The Domestic Politics of Strategic Retrenchment, Power Shifts, and Preventive War

Terrence L. Chapman*  Patrick J. McDonald†  Scott Moser‡

25 October 2013

Abstract

We present a formal model of international bargaining between two states in which one government must negotiate with a domestic opposition faction to secure tax revenue to fund military spending. It examines how robust the international order is to random domestic political crises that activate a stark tradeoff to a governing coalition: fiscal relief to stave off domestic revolution can simultaneously undermine the larger international political order via sizable shifts in the relative distribution of military power between states. We find that the likelihood of preventive war is shaped by two key domestic conditions: the distribution of income within an economy and the relative economic stake that opposition groups possess in international settlements.

*Corresponding author. Associate Professor, Department of Government, University of Texas at Austin, 1 University Sta. A1800, Austin, TX, 78712; Ph.: (512) 232-7221, Fax: (512) 471-1061, Email: t.chapman@austin.utexas.edu
†Associate Professor, Department of Government, University of Texas at Austin, 1 University Sta. A1800, Austin, TX, 78712; Ph.: (512) 232-1747, Fax: (512) 471-1061, Email: pjmcdonald@austin.utexas.edu
‡Assistant Professor, Department of Government, University of Texas at Austin, 1 University Sta. A1800, Austin, TX, 78712; Ph.: (512) 232-7305, Fax: (512) 471-1061; Email: smoser@austin.utexas.edu URL: http://smoser.webhost.utexas.edu/
1 Introduction

How does domestic distributional conflict shape international political stability and the likelihood of war among states? Key historical examples suggest that internal fiscal struggles over tax burdens and public spending have played a critical role in violent political change. A fiscal crisis over the distribution of taxation that was itself prompted by the Seven Years War and the American Revolution catalyzed the French Revolution and the subsequent wars initiated by France. Likewise, growing domestic political resistance to the costs associated with stabilizing the international distribution of military power through another round in the arms race on land pushed both France and Germany to war in 1914. Concerns over the willingness of the American public to shoulder the fiscal burdens of a new commitment to Europe and an extended arms race with the Soviet Union shaped numerous crises in the early stages of the Cold War by leading the United States to increase its dependence on nuclear weapons and push for German rearmament.

This paper engages this question by examining how domestic bargaining over taxation influences bargaining between two states. We locate the sources of international political change within the domestic political order of states. The domestic order is conceptualized by the structure of the fiscal contract within a polity that distributes the cost of public goods like military spending between a governing coalition and an opposition faction. The terms and sustainability of this fiscal contract shape the capacity of governments to remain in power, direct societal wealth to the military, sustain arms races with international adversaries capable of altering the global distribution of power, and make commitments to preserving the international political status quo.

While war is often financed through bargaining, the ability to borrow rests on the expectations about future domestic fiscal stability. Thus, while we do not directly analyze the consequences of borrowing in this paper, our framework speaks to relevant determinants of a country’s ability to borrow to finance a military effort.
We develop these arguments with a game theoretic model that blends insights from recent work on democratization (e.g. Acemoglu and Robinson 2005, Morrison 2007, Dunning 2008) with the bargaining model of war (e.g. Fearon 1995, Reiter 2003, Powell 2006, Wagner 2007). The model is simple and abstracts away from many potentially important factors, but in so doing allows us to focus on several critical dynamics linking domestic and international politics. In a bargaining situation between two countries, one government must simultaneously negotiate with a domestic opposition faction to secure tax revenue that sets military spending levels. Military spending serves two key political ends. It protects domestically-sourced income from external predation and strengthens the government’s bargaining leverage over the issue in dispute relative to a foreign rival. The government, though, faces a stark tradeoff when trying to augment its external strength. Higher levels of taxation reduce domestic consumption and increase the likelihood of revolt by the opposition faction, which shoulders a disproportionate burden of the costs of military spending. The high costs of domestic revolt—both the expropriation of domestic assets held by the governing coalition and significant international retrenchment—push the government to sacrifice some of its potential external bargaining leverage to remain in power at home.

The robustness of a government’s international position and, as a consequence, the stability of the larger international political order depend on how random domestic political crises or shocks magnify the severity of these domestic and international tradeoffs. By prompting strategic retrenchment, domestic political-fiscal crises in great powers can destabilize the larger international political order as other states seek to fill any emerging international political vacuum. The depth of this strategic retrenchment shapes the likelihood of war by influencing expectations about future shifts in the distribution of military power once a regime reconsolidates its political position at home and attempts to reclaim the external concessions extended during the period of domestic crisis. Foreign powers may be tempted to launch a preventive war to consolidate their newfound position of international strength and forestall the
post-crisis recovery of their adversary.

The depth of this decline and the likelihood of preventive war depend on two key factors that shape the elasticity of the larger international political order to domestic political instability—the level of domestic income inequality and the quantity of private goods that opposition groups generate from the set of agreements that constitute the international status quo. The level of income inequality within a society influences the size of the tax concessions that a government must offer to an opposition coalition when faced with a credible threat of revolt. These tax concessions divert domestic resources away from military spending, undermining a government’s external bargaining position while simultaneously prompting some strategic retrenchment. Higher levels of income inequality within an economy heighten the risks of preventive war during periods of domestic political crisis by requiring larger tax concessions, by deepening cuts in military spending, and by generating larger shifts in the relative distribution of military power. Alternatively, income equality insulates the international political order from domestic political instability. By enabling a government to limit tax concessions, it maintains higher levels of defense spending and minimizes changes in the relative distribution of military power among states.

The relative stake that opposition groups possess in the international status quo also shapes the robustness of this larger international political order. Similar to the situation when the distribution of domestic income is relatively equal, a government can remain in power with fewer tax concessions, fewer cuts in military spending, and minimal strategic retrenchment when opposition groups receive relatively more private economic benefits from the existing set of international settlements. This result implies that any set of economic policies, domestic institutions, and/or international settlements that increase the relative stakeholding status of opposition groups in the international order also help to stabilize this order and reduce the likelihood of war among states.

The rest of this paper proceeds in four broad sections. The next section briefly outlines prominent contributions to the bargaining and democratization literatures
that motivate this paper. A third section presents a formal model that outlines the conditions under which domestic distributional conflict can be utilized to preserve the international status quo. A fourth section applies this logic to examine how the Russian Revolution of 1905 contributed to World War I. A final section then examines the implication of these arguments for research on commercial liberalism and strategic retrenchment.

2 Bargaining and Commitment

This paper draws on the bargaining model to characterize the process by which political disputes between states can escalate to war. In particular, we focus on the now well-developed dynamic of the commitment problem. It arises when a change in the value of the “outside option” (war) for one or both parties prompts incentives for renegotiation. The sources of international commitment problems are examined in Powell (2006). Sates may go to war because they fear the political consequences of a peace in which their bargaining power is successively negotiated away. The central problem is not the identification of peaceful bargain that leaves both parties better off by avoiding war but the inability of either to refrain in the future from demanding a renegotiation of the agreement once their bargaining leverage has improved.

Powell identifies five examples of bargaining failures caused by commitment problems. Four of these five—preventive war, preemptive war, bargaining over issues that change the balance of power, and a domestic version of preventive war—can be traced to a common mechanism: a large and rapid shift in the balance of military or political power between bargaining entities. War breaks out in these situations when one side is unable to commit to refrain from exploiting the future improvement in its bargaining leverage caused by the shift of military power in its favor. The fifth points to a domestic inability to sustain an arms race, which may instead be cast as the inability to prevent a sizable shift in the relative distribution of military power.

