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Oriol Sabaté[1] and Eduardo Sanz-Arcega[2]

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Abstract

Military might and political elites' commercial mindset are two important preconditions that explain nations' economic income differences. The combination of elites' economic risk appetite and its bargain power at the national and international arenas sustained by its own military might lead to the array of economic outcomes achieved by nations over time. To the best of our knowledge, the proposed argument fits historical evidence but has not been properly developed by the previous literature.

Keywords: wealth of nations, military power, elites' commercial mindset

JEL Classification: O1, N4

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1. Introduction

Factor accumulation by itself does not explain persistent differences in growth rates across countries. After adjusting for factor endowment levels, including human capital and R&D, recent economic literature highlights the importance of institutions as a critical input accounting for income differences (Hall and Jones, 1999; Easterly and Levine, 2001; Rodrik et al., 2004; Helpman, 2008; Góes, 2016; Zergawu et al., 2020).

Thus, "the central issue of economic history and economic development [has been] to account for the evolution of political and economic institutions that create an economic environment that induces increasing productivity" (North, 1991: 98). So far, this strand of the literature has devoted its attention to the development of inclusive institutions that allow societies as a whole to prosper (Sen, 1999; Acemoglu and Robinson, 2012) and to how these inclusive institutions may flourish, persist and evolve upon different political equilibria (Acemoglu, Johnson and Robinson, 2002; Acemoglu, 2003; Acemoglu and Robinson, 2006a; Chang, 2010).

However, to the best of our knowledge, most of the institutional literature sticks with describing a world of sovereign (say, self-governed) nations, bypassing international coercion and, therefore, the historical importance of a third nation's (or coalition of nations') military power shaping the international economic order. At the same time, institutional developments tend to assume that (sovereign) political elites behave as wealth maximizers, subject just to staying in power (Acemoglu and Robinson, 2006b). In doing so, this literature has scarcely explained why some elites did not actually behave like wealth maximizers and promoted pro-growth policies. The aim of this paper is to contribute to fill this void in the literature.

Taking an international approach, and *ceteris paribus* factor endowments issues, essential for economic growth (Marx, 1867; Gerschenkron, 1962; Solow, 1956; Lucas, 1988; Easterly and

Levine, 2003), we argue that military might and political elites' commercial mindset are preconditions that pave the way for nations' economic income differences. To the best of our knowledge, the proposed argument, built on the institutional literature that highlights the power of ideas for influencing economic policy (Keynes, 1936; Rodrik, 2014; Mukand and Rodrik, 2018), fits historical evidence and has not been put together in the literature.

On the one hand, military hegemony allows a nation (or coalition of nations) to impose self-benefiting norms on others, as well as to avoid being forced to adopt undesired rules. In sum, military hegemony is a prerequisite for self-government, particularly in a context of loose international rules of sovereignty. At the same time, however, military power entails political and economic costs that might eventually erode the capacity to influence policy (Kennedy, 1989; Dunne and Tian, 2013).

On the other hand, even a sovereign nation may not implement market-friendly policies due to the political elites' commercial mindset. In short, risk appetite—trade propensity being one of its manifestations—differs across national political elites, which explains why growth-inducing policies are not ubiquitously implemented. This might be driven by cultural reasons and specific economic interests, and it depends to a certain extent on the degree of threat to the status quo.

The paper is organized as follows. The next two sections explore, respectively, the role of military power and elites' commercial mindset as preconditions for economic success. The fourth section highlights some final remarks.

2. *Vae Victis!* Military Power as Precondition for Nations' Economic Success

Markets are artefactual creations whose rules are shaped by dominant players benefiting from their superior bargaining power (Polanyi, 1944; North, 1990). The mightiest nation (or coalition) is therefore able to exert its power to set self-benefiting commercial rules, as trade (Findlay and O'Rourke, 2009; Rodrik, 2018) and peace agreements (Keynes, 1919) illustrate. The negative consequences of being on the wrong side of the bargaining table are clearly exemplified by the Indian deindustrialization in the nineteenth century amid the British-imposed trade regulation (Parthasarathi, 2011).

It naturally follows that military might does not only allow the hegemon (or coalition) to set the rules of the game to its benefit, but it also provides security against external aggression. Economic growth and richness in the absence of coercive capacity may induce predation by other polities because the marginal benefits of domination may exceed its costs (Geloso and Salter, 2020). This might be of particular concern in the context of weak international rules of sovereignty, in which direct conquest and subjugation are accepted policy solutions to international conflicts. The lack of state capacity to protect the economy from external predation has been indeed related with truncated experiences of economic growth, such as in the case of ancient Greece or medieval Europe (Johnson and Koyama, 2016).

