How the Power of Business Affects the Commercial Peace: Commercial Interests, Economic Interdependence, and Militarized Conflict

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Chapter One: Introduction

The argument that the benefits accrued through interstate commerce would increase the costs of war and hence reduce its occurrence can be found as far back as the writings of Kant and Montesquieu. The current body of literature, however, more directly emerges from Solomon W. Polachek's empirical formulation of the opportunity cost argument: "the implicit price of being hostile is the diminution of welfare associated with potential trade losses" (1980, 60). John R. Oneal and Bruce M. Russett extend this argument, explaining that "fearful of the domestic political consequences of losing the benefits of trade, policymakers avoid the use of force against states with which they engage in economically important trade" (1999, 5). For the past three decades, most research has operationalized these opportunity costs as trade interdependence and analyzed its potential effects on the probability of militarized conflict. During much of this period, realists and liberals have debated whether the commercial peace existed by means of statistical models measuring the correlation between levels of economic interdependence and the likelihood of conflict. While most found substantial effects for economic interdependence, a significant minority produced contradicting results; either trade increased conflict (Barbieri 2002; Barbieri 1996), had no substantive effect (Gartzke 2007; Gartzke and Li 2003), or the results were ambiguous (Morrow 1999). Within the last decade, however, a consensus has emerged that these variant findings were an artifact "of the discrepancy to variable construction alone" (Gartzke and Zhang 2015, 429). This has not resulted in a clear victory for the proponents of commercial liberalism given that the literature has sought to expand beyond a simple correlation between economic interdependence and conflict.

The following reviews the latest research on the commercial peace, highlighting unresolved controversies and gaps that scholars have yet to address. Most pressingly, the commercial peace thesis lacks a micro-foundational causal process explaining how economic ties reduce militarized disputes. This chapter lays out the basic theoretical framework of my argument to be further developed in Chapter Two.

Literature Review

Trade Elasticities

Some authors have argued that opportunity costs should be reformulated as "a function of economic activity within the context of available alternatives" (Crescenzi 2003).[1] This shifts the focus to the costs of exiting a trading relationship, which "are…what is lost in switching from this "best" option to the next best alternative" (Ibid.). This may be more what Polachek, himself, had in mind given that he asserts that tests of the commercial peace should go beyond trade flows, "but also on some measure of the welfare gain…. Precise measures of these require knowledge of each country's demand and supply curves for all commodities" (1980, 67). While this data was not available in 1980, limited measures on trade elasticities have since been developed. Polachek and McDonald (1992) use bilateral trade elasticities computed by Marquez (1990) at the country level for OECD countries and conclude that trade inelasticities have a greater pacifying effect on conflict than the trade/GDP ratio. Crescenzi (2003; 2005) uses the

[1] See also (Peterson 2014).

same Marquez elasticities, which he multiplies by trade share (bilateral trade/total trade), and comes to the same conclusion. Zeev Maoz (2009) employs a newer and expanded elasticity dataset calculated at the commodity level by Kee et al. (2008) and aggregated at the county level. This figure is normalized and multiplied by Maoz's unique dependence ratio (imports from partner country/GDP). This measure is also positively correlated with a reduction in militarized conflict. While these authors make a strong case that incorporating demand elasticities produces a more accurate measure of potential costs of trade disruption, they entail a significant trade off in the coverage of dyads and years included. It is significant, however, that there is agreement across these studies that opportunity costs as operationalized by trade elasticities decrease the likelihood of military conflict.

Third Parties and Networks

A further extension of opportunity costs is determining the effects of third party trade. While most conflicts are dyadic, trade is not. Thus, the focus on dyads risks oversimplifying the multilateral nature of the international system. In particular, the involvement of third parties has the potential to alter the costs of interstate conflict. Katja B. Kleinberg et al. argue that "When states have few alternatives to their existing trade, the risk of violent conflict declines. Moreover, this effect is largely independent of the size of the dyadic trade relationship with a potential opponent" (2012, 529). This argument is similar to the previous discussion of exit costs and the elasticity of trade. Here though, it is not about the goods themselves, but that exit costs are incurred by the difficulty of the state in replacing its trade partners. On the other hand, Yonatan Lupu and Vincent A. Traag find that "indirect trade ties decrease the probability of conflict by increasing the costs of war both for the potential combatants and for their commercial partners" (2013, 23). Similarly, researchers have found that having multiple links to the international trade network significantly decreases the likelihood of conflict (Dorussen and Ward 2010; Kinne 2012).