The model presented below builds on the latter point discussed by Powell, exam-
ining the domestic conditions that may facilitate a large and rapid shift of power. It does not follow the typical strategy though in international relations of focusing on regime type to differentiate states. Instead, it exploits recent research on democratization and conceptualizes domestic political order by the terms and sustainability of a fiscal bargain that distributes the costs of public goods between competing coalitions (e.g. Boix 2003, Acemoglu and Robinson 2005, Morrison 2007). The integration of this framework with the standard bargaining model enables us to link domestic and international distributional conflict and examine how changes in the terms to one of these deals can simultaneously alter the sustainability of the other. We focus on the relative bargaining strength between governing and opposition coalitions and examine several factors, including income inequality, that influence the willingness of a society to fund military spending.

3 Model

This section describes the basic features of a two-period international bargaining game between two states in which the military strength of one government is determined by negotiating military funding levels with an opposition faction. To preview the model and outline some initial intuition, suppose there are two domestic factions in state 1, A and B. We treat state 2 as a unitary actor. A initially holds power in state 1. The military of state 1 is funded through domestic taxation. Greater revenues result in a stronger military and a stronger international bargaining position relative to state 2. This bargaining strength benefits both factions, A and B, though these gains are distributed unevenly. The two domestic groups pay differential tax rates, and A

Although we do not focus on the use of credit to fund wars (e.g. Schultz and Weingast 2003; Slantchev 2012), our analysis bears on this relationship because the ability of governments to borrow rests on expectations about future streams of public revenues.
and $B$ disagree about their most preferred tax rates. The governing faction, $A$, sets a tax rate on $B$, which can equivalently be thought of as the difference between tax rates on the two groups. Consequently, the burdens of military funding ultimately rest disproportionately on faction $B$. This differential burden motivates domestic political conflict over the appropriate level of taxation and the state’s external position. When $A$ sets taxes too high, $B$ may revolt and throw $A$ out of power. Revolt carries the key benefit of enabling $B$ to expropriate the domestically held assets of $A$. However, this revolution temptation is partially deterred by the costs of revolt, $\mu$. In short, $A$ is limited in raising revenues because faction $B$ can revolt if the taxes imposed on it are set too high. Similarly, $A$ can appease $B$ and preempt revolt by reducing tax rates.

The model below simplifies the domestic disagreement regarding military funding by allowing $A$ to set one tax rate on $B$, equivalently making the tax rate on $A$ equal to 0. While a stark form of disagreement, the model captures the fundamental domestic dynamics we are interested in, namely disagreements over the appropriate level of military spending and the distribution of its cost. Indeed, one could imagine an extension of this basic model to one in which faction $A$ could tax itself. While $A$ might opt for strictly positive self-tax to avoid preventive war, doing so is a concession to $B$ which has limits. Once the limits of concessions are met, the domestic disagreement returns to the setting we model. Hence, the mechanism we focus on is can be extended to any context in which $A$ and $B$ provide different levels of public revenue and they disagree about the distribution of the revenue burden (provided the domestic disagreement is sufficiently large).

We are primarily interested in how the ability of state 1 to raise revenue affects a traditional take-it-or-leave it international bargaining game. Given a direct rela-

---

3In this way, taxation in our model diverges from its role in the original Acemoglu and Robinson formulation. The divergence is due to our focus on military spending, as opposed to redistribution, although redistribution occurs in our model through the sharing of international spoils.
tionship between sustainable taxation levels and military capabilities, the decision of state 2 for war is a function of A’s fiscal capacity and its own power and resolve. This fiscal capacity depends on the attractiveness of revolt for faction B. B’s utility depends on two key factors: tax rates that set its consumption level for domestically sourced income; and the distribution of economic benefits derived from external settlements that constitute the international status quo. Faction B faces an interesting tradeoff. While lower taxes increase domestically sourced income, they simultaneously limit military spending, weaken international bargaining power, and reduce the absolute size of any international settlement secured by state 1 from state 2. Since faction B captures some share of that settlement, it must decide how large a tax burden it is willing to bear given the relative value of domestic consumption and international spoils. We diverge from typical formal models of conflict by allowing the spoils of an international settlement to vary across society as a function of a sharing rule, $\rho$, that defines how the portion of the international settlement captured by state 1 from state 2 is further subdivided internally between factions A and B. This sharing rule can also be conceptualized as the domestic distribution of private benefits generated by an external bargain.

In sum, this framework allows us to examine the international consequences of domestic distributional conflict. It poses a stark tradeoff among a government’s political capacity to remain in power, to set sustainable tax levels, and to preserve its external bargaining leverage. While domestic disagreement in our model is extreme, as the out faction bears a disproportionate burden for military preparedness, the logic extends to any setting where costs of military strength (i.e. conscription, casualties) are borne unequally relative to the benefits of the international status quo. This approach is also distinct from other prominent efforts to tie together domestic and

\[4\] Allowing A to tax itself would introduce new equilibria, however, as there could be situations in which A taxes itself to make up for revenue forgone by lowering the tax-rate on B, i.e. to prevent B from revolting. A’s willingness to tax itself would be increasing in the sharing rule, $\rho$. In this range, the effect of $\rho$ could be indeterminate
international politics in a two-level game (e.g. Bueno de Mesquita et al. 2003). First, it focuses on the domestic origins of international commitment problems generated through dynamic changes in the capacity to fund the military. Second, by examining the fiscal capacity of the state as shaped by the credibility of domestic revolt, it shifts explanatory focus away from domestic institutions to alternative factors like the distribution of income. Third, it treats international goods as unequally shared amongst societal groups, generating disagreement over the optimal investment in the state’s external bargaining power. These features allow us to extend work linking domestic and international politics in new directions.

3.1 Sequence

In period 1, the following stage game is played. The sequence is as follows:

1. Nature draws a cost of revolting for faction $B$, $\mu \in \{\mu^H, \mu^L\}$, with $\mu^H < \mu^L$.
2. $A$ sets a tax level, $\tau$, that determines the portion of income $B$ keeps.
3. $B$ accepts the tax level and does not revolt, or revolts.
   (a) If $B$ revolts, the game is over.
   (b) If $B$ does not revolt, state 1’s taxes are translated into military power, $\pi(\tau)$.

As an increase makes appeasing faction $B$ more expensive, but also increases $A$’s interest in favorable international settlements, i.e. increases $A$’s willingness to tax itself. But equilibria of this sort could only exist for a limited range of parameters. Hence, the analysis we present will hold in some equilibria of a model in which $A$ could tax itself, though possibly not all equilibria.

We adopt notation used by Acemoglu and Robinson (2005), where $\mu^H$ refers to a high likelihood of revolt (and hence low costs of revolt), while $\mu^L$ refers to a low likelihood of revolt (and hence high costs of revolt). Although this might be counter-intuitive for some readers, we opt for consistency with Acemoglu and Robinson.
4. A makes an offer of $0 \leq (1 - x) \leq 1$ to state 2.

