**	$2.29*10^{-12}$**
	$(9.44*10^{-10})$	$(9.65*10^{-10})$	$(9.37*10^{-9})$	$(9.43*10^{-13})$
GDP$_H$	$4.10*10^{-10}$**	$3.99*10^{-10}$*	$4.26*10^{-10}$**	$5.26*10^{-13}$**
	$(1.92*10^{-10})$	$(2.05*10^{-10})$	$(1.90*10^{-10})$	$(2.12*10^{-13})$
DISTANCE	-0.373**	-0.417**	-0.377**	-0.409**
	(0.187)	(0.201)	(0.186)	(0.197)
IMPDUTY$_H$	0.023**	0.015*	0.234***	0.018**
	(0.089)	(0.008)	(0.009)	(0.008)
CONSTANT	-0.328	0.452	-0.357	-0.137
	(1.577)	(1.609)	(1.562)	(1.607)
N	57,860	57,323	58,457	58,457
Log likelihood	-743.842	-729.423	-754.148	-752.042

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Variable	Model 1	Model 2	Model 3
ALLY	-0.044 (0.318)	0.076 (0.317)	0.226 (0.291)
CONTIGUITY	2.188*** (0.567)	1.974*** (0.532)	1.797*** (0.485)
CAPRATIO	-0.073 (0.106)	-0.029 (0.096)	0.015 (0.089)
GROWTH$_L$	-3.142 (1.936)	-3.357 (2.055)	-5.544*** (1.882)
DEM$_L$	-0.032 (0.020)	-0.027 (0.019)	-0.034** (0.017)
DEM$_H$	-0.007 (0.021)	-0.010 (0.019)	-0.014 (0.018)
AFFINITY	-0.394 (0.521)	-0.851* (0.494)	-1.115** (0.440)

(continued)

TABLE 5.2: Robustness checks for MAJPOW, GOV, DISPUTE--dyadic tests of market competition on military conflict. MIDON is dependent variable. Robust standard errors are listed in parentheses. Each model also includes a natural spline function (not shown) with a base and three knots. *** $p \leq 0.01$; ** $p \leq 0.05$; * $p \leq 0.1$. Two-tailed tests for all estimates.

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TABLE 5.2: (continued),

Variable	Model 1	Model 2	Model 3
GDP$_L$	$6.13*10^{-10}$ $(1.20*10^{-9})$	$1.82*10^{-9}*$ $(9.53*10^{-10})$	$2.13*10^{-9}**$ $(9.09*10^{-10})$
GDP$_H$	$1.80*10^{-10}$ $(1.88*10^{-10})$	$3.91*10^{-10}**$ $(1.84*10^{-10})$	$3.19*10^{-10}*$ $(1.65*10^{-10})$
DISTANCE	-0.389** (0.195)	-0.382** (0.186)	-0.398** (0.186)
IMPDUTY$_H$	0.029*** (0.009)	0.024*** (0.009)	0.019** (0.009)
GOV$_H$		-0.011 (0.014)	
MAJPOW	1.708*** (0.423)		
CONSTANT	-0.766 (1.656)	0.014 (1.715)	0.649 (1.495)
N	57,860	57,860	57,860
Log likelihood	-733.156	-743.344	-757.787

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Variable	_Model 1_	_Model 2_	_Model 3_	_Model 4_
ALLY	0.210 (0.218)	0.104 (0.209)	0.365 (0.228)	0.234 (0.218)
CONTIGUITY	2.251*** (0.366)	2.102*** (0.360)	2.537*** (0.378)	2.375*** (0.385)
CAPRATIO	-0.217*** (0.451)	-0.223*** (0.044)	-0.181*** (0.050)	-0.192*** (0.048)
DEPEND$_A$		0.569 (1.051)		1.507 (1.470)
IMPUTE		-0.957*** (0.187)		-0.922*** (0.211)
GROWTH$_A$	-2.428*** (1.055)	-3.019*** (1.135)	-3.405*** (1.151)	-3.935*** (1.219)
DEM$_A$	-0.006 (0.008)	-0.008 (0.008)	-0.017** (0.010)	-0.019* (0.010)
AFFINITY	-1.531*** (0.380)	-1.560*** (0.345)	-1.697*** (0.372)	-1.744*** (0.345)

(continued)

TABLE 5.3: Directed dyadic tests of effects of market competition on ONSET and initiation of a MID. Robust standard errors are listed in parentheses. Each model also includes a natural spline function (not shown) with a base and three knots.
*** $p \le 0.01$; ** $p \le 0.05$; * $p \le 0.1$. Two-tailed tests for all estimates.

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TABLE 5.3: (continued),

Variable	Model 1	Model 2	Model 3	Model 4
GDP$_A$	$5.33*10^{-10}$***	$4.46*10^{-10}$***	$5.39*10^{-10}$***	$4.62*10^{-10}$***
	$(9.46*10^{-11})$	$(8.47*10^{-11})$	$(1.05*10^{-10})$	$(9.51*10^{-11})$
DISTANCE	-0.354***	-0.338***	-0.346***	-0.340***
	(0.132)	(0.129)	(0.124)	(0.125)
IMPDUTY$_H$	0.013*	0.014**	0.027***	0.026***
	(0.007)	(0.006)	(0.007)	(0.007)
CONSTANT	0.399	0.735	-0.902	-0.430
	(1.143)	(1.091)	(1.102)	(1.095)
N	224,243	223,241	224,243	223,241
Log likelihood	-2831.765	-2784.517	-1742.528	-1717.091

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CHAPTER 6

LIBERALISM'S ACHILLES HEEL? GLOBALIZATION AND WORLD WAR I

Debate over the sources and consequences of globalization has sought to place the current era in a broader historical context. Noting that the recent expansion of transnational flows of trade, capital, technology, and labor is not unprecedented, scholars increasingly look to the period prior to the outbreak of World War I for insight into the contemporary era. For those hoping that globalization will promote a new era of peace in which webs of mutual dependence bind states together and raise the costs of war to politically unacceptable levels, that period seems to provide powerful yet disconfirming evidence. Even though the combatants of World War I were each other's primary economic partners, globalization either failed to prevent war or may have even played a crucial role in the outbreak of war (Rowe 2001). Realist scholars have long held out this critical case as offering a fatal blow to the commercial peace hypothesis (e.g. Waltz 1979, Mearsheimer 1991).

In this chapter, I challenge conventional wisdoms about how globalization shaped the outbreak of war by casting doubt on the common characterization of it as the archetypal liberal and interdependent economic order. With the exception of Britain, the Great Power combatants all maintained important means of intervening in their domestic

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economies. Widespread tariffs--both for protection and government revenue--, capital controls that set the terms of sovereign lending, and substantial public assets critically shaped the ability of states to mobilize domestic resources for war. As a consequence, even in the relatively democratic polities of France and Germany, domestic societies lacked the means to restrain their governments from generating sufficient revenues to undertake a costly arms race on land following the Bosnian annexation crisis that would culminate in the outbreak of war in July of 1914.

These arguments are embedded in a broader criticism of both conceptualizations of interdependence and the commercial peace hypothesis. Proponents of commercial liberalism have long held that trade flows between countries provide a reasonable proxy for economic interdependence and economic liberalism. An increase in trade implies a decrease in barriers to trade and vice versa. As exposure to the global economy increases, the political power of trading elements within society necessarily opposed to war should increase as well. Such views neglect the possibility that trade policies constitute only one input into the price of a traded good. Economic historians now agree that the rapid expansion in trade, labor, and capital flows across national boundaries in the decades prior to World War I was largely the product of a dramatic decline in transportation costs dating from the middle of the nineteenth century (Bairoch 1989; Bordo, Eichengreen, and Irwin 1999; O'Rourke and Williamson 1999). Moreover, in response to this shock, most governments reversed earlier trends of liberalization by reinstituting wide-ranging tariffs in the decades leading up to the war (Williamson 1998).

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If liberal theory focuses on individual liberty as the foundation to peace, then we need to be skeptical of claims that interdependence and trade necessarily decrease the probability of war if they do not simultaneously constrain the state's role in regulating a domestic economy. An understanding of the international consequences of globalization and interdependence first necessitates an examination of how domestic institutions refract these pressures into public policy outcomes.[1] By integrating what I labeled earlier as "second image dynamics" of the commercial peace hypothesis, I argue that the onset of World War I does not stand out as contradictory to liberal explanations of war as realists claim. Moreover, a broader conception of liberal IR theory, which focuses on the state's capacity to influence domestic economic activity can explain the origins of the prewar arms race and the outbreak of conflict in July 1914.

In the case of World War I, mercantilist controls played a crucial role in shaping a rapidly changing balance of power in Europe in the decade prior to the July crisis. Following a small period of relatively liberal commercial policies, continental governments reintroduced a series of tariffs in the period after 1879, upon which they relied for fiscal support and to build domestic coalitions that favored more aggressive foreign policies. Capital controls in France and Germany allowed these governments to use large pools of domestic savings for diplomatic influence. A series of state-sanctioned loans from France rescued Russia from fiscal collapse in 1906 and helped build Russian railways that in turn increased public revenues and decreased the mobilization times of its army. Finally, large public holdings of property in Russia rendered the rebuilding of state

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[1] This parallels the argument made by Verdier (2001) that domestic capital mobility, achieved through

finances so successful that by 1914 many European leaders felt they could no longer afford an arms race with Russia. Ultimately, it was this fear of rising Russian power that provided a crucial dynamic to the outbreak of war in July 1914.

To develop these arguments, this chapter has three primary sections. The first, while serving as background, reviews conventional applications of commercial liberalism that see in the outbreak of World War I strong contradictory evidence. The second challenges both common conceptualizations of interdependence and the identification of that period as representative of an open economic order by examining a number of institutions regulating economic activity within the European Great Powers. It discusses both how mobile capital and competitive markets constrained aggressive foreign policy; and how economic regulations and state-owned assets allowed governments to acquire economic and political resources necessary to go to war. The third section examines how a resurgent Russia shaped perceptions of security and the decision for war in the decade prior to July 1914.

CONFOUNDING THE COMMERCIAL PEACE HYPOTHESES

Despite the accumulation of a substantial amount of statistical evidence during the past two decades, the commercial peace hypothesis is not without its detractors. Perhaps the strongest criticism centers on one crucial case--the failure of interdependence to prevent the outbreak of World War I. For example, Mearsheimer (1991) argues that interdependence is just as likely to lead to conflict as states attempt to escape the

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developed equity markets, is necessary for capital to be mobile across national boundaries.

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vulnerability that the specialization of production brings. He then dismisses the liberal argument by pointing to the outbreak of World War I following "the time of greatest economic interdependence in Europe's history" (ibid., 182). Ripsman and Blanchard (1996/97) challenge the commercial liberal hypothesis by arguing that German leaders were aware of their vulnerability to a blockade by the British navy and yet still chose to go to war in 1914. Pointing to World War I as "glaring anomaly for liberal theory," Copeland (1996, 4) argues that interdependence is only likely to promote peace when states have expectations that commerce will continue in the future. Referring to the commercial liberal hypothesis as the "Manchester creed," Blainey (1988, 31) points to the two world wars as evidence that such hypotheses cannot be part of a broader theory of war and peace. Finally, Rowe (1999, 2001) argues that instead of strengthening the forces for peace, globalization caused the outbreak of World War I by steadily eroding the capacity of governments to mobilize societal resources for national defense. These difficulties heightened insecurity across the continent and undermined the ability of states to maintain a balance of power capable of preserving the peace.

