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## Taming the Leviathan: Examining the Impact of External Threat on State Capacity\*

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This article argues that the systemic security environment influences the structure of domestic political and economic institutions. If states have been primarily created to protect one group from predation by another, then the state may visibly change as external threats rise and fall. The authors argue that political elites respond to threatening environments by enhancing the ability of the state to extract resources from society in order to protect itself. Using data from the Armed Conflict Dataset, Banks's Cross National Data Archive, and COW data from 1975 to 1995, the authors find evidence that supports the conjectured relationship between threat and state strength. As a response to a more threatening environment, the authors find that states significantly increase their capacity in terms of revenue, government spending, and military spending, but they do not easily relinquish these gains. The authors also observe that nation-state security is heavily influenced by regional regime-type patterns. State capacity increases as the regional neighborhood becomes increasingly autocratic. This suggests political elites not only regard violent conflict in the region as a serious concern to national security, but also appear to consider political change a threat as well.

### Introduction

With increasing interdependence, there has been talk of a post-nation-state world. However, despite the flurry of attention in recent years, such discourse is not entirely original. Over 30 years ago, Brown (1972) discussed the emerging borderless world, and Kindleberger (1969) insisted that the state was becoming less relevant as an economic actor. Perhaps the most prominent work on such a brave new world was put forward by

Keohane & Nye (1977). While not predicting a stateless world, they did envision a much more complex and dynamic international arena, where nation-states represent only one of many political and economic actors making important policy decisions (also see Ferguson & Mansbach, 1996, 1999; Mann, 1997). Barber (1996, 1998) and Huntington (1993) have more recently taken up the issue of state relevance and both insist that the nation-state is on the way out. Barber (1996) fears that states will eventually be eclipsed by multinational corporations seeking a borderless economic world. Huntington (1993) also expects the erosion

\*The data used in this article can be found at <http://www.prio.no/jpr/datasets>. Please direct correspondence to david.lektzian@ttu.edu or bprins@utk.edu.

of national identities and boundaries as civilizational faultlines begin to emerge and divide the world. Despite very different visions of the future, both scholars see the nation-state becoming less important in world affairs.

Cassandras aside, the state continues to survive and even thrive in the post-9/11 world. To use an old and tired cliché, the demise of the nation-state has been greatly exaggerated. Despite technological advances in both communications and transportation that tend to erode cross-state distinctions, the nation-state still functions as the primary political, economic, and cultural unit that people recognize. Even with the collapse of the Soviet Union and the subsequent conclusion to the 45-year ideological struggle between the communist East and the democratic and capitalist West, the state shows few signs of catching a fatal cold.<sup>1</sup>

Admittedly, economic interdependence has reduced the relevance of boundaries. The volume of trade today in goods and services is over 16 times larger than in 1950 and \$1.5 trillion moves through the world's foreign exchange markets each and every day (*The Economist*, 1998, 1997). Further, in order to facilitate greater efficiency in economic exchange, member states of the European Union have essentially erased age-old boundary lines that demarcate where one country begins and the other ends. Soon it will be possible to drive from Lisbon to Tallinn without ever showing one's passport. Yet, the nation-state is remarkably resilient and despite the multitude of other actors on the world scene, none attain the same level of loyalty and blind obligation as that of the nation-state.

<sup>1</sup> McNeill (1997: 274) insists that 'no promising alternative to the territorial organization of armed force has even begun to emerge'. Thompson (1994) disagrees and maintains that states are increasingly incapable of securing their citizens. Thus, praetorian guards appear to be on the rise, according to Thompson.

In part, talk of the demise of the nation-state can be traced to a more secure international environment. Even before the collapse of the Soviet Union, great-power war seemed only a distant possibility. Why create a garrison state if there is nothing to garrison against? Talk of trade, financial investment, and information processing have dominated debates about the emerging liberal order. Neorealists, as well, agree that without the constant threat of war, states would be able to focus on cooperative relations (Waltz, 1979: 71). In the wake of 11 September 2001, though, the state has suddenly re-emerged as the essential security provider. Citizens look to the state for assurances that they are safe against foreign enemies. The outpouring of nationalist sentiment that occurs after terrorist attacks also demonstrates that nation-states continue to command individuals' primary allegiance, and they remain the defining criterion for an 'us' versus 'them' distinction.

While considerable theoretical and empirical attention has focused on the relationship between domestic political institutions and processes and foreign policy decisionmaking (so-called second image relationships), less is known about the changes wrought domestically as a result of systemic or structural forces. Certainly, comparativists show concern for how the international economic system impacts the development of domestic economies and even political institutions. For example, Wallerstein (1974) insists that export-oriented trade policies or import-substitution policies depend strongly on a state's position within the capitalist world economy. However, the systemic security environment also influences the structure of domestic political and economic institutions (see Gourevitch, 1978). If states have been primarily created to protect one group from predation by another (Tilly, 1975; Downing, 1992), then the state may visibly change as external threats rise and fall. States become

stronger when external threats grow larger and, perhaps, when such threats diminish, so too do states in both size and strength.

Gourevitch (1978: 883) wrote that 'political development is shaped by war and trade' (also see Spruyt, 1994a). Indeed, not only does war create the need for a state, but growth in state capacity can perhaps be tied to an increasingly insecure international environment. While Rasler & Thompson (1985) provided some early evidence supporting this relationship, we think a more generalizable link may exist between state capacity and systemic insecurity. That is, we insist that dangerous neighborhoods are populated with strong states.<sup>2</sup> Political elites respond to threatening environments by enhancing the ability of the state to extract resources from society in order to protect itself. Using conflict data from the Armed Conflict Dataset, government revenue and spending data from Banks's Cross National Data Archive, and data on military expenditures from the Correlates of War National Capabilities Index, we find evidence that supports the conjectured relationship between threat and state strength.

