The Cartel System of States

An Economic Theory of International Politics

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Contents

1 Introduction **11**

1.1 A View from the U.S.-Canada Border 11
1.2 The Questions 13
1.3 The State System as an Economic Cartel 15
1.4 The Origins and Growth of the Cartel 19
1.5 The Development of the Cartel over Time 21
1.6 The Cartel Today 28
1.7 A New Theory of International Politics 31

2 The Cartel Model **33**

2.1 The Market for Governance 33
2.2 A Simple Model 35
2.3 Competition in the Governance Market 38
2.4 Collusion in the Governance Market 39
2.5 The Assumptions of the Model 41
2.5.1 The Terrain 41
2.5.2 Citizens, Rulers, and their Objectives 43
2.5.3 Coercion in the Governance Market 45
2.5.4 Coordination 46
2.5.5 From Two Rulers to Many 47
2.6 Closely Related Ideas 49
2.7 Other Theories 51
2.7.1 Theories of Ideological Change 52
2.7.2 Modern Realist Theories 53
2.7.3 Spruyt's Theory of Institutional Selection 55
2.8 Summary 56

3 The Cartel Emerges **59**
3.1 Europe Before the Cartel 59
3.2 Understanding the Transformation 61
3.2.1 Economic and Technological Development 61
3.2.2 The Creation of the Territorial State System 64
3.2.3 A Model of the Transformation 67
3.3 Consequences of the Transition 71
3.3.1 The Rise of Diplomacy 71
3.3.2 Internal Consolidation 73
3.4 The Theory at Work: Demarcating the Anglo-Scottish Border 77
3.4.1 The Border in the Era of Competition 78
3.4.2 Evidence for Cooperation 80
3.4.3 Motivations for Cooperation 83
3.5 From Bilateral Cooperation to a State System 85

4 The Cartel Takes Over **89**
4.1 Africa and Asia before the West 90
4.2 Colonial Conquest 93
4.3 Involuntary Openings 96
4.4 Imperfect Hegemony 97
4.4.1 The Durand Line 97
4.4.2 The Weak States of Africa 103
4.5 Discussion and Conclusion 105

5 Challenges to the Cartel **107**
5.1 Territorial Disputes 108
5.1.1 A Model of Territorial Shifts 110
5.1.2 An Illustration: The Atacama Desert 112
5.2 Opportunistic Entry 114
5.2.1 A Model of Entry Deterrence 115
5.2.2 Successful Deterrence 117
5.3 The Democratic Political Economy of the Cartel System . . . 123
5.3.1 A Simple Model 124
5.3.2 Democratic Repression in Practice 128
5.3.3 Democracy and Competition 130
5.3.4 The Secession of Poor Regions 131
5.4 Open Questions and Potential Limitations 133

6 Resilience of the Cartel **137**
6.1 Nationalism . . . 139
6.1.1 A Model of the Effects of Nationalism . . . 141
6.1.2 Nepal and Sikkim . . . 144
6.2 International Institutions . . . 147
6.2.1 The Problem of Coordination . . . 147
6.2.2 International Organizations . . . 150
6.2.3 International Law . . . 157
6.3 Discussion and Conclusion . . . 158

7 The Cartel Today **161**
7.1 A More Complex Governance Market . . . 163
7.1.1 Dividing the New Market . . . 165
7.1.2 Managing Competition in the New Market . . . 167
7.2 Political Challenges . . . 171
7.2.1 Immigration . . . 171
7.2.2 Failed States . . . 178
7.2.3 Power Shifts . . . 180
7.2.4 Climate Change . . . 184
7.3 The Future of the Cartel . . . 185

For Katie, my love.
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Chapter 1

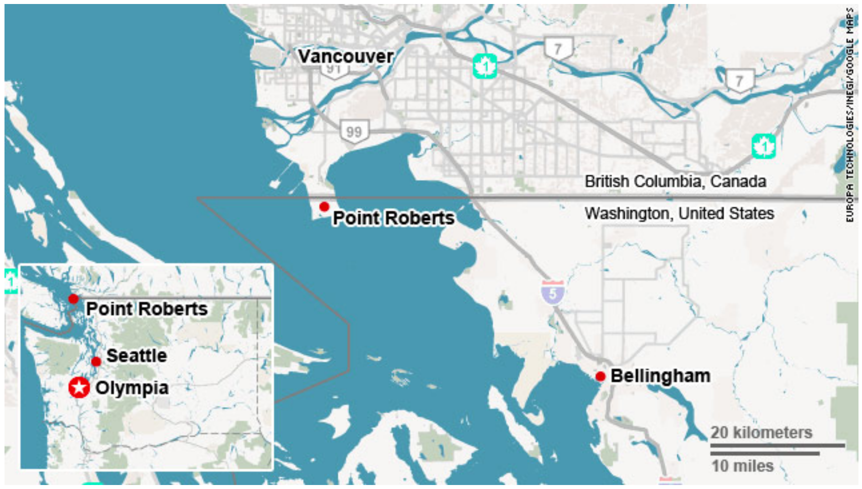
Introduction

1.1 A View from the U.S.-Canada Border

Neche, North Dakota (population 371) and Gretna, Manitoba (population 541) are two towns that lie on opposite sides of the U.S.-Canada border. Gretna was settled in the mid 19th century after the Anglo-American convention of 1818 established the 49th parallel as the U.S.-Canada border in much of the region west of the Great Lakes, and Neche was laid out a couple decades later.