5. State 2 accepts $1 - x$ or goes to war.

   (a) If state 2 goes to war, both states pay a cost of war, $c$, and the outcome of war is determined probabilistically, proportional to state 1’s military strength, $\pi(\tau)$.

   (b) If state 2 accepts, the stage game is repeated in period 2 with a new draw of $\mu$.

3.2 Payoffs

Table 1 lists the notation used in the model. For the one-period stage-game, payoffs are defined below.

In the event of a revolt by $B$, the game is over, and payoffs are

$$
\begin{pmatrix}
A & 0 \\
B & (1 - \mu)\bar{y} \\
2 & 1
\end{pmatrix},
$$

where $\bar{y}$ is the GDP of State 1. In other words, $A$ loses the entire domestic pie, $B$ gets whatever is not destroyed in the revolution, and state 2 secures the entire stake of the international issue(s) in dispute.

If $B$ does not revolt to tax rate $\tau$ its share of national resources, $(1 - \theta)\bar{y}$, is taxed at rate $\tau$. Additionally, the military might of state 1 is determined by $\pi(\tau) \in [0, 1]$, interpreted as the probability that state 1 wins a war, given domestic tax rate of $\tau$. We assume $\frac{d\pi}{d\tau} > 0, \frac{d^2\pi}{d\tau^2} < 0$. We do not specify a particular functional form of the technology by which tax revenues are translated into military strength. We only assume the substantive feature of increasing but diminishing returns to military spending. We further assume that $\pi(1) < 1 - c$, which implies that state 1 would not win with certainty when the tax rate was set at 100% (in fact, it would win a war with probability
Table 1:

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\hat{y}$</td>
<td>total GDP of state 1</td>
</tr>
<tr>
<td>$\theta$</td>
<td>percent of economy that faction A commands, assumed to be greater than $1/2$</td>
</tr>
<tr>
<td>$\tau$</td>
<td>tax rate</td>
</tr>
<tr>
<td>$0 &lt; c &lt; 1$</td>
<td>cost of fighting a war</td>
</tr>
<tr>
<td>$x$</td>
<td>State 1’s proposed portion of international spoils.</td>
</tr>
<tr>
<td>$\mu$</td>
<td>cost of revolt, as a fraction of the total economy, either $\mu^H$ (a high incentive to revolt) or $\mu^L$ (a low incentive to revolt).</td>
</tr>
<tr>
<td>$q$</td>
<td>probability that the cost of revolt is $\mu^L$. Assume $q \in (0.5, 1)$. Revolt by B is credible only when $\mu^H$ is drawn (which occurs with probability $1 - q$).</td>
</tr>
<tr>
<td>$\delta$</td>
<td>common discount factor</td>
</tr>
<tr>
<td>$\pi(\tau) \in [0, 1]$</td>
<td>probability that state 1 wins a war, given domestic tax rate of $\tau$. We assume $\frac{dp}{d\tau} &gt; 0$, $\frac{d^2p}{d\tau^2} &lt; 0$ and that $\pi(1) &lt; 1 - c$.</td>
</tr>
<tr>
<td>$\rho$</td>
<td>sharing rule determining the fraction of international spoils received by faction A (with a fraction $1 - \rho$ going to B)</td>
</tr>
</tbody>
</table>
A then makes an offer of \((1-x) \in [0,1]\) to state 2. State 2 may accept or go to war. If state 2 accepts, the payoffs are

\[
\begin{align*}
A &: y^A + \rho x \\
B &: (1-\tau)y^B + (1-\rho)(x) \\
2 &: 1-x
\end{align*}
\]

If state 2 chooses war, a costly lottery is played with the following expected payoffs and the game ends.

\[
\begin{align*}
A &: y^A + \rho\pi(\tau - c) \\
B &: (1-\tau)y^B + (1-\rho)(\pi(\tau) - c) \\
2 &: 1-\pi(\tau) - c
\end{align*}
\]

If there is no revolt, and no war in period 1, the stage game is repeated in period two with new costs of revolt drawn by nature, such that the probability that the cost of revolt is low, \(\mu^H\), is \(1-q\), and the probability that the cost of revolt is high, \(\mu^L\), is \(q > .5\). That is, credible revolutionary times are less common than normal times (in which revolt is not credible by virtue of costs being prohibitively high). Payoffs for the two-period game are the sum of period one and period two payoffs, the latter discounted by a common factor \(\delta \in (0,1)\).

### 3.3 Stage Game

In this section we solve for subgame perfect equilibria of the stage game. The stage game helps to illustrate the core innovation of our model, namely, the addition of a

---

\(^6\)The assumption \(\pi(1) < 1-\) ensures that even if the tax rate were 1, state 1 would not win with certainty (in fact, would win a war with probability less than \(1-\)) and be willing to offer state 2 more than the whole pie to avoid war, but it cannot.
domestic bargaining game between two factions in one of the countries. To understand the dynamics of the domestic bargaining game it is useful to establish the most preferred tax rates for \( A \) and \( B \). The magnitude of the domestic dispute can be conceptualized as the difference in faction \( A \)'s and \( B \)'s most preferred tax rates. To that end, let \( \tau^A \) be faction \( A \)'s most preferred tax rate and \( \tau^B \) represent faction \( B \)'s most preferred tax rate. Lemmas 1.1 and 1.2 in the Supplemental Information (SI) establish these rates. The difference in most preferred tax rates, as noted below, depends on: domestic inequality (\( \theta \)) and the relative benefits of the international status quo (relative to State 1’s domestic resources, \( \bar{y} \)).

**Proposition 3.1.** \( \tau^A - \tau^B \) is decreasing in faction \( A \)'s share of nation resources, \( \theta \); is increasing in national resources, \( \bar{y} \), and; is decreasing in faction \( A \)'s share of (net) international spoils, \( \rho \).

All proofs are given in the Supplemental Information. Proposition 3.1 foreshadows comparative statics of interest and points to the fundamental assumptions of the model: that there is some domestic disagreement over funding levels for military strength and that this difference depends on domestic inequality (\( \theta \)) and the relative benefits of the international status quo to the separate factions. As the distribution of income becomes more equal (as \( \theta \) decreases to \( 1/2 \)) and as the value of domestic income, \( \bar{y} \), decreases, the degree of disagreement over taxation decreases. Likewise, as \( B \)'s stake in the international settlement, \( 1 - \rho \), increases, disagreement decreases as both factions become vested in funding military spending and enhancing the bargaining position of the state.

Absent any revolutionary threat, \( A \) would simply implement it’s most preferred tax rate \( \tau^A \). However, \( B \)'s outside option is revolt, which is costly for \( A \). Thus, \( A \) must operate within constraints posed by \( B \)'s revolt threat, when such a threat is credible. To understand the incentives for revolt, consider \( B \)'s response to equilibrium tax rates.

\(^7\text{Recall the size of the international pie is normalized to 1, so that the relative size of domestic resources to the international status quo, } \frac{\bar{y}}{1}, \text{ is simply } \bar{y}.\)
In particular, $B$ revolts to tax rate $\tau$ when

$$(1 - \mu)\bar{y} > (1 - \tau)(1 - \theta)\bar{y} + (1 - \rho)x^*(\tau),$$

where $x^*(\tau)$ is the offer made by faction $A$, conditional on $B$ not revolting to $\tau$. Since faction $A$’s utility is increasing in state 1’s international settlement, $A$ will only offer state 2 just enough to make it indifferent between accepting and going to war.