As a response to a more threatening environment, states significantly increase their capacity in terms of revenue, government spending, and military spending, but they do not easily relinquish these gains. Both government spending and military spending show significant increases following increases in interstate war involvement by neighboring states, but in neither case is there a subsequent significant decline in spending in the following year. Revenues do fall off in the year after they increase, but not by as great a degree as they increased. We also find that if

neighboring states become, on average, more autocratic, states respond by increasing state capacity in terms of spending. Finally, states respond to large increases in military expenditures by a neighboring state with increases in their own military expenditures that are not relinquished in the following year. Regarding civil wars in neighboring states, there was no clear evidence that states respond with a significant increase or decrease in capacity. While civil war occurring in a bordering state is likely to be seen as threatening to regional stability, civil wars are also likely to reduce the capacity of the neighboring state, thus decreasing the perceived threat. Given this equivocality of threat perception, it is not surprising that a clear pattern of response was not discernable.

### Second Image Reversed Revisited

While war may have been the primary impetus behind state formation (see Tilly, 1975, 1990; Mann, 1988; Downing, 1992), few theories of international politics explore the 'war making-state building process' (Rasler & Thompson, 1985: 491).<sup>3</sup> Realists and liberals alike tend to ignore the ways domestic political and economic institutions respond to systemic structure (see, for example, Kahler, 1984). Realists, for example, not only ignore institutional differences across nation-states, but the fundamental assumption of anarchy also places states in a veritable constant-threat environment.<sup>4</sup> With no supranational authority to enforce

<sup>3</sup> This is in part because many view the post-Westphalian system as permanently fixed (Waltz, 1979, for example). However, the international system is much more dynamic and states regularly increase and decrease in size and strength as a result of systemic and domestic forces (see Ruggie, 1983).

<sup>4</sup> Waltz (1979: 93) writes, 'The states that are the units of international-political systems are not formally differentiated by the functions they perform.' Threat is constant. Only in a unipolar world could a state escape from security concerns. In that instance, a unipolar power would possess enough capabilities to defeat all the rest of the states combined.

<sup>2</sup> Gleditsch & Ward (2000) observe that the baseline probability of war is heavily affected by neighborhood characteristics. Similarly, Most & Starr (1980) conclude that neighboring wars influence leader beliefs about the security of the surrounding geopolitical environment (also see Rapoport, 1960).

order, survival is ultimately the core responsibility of each state. Inasmuch as the aggressive ambitions of states can never fully be curbed through defensive military buildup, states constantly face a very precarious international environment. 'The state among states', Waltz (1979: 102) writes, 'conducts its affairs in the brooding shadow of violence. Because some states may at any time use force, all states must be prepared to do so – or live at the mercy of their militarily more vigorous neighbors'. For Waltz (1979), it seems, nation-states must constantly secure themselves against predation, leaving few opportunities to strengthen civil society vis-à-vis the state.<sup>5</sup>

Liberal scholars, in contrast, do show a strong concern for second-image processes, but, to date, theoretical and empirical analyses have tended to focus on inside-out explanations. The democratic peace program, for example, stresses the relationship between domestic political structure and foreign policy decisionmaking. The causal arrow runs from domestic political environment to events on the international stage. Less attention has been given to the impact systemic structure has on domestic institutions and processes. That is, institutions and policy outcomes may reflect, in part, the uncertainty and insecurity that states confront.

Many liberal internationalists insist that states have crafted a variety of international organizations to help address new and difficult transnational problems. Until recently, these institutional bodies had little authority and only minimal impact on international politics.<sup>6</sup> Over the last decade, however, the

role of international and nongovernmental organizations has, according to some, changed. Interventions into Somalia, Haiti, Bosnia, and Kosovo have brought into question the whole notion of sovereignty. Yet, as Thompson (1996) averred, we are putting the cart before the horse. Arguably, international institutions are imbued with authority only because states have achieved a certain level of security. As security declines or as the international environment becomes increasingly dangerous, states recover authority previously delegated away to other institutional actors. Mathews (1997: 65) presciently asked, a number of years ago, whether 'the decline in state power [might] prove transitory'. Indeed, the profound changes wrought by globalization helped to provoke a reassertion of more traditional and jingoistic values. The terrorist attacks against the United States in 2001 only strengthened fear within many developed countries that unrest in many parts of the world would inevitably reach them. As such, states have once again started to build bigger walls.

While scholars of international relations have, to a large extent, ignored domestic structure as a dependent variable, comparativists, particularly those concerned with democratization, consider domestic political institutions and processes a core puzzle to explain (e.g. Dahl, 1998; Haggard & Kaufman, 1995; Huntington, 1991; Moore, 1966). To account for the structure of domestic political institutions, Gourevitch (1978: 881–882) insists that 'the international system may itself become an explanatory variable. Instead of being a cause of international politics, domestic structure may be a consequence of it'. For many comparativists, the question of foreign influence on domestic affairs centers on two primary issues (Stallings, 1992). First, do international conditions have a greater impact on the institutional structure of a state than domestic factors? Second, if international

<sup>5</sup> Gilpin (1981) acknowledges that states are rational, purposive actors and that the actions states take can alter the international system. Still, Gilpin ignores more fundamental change to the actual types of units/polities making these critical decisions.

<sup>6</sup> Kahler (1995) concludes that the highly institutionalized structure of the IMF prevented this organization from effectively addressing changes in capital mobility. The GATT, in contrast, appears more successful to Kahler, owing to looser rules enabling the organization to adjust to a swiftly moving international environment.

conditions do play an important role in domestic development, do they have positive or negative effects? (See Stallings, 1992.)

