The Cartel System of States

An Economic Theory of International Politics

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Chapter 1

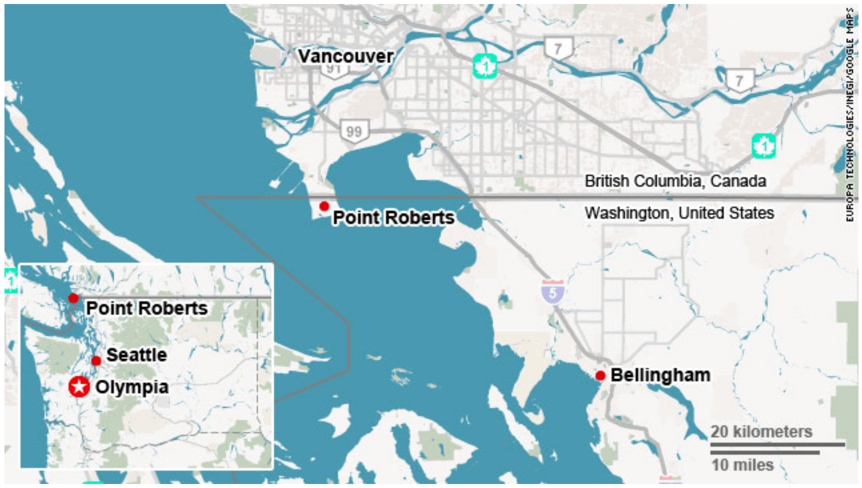
Introduction

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 US-Canada border. Gretna was settled in the mid-19th century after the 1818 Anglo-American Convention established the 49th parallel as the US-Canada border in much of the region west of the Great Lakes. Neche was laid out a couple decades later.

The two communities are very similar, and they are in fact each other's nearest neighbors. 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 is the cause of remarkable inconveniences. Consider another example of a town on the US-Canada border: Point Roberts, Washington, which lies on the southernmost tip of the Tsawwassen Peninsula, just across the Strait of Georgia from mainland



Point Roberts, Washington is a small American enclave. Its residents must cross the US 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?

Washington. Residents of this enclave must cross the US-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 health care 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 exist around the world. They are curious to us, but not just because of the interesting events that led to their creation. Equally important is the degree to which they highlight how borders often conflict with the interests of the people who live near them. As citizens of a thriving democracy, the inconveniences experienced by the residents of Point Roberts are not as great as they would be in other examples from developing countries (the last remaining *chitmahal* of Bangladesh in India, for example), and perhaps most of them could easily choose to move elsewhere if they wanted. But the continued existence of an enclave like this on the US-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.

In modern times, international borders 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 are 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 modern territorial states that claimed absolute internal control and freedom from external influence, and which recognized one another as possessing

[1]Outside of Europe, Tokugawa 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 some degree of authority held by higher-level political authorities, perhaps paying them some tribute, sending contingents to their wars, and allowing appeals to their courts.

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) puts it succinctly: "the clearest storyline of the last thousand years is the extruding out of universal alternatives to the sovereign state" (p. 261).

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. This system continued to develop from the Early Modern period through the 20th century as new states emerged. By the end of the period of decolonization, 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 political independence of even the most powerless states.

How do we understand the modern state system as it exists and continues to develop? 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 health care while also paying taxes to the US 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 *à la carte* basis, with governments competing with one another to provide higher quality services at the lowest cost, in a 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 purchase, 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 voted to implement 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 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 farsighted and self-interested, always seeking 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 — 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 French Revolution. So, although 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 most 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, health care, and scientific research. Because these services have value, there is 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 taxes that they consider too high relative to the benefits they receive may instead join another polity. 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 only a small markup above 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 cost of providing governance for each state varies spatially. Each state possesses a zone, often (but not always) 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 for 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 impact on the spread of state administration, with flat settled areas easy to administer than rougher terrain that may be closer. Culture and language also 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 the state would 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 state not only did not collect land taxes but also furnished the local khans with generous subsidies.