**Lemma 3.2.** The best response for faction $A$, conditional on $B$ not revolting to tax rate $\tau$, is to offer state 2 $1 - x^*(\tau)$, where $x^*(\tau) = \pi(\tau) + c$.

By Lemma 3.2, faction $B$ revolts to tax rate $\tau$ when

$$(1 - \mu)\bar{y} > (1 - \tau)(1 - \theta)\bar{y} + (1 - \rho)(\pi(\tau) + c).$$

Note that for certain costs of revolt faction $B$ would never revolt. If $B$ would not revolt when offered their least preferred tax rate, they would not revolt to any tax rate. Since $B$’s utility of not revolting to tax rate $\tau$ is decreasing in $\tau$ for $\tau > \tau^{*B}$, it follows that if $B$ does not revolt to $\tau^{*A}$, it would not revolt to any $\tau \in [\tau^{*B}, 1]$. Further, $A$ would never set a tax rate less than $\tau^{*B}$ as $A$’s utility for non-revolt is increasing in $\tau$. Let $\bar{\mu}$ solve

$$(1 - \bar{\mu})\bar{y} = (1 - \tau^{*A})(1 - \theta)\bar{y} + (1 - \rho)(\pi(\tau^{*A}) + c).$$

Hence, for $\mu > \bar{\mu} = 1 - \frac{(1 - \rho)(\pi(1 - c))}{(1 - \theta)\bar{y}}$, revolt is never a best response to any tax level.\(^8\)

It is also the case that for certain costs of revolt, faction $B$ would always revolt. If $B$ would rather revolt than accept its most preferred tax, $\tau^{*B}$, then it will revolt to any

\[^8\text{This, and the reciprocal argument, are not novel (e.g. Acemoglu and Robinson 2005).} \]
tax rate. To that end, let $\underline{\mu}$ solve \ref{3.2} when $\tau = \tau^B$ with equality:

$$(1 - \mu) \bar{y} = (1 - \tau^B)(1 - \theta) \bar{y} + (1 - \rho)(\pi(\tau^B) + c).$$

Then, for $\mu < \underline{\mu}$, revolt is a best response to any tax level, and hence revolt cannot be avoided.

By the preceding, we see that when the costs of revolt are not too big nor too small – when $\mu \in [\mu, \bar{\mu}]$ – faction $B$ is responsive to the tax rate set by faction $A$. That is, when $\mu \in [\mu, \bar{\mu}]$, there exists a $\hat{\tau}$ that solves

$$(1 - \mu) \bar{y} = (1 - \hat{\tau})(1 - \theta) \bar{y} + (1 - \rho)(\pi(\hat{\tau}) + c).$$

\label{3.4}

When $\mu \in [\mu, \bar{\mu}]$ faction $B$ is indifferent between revolting to the tax rate $\hat{\tau}$ and not revolting.

By the above arguments, we can generally characterize a subgame perfect equilibrium for the stage game as follows.

**Proposition 3.3.** SPNE offers and tax rates are as follows:

- $\mu < \underline{\mu}$: $A$ sets any $\tau$ and offers $1 - \pi(\tau) - c$; $B$ revolts; state 2 accepts offer.

- $\mu > \bar{\mu}$: $A$ sets $\tau^A$, offers $1 - \pi(\tau^A) - c$; $B$ does not revolt; state 2 accepts offer.

- $\mu \in [\mu, \bar{\mu}]$: $A$ sets $\hat{\tau}$ and offers $x^*(\hat{\tau})$; $B$ does not revolt to any $\tau \leq \hat{\tau}$, and revolts to any $\tau > \hat{\tau}$; state 2 accepts offers $1 - \pi(\hat{\tau}) - c$.

As is standard in complete information ultimatum bargaining games in which war is an outside option, war does not occur in equilibrium. Both states are able to agree to bargains that are at least as efficient as war.

### 3.4 The Two Period Game

In the stage game we illustrated the basic dynamics of the domestic fiscal contract, by which faction $A$ sets its optimal tax rate within the constraint posed by faction $B$’s
outside option of revolt. However, in a static setting with complete information, the domestic bargaining game has little bearing on international bargaining, other than establishing state 1’s military strength which, through $\pi(\tau)$, partially determines the expected value of the outside option of war. In this section, we consider a two-period model where the state, $\mu$, is independently drawn in each period. To unpack the domestic sources of power shifts, we focus on situations in which preventive war occurs in period 1 because state 2 fears a large and rapid decline in its relative military power. Specifically, our focus is on the likelihood that the tax rate in period 2 ($\tau_2$) is substantially larger than the tax rate in period 1 ($\tau_1$). This shift allows the governing faction, $A$, in state 1 to devote more resources to the military and alter the international balance of power in its favor.

Given the sequence of our model, growth in fiscal capacity occurs when faction $B$’s cost of revolt increases between the two periods. This corresponds to the situation in which nature first draws $\mu^H$ in period 1 and then draws $\mu^L$ (which occurs with probability $q < 1$) in period 2. We assume that shocks posing a heightened risk of revolution are less likely than normal conditions associated with a stable domestic political order (i.e. $q > 1/2$). For analysis of the two period game, see Supplemental Information, Section II.

3.5 Preventive war

This section identifies a condition under which state 2 goes to war in period 1. It does so to forestall a significant increase in the state 1’s military power when political stability returns in period 2. This power shift is prompted by a sizable increase in the fiscal capacity of the governing faction $A$, which is reflected in higher tax rates on $B$. We focus here on the situation in which the cost of revolting in period 1 is $\mu^H$ with tax rate $\hat{\tau}^H_1$.

**Proposition 3.4.** Let $\mu^H \in M$. Then $x^*(\hat{\tau}^H_1) = \pi(\hat{\tau}^H_1) + c \leq 1$ such that:
• State 2 accepts \((1 - x^*(\hat{\tau}^H_1))\) in period 1 if

\[
(1 - q)\pi(\hat{\tau}) - \pi(\hat{\tau}^H_1) < c + q\pi(1). \tag{3.5}
\]

• State 2 rejects \((1 - x^*(\hat{\tau}^H_1))\) in period 1 if

\[
(1 - q)\pi(\hat{\tau}) - \pi(\hat{\tau}^H_1) > c + q\pi(1). \tag{3.6}
\]

• State 2 is indifferent between going to war and accepting offer \((1 - x^*(\hat{\tau}^H_1))\) in period 1 if

\[
(1 - q)\pi(\hat{\tau}) - \pi(\hat{\tau}^H_1) = c + q\pi(1). \tag{3.7}
\]

Proposition 3.4 formalizes shifts in the distribution of military power that are sizable enough to generate war. When the model parameters satisfy equation 3.5 or 3.7, state 2 does not engage in preventive war in equilibrium. Conversely, when equation 3.6 is satisfied, State 2 rejects 1’s offer in period 1 and goes to war.

### 3.6 Comparative statics, preventive war

In this section, we identify factors that contribute to the breakdown of international bargaining into war. To that end, we focus on the left-hand side of inequality 3.5 and say that preventive war is increasing in parameter \(g \in \{\theta, \rho, \mu, c\}\) if inequality 3.5 is satisfied for a larger set of parameters as \(g\) increases.\(^9\) For example, as the left-hand side of 3.5 increases, ceterus paribus, the set of parameters for which there exists a no-war, no revolt equilibrium shrinks.\(^{10}\)

---

\(^9\)For example, preventive war is increasing in \(\theta\) if \(\frac{\partial(1-q)\pi(\hat{\tau}) - \pi(\hat{\tau}^H_1)}{\partial \theta} > 0\).