Both Dependency Theory and Wallerstein's World System Theory posit a relationship between the structure of the international economic system and state development (Wallerstein, 1974; Evans, 1979). Neither considers foreign influence positively supporting political or economic progress. Third World states tend to be sabotaged from developing by multinational companies, international financial institutions, and foreign governments, as well as domestic groups that align themselves with these foreign usurpers (Stallings, 1992). Not only are valuable natural resources extracted from these impoverished countries with little benefit going to local populations, but economic diversification is itself frustrated by these international relationships, and authoritarian governments are kept in power to preserve these beneficial links between center and periphery. Both theoretical traditions focus on the structure of the international economic system as the driving causal factor in preventing the development of low-income countries. As Nicholson writes (1998: 129) in describing dependency theory, 'the capitalist nature of the international economic system is fundamentally to blame for continued poverty'.

Whereas the international economic system is the catalyst of political development (or lack thereof), Wallerstein (1974) and Rasler & Thompson (1985) insist that the security environment plays a crucial role in state capacity as well. Drawing on long-cycle theory (see, for example, Modelski, 1987), Rasler & Thompson (1985: 493–494) note the importance of global war in affecting societal change. A foreign threat provides the justification for expanding the scope of government involvement in society, and institutional inertia typically makes demobilization later on difficult and, thus, unlikely. War frequently upsets extant domestic coalitions as

well, creating an environment for dramatic political realignment. 'Wars, especially major wars', Rasler & Thompson (1985: 494) write, 'induce direct domestic changes in the short run and also serve as catalysts and facilitators for direct and indirect domestic changes in the long run'. Indeed, Great Britain successfully met the challenges of World War II, and especially the German blockade, largely by increasing the organizational and administrative capacities of the British state (see Olson, 1963).

### War-Making and State-Building

While current political development may be influenced by security concerns and systemic structure, one may reasonably ask how the territorial state emerged originally. Did war make the state? Or, did earlier political developments enable states to win wars? Tilly (1975) and Hintze (1975) noted that the organization of the state revolved in part around the distribution of military capabilities in the international system. Hintze (1975: 199) wrote:

Absolutism and militarism go together on the Continent just as do self-government and militia in England. The main explanation for the difference in the way political and military organization developed between England and the Continent – one which became more and more distinct after the middle of the seventeenth century – lies in the difference in the foreign situation.

Along similar lines, Hadenius (2001) maintains that developments in warfare after the 16th and 17th centuries directly led to the garrison state in central Europe. Downing (1992) agrees and specifically emphasizes the technological development of gunpowder artillery and the improved fighting efficiency of the infantry as key factors enabling states to outperform alternative political rivals. Further, geographic vulnerability separated states such as France, Prussia, and Russia

from more protected neighbors across the Channel and over the Alps. In response to such threats of predation, France and Prussia, in particular, established political institutions capable of extracting sizable resources from society (also see Mearsheimer, 2001). Liberal institutions may therefore be considered a consequence of systemic stability and security rather than a cause of them.

Spruyt (1994a), however, views the war-making successes of the territorial state as a function of organizational capacities developed earlier. The emergence of towns and increasing trade not only undermined the late medieval feudal order, but also led to the nascent state. Indeed, political entrepreneurs capitalized on the economic transformation taking place. Traders required rules to regulate commercial relations, and leaders sought new revenue streams to strengthen budding political institutions (Spruyt, 1994b: 529). Consequently, these new political elites effectively organized commercial transactions by standardizing weights and measures, eliminating competing currencies, and codifying legal procedures and rules. These institutional developments enabled the territorial state to fight off challengers, such as city-states and city-leagues (Spruyt, 1994b). War, then, according to Spruyt, did not give rise to the state. In fact, successful war-making was a consequence of organizational capacities developed earlier to facilitate and regulate commercial transactions and trade.<sup>7</sup>

Spruyt (1994b) does acknowledge the critical role played by security in state formation and state perpetuation. However, growth in state capacity seemingly flows in only one direction. Political elites seized the opportunity to capture the returns from economic

expansion by protecting property rights and regulating commerce (Spruyt, 1994a). It remains unclear whether Spruyt expects political leaders to limit the regulatory role played by government during economic contractions. Yet, this is an important question, since recent scholarship suggests territorial states may limit their governing reach as external conditions become less threatening. Following the collapse of the Soviet Empire in the early 1990s, for example, Desch (1996) suggested that the end of the Cold War could fundamentally alter the state as we know it. Not only might the more stable and secure international environment lead to less expansive states, but also other political actors will most likely be empowered to help address new and difficult transnational issues. As security fades into the background as the core concern of nation-states, economic, resource, and environmental issues may come to dominate agendas (also see Nye, 2002). In such an issue-environment, businesses, nongovernmental organizations, and international institutions possess obvious advantages. Where states are failing, these decentralized institutions utilize developments in transportation and communication to provide needed services to local communities (see Mathews, 1997).<sup>8</sup>

Desch (1996) maintains that a similar situation emerged in 19th-century Europe. The post-Napoleonic peace led naturally and inevitably to state debility. The civil unrest that marked this period of time in many European countries is illustrative of the impact the systemic security environment has on domestic political and economic conditions. Similarly, the rise in civil conflict around the world after the collapse of the Soviet empire can also arguably be traced to

<sup>7</sup> Tilly (1990) wonders whether the organizational capacity of territorial political units in Europe derived from the expansion of trade or from earlier security demands. Spruyt (1994a) assumes that the decline in eastern-originating invasions into Europe was not a result of security-enhancing moves by local political units.