The desire to eliminate unstable, unprofitable border zones has been an important motivation in the creation of the state system. The system is a product of cooperation among rulers against their citizens, where rulers divide the governance market among themselves and agree to not provide governance outside their borders. 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 receives 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.

The state system that we describe resembles an economic cartel in many respects. Just as Archer Daniels Midland and its Japanese and Korean competitors distributed the global market in lysine among themselves 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 could 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, it 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 collusion that exist in many countries. However, very much like economic cartels, the state system is haunted by the specter of cheating— the fear that one player will attempt to steal the market share of 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 noncompetition 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, any state that tries to govern outside of its internationally recognized borders today is clearly violating the norms of the system. These violations do occur in practice, but they are often very indirect.

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 the 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, possibly with the cooperation of some of their people. 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 their capitals are considered the formal equals of more competent states.

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' citizens, 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 residents. 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.

There is another important way in which borders have become more stable. Since most, though not all, states nationalize their citizens (through public education, state media, etc.) many individuals are socialized to be loyal to a particular state, and prefer its governance to any other. In the context of cartel theory, this 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 over time come to correspond to steep changes in governance costs. This extreme and self-reinforcing brand loyalty, which we call nationalism, is an important difference between economic and governance cartels. It is a key to both the latter's exceptional stability and why competitive alternatives to the system are so rarely considered, even in theory.

How does cartel theory help explain the puzzle of discontinuous political changes that take 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 benefits states at the expense of citizens. This is the argument that we lay out and develop in this book.

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, its spread to the rest of the world, and its development through the centuries. Both in the field 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 **??** 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 **??** we discuss the spread of the cartel system to the rest of the world through colonialism and other Western influences.

In pre-modern times, 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. Vast amounts of territory in pre-modern Europe were not governed by any of the bureaucracies of the larger polities. Consequently, the central governing institutions of one large ruler hardly came into contact with that of another. These lands, controlled by local elites (the feudal nobility), 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 farther away from their capitals with greater ease and sophistication, and developed organized administrative practices to do so. At the same time, the profitability of long distance trade made these faraway places valuable to colonizers and conquerors. Rulers came to appreciate being able to tax commerce in distant regions that would previously have been unprofitable.

The true boundaries of states thus shifted outward. More and more people were incorporated as citizens of these growing states. Areas that were previously ungoverned by the central administration of a ruler growing in power disappeared as the true boundaries of one growing state came in contact with the true boundaries of another. Eventually, there reached a point where these rulers could not incorporate one another into their growing polities, and therefore could not increase their influence further without becoming competitors in the market for governance in the regions 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 to respect each other's rights to govern within their borders, exchanged ambassadors to facilitate communication, and entered into 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, the natural evolution of governance systems of these parts of the world was disrupted with the conquests of European powers.

Europe imposed its own state system on the rest of the world largely 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 of sovereignty and the exchange of ambassadors. In most of Africa, South and Southeast Asia and the New World, by contrast, Europeans divided and controlled territory themselves.

The process of colonial map drawing was made easier by the actors involved abiding by the rules of the system at home, and in some cases by the replacement of native populations with 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 an eye to their own profit and internal balance of power and no concern for the interests of the native populations. 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 at a precise moment in time to create the cartel. Anti-trust prosecutors can sometimes even point to a specific meeting or unearth the secret communications that led to the start of collusion. The state system, on the other hand, was created by people who may have 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.[2] Rather, over several centuries, statesmen simply sought to shape bilateral relations with other states in ways that benefited them mutually, at the expense of local elites in the frontier zone. Even in the 19th century, when the triumph of territorially bounded states over alternative political arrangements seemed complete, the state system was less a conscious, less intentional 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, how is it so stable? Norms tend to change 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 dealt with these challenges

[2] In fact, this is why attempts to identify a single point of origin, such as the Peace of Westphalia, have failed. We say more about this at the end of Chapter 2.

with remarkable success. In Chapter **??** we discuss three of these challenges, and in Chapter **??** we discuss two factors that have enabled the cartel to overcome these challenges. We summarize these as follows.