\(^{10}\)Note that even if preventive war is more likely as \(g\) increases, the left hand side of 3.5 may not exceed the right hand side of 3.5 for any valid value of \(g\).
Our main result is stated below. The proof relies on several results, collected in the Supplemental Information.

**Theorem 3.5.** [Comparative statics, no-war]

1. Preventive war is decreasing in $c$.
2. Preventive war is decreasing in $\mu^H$.
3. Preventive war is increasing in $\theta$.
4. For sufficiently large $\delta$, preventive war is increasing in $\rho$.

These comparative statics generate the main empirical implications of our model. The first claim, that preventive war is decreasing in the costs of war ($c$), is a fairly straightforward result of conventional bargaining approaches to war. The second claim links the cost of revolt to the likelihood of preventive war. The logic behind this claim is also straightforward. In our model, $\mu$ is exogenously drawn anew in period 2 and may shift from $\mu^H$, or a state in which faction $B$ is relatively unconstrained in its ability to replace faction $A$, to $\mu^L$, in which revolt for faction $B$ is a not a credible option. If this divergence in the costs of revolt across the two periods is large enough, an international commitment problem for state 1 can emerge and generate conditions for preventive war. The potential size of this shift in revolt costs shrinks as $\mu^H$ becomes larger, which implies greater impediments to revolt when the conditions for revolt are most favorable. Because it involves an exogenous shift, this result is analogous to the well-established condition for preventive war established by Powell and others. However, in our model the exogenous shift generates a power transition through the mechanism of taxation and military spending.

The third claim holds that the likelihood of preventive war increases when the distribution of income within state 1 (captured by the proportion of domestic income held by $A$) is more unequal. Greater levels of income inequality increase the expected payoff associated with domestic revolt for the faction out of power because
a change in government creates the opportunity to legislate the expropriation of the disproportionately large quantity of assets held by the governing coalition. As the gap in the amount of assets held by $A$ and $B$ grows, the coalition out of power becomes more willing to absorb the costs associated with revolt to secure $A$’s resources. In essence, revolt becomes more attractive for faction $B$ as their share of domestic resources decreases. However, in equilibrium, the government preempts revolution by offering concessions in the form of tax cuts. Higher levels of income inequality necessitate larger tax cuts to ensure that the government can avoid confiscation of its assets. Most importantly, larger tax cuts deepen military decline, require greater strategic retrenchment, and create larger shifts in the distribution of military power by the return to post-crisis tax and military spending levels.

Alternatively, the depth of military decline is shallower and the risk of preventive war is attenuated when the distribution of income is more equal. Because a smaller income gap reduces the aggregate pool of resources for expropriation, the government can coopt the opposition and maintain its hold on power at home with a more limited program of tax cuts than in the case of high income inequality. The capacity to maintain higher tax rates limits military decline and the scope of international concessions required during this period of domestic political instability. A smaller power shift reduces the likelihood of preventive war.

The fourth claim links the economic benefits obtained by $B$ from an international settlement to the outbreak of war. It leverages our modeling decision to allow the domestic distribution of the benefits generated by any international agreement to vary across domestic groups. This choice has important conceptual significance. Namely, it captures the size of the stake that each of the two domestic factions in state 1 holds in the broader international order. For instance, imagine a spheres of influence agreement like the division of Europe between the Soviet Union and the United States during the Cold War. This agreement generates some set of benefits—such as alliance partnerships, basing rights, and access to consumer markets and raw materials—to both states. Some of these benefits—like an alliance partner that offsets some costs of
national defense–may have the characteristics of a public good and others–like preferential economic access–may be distributed unevenly within a society. For example, domestically oriented producers in the United States may only benefit from the national security public goods while export-oriented interests might also benefit from market access to Western Europe. As \( \rho \) increases, the governing coalition captures a greater proportion of the private benefits generated by the agreements that constitute the international status quo. Smaller values of \( \rho \) suggest that \( B \) possesses a larger stake in the international status quo and has a greater interest in preserving it. \(^{11}\) Along these lines, \( \rho \) could also be thought of as reflecting the level of isolationism in \( B \)'s foreign policy interests.

This stakeholding status carries important implications for society’s willingness to tolerate higher taxes necessary to sustain military expenditures. As a group’s stake in the international order grows, its demand for military resources capable of protecting those benefits and willingness to pay for that security increases. Given that our model focuses on the taxes leveled on \( B \), we discuss here how variations in \( \rho \) alter \( B \)'s resistance to taxation and the depth of military decline during periods of domestic instability.

The depth of military decline sparked by domestic political instability is less severe and the risk of preventive war is diminished when \( \rho \) is lower. Under this condition, the members of group \( B \) are relatively more vested in the international order. Consequently, they are willing to pay higher taxes to preserve that stream of external benefits. This enables the governing coalition to offer smaller tax cuts to prevent

\(^{11}\)This distributional variation also opens up the possibility that some significant revenue stream from the international status quo might make \( B \) more willing to countenance higher levels of domestic income inequality without revolt. This scenario is similar conceptually to the logic in Dunning (2008). He holds that natural resource wealth may be associated with democracy when it can counteract domestic pressures for redistribution in highly unequal societies.
domestic revolt and the expropriation of its wealth when faced with domestic political instability. Alternatively, as $\rho$ increases, the benefits of any external agreement are concentrated in the hands of the governing coalition and the coalition that is excluded from power is relatively more isolationist. Similar to the case of high income inequality, the government must offer deeper tax cuts to maintain its hold on power. These cuts deepen military decline, increase the size of the potential power shift upon the return of domestic political stability, and heighten the risk of preventive war.

4 An empirical example: revolution in 1905, retrenchment, and war in 1914

The typical preventive war model posits a shift in the distribution of power that strengthens one state, leading it to demand a favorable adjustment in the international political status quo. Declining states may fight a war rather than making these concessions. Alternatively, our model focuses on factors that limit military decline or strategic withdrawal. The international political order is more stable, or less vulnerable to a violent reordering of it, when domestic conditions limit military decline or strategic engagement in the face of internal political instability. The risk of military conflict stems not from a new challenge to the existing status quo. Instead, it is sparked by the decline of one state, the creation of a temporary new status quo, and a subsequent attempt by the recovering state to restore the prior international status quo. Existing powers launch a preventive war because states recovering from a domestic crisis cannot commit to staying retrenched.

This alternative way of thinking about the domestic origins of preventive war can be illustrated by examining how the Russian revolution of 1905 contributed to the outbreak of World War I. It complements the traditional concentration in the historiography of World War I on German incentives for preventive war in 1914 (e.g. Mom-}

21
the distribution of military power between Russia and Germany. In particular, the focus here on how domestic distributional conflict heightens the risk of preventive war corresponds with at least five attributes of Russia’s collapse and destabilizing recovery: the role of domestic distributional conflict in activating the revolution; significant political and economic concessions targeted at opposition groups to preserve the Tsarist regime; a central role for financial weakness and then strength in Russian foreign policy from 1905 to 1914; the depth of Russia’s domestically-induced strategic retrenchment in the Far East, Central Asia, the Black Sea, and the Balkans after 1905; the domestic and international challenges associated with preserving any Russian commitment to stay retrenched after the threat of domestic revolt had receded.

