

The Robustness of the Capitalistic Peace Theory Across Regions

Honors Thesis

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Part I: Introduction

The democratic peace theory states that democracies rarely, or even never, go to war with other democracies. Jake Levy in his 1988 study entitled “Domestic Politics and War” even wrote, “This absence of war between democracies comes as close as anything we have to an empirical law in international relations” (Levy, 1988, 661). Can anything else but democracy account for liberal peace? One answer might be the capitalistic peace theory which states that developed economies rarely, or even never, go to war or engage in low-level disputes with each other.

Recent analyses by Erik Gartzke, Quan Li, Dominic Rohner and Charles Boehmer have questioned the robustness of the democratic peace theory. Introducing the concept of “capitalistic peace” one of these studies highlight the importance of correctly defining the economic interdependence variable in the post World War II era in the Kantian peace triangle (Gartzke, 2007). Instead of measuring economic interdependence with bilateral trade, which is commonly used in the democratic peace theory literature, Gartzke emphasis that capitalism is more than just trade (Gartzke, 2007). Gartzke argues that economic interdependence is based on free capital markets and financial openness (Gartzke, 2007). Gartzke finds that capitalism is a powerful force and maybe more powerful then democracy as a force as an explanation for the liberal peace (Gartzke, 2007).

Gartzke makes the assumption that the capitalistic peace theory is equally applicable across regions and culture, which allowed him to pool data for dyads globally. In this study I empirically examine the robustness of the capitalistic peace theory introduced by Gartzke in his 2007 study entitled “The Capitalistic Peace” by questioning this assumption. The main question

that this paper seeks to explain is whether the capitalist peace theory holds across different region.

Part II discusses the literature regarding the capitalistic peace theory. Part III discusses the four primary theories regarding the capitalistic peace theory. Part IV discusses my hypotheses that are going to be tested. Part V explains the data used in this study. Part VI discusses the methodology used to conduct my statistical tests. Part VII reports the findings and discussions the results of my statistical test. Part VIII discusses some limitations that I came across and in part IX I conclude with some final remarks.

Part II: Literature Review

At the most fundamental level the democratic peace theory and the capitalistic peace theory were first hypothesized by Immanuel Kant in his 1795 essay entitled “Perpetual Peace.” In his essay, Kant suggests that there are three factors that cause a “liberal peace.” The first cause is that “the civil constitution of every state shall be republican” as Kant explains that the checks and balances that are inherent in a constitutional republic can prevent them from engaging in war with each other (Kant, 1795). The reasoning behind this as Kant explains is that consent of the citizens is required to engage in war and citizens will be very cautious about going to war because they will be the ones who will be paying for the war and they will be the ones fighting in the war (Kant, 1795). The second cause is “a federation of free states” as Kant explains “states should renounce their savage and lawless freedom, adapt themselves to public coercive laws, and thus form an international state, which would necessarily continue to grow until it embraced all the peoples of the earth” (Kant, 1795, 105). The third cause, which is the basis for the capitalistic peace theory, is the “commercial spirit”. Kant explains “Nature also unites nations which the concept of cosmopolitan right would not have protected from violence and war, and does so by

means of their mutual self interest. For the spirit of commerce sooner or later takes hold of every people, and it cannot exist side by side with war” (Kant, 1795, 114). Modern scholars have translated these three factors into democracy, international organization membership/alliance membership and economic interdependence, which is known as the Kantian peace triangle (Cederman and Rao, 2001).

Other explanation have been proposed since Kant but the modern literature surround the capitalistic peace theory started in 1909 when Norman Angell first published his book “Europe’s Optical Illusion” which was republished in 1910 and renamed “The Great Illusion” which was later revised in 1933. In the last version of his book, Angell argues that integration of the economies in Europe had grown to such a degree that an economic war between nations would be futile and nations cannot enrich itself through conquest of its neighbors. Angell outlined two processes that decrease the incentive for integrated economies to go to war. The first process is that changes in the nature of production make it difficult to cheaply subdue and to profitably manage modern economies through force (Angell, 1933). The second process is that that the integration of world markets not only facilitates commerce but also creates new interests to prevent war because financial interdependence ensures that damage inflicted on one economy travels through the global system (Angell, 1933).

Unfortunately, Angell and Kant were proven wrong as two world wars and the great depression created a concern as to how can capitalism ensures peace between countries. As the Cold War went on, the literature surrounding the capitalistic peace theory was dormant until 1992 when Stuart Bremer published his study entitled “Dangerous Dyads: Conditions Affecting the Likelihood on Interstate War, 1816-1965.” In his study, Bremer finds that capitalism to be a powerful force in discouraging war between developed economies, “In the economic sphere,

these results suggest that the likelihood of war starting between "have" states is considerably lower than between "have" and "have not" or between "have not" states (Bremer, 1992, 336-337).