Liberals, on the other, have chosen either to ignore this important case or argue that the constraints posed by an open global economy often depend its interactive effects with other variables that were not present in 1914 (Rowe 2001). Rosecrance (1996) argues that national leaders failed to perceive the extent of their dependence and the costs that would be inflicted by an extended conflict. Papayoanou (1999) claims that the presence of a political system that grants trading interests political expression is crucial in the relationship between interdependence and grand strategy. Because Germany was not

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a democracy, those segments most likely to be hurt by an interruption in trade lacked the political means to constrain the government from going to war. Similarly, Oneal and Russett (2001) point to the absence of liberal variables such as joint democracy and membership in international organizations as some of the reasons behind trade's inability to prevent conflict in the period leading up the Great War.

Even though realism and liberalism disagree about the international consequences of globalization, there is less distance in their positions with respect to explaining the origins of World War I. Support from both schools can be found for the proposition that interdependence had little effect on the outbreak of this war.[2] While this is largely consistent with realist theories tracing the origins of military conflict to systemic forces like shifts in the global distribution of power or the offense-defense balance, it is more troublesome for the liberal paradigm that focuses on how the expansion of individual freedoms through democratic elections, civil liberties, and open international markets constrain the independent ability of governments to wage war against broader societal interests in peace. In light of this limitation, we must ask: how fatal a blow does World War I provide to a liberal theory of international relations?

World War I serves as such a difficult case for commercial liberalism because most common specifications of this general hypothesis are underspecified and fail to incorporate liberal theory's broader conception about the origins of war and peace. By positing individuals as the primary unit of analysis and focusing on the relationship between the state and society to explain the dynamics of interstate relations, liberal theory

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[2] For an argument that extends this argument outside the World War I case see Buzan (1984).

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views war as part of a larger government effort to remain in power and redistribute income toward political supporters. To prevent war, societies need mechanisms to monitor and punish the behavior of the state.

As argued in chapter five, the literature linking commerce and peace has generally overestimated the ability of commerce alone to promote peace by conflating interdependence with liberal economic structures. This oversight is particularly relevant in the pre-World War I era of globalization. Scholars examining this period generally point to the continuing expansion of trade in the decades before World War I as evidence of free trade and increasing economic constraints on the state. However, this period also saw tariff increases as states responded to pressures of international competition by protecting nascent industrialization. In many ways, the state's increasing ability to shape international trade during this period casts doubt on whether this case really represents an open economic order. Because a number of continental economies relied on tariffs as a primary source of public revenue, the expansion of trade may actually have increased public revenues and eased the efforts of governments to divert resources into defense sector. Strengthening the state instead of society, trade may have made war more likely.

This hypothesis is consistent with the second image version of the commercial peace that focuses on the ability of free trade, and not just trade, to shift the domestic distribution of power in a society toward those interests most likely to support peace. As tariffs shield noncompetitive sectors and shift the distribution of wealth in a society toward these groups and away from consumers, the political motivation behind free trade has just as often been domestic as international i.e. to promote peace. The removal of

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tariffs and the encouragement of free trade transform the domestic balance of power by strengthening those who benefit from free trade and consequently are most interested in peace. At the same time, free trade erodes a system of tariff regulations that increases the income of societal groups that stand to gain from a decrease in foreign competition resulting from the contraction of global markets and war. The ability of commerce to promote peace thus depends crucially on trade's ability to alter the structure of domestic politics. In this second-image variant of the commercial peace hypothesis, free trade and not necessarily trade promotes peace. Conversely, it also suggests that as the state's ability to intervene and regulate economic transactions increases, the probability of conflict with other states should increase as well.

A LIBERAL ECONOMIC ORDER?

These arguments carry important implications for understanding the relationship between interdependence and World War I. First, they demand a reexamination of the degree of "liberalism" in the European economies. Did the expansion of trade flows in this period necessarily suggest society was more able to prevent these states from going to war? Or did these states possess other regulatory capacities that allowed them to devote increasing portions of societal wealth to armaments thereby fueling the fire of war? In this section, to challenge the claim that the outbreak of World War I undermines liberal IR theory, I examine how the major combatants possessed a variety of means to interrupt flows of goods and capital. In particular, I examine how tariffs, capital controls,

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and state-owned assets shaped the fiscal ability of states to fund rearmament and build political coalitions in support of more aggressive foreign policies. Trade did not imply free trade and open domestic markets in this era. On this basis alone, we should not be surprised that interdependence failed to promote peace.

Trade

A simple glance at the expansion on nineteenth century trade flows provides a strong prima facie case for the critics of commercial liberalism. Table 6.1 shows this growth in terms of the volume of exports of some of the largest economies. Using 1913 as a base year, British exports grew by over a factor of 35 between 1820 and 1913. The volume of French exports in 1820 was only a little over four percent of its level in 1913. These dramatic increases remained even in the final years before the war. For example, French, German, and American exports all grew by over thirty percent in the three-year period before the outbreak of war.

More importantly though for the commercial peace hypothesis, economic historians now argue that the rapid globalization and integration of national economies that occurred in the nineteenth century was entirely the product of a sharp reduction in transportation costs and was not attributable to a more liberal trading order. O'Rourke and Williamson write, "[a]ll of the commodity market integration in the Atlantic economy after the 1860s was due to the fall in transport costs between markets, and *none* was due to more liberal trade policy. In contrast, most of the commodity market

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integration after the 1950s was (we suspect) due to more liberal trade policy" (1999, 29).

Two key technological developments in this era were largely responsible for this change.

Dramatic railway construction after 1850 integrated national markets and reduced the costs of bringing goods from the interior of a country to coastal regions. The advent of the steam engine also reduced the costs and time of transportation along waterways. The effects of these technological innovations can be seen through changes in the proportion that transportation costs made up in the total price of traded goods. Bairoch (1989, 56) estimates that transportation costs of wheat and bar iron made up 76-82 percent and 89-94 percent of the price of these goods in 1830. By 1910, these respective percentages had been reduced 25-30 and 27-31 percent.

As standard theory suggests, these radical changes in the price of transporting goods led to an explosion in international trade. However, market integration simultaneously eroded the relative income of scarce factors of production within economies and led to political pressures demanding protection from these shocks (Williamson 1998). One of the largest dislocations occurred in European agriculture as cheap grain from land-abundant economies like Russia and the United States eroded returns accruing to land. These pressures were particularly intense in Germany. Seeing his nation become a net importer of grain, Bismarck reversed earlier trends toward liberalization in 1879 and introduced new tariffs protecting both agriculture and industry. This action then touched off a series of protectionist responses by most other governments in Europe (among large countries, Britain was the exception) and effectively ended the one brief period of trade liberalization in Europe begun with the

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signing of the Cobden-Chevalier Treaty in 1860. This shift toward protectionism would continue until the outbreak of World War II (Bairoch 1989). Contradictory to the conventional wisdom often posited in this debate, free trade was not on the rise during this period. Rather, the ability of states to control international commerce increased as tariffs replaced transportation costs in the price of traded goods.

Apart from sheltering noncompetitive domestic producers, the sale of economic regulation, such as tariffs, also often constitutes an important source of public revenues (e.g. Ekelund and Tollison 1981, 1997). Measured as a percentage of total government revenues, Table 3.1 (page 92) demonstrated the significance of customs revenue to a number of economies during this era and compared these to the current period of globalization. Germany stands out as a prime case of a state dependent on customs revenue. The federal system within the Reich allowed the separate German states to defend their capacity to impose incomes taxes while simultaneously forcing the federal government to rely on tariffs for funding the largest expenditure of its budget--defense (Ferguson 1994). Moreover, indirect means of taxation, of which customs duties were often the largest component, served as the primary means of generating revenue in the other Great Power continental combatants of World War I--France, Austria-Hungary, and Russia (Ferguson 1998).

Cast within the broader logic of liberal theory that explains the outbreak of war in terms of efforts to redistribute income within a society, tariffs provide one means of such redistribution. Assuming that a country is small and cannot alter its terms of trade, the costs of tariffs generally fall on a disaggregated group and traditionally poorer segment of

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domestic society—consumers—that face organizational disincentives to lobby the state if these gains from trade are threatened by potential interstate conflict.[3] More importantly, the sale of economic regulation provides a powerful means to generate domestic political support for an aggressive foreign policy.

Weltpolitik

The domestic political dynamics that culminated in the construction of navy to implement Weltpolitik and challenge British hegemony provide a powerful example of how state regulation of the domestic economy through the imposition of tariffs can shape both the mobilization process and the pressures toward war. Industrialization and urbanization had created a looming political crisis in Germany following unification. By fueling demand for an urban labor force, industrialization fostered the emergence of a growing political tension between a socialist electorate in the cities and the conservative agrarian class whose waning political influence was propped up by a constitution that protected rural representation and the rights of the individual states. These pressures loomed throughout the 1890's as the Kaiser and conservative elements in his cabinet and the army contemplated a coup d'etat to disband the Reichstag and rewrite the electoral laws so as to minimize socialist representation.

The launching of the German naval program created an opportunity for the government to counteract these pressures and reestablish the alliance between conservatives and industrial interests that had been undermined by the Caprivi tariff reforms. While Tirpitz trumpeted the strategic benefits of a navy that could challenge

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[3] In the case of a large country, some of these costs are borne by foreign producers.

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Britain's commercial supremacy and be used as an instrument of coercive diplomacy, the opportunity to consolidate the government's support coalition without threatening civil war was crucial in the passing of the Navy Laws of 1898 and 1900 (e.g. Berghahn 1993, Gordon 1974, Fischer 1975). Industrial interests favored the construction of a navy because it offered strategic protection to international commerce if the global economy were to break apart into trading blocs as Chamberlain's campaign for imperial preference in Great Britain suggested. Additionally, in light of the long depression from which Europe had only recently emerged, steady government demand for new battleships also created protection against downturns in the business cycle.[4]

Arguing that Germany was necessarily a continental power, agrarian interests preferred that the resources devoted to the navy instead would have gone to the army.[5] However, the decision to pay for the navy by reestablishing a broad set of agricultural tariffs that reduced grain imports from its American, Argentine and Russian competitors was crucial in solidifying agricultural support behind Weltpolitik. While it was believed that these tariffs would generate the necessary revenue to pay for this naval buildup, they simultaneously increased the incomes of the agricultural class. The imposition of the tariffs thus allowed the government to generate side payments for conservative support of its navy and divert the massive armament costs to the left wing of the electorate.

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[4] Moreover, apart from building supportive coalitions, Stevenson (1996) suggests that the state's ability to intervene in domestic markets reduced its economic costs of mobilization because of a monopsony position in armaments purchases. Thus, even though the prewar period was marked by a structural transformation in armaments production as the center of construction switched from state-owned to private firms, governments did not lose their ability to manipulate defense production and these firms. Krupp in Germany provides an excellent example of this. Stevenson (1996, 23) notes, "In general, Krupp was less profitable than purely civilian steel and metalworking firms, and its special relationship with the state authorities probably impeded it from maximizing its rate of return."

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Most importantly, the international ramifications of these domestic pressures were immense. By utilizing naval construction and the agricultural tariffs as a means to solidify domestic support, the German government had also initiated a policy that would challenge fundamental British interests. Despite repeated attempts to convince the British government of its benign intentions, the navy program and Germany's unwillingness to slow construction until 1912 served as a signal that Germany wished to challenge British commercial hegemony throughout the world. Providing a focal point for the emerging Anglo-German rivalry, Weltpolitik put the two states on a collision course that would help push them to war in 1914 (e.g. Kennedy 1980, Steiner 1977).