Multiple manifestations of strategic retrenchment by Russia from 1905 to 1909 altered the status quo international political order among great powers during this period. This retrenchment can be captured conceptually in our model as concessions (say over territory or spheres of influence) from state 1 (in this case Russia) to another state that help initially to create peace. In the Treaty of Portsmouth that ended the war with Japan in 1905, Russia evacuated from Manchuria and conceded its territorial lease in the Liaodong peninsula, control over its railways in southern Manchuria, and half of Sakhalin Island to Japan. In the spheres of influence agreement with the British in 1907, Russia recognized a neutral region in central Persia and British dominance in the south. It also acceded to exclusive British influence in both Afghanistan and Tibet. Russia temporarily surrendered its influence in the Balkans and was forced to recognize Austria-Hungary’s 1908 annexation of Bosnia under a German threat of war. Moreover, given that Russia had initially sought to utilize the Bosnian issue to secure control of the Straits, this confrontation with the Dual Alliance over Bosnia also forced it to sacrifice this long term interest.

The 1905 domestic revolution in Russia and the regime’s subsequent reestablishment of authority at home played a critical role in this broad policy of strategic retrenchment. While the outbreak of the revolt was activated by the public’s growing

\[12\] See for example Lieven (1983), Geyer (1987), McDonald (1992), Gattrell (1994),
frustration with battlefield failures in the war against Japan and from the accumulating costs of the conflict that slowed aggregate economic activity, it was also motivated by long term grievances with the Russian state that had increasingly manifested in sporadic peasant disturbances and industrial strikes after the turn of the century. Strikes and revolutionary violence in both urban areas and the countryside escalated steadily in 1905. The successful completion of a peace settlement with Japan in September 1905 and the Tsar’s October Manifesto creating an elected legislative body failed to slow these trends. The onset of a general strike and an armed revolt in Moscow in December of 1905 marked the highpoint of domestic instability. Thereafter, the Russian regime restored some order through a systematic campaign of coercion that included arrests, executions, and punitive raids to intimidate the population. By arresting significant components of the opposition leadership and raising the costs of organized political activity, the government splintered the opposition and effectively quelled the revolt by pushing it into a new phase in which the confrontation would occur largely in the legislative arena.

According to our modeling framework, governments facing a credible threat of revolution—as the Tsar did in the final months of 1905—will implement a series of concessions or reforms to remain in power. Russia’s foreign policy from 1905 to 1912 was regularly constrained by the need to preserve peace so that these domestic reforms could be consolidated. We highlight at least four aspects of this phase of recovery here and then link these pressures to the multiple manifestations of strategic retrenchment by Russia during this period.

First, our model holds that higher levels of income inequality prompt deeper strategic retrenchment as a government makes significant concessions to opposition groups to remain in power. While data on income inequality in Russia during this period appears to be nearly nonexistent, we can get some sense of it by looking at and Neilson (1995).

This discussion draws on Ascher (2004).

A recent NBER working paper by Nafziger and Lindert (2012) discusses this data.
some aggregate statistics on the distribution of landholdings between peasants and the nobility. These estimates have particular importance for this case because peasants constituted 80% of the population and were—along with industrial workers, liberals in the middle class and the gentry, and national minorities—one of the four key groups of opposition forces during the revolution.

Land ownership in Russia was highly unequal. Based on individual land holdings alone, Lindert and Nafziger (2012) estimate a gini coefficient for Russia in 1904 of 0.88. For example, while constituting only 1.5% of the population, the nobility held 50% of all privately held arable land in 1861 (Ascher 2004, 7). In Latvia, 1500 German nobles owned about 6.75 million acres of land; 1.3 million peasants owned 5.4 million acres (Ascher 2004, 51). While the end of serfdom in 1861 had ostensibly created more economic opportunities for large portions of the Russian peasantry, the costs of land ownership were particularly steep in large part because it was restricted to unproductive communes that discouraged investment. Designed to facilitate the repayment of debts, withdrawal from the commune was restricted. As the peasant population increased by about fifty percent in the ensuing four decades after emancipation, relatively fixed communal holdings were regularly redistributed so that already meager individual land holdings by peasants declined by about 20% from 1861 to 1905 (Ascher 2004, 7).

Under the leadership of Peter Stolypin, Russia began a large program of agrarian paucity and estimates income inequality in 1904 for European Russia in the aggregate and for 50 districts individually. It characterizes overall income inequality in Russia in 1904 as middling for that era, with an estimated gini coefficient of 0.36. However, they find income inequality to be much higher in some regions of the country where the revolt was most intense, namely St. Petersburg, Moscow, and the Baltic and Black Sea regions. They estimate a gini coefficient for St. Petersburg of 0.61 and 0.59 for Moscow.

\[^{15}\text{It falls to 0.60 if peasant holdings in communes are included.}\]
reform in 1906 to stabilize the countryside by raising the standard of living among peasants. Stolypin made more public lands available for sale to peasants, eased credit terms for these purchases, and instituted a series of administrative procedures to break up the communes and privatize their land holdings. In the era of tight budgets that followed, Stolypin and his protégé, Alexander Krivoshein, regularly secured increasing fiscal resources to ensure the implementation of these reforms. Most importantly, until his assassination in 1911, Stolypin, along with the finance minister, Vladimir Kokovtsov, consistently advocated for limited military spending and a restrained foreign policy to preserve peace and ensure that these domestic reforms could be consolidated.

The creation of the Duma highlighted a second key set of temporary political concessions made by the Russian state. Opposition groups dominated the first two Dumas. They, particularly the radical Constitutional Democrats, sought to secure portfolios within the Tsar’s government and the forced expropriation of land. Both Dumas were dissolved successively in the summers of 1906 and 1907. The Russian government then altered the electoral laws to ensure a more pliant legislature. The economic makeup of the deputies to Third Duma reflected the reconsolidation of political influence by the wealthiest members of society. New rules limited worker representation by dividing urban districts into poor and wealthy parts; and altered the balance of representation between the nobility and peasants by adding private land ownership as an electoral qualification. While its power was successively whit-

---

16 This discussion of the Stolypin reforms draws on Hosking (1973) and Ascher (2001).

17 Gatrell (1994, 148) notes that spending for agricultural ministry increased from 58 million rubles in 1908 to 136 million rubles in 1913 (or from 2.2% to 4.0% of total government expenditures).

18 For a discussion of these consistent foreign policy preferences see McDonald (1992) and Ascher (2001, 256-260).

19 This discussion is based on chapter 2 of Hosking (1973).
tled down as instability receded, the Duma still preserved the capacity to influence the budget process and publicize corruption and administrative inefficiency. More importantly, the dominance of nationalist and conservative deputies in this Duma created a working majority for the government that supported the program of armaments expansion that Russia would pursue after 1910 (Gatrell 1994).

The history of the Duma from 1906 to 1914 and changes to the composition of interests within it broadly reflect the theoretical story presented here. In a moment of revolutionary desperation, the Tsar made significant concessions that temporarily empowered an opposition favoring a program of land expropriation that would redistribute wealth from the rich to the poor. Relying in part on coercion and changes to the electoral law, the Russian government transformed membership within the Duma so it reflected the interests of the landed nobility and wealthy urban classes. These groups opposed the expropriation of private land and supported rearmament that could strengthen Russia’s position in the Balkans and the Black Sea region.

