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THE MAKING OF NATION-STATES IN EUROPE

A PUBLIC ECONOMICS PERSPECTIVE

Size and power of governments: an economic assessment of the organization of the European states during the 17th century

INTRODUCTION

The Thirty Years War begins in 1618 and ends in 1648 with the Peace of Westphalia. It takes place mostly in German speaking territories and it involves *Austria, Sweden, France*, and also *Holland* and *Spain*: these are **nation-states** at the top of their power.

Germany ends up totally destroyed, the overall population in the German speaking territories collapsing from 21 million to 13 million. In some places, population falls dramatically:

Württemberg: from 400,000 to 50,000;

Bohemia: from 3 million to 800,000.

The Peace of Westphalia fragments the German territory into 300 small sovereign states, a feudal organisation in a depleted land. “Germany”, organized into **decentralized club-states**, is at that time surrounded by **increasingly centralised neighbouring states**.

Huge nation-states are growing rapidly, building on **large scale absolutism**.

“Germany” will rebuild itself, using an original form of **competitive government**, largely dictated by historical circumstances.

1. THE DOMINANT MODEL OF NATION-STATES IN EUROPE: LARGE SCALE ABSOLUTISM

1.1. The centralization of power

England, France and Spain experience **large scale absolutism**.

They control huge geographic areas (at the European scale!), which implies **low resource mobility** (capital and labor).

Taxation is thus relatively easy to impose!

Kingdoms are organized as centralized states.

The economic doctrine behind centralization is **mercantilism**.

Mercantilism is not only a doctrine on commerce (maximization of government revenues through the control of imports and exports); it also advocates an economic organization aiming at:

Centralizing public resources,

Maximizing those resources.

Centralization of public resources goes along a trend towards **monopolization of power by the central government**,

Maximization of public resources amounts to **optimizing the discretionary power of government.**

1.2. Modelling a centralized state

The “Constitutional entrepreneur”:

Framework: Hotelling line segment $[0,1]$

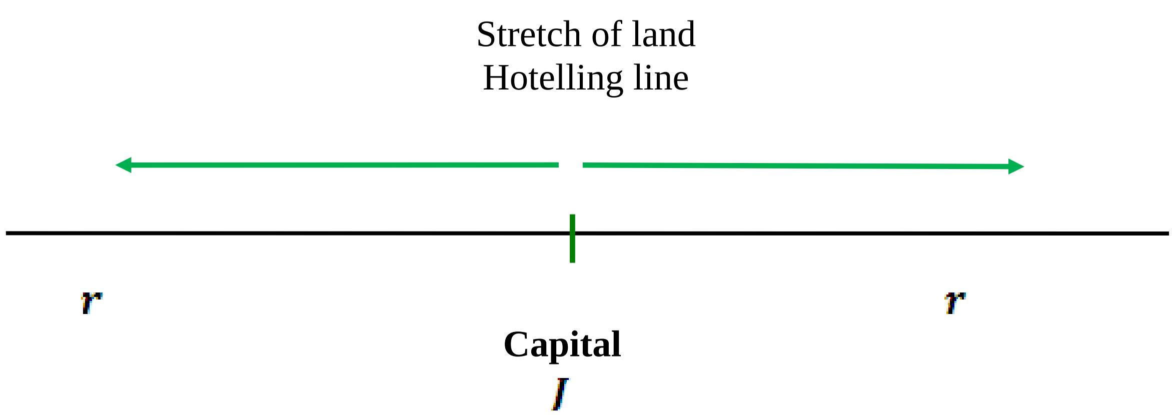
Provision of a national public good

"Government" pool of services and symbols

Symbolic and geographic location: capital J (exogenous)

Territorial extent: radius r (still unknown)

Figure 1: The spatial dimension of the nation-state



From individuals to citizens:

$i \in [0, 1]$

Individuals :