The two communities are very similar, and they are in fact each others' nearest communities. Their residents frequently cross the border, for example to buy gas in Neche, or eat out at Nora's Diner in Gretna. At the same time, however, the border between these two communities corresponds to a sharp change in political authority that has profound consequences. The residents of Gretna are Canadian residents; are subject to Canadian laws; pay their taxes to the various tiers of Canadian government; and enjoy access to Canadian public services such as Canadian government healthcare. The residents of Neche, on the other hand, are residents of the United States; are subject to American laws; pay their taxes to the various tiers of American government; and enjoy American public infrastructure and services, such as American roads and highways, public schools and universities.

That the international border between places like Gretna and Neche is so meaningful is a fact of modern political life— one that many of us have come to take for granted even when it implies remarkable inconveniences. To get a sense of what these inconveniences could be, consider another example of a town on the U.S.-Canada border: Point Roberts, Washington, which lies on the southern-most tip of the Tsawwassen Peninsula, just across the Strait of



Point Roberts, Washington is a small American enclave. Its residents must cross the U.S. border twice to access important services in the nearest American city of Bellingham, Washington, even though these services are provided in Vancouver, British Columbia, which is much closer. Why do they have to put up with these inconveniences? Why do inter-state borders correspond to such sharp political and economic discontinuities?

Georgia from mainland Washington. Residents of this enclave must cross the U.S.-Canada border twice when traveling to other parts of the United States. Because of this, they do much of their shopping for goods and services in Canada. But they cannot do all of their commerce in Canada, for some important Canadian services are not available to them. The town has no hospital, doctor, or dentist, and American insurers do not pay for coverage by Canadian healthcare providers. In cases of emergency, the residents of Point Roberts have to get care in Bellingham, Washington, even though Vancouver is much closer.

Enclaves like Point Roberts have existed and continue to exist around the world. They are curious to us, but not just because of the histories that led to their creation. Equally important is the degree to which they highlight how borders often conflict with the interests of people who live near them. As citizens of a thriving democracy, the inconveniences experienced by the residents of Point Roberts are not great, and perhaps most of them could easily choose to move elsewhere if they wanted. In light of this, the continued existence of an enclave like this on the U.S.-Canada border is still a curiosity. If the residents of Point Roberts could access all of the services available in Vancouver but not in their small community, things life would certainly be more convenient for them. But this is not the case.

International borders, in modern times, reflect discontinuous changes in political authority, no matter what the inconveniences and inefficiencies are for the individuals that are separated by them.

1.2 The Questions

Borders represent one of the most tangible features of the international state system— a system that exists now almost universally. What explains this fact? Why are the citizens of neighboring regions that happen to lie across an international border often subject to very different governance systems? These questions are the subject of this book.

To put these questions in perspective, consider the fact that in much of human history, borders did not carry the same degree of political significance that they do today. Borders have existed since antiquity, but the tremendous social and economic implications for life in the neighboring regions that they separate are relatively new, associated with the rise of modern territorial states. Western Europe in the Medieval and Early Modern periods, for example, did not have territorial states, in the modern sense of this term. A few ambitious polities, such as the papacy and the Holy Roman Empire, claimed universal (or at least undefined) dominion, while the rulers of numerous smaller units—city states, duchies, baronies—contented themselves with less than absolute political authority. The borders between these units were correspondingly fuzzy, with personal loyalty and feudal obedience being more important than territorial division. Unlike the residents of today's Gretna and Neche, skillful elites like the Valois Dukes of Burgundy who lived in borderlands between two larger polities played their neighbors off against each other to great benefit.[1]

All of this changed over the last half millennium. By the time the League of Nations was formed in 1920, both the big empires and small feudal polities had disappeared in Europe, either evolving into or being absorbed into the sovereign territorial states that both claimed absolute internal control and freedom from external influence, and which recognized one another as pos-

[1]Outside of Europe, Tokagawa Japan and Mughal India similarly contained hundreds of lordships and cities that exercised autonomous political authority, raising taxes and waging war, much as modern states do. At the same time, these units acknowledged the partial authority of higher level political authorities, perhaps paying them some tribute, sending contingents to their wars, and allowing appeals to their courts.

sessing these traits. Most borders were formally demarcated on the ground and recognized by the relevant states. Universal claims were abandoned as either farcical or dangerous. Stephen Krasner (1993, 261) puts it succinctly: "the clearest storyline of the last thousand years is the extruding out of universal alternatives to the sovereign state."

As more and more borders became formally demarcated, a state system emerged that sought to guarantee the traits of modern statehood to those of the world's polities that came to be recognized by their peers as states. The development of this state system continued through the 20th century as new states emerged around the world. By the end of the period of decolonization in 1960, the European conception of statehood and territoriality had spread to virtually the entire world. The limits of the newly created states were defined by borders of unprecedented salience. And while the intervention of more powerful states in less powerful ones continues to this day, these interventions have become increasingly cloaked in an elaborate regard for the sovereignty of even the most powerless states.

As ubiquitous as the modern territorial state system is, the sharpening of international borders continues even in the 21st century. In many parts of the developing world, governments attempt to exercise some sort of political power outside the boundaries assigned to them on world maps. In fact, in many parts of the world today, borders are highly contested. Residents of the zones of weak state presence and unclear political authority between Afghanistan and Pakistan, and the disputed and ambiguous boundary between Sudan and South Sudan, for example, may be able to choose which of the two governments or their local proxies they owe their primary allegiance to. And they may face demands from both sides for taxes and military support. In these cases, the "border" is less a line than a broad zone of disputed and ambiguous political authority.

How do we understand the modern state system as it continues to develop and evolve? What purpose does it serve? And what effect does it have on the lives of people— the individuals that it governs?