Third, consistent with the focus on fiscal capacity in our model, the preservation of the Tsarist regime and its subsequent military recovery both depended on its ability to secure sufficient revenues. Russia was unique among great powers during this period for its dependence on foreign loans and state-owned assets to fund public expenditures (McDonald 2009). For example, this dependence on foreign loans to fund the war against Japan pushed the Tsar to pursue peace talks when the French government closed off the Paris money market. The French government then enabled Russia to remain on the gold standard by approving a series of emergency loans in 1906, loans that opposition forces sought to block to enhance the Duma’s political leverage when it convened. Similarly, French capital facilitated rearmament by funding railway expansion in Western Russia after 1913.

Even with access to foreign capital and state-owned assets, Russia’s taxation burdens remained regressive (e.g. Geyer 1987, Gatrell 1994). These resources enabled the government to shield wealthier groups in society with some of the lowest direct

---

taxation rates (i.e. on property and income) in Europe (McDonald 2009). Heavy tariff barriers raised consumer prices, fostered regular tariff wars with its key trading partner (Germany), and decreased peasant incomes by shrinking the market for agricultural exports. Over a quarter of the government’s revenue was generated via a form of consumption tax through the state-owned vodka monopoly.

Most importantly, the immediate financial constraints generated by war and revolution hampered rearmament, particularly until 1910. Even though the war with Japan had essentially destroyed the Russian navy, Kokovtsov pushed naval spending steadily downward until 1910 (Gattrell 1994, 95-102, 140). Spending on the army did not accelerate until 1908, after the government’s financial situation had stabilized.

Fourth, fiscal austerity and the need to preserve domestic stability in the aftermath of 1905 remained the dominant interest of the two key members of the Council of Ministers, Stolypin and Kokovtsov, from 1906 to 1912.\(^21\) They both remained consistent advocates for strategic retrenchment and peace, playing critical roles in restraining Russia’s foreign policy. As noted earlier, there were four key manifestations of this strategic retrenchment—in the Far East, Central Asia, the Straits, and the Balkans. We have already noted how the costs of revolution and the halting of French loans pushed Russia to make concessions that ended war with Japan. Because of Japan’s alliance with Britain, the Russian Foreign Minister, Izvolsky, pursued a spheres of influence with the latter in Central Asia that limited Russian access to Persia, Afghanistan, and Tibet. He, along with Stolypin and Kokovtsov, sought to ensure that a confrontation in the Far East or Central Asia would not undermine domestic reforms or Russia’s position in Europe.\(^22\) Continued instability in 1906 helped reverse the positions of

\(^{21}\)For examples of these claims, see Lieven (1983), McDonald (1992), Ascher (2001), McMeekin (2011).

\(^{22}\)For example, in August 1907 right before the agreement, Stolypin argued before the Council of Ministers: [T]he successful conclusion of our agreement with England represents a truly great matter of state. Our internal situation does not allow us to conduct an aggressive foreign policy. The absence of fear from the point of view of
cabinet ministers that had previously opposed any concessions in Persia. Russia's acquiescence to Austria-Hungary's annexation of Bosnia under a German threat of war reflects these same sets of domestic pressures for retrenchment and peace at all costs. Again, the Council of Ministers was unwilling to risk war, and the expected domestic instability, to defend their traditional interests in the Balkans. This concession came at significant domestic cost that would carry important implications for 1914. It angered conservative groups generally associated with Pan Slavism that saw the Balkans as central to Russia's sphere of influence. Moreover, because Izvolsky sought to link Russian acceptance of Bosnian annexation to Austro-Hungarian support for Russian control of the Straits, it also forced Russia to pull back from its traditional goal of obtaining a warm water port.

The final step in our argument links war to the inability of a state, like Russia in this case, to commit to remaining retrenched upon recovering from a domestic political crisis. The first key challenge to any Russian commitment to stay retrenched emerged from the rapid growth of Russian public revenues after 1908. Fiscal recovery in Russia activated an arms race on land in Europe that culminated with the Great Program of military spending in 1914 (Herrmann 1996, Stevenson 1996, McDonald 2009). The resulting shift in the distribution of military power led to calls in Germany by civilian and military officials alike for launching a preventive war against Russia before the rearmament program could be completed in 1917. Second, these fears were given new credence by increasing Russian activity in the Balkans, particularly its support of the Balkan League (e.g. Clark 2013). Given Serbia's efforts to destabilize the Austro-Hungarian Empire after 1903, the renewal of Russian international relations is extremely important for us since it will give us the opportunity to dedicate with full tranquility our strength to the repair of matters within the country— (McDonald 1992, 110). On how these domestic pressures facilitated an accord see McDonald (1992, 107-11), chapter 9 in Neilson (1995), and Ascher (2001, 252-253).
support for Serbia during the Balkan Wars directly threatened the political status quo in the region, the stability of the Austro-Hungarian Empire, and the combined strength of Germany’s alliance with Austria-Hungary. In short, political and financial recovery in Russia precipitated its attempts to revise the Balkan status quo of 1908 that had reflected its post-1905 strategic retrenchment. Third, evidence from recent studies on World War I highlighting Russia’s role in its outbreak suggest that Russia could not commit to a policy of abnegation relative to the Straits because it threatened the agrarian reforms instituted by Stolypin (McMeekin 2011). Because most Russian grain exports were transported through the Straits, the Ottoman closure of the Straits during the Balkan Wars highlighted the vulnerability of the Russian economy to an embargo there. McMeekin (2011, 29-30) argues that that Krivoshein, the most powerful member of the Council of Ministers in 1914 and a protégé of Stolypin, supported the decision for war in 1914 to secure access to the Straits and protect the agricultural sector. In sum, Germany and Austria-Hungary launched a preventive war against Russia in 1914 because the latter could not commit to preserving the political and territorial concessions it had made from 1905 to 1909.

5 Theoretical implications

In addition to identifying some domestic conditions that can activate commitment problems and war among states, this model carries theoretical implications for at least two more literatures. First, allowing the international settlement to be further subdivided internally between government and opposition factions suggests a new mechanism by which globalization promotes peace. Second, the model also allows us to specify the conditions under which strategic retrenchment leads to war and move beyond regime type to characterize the domestic sources of retrenchment.
5.1 Commercial liberalism

The comparative static linking $\rho$ to preventive war implies that globalization stabilizes the international political order by insulating it from domestic political conflict and change. As $\rho$ decreases, military spending levels are less “elastic” to political instability because the opposition coalition captures more of the private benefits associated with the external bargains that comprise the international status quo. This stabilization in military spending levels helps to prevent strategic retrenchment and power transitions between states that can cause war. This result suggests that a set of conditions—say the institutional characteristics or policies of a state; or the specific terms of an international bargain, like a preferential trading agreement—that increases the stake of opposition coalition in the broader international order can also reduce the risk of war. For example, the domestic income effects generated by greater levels of international trade may help to create an armed peace among states when opposition groups hold an abundant factor of production like labor.\footnote{This implication may not follow if the ownership of the abundant factor in an economy, like capital, is concentrated. Consequently, the politically stabilizing benefits generated by the opposition’s enhanced stakeholding status may be offset by increasing domestic income inequality.}