<sup>8</sup> Another consequence of a more stable and peaceful international or regional environment may be the development and diffusion of democratic political institutions. When war is on one's doorstep, political and economic freedoms are unlikely to flourish (see Gleditsch & Ward [2000], for example, on how zones of peace and democracy are spatially correlated).

changes in the international environment. Further, both in the United States and Great Britain, government expenditures as a percentage of the gross national product have typically increased substantially during wartime and also, it appears, during periods of heightened threat, such as the mid- to late 1930s and the early 1980s. Thus, according to Desch (1996: 245), 'the relative need to raise taxes for defense determined the scope of government intervention in the economy'. Periods of international peace and stability often result in the decentralization and deterioration of the state as defense, and controls necessary for effective defense, no longer are paramount concerns. Unfortunately, reductions in state capacity sometimes lead dissatisfied domestic groups to challenge regime authority. Both international peace and civil unrest often ensue.

Of course, both Desch (1996) and Mathews (1997) acknowledge that the state may persist even in the face of the global changes that Barber (1996) and Nye (2002) note.<sup>9</sup> That is, new threats may emerge resulting in a reassertion of state autonomy and authority. The violent strikes against the United States in 2001, for example, seemingly have had a dramatic impact on perceptions about the security of nation-states today from outside attacks. Many governments today seek new authority to intervene in the affairs of citizens to prevent such violent assaults against civilian and military targets in the future. Similarly, the inequalities resulting from rapid integration into the international economic system have led some political elites to propose increased regulation of markets in the hope of offering

additional protection to the hardest hit by trade and financial liberalization (Velasco, 2002).

The post-9/11 world, it appears, may not be one of decentralization and decline, as many have predicted, but one in which state security, authority, and autonomy remain dominant. To be able to continue in its primary role of suppression of internal rivals and the defeat of external enemies, the state will be forced to evolve by creating new bureaucracies, such as the US Department of Homeland Security, and strengthening existing measures, such as through the Patriot Act in the USA.

While 9/11 clearly has led to some state reassertion, it remains to be seen what the long-term trend in state capacity will be. Will states be permanently strengthened to respond better to unconventional threats, or will the forces of globalization continue to tear down borders and reduce the importance of the state? Perhaps the relationship between threat and capacity is more fluid and nuanced than this. Indeed, states may anticipate changes in the international environment and invest in capacity to prepare for possible future challenges. Desch (1996) and Mathews (1997) seemingly envision such a continuous relationship between external security and state capacity. States respond rationally and persistently to the systemic environment.<sup>10</sup> Presumably war, especially great-power war, upsets and alters domestic political institutions and processes. But whether state capacity responds efficiently to systemic uncertainties rather than domestic demands or warfare remains unclear.

<sup>9</sup> Barber (1996) insists that capitalist processes naturally destroy borders, as companies seek to sell their products abroad and open up new markets for economic expansion. Arbitrarily drawn boundaries and the rules and regulations that flow from them only impede the transfer of goods and services.

<sup>10</sup> Rasler & Thompson (1985), on the other hand, note the transformational impact of war on the structure of states. They find an abrupt and permanent increase in state expenditures as a result of war and, thus, do not consider the possible impact of threat.

## A Perilous World

In a dangerous environment, autonomous actors seek security. Thus, sovereign territorial state-building emerged from a search for sanctuary (Levi, 1988; Bean, 1973). As land became scarce, Carneiro (1970) argues, villages began contesting control of local resources and, as the incidence of predation increased, so too did the administrative and extracting capacity of political units. This early security dilemma enabled leaders to construct political institutions to combat both external and internal enemies (Rasler & Thompson, 1985: 493). Unfortunately (or perhaps fortunately), threats to security rarely disappear entirely, thus justifying a perpetual garrison state. Even if threats do diminish, political elites can manufacture foreign enemies to stimulate a demand for protection.<sup>11</sup>

While fears of predation may have demanded larger and larger states, more modern governments confront an additional responsibility that early political elites did not necessarily have to face. Modern states must provide both security and social welfare, and these dual concerns frequently result in erratic policy. Political elites today often press for state retrenchment even in the face of external dangers. Since the high cost of national security may weaken a state's economic potential, a more efficient central government better serves the demands for increased wealth and welfare. Thus, when the price of security places welfare in jeopardy, political elites may reduce the extracting capacity of the state to facilitate gains in economic efficiency and aggregate welfare.

The desire for security naturally leads to increases in state capacity (Downing, 1992). The puzzle, then, is not simply whether systemic threat contributes to state growth, but also whether increases in state capacity slow or reverse during periods of peace and stability.

<sup>11</sup> Political elites also hesitate to surrender authority, as the privileges of power are typically appealing.

The demand for economic efficiency and wealth creation would seemingly present political elites with a sufficient incentive to enervate the state. However, bureaucratic inertia may complicate capacity reduction, resulting in a much weaker relationship. Two important conjectures can be drawn from the preceding discussion. First, can a relationship be empirically found between threat and state capacity? Second, is capacity relinquished similarly to how it is enhanced? That is, does external threat lead to ever-larger states? Or, once seized, can state capacity be let go?

*H1:* Systemic threat (defined as positive changes in interstate or intrastate conflict, increases in defense expenditures, or movements toward autocratic regimes in border states) leads states to invest in capacity (defined in terms of increases in government revenue, increases in overall government spending, or increases in military spending). Generally, increases in threats to the state lead to increases in state capacity.

*H2:* A decline in external threat does not lead to a decline in the capacity of states.