Uniformly distributed along the Hotelling line

Individuals are not mobile

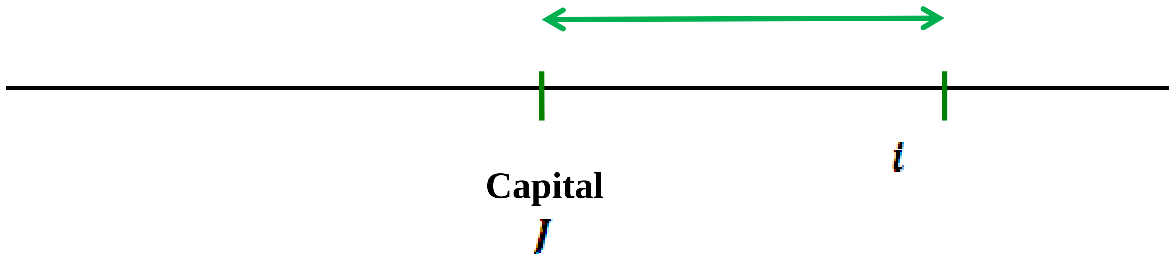
(Hotellinian assumption: no Tiebout competition)

In presence of a constituted state

Distance l_i to capital I : geographical and/or preference-distance

$l_i - I$

Figure 2: The individual and the constitutional entrepreneur



Citizenship: geography or preference?

In this model: Both: territoriality principle personality principle

Citizenship: product of the interaction between the individuals' willingness to consent to the state and the objective of the constitutional entrepreneur.

Defining the size and prerogatives of the nation-state:

Individual willingness to consent to the state: w

It depends on the distance to the capital: l_i

$w = w(l_i)$

Cost of control of the territory:

Territorial extent: radius r

$2 \times r$: Extent of territorial control on either side of the capital

Average cost of control: $c(r)$

Average willingness to consent: $w(r)$

Optimizing the discretionary power of government

Optimal radius

Where citizens j are located at each border of the state

Solution to the program

Discretionary power: total willingness to consent $rw(r)$ minus total cost of control $rc(r)$

First order condition:

$$r_J w'(r_J) + w(r_J) = r_J c'(r_J) + c(r_J)$$

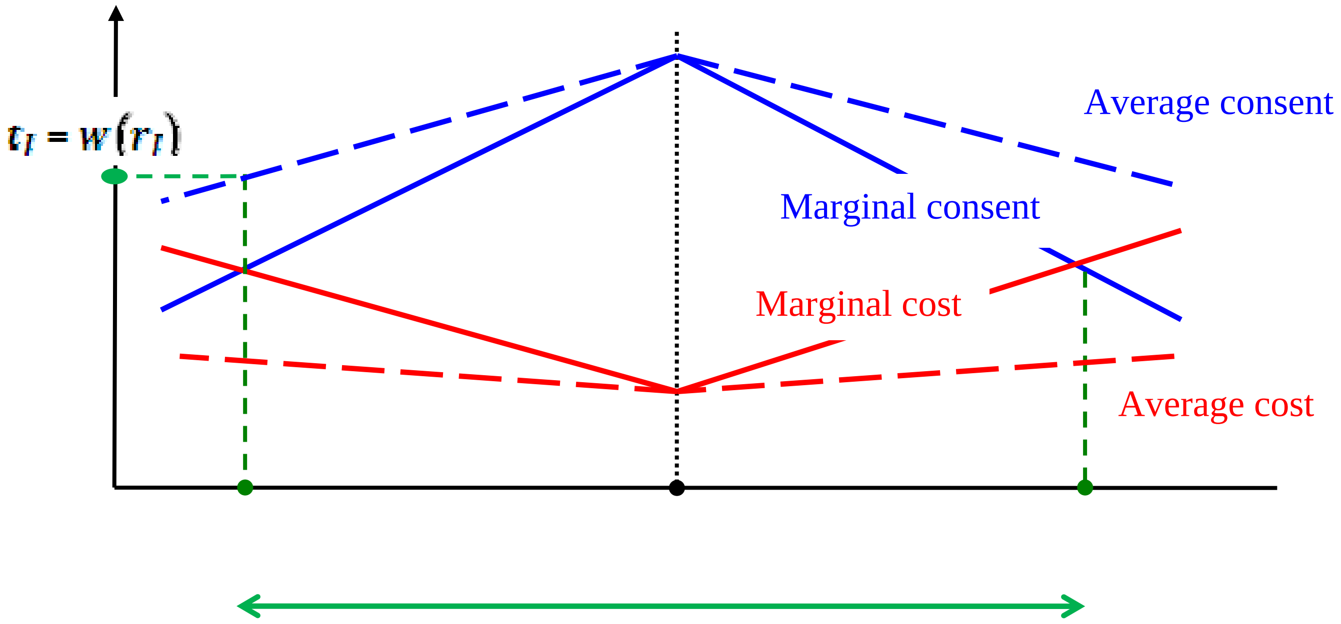
Marginal consent at the border **=** marginal control cost at the border