This potential explanation for a commercial peace differs from an existing literature that surprisingly neglects the capacity of expanding international markets to foster political change. While fruitful, the application of bargaining insights to questions surrounding the capacity of international commerce to promote peace has largely been confined to its capacity to alleviate private information through costly signaling while simultaneously neglecting how trade might exacerbate or attenuate commitment problems (e.g. Gartzke, Li, and Boehmer 2001; Mansfield and Pollins 2003).\footnote{For an exception see Eilstrup-Sangiovanni and Verdier (2005).} This neglect is surprising because of a critical underlying conceptual similarity between globalization and commitment problems, stemming from the inherent
element of dynamism that is intrinsic to each. Globalization has long been pointed to as potent source of political change (e.g. Polanyi 1944, Gilpin 1981), particularly given its capacity to generate income growth and alter the distribution of income within and between societies. Alternatively, the logic of the commitment problem suggests that war is caused by rapid and large changes to the distribution of military power among states. In short, if globalization promotes peace, how can it simultaneously stabilize the distribution of military power among states and foster domestic political change? Our model suggests that globalization may be able to internationalize the interests of groups excluded from power within domestic orders and increase their willingness to pay the costs associated with protecting those external interests. As a consequence, globalization promotes peace by helping to make the agreements among states that constitute the larger international order more robust to domestic political change.

5.2 The domestic politics of strategic retrenchment and preventive war

Apart from extending the broader literature on how the commitment problem causes war, this model possesses implications for research on the domestic politics of great power retrenchment and empire (e.g. Kupchan 1994, Lobell 2003, Spruyt 2005, MacDonald and Parent 2011). We differ and build on this literature in at least two ways. First, the causal mechanisms linking retrenchment, defined here as political (often territorial) concessions, to war generally remain underspecified in this literature. Instead, we draw on the bargaining framework to identify the conditions under which retrenchment may heighten the risk of war. This discussion focuses on two attributes

---

25 Even though he does not couch his theory in the language of commitment problems, Rowe’s (1999, 2005) focus on how globalization altered the capacity of states to sustain the arms race and preserve the status quo distribution of military power in pre-World War I Europe is an important exception to this statement.
of retrenchment—its depth and its credibility. Captured by more significant concessions, deeper strategic retrenchment heightens the risk of war as one state attempts to consolidate its hold over newly acquired possessions with force. Alternatively, limited strategic retrenchment does not threaten peace because the maintenance of smaller political gains insufficiently compensates the other state (2 in our model) for the costs of war.\footnote{Consequently, we don’t think the claims developed here are necessarily at odds with those of MacDonald and Parent (2011) who argue that episodes of great power retrenchment are not associated with a higher propensity to engage in military disputes. Our model is consistent with the rarity of preventive war. Moreover, we argue that war is not caused by strategic retrenchment (which temporarily facilitates peace) but the attempt to reclaim prior political concessions made from an erstwhile position of military weakness.}

Our model also highlights the credibility of strategic retrenchment as an important aspect of war. An adjusted international status quo that reflects retrenchment by one great power may be less vulnerable to war if a state can commit to maintaining these concessions. For example, the surrender of Soviet influence in the domestic politics of Eastern European states (manifesting in German unification and competitive elections) may have strengthened peace during this period of transition by committing the Soviet Union to imperial retrenchment there.

Second, rather than institutional attributes—like cartelized political systems (Snyder 1991), regime type (Schweller 1992, Levy 2008), or veto points (Spruyt 2005)—we focus on two neglected attributes of domestic variation: income inequality and the domestic distribution of an international settlement.\footnote{Our suggestion that the benefits of international trade can capture the domestic distribution of an international (economic) settlement shares some similarity to the focus on the domestic conflict between internationalist (free traders) and nationalist-mercantilist-imperialist coalitions found in Solingen (1998) and Lobell (2003). We disagree with their claims though that beneficiaries of free trade necessarily oppose} Consequently, we provide a
deductive foundation to link the distribution of domestic resources, particularly high levels of income inequality, to military conflict.

Finally, while moving beyond regime type to understand the domestic sources of international outcomes like war constitutes a potential attribute of this framework, a reliance on the model found in Acemoglu and Robinson (2005) poses at least one potential challenge to the generalizability of these results. If the threat of revolt is limited to authoritarian states, our model may have trouble explaining retrenchment by democratic states. On the one hand, given that there has always been at least one autocratic great power in the post-1815 international system, this does not necessarily limit the empirical applicability of this model to great power politics.

On the other hand, the framework is general enough to suggest implications about the consequences of regime type by examining how democracy might influence some of the model parameters. A successful revolt possesses two key attributes—the replacement of a government with a different set of foreign policy interests and the expropriation of assets held by the prior governing coalition. Through regular and competitive elections, democracy reduces the costs of replacing a government during normal political times. As a consequence, it might also limit the amount of redistributive policy a new government pursues given that it has to anticipate the possibility of being in the opposition in the future. The first condition can be captured through our costs of revolt term, $\mu$. The generation of a power shift large enough to cause war depends on a sizable difference in this costs of revolt term across two periods that could be described as ones of crisis and stability respectively. To the extent that democracy reduces the costs of successfully replacing a government, it helps to limit the difference in the costs of replacing a government between the periods of crisis and stability. The narrowing of this cost difference limits strategic retrench—military spending. Instead, our arguments suggest that these economic benefits generated by the international status quo increase the demand for military protection and increase their willingness to pay taxes for national defense.

\[28\] This result is akin to part 2 of Theorem 3.5
ment during the period of crisis and reduces the subsequent risk of war. Moreover, by limiting the quantity of resources that an opposition coalition might expropriate when it comes to power, democracy might also limit the concessions that a government might have to make to that same opposition group during a period of domestic political crisis to remain in power. Again, this suggests that democracy could limit strategic retrenchment and the risk of preventive war. While a deeper investigation of these possibilities must be reserved for future work, they suggest that the theoretical implications generated by this modeling framework do not have to be restricted to autocratic regimes.

6 Conclusion

This paper connects the emergence of commitment problems that threaten the stability of bargains states make with each other to domestic negotiations that distribute the costs of public goods and divide societal wealth among contending internal groups. The model yields several novel claims about the links between domestic fiscal conditions and the sustainability of international settlements. The breakdown of an international settlement into war becomes more likely when a state's bargaining leverage relative to other states is more elastic with respect to domestic political crises. This elasticity, which occurs when income inequality is high and opposition groups receive relatively few private benefits from an international settlement, requires deeper strategic retrenchment and deeper change to the international status quo. Accordingly, a state's adversaries may opt to launch a preventive war, attempting to make that retrenchment permanent, because the government cannot commit to staying retrenched when domestic political stability returns.

This model of domestic and international politics provides multiple sources of “large and rapid shifts in the distribution of power” and clarifies a number of relationships that have been hinted at in previous literature. It provides an analytic focus that elevates the role of strategic retrenchment in the origins of major wars of
the twentieth century. We also discussed how this framework can be utilized to re-examine the theoretical foundations of a commercial peace. In this way, we add to the growing literature on the logics of international bargaining and war by highlighting how domestic distributional struggles shape continuity and rapid changes in the international balance of power.
References


38