From Rivals to Partners: The Alignment of Capital and State Coercion in the Rise of Modern Economic Growth

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Abstract

The conventional wisdom on the source of economic growth emphasizes inclusive institutions and technical change: constraints on state elites, which allow open access to political and economic power, guarantee secure property rights and investment returns more broadly. Yet, in many contexts where economic growth has emerged, we see the partnership of private enterprise and powerful, coercive (often nondemocratic) states with the ability to expropriate: from Industrial Revolution Britain, to the post-WWII Asian economic tigers, to post-Mao China. Focusing on the emergence of modern growth in Britain, we propose a model of a partnership between coercive states and private actors: merchants cooperate with the state, for example by lending money, which helps the state develop coercive capacity, making the state internally and externally stronger. Merchants benefit from expanded trade, which is then taxed. We explore conditions under which good state behavior (non-expropriation of merchants, i.e., “good institutions”) is an equilibrium outcome, rather than a cause of increased economic activity, and the good outcome is driven by aligned incentives, not political inclusion. The source of aligned incentives is the joint surplus made possible when, in a mercantilist world, the state projects violence outward, to create opportunities for private profit. Using secondary evidence as well as original archival research, we illustrate the key conditions for that good equilibrium and show they were met in mercantilist England: a strong commercial orientation in economic activity and in foreign conflict, cooperation by commercial elites who lend to the government, a strong government involvement in conflict, and substantial fiscal returns from war-induced commerce.