Apart from provoking British hostility, the agricultural tariffs also alienated powerful groups within Russia and played a large role in the steady deterioration of Russo-German relations in the decade prior to 1914.[6] This hostility was most apparent in the press war that occurred between the two countries following the Liman von Sanders crisis and up to the July 1914. Given Russia's land abundance, grain exports were crucial to the health of its economy. And yet German tariffs and subsidies to agriculture were making it possible for Prussian farmers to export grain into western Russia. In response to agricultural pressures, the Russian government had instituted a tariff on German rye exports to Finland and the western provinces in 1914. Increasing German influence over a decaying Ottoman empire and the dangerous potential that control of the Straits could fall to them only accentuated these fears of an eroding economic position among Russian

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[5] For a good discussion of the relative breakdown of economic and political interests within Germany and England during this period see chapter 17 in Kennedy (1980).

agricultural interests. Most importantly, these anti-German elements within Russian, most notably the wealthy industrial interests in addition to agricultural groups, made up the one portion of society that government had been responsive to following the political reforms of 1905. These groups comprised the Oktobrist and Nationalist parties, the government's key supportive coalition within the Duma since Stolypin's radical restructuring of that body in 1907. Thus, when the July crisis broke out, the most powerful political elements of Russian society actively encouraged the government to support Serbia and adopt a strong response to Austria-Hungary and Germany that could very well lead to war.

Financial Capital

The period prior to World War I also witnessed a dramatic expansion in the flow of capital across national boundaries. As markets opened in the Americas, Australia, Asia, and Africa, European capital from the financial centers of London, Paris, and Berlin quickly sought out these outlets. In terms of foreign investment as a percentage of domestic savings, no OECD economy today exports as much capital did as Britain did during this period (O'Rourke and Williamson, 1999, 209). Bordo et al (1999) offer similar conclusions when measuring globalization in terms of capital exports as a percentage of GDP. Strands of liberal theory suggest that capital market integration

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[6] For an argument that emphasizes how the Russo-German commercial antagonism led to steady deteriorating relations between the two powers in 1914 and thus played a key role in the outbreak of war see Spring (1988b).

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during this period should also have reduced conflict among states.[7] But like trade, expansion in flows tells us little about the state's ability to channel this investment and use it for political purposes.

To understand the extent of government's ability to control capital flows during this period, it is first important to note that the financial centers of London, Paris, and Berlin dominated capital markets. Staley (1935, 9) estimates that over 80 percent of total global capital exports came from these three sources in 1913. He puts this figure at over 95 percent in 1900. Perhaps more importantly though, Germany and France, unlike Great Britain, actively intervened and controlled the flow of surplus capital to foreign destinations. They did this largely by regulating the listing of foreign government securities at the Berlin and Paris exchanges. The chancellor in Germany gained his right of interference through two formal means (Laves 1977). The first was exercised through the chancellor's position on the directorate for the Reichsbank. If the chancellor wished to prevent a foreign government from obtaining loans in Germany, he could direct the Reichsbank to stop accepting its bonds as collateral for loans. Dramatically decreasing the value of these securities, financial intermediaries would be discouraged from attempting to place any more of that government's debt in the future with its investors. Bismarck had effectively used this instrument to close German capital markets to Russia in 1887.[8] Second, as the Prime Minister of Prussia, the chancellor could prevent any foreign securities from being listed in that state. Under a stock exchange law introduced

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[7] Stein (1993) calls this financial liberalism.
[8] Many have argued that this action played a large role in the origins of the Franco-Russian alliance as the latter was desperate for a foreign loan at the time. Moreover, because British investors were hesitant to

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in 1896, each state was required to comply with the restrictions imposed on foreign securities in all other states. The chancellor's right of control within Prussia was thereby extended to all other exchanges in Germany.

Through decrees in 1823 and 1873 both the Minister of Finance and the Minister of Foreign Affairs in France obtained the right to veto any public listing of a foreign government. While in practice, these restrictions could be circumvented by buying securities listed in foreign exchanges such as Brussels, Feis (1930, 121-122) writes, "Despite these means of evasion, the powers possessed by the French government were sufficient to make its will effective. Listing on the official Bourse or some direct manifestation of government favor was essential to the success of a large foreign security emission." In a report to the British foreign secretary on the health of the German financial system, F. Oppenheimer agrees, writing, "French finance is always to a certain extent dependent upon the Government of the day because the French Bourse is at the latter's mercy: no issue could there be effected against the wishes of the cabinet" (Gooch and Temperley, 1932, vol. 7, 799). Consequently, whenever a foreign government wished to tap the supply of capital in either France or Germany, the official position of the government with respect to the loan had to be included in negotiations.

This veto power was even more significant because government loans made up a large portion of the total capital market activity during this period. For example, Feis (1930, 57) estimates that over half of French foreign investment was made up of loans to foreign governments. Bordo et al (1999) note that because of contractual problems,

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invest in Russian securities without an alliance between the governments, this left the Russian government

information asymmetries, and the failure to adopt standard accounting practices most investors throughout Western Europe were skeptical of private investment ventures. As a consequence, holdings of government bonds and railway securities dominated capital exports. The former was often chosen on the basis of political alliances and the latter because of the ease of shareholders in monitoring how their funds were being spent. Investors could more easily evaluate the risk of these investments by verifying the extent of new track construction and the volume of traffic on these lines.

What are some of the political implications of these capital controls? Given the ability of France and Germany to control lending to foreign governments, it was more difficult for owners of capital to use it as a political weapon to shape the conduct of their government's foreign policy. In fact, the French and German governments repeatedly exploited their regulatory capacity over vast pools of domestic savings for diplomatic purposes. I have already mentioned how Bismarck's action to prevent the Russian government from obtaining loans from the pool of German savings helped to play a role in the origins of the Franco-Russian alliance. At the time of domestic revolution and severe fiscal crisis in Russia, France traded formal approval of Russian loans on the Paris Bourse in exchange for Russian support at the Algeciras conference in 1906 (Long, 1968). During this same period of Russian weakness, Wilhelm had also offered access to the German capital market in hopes of reaching a political agreement with Nicholas that would serve to split the Franco-Russian alliance. When the Russians sided with France at Algeciras, the German government forbade its firms to participate in the giant bailout

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with little choice but France. For examples of these arguments see Viner (1951, 49-85) and Geyer (1987).

loan of the Russian government in 1906. The German market remained closed to Russian government securities throughout the period leading up to World War I (Viner, 1951, 56). Austro-Hungarian attempts to gain access to the Paris Bourse were denied three times by the French government in 1909, 1910, and 1911, sometimes at Russia's request (ibid., 64-66). Russia persuaded the French government to open the Paris Bourse to Serbia and help fund its military buildup following the Bosnian annexation crisis in 1908 (Feis, 1930, 262-266). Worried about the ability of Russia to launch an effective offensive against Germany, the French forced Russia into building strategic railways in Poland as a condition for a series of government-backed railroad loans beginning in 1913 (Spring 1988a; Stevenson, 1996, 323-326). These examples cast doubt on the ability of business interests and financiers to use their assets as a means of preventing war in 1914.[9]

The Agadir Crisis

Despite the ability of the French and German governments to manipulate financial markets, mobile wealth was at times able to induce caution in the foreign policy of states during this era. Perhaps the best example of this is provided by the second Moroccan crisis in the summer of 1911. Ostensibly to protect foreign nationals threatened in a local uprising against the Sultan, the French government announced its intention to insert troops into Morocco in May of 1911. Because this violated the 1906 accord stipulating that no European government could challenge Moroccan independence without consulting the other signatories, Kiderlin, the foreign minister of Germany, argued that the French action necessitated a strong response. Assuming that Great Britain and Russia

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[9] For a discussion of the argument that financiers tried to prevent a general European war in 1914; and then

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would not be willing to fight over Morocco, Kiderlin believed Germany could demand and successfully receive compensation in southern Morocco or the French Congo in return for recognizing France's special rights in Morocco. A diplomatic victory would create commercial benefits and provide a means of domestically strengthening the government prior to the 1912 elections (Fischer 1975, 71-94).

To achieve this end, a German warship was sent to Agadir on July 1 in southern Morocco promptly provoking a diplomatic crisis. Great Britain entered the fray in a very public manner later in the month as Lloyd George issued a direct warning indicating solidarity with France. While Kiderlin reacted to this speech with private assurances that Germany did seek Moroccan territory, naval alerts in Great Britain and Germany heightened tensions as public opinion in both states simultaneous argued that their respective governments could not back down. Negotiations between Kiderlen and Cambon, the French ambassador to Berlin, repeatedly faltered in July and August. Caillaux, the French prime minister, refused to accede to demands that the French surrender their holdings in the Congo in exchange for a German recognition of a French protectorate in Morocco.

The negotiations were given a push in September as fear of war struck the Berlin financial markets. The stock market plunged sharply in value on September 4 and continued to fall for the next two weeks. Banks faced a liquidity crunch as depositors began withdrawing their savings fearing that the Germany would be forced to abandon the gold standard. While not arguing that the banking community demanded that the

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failed to do so see Ferguson (1998, 186-197).

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government capitulate in the crisis, Kirshner (1995, 83-85) argues the financial pressure on the government was crucial to the timing of its end.[10] By fleeing a risky environment, mobile capital helped generate a liquidity crisis that threatened to drive Germany off the gold standard, which subsequently pushed its government toward a peaceful resolution to the second Moroccan crisis.

More importantly, there is evidence that financial interests explicitly sought to punish the government for its diplomacy. In a study of the financial weakness of Germany commissioned by the British foreign secretary, Grey, F. Oppenheimer (Temperley and Gooch, 1932, 796-805) argues that the largest banks could have intervened to halt the crisis.[11] When they chose not to, small investors and depositors took this as a signal that the largest banks had lost confidence in the government's policy and the run on savings banks ensued. Oppenheimer (Temperley and Gooch, 1932, 802) writes:

> The leading bankers were conscious of the damage which the deroute of September 4th was inflicting upon the prestige of German finance; they would have been prepared to intervene, if the Government had given them the least indication concerning the course of the diplomatic negotiations...But the Secretary of State for Foreign Affairs declined to throw out any hints. Perhaps this refusal made the political situation appear more critical at a critical moment, but it is more likely that the bankers' inactivity was intended as demonstration against the bureaucratic methods adopted by the German Foreign Office. They were determined to leave the Bourse to its own devices in order to impress official quarters with their power...

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[10] Garztke, Li, and Boehmer (2001) cite this case as an example in which financial market pressure was utilized as a costly signal that helped resolve a military crisis.

[11] The French Prime Minister later claimed to have initiated this panic by encouraging the withdrawal of French and Russian assets from Germany (Williamson 1969, 163; Stevenson 1996, 193).

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In short, the holders of mobile capital possessed the ability to shape the course of foreign policy within the German political system and helped to push the Foreign Minister to a resolution of the crisis with France.

State-owned assets

The final piece of evidence casting doubt on the characterization of this period of globalization as a liberal economic order concerns the reliance of the Russian government on state property to generate public revenue. Private property serves as one of the foundations of the commercial peace hypothesis. Society lobbies the state for peace because it fears the loss of trade-related income from war. If society does not possess significant private holdings that are threatened by conflict, it may suffer fewer costs from war and be less willing to lobby for peace. Moreover, if a substantial amount of firms are publicly owned and value the maximization of employment instead of income, they also may be less willing to lobby for peace. In short, we should not expect trade to promote peace, unless that trade is occurring between the private sector and not the government (Viner 1951, 216-231).