Another way to provide some perspective on these questions is to consider some hypothetical alternatives to the current state system. Imagine, for a moment, a world in which the residents of towns like Neche and Gretna that we mentioned above could decide for themselves if they wanted to pay a portion of their taxes to the Canadian government to "buy in" to Canadian healthcare while paying another remaining portion of their taxes to the U.S. government to enjoy access to American public services, such as the ability to enjoy in-state tuition in nearby public colleges. We could even ask this question of cities, towns and communities that are not border communities. Why can't public services be bought piecemeal, on an *a-la-carte* basis, with governments competing with one another to provide higher quality services at the lowest cost, in a sort-of marketplace for government services? Even if governments demand that all of their services be purchased together, or that there are synergies from having all services provided by a single government, why are most citizens not allowed to choose which "bundle" they will pay taxes for, instead being assigned to a government based on birth or residence? If the basic rules of economics apply, this competition would be good for citizens since governments would be compelled to provide more and better services at lower costs, or else be driven out of the market. Why haven't citizens living in two bordering democracies demanded such a competitive market system in the provision of governance?

We argue that the defining feature of the modern territorial state system is the local, bounded, monopoly that states have in governing their citizens. States refuse to violate each other's monopolies, even when they could do so easily. Even attempts to seize territory by force have become rarer over time. We examine what makes this system is stable, when and how it emerged, how it spread, how it has been challenged, what led it to be so resilient over time, and how might it evolve in the future.

1.3 The State System as an Economic Cartel

The territorial state system represents an economic cartel. It is an agreement among states to divide what we call the "market for governance" in ways that reduce competition and deter entry, at the expense of their citizens. The system exists because early states were governed by rulers that were forward-looking and self-interested, always seeking to find ways to maximize their power over their citizens, and enrich themselves.

While many of us — especially those of us who live in democracies where citizens enjoy a high quality of life and hold their leaders accountable to their interests— do not think of states in such exploitative terms, the vast majority of states in human history were founded and designed to serve the interests of their rulers at the expense of their citizens. The modern French state, for example, originated in the efforts of King Philip Augustus to consolidate power over the territories that would become France, and his descendants ruled exploitatively over their subjects until the eve of the French Revolution. While power is sometimes distributed in a more egalitarian manner today (a point to which we will return below) we will proceed for the moment with the (historically accurate) assumption that states were built to serve the interests of a relatively small ruling class.

In our cartel theory, the term “governance” refers to a package of services that states provide to their citizens. The most basic of these are protection and dispute resolution, but states can also provide a wide range of modern public services and infrastructure, such as education, healthcare, and scientific research. Because these services have value, citizens possess a demand for them, whether they are provided by the state, by other actors, or not provided at all. Since there is both a demand for these services, and a supply, we say that there is a “market for governance.” This is the loose sense in which we use the term “market.”

A key premise of our theory is that the market for governance has the potential to be competitive. Communities or powerful individuals facing tax demands that they consider too high relative to the benefits they receive may instead join another polity. In this market, individuals that are placed between two states can potentially pit them against each other, demanding more services or less taxation in return for their allegiance. The tax rates paid by individuals for these services are regulated by the availability of alternative states or providers, and the costs that those providers face in delivering the services. Individuals in a competitive governance market will pay a price for services that is close to the costs of the competing states, with the more efficient states offering the most competitive prices. Individuals in noncompetitive markets, however, pay a monopoly price, which can be substantially greater than the cost of providing the services. This is a feature that the governance market shares with other markets. Citizens in a town with a single hardware store, for instance, will pay more for their nails than those of a town with multiple, competitive hardware stores.

The costs of providing governance for each state varies spatially. Each state possesses a zone, often (though not always) the zone around the capital, where its ability to extract resources and apply coercive force is very high. The farther away from this zone the state attempts to expand, the longer communications become, the farther armies have to travel, and the more unfamiliar local society becomes to officials. All of these features raise the costs of providing governance relative to the taxes that can be extracted from these peripheral areas. Hawaii is more costly to the United States government to administer and defend than Pennsylvania, and the Amazon is more costly for Brazil to govern than Minas Gerais.

The increase of cost with distance is not necessarily linear. Topography can have a crucial importance for the spread of state administration, with states finding flat settled areas easy to administer but having a harder time administering rougher terrain that may be closer. Culture and language affect the costs of governing. It is cheaper to govern individuals who share the same culture and language as the administrators of the state, and express a loyalty to the state through their sense of national identity.

Taking this variation in costs into account, as we move from the center of one state, we may be moving towards the center of another. This will have an effect on the taxes that that the state could collect under a competitive system, since its residents living near the border have an outside option. By threatening, even if only implicitly, to switch their allegiance to a rival polity, these border residents may be able to extract concessions, usually in the form of lower taxes, increased services, or increased local autonomy. Put in economic terms, competition in the governance market is accompanied by lower prices and higher levels of services. In colonial India, for example, the British Raj was the main provider of governance and thus had broad discretion in setting tax rates. On the North West Frontier, however, where the colonial government was competing with the Afghan government, the colonial state not only did not collect land taxes but also furnished the local khans with generous subsidies.[2]

The desire to eliminate unstable, unprofitable border zones has been the main factor in the creation and stability of the state system. The state system, at its basis, is a product of cooperation by rulers against their citizens, where polities divide the governance market among themselves, and agree to not provide governance outside of their boundaries. Since each state is now a local monopolist in the provision of governance, individuals must pay them the monopoly price, leading to higher tax burdens.

In our theory, the individual is the actor who buys governance. However, in most historical cases only relatively powerful individuals, such as medieval counts and African chieftains, played a political role and engaged in the types of calculations we discuss. These local elites provided whatever government occurred in the "ungoverned" space between larger states, and bargained with their larger neighbors. In modern times, it is not just individual citizens who are the relevant actors but also businesses and corporations, both national and multi-national. When we say that competition in the governance market favors individuals, it is worth emphasizing that the individuals in question are often only the powerful, who are able to arrogate the gains to competition to themselves.