## Methods and Empirical Analysis

### Methods

To test our hypotheses regarding changes in state capacity as a response to threat environment, we create a dataset of all states from 1975 to 1995, organized with the state as the central unit of analysis.<sup>12</sup> Since our data are structured as a panel and our dependent variable is continuous, we use a random-effects regression model with robust standard errors grouped on the country. The main statistical model is designed to test the response of states to changes in external threat environments. Therefore, both the independent and dependent variables in this

<sup>12</sup> *EUGene V 3.04* (Bennett & Stam, 2000) was used to create the basic structure of the dataset.

model are differenced. The empirical tests center around two types of potential government responses to threats from the international environment. The first set of tests focuses on revenue collection. Increased revenue collection on the part of the state indicates not only a growth in state power, but also a tacit form of approval on the part of its citizens who pay the taxes. The contemporaneous effect is tested, as well as leads of one and two years, to capture the sustained effects (if any) of changes in external threats on the growth of the state. In other words, if there is an increase in state revenue collection that leads changes in external threat by one year, we want to know if there will also be a significant decrease in state spending in the following year.

The second set of tests is focused on state spending as a result of external threats. There are two types of spending that are of interest. The first is changes in general government spending, and the second is changes in government spending on the military. Leads of the dependent variables are also included to capture potential long-term effects on government spending. The differenced terms in the models are of the form:

- (a)  $Y_{it} - Y_{it-1} = X_{it} - X_{it-1}$
- (b)  $Y_{it+1} - Y_{it} = X_{it} - X_{it-1}$
- (c)  $Y_{it+2} - Y_{it+1} = X_{it} - X_{it-1}$ .

#### *Dependent Variables: Changes in State Capacity*

The primary dependent variable of interest is change in state strength, or state capacity. State strength presents a difficult concept to define concisely. In fact, it is the subject of much debate among scholars concerned with state development and regime transition. Skocpol (1985) maintains that state strength relies on both autonomy from civil society and capacity to implement policies. Migdal (1988) considers capacity to reflect the ability of states to implement policies and mobilize publics. Badie & Birnbaum (1983: 35) insist that "The progress of state building

can be measured by the degree of development of certain instrumentalities whose purpose is to make the action of the state effective: bureaucracy, courts, and the military, for example.'

We propose that observing changes in government revenue collection and overall government spending, as well as spending on the military, can proxy for growth or decline in state capabilities. Leaders wishing to expand the reaches of their state must expand their states' ability to collect revenues in order to increase the size and complexity of their states' bureaucracy. When the impetus for this growth is a change in external threat, it is likely that some of the increased revenue will be used to bolster the military.

Government revenue and government spending are operationalized using variables from Banks's Cross National Time-Series Data Archive (Banks, 2002). Banks provides these variables in per capita form and scaled by .01. We maintain this scaling to make the coefficients easier to present, although we transform them back into their original level to present substantive effects. Military expenditures are operationalized using data from the COW national capabilities index (CINC) (Singer, Bremer & Stuckey, 1972). We also scale military expenditures by .01 to make it more comparable to revenue and spending data. To capture changes, as well as to control for any natural growth in these series, we difference each of the dependent variables:

- (a) change in per capita government revenue
- (b) change in per capita government spending
- (c) change in military expenditures.

#### *Independent Variables: Threats to State Sovereignty*

Our primary interest is in how threats from the international system shape the development of the state. In order to determine the threat faced by any state, we look at the activity taking place in a state's contiguous

neighbors during each year observed.<sup>13</sup> States may feel threatened by both increases in military activity in neighboring states and ideological divides, and we will operationalize variables to capture both types of threats.

The state can face many types of threats to its existence, but armed conflict in neighboring states poses one of the most immediate threats. If the primary function of the state is to provide for the security of its citizens, then when war looms on state borders, leaders are compelled to act. This includes increases in interstate as well as internal wars that occur in bordering states.<sup>14</sup>

To capture the level of military threat a state perceives from its neighbors, our independent variables should indicate the amount of militarized conflict in surrounding states but be distinguishable from direct state involvement in war. Others have looked at the impact of direct involvement in a war on state strength (Rasler & Thompson, 1985; Tilly, 1975; Peacock & Wiseman, 1961). For example, Rasler & Thompson (1985) look at the effect of participation in global wars on the growth of the state in Great Britain, the United States, France, and Japan. Our question is closely related, but our focus is on factors outside the state that influence its growth. Our interest is more in the everyday threats that states must deal with in their quest for security. These effects on the state are more subtle but, nonetheless, still real.

To operationalize military threat, we use data on armed conflicts from Gleditsch et al. (2002). The operational definition of an armed conflict in this dataset is 'a contested incompatibility that concerns government and/or territory where the use of armed force between two parties, of which at least one is

the government of a state, results in at least 25 battle-related deaths' (Strand, Wilhelmsen & Gleditsch, 2002: 2). Four types of conflicts with three levels of intensity are operationalized. The types of conflict are *Extra-state* (involving conflict over territory that is a colony of the government), *Interstate*, *Internal*, and *Internationalized Internal* (similar to internal only involving external support from other governments). The levels of intensity are *Minor* – involving more than 25 battle-related deaths per year for every year in the period; *Intermediate* – involving more than 25 battle-related deaths and a total conflict history of more than 1,000 battle-related deaths; *War* – more than 1,000 battle-related deaths per year for every year in the period.

The occurrence of any of these events, at any level, by a contiguous state should be a cause for increased security concern. However, states may view internal (civil) wars in neighboring states differently than they view interstate war participation by neighbors. Therefore, we create two main conflict variables to measure the level of external threat. These variables are counts for conflicts in contiguous states during the year. Since we are interested in how states respond to changes in the threat environment in surrounding states, we difference these variables:<sup>15</sup>

- (a) *change in total interstate conflicts*
- (b) *change in total intrastate conflicts.*

Two additional measures of threat environment that do not explicitly include militarized action in surrounding states are increases in military spending and changes in the political ideology of neighboring states. First, the largest change in the amount of

<sup>13</sup> We define contiguity as contiguous by land or less than 25 miles of water.