Since the publication of Bremer's study, Erik Gartzke, Dominic Rohner, Quan Li and Chalres Boehmer have written numerous studies explaining that not only is capitalism the reason why developed economies do not go to war with each other but that capitalism is more powerful force than democracy in preventing war. These studies argue that nations with a high level of capital openness are able to avoid conflict with each other and maintain a lasting peace. In particular, nations with freer capital markets are more dependent on international investors, because the investors are likely to withdraw if the country is engaged in a war or inter-state conflict. As a result, leaders of states give greater credibility to threats made by countries with higher levels of capital openness, causing the aforementioned countries to be more peaceful than others by avoiding the possibility of misrepresentation of information (Gartzke and Rohner, 2011; Gartzke and Li, 2003; Gartzke, Li and Boehmer, 2001; Gartzke, 2007). This study empirically examines the robustness of the capitalistic peace theory by seeing if there are any important regional differences.

Part III: Theory

It should be explained that within the capitalistic peace theory there are four primary theories that each try to explain the capitalistic peace theory. The first theory is trade interdependence, which states that trade, and free markets are tied with development and peace, which Weede proposed in his book called "Economic Development, Social Order, and World Politics" (Weede, 1996). The second theory is the size of the government introduced by Patrick McDonald. His theory states that substantial quantities of public property generate fiscal

autonomy for governments, strengthen their hold on the domestic reigns of power, and create opportunities to pursue more aggressive foreign policies. Statistical tests show that greater quantities of publicly held assets increase the likelihood that a state will participate in military conflict. Given that the predominance of privately held property is one of the defining institutions of capitalism, McDonald's results support the claim that capitalism promotes peace. (McDonald, 2007; McDonald, 2010). The third theory is the economic norm theory, which is based on clientelism and was introduced by Michael Mosseau. Mosseau argues that bounded rationality and divergent hierarchies between clients and the states is the reason why developed economies do not go to war with each other (Mosseau, 2003). The fourth theory is the free capital market and capital openness theory, which was explained above in the literature review and is the basis for the rest of this study.

Part IV: Hypotheses

The purpose of this paper is to examine to see how robust the capitalistic peace theory is across five different regions (West, Latin America, Africa, Asia and Middle East). In order to test this, I will perform multiple regressions and compare the results.

My hypotheses are therefore:

H1: The Capitalistic Peace is a universal phenomenon

Accepted by a finding a negative and significant relationship between joint dyads and Militarized Interstate Disputes (MID) for every region and it is rejected by finding a positive and significant relationship in any or all of the regions.

H2: The Capitalistic Peace is only a western phenomenon

Accepted by a finding that a. the Capitalistic Peace holds in the West and b. it does not hold in any region outside the West. I will reject H2 if I fail to find all of these relationships.

Part V: Data

The source of my data will be from the study by Gartzke entitled “The Capitalistic Peace” (he was nice enough to e-mail me his data). The Gartzke study used the list of dyad states published by the Correlates of War (COW) project with the unit of analyses being the dyadic year. The Gartzke study analyzes the time period between 1950-1992. The dependent variables used by the Gartzke study is Militarized Interstate Disputes (MID), defined by the Correlates of War (COW) project, “as a set of interactions between or among states involving threats to use military force, displays of military force, or actual uses of military force.” Militarized Interstate Disputes is coded “1” if the dyad in question experienced a Militarized Instate Dispute (MID) in a given year and coded “0” otherwise (Gartzke, 2007, 174).

The independent variables of interest are financial openness (FinopenLO), economic interdependence (TradeLO), democracy (DemocracyLO), economic development (GDPPCLO), contiguity (Contiguity), distance (Distance), major power status (MajorPower), allies (Allies) and capability ratio (PowerRatio).

The primary independent variables are financial openness (Fin Open LO) and economic interdependence (Trade LO). The International Monetary Fund (IMF) data is the basis for the financial openness variable. The IMF provides several indicators of market size, robustness and liberalization. The IMF publication Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) lists a series of variables measuring economic openness. Gartzke used an index evaluated in previous studies that takes the difference between eight and the sum of eight types of government restrictions on foreign exchange, current and capital accounts (Gartzke, 174, 2007). The trade interdependence variable is measured as exports plus imports divided by GDP (Gartzke,174, 2007). The Gartzke study used the data set on gross domestic

product (GDP) and trade compiled by Kristian S. Gleditsch who published a data set on gross domestic product (GDP) and trade in the *Journal of Conflict Resolution* in 2001.