Conflict. An important threat faced by the cartel has been the challenge of interstate conflict, which represents the possibility that more efficient and more powerful states will steal the governance market share of less capable ones. But the cartel has handled this challenge with notable success. Even the two great wars of the last century did not unravel the system, and following the end of World War II interstate wars have become even more uncommon. How has the cartel survived the destruction of interstate conflict? How has it made interstate war as rare as it is?

We can draw a loose analogy between interstate 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 supplier improves, it is natural for it to seek a greater share of the market. But at the same time, it is difficult for others to know whether the claims of that provider are based on real improvements in efficiency or strength. If a state is 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 that credibly resolves the dispute. In this model, once the war is over, the cartel members return to cooperation. They continue recognize each other's 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, brief periods of war are not at all inconsistent with long spells of cooperation.

Entry Deterrence. Another important challenge faced by the cartel 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 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 discuss 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 its existing members. Throughout history, groups that have attempted to challenge existing cartel members have been labeled as rebels, pirates, or terrorists. They have been cut off from international assistance and have occasionally been the targets of coercion. In some notable instances, the efforts of these opportunistic market entrants have 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 moderately successful states that failed to gain de jure recognition from existing cartel members. Somaliland is a polity that has remained unrecognized for nearly three decades despite developing many state institutions. Even regimes that control all of a state's recognized territory, like Afghanistan's Taliban today, could be denied recognition if other states consider them unreliable participants in the governance cartel.

At the same time, there have been some critical moments in history 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 attributes their success to an alignment of interests between the entrants and the most powerful states, who led the cartel's 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 actively supported by the lone superpower at the time, the United States, along with its western European allies. In all of these cases, the great powers that led the cartel believed that they could more easily exercise influence over the smaller new states than the larger old ones. The point is that the cartel is typically powerful enough to decide who has the right to enter, and will allow entry if it suits the interests of its most powerful members.[3]

Democracy. Over the course of the 20th century, the number of democracies grew, and established democracies greatly expanded voting rights. This growth in democracy, however, points to a puzzle: If the cartel is an exploitative system that serves the interests of states and their rulers at the

[3]This is part of the argument Coggins (2014) makes.

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 explain this fact, we offer a simple model whose logic proceeds in three steps. First, we point out 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. Second, we note that incrementally increasing competition in the governance market typically benefits only a minority of citizens at each step. Third, we draw on standard political economy models that assume 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. As a consequence, the majority of citizens may oppose incremental increases in competition in the governance market.

This argument hinges on the assumption that opening up competition in the governance market would have to take place in incremental steps. This assumption is motivated by the fact that the main development that has increased competition in the governance market in the last half century—namely, the lowering of trade barriers between states— has in fact proceeded incrementally. 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.[4]

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 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

[4]See, e.g., Pierson (2000), Page (2006) and North (1992).

surprising since it is natural for voters to 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.[5] 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 benefit or harm them.

International Institutions. Over the last five centuries, world politics and the world economy became increasingly complex, fueled by developments such as the Age of Discovery and the Industrial Revolution. As a result, the management of the cartel also became more complicated over time. In response, states 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 ad hoc international conferences like the Congress of Vienna to manage relations between them and to 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 United Nations (UN) and the World Trade Organization (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 as the Organization of the Petroleum Exporting Countries (OPEC), which has a permanent secretariat to facilitate coordination.[6]

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 UN Security Council resolutions, organized a coalition of 35 nations in 1991 to prevent the Iraqi takeover of Kuwait. In other cases, it may mean ignoring unilateral land grabs such as the Russian takeover of Crimea. In some cases, it may mean fighting entry into the governance market on behalf of existing cartel members, as with the UN's refusal to admit Taiwan as a

[5] Peters (2017) makes this argument.

[6] 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.

full member in its own right. In other cases, it may mean welcoming new providers into the governance market, 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. More generally, the WTO helps stabilize the norms of the cartel by clarifying what happens when those norms are broken, even if it is ultimately up to the member states themselves to carry out any punishments.