FDI

Trade is simply one form of economic exchange binding states in the international system. Foreign direct investment (FDI) may build stronger ties than trade. James R. Masterson points out that “Unlike trade, which can be diverted during a disruption of trade flows between states, FDI is largely permanent and may actually be used against the home country should conflict ensue” (2012, 8). Unfortunately, the data on FDI is far more limited than trade. Early studies used a monadic approach of total FDI inflows. Gartzke et al. (2001) and Hoon Lee (2005) found that states with larger FDI flows are less likely to use military force. Rosecrance and Thompson critique these studies, however, on the grounds that “all previous studies have looked at systematic factors, not particular FDI relationships and their effect on conflict between the countries doing and receiving the investing” (2003, 389). Addressing this issue, both Margit Bussmann (2010) and Polachek et al. (2012) find that bilateral FDI inflows and stocks substantially reduce militarized interstate disputes, even when controlling for endogeneity. Extending these analyses, Hoon Lee and Sara McLaughlin Mitchel find that “Higher levels of bilateral and monadic FDI flows reduce the chances for severe militarized disputes over border issues” (2012, 698). In sum, there has been strong and consistent support for the pacific effects of economic interdependence measured as FDI.

Asymmetry

Another controversy regarding the commercial peace thesis is the problem of asymmetry. Neorealists assert that trade imbalances may increase the likelihood of war "since the gains from trade do not accrue equally” (Masterson 2012, 5). As a result, states may “fear…that gains from trade accruing to other countries can lead to a military advantage for them. This is of particular significance in cases in which the trading states are enemies” (Massoud and Magee 2012, 5). If this contention were true, then states would be expected to avoid this security externality by preventing the establishment of substantial economic ties. James D. Morrow also points out that this logic requires the assumption that "marginal increases are of the magnitude of total military allocations relative to total national product" (1997, 27). He finds, however, that even for long-term rivals such as India and Pakistan "defense preparations are endogenous" (Ibid.). Therefore, "security externalities should not block trade between rivals during peacetime" (Ibid.). Similarly, Peter Liberman has shown that security constraints do not obstruct economic cooperation under the conditions of multipolarity (1996; 1999). Liberman's qualitative analyses of "British trade with Germany prior to the First World War and U.S. trade with Japan in the decade leading up to the Second" reveals that "neither Britain nor the United States significantly restricted trade until war was virtually upon them" (1996). Finally, Brandon J. Kinne demonstrates that network trading ties constrain initiation of militarized conflict, even when trading ties are highly asymmetric (2012).

Distribution of Trade Benefits

The uneven distribution of benefits from trade within nations is another issue receiving more attention from scholars. This argument hypothesizes that groups disadvantaged by international competition might lobby for the use of military force to protect their interests.[2] Not only is there a lack of empirical support for this argument, particularly for the post-World War Two era, but it is also logically flawed. The costs of militarized conflict extend beyond the loss of trading opportunities and are likely to offset any possible benefit from decreased economic competition. Moreover, "there are…many other mechanisms for limiting imports that are less costly, more likely to be effective, and face fewer political barriers to enact" (Brooks 2013, 873).[3] Actors, who

[2] For example, see P. J. McDonald 2009, 69-70; Schneider 2014, 177.
[3] Helen Milner also notes that even those firms who may lose from import competition will encourage economic openness if their operations are integrated into global production networks (1988, 365).

perceive that they are being hurt by trade, may be neutral—not pushing for peace—but not advocating for war either.[4]