Simultaneous delineation of power and size:

Size

Power: monopoly pricing $t_J = w(r_J)$

Figure 3: Optimization of size and power


$t_I = w(r_I)$
Average consent
Marginal consent
Marginal cost
Average cost

1.3. The size and power of the nation-states: Leviathan at work

The previous model can be interpreted:

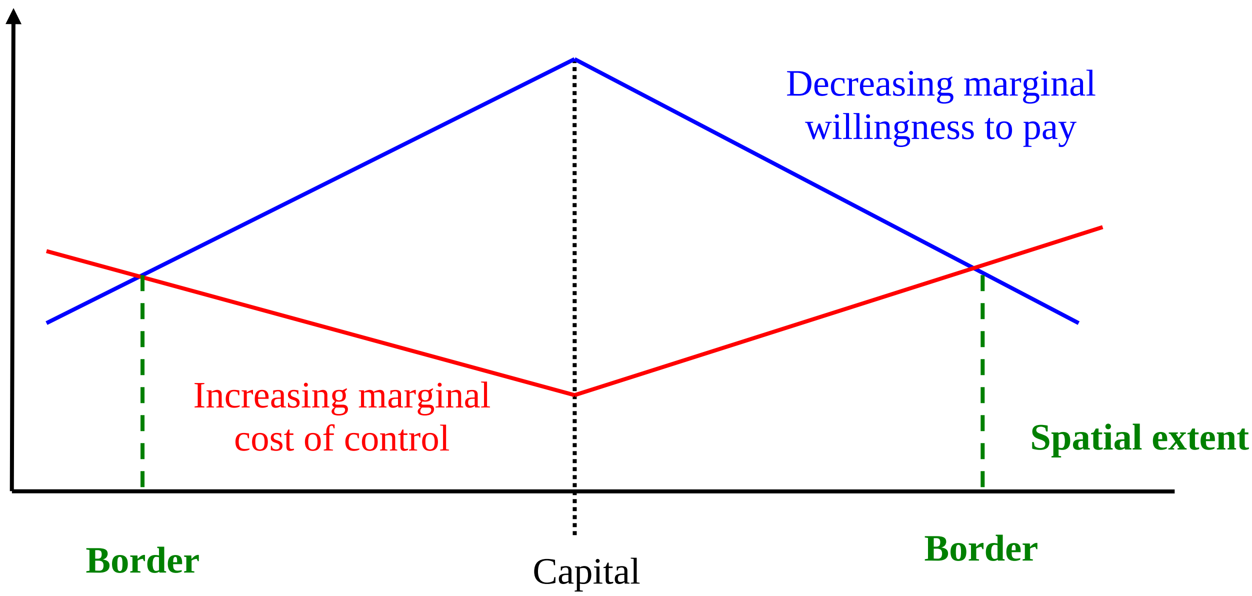
In terms of constitutional power (t_J representing the legal prerogatives of the state)

In terms of taxation power (t_J representing the share of income preempted by the state)

In the latter case, the willingness to consent becomes the standard willingness to pay.

The discretionary income is defined as the difference between public revenues and costs of control of the territory (control costs including the provision of public goods).

Figure 4: Construction of a Leviathan state



The state will spatially expand until the marginal cost of control equals the marginal willingness to accept the state. Individuals at the border are indifferent between belonging and not belonging to the state.

The discretionary income is maximized when the size of the state is such that extending the border would cost more than it would yield revenue.