Prior to the Communist revolution in 1917, the Russian state already held vast assets throughout its country. Apart from the tremendous base of natural resources that included land used for agriculture, mines, timber, and oil, a program of nationalizing private railways had been initiated in the 1880's. By 1912, 67.7 percent of the total railway mileage in Russia was owned by the state (Apostol, Bernatzky, and Michelson, 1928, 56). Moreover, revenues derived from these holdings made up a sizeable share of

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total government revenues. Table 6.2 shows that between 1903 and 1913, railway revenues usually accounted for nearly a quarter of annual ordinary receipts. In addition to these assets, a state monopoly on the sale of vodka provided a second lucrative public holding. Beginning in 1893, the government began taking over this industry by forcing distillation to occur under government supervision or in state-owned distilleries. All retail sales were conducted through state shops at prices set by the Treasury. In the decade prior to World War I, the vodka monopoly provided over a quarter of the state's revenue. Most importantly, table 6.2 demonstrates how state property combined with customs duties dominated government receipts, making up consistently two thirds of public revenues throughout this period. More importantly, these assets would allow the Russian government to avoid the domestic resistance plaguing all other great powers that followed the introduction of new taxes to pay for armaments production.

THE RUSSIAN PHOENIX AND THE ORIGINS OF WORLD WAR I

To understand why globalization did not prevent the outbreak of war in 1914, this final section uses as its point of departure one of the few points of agreement in the historiography of World War I. German perceptions of a narrowing window of opportunity to maintain its security and position within the European balance of power was one of the primary factors in the decision for preventive war against the Triple Entente in 1914 (e.g. Berghahn 1993; Ferguson 1994, 1998; Fischer 1975; Kaiser 1983; Lieven 1983). Inability to reach a naval accord with Britain in 1912 and the loss of the

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naval arms race suggested the failure of Germany's Weltpolitik and its goal of acquiring global, rather than just continental, hegemony. France had just successfully imposed a three-year conscription law that helped to erode Germany's advantage on the western front. Most importantly, the Russian colossus had initiated dramatic military reforms culminating in the Great Program of 1913-14 and the decision to build a number of strategic railways in European Russia. The completion of Russia's strategic railways and the Great Program in 1917 would predetermine Germany's fate in a crisis. Forced to capitulate on a number of outstanding disagreements or face certain defeat on the battlefield, Germany would cease to exist as a great power.

The rapid rise of Russia's strength begs an important series of questions. How was it able to escape the fiscal constraints on military expenditures that were crippling other European powers? More importantly, how could Russia suffer domestic revolution, the loss of its Great Power status through military defeat in the Far East, and near bankruptcy only to stage a dramatic recovery in such a short period of time? The remainder of this chapter will briefly discuss the Russian phoenix. In particular, I focus on two key fiscal foundations of Russian power. The first derived from its alliance with France and that government's pervasive willingness to channel the savings of its population into Russian recovery. The second focuses on the unique nature of Russia's system of procuring resources for state expenditures. Unlike its European counterparts that were seeing their ability to mobilize private sector resources decrease, state revenues in Russia following the war in Japan were growing faster than the rate of economic growth. This fiscal strength was due in large part to vast expanse of state property that

granted the government the freedom to maintain constant rates of taxation and spending in nonmilitary areas to prevent the provocation of further domestic resistance to its buildup.

Much of the literature on the origins of the World War I has focused on the series of arms races, both on land on water, in the decade before its outbreak. The navies of Britain and Germany attempted to outbuild each other in Dreadnoughts in the Baltic. Italy and Austria-Hungary competed in the Aegean Sea; Russia and Turkey in the Black Sea. However, by 1912, the outcome of these races had largely been determined and the European states turned their attention to the race in armaments and soldiers on land. Key developments in this arms race included the adoption of recent innovations in artillery and substantial increases in the number of soldiers under arms. The German Reichstag passed army bills in 1912 and 1913. As the largest army law in the state's history, the latter increased force size by nearly one-sixth (Herrmann, 1996, 190). The French responded two weeks later in July of 1913 by moving to a three-year term of service for conscripts in the active army. The Russians responded with their famous "Great Program" that was ultimately approved by the Duma in June of 1914. Scheduled for completion in 1917, this massive rearmament would expand Russia's peacetime army by over 460,000 men or 40 percent of its current force (Fuller, 1992, 437). At the same time as this program was being hatched, Russia negotiated with the French government for a series of railway loans. The final loan agreement provided Russia with five disbursements from the Paris bourse of up to 500 million francs annually to build strategic railways in European Russia and commercial railways in the Far East.

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Two recent studies (Herrmann 1996, Stevenson 1996) argue that the Russian collapse in 1905 and then its rebirth was the primary force behind this arms race on land that was leading the continent to war. Stevenson (1996, 146) writes, "Developments in Russia between 1908 and 1912 undermined the military equilibrium not only in Eastern Europe but in Europe as a whole: in the land arms race the government in St. Petersburg can most justifiably by said to have fired the starting shot." Herrmann concurs, writing, "The history of the balance of military power in Europe in the decade between 1904 and the outbreak of the First World War was in large measure the story of Russia's prostration, its subsequent recovery, and the effects of this development upon the strategic situation" (1996, 7).

Apart from playing a large role in the continental arms race, it is clear that perceptions of growing Russian military capacities and the consequences this meant for German military power loomed large in the minds of German decision makers, particularly Bethmann Hollweg and Moltke (e.g. Kaiser 1983) up to and during the July crisis. Kurt Riezler, Bethmann Hollweg's personal secretary, notes that the Chancellor remarked on July 6th, "[t]he future belongs to Russia which grows and grows and weighs upon us as an ever more terrible nightmare" (quoted in Fischer, 1975, 469). Moltke had repeatedly justified a preventive war for the same reason. In May 1914 he commented:

> In two to three years' time Russia's armaments would be completed, and would
> have a superiority over Germany's that he (Moltke) did not know how to counter,
> whereas 'at present we would be to some degree a match for them. In his opinion
> there remained nothing left but to wage a preventive war, in order to strike the
> enemy while we still had a fair chance of winning the battle.' (quoted in
> Stevenson, 1996, 363-364)

Even though Russia had yet in 1914 to achieve these breakthroughs in military development that the German leadership feared, the latter still worried about a narrowing window of opportunity in which their superior military strength still possessed value on the battlefield and at the bargaining table. The shifting balance of military power away from Germany and toward Russia was one of the key elements in the German decision for war in July of 1914.[12]

The rise of Russia and the pressure that it placed on Germany to launch a preventive war is all the more remarkable when considering how low Russian military capabilities had been at the end of the Russo-Japanese war and even up until the Bosnian annexation crisis. Apart from suffering a tremendous defeat in the Far East resulting in the almost complete destruction of its navy and a dangerous shift of much of its army from the western portion of the empire to the east, the war had left Russia on the verge of political chaos. A series of strikes had paralyzed industrial production in the winter of 1904/05 and forced increasing components of the Russian military to be diverted to internal policing duties. Eventually to stave off Revolution, the Tsar capitulated to popular pressure and allowed the creation of the popularly elected legislative body—the Duma. Perhaps more importantly, the war had exerted a terrible financial toll on the government pushing it to the verge of bankruptcy.

From its beginning, the Russian Finance Minister, Kokovtsov, desired to fund the war against Japan through foreign loans, domestic loans, a previous budget surplus, an

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[12] This is admittedly a cursory treatment of this element in the story of World War I. Despite the controversy surrounding the Fischer thesis, this component of the argument--namely the German fear of rising Russian military strength and the role it played in German decision making--is accepted by most

expansion of the money supply in the Far East, and reduced government expenditures on nonmilitary items. He did not want to provoke further domestic instability by increasing taxes. These plans were largely successful until continued military setbacks in the Far East and the Tsar's repression of a peaceful demonstration in St. Petersburg in January of 1905 (Bloody Sunday) began to spook capital markets. While Russia was able to meet war expenses in the summer of 1905 through domestic loans, domestic chaos evolved into financial crisis. Opposition groups within Russia had organized a massive campaign to withdraw their savings from Russian banks in the hopes of bringing down the banking system and forcing Russia off the gold standard. Furthermore, with the Tsar's pronouncement of the October Manifesto to create the Duma, organized political parties had issued a warning to all foreign creditors. They would not honor the terms of any foreign loan granted to Russia before the Duma was in session. These internal complications were magnified by the first Moroccan crisis. Fearing the possibility of a European war, there had been a run on French banks that held large amounts of Russian securities. By the end of December, on the brink of financial bankruptcy and revolution, the Tsar sent Kokovtsov to Paris with instructions to make the French aware that he was willing to trade support at the Algeciras conference for loans (Kokovstov 1935, 90). Long (1968) argues that it took pressure from Rouvier, the French Prime Minister, to get hesitant banks to agree to a short-term credit to Russia of 100,000,000 rubles in January

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sides of the debate. For discussions of this aspect of the war's origins and the Fischer thesis in general see Kaiser (1983), Schollgen (1990), Langdon (1991), and Trachtenberg (1991).

1905.[13] Upon the successful completion of the Algeciras conference, negotiations were completed for a giant loan of nearly 850,000,000 rubles (over half of which was subscribed to in France) that would put an end to the financial crisis in Russia.[14]

The assistance of the French government in securing these loans had been crucial in salvaging the financial position of the Russian state during this revolutionary period.[15] First, Russia's diplomatic support of the French and Germany's subsequent defeat at Algeciras would lead the chancellor to close the Berlin money market to the Russian government. Consequently, Russia had no place else to turn given British hesitation over the lack of a political alliance and outstanding disagreements between the two governments in Central Asia. Second, the scale of these loans with respect to normal government revenues was enormous. The two loans issued in 1906 were nearly 50 percent of ordinary government revenues in that year. Third, the role of foreign loans must be examined in relation to how the war was financed. The total cost of the war in Manchuria was over 3 billion rubles. Over 80 percent of these expenditures were met through foreign borrowing (Apostol et al, 1928, 68)! Kokovtsov had been largely successful in financing a war without increasing the burden of taxation on the Russian people.[16] Moreover, by preventing bankruptcy Russian finances were able to recover

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[13] One of the conditions of this loan was that all of the money stay in Paris to meet short-term obligations of the Russian government on its debt. This argument is also supported by Kokovstov's memoirs (1935, 91-97).

[14] Because elections to the Duma had just been held in March, the French were still concerned that it still might default on all of Russian obligations incurred during the war. Poincare demanded that the Tsar issue an ukaz (which the latter subsequently did on April 10) stripping the Duma of any control over credit operations.

[15] Long (1968, 225) writes of a statement made by Witte that the 1906 loan saved Russia from bankruptcy and financial anarchy.

[16] While this chapter focuses on the links between illiberal economic institutions and the outbreak of World War I, the case of the Russo-Japanese war also offers strong support for the general arguments linking

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quickly after the war. With the help of another loan in 1909 from France, the Russian treasury possessed a surplus by 1910. In the period between 1908 and 1913, government ordinary revenues skyrocketed, growing over 42 percent (Apostol, 1928, 222). This expansion was larger than the level of growth for the entire Russian economy during this period, which was approximately 34 percent (Gregory 1982).