Resources

Similarly, some scholars contend that states may be motivated to use military force to further the commercial interests of influential sectors (P. J. McDonald 2009, 70). According to this reasoning, states are incentivized to pursue militarized conflict to secure “key raw materials and inputs to the production process” (295). While there is some historical evidence to suggest the validity of this argument, there are no instances where this is the case after 1965 (Brooks 2013, 877; Brecher and Wilkenfeld 1997). Not only has trade become a more cost-effective substitute for these earlier conflicts of conquest, but the rise of FDI has provided a more secure means to obtain resources and supplies. This is borne out by the results of Lee and Mitchell’s study, which demonstrate that “increasing global FDI reduces states’ incentives to obtain resources by capturing neighboring territories” (2012, 690). Yet, the notion that states will pursue a strategy of military aggression to obtain strategic resources is most persistent when this resource is petroleum. In Chapter 4, I discuss the problem with this conventional narrative and how it has obscured the role that oil dependence has on business-state relations and the consequences for international security. Instead of seeing petroleum rich states as targets of aggression, I demonstrate how my theory of the commercial peace explains the tendency of these states to use military force even when economic ties should constrain them.

Domestic Institutions

Despite the increased empirical sophistication of work on the commercial peace, one thing all of these analyses have in common is that the relationship between economic interdependence and conflict is framed as unconditional, giving the impression that the proposition is universal,

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[4] This assertion is supported by Kirshner’s qualitative analyses of bankers and war (2007).

equally applicable to all actors at all times and places (Mansfield and Pollins 2001, 844). Two sets of studies that are exceptions that prove the rule, Gelpi and Grieco (2003; 2008) and Papayoanou (1999), focus on the constraints that political institutions place on national leaders. Both sets of authors argue that economic interdependence is pacific only for dyads in which both states are democracies because the survival of political leaders in authoritarian governments does not depend on the commercial class. More recent work in International Relations, however, has updated conventional thinking on the domestic accountability for the foreign policy decisions of authoritarian leaders (Weeks 2008; 2012; Colgan and Weeks 2015). These studies suggest that there may be distinctions between the type of autocratic government that affect their responsiveness to business interests. The problem of assuming autocracies are homogeneous is further supported by the fact that Gelpi and Grieco's findings have not been replicated in subsequent studies. The case studies in this dissertation feature two very different autocratic types of government and may shed some insight on what internal dimensions of autocracies may influence the degree of business power on policymaking.

Qualitative

As evident from this survey of the commercial peace literature, it is striking that the findings from quantitative studies have been so robust. Moreover, while Keshk et al. (2004; 2010) challenged these results as being driven by the endogenous effects of militarized disputes on trading relationships, newer research has reaffirmed the pacific influence of bilateral trade on interstate relations (Hegre, Oneal, and Russett 2010; Robst, Polachek, and Chang 2007; J.-W. Lee and Pyun 2016). Yet, there remains great skepticism of the validity of the commercial peace thesis. One reason is the weight of the counterexample of World War One. That the world's most devastating conflict up to that point broke out in the wake of the first wave of globalization calls for a stronger theoretical explanation for how economic ties generate pacific resolutions of international disputes and what conditions their success.[5] A key obstacle to expanding the commercial peace thesis beyond a simplistic correlation between measures of trade and FDI to militarized conflict is the dearth of qualitative analyses, particularly after World War One and between non-European powers. Mansfield and Pollins make this point, explaining that "resolving issues of historical boundedness, causal mechanisms, and contingency that are central to the relationship between interdependence and conflict—as well as issues surrounding the definition and measuring of both factors—will surely be aided by carefully constructed case studies" (2003, 20). To this end, my dissertation includes two detailed case studies that demonstrate the validity of the causal process, as well as highlighting the conditions that limit its success.