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 obvious that national identities were created to serve this purpose. An important byproduct of nationalism has been changes in governance costs that coincide with the borders between states— changes that have stabilized the borders between them. Nationalism simultaneously lowers the cost of governing one's own population while raising the costs of governing other populations, thereby generating steep differences in governance costs at interstate boundaries. 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 one's own population. Cartel theory 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 costs 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 very similar to the kind of brand loyalty that enables producers of economic goods and services to extract a larger share of the consumer surplus.

This logic helps explain why increased competition in the governance market arising out of globalization has benefited mainly those who are willing to forgo national attachments to take advantage of foreign opportunities, including economic migrants who are willing to change their nationalities to find better work opportunities or avoid paying taxes.[7] 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.[8]

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, as well as a myriad of other challenges. We elaborate upon these in the final chapter of the book.

Globalization. Today's governance market is more than a market for control of physical territory. Competition in this market now takes place in the complex and abstract space of economic policies that regulate international commerce and the world economy. 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

[7] In the US, Senators Chuck Schumer (D-NY) and Bob Casey (D-PA) introduced the Ex-PATRIOT Act (S. 3205), which would levy a 30 percent capital gains tax on individuals who had renounced US citizenship, with evaders barred from re-entering the country.

[8] To quote Rodrik (1997): "owners of internationally mobile factors become disengaged from their local communities and disinterested in their development and prosperity" (p. 70). Stiglitz (2002) is more blunt: "firms threatened to leave the country unless taxes were lower: there was no patriotism among these multinationals" (p. 40).

financial competition have all increased, tempting 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 brought in foreign unskilled workers, who are willing to accept low wages. 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 offered favorable tax rates to entice wealthy individuals and corporations to relocate their businesses. Even the small stream of revenue that these low taxes generate can contribute significantly to the funds required to run their small governments.

These trends have changed the way the cartel operates. They have generated countervailing pressures against the cartel's original intent to limit competition in the governance market. Nevertheless, the choice to soften borders has clearly been a political choice made 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 interconnected world economy as seeking to control and manage competition in the market for governance rather than to limit it in all instances.

As a result of these trends, new political challenges have emerged. Incremental increases in competition in the governance market through free trade policies may have increased the overall 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 development of policies to quickly compensate the losers by redistributing some of the gains from the winners.[9] This in turn has made it harder for governments to further increase political support for greater international openness. Part of the challenge has been that 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 one that does the same, if the individual stands to benefit from the first policy but lose 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.

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

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, this opposition 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 the citizens who support these movements 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 prevent them from being harmed, in expectation. Even when greater competition in the governance market leads to efficiency, these voters don't perceive themselves as sharing in those benefits. Others support these movements out of nationalist emotional attachment. Yet others are driven by ,economic concerns, seeing interstate competition in governance as a destructive race-to-the-bottom in social provision. Whatever their reasons, the goal of these voters has been to exclude external labor, goods, and influences on state policy.

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 ability 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. Even when they do not relocate personally, 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 the uneven distribution of governance quality that we see around the world, as migration costs continue to decline. In the opening paragraphs of this book we talked about the US-Canada border. But on this point, it is the US-Mexico border that is more pertinent.[10] Even though governance in Mexico has steadily improved over the years, the number of Mexican immigrants in the US 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 US-Mexico border—has continued to rise.[11] Out-migration from countries with poor governance 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 trafficking diminishes while the power of the criminals grows. This leads even more people to leave, exacerbating the power difference. Such countries can 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, to name a few—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. We discuss some of these challenges in further detail in the final chapter, and comment on how the cartel might evolve with time to address them.

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

[10]The inequality in governance quality across this border is notable. The residents of El Paso, Texas, for instance, receive much better protection from murder, assault and theft than those of 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 (Social Security Administration, 2015).

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

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 they provide governance to citizens and citizens pay taxes to the states that govern them. The system of states in the world, 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 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%.[12] 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 fixated on understanding the sources of conflict between states, we are interested, on the other hand, 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 number of questions. Why do states sometimes fight each other? Why do they so often return to cooperation after the war is over? Why is it so difficult to create new states without the consent of existing states? How will states approach 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 woven into the current system of territorially bounded states will determine both the system's future stability and the internal politics of its members.

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

The Pacific end of the US-Mexico Border Barrier, Tijuana

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