<sup>14</sup> See Levy (1982) and Hill & Rothchild (1987) on the idea that the outbreak of war tends to be contagious. See Li & Thompson (1975) regarding the 'Coup Contagion'.

<sup>15</sup> We also ran several other models (not reported here) with different combinations of threat variables, including distinguishing wars from minor conflicts. The results were largely the same whether we only looked at wars or included all conflict. The results presented in this article use the more general operationalization of all levels of conflict (level one, two, or three) with separate variables for interstate or intrastate conflicts.

annual military expenditures in surrounding states was computed.<sup>16</sup> If even one neighboring state is increasing military expenditures by large amounts, a state is likely to feel insecure and compelled to respond. As noted above, this variable is operationalized using military expenditures from the COW national capabilities index (Singer, Bremer & Stuckey, 1972) scaled by .01. Second, states that are surrounded by autocratic countries with more unpredictable and potentially more aggressive foreign policies may feel a greater threat to their security. If the environment becomes more autocratic than in previous years, states may view such a change as threatening to security and react accordingly. We operationalize polity using the polity2 time-series variable from the Polity IV data (Marshall & Jaggers, 2002).

- (a) *Change in military expenditures in region*
- (b) *Change in level of democracy in region.*

### *Control Variables*

**Wealth** Since changes in the level of development could have an independent effect on decisions regarding revenue collection, government spending, and military expenditures, we include a variable to control for this effect. Changes in wealth are operationalized as the first difference of *GDPPC* in constant 1995 USD. These data come from Banks's Cross National Time-Series Data Archive (Banks, 2002).

**Polity** Different types of political systems may have different ideas about taxing and government spending as well as government spending on the military. We control for changes in regime type by including the first

difference of a state's polity2 score from the Polity IV data (Marshall & Jaggers, 2002).

**Major Power** We also control for whether the state is a major power (but not changes in major-power status, since that occurs so infrequently). Major powers may respond differently to threat environments, so we control for this effect in our statistical model. The major power variable is attained from *EUGene V 3.04* (Bennett & Stam, 2000) and is operationalized according to definitions provided in Singer & Small (1982).

### **Empirical Results**

Table I summarizes the effect of changes in the international environment on changes in government revenue. As anticipated, government revenue responds positively to threats in the international system measured as interstate conflict involvement by contiguous neighbors. The effect is seen in the one-year lead variable, which is expected, since it may take states time to respond to an increased threat. However, the effect is only partially sustained. In the two-year lead, there is a negative change in government spending that is substantively smaller and statistically significant. The results support the proposition that states will respond to an increased threat from the international environment by increasing the size of the state, and they will only partially relinquish this growth in the coming years.<sup>17</sup> Substantively, the effect is quite large. For example, holding other variables constant at their means, the predicted change in annual levels of per capita revenue collection in US dollars for a

<sup>16</sup> We also operationalized a variable for the average amount that any one neighboring state spends. This variable produced similar results as the average spending variable, but we report only the models using the maximum spending variable.

<sup>17</sup> To check the robustness of this finding, we also ran the model with Uppsala wars in contiguous states as the independent variable and found the same pattern of response. The one-year lead is positive, significant, and substantively larger than the finding using all conflicts. The two-year lead is also significant and negative, yet substantively smaller than the increase in the one-year lead.

Table I. Changes in Government Revenue and Changes in Neighborhood Threats, 1975–95

	$\Delta$ Gov. revenue (per cap.)	$\Delta$ Gov. revenue (per cap.) +1	$\Delta$ Gov. revenue (per cap.) +2
$\Delta$ Interstate conflict involvement by contiguous states	-1,359.300 (0.89)	8,222.648 (2.48)**	-6,452.534 (1.80)*
$\Delta$ Intrastate conflicts in contiguous states	-1,054.089 (0.82)	1,575.583 (0.81)	1,414.796 (0.65)
$\Delta$ Average polity in contiguous states	-504.555 (1.36)	-855.012 (0.75)	664.413 (1.15)
$\Delta$ Max. defense expenditure in contiguous states	0.003 (0.80)	-0.005 (0.59)	-0.002 (0.16)
$\Delta$ Polity	100.936 (1.12)	-29.687 (0.31)	-88.591 (0.98)
$\Delta$ Wealth (GDPPC)	14.982 (3.83)***	19.662 (3.27)***	24.829 (2.40)**
Major power	20,960.726 (2.03)**	14,598.071 (1.65)*	15,277.290 (1.90)*
Constant	6,227.301 (3.62)***	6,611.687 (3.02)***	6,382.124 (2.29)**
Observations	1,665	1,580	1,491
Wald $\chi^2$ (7)	23.63***	23.63***	15.54**

Robust z statistics in parentheses.

\*significant at 10%; \*\*significant at 5%; \*\*\*significant at 1% (two-tailed significance tests).

non-major power that does not experience a change in polity and that experiences no changes in threat environment in the form of increased interstate conflict is approximately \$83. If this same state were to experience a one-unit positive change in the number of interstate wars in contiguous states, predicted revenues increase nearly 100% to approximately \$165 per capita.

Table I also shows that states do not respond to changes in the other environmental variables in the model. Intrastate wars, changes in average polity levels, and changes in military expenditures, for the most part, do not produce significant changes in government revenue collection. Also, as one might expect, there are no significant changes in government revenue during the contemporaneous year of a change in the threat environment. In general, this likely indicates that political leaders fail to anticipate rising threats along borders, but these same leaders do

appear to respond rather quickly once the threat emerges.