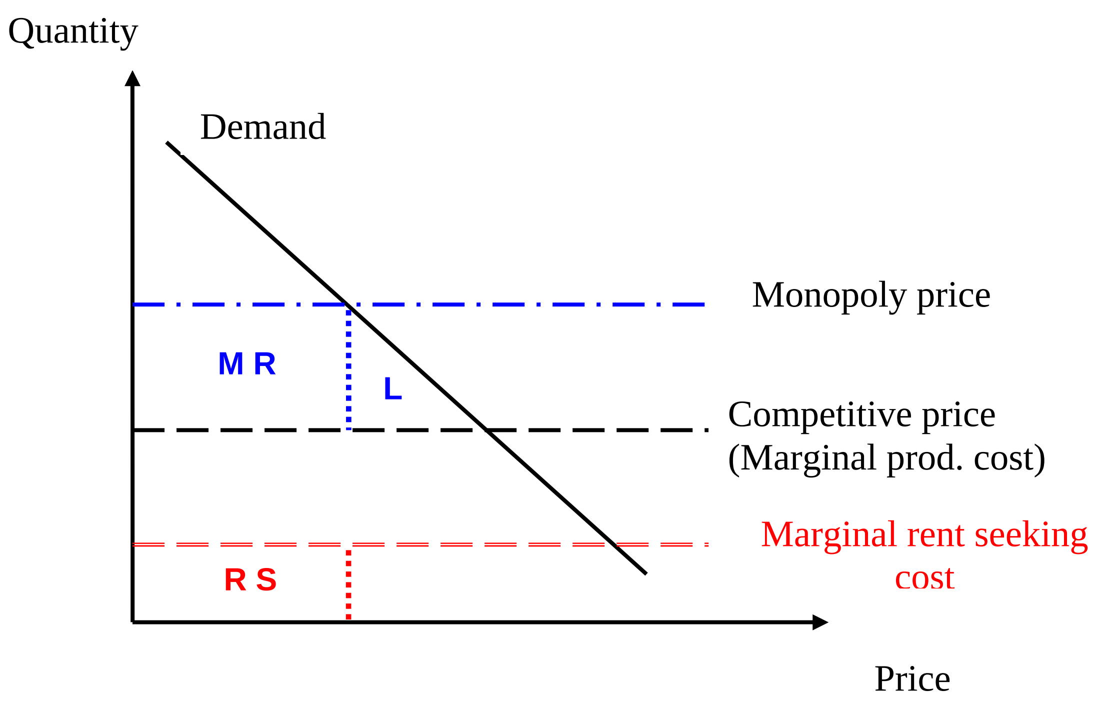
1.4. High taxation and rent-seeking

In the context of large scale absolutism, rent-seeking can thrive (Tullock, 1967)

Rent-seeking can be defined as

> The lobbying on the political market to get a dominant position on an economic market

Figure 5: The rent-seeking mechanism



Traditional monopoly: monopoly rent **MR** is a pure redistribution of income from consumers to the producer.

Efficiency losses are limited to triangle **L**.

Rent-seeking monopoly: there is an additional efficiency loss **RS**, which is a combination of