The third independent variable is democracy (Democracy LO) “which gauges the extent of joint democracy for the dyad by focusing on the regime score of the least democratic state in the dyad” (Russert and Oneal, 2001). The Gartzke study used the polity data set, which is coded in values from -10 (highest autocracy) to +10 (highest democracy). The fourth independent variable is economic development (GDP PP LO), which is measured as gross domestic product (GDP) per capita (Gartzke, 175, 2007). Gartzke got the data for economic development from the Gleditsch data set on gross domestic product (GDP) and trade. The fifth independent variable is geographic continuity (Non Contiguity), which measures if the dyads in question share a border or are separated by less than 150 miles of water. This variable is coded 0 (border) or 1 (separated by more than 150 miles of water) (Gartzke, 176, 2007). The Gartzke study used the Correlates of War (COW) project direct contiguity index to measure this variable. The sixth independent variable is distance (Distance), which is meant for all dyads and is measured by the natural log of the distance in miles between capital cities (Gartzke, 176, 2007). The seventh independent variable is major power status (Major Power) which is coded either 1 if the dyad contains a major power and 0 if the dyad contains no major power (Gartzke, 2007, 176). According to the Gartzke study, “major powers” are China, France, United States, United Kingdom and USSR. The eighth independent variable is alliance membership, which correspond to whether the countries in the dyad are allies (Allies), which is coded “1” (allies) and “0” (non-allies) (Gartzke, 2007, 176). The Gartzke study uses the Correlates of War (COW) project alliance membership index to measure this variable. The ninth and last independent variable is the capability ratio (Power Ratio), which is a statistical measure of national power. This variable is composed of a

country's share of the international system's total population, urban population, energy consumption, iron and steel production, military manpower and military expenditures. Capability ratio is measured as the log of the ratio of the larger to the smaller value for a given dyad (Gartzke, 2007, 176). The Gartzke study uses the Correlates of War (COW) project composite capabilities index to measure this variable.

I also created five intra-regional dummy variables, which is coded "1" if the dyad in question includes two countries in the specific region and a "0" if the dyad in question does not include countries in the same region. The variables are West (North America and Europe), Africa (Africa), Asia (Asia), LatinAm (Latin America) and MidEast (Middle East).

Part VI: Methodology

In order to see if there are regional differences with regards to the capitalistic peace theory, five different regressions are performed for each of the five regions (West, Africa, Latin America, Asia and Middle East). In each of the five regressions I will restrict the data set to only the dyads in the same regions written as an "if" statement in stata. (if West==1, if Africa==1, if LatinAm==1, if Asia==1 and if MidEast==1).

It is also important to note here that unlike the Gratzke study which ran a logit regression because the dependent variable Militarized Interstate Disputes (MID) is dichotomous (coded either "1" or "0"), I will run a rare event logit or relogit test. Created by Gary King and Lanhcge Zeng, a rare event logit or relogit tests takes into account the fact that some dependent variables like war are observed infrequently (more "0's" than "1's" in the data) when estimating the coefficients (King and Zeng, 2001).

Part VII: Findings and Discussion

Figure 1 is the recreation of Gartzke original model. All the key independent variables (Fin

Open LO and Trade LO) are negative (an increase in financial openness and trade decreases the likelihood of a MID) and statistically significant at the .05 alpha level, with p-values of .032 and .000, respectively. These results are the same as Gartzke's original model, which shows the robustness of the capitalistic peace theory.

In figures 2,3,4,5 and 6, I rerun Gartzke original model but restrict the model to only the interstate dyads to test if regions matter in testing the capitalistic peace theory. Figure 2 is the test for the Western (North America and Europe) dyads. This test reveals that all the key independent variables (Fin Open LO and Trade LO) are negative (an increase in financial openness and trade decreases the likelihood of a MID) and statistically significant. These results show that the capitalistic peace theory holds in the West. Figure 3 is the test for Asian dyads. This test reveals that financial openness is negative (an increase in financial openness decrease the likelihood of a MID) and statistically significant as well. The other key independent variable (Trade LO) is negative but is not significant at the .05 alpha level with a p-value of .106. These results show that the capitalistic peace theory holds in Asian in terms of the Gartzke's argument of financial openness but not in terms of Weede's argument of interdependence. Figure 4 is the test for African dyads. This test reveals that all the key independent variables (Fin Open LO and Trade LO) are negative (an increase in financial openness and trade decreases the likelihood of a MID) and significant at the .05 alpha level with p-values of .021 and .000 respectively. These results show that the capitalistic peace theory holds in Africa. Figure 5 is the test for Latin American dyads. This test reveals that all the key independent variables (Fin Open LO and Trade LO) are negative (an increase in financial openness and trade decreases the likelihood of a MID) and significant at the .05 alpha level with p-values of .032 and .000 respectively. These results show that the capitalistic peace theory holds in Latin America as well. Lastly, Figure 6 tests the Middle