[2] Tripodi (2016).

The state system that we describe resembles a traditional economic cartel in many respects. Just as Archer Daniels Midland and its Japanese and Korean competitors distributed among themselves the global market in lysine in the 1990s, or Osram, General Electric, Associated Electrical Industries, and Philips divided the global market in lightbulbs in the 1920s, contemporary states divide among themselves the right to tax and govern the world. This coordination can occur in large multilateral meetings like the Congress of Vienna or the Treaty of Versailles which deliberately redrew the boundaries of much of the world to allocate and reallocate shares of the governance market to different states, but more typically they occurred in bilateral treaties between neighbors that adhere to a loose set of international norms. By limiting competition, the members of the cartel can charge their citizens much higher prices (taxes) than they would be able to otherwise.

What makes the cartel system stable? Unlike most modern economic cartels, the state system is untroubled by the legal anti-trust restrictions on such arrangements that exist in many countries. However, very much like economic cartels, the state system is haunted by the specter of cheating—that one player will attempt to steal the market share of the others. The territorial division that is characteristic of the contemporary state system is a means for reducing this type of cheating. Violations of the norm of non-competition are easier to police when they are unambiguous and visible. The mutually agreed, demarcated territorial border serves as a marker of political division between one taxing monopoly and another. While a medieval border violation may be difficult to separate from the legitimate exercise of political authority, today any state that tries to govern outside of its internationally recognized borders is clearly violating the norms of the state system. These violations do occur in practice, but they are nevertheless indirect. When they are spotted, and considered to be violations, there are mechanisms in place to hold accountable those that commit them.

Both in theory and in practice, it is this mutual recognition of territorial sovereignty that sets states apart from other political units, rather than the efficiency of their institutions. In fact, some states, such as many in contemporary Africa, are so institutionally weak that they are unable to provide much in the way of state services, or to extract much in way of taxes. These efficiency problems might doom these states in a perfectly competitive system—they may be replaced by new states, or gobbled up by their neighbors, probably with the cooperation of some of their inhabitants. But, instead, the state system guarantees them a share of the market, much as economic cartels can also guarantee the survival of inefficient producers.

Even failed states that are unable to provide a minimal amount of state services outside the capital, are considered to be the formal equals of states with a much higher actual ability to govern.

Cooperation between states can be made self-enforcing with the help of strategies that punish deviating states for violations of the cooperative norm. While a state might gain revenues by collecting taxes from its neighbors' subjects, this would lead to a loss of future revenue, as then the cheating state would have to reduce taxes in the face of competition for the allegiance of its own border subjects. However, it may still be in a state's interests to seek to alter the border in its favor. To reduce such attempts, the state system has developed a complicated set of norms that discourage the unilateral initiation of conflict, and unilateral annexation of territory.

How does cartel theory help explain the puzzle of discontinuous political changes that takes place at international borders? The residents of Neche or Gretna or Point Roberts cannot "buy" government service across the border because the governments of the United States and Canada have mutually agreed that they cannot do this. As long as this agreement between the states is in effect, both governments can then provide levels of taxation and services that are unconstrained by the threat of competition. This is the argument that we lay out and develop in this book. We develop the argument through the lens of a simple model that we present in Chapter 2, which serves as the basis for various extensions of our argument that appear in later chapters.

1.4 The Origins and Growth of the Cartel

Cartel theory helps us understand the origins of the territorial state system in Early Modern Europe, it's spread to the rest of the world, and its development through the centuries. Both in the fields of history and in political science, quite a bit of ink has been spilled theorizing about the origins of this system. We argue in Chapter 3 that it developed in Europe as rulers sought to exert control over the peripheral areas of their growing states, where their influence came into contact with the influence of other rulers. In Chapter 4 we discuss the spread of the cartel system to the rest of the world.

In pre-Modern Europe, states had a difficult time projecting their power over great distances, due to the fact that governance costs were sharply increasing in distance away from the state's administrative centers. News and orders could travel no faster than a man on horseback, literacy was limited, and military technology and bureaucratic institutions were primitive. Consequently, vast amounts of territory in pre-Modern Europe remained ungoverned by the larger polities, as the administrative influence of one larger ruler hardly came into contact with that of another. These spaces, controlled by local elites, lay in the marginal spaces between the administrative centers of the largest polities.

It was not until the invention of gunpowder and improvements in military and bureaucratic organization that took place gradually starting in the late medieval period that the high costs of governing began to decline. Rulers started being able to exert control over territory further away from their capitals with greater ease and sophistication. At the same time, economic growth fueled by long distance trade started to raise the value to rulers of conquering and governing these faraway places. Rulers started to appreciate the value of being able to tax commerce in distant regions where they would previously have considered it unprofitable.

The boundaries of states thus shifted outward. More and more individuals were incorporated as citizens of these growing states. Eventually the spaces that had been left ungoverned by the powerful polities disappeared as the boundaries of one growing state came in contact with the boundaries of another. Rulers could not increase their influence further without becoming competitors in the market for governance in the areas in which their influence overlapped. This competition threatened the profits they could earn from governing these places, and they started to devise plans to avoid their losses. They signed border treaties, developed bilateral agreements on how to respect each others rights to govern within their borders, exchanged ambassadors to facilitate communication between them, and extended their bilateral agreements to multilateral agreements involving many players.

The non-European world before the 19th century had many similarities to medieval Europe, with a few powerful polities that claimed broad dominion (e.g. Qing China and the Mali Empire) that were separated from each other by vast stretches of space inhabited by small political units of "barbarians." As in Europe, these empires considered it unprofitable to even attempt to govern in distant areas. However, in the 19th century, Europe imposed its own state system on the rest of the world by force. In some polities that were not colonized, such as China and Japan, rulers were intimidated into adopting the evolved practices of the European state system, such as mutual recognition and the exchange of ambassadors.