Causal Mechanism

The core problem with the commercial peace thesis is that it lacks a causal explanation that incorporates domestic level actors, such as the firms doing the trading, foreign policy making, and interstate relations (Mansfield and Pollins 2001; Simmons 2003; Schneider 2014). Given that states themselves do not trade, the commercial peace argument needs a "plausible mechanism linking private trade to public conflict behavior" (Simmons 2003: 31). My dissertation addresses this critical gap in the literature by developing a two-level theoretical framework linking the domestic politics of policy-making within the interstate bargaining process. I argue that economic interdependence will deter the use of military force to resolve international conflict when those businesses that would be harmed by the loss of the commercial relationship have sufficient power to influence policy outcomes in both states. Furthermore,

[5] For studies that dispute this conventional narrative of economic interdependence and World War One see Papayoanou (1999) who emphasizes that the lack of democratic institutions limited the influence of economic interests on German foreign policy; Solingen (2014) who argues that Germany under Wilhelm II's Kaiserreich (1888–1919) was dominated by a hyper-nationalist coalition promoting protectionism and militarization; and Gartzke and Lupu (2012) who argue that the war originated with Austria-Hungry and Serbia, which did not share meaningful economic ties, and who ultimately dragged in their allies Germany and Russia culminating in the broader European war.

locating the causal mechanism in the power of business at the domestic level addresses the need for international relations theories that go beyond treating the state as a black box to recognizing that the "state is not autonomous [and] leaders must listen to powerful interest groups" (Baird and Dixon 2010, 9).

Methods

This theory is evaluated using a multi-method approach. Two statistical models test whether the size of the public sector mediates the pacific effects of economic interdependence on militarized disputes. While the quantitative approach establishes the generalizability of the argument, process-tracing case studies are necessary to establish the causal process by which business seeks to influence international security policy when their interests are at stake. This dissertation examines two very different rivalries: Colombia - Venezuela from 1985 - 2010 and China - Japan over the Senkaku/Diaoyu Islands disputes. Both cases move beyond the euro-centric focus of qualitative studies that have characterized this topic. The Colombia - Venezuela case study is also unique as they are medium powers, countering the major power bias in existing research. Moreover, the variation within the cases of the efficacy of economic interdependence differs from past studies, which were chosen because the rivalry ended in war.[6]

Both cases selected are strategic rivalries—"relationships in which decision-makers have singled out other states as distinctive competitors and enemies posing some actual or potential military threat" (Colaresi, Rasler, and Thompson 2008, 3). Thus, they are least likely cases for the general proposition that economic interdependence reduces militarized conflict. Baird and Dixon point out that "In the classic realist framework, states engaged in security competition should not be affected by economic relationships, least of all economic relationships with the enemy" (Baird and Dixon 2010, 2). Additionally, China itself is a most difficult case for the commercial peace thesis. China's status as an autarky until 1978 makes it a latecomer "to

[6] Copeland 2014.

participation in the global economy and international institutions" (Masterson 2012, 8). As a result, internationally oriented economic interest groups have had less time to establish pathways of power and influence on state policymaking. Moreover, China's strict capital controls and large domestic economy insulates it from "punishment" by international financial markets for its aggressive behavior (Kirshner 2007).

Scope

These case studies are also notable because they occur in the post-Cold War era. That most case studies of economic interdependence consist of pre-World War Two conflicts is puzzling as the scope of the majority of quantitative studies begin with the 1950's. Defining the period of the theory's applicability is important as the state's responsibility and intervention in the economy has varied considerably. While the logic of the commercial peace certainly extends to earlier eras, governments became responsible for the performance of the national economy to a much higher degree through the institutions that emerged out of Bretton Woods. Moreover, prior to World War One "publics did not expect or require government to manage the economy, and recessions were considered (like earthquakes) to be acts of God. In the then prevailing climate of "laissez-faire," governments were not implicated in economic downturns and were not asked to work with other countries to avoid them" (Rosecrance and Thompson 2003, 380). For these reasons, the theoretical framework developed in this dissertation applies to the post-World War Two period.

Significance

The commercial peace thesis has yet to substantially evolve beyond Kant's opportunity cost formulation. Therefore, this dissertation advances the theory that economic interdependence reduces militarized conflict with a two-level framework incorporating the domestic politics of foreign policy-making within the interstate bargaining process. Developing the micro-foundational causal process of the commercial peace enhances the theory's predictive power by establishing the conditions in which economic ties are more or less likely to alter the decision to use military force as a means of dispute resolution. This allows the argument to be applied to non-traditional issues of international security, such as the problem of petrostate aggression. The mixed methods research design evaluating my argument that business must have influence on policymaking in both countries in order for economic interdependence to reduce militarized interstate disputes moves the literature beyond statistical modeling debates that have characterized much of the research on this topic.