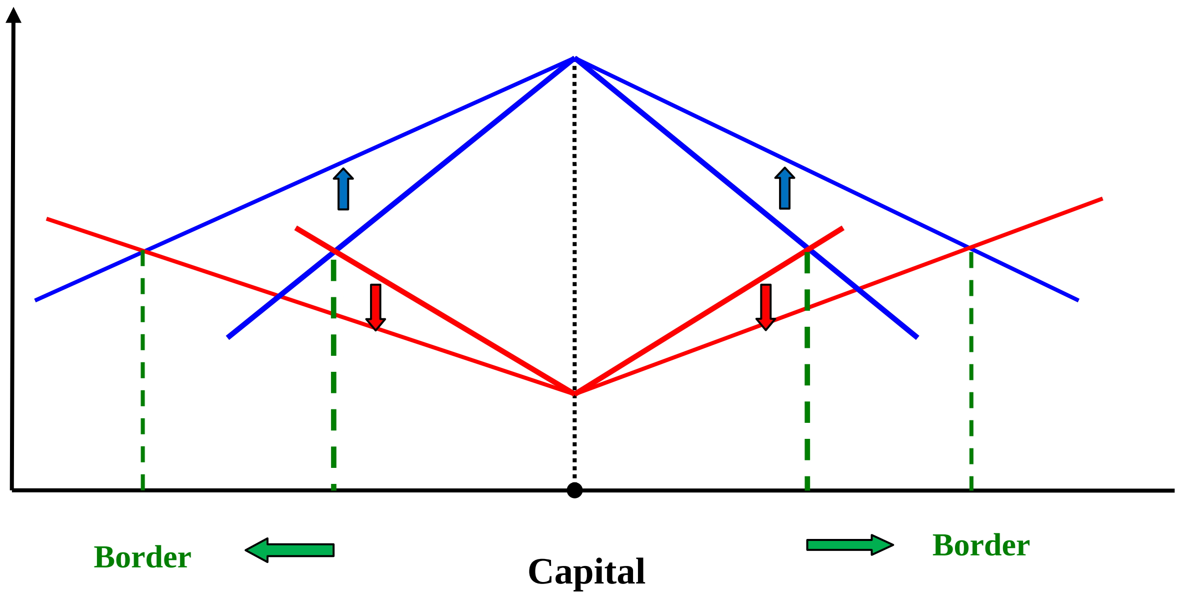
- Lobbying efforts by the rent-seekers
- Efforts by government officials to obtain or to react to those lobbying efforts
- Side effects on third parties (mimicking of rent-seeking behavior, disincentives for non rent-seeker)

Rent seeking can go through procurements, public firms, regulations, quotas, and tariffs, etc...

Complex administrative structures, significantly large budgets, discretionary power of bureaucracy, all paves the way for rent-seeking, particularly in centralized states.

1.5. Expansionism

Figure 6: Extending a Leviathan state



Increasing the willingness to adhere to the state:

Common language
Stable rule of law

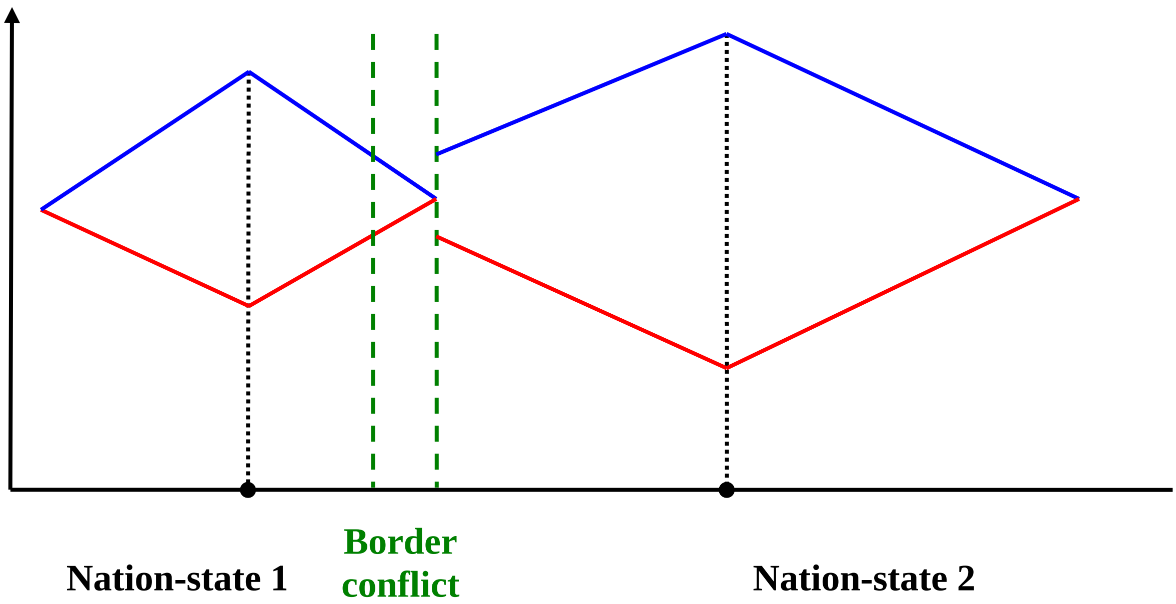
Decreasing the cost of control:

Infrastructures and transport
Security technologies

Border conflicts occur when two neighboring nation-states have overlapping spatial extents.