In most of Africa, South and Southeast Asia and the New World, however, Europeans conquered and divided territory among themselves. The process of colonial map drawing was made easier by the fact that all the actors involved abided by the rules of the system at home, and the fact that in some cases colonization coincided with the replacement of native populations by Europeans who were already familiar with such a system. For these reasons, colonial state-building exercises such as the Congress of Berlin were in many ways a purer demonstration of the logic of the cartel theory than the bilateral agreements that fixed the borders between European polities. A small group of leaders of the most powerful states divided the rights to govern Africa among themselves, and did so with sharp lines on a map. They negotiated with a great deal of concern for their own profit and internal balance of power and no concern for the interests of the native populations, or for the claims of the smaller rulers who had ruled them in the past, or even for the actual ability of the parties involved to govern the territories they claimed. Despite the artificiality of colonial boundaries, so many of them have remained stable, with the new rulers who control post-independence capitals seeing the advantages that their status as rulers of modern states gives them over other political actors within their borders.

In economic cartels, firms usually set out from the beginning to create the cartel. Anti-trust prosecutors can sometimes even point to a specific meeting or unearth the secret communications that created the cartel. The state system, on the other hand, was created by people who had no intention of creating a new global order, and who might well have been ideologically opposed to the state system as it exists today. It is for this reason that attempts to discover to a single point of origin to the state system, such as the Peace of Westphalia, have failed. (We say more about this at the end of the next chapter.) Rather, over several centuries, statesmen simply sought to shape bilateral relations with other states in ways that benefit them mutually, at the expense of local elites in the frontier zone. Even in the 19th century, when the triumph of sovereign states over alternative political arrangements seemed complete, the state system was less a conscious, intended arrangement than a complex agglomeration of bilateral relationships. Yet as these bilateral arrangements became more sophisticated and widespread, they generated a set of norms that became widely accepted. It is precisely these norms that represent what we mean by the state "system."

1.5 The Development of the Cartel over Time

If the state system represents simply a set of norms, then how has it remained so stable for so long? Norms tend to change significantly over long periods of time, especially in the face of a changing environment and changing incentives, and often in unpredictable ways. The cartel system too has faced some major, potentially destabilizing challenges over the course of its history. But it has so far dealt with these challenges with remarkable success. In Chapter 5 we discuss three of these challenges, and in Chapter 6 we discuss two factors that have enabled the cartel to overcome these challenges. We summarize these as follows.

Conflict An important threat faced by cartel system has been the challenge of inter-state conflict, which represents the possibility that more efficient and more powerful states will steal the governance market share of less efficient ones. It is, in some ways, surprising that even the two great wars of the last century did not unravel the cartel system. Equally surprising is the fact that following the end of World War II, inter-state wars have become vanishingly uncommon. How has the cartel survived the destruction of inter-state wars? How has it made inter-state war so rare?

We start by drawing an analogy between inter-state conflict and the challenges that economic cartels face in managing price wars between their members, or fights to control market share ("turf"). Wars can be understood within the cartel system as ways of credibly communicating changes in relative market power. As the strength and efficiency of one cartel provider improves, it is natural for that provider to seek a greater share of the market. At the same time, however, it is difficult for other players in the system to know whether the claims of that provider are legitimately based on real improvements in efficiency or strength. If the state would be willing to go to war over a piece of territory only if these improvements are real (and state efficiency is associated with success in war) then war serves as a mechanism by which the claims of stronger players can be unilaterally imposed on weaker ones. In this model, once the war is over, the cartel members return to cooperation: they recognize each others' sovereignty, or at least the limits of their own claims. Just as it is possible for oligopolists to return to collusion after their relationship is briefly destabilized by a price war, so too is it possible for states to return to cooperation after a period of conflict. In cartel theory in general, brief periods of war are not at all inconsistent with long spells of cooperation.

Entry Deterrence Another important challenge faced by the cartel system is the threat of entry into the governance market by opportunistic actors seeking to establish new states. The threat of entry is certainly a real threat— the number of countries in the world has grown over time, especially in key periods such as the period of decolonization and the end of the

Cold War. But at the same time, it is notable that the number of states today is still much smaller than the number of areas whose elites would like to establish their own states. How has the cartel virtually eliminated both territorial war and unilateral entry (i.e. entry without the consent of the existing cartel members)?

We study the issue of entry deterrence by building on the idea that an important objective of any successful cartel is to suppress the emergence of new market entrants, an act that may require coordination among the existing cartel members. Throughout the history of the cartel system of states, groups that have attempted to challenge existing cartel members have been labeled as "rebels," "pirates," or "terrorists," cut off from international assistance and occasionally the target of coercion. In some notable instances, the efforts of these opportunistic market entrants succeeded; but in a great number of cases, they have failed. The Rif State in Morocco, the Confederate States of America, and the Biafran secession in Nigeria are examples of when moderately successful states failed to gain de jure recognition from existing cartel members. Somaliland is a case of a state that has remained unrecognized for nearly three decades despite developing the institutions of a state. Even regimes that control all of a state's recognized territory, like Afghanistan's Taliban today, may be denied recognition if other states consider them unreliable participants in the cartel.

At the same time, there have been some critical moments in history, such as the period of decolonization, when incumbent states actively welcomed the entry of new states into the world system rather than deterred their entry. Belgium, Algeria, and Ukraine are examples of successful new states that were able to win recognition from the existing cartel and claim a share of the governance market. Cartel theory explains their success in gaining recognition as reflecting an alignment of interests between the entrants and the most powerful states, who lead the response on behalf of the smaller and weaker cartel members. Belgian independence was favored by Britain, the dissolution of colonial empires was actively encouraged by the newly powerful United States and Soviet Union, and the dismemberment of the Soviet Union following the end of the Cold War was of course actively supported by the lone superpower at the time—the United States, along with its western European allies. In all of these cases, the superpowers believed (perhaps rightly) that they could more easily exercise influence over the smaller new states than the larger old ones. The point is that the cartel is often powerful enough to decide who has the right to enter.