The control variables, while not of direct interest, perform mostly as expected. Increases in wealth generate greater revenue. Major powers seem to collect higher revenues, on average, than other types of states. Finally, short-term swings toward greater democracy do not lead immediately to increases in government revenue. Democracies are likely to collect greater revenue on average than autocratic states, but the effect is probably a threshold one and thus not seen with short-term increases or decreases in the polity level (see Levi, 1988).

Table II, which summarizes the effect of changes in the international environment on government spending, reveals that interstate conflicts have a similar effect on spending as on revenues. Not only do states collect more revenue as interstate conflict involvement by neighboring states increases, but also

Table II. Changes in Government Spending and Changes in Neighborhood Threats, 1975–95

	$\Delta$ Gov. spending (per cap.)	$\Delta$ Gov. spending (per cap.)+1	$\Delta$ Gov. spending (per cap.)+2
$\Delta$ Interstate conflict involve- ment by contiguous states	-1,568.051 (0.79)	10,621.231 (3.85)***	-1,504.105 (0.67)
$\Delta$ Intrastate conflicts in contiguous states	-861.491 (0.67)	-1,522.372 (0.76)	-299.528 (0.17)
$\Delta$ Average polity in contiguous states	-704.051* (1.68)	-296.904 (0.44)	200.084 (0.29)
$\Delta$ Max. defense expenditure in contiguous states	0.006 (1.14)	-0.000 (0.04)	-0.014 (1.64)
$\Delta$ Polity	-48.730 (0.63)	-105.462 (1.20)	-42.390 (0.46)
$\Delta$ Wealth (GDPPC)	11.056 (2.38)**	16.525 (3.96)***	14.492 (2.83)***
Major power	27,580.702 (2.90)***	25,707.120 (2.50)**	23,313.752 (2.15)**
Constant	6,928.858 (8.25)***	7,172.396 (7.39)***	6,462.048 (5.44)***
Observations	1,667	1,579	1,488
Wald $\chi^2$ (7)	19.68**	40.50***	17.5**

Robust z statistics in parentheses.

\*significant at 10%; \*\*significant at 5%; \*\*\*significant at 1% (two-tailed significance tests).

government spending increases significantly as well. As with revenue collection, the effect on spending is sustained, but, in the spending model, the effect is sustained at greater levels.<sup>18</sup> The change in spending is substantively larger than the change in revenue, and there is no subsequent significant reduction in spending during the following year.<sup>19</sup> Also, as in the revenue model, changes in spending are most responsive to changes in interstate conflicts. Civil wars and the presence of a large increase in military spending by a neighbor do not result in significantly increased spending by a state. Substantively, taking the same base state as above (not a major power),

with no change in polity, and increasing neighborhood conflicts by one unit, predicted levels of spending increase from approximately \$86 per capita to approximately \$193 per capita.

Also in the spending model presented in Table II, states do respond significantly to changes in the political regimes of surrounding states. The average polity level of contiguous states is negatively related to government spending, meaning that if the region were to become more autocratic, states would respond with increased levels of spending. This supports the idea that democratic states are viewed as less threatening than autocratic states. Indeed, the unpredictable nature of decisionmaking in many non-democratic countries, coupled with few checks on executive authority, lead states (democratic ones in particular) to be wary of non-democratic neighbors. The immediate reaction in spending to regime change in neighboring countries also indicates that

<sup>18</sup> For robustness, we also ran this model with Uppsala wars instead of the more general conflict variable. The signs and significance of all variables remain unchanged, although, as expected, the substantive effects for wars are generally larger.

<sup>19</sup> We also ran this model with leads of three, four, and five years. There were no significant decreases in government spending in any of the additional leads, although there was another significant increase at the five-year lead.

political leaders are better able to anticipate political change rather than military aggression. The control variables function in a similarly expected fashion as they do in the revenue model. These results are tempered by the relatively small substantive effect that they produce. For example, our standard non-major-power state that did not experience a change in its own polity would increase its spending by about \$7 per capita for every unit decrease in the average level of polity in the surrounding neighborhood. While this effect is small compared with the effect of increased levels of interstate conflict in the neighborhood, it could have quite large substantive effects in a state's spending levels if there were to be a major shift in the polity in the neighborhood. For example, a decrease in the average level of polity in contiguous states of 6.5, which represents the 75th percentile in the data, would produce a greater than 50% increase in expected levels of spending from \$80 to \$125 per capita.

Table III summarizes the effect of changes in the international environment on changes in military expenditures. The pattern with regard to military spending is somewhat different than that seen in the government revenue and spending models. First, military spending responds immediately and positively to increases in interstate wars in the region rather than in the year following the increase. In the following year there is a decrease in spending, but it is insignificant, indicating that as in the spending and revenue models, the increases are sustained.<sup>20</sup> The immediacy of defense-related spending increases indicates that political (and or military) leaders may be more prescient than suggested above. Since aggregate spending does not react immediately to threat, leaders may reallocate funds from domestic welfare

to defense. The increase in revenue and general government spending the next year may then suggest attempts to recalibrate the public budget. Substantively, as one might expect, the change in military expenditures in response to interstate conflict in contiguous states is the largest of all the indicators of changes in state capacity. The magnitude of this change, however, is probably beyond what most would expect. The average non-major power with no shift in its own polity levels would experience an average annual increase in defense spending of about \$57,000 during the period observed. However, a one-unit increase in interstate conflicts in the neighborhood produces an immediate change in the annual increase in military spending to approximately \$1,233,000. This represents an increase of over 2000%.<sup>21</sup>

The second difference observed in the response of military spending to threat levels is that an increase in military spending by another state in the neighborhood produces a significant increase in military expenditures in the following year.<sup>22</sup> This could be evidence of arms races, with an increase in military expenditures by a neighboring state producing an increase in the individual state the next year. However, there is no increase in state revenue or general government spending following an increase in military spending by a neighboring state. Thus, if there is an arms race occurring, it appears to be funded by an internal reallocation of funds toward the military, not by an overall increase in the amount of revenues and spending. Moreover, while the significant positive coefficient indicates increases in response to changes in neighborhood defense spending, the size of the coefficient reveals that these changes are substantively very small.