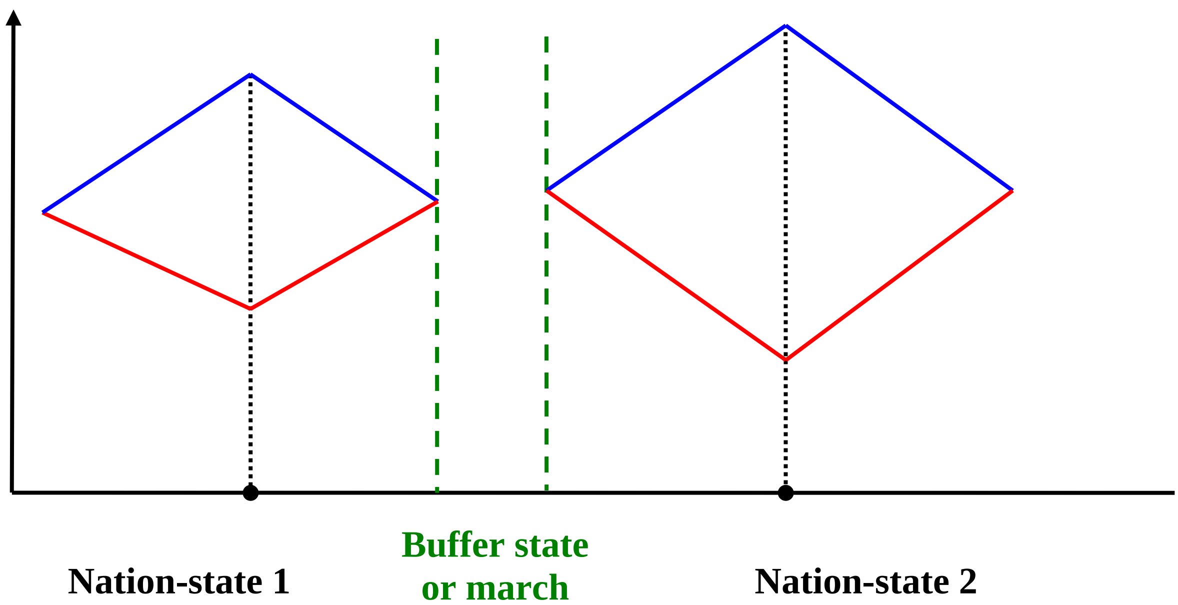
Spatial competition with explicit conflict:

Figure 7: Border conflict involving two Leviathan states



Spatial competition with latent conflict:

Figure 8: Buffer state or march between two Leviathan states



Conflict will arise if new technologies of consent and control allow it.

2. THE ALTERNATIVE MODEL OF CLUB-STATES IN THE GERMAN SPEAKING TERRITORIES

2.1. A de facto decentralized power

A feudal organization of 300 small sovereign states

Those states are very small, with a very simple administration, which gives little room to rent-seeking (there are not many rents to seek and not many bureaus to lobby).

The extent and use of power by the states' governments depends upon their ability to control production factors.

We are at the end at the Thirty Years war:

In a depleted Germany, **capital** is evenly underdeveloped

Private capitals have no significant strategic power: their strength is not significant enough to convey a threat of mobility for instance, nor do they have enough financial weight to enter a lobbying or rent-seeking process.

Furthermore, industrial assets mostly belong to the heads of states.

Remark: the situation is quite different from that in France or England, for instance. There, heavy industries are progressively emerging under the monopolistic control of the central power.

Land mostly belongs to the states' rulers, in a quasi feudal organization.

Labor is a scarce and highly mobile resource

Peasants and craftsmen are free to choose where they live; they cannot be compelled to live in a given state. One aspect of feudalism is thus ruled out.

There is thus little power of taxation on labor.