Democracy Over the course of the 20th century, the number of democracies grew, and established democracies greatly expanded voting rights. These developments create a puzzle: If the cartel system is an exploitative system that serves the interests of states and their rulers at the expense of their citizens, why wasn't the system undermined following the advent of democracy? Wouldn't citizens vote to replace the governance monopolies that they face with a system in which there is more competition in the governance market—if competition benefits them?

At least in the early days, the expansion of democracy certainly did not undermine the cartel system, which became ever more stable in the 20th century. To understand why, recall that the cartel helps rulers exploit their citizens, and this is true whether the "ruler" is an autocrat or the pivotal voter or powerful special interest group in a democracy. An important observation is that incrementally increasing competition in the governance market typically benefits only a minority of citizens at each step. If this is true, why should the majority favor these incremental increases in competition? In standard political economy models of democracy, it is assumed that democracies redistribute what they collect from taxes back to the populace, in the form of transfers, social insurance, and public services that benefit the citizenry. If opening up the governance market to foreign competition reduces what the state can collect from a minority of citizens, then under balanced-budget redistribution, it necessarily harms the interests of the majority of net receivers. We elucidate these calculations in Chapter 5.

The argument of the previous paragraph rests on the assumption that opening up competition in the governance market would have to take place in incremental steps, exactly in the way that the lowering of trade barriers between states in the past fifty years has proceeded— a development that has effectively increased competition in the governance market. To increase competition in the governance market in any other way would carry significant transition costs, and result in massive and uncertain changes in how power is divided within and across societies. This uncertainty is a powerful force that can lead to inertia, as is often argued in theories of institutional stability and path dependence.[3]

At the same time, it is interesting to note that it was mainly the industrialized democracies of the West that led the effort to open up competition in the governance market following World War II by promoting globalization and free trade. While these policies create winners and losers, the most powerful political interests in an industrial democracy (producers with lobbying

[3]See for example Pierson (2000), Page (2006) and North (1992).

power, or the majority of consumers) typically benefit from this enhanced competition in the governance market. By contrast, support for free labor mobility has been comparatively weaker, as most of these countries still heavily regulate immigration. This is not surprising, as it is natural for voters seek the kind of competition in the governance market that enhances their own consumer surplus, not that of other populations seeking to migrate into their societies.[4] The more general point is that voters and special interest groups in a democracy (as well as powerful interests in an autocracy) may support or oppose increasing competition in the governance market depending on whether these increases in competition benefits or harms them.

International Institutions Over the last five centuries the world economy and world politics became increasingly complex, fueled by important developments in world history, such as the Age of Discovery and the Industrial Revolution. As a result, the management of the cartel also became more complicated over over time. In response, states gradually started to develop international institutions to clarify the norms of the cartel, and to enable them to adapt to the concomitant changes in technology, culture and economics. In the 19th century, they held numerous ad hoc international conferences like the Congress of Vienna to manage their relations between them and clarify and propagate the norms of the cartel. In the 20th century, they tried to institutionalize many of these norms, or at least supplement them, with the creation of formal bodies like the UN and the WTO. The principal objective of these bodies was to improve coordination between cartel members through codified rules of engagement. There are obvious parallels to economic cartels such OPEC, which has a permanent secretariat to facilitate coordination.[5]

We take up the question of how to understand the role of international institutions in enhancing the stability of the state system. We argue that their primary goal is not to suppress conflict, but to help the cartel leaders coordinate their collective interests in the governance market when such a collective interest exists. In some cases, this may coincide with suppressing aggression by one state upon another, as when the United States, through a series of resolutions by UN Security Council, initiated the process of organizing a coalition of 35 nations in 1991 to prevent the Iraqi takeover of Kuwait.

[4] This is the argument made by Peters (2017).

[5] But since these organizations do not have the same degree of coercive power that the rulers of states exert upon their citizens, it is most accurate to think of the state system as continuing to represent a set of self-enforcing norms.

In other cases, it may mean ignoring unilateral land grabs such as the Russian takeover of Crimea, or the invasion by the Rwandan Peoples Front from Ugandan soil that precipitated the 1994 Rwandan Civil War and genocide. In some cases, it may mean fighting entry into the governance market on behalf of existing cartel members, as when Taiwan is refused UN membership. In other cases, it may mean welcoming new providers into the governance market as new cartel members, as when South Sudan was recognized as a state and granted UN membership in 2011. International institutions help the most powerful cartel members coordinate action on issues of common interest when such a common interest exists.

International institutions also serve an important function by simply clarifying the norms of the system, even if they do not have the power to enforce them. The WTO provides a good example. It clarifies exactly what a member state can expect to happen if it breaks the rules governing trade that each is expected to abide by. The WTO contributes to stabilizing the norms of the cartel by developing common expectations about what happens when the norms are broken, even if it is ultimately up to the member states themselves to carry out any punishments to those that violate the norms.

Nationalism The creation and strengthening of national identities has helped the cartel overcome the challenges of war and democracy in important ways, even though it is not clear that national identities were created to serve this purpose. An important byproduct of nationalism has been to create steep changes in governance costs that coincide with the borders between states, which in turn stabilizes the borders between them. Nationalism contributes to stabilizing the cartel by simultaneously lowering the cost of governing one's own population while raising the costs of governing other populations. This creates these steep changes in governance costs at inter-state boundaries, and these steep differences shield neighboring states from the risk that small changes in the cost of governance could shift the efficient boundary between them dramatically to one side or the other.