<sup>20</sup> As with the other models, we ran additional leads out to five years and found no significant decreases in spending on national defense to offset the initial increase.

<sup>21</sup> Even if we were to take a more conservative approach and look at changes in defense spending for major powers, which already have high levels of increases in annual defense spending during this period, the increase would still be relatively large at 150%.

<sup>22</sup> This increase is also sustained in additional leads out to five years.

Table III. Changes in Spending on National Defense and Changes in Neighborhood Threats, 1975–95

	$\Delta$ Military expenditures	$\Delta$ Military expenditures +1	$\Delta$ Military expenditures +2
$\Delta$ Interstate conflict involvement by contiguous states	11,754.574 (2.05)**	-5,635.242 (1.32)	-3,425.615 (0.91)
$\Delta$ Intrastate conflicts in contiguous states	3,318.006 (0.79)	-1,671.085 (0.61)	-2,719.256 (0.63)
$\Delta$ Average polity in contiguous states	-1,418.769 (1.17)	-114.904 (0.53)	-723.015 (0.79)
$\Delta$ Max. defense expenditure in contiguous states	-0.015 (1.41)	0.015 (1.89) *	0.016 (1.06)
$\Delta$ Polity	-148.877 (1.02)	-81.474 (1.05)	286.564 (1.35)
$\Delta$ Wealth (GDPPC)	2.125 (0.65)	2.797 (1.91)*	0.894 (0.44)
Major power	7,246.582 (0.24)	8,245.258 (0.25)	14,853.007 (0.41)
Constant	669.706 (1.97)**	536.289 (2.03)**	873.191 (2.23)**
Observations	1,802	1,701	1,595
Wald $\chi^2$ (7)	20.52**	9.26	19.06**

Robust z statistics in parentheses.

\*Significant at 10%, \*\*significant at 5%, \*\*\*Significant at 1% (two-tailed significance tests).

## Conclusion

In his farewell address, US President George Washington warned of entangling alliances that would invariably draw the new republic into foreign disputes. Washington did not principally fear foreign military forces, but rather the impact such alliances might have on the nascent constitutional government. That is, military conflict and conquest would necessitate a strong state, ultimately threatening US democratic institutions and processes. Democracy would thrive and civil society would remain vibrant only if the United States secured itself from external threats. Washington's warning seems quite prescient today. In general, governments do grow larger as threats to security increase in the surrounding region. Admittedly, we do not measure political freedom per se, but we do observe state capacity not only increasing with external threat, but also failing to return to pre-threat levels. Once political leaders accrue new powers, they do not give them up

entirely once the regional threat has faded. While we find decreases in government revenue and spending two years after changes in the threat level, neither decrease matches the increase of the year before. Over time, then, the result is an expanded state that has more resources (in terms of revenues), is more involved in the state's economy (in terms of state spending), and provides greater levels of security for its citizens (in terms of increased military expenditures).

Of secondary importance is the null finding that the second image-reversed argument does not extend to intrastate wars. While states respond to interstate war involvement by neighboring countries, this is not true of intrastate wars. There is no evidence of states significantly increasing or decreasing their capacity in response to changes in civil war in neighboring states. One potential reason for these results is that interstate wars show both the ability and proclivity to breach sovereign borders, while intrastate wars indicate neither.

States involved in intrastate wars involving leadership struggles may not possess the organizational consistency to threaten neighboring states in the way those involved in interstate wars do. Also, refugee inflows from states involved in civil wars could result in a temporary economic decline in neighboring states and cause per capita revenue and spending to decline.

Our results also suggest a relationship between the political neighborhood and threat perception. American leaders (today and in the past) have regularly championed the virtues of political democracy. Former US Deputy Secretary of State Strobe Talbott (1996: 63) articulated this view when he wrote, 'Only in an increasingly democratic world will the American people feel themselves truly secure.' Our models demonstrate some support for changes towards autocracy generating insecurity. States increase spending when regions turn more autocratic. This result is significant only in the government spending model, but revenue and military spending show changes in the same direction (although statistically insignificant) as well. While the increased spending does not last, the contemporaneous one-term change shows that political elites are sensitive to regime change in their geographic neighborhood.

While the evidence is supportive of a second image-reversed relationship, our analyses here suggest important paths for future research. For example, this study has not accounted for any domestic demands for increased state capacity. However, might government spending and revenue decisions respond more strongly and quickly to domestic welfare concerns rather than national security? Economic weakness and social instability may lead to increased state strength. The additional authority could be used both to combat political insurrection and to more vigorously regulate the economic system.

Future studies should also model domestic spending specifically. Ruggie (1982), for

one, maintains that market openness correlates with social safety nets. Political elites respond to the adverse consequences of trade by offering constituents welfare protection. Political leaders may respond to rising threats in neighboring states with particular domestic plans and pledges. Further, since our analysis remains limited to the post-1975 environment, nearly every state included provides both security and welfare. It would be useful to compare our findings with a model of state capacity that relies on state decisionmaking from the 19th and early 20th centuries. Such pre-welfare-state observations would enable a more generalizable assessment of how external threat affects the decisionmaking of political leaders.<sup>23</sup>

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<sup>23</sup> Future research might also explore the domestic-political struggles over government action that take place in response to threatening regional conditions. In the United States, for example, Democrats and Republicans may offer different solutions to dangerous external conditions.

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