This recovery of the Russian fiscal system needs to be compared to the ability of other European states to fund their war machines. It enabled Russia to begin to rebuild its navy in 1910 with the "small program"--an allocation of over 700 million rubles to the navy over a ten-year period. The army was also given a similar appropriation in 1910, which was then followed by the Great Program of 1913. The French were very willing to approve the necessary funding to augment the strategic railway network in Poland. While the rest of the Europe had matched these efforts with a series of army bills in 1912 and 1913, there was a growing feeling that Russia held the fiscal advantage and would eventually be able to win any arms race. The British ambassador to Russia, Sir George Buchanon, wrote in 1913, "She (Russia) can bear the strain far easier than Germany, as finances are flourishing and her supply of men almost inexhaustible" (quoted in Neilson, 1985, 207). Commenting on British perceptions of Russian capabilities during this period, Neilson (1985, 207) writes, "As far as the British were concerned, Russia had clearly remained in the first division of European great powers, at least in terms of financial terms." This feeling was particularly acute in Germany. Ferguson (1994) argues that one of the primary causes of the German decision for preventive war in 1914 was the

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mobilizational capacity and war. The Russian government's ability to rely on external funding from the

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feeling that it lacked the financial capability to win an arms race with its enemies. The Reich's inability to wrestle the power to institute a federal income tax from the individual states of the Reich prevented it from modernizing its financial system as Britain and France had done. These difficulties were compounded by the shrinking size of the Berlin capital market to government securities and Germany's lack of access to the Paris bourse. Ferguson sums up these difficulties:

> Unable to borrow as much as the Russian or French states, unable to raise as much in direct taxation as the British, and unable to reduce the large shares of the states and local government in total public revenue, the Reich could not win the arms races it engaged with its rivals (1994, 164).

Unlike its continental neighbors, Russia possessed a unique advantage during the arms races that led up to the outbreak of war in 1914. Given continual access to the Paris bourse by the French government, it was able to avert financial chaos and bankruptcy in the domestic tumult following defeat against Japan in 1905. Moreover, the railway loans that had flowed into Russia for a number of years had essentially served as an investment in government property given the nationalization campaign dating back to the 1880s. French investors had not only given provided short term liquidity to the Russian financial system, they had also provided it with the long term capacity to expand its revenue base without increasing the burden of taxation on Russian domestic society. At the outbreak of war in 1914, well over fifty percent of public revenues in the Russia were derived from state property. This financial strength had enormous consequences for the shifting balance of power in Europe in the decade leading up to the war. It would enable the Russia to rebuild its military and eventually create the perception in Germany that

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French allowed it to continue a war effort despite significant domestic resistance.

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preventive war in 1914 was a better option than facing Russia on the battlefield in 1917 when the latter's military programs had been completed.

CONCLUSION

This chapter has sought to reexamine the case that seemingly provides one of the trump cards for critics of the commercial peace hypothesis. If the integration of national markets promotes peace by establishing ties of mutual interdependence and raising the costs of war, then why did history's first era of globalization in the decades prior to World War I fail to prevent that war? I have challenged these skeptics on two grounds. First, the expansion of trade and capital flows prior to World War I did not decrease the level of state intervention in economic activities. Responding to the price pressures inaugurated by technological breakthroughs that dramatically reduced transportation costs, tariff levels actually increased between 1879 and 1914. Even though trade may have been on the rise, free trade—the crucial variable in the commercial peace hypothesis—was not. Additionally, three countries dominated global capital markets notable for their lack of diversification. Because of informational asymmetries and contractual uncertainty, most foreign capital was invested in either railways or government loans. The need for governmental approval when attempting to raise capital in France or Germany enabled these states to divert excess domestic savings to their political allies. The pre-World War I global marketplace was not a liberal economic order.

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Second, I have argued that the presence of mercantilist instruments of policy, namely capital controls, tariffs, and substantial government property, fostered rivalry between Germany and the Triple Entente and enabled the Franco-Russian alliance to rebuild Russian military capabilities following disaster in 1905. This rebirth initiated the arms race on land in Europe following the Bosnian annexation crisis that culminated with Germany's decision to launch preventive war in 1914. An expanded view of the institutions which protect individual liberties illustrates how World War I confirms, instead of contradicts, broader liberal claims about the origins of war.

Finally, the period of globalization prior to World War I also provides the opportunity to compare the relative strength of variants of the commercial peace hypothesis. In this case, the opportunity cost and second image arguments provide very different predictions. It is clear that the European great powers were each other's primary trading partners and thus economically dependent.[17] According to the opportunity cost hypothesis, these mutual dependencies should have prevented war. The outbreak of war in 1914 thus seems to contradict these claims. On the other hand, the second image commercial peace hypothesis discussed in chapter 1 offers a very different prediction. By pointing to the rise of tariffs, capital controls, and the sale of economic regulation in the decades leading up to July 1914, it would instead predict military conflict. The confirmation of this prediction suggests that the variant of commercial

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[17] For example, Ripsman and Blanchard (1996/97) discuss how Germany was dependent on imports of food and raw materials. Consequently, they also relied on British goodwill to make sure shipping lanes remained open. Kennedy (1983) argues that Britain would suffer severe financial devastation from a war with Germany because the London financial sector heavily insured German trade. Finally, Spring (1998b) notes that Russia was dependent on its trading links with Germany. He writes (82), "In 1913 45 percent of

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liberalism emphasized here and presented as more consistent with the broader foundations of liberal IR theory sheds important light on the debate over the precise mechanisms linking commerce and conflict.

Russian exports and 50 percent of her imports were with Germany. No other great power was so dependent on one market."

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	France	Germany	Italy	U.K.	U.S.A
1820	4.31		7.33	2.86	1.31
1830	4.24			4.47	2.13
1840	6.51	4.30		7.38	4.08
1850	10.56	5.90		13.07	4.07
1860	19.55	9.80		22.68	9.61
1870	31.10	17.70	38.70	31.10	13.00
1880	43.50	22.40	51.70	41.20	35.00
1890	53.00	29.80	43.20	55.10	40.40
1900	61.60	44.70	64.40	58.60	72.80
1910	75.10	77.40	91.70	88.00	73.10
1913	100.00	100.00	100.00	100.00	100.00
1920	86.00	36.70	105.50	70.70	141.80
1930	132.00	87.00	104.70	66.70	130.30
1940	40.00	38.50	63.30	41.30	153.60
1950	149.20	34.80	126.50	100.00	224.60
1960	298.40	154.70	366.90	120.00	387.90
1970	678.20	386.60	1265.00	192.00	680.60
1980	1371.20	683.30	2303.00	313.40	1337.60
1989	1900.70	1060.80	3363.50	446.10	1894.10

TABLE 6.1: Volume of exports of main economies, 1820-1913. (1913=100)
Source: Maddison (1991).

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	1903	1909	1913
Customs	241.4	274.3	352.9
Monopoly on Vodka	542.2	718.8	899.2
Railways	453.3	567.9	813.6
Other state-owned property	117.1	140.3	229.9
Other sources	677.8	825.0	1121.8
Total ordinary revenues	2,031.8	2,526.3	3,417.4

TABLE 6.2: Annual components of Russian government revenue, 1903-1913. Measured in millions of current rubles.
Source: Apostol, Bernatzky, and Michelson (1928; 43, 61, 222).

CHAPTER 7

CONCLUSION

Apart from ushering in a new historical epoch marked by cautious optimism about the potentials for peace and development, the end of the Cold War has also provided new opportunities to break down boundaries separating a wide variety of topics and approaches in the study of international relations. The separation between security studies and international political economy provides one such example. Scholars have noted that the concentration of policymakers and scholars on the possibility of nuclear war during the Cold War served to separate the study of international politics from international economics (Kirshner 1998; Mastanduno 1998). Presuming that survival in the international system forced states to jealously protect their security and subordinate all other policy goals, many studies minimized the role that global economic forces could play on power politics. Increasingly, scholars have explored how trade and capital flows across national boundaries shape alliance decisions, the economic foundations of grand strategy, and decisions for war or peace. While continuing in this tradition by examining how capitalism affects the prospects for peace, the theoretical approach here also demonstrates that the tools of neoclassical economics provide a strong deductive base and the opportunity to develop new insights about a critical question facing students of social behavior: under what conditions do wars begin?

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To understand the origins of war, this project first looked to classical liberal theory and its concentration on problems in the social contract that lead a governing elite to use military conflict with other states to consolidate its domestic hold on power. As democracy, the rule of law, and private property expand individual liberties, the state's freedom to undertake risky foreign policy is curtailed. Despite this central insight, contemporary work on the liberal peace has yet to extend and explore all of its implications. By focusing largely on the presence or absence of democratic elections to distinguish the domestic constraints placed on foreign policy, the role of other institutions, such as private property and competitive market structures, has been neglected. The debate linking commerce and conflict has instead often simply ignored or adopted questionable assumptions about the intervening role of domestic politics.

By integrating the institutions of capitalism into a theoretical framework that focuses on the state's ability to mobilize the wealth of its citizens to implement foreign policy, this project has sought to fill some of these gaps. Private property, domestic market structure, and asset mobility shape the two crucial aspects of the decision for war. First, these characteristics alter the *domestic economics* of war. Credible commitments to protect private property raise the costs of expropriating societal assets to build a war machine. Once the state surrenders the capacity to allocate the factors of production, it must either compete with the civilian economy to acquire these resources or risk undermining business confidence necessary for sustained growth by choosing to seize these assets instead. While state-owned assets create fiscal independence for the state and limit society's ability to trade their wealth for political oversight, greater quantities of

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private property instead increase the state's dependence on society to provide the resources for its war machine.

Second, these same characteristics alter the *domestic politics* of war. Because the state defines the institutional infrastructure, including property rights and contract enforcement, necessary for an exchange-based economy to function, it simultaneously can use these powers to redistribute wealth and build domestic support for a wide variety of policies. For example, the state can restrict entry into domestic markets through tariffs and allow producers to charge higher prices than would otherwise prevail in competitive markets. By increasing the reliance of some groups on these particularistic benefits, the state creates interests that wish it to remain in power despite unpopular and costly policies like the decision to go to war. As the domestic economy liberalizes, the state loses these opportunities and finds it more difficult to sustain supportive coalitions as the inevitable domestic costs of war increase.

Empirical support for these arguments was found across a variety of quantitative and qualitative tests. Chapter 4 examined how variations in property rights regimes altered the likelihood of military conflict between states. Both the credibility of commitments to protect private property and the quantity of private property within a domestic economy were negatively related to the outbreak of military conflict. Chapter 5 found strong evidence that increasing levels of competition in domestic markets were negatively related to the outbreak of military conflict. Because barriers to international trade are necessary for domestic monopolies to exist, tariff levels provide one means to gauge both the level of competition in domestic markets. Higher tariff levels increase the

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likelihood of monopolistic markets. In the statistical tests across the monadic and dyadic designs, an increase in tariff rates was positively correlated to the outbreak of military conflict between states.

Chapter 6 traced the causal mechanisms of these arguments by exploring how the ability of states to intervene in their domestic economies shaped the character of military conflict during the era of globalization prior to World War I. Challenging the conventional wisdom characterizing this period as the archetype of an open, liberal economic order, I focused on how tariffs, capital controls, and public property enabled the continental governments of Europe to build domestic coalitions supportive of aggressive foreign policies and even mobilize resources for war despite societal resistance.

Germany used a series of agricultural tariffs to initiate a massive naval building program that unified agricultural and industrial sectors in support of the government. The international consequences of this program were enormous. Not only did it quash any hopes of an alliance with Britain, it also generated support among Russian agricultural interests for a more aggressive foreign policy by the Tsarist regime against Germany.