The logic is as follows. If it is too expensive for a state with expansionist ambitions to govern a neighboring population relative to what it can earn from providing governance to that territory, then it is less tempted to initiate a conflict to try to conquer that territory. On the flip side, if it is cheap for a state to govern its own population, then it is more willing to defend its right to do so against an aggressor state. Nationalism creates precisely these conditions: it makes it expensive to govern other populations, and cheaper to govern ones own population. Cartel theory therefore provides an economic rationale behind this argument by casting it in terms of the costs and benefits of claiming a greater share of the governance market.

In addition, nationalism also works against the temptation for democracies to open up the governance market to competition from foreign providers. If national attachments are so intense that the cost to rival states of governing the citizens of other countries are higher than the value that can be extracted from them, then opening the governance market to more competition will not benefit anyone, even in a democracy. Nationalism makes citizens of democracies loyal to their own monopolist provider however extractive that provider may be. This is an extreme form of the kind of brand loyalty that enables producers of economic goods and services to extract a larger share of the consumer surplus. In the context of our theory, it means that today even substantial financial concessions would not convince the citizens of many states to switch governments; indeed, many of them are prepared to die rather than accept doing so. Borders, even the most seemingly arbitrary ones, can therefore over time reify themselves.

This logic also helps explain why increased competition in governance market arising out of globalization has benefited mainly those who are willing to forgo national attachments to take advantage of foreign opportunities opportunities, including economic migrants who are willing to change their nationalities to find better work opportunities or avoid paying taxes.[6] In fact, some of the biggest beneficiaries have been corporations that register themselves in tax havens around the world to lower their tax burden. While nationalism makes individuals loyal to their states, unwilling to be governed by other states, corporations are typically not subject to these sentiments. To quote Dani Rodrik (1997): "owners of internationally mobile factors become disengaged from their local communities and disinterested in their development and prosperity" (p. 70). Joseph Stiglitz (2002) is even more blunt: "firms threatened to leave the country unless taxes were lower: there was no patriotism among these multinationals" (p. 40).

[6] In the United States, Senators Chuck Schumer and Bob Casey have introduced the Ex-PATRIOT act in Congress (which would force individuals that the IRS listed as having renounced U.S. citizenship to avoid paying taxes to pay a 30 percent capital gains tax or else be barred from re-entering the country) partly in response to their belief that billionaires like Facebook co-founder Eduardo Saverin who renounced American citizenship and moved to Singapore change their nationalities to avoid paying taxes.

1.6 The Cartel Today

In recent decades, the state system has faced new challenges created by technological developments, globalization, and the uneven success of states in providing governance. We elaborate upon these in the final chapter of the book, and offer some speculative thoughts (that emerge from our view of the state system as a cartel) on how this system might evolve in the future.

Globalization Today's governance market is more than a just a market for control of physical territory. Competition in this market now takes place in a complex and abstract space of economic policies that regulate international commerce and the world economy. At the same time, technological improvements that have resulted in better communication, cheaper transportation costs, and greater financial mobility have complicated a state's task of exercising control over its share of the governance market. On the one hand, these technologies are available to governments to track the movement of people, money and goods in and out of their borders. On the other hand, human migration, trade and financial competition have all increased, as these developments have tempted many states to break the collusive cartel agreement in creative and often subtle ways. Several developed economies have welcomed high skill workers from developing countries, and many rich countries from the oil-exporters of the Middle East, to the emerging economies of Southeast Asia have also welcomed unskilled workers to take advantage of the relatively low wages that they are willing to accept. All countries, especially the fast growing economies of Asia, have worked hard to attract greater foreign direct investment. Many small countries like Andorra, Mauritius, Lichtenstein and Monaco have enticed wealthy individuals and corporations to relocate their businesses by offering favorable tax rates. Even the small stream of revenue that these low taxes generate can contribute significantly to the funds required to run their small governments.

The upshot of all this is that competition in the governance market has increased significantly. These trends have challenged the way the cartel operated historically, and they have generated countervailing pressures against the cartel's original intent to limit competition in the governance market. Nevertheless, it is important to recognize that the choice to soften borders is a political choice that the leaders of the cartel have made, often as part of a coordinated strategy to reap the benefits of globalization. Because of this, it is probably more appropriate to think of the cartel's objective in today's inter-connected world economy as seeking to control and manage competition in the market for governance rather than to limit it in all instances.

As a consequence of these trends, however, new political challenges have emerged. Incremental increases in competition in the governance market through free trade policies may have increased the overall economic pie, but they have also created distinct groups of economic winners and losers. In many cases, governments have found it difficult to identify these groups in the short run, complicating the task of finding political support for greater international openness by developing policies to quickly compensate the losers by redistributing some of the gains from the winners.[7] Part of the challenge has been taht for any two distinct policies that regulate competition in the governance market in different ways, the sets of supporters of the policy may differ significantly. An individual who supports one policy that enhances competition in the governance market may oppose another policy that also enhances competition but in a different way, if the individual stands to be a winner from the first policy but a loser from the second. This can lead individuals to oppose broad policies even when they include some components that they can identify as clearly benefiting them.

These factors have led many voters to oppose increasing competition in the governance market even if their countries are well-positioned to take advantage of the economic gains from globalization. In Europe and the United States, opposition to increasing competition in the governance market has come in the form of a new kind of populist nationalism. Donald Trump's election as president of the United States, Britain's exit from the European Union, and the rise of parties like the Rassemblement National (previously the Front National) in France are some examples. These movements have drawn the support of citizens who want the cartel to operate as it did historically. Some of these citizens rationally see themselves as benefiting from closed borders and the suppression of competition in the governance market because they believe that the closing of borders helps them materially, or prevents them from being harmed, in expectation. Interstate competition in governance, in the view of many of these voters, leads to a destructive "race to the bottom" in social provision even if it also results in welfare enhancing efficiency gains which they see themselves as uncertain and unlikely to share in. Others support these movements because of their nationalist emotional attachments. Either way, the goal of these coalitions has been to exclude external labor, goods, and influences on state policy.