This dissertation is one of a very small number of international relations studies that directly considers how the interests of business affect foreign policy decisions on matters of national security. While the comparative politics literature has begun to explore the influence of business interests on internal military conflicts, similar examinations of business power in international security issues have not been forthcoming. Incorporating the comparative literature on business power has the potential to enhance the explanatory ability of many international relations theories. Moreover, the Colombia - Venezuela case study is one of the first to directly examine the inclusion of business in national security decision-making with in-depth qualitative research including interviews with economic elites and government officials at all levels, including the heads of the ministries of Foreign Affairs, Defense, Trade, and Finance.

Structure

The following chapter builds a two-level causal theory of the commercial peace that asserts that the efficacy of economic interdependence to reduce militarized interstate disputes depends on the extent to which business influences foreign policymaking. To do so, I assess the still nascent research on business power by detailing the levels of aggregation of these economic interests and the mechanisms available to them to influence policy outcomes. I also discuss the difficulty of measuring the degree of business influence, particularly for quantitative tests while explaining the operationalization choices used in Chapter Three. Chapter Three adapts statistical models of the commercial peace to test whether measures of private sector size mediate the effectiveness of trade interdependence to reduce the use of military force in resolving interstate disputes. These measures are the government's percentage of total consumption, the percentage of government revenue that comes from taxes, the amount of credit available to the private sector as a percentage of GDP, and the ratio between investment by the private sector and total investment normalized by GDP.

Chapter Four turns to the literature on the natural resource curse and the political economy of oil dependent nations. An understudied problem in international relations is the aggressiveness of petrostates. Dyads containing at least one petrostate are 50% more likely to be involved in a militarized dispute with fatalities. I offer one explanation to this puzzle by asserting that petrostates are undeterred by economic interests in the decision to use military force in interstate disputes. This is because the "Dutch disease" and rentier politics of oil dependence reduces the influence of both public and private economic interests. I show that economic interdependence does not affect militarized conflict for petrostate dyads while exerting substantial pacific effects on their counterparts. Confirmation of these results also reinforces the theory's key explanatory variable—business power.

Chapters Five and Six employ process tracing to illustrate the causal pathway by which business-state relations alter the effectiveness of economic interdependence to reduce militarized interstate disputes in the strategic rivalries of Colombia - Venezuela and China - Japan. Interviews in Colombia and Venezuela reveal large differences in business-state relations. While business is both formally and informally involved in national security institutions in Colombia, Venezuela's rentier politics makes the inclusion of business interests somewhat arbitrary and limited at best. The fact that business was unable to protect its interests in any way under Hugo Chávez underscores the problem of deterring the military aggressiveness of petrostates.

Chapter Six explores the potential and limitations of economic interdependence to temper the challenges brought about by the relative change in the balance of power between China and Japan. The dispute over the Senkaku/Diaoyu Islands continues to raise fears, particularly from neighboring countries, that a militarized incident could escalate into a much larger conflict. A key question for this case is determining the extent to which business influences policy when nationalist sentiments by the Chinese public, which are key to the Communist Party's political survival, urge for more aggressive actions. While dueling nationalisms keep the fire alive over the islands dispute, the economic harm inflicted to interests in both countries have led to the use of new bilateral commitments to economic cooperation as a means of dispute de-escalation. This study reveals that realist concerns cannot be completely sublimated by the liberal peace. On the other hand, economic ties do not become irrelevant when the impetus for geopolitical conflict is at its highest. Accepting these nuances may make the commercial peace a more powerful tool for reducing militarized interstate disputes by enhancing the knowledge of the conditions that affect the degree of business power and thereby the effectiveness of economic interdependence to reduce the likelihood of militarized conflict.

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