By requiring official approval on any bond offering of a foreign government in the Paris money market, the French government diverted a vast pool of domestic savings to help its Russian ally recover from defeat in East Asia. French wealth paid a large portion of Russia's war expenses from 1904 and 1905, funded strategic railways that would help decrease Russian mobilization times on Germany's eastern front, and helped to arm Serbia following the Bosnian annexation crisis. Most importantly, the

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combination of these loans and substantial public assets allowed the Russian government to avoid the central fiscal dilemma faced by all other governments in Europe—how to pay for the rising costs of an arms race without alienating key domestic support coalitions. This fiscal strength translated into military might and played an enormous role in the outbreak of World War I, leading both Germany and Austria-Hungary to launch a preventive war in 1914.

Apart from demonstrating how economic regulations often made military conflict more likely, this period also provided instances in which free markets constrained both mobilizational capacity and crisis diplomacy. Voluntary enlistment in Great Britain forced the government to compete with a growing civilian economy to build its army. As British strategy increasingly depended on its ability to insert land forces on the continent, it was forced to induct fewer and poorer quality soldiers into its army. The powerful financial sector in Great Britain often tied the government's hands by limiting its ability to intervene in continental affairs without disrupting the financial markets. Finally, there is also evidence that the constraints placed created by mobile capital also impacted the authoritarian states like Germany. The financial panic created in Berlin during September 1911 helped bring about a resolution to the second Moroccan crisis.

In sum, government intervention in economic activities shapes its ability to build and utilize an effective war machine in service of its foreign policy. While previous studies have shown that democracy, interdependence, and membership in international organizations all promote peace, I have argued and demonstrated why capitalism should be added to this list. Greater quantities of private property, more competitive domestic

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markets, and increasing levels of mobile wealth in an economy all tend to reduce the likelihood of military conflict between states. These arguments carry a number of broader implications for international relations theory and the character of the current international system. The rest of this chapter explores four of these issues. First, they suggest the need to revisit one of the foundational questions to the study of international political economy, namely what is the relationship between wealth and power in the international system? The arguments that capitalism causes peace by limiting the state's ability to build a war machine suggest we have yet to explore sufficiently the conditions under economic growth paradoxically undermines national power. Second, the concentration on the fiscal capacity of states here provides one means to reexamine some of the theoretical mechanisms linking democracy and peace. Third, these arguments point to a different relationship between the realist and liberal paradigms than the fundamentally contradictory one normally posited in the literature. Instead, I suggest that these worldviews are largely complementary perspectives. Finally, the potential for capitalism to cause peace suggests reasons to be optimistic about the prospects for peace in the current international system. While the last period of globalization culminated in a catastrophic world war, recent examples suggest institutional differences across these two eras could limit those possibilities in the future.

IMPLICATIONS

Wealth and Power in the international system

Understanding the relationship between national wealth and national power has long served as the cornerstone of the study of international political economy.[1] Classical and contemporary scholars across traditional boundaries agree that economic capacity is a fundamental prerequisite to a state's ability to protect its territory and extend its influence over other actors in the international system. Growth generates a larger productive base from which the state can tap to build its military and it unleashes a technological dynamism that improves the efficiency of a state's war machine.[2] The reciprocal relationship also seems to hold. Military strength enables states to protect the commercial activities of its merchants and expand wealth by seizing the assets of other states or groups in the global economy.

These insights underpin a number of research programs in the field. The power transition literature explores how global patterns of conflict are traceable to changes in the long run health of the global economy (e.g. Goldstein 1988, Pollins 1996). Hegemonic stability theory examines how the distribution of power in the international system affects openness or the extent of transnational commerce in the global economy

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[1] For example, Robert Gilpin (1975, 43) writes, "In brief, political economy in this study means the reciprocal and dynamic interaction in international relations of the pursuit of wealth and the pursuit of power."

[2] Albert Hirschman (1945) labels this the supply effect of international trade. He writes, "By providing a more plentiful supply of goods or by replacing goods wanted less by goods wanted more (from the power standpoint), foreign trade enhances the potential military force of a country...foreign trade serves as means

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(e.g. Krasner 1976, Lake 1988). The democratic strength literature has explored how regime type affects economic growth and the ability of states to acquire credit necessary to sustain war efforts. Because democracies generally have more productive economies than authoritarian regimes and they can credibly commit not to default on loans, they can build larger militaries necessary to achieve victory on the battlefield (Lake 1992, Schultz and Weingast 1998).[3]

The ultimate compatibility between wealth and power provides an important and potentially contradictory implication for the conclusions offered by this study. If liberal institutions, such as private property and competitive market structures, generate long-term economic growth, might they also increase a nation's military capacity? Even if liberal institutions reduce the portion of total wealth mobilized the state, can political officials make up this difference by tapping an even large pool of resources? More importantly, could this enhanced military capacity lead a more aggressive foreign policy, rather than they pacific orientation argued here?

Despite the literature's tendency to focus on the ability of wealth to augment power, a long tradition in both classical liberalism and mercantilist scholarship has understood that growth can have contradictory effects and sometimes undermine national strength. In a review of classical writings on this possibility, Albert Hirschman describes the fundamental tension between wealth and power in the eighteenth century writings of Sir James Steuart:

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of increasing the efficiency of military pressure which one country may bring to bear upon other countries" (1945, 14)

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Thoroughly familiar with mercantilist thinking and in some respects still under its influence, he knew that trade and industry, if conducted properly, were supposed to increase the power of the realm and therefore that of the sovereign. At the same time, observation of actual social development as well as, presumably, acquaintance with the new historical thought of his fellow Scots...pointed to a very different set of consequences: trade expansion strengthened the position of the "middle rank of men" at the expense of the lords and eventually also of the king (Hirschman, 1997, 82-83).

Adam Smith also recognized that market expansion and wealth could undermine national power. The evolution to a manufacturing society would leave less time and fewer individuals available for military defense. Consequently, the state needed to create a standing army (Smith 1937.V.1, 659-660). Schumpeter argued that capitalism would rationalize the warrior class and divert their attention toward production. Mercantilist writings have long held that even if trade enhances the wealth of society, it can undermine national power by rendering economies vulnerable to disruption in supply lines when they are most necessary as in a military crisis. In the contemporary literature, this concern goes to the heart of the relative gains debate (e.g. Grieco 1988, Keohane 1993).

The possibility that the expansion of markets and trade can both undermine and enhance military capabilities illustrates that the relationship between wealth and power is not unidirectional. Economic growth is both a creative and a destructive process. It can increase potential influence in the international system, while simultaneously limiting the authority of the state by strengthening the commercial and middle classes of society. Because states do not own or possess all of the wealth contained within the territories,

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[3] Reiter and Stam (2002) dispute these explanations of a democratic advantage in war. Instead, they argue that democracies win wars because they fight only those that they can win (the selection effect) and

their ability to utilize these assets depends on the domestic institutional structure of both the polity and economy. Accordingly, a concentration on the mobilizational capacity of the state must provide the starting point of any study examining the relationship between wealth and power in the international system.

While recognizing that the relationship between wealth and power is conditional, two additional empirical responses illustrate that growth's positive effects on military capacity do not undermine the broader conclusions linking capitalism with peace. First, the inclusion of control variables for gross national product and economic growth in the statistical analyses conducted in chapters 4 and 5 removes the potential for the wealth effect to confound the relationship between liberal economic institutions and conflict. The coefficients yielded the predicted effects while holding national income and growth constant. While the often positive and significant coefficient on national income illustrates that larger economies are more likely to be involved in military conflict, the indicators for property rights regimes and market competition maintained their predicted effects.

Second, the series of cases examined the pre World War I period of globalization illustrated how economic growth can both strengthen and undermine the state's ability to mobilize societal resources for national defense. For example, economic growth in Germany increased the state's tax revenues and allowed Bulow and Bethmann to fund both naval and army expansion while postponing dramatic taxation reforms that would alienate the Prussian conservatives. On the other hand, the British case illustrates the

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because the soldiers of democratic societies fight more effectively on the battlefield.

opposite tendencies. When the time came to shift from a maritime to a continental strategy, the system of voluntary recruitment and parliament's unwillingness to increase soldier pay forced the military to compete with the civilian economy to build its army. As trade and economic growth increased civilian wages, the army inducted fewer and less qualified recruits, leading to disastrous results on the battlefield during World War I (Rowe, Bearce, and McDonald, 2002). Fearing that crisis diplomacy and war would devalue financial assets, the City of London pressured the government to stay out of continental affairs throughout this period.

In short, this dissertation has provided both theoretical and empirical support for the argument that relationship between wealth and power is conditional. Consequently, the possibility that growth may increase military capabilities should not undermine the broader conclusions linking capitalism, mobilizational capacity, and international conflict. Moreover, these contradictory dynamics underscore the need for exploring the conditions under which growth either strengthens or weakens national power. While this was not the primary question under investigation, the arguments here suggest that the structure of institutions that regulate the domestic economy is a crucial intervening variable. When states own a large portion of assets in the domestic economy or sanction monopolistic practices, they are in a better position to translate growth into military strength.

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This project began with a liberal critique of the democratic peace. While classical theorists argued that an expansion of individual liberties enhanced prospects for peace and provided many institutions that could advance this goal, the contemporary literature has neglected these insights by focusing on democracy as the primary indicator of domestic institutional variation. This oversight carried potentially devastating consequences for the conclusion that democracy prevents international conflict. Given prevailing arguments that economic freedoms embodied in capitalism are necessary for democracy to thrive along with casual observation that democracies are capitalist states, might the democratic peace really be an artifact of a larger capitalist peace among states?

The statistical results in chapter 4 provides strong evidence for a negative answer to this question. While including various measurements of the level of capitalism in the economy, the democracy term more often than not was statistically significant while retaining the predicted negative effect on the outbreak of military conflict. In line with the arguments of Schumpeter, both democracy and capitalism promote peace among states.

While the argument that capitalism helps to prevent conflict does not undermine the empirical links between democracy and peace, the theoretical concentration on mobilizational capacity offers an opportunity to extend and question some of its explanatory foundations. By focusing on the processes by which democracies tap private sector resources to fund its war machine, new hypotheses and directions for future

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research about when both democracies and democratizing states go to war can be generated.

Critics of the democratic peace literature argue that despite the constraints posed by regular elections, governments often find ways to circumvent them (e.g. Gowa 1999, Gaubatz 1999). Because political opposition can be costly and is subject to the dynamics of the collection action problem, elections may be insufficient to restrain even democracies from war. One way in which democratic leaders may be able to evade electoral constraints is by generating public revenues and funding wars through indirect taxation, like tariffs, whose costs fall disproportionately on consumers or broader segments of the economy. Because consumers face the collective action problem in overturning such policies and moving to revenue systems based largely on income taxes, some democratic societies may lack "fiscal democracy" or the ability to constrain the means (funding) by which governments can generate room to maneuver in foreign policy outside societal oversight. The links between elections and war may not flow through the ballot box but through the pocket book instead. As the size of the electorate expands and broader segments of the population demand changes in public finance, democracy may cause peace by pushing governments to adopt more equitable means of taxation that in turn limit its ability to redistribute the costs and benefits of war. Accordingly, democracy may not prevent conflict until fiscal reform occurs. The cases of France, Germany, and United States in the pre-World War I era and India during the Cold War stand out both as contradictory cases to the democratic peace and examples of governments that relied heavily on tariffs and consumption taxes for public revenues.