[7] Fernandez and Rodrik (1991) argue that when this happens a majority of voters may oppose efficient policies.

Uneven Governance Quality Another political challenge has arisen from the fact that some states have failed to provide even the most basic forms of governance to their citizens, such as security. For many citizens of poor countries, the value of governance they receive is lower than the costs they pay to receive it, especially if we measure these costs as including not just the direct taxes they pay to the state but also the opportunity costs of not being able to earn a higher return on their labor were they to move to a more functional state. Inequalities in state strength and the abilities of states to govern have always existed, but in a world in which the costs of migration are smaller than they have ever been, citizens are also on the move, quite as much as corporations seeking better tax and regulatory environments for their businesses. Even when they do not move themselves, they may move their wealth to safer jurisdictions abroad, further draining resources from inefficient states and potentially amplifying any existing disparities in governance ability.

An important question that emerges from these observations is whether the cartel system can withstand an increasingly uneven distribution of quality of governance that we see around the world, as the quality of governance in many states improves rapidly but in other it improves at a slower pace, and in some states such as Somalia, Syria and Afghanistan it stagnates or even deteriorates. In the opening paragraphs of this book we talked about the U.S.-Canada border. But on this point, it is the U.S.-Mexico border that is more pertinent with the notable differences in governance quality between the two states.[8] Even though governance in Mexico has steadily improved over time, the number of Mexican immigrants in the U.S. surged in the 1990s and early 2000s and has leveled off after the Great Recession. On the other hand, the number of immigrants from other Central American countries such as El Salvador, Guatemala and Honduras—many of whom arrive by crossing the U.S.-Mexico border—has continued to increase.[9] Out-migration from countries with poor governance such as these and others in Africa and Asia creates a vicious reinforcing cycle: people leave these places to escape crime and insecurity, but when this happens their voices are lost and the political power of those who oppose terrorism, organized crime, and drug and human

[8]The residents of El Paso, Texas, for instance, receive much better protection from murder, assault and theft than the neighboring Mexican city of Juarez, not to mention a better set of roads, schools and hospitals. Because they are born on the wrong side of the border, residents of Juarez live seven fewer years and earn an old age pension of approximately 17% of the size of an El Paso resident.

[9]These claims are based on U.S. immigration trend data reported by the Migration Policy Institute; the data are available at `https://www.migrationpolicy.org/`.

trafficking declines while the power of the criminals increases. This leads even more people to leave, exacerbating the power difference. These places then become the breeding ground for actors who challenge the norms (and in the case of the Islamic State, the very premise) of the state system, resulting in major negative externalities on the rest of the world.

Other Challenges In addition to globalization and state failure, there are also many other new challenges to the cartel in recent decades, nuclear proliferation, global climate change, and cyber-warfare—all consequences of developments that allow actions within one state's borders to create negative externalities for other states. Effective solutions to these problems require interstate coordination in the face of temptations to purse private interests at the expense of cartel stability. In many ways the cartel should be well-suited to addressing these challenges. Imagine trying to coordinate action against a collective action problem like the existential threat of climate change in an alternative world where every state is a competitive supplier in the governance market, and there is no coordination among these suppliers. The norms of the international system, and the international institutions that were set up following World War II, provide a way to coordinate collective responses to these problem, even though (in the eyes of many concerned individuals who do not think of this counterfactual) the effectiveness of these institutions at solving these problems has so far been disappointing.

Maybe we should remove this paragraph from the intro...?

1.7 A New Theory of International Politics

Our goal in this book is to offer a new theory of international political economy based on the competitive political economy of governance. The cartel theory that we develop in subsequent chapters provides the basis for understanding a wide range of phenomena in international politics— the drawing of borders, the control of capital flows and human migration across these borders, the role of national identity in international politics, and the cooperation of states through international institutions on persistent political issues such as trade, terrorism, state failure, and climate change.

In our model states are competitors in a market for governance, in which states provide governance to citizens, and citizens pay taxes to the states that govern them. The system of states, we argue, is a collusive arrangement held together by a set of norms under which states segment the market for governance and exercise monopoly power to tax and govern within their shares of the market, free of competition from other states. States have have managed to reach a high degree of consensus and cooperation in dividing the market: Outside of Antarctica nearly every square inch of land in the world belongs to a state, and the fraction of land that is claimed by more than one state is less than 1.6%.[10] This means that almost nowhere in the world do two or more states openly compete to provide governance to the same citizens. While much of international relations theory is concerned with understanding the sources of conflict between states, we are interested in understanding this remarkable degree of cooperation between them. This cooperation is so deep and widespread that it easily escapes our notice, leading us to often focus on violations of the cooperative norm rather than on the norm itself.

This new understanding of the state system raises a set of questions that will be further explored in later chapters. Why states do sometimes fight each other? Why do they so often return to cooperation after the fight is over? Why it is so difficult to create new states without the consent of existing states? It also sheds light on how the states will approach some of the emergent problems of the 21st century associated with globalization, in which corporations and citizens exploit the lower costs of movement across borders to (at least partially) reestablish interstate competition in the governance market. The struggle, currently ongoing, between this renewed competitive dynamic and the formidable set of institutions, norms and incentives bound up in the current system of territorially bounded states will determine both the system's future stability and the internal politics of its members.

[10]This calculation is for the year 2000 and based on the data in Schultz (2015).