2.2. Governments of club-states as political entrepreneurs

Objective of rulers:

To maximize the population size of their club-state

Labor is indeed scarce and is required for agricultural and industrial production

In order to attract labor, club-state governments must

Maximize the well-being of their subjects

Mobility of workers implies the equivalence of the two maximization programs

In this case, maximizing the well-being of the subjects does not require benevolence or utility interdependence, the aim is rather to attract immigrants (labor).

Public revenue will finance public goods that participate in the attraction of individuals:

Public revenue are financed from

Excise taxes: indirect taxes on goods (large tax base, difficult tax avoidance) (ancestor of VAT),

Taxation of the ruler's properties (agriculture, mines, manufactures), which amounts to a kind of self taxation.

Governments are organized like clubs

2.3. A quick glance at club theory

Characteristics of the population

Total population on a territory: $i = 1, \dots, I$ individuals

Assumption: identical individuals: $u_i = u \qquad \forall i = 1, \dots, I$

Exogenous income y expressed in terms of the numéraire

Utility functions

$u(x, g)$

Private good x (numéraire, unit of account)

Partially rival public good g provided by the club(s)

Definition of a club:

$$n \, \imath \, I$$

Group of individuals sharing an excludable and partially rival public good on a voluntary basis (Buchanan 1965)

Cost of provision is denoted $c(g, n)$

Cost thus has two dimensions:

The quantity g of public good

n I

The club size

<u>Figure 9: Cost per user of the provision of a club good</u>

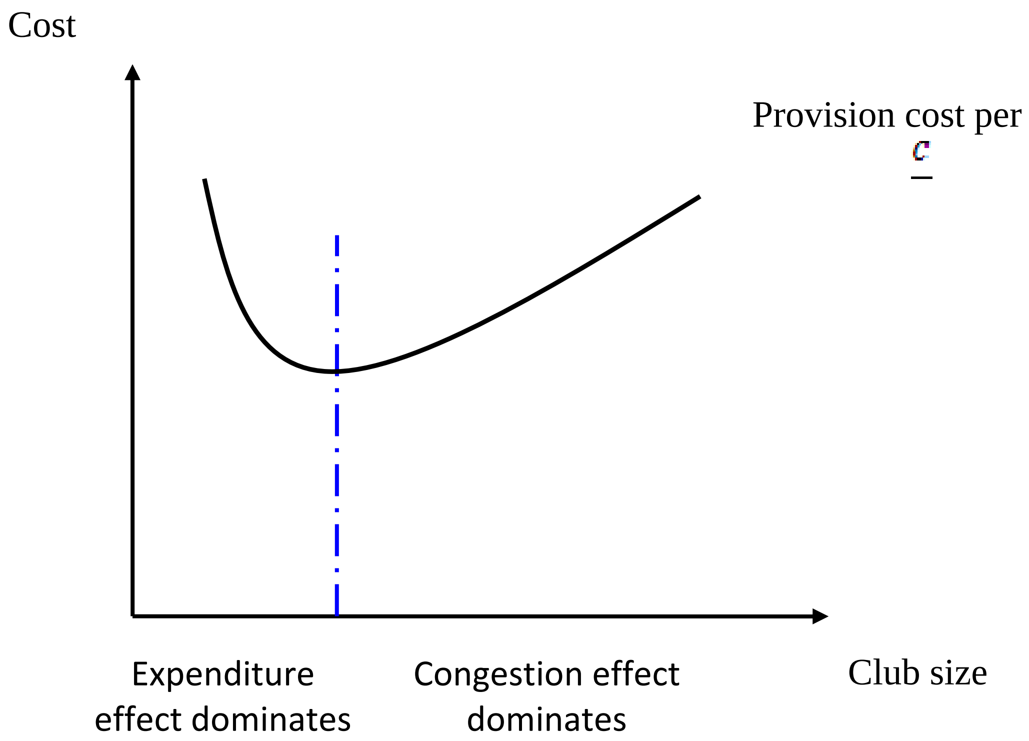


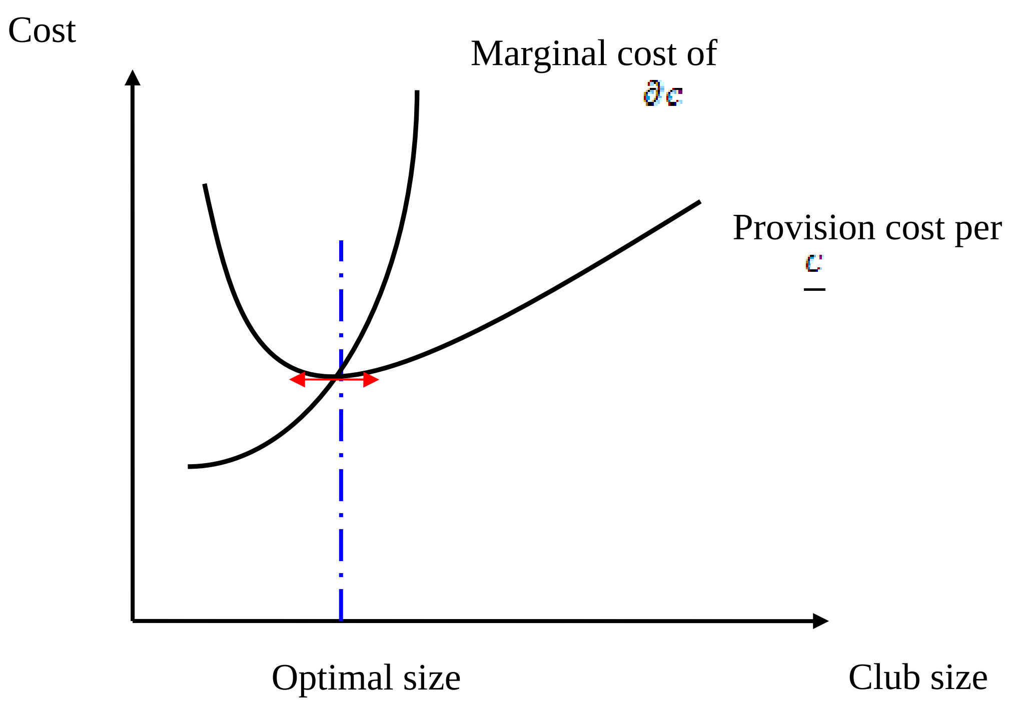
Figure 9 evidences two opposite effects as the number of members increases (for a given quality of the service provided by the club good):

Expenditure effect: cost per user decreases (cost is shared among more individuals)

Congestion effect: cost per user increases (to maintain quality with more members, hence with more rivalry)

Optimal size of a club:

Figure 10: Optimal size of a club



If a territory is organized through club-states in the context of potential mobility of club members, citizenship becomes an elusive concept.

Attachment may be more with the territory (e.g. common language and culture) than with one particular club-state.

The territory is organized in a Tiebout way.

2.4. A Tiebout organization of governments

Allocation of individuals among clubs

Buchanan (1965):

If clubs can be replicated at no cost

Then each individual:

Either belongs to a club
Or does not feel the need to belong to a club

A club member has no incentive to move to another club (existing or to be created)

Co-operative game interpretation:

No individual has an incentive to form a new club (coalition) with other individuals: this new coalition could not provide a greater level of utility.

In the absence of any such coalitions, the co-operative solution is a core solution (provided that the latter exists) and it can be shown that it is Pareto-efficient.

In the core of the game, total population is partitioned into stable coalitions.

In our context, coalitions are the club-states

Remark: The same reasoning can be applied to alliances envisaged as coalitions of countries

It can also characterize a **Tiebout (1956) organization of the territory**:

There is an assumption of perfect individual mobility.

If the supply of jurisdictions is sufficient, then people can locate in their most preferred local community or club-state (with respect to the offer of local public goods and local taxes).

Individuals thus reveal their preferences for (local) public goods through mobility and location choices.

It helps avoid the standard problem of revelation of preferences for public goods.

The ensuing allocation of resources can be shown to be Pareto-efficient, through the endogenous formation of jurisdictions.

CONCLUSION

Is there a historical sequence?

Anarchy club-states nation-states ˈ conflict anarchy

No definite answer can be given by economics

Public economics however points out the importance of an efficient provision of public goods

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