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An examination of "fiscal democracy" also may offer some insight into another critique of the democratic peace literature—namely that the transition to autocracy may actually increase a state's willingness to go to war. Mansfield and Snyder (1995, 2002a, 2002b) caution that the weakness of government institutions, incentives to use nationalist ideologies, and the enhanced influence of domestic elites possessing particularistic interests in military conflict enhance the probability that democratizing states go to war. Consequently, the democratic zone of peace is restricted to consolidated and mature democracies. They point to the rise of nationalist ideologies and the uneasy transition to democracy in Germany prior to World War I as important evidence supporting their claims.

This period was also unique in that pressures toward urbanization and democratization ushered in by the industrial revolution had begun to manifest in a series of fiscal crises for many European states. As unionization and the expansion in suffrage enhanced the bargaining position of labor, the demands for greater social welfare spending along with a more equitable system of taxation that included income taxes on the wealthy industrial and agrarian classes grew. More importantly, the governments of Europe faced these pressures just as an armaments race broke out both at sea and on land. Democratization, fiscal reform, the growing clout of socialist parties, and armaments spending were all inextricably linked. Just as governments needed to increase taxation to pay for Dreadnoughts, artillery improvements, and more soldiers, they found it harder to squeeze any more resources out of the classes that had traditionally supplied the materials of war. These governments faced a dilemma. They could choose either to

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reduce armaments spending and risk attack or diminished international influence or they could alienate their traditional domestic coalitions of support by demanding that they pay a larger proportion of the arms burden. At some point, Great Britain, France, and Germany all chose variants of latter strategy while attempting to win the arms race. D'Lugo and Rogowski (1993) argue that the Liberal Party in Great Britain was able to win the naval race with Germany because its domestic coalitions of support, and in particular labor, pushed it to institute property and income taxes on the wealthier segments of British society to finance greater naval expenditures. The governments of Germany and France integrated coalitions on the left to acquire the political support to impose taxes on income and property necessary to fund the massive army bills of 1913. While previously opposing further armaments spending, the left in both countries acquiesced for the opportunity to revise taxation policies.[4]

These possibilities suggest that increased propensity for war in democratizing states may arise from a tax bonanza that follows from a coalitional shift demanded by increased political participation. An expansion in the size of the selectorate that includes the poorer elements of society can allow governments to shift their base of support from the right of the political spectrum to the left. Assuming that all governments do not tax segments of society equally, this creates an opportunity to tax wealthier classes that

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[4] Examining the German army bill of 1913, David Herrmann (1996, 191) writes, "To pass the tax, Bethmann actually resorted to the support of the parliamentary left in an unprecedented *volte-face*...a coalition of the center and the left, including the Social Democrats, voted for the latter (the funding bill) to secure the principle of direct taxation of wealth by the Reichstag." He then notes that this coalitional strategy was also adopted in France. Referring to the government's need to coax the Radicals into supporting the Three-Year Law with a progressive property tax, he writes (194), "The tactic, which came as a bitter blow to the center and right, bore an uncanny resemblance to Bethmann Hollweg's maneuver at the

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traditionally resided on the political right and in the government's coalition. Parties on the left thus support more aggressive foreign policies in exchange for reform that equalizes the burdens of taxation and the distribution of domestic political power.[5]

Revisiting the paradigm wars

Realism and liberalism are often painted as largely opposite perspectives on international relations. Where realism sees enduring military conflict among states in an anarchic international system, liberalism instead adopts a progressive view of history in which institutional constraints can evolve to lessen conflict among states and individuals. By focusing on the domestic origins of war, the framework adopted here suggests a different relationship between the paradigms, focusing on how they complement rather than compete with each other. This compatibility is illustrated by comparing how each paradigm's assumption about the primary unit of social behavior shapes its broader views about the origins of war.

Because liberalism focuses on individuals, social behavior is understood as emerging from a process in which individual interests are aggregated to produce social choices. Foreign policy reflects such a social choice. Liberalism necessarily looks inside

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same time to lure the left of the Reichstag into the financing the 1913 army law at the expense of the agrarian-industrial bloc."

[5] This same set of mechanisms also suggests another explanation for why democracies are more likely to win wars than other regimes (Lake 1992, Bueno de Mesquita et. al. 1999, Reiter and Stam 2002). Unless they preside over a centrally directed economy, wealthy or capital interests generally form an important base of support in autocratic regimes. Because they rely on these groups for political support, these same governments may find it difficult to tax capital or the wealthiest elements of society. By expanding the size of the selectorate, governments can reduce their political dependence on capital and simultaneously

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the black box of domestic politics when generating hypotheses on state behavior. It allows the foreign policy interests of state leaders, which are often treated as representative of broader societal interests, to be defined both in the context of the domestic and international political environments. Liberalism tends to see foreign policy in instrumental terms with respect to domestic aims.

By assuming that man is a social animal and that collectives are the fundamental unit of social behavior, realism instead neglects the fundamental problem of aggregating individual interests and looks to the incentives and constraints created by the anarchic structure of the international system to understand the foreign policy of states. State interests are first defined with respect to systemic variables like the balance of power or the need to preserve the state from external challenges. While only neorealism adopts an extreme view of domestic politics that largely ignores its role on state behavior, the broader body of realist work also relegates domestic constraints to a secondary role in explanations of state behavior. For example, recent realist studies that explicitly incorporate domestic level variables treat them as intervening variables and privilege external constraints. [6]

In short, different conceptions about the role of domestic politics in international relations provide one of the key boundaries between the two approaches. By focusing on

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enhance their capacity to mobilize its wealth for war. Thus, democracies may win wars, particularly in the modern era, because they are more efficient than autocracies at mobilizing capital.

[6] In a review of this relatively new camp, Rose (1998, 146) writes of neoclassical realism, "Its adherents argue that the scope and ambition of a country's foreign policy is driven first and foremost by its place in the international system and specifically by its relative material capabilities. This is why they are realist. They argue further, however, that the impact of such power capabilities on foreign policy is indirect and complex, because systemic pressures must be translated through intervening variables at the unit level. This is why they are neoclassical."

the behavior of individuals, liberalism concentrates on the domestic politics of foreign policy. By assuming that individuals act in collectives, realism tends to bypass domestic variation and instead concentrate on the structure of the international system that constrains how states interact with each other. And yet if many of the disagreements between realism and liberalism can be traced to this distinction, there is reason to believe the paradigms are perhaps more complementary than traditionally assumed.

This compatibility can be seen by revisiting bargaining models of war, labeled by Fearon (1995, 380) as neorealist theories of war, which explicitly focus on how structural constraints shape the behavior of states. The central puzzle faced by such models is the following: if wars are costly policy options, why do they nonetheless occur? Given these costs, states should instead be able to reach a bargaining solution that leaves both parties better off than had they gone to war. The structure of the bargaining relationship between states, namely an inability to make credible commitments, incentives to misrepresent private information, and the inability to divide issues under dispute, can lead states to conclude that the benefits of war outweigh its costs.

Liberal theory complements this approach by questioning the assumption that necessarily motivates the search for structural explanations of war. According to liberal IR theory, war may not a costly policy option for the state. Because it possesses the capacity to redistribute income in society, the state can shield itself and its supportive coalition from the destructive nature of war. Even if society as a whole pays some aggregate cost of war, these costs are not borne equally by all groups. If some groups in

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society, including the state, receive positive utility for going to war, then war will not solely result from commitment problems, private information, or issue indivisibilities.[7]

A focus on the structural causes of war necessarily requires an assumption about the domestic politics of war--its costs are distributed evenly across society--that neglects the central liberal insight about war. At the same time, by focusing on the domestic incentives for war, liberal theories of war neglect how strategic interaction among states may also shape the origins of war. When trying to understand the origins of war, *realism and liberalism simply concentrate on opposite sides of the same coin.* They often choose to hold constant factors that the other approach chooses to emphasize. Surprisingly, even though the argument that structural or third image factors must be privileged over domestic approaches is often attributed to Kenneth Waltz,[8] his earlier work suggests this view about their ultimate compatibility. The final sentence from *Man, the State and War* reads as follows:

> The third image describes the framework of world politics, but without the first and second images there can be no knowledge of the forces that determine policy; the first and second images describe the forces in world politics, but without the third image it is impossible to assess their importance or predict their results (1959, 238).

Instead of being construed as contradictory approaches, realism and liberalism should be viewed as entirely complementary.

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[7] Fearon (1995, 379) explicitly acknowledge this possibility. He writes in footnote 1, "[w]ar may be rational for civilian or military leaders if they will enjoy various benefits of war without suffering costs imposed on the population."

[8] For example, he writes (1979, 66) "Interactions occur at the level of the units, not at the level of the system. Like the outcome of states' actions, the implications of interactions cannot be known, or intelligently guessed at, without knowledge of the situation within which interactions occur."

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Despite the ability of governments to harness the benefits of industrialization and globalization for military purposes prior to World War I, there is reason to believe these capacities are not as strong in the current era. While the first boom in trade was driven by a reduction in transportation costs, today's expansion appears to be the result of decreasing barriers to trade (O'Rourke and Williamson 1999, 29). A reduction in tariff barriers reduces the ability of states to shift the burdens of taxation on consumers. Moreover, the adoption of standard accounting practices and communication breakthroughs have reduced informational asymmetries and expanded the willingness of markets to look beyond government securities as safe and profitable investments. Competitive deregulation has led to the virtual abandonment of government capacities to regulate capital flows (e.g. Andrews 1994; Goodman and Pauly 1993). In short, the capacity of consumers and internationally competitive businesses (those groups that benefit most from peace) to constrain the state's foreign policy is probably much greater in the current era of globalization than it was nearly a hundred years ago.

Moreover, recent examples in the current international system suggest that the forces of globalization and capitalism can extend the liberal peace by substituting for or strengthening democratic constraints on war. Solingen (1998) argues that the victory of coalitions benefiting from increasing openness to international markets has played a large role in the development of security cooperation throughout the world where democracy has yet to take hold. For example, she argues that the rise of internationalist coalitions

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and not democratization helped to strengthen security cooperation and denuclearization in the past decade between Brazil and Argentina. She further notes that economic liberalization initiated by Pinochet in Chile during the 1970's played a large role in preventing war and resolving a territorial dispute between Chile and Argentina over the Beagle Channel islands dating back to the nineteenth century. In the midst of a military confrontation in December 1978, Pinochet notes in his own memoirs that a desire to preserve his economic reforms increased his hesitancy to go to war (Solingen 1998, 135-136). A recent article in the *New York Times* (Friedman, 2002) argued that lobbying by a nascent information technology sector in India dependent on international contracts played a crucial role in pressuring the government to de-escalate the nuclear crisis with Pakistan in the summer of 2002. Recent crises between China and Taiwan over the latter's sovereignty have sparked sharp declines in the stock markets and capital flight. In short, the current international system seems to be providing examples in which economic reforms and the spread of capitalism constrains military conflict between states.

Perhaps a large part of the allure of the liberal research program flows from its hope for the future. As economic interdependence ties states together, as previously authoritarian regimes initiate political reform, and as states increasingly recognize the legitimacy of international law, the presence of war in the international system should decrease. While seeking to challenge the theoretical propositions that underlie this optimism, the finding that capitalism promotes peace suggests that it may not be misplaced. If one of the defining characteristics of the current era of globalization is that

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states are facing competitive pressures to minimize their ability to manipulate productive and consumption decisions for political gain, then markets are supplanting political authority as coordinators of social interactions. As the everyday decisions of individuals such as where to shop, where to work, and whether or not to participate in the political process increasingly reflect price signals rather than state directives, government policy, emerging from societal pressures and domestic institutions that aggregate these interests, is also subjected to the same set of competitive pressures. To build a war machine, states must compete within markets in a capitalist economy to acquire these assets. By punishing inefficient allocations, competitive markets raise the costs of war and restrain the state's recourse to war for domestic political benefits. Just as the invisible hand transforms individual greed into a positive social outcome by improving material welfare, these externalities also extend to the decision to use military force against another state. Capitalism promotes peace in an anarchic international order.

