

The Modern Economic Peace

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3. Others delegate protection to most powerful state, but pay nothing
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We think we know how to explain this, but we don't.

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In principle, *no theory based on these can explain the facts.*

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Use economic principle: involuntary transfers (taxes) impose costs.

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- ▶ Government one of two types:
 1. "Democracy" maximizes own citizenry's welfare
 2. "Dictatorship" maximizes its own welfare

A's Ideal Tax on *B*

If *A* is not economically integrated with *B*:

- ▶ higher sensitivity of *B*'s economy \Rightarrow lower imposed tax
- ▶ tax independent of whether *A* is democracy or dictatorship
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Sensitivity, integration, relative prosperity, and representative government decrease incentives for coercive transfer.

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Democracy strengthens the effects of sensitivity and integration

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In this context:

- ▶ Very high incentives for coercive transfers
- ▶ Prosperity and power are closely linked
- ▶ Balance of power matters and will be competed over
- ▶ Tense relations and occasional wars

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- ▶ Hard to tax entrepreneurs and innovators in prosperous economies, who can afford to work less in response
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If effects of sensitivity, integration, democracy are large enough:

- ▶ Low incentives for coercive transfers
- ▶ Prosperity determined by economic fundamentals
- ▶ Balance of power irrelevant among these nations
- ▶ Warm, trusting relations and durable peace

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- ▶ GDP of both is about \$15 trillion
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The answer is *0.04% (from 3% per year to 2.9988)!*

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Sensitivity and integration also affect relative performance of regime types, so may also explain spread of democracy