Military power, therefore, guarantees self-government and the possibility of economic growth, at the same time that it constrains internal unrest. However, coercive capacity may come at a price. Firstly, powerful armies may constitute a serious threat to civil political and economic elites, as they have the resources to overthrow the government and to impose regime change (Besley and Robinson, 2010). Secondly, military hegemons may succumb to the costs of empire. International commitments might overburden them to the extent of undermining their very same hegemony and capacity to influence policy (Kennedy, 1989). Finally, military expenditure might affect growth negatively through indebtedness, fiscal pressure, the crowding out of non-military public spending, and by igniting costly and disrupting arms races (Dunne and Tian, 2013). Hegemons, thus, must not simply build up military power, but must exercise it thoughtfully.

In this regard, the political elite in a hegemon nation (or coalition) has to choose the way to exert that power, both abroad and at home. For the purposes of this paper, let us now focus on the implications of military hegemony from an international perspective. Building on Olson's seminal paper (1993), the options at their disposal range from stationary bandit to allowing for the growth of market-friendly inclusive institutions (Smith, 1776; Hayek, 1988; Nunn, 2008; Acemoglu and Robinson, 2012). In case the profits arising from economic dominance outnumber the costs of subjugation, the hegemon nation (or coalition) will have an incentive to act as a stationary bandit. In this situation, it can either take some regular tribute from third nations, impose trade rules benefiting its own economic structure, or go for both. Depending on its economic appetite and policy toolkit, the hegemon can even opt for isolationism and simply protect its own jurisdiction from external attacks (as ancient China did). The next section of this paper is precisely devoted to the analysis of elites' commercial attitudes reflected in economic policy.

3. Political Elites' Commercial Mindset: Towards *the Entrepreneurial State*[1]

The importance of public sector intervention is based on its combining action of regulation and spending, which has made the state the most influential economic agent over time. This is why a wide strand of the public sector and institutional economic literature has devoted attention to the

[1] We borrowed the words in italics from the title of Mazzucato's 2013 book.

analysis of economic policies' incentives, designers and beneficiaries (Stigler, 1971; Wolf, 1986; Chang, 2002; Mazzucato, 2013).[2]

Here, as in the realm of military power, political elites have the ability to influence policy (Polanyi, 1994; North, 1990; Acemoglu and Robinson, 2006a; Greif and Mokyr, 2017). To begin with, they can shape the functioning of markets by altering the rules in place (Chang, 2002). Secondly, elites' preferences (or those of national coalitions of power, given democratic rule) exert disproportionate influence on policy-making and public spending decisions (Gilens and Page, 2014). Thirdly, elites can also open new market opportunities through investment and research (notably in the 20th and 21st centuries), the profits of which may be captured depending on how policies were designed (Mazzucato, 2013).

However, elites with low risk appetite have historically not embarked the public sector in promoting growth, but just in policing the maintenance of the status quo. It is precisely the political elites' commercial appetite that matters in order to explain why some military hegemons do not become economic hegemons and, at the same time, why they try to (or not) influence third nations' economic policy, notably in trade agreements (Rodrik, 2018). In fact, elites can seek for inclusive or extractive international economic orders, as a new strand of the institutional literature points out (Varoufakis, 2011; Acemoglu and Robinson, 2012; López Castellano and López Quero, 2019).

The commercial appetite of the elites may be driven by cultural, historical, or even religious motives, and hinges to a certain extent on how secure they feel in power (Rodrik, 2014; Mukand

[2] On the most basic level, we have already mentioned that the state's military might contributes to guaranteeing external security and defending economic interests abroad (O'Brien, 2011). A peaceful environment that secures property rights has indeed been linked to more investment over the long run (Smith, 1776; Olson, 1993), the better if additional investment-friendly institutions are also effectively in force (Chang, 2002; Acemoglu and Robinson, 2012).

and Rodrik, 2018). In the absence of major threats against the status quo, elites would just block any reform they think that may eventually harm their interests, no matter its impact on economic growth (Acemoglu and Robinson, 2006 and 2012). On the contrary, elites whose power is threatened by other ascending (and thus, competing) elites will tend to embark the state in promoting social welfare through pro-growth policies (and even redistributive ones, see Lindert, 2004a and 2004b) in order to appease social unrest and to retain their status, especially when repression costs become too high.

4. Final Remarks

This paper proposes military might and political elites' commercial mindset as preconditions for explaining nations' income differences over time. This argument fits the historical evidence but has not been properly developed by the previous literature. A natural extension of this work might be to apply our reasoning to past and current episodes of international economic equilibria, such us the era of Pax Britannica. A second and empirical extension of this paper would be to contrast econometrically the economic implications of peace and commercial treaties, controlling for the military power of the opposing parties. Peace and trade treaties emerge as historical evidence of the degree of elites' commercial appetite. Last but not least, a third research avenue stemming from this paper would be to extend our framework in order to contribute to the literature on how bottom-up social interactions may influence political elites' commercial mindset.

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