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APPENDIX A
SUMMARY STATISTICS FOR BASELINE
MODELS OF CHAPTERS 4 AND 5

Variable	Mean	Std. Dev.	Minimum	Maximum
MIDON	0.00334	0.05770	0.0	1.0
ALLY	0.14118	0.34820	0.0	1.0
CONTIGUITY	0.02563	0.15802	0.0	1.0
CAPRATIO	2.10014	1.56046	0.0	9.2737
$DEPEND_L$	0.00050	0.00326	0.0	0.1720
$DEPEND_H$	0.00438	0.02003	0.0	0.6530
IMPUTE	0.49462	0.49997	0.0	1.0
$GROWTH_L$	-0.00387	0.04319	-0.30180	0.2998
$DEMOCRACY_L$	-4.84022	5.95803	-10.0	10.0
$DEMOCRACY_H$	3.62154	7.30025	-10.0	10.0
GDP_L	$1.93*10^7$	$5.47*10^7$	144730.3	$2.17*10^9$
GDP_H	$2.00*10^8$	$4.81*10^8$	210123.0	$4.52*10^9$
AFFINITY	0.58525	0.29279	-1.0	1.0
DISTANCE	8.24530	0.77381	1.09861	9.42505
GOV_L	22.79469	8.05829	4.1	64.8

Summary statistics for model 1 of table 4.1 (n=201,747).

(continued)

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Appendix A: (continued),

MIDON	0.00338	0.05805	0.0	1.0
ALLY	0.14229	0.34935	0.0	1.0
CONTIGUITY	0.02613	0.15952	0.0	1.0
CAPRATIO	2.11225	1.56599	0.0	9.27373
DEPEND$_L$	0.00052	0.00332	0.0	0.17193
DEPEND$_H$	0.00453	0.02036	0.0	0.65293
IMPUTE	0.47906	0.49956	0.0	1.0
GROWTH$_L$	-0.00235	0.04094	-0.30179	0.29979
DEMOCRACY$_L$	-4.74913	6.01431	-10.0	10.0
DEMOCRACY$_H$	3.76109	7.26082	-10.0	10.0
GDP$_L$	$1.97*10^7$	$5.55*10^7$	169328.0	$2.17*10^9$
GDP$_H$	$2.04*10^8$	$4.86*10^8$	324851.0	$4.52*10^9$
AFFINITY	0.58087	0.29275	-1.0	1.0
DISTANCE	8.24427	0.77815	1.09861	9.42505
PRIV$_L$	76.56575	11.93164	12.7	110.0

Summary statistics for model 2 of table 4.1 (n=194,924).

MIDON	0.00377	0.06125	0.0	1.0
ALLY	0.15544	0.36232	0.0	1.0
CONTIGUITY	0.02811	0.16527	0.0	1.0
CAPRATIO	2.03023	1.51244	0.0	9.01074
DEPEND$_L$	0.00053	0.00324	0.0	0.17193
DEPEND$_H$	0.00444	0.01936	0.0	0.61416
IMPUTE	0.49021	0.49991	0.0	1.0
GROWTH$_L$	0.00259	0.03664	-0.20807	0.29979
DEMOCRACY$_L$	-4.95518	5.77865	-10.0	10.0
DEMOCRACY$_H$	3.41030	7.32064	-10.0	10.0
GDP$_L$	$1.84*10^7$	$4.86*10^7$	10715.43	$1.96*10^9$
GDP$_H$	$1.83*10^8$	$4.42*10^8$	324851.0	$3.96*10^9$
AFFINITY	0.55005	0.28985	-1.0	1.0
DISTANCE	8.23141	0.78498	1.09861	9.42505
SCOPE$_L$	4.18015	1.70534	1.0	9.0

Summary statistics for model 3 of table 4.1 (n=148,158).

(continued)

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Appendix A: (continued),

Variable	Mean	Std. Dev.	Minimum	Maximum
MIDON	0.00665	0.08128	0.0	1.0
ALLY	0.16032	0.36691	0.0	1.0
CONTIGUITY	0.03828	0.19188	0.0	1.0
CAPRATIO	1.38612	1.03067	0.00009	5.78213
DEPEND$_L$	0.00224	0.00773	0.0	0.17193
DEPEND$_H$	0.01238	0.03658	0.0	0.61417
IMPUTE	0.21352	0.40980	0.0	1.0
GROWTH$_L$	-0.00085	0.03980	-0.20807	0.16450
DEMOCRACY$_L$	-0.57201	7.60284	-10.0	10.0
DEMOCRACY$_H$	7.47274	4.99075	-10.0	10.0
GDP$_L$	$8.97*10^7$	$1.19*10^8$	20290.16	$1.77*10^9$
GDP$_H$	$4.84*10^8$	$7.74*10^8$	6957660.0	$4.52*10^9$
AFFINITY	0.54709	0.31078	-1.0	1.0
DISTANCE	8.24289	0.85395	4.68213	9.42246
BERIV$_L$	7.62128	1.99689	2.35	13.7

Summary statistics for model 4 of table 4.1 (n=16,692).

MIDON	0.29944	0.45807	0.0	1.0
ISLAND	0.09754	0.29672	0.0	1.0
CAPABILITY	0.00897	0.02762	0.00001	0.31124
OPEN	57.18094	38.96168	4.67	423.41
GROWTH	0.02104	0.04788	-0.30180	0.88508
DEMOCRACY	0.05828	7.91348	-10.0	10.0
GDP	$1.14*10^8$	$3.52*10^8$	169328.0	$4.52*10^9$
GOV	17.79639	7.76124	3.3	64.8

Summary statistics for model 1 of table 4.6 (n=4,101).

MIDON	0.30535	0.46063	0.0	1.0
ISLAND	0.09071	0.28725	0.0	1.0
CAPABILITY	0.00925	0.02869	0.00003	0.31124
OPEN	53.82321	36.07298	4.67	423.41
GROWTH	0.02557	0.04560	-0.20807	0.88508
DEMOCRACY	-0.13500	7.86447	-10.0	10.0
GDP	$1.03*10^8$	$3.17*10^8$	324851.0	$3.96*10^9$
SCOPE	5.30105	1.94766	1.0	9.0

Summary statistics for model 3 of table 4.6 (n=3,252).

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Appendix A: (continued),

Variable	Mean	Std. Dev.	Minimum	Maximum
MIDON	0.00327	0.05712	0.0	1.0
ALLY	0.12225	0.32758	0.0	1.0
CONTIGUITY	0.02349	0.15146	0.0	1.0
CAPRATIO	2.24971	1.71271	0.0	11.99711
DEPEND$_A$	0.00203	0.01311	0.0	0.65293
IMPUTE	0.53043	0.49908	0.0	1.0
GROWTH$_A$	0.01910	0.05610	-0.30179	1.15567
DEMOCRACY$_L$	-0.51378	7.90648	-10.0	10.0
GDP$_A$	$1.11*10^8$	$3.58*10^8$	144730.3	$4.52*10^9$
AFFINITY	0.58349	0.30014	-1.0	1.0
DISTANCE	8.24956	0.77224	1.09861	9.42505
GOV$_A$	18.45765	8.04868	3.3	64.8

Summary statistics for model 1 of table 4.8 (n=500,759).

Variable	Mean	Std. Dev.	Minimum	Maximum
MIDON	0.00360	0.05991	0.0	1.0
ALLY	0.13152	0.33797	0.0	1.0
CONTIGUITY	0.02514	0.15656	0.0	1.0
CAPRATIO	2.18339	1.66170	0.0	11.44198
DEPEND$_A$	0.00205	0.01290	0.0	0.61416
IMPUTE	0.53067	0.49906	0.0	1.0
GROWTH$_A$	0.02401	0.05334	-0.20807	1.15567
DEMOCRACY$_L$	-0.71630	7.82446	-10.0	10.0
GDP$_A$	$1.03*10^8$	$3.31*10^8$	10715.43	$3.96*10^9$
AFFINITY	0.55330	0.29993	-1.0	1.0
DISTANCE	8.23813	0.77911	1.09861	9.42505
SCOPE$_A$	5.16606	1.96296	1.0	9.0

Summary statistics for model 3 of table 4.8 (n=385,859).

(continued)

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Appendix A: (continued),

Variable	Mean	Std. Dev.	Minimum	Maximum
MIDON	0.00421	0.06477	0.0	1.0
ALLY	0.09318	0.29068	0.0	1.0
CONTIGUITY	0.02279	0.14924	0.0	1.0
CAPRATIO	2.57578	1.93081	0.0	11.99711
DEPEND$_A$	0.00237	0.01490	0.0	0.61416
IMPUTE	0.36445	0.48128	0.0	1.0
GROWTH$_A$	0.01790	0.04084	-0.20807	0.20693
DEMOCRACY$_A$	3.27603	7.61438	-10.0	10.0
GDP$_A$	$2.79*10^8$	$5.93*10^8$	20290.16	$4.52*10^9$
AFFINITY	0.58524	0.30855	-1.0	1.0
DISTANCE	8.28895	0.75647	1.09861	9.42505
BERI$_A$	9.03541	2.55751	2.35	14.8

Summary statistics for model 4 of table 4.8 (n=118,687).

Variable	Mean	Std. Dev.	Minimum	Maximum
MIDON	0.00321	0.05661	0.0	1.0
ALLY	0.11868	0.32342	0.0	1.0
CONTIGUITY	0.02150	0.14505	0.0	1.0
CAPRATIO	2.09910	1.52910	0.0	8.88662
GROWTH$_L$	0.01790	0.04084	-0.20807	0.20693
DEMOCRACY$_L$	-3.82961	6.68804	-10.0	10.0
DEMOCRACY$_H$	4.95569	6.84263	-10.0	10.0
GDP$_L$	$2.62*10^7$	$6.94*10^7$	167657.8	$1.77*10^9$
GDP$_H$	$2.69*10^8$	$6.10*10^8$	230750.0	$4.52*10^9$
AFFINITY	0.65286	0.29046	-1.0	1.0
DISTANCE	8.31725	0.74702	1.09861	9.42246
IMPDUTY$_H$	17.52066	8.92957	0.0	61.10203

Summary statistics for model 1 of table 5.1 (n=57,860).

(continued)

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Appendix A: (continued),

Variable	Mean	Std. Dev.	Minimum	Maximum
MIDON	0.00298	0.05454	0.0	1.0
ALLY	0.10475	0.30623	0.0	1.0
CONTIGUITY	0.01995	0.13983	0.0	1.0
CAPRATIO	2.33721	1.77492	0.0	11.99711
DEPEND$_A$	0.00206	0.01345	0.0	0.65293
IMPUTE	0.50169	0.50000	0.0	1.0
GROWTH$_A$	0.01649	0.06395	-0.26699	1.15567
DEMOCRACY$_A$	0.58562	8.06054	-10.0	10.0
GDP$_A$	$1.47*10^8$	$4.50*10^8$	167567.8	$4.52*10^9$
AFFINITY	0.65607	0.28478	-1.0	1.0
DISTANCE	8.29312	0.752398	1.09861	9.42505
IMPDUTY$_A$	12.44949	9.300224	0.0	61.10203

Summary statistics for model 1 of table 5.3 (n=223,241).

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