Eastern dyads. This test reveals that all the key independent variables (Fin Open LO and Trade LO) are negative (an increase in financial openness and trade decreases the likelihood of a MID) and significant at the .05 alpha level with p-values of .010 and .000 respectively. These results show that the capitalistic peace theory holds in the Middle East.

These 5 tests reveal some important ideas behind the robustness of the capitalistic peace theory. First I can reject H2 (The capitalistic peace theory is only a western phenomenon) because even though I found a negative and significant relationship in the West, I did not find that the capitalistic peace theory does not hold in any region outside the West. Second I can accept H1 (The capitalistic peace theory is a universal phenomenon) because I found a negative and significant relationship between financial openness and Militarized Interstate Disputes (MID) in every region. The fact that I can accept H1 is important because it shows that capitalistic peace theory is a universal phenomenon. These facts show that no matter if you are a dyad in Africa, Asia, Latin America, the West and the Middle East capitalism will reduce the chances of conflict.

Part VIII: Limitations

Even though the results support my hypotheses; additional research is needed to provide more accuracy to my findings. One limitation is that my study only tested dyads between 1950-1992, so there is still almost two decades of recent data that can be used to enlarge the sample size. Future studies should incorporate data since 1992 which and retest to see if my results still hold. Post 1992 data could provide additional insights because it will incorporate a world after the end of the Cold War.

Another limitation is the militarized interstate disputes (MID) variable, which is defined “as a set of interactions between or among states involving threats to use military force, displays

of military force, or actual uses of military force.” This definition does not really tap into the concept of war. I believe that this variable overestimates the number of wars that has actually occurred because it counts the threat and the display of force instead of just counting the use of force or a conflict that resulted in casualties. Future studies should try to find a better variable that taps into the concept of war.

A third limitation is the fact that I pooled data for all dyads globally to create my 5 regions. Bruce Russett and John Oneal who published “Triangulating Peace: Democracy, Interdependence and International Organization” in 2001 who are the pioneers of the democratic peace theory warn that many things are missing from their model, especially the consideration of perception and different patterns of behavior for particular subgroup of state and by geographical regions (Russett and Oneal, 2001).

Part IX: Conclusion

The literature regarding the capitalistic peace theory is large and has expanded enormously since the publication of “The Great Illusion” in 1933. This study was a way to examine and understand another dimension of the capitalistic peace theory to see if there is a regional dimension to this theory. Even though as stated earlier future studies is needed to fix and extend my results, this study is very promising. This study offers evidence suggesting that the capitalistic peace theory holds generally around the regions of the world and is not limited to any specific region.

These results have implications especially revolving around American foreign policy. Promoting democracy around the world has been a cornerstone of American foreign policy. In his 2004 State of the Union then President Bill Clinton said, “Ultimately, the best strategy to ensure our security and to build a durable peace is to support the advance of democracy

elsewhere. Democracies don't attack each other." In a 2008 press conference regarding the Iraq war then President George Bush said, "And the reason why I'm so strong on democracy is democracies don't go to war with each other. And the reason why is the people of most societies don't like war, and they understand what war means.... I've got great faith in democracies to promote peace. And that's why I'm such a strong believer that the way forward in the Middle East, the broader Middle East, is to promote democracy." Maybe American foreign policy experts should take a step back and reexamine its strategy of promoting democracy around the world. Instead of promoting democracy around the world, American foreign policy experts should instead promote capitalism to countries that are unstable. Once a strong economy is established and the chances of war are reduced, democracy can soon follow.

If both capitalism and democracy fails the United States can just follow Thomas Friedman's advise and adopt the Golden Arches Theory of Conflict Prevention and build a bunch of McDonald's around the world which will reduce the chances of conflict.

Appendix

Figure 1: Recreation of Gartzke Original Model

MID	Robust Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Fin Open LO	-.0729224	.0340114	-2.14	0.032	-.1395835	-.0062614
Trade LO	-2.606402	.47643	-5.47	0.000	-3.540188	-1.672617
Democracy LO	-.0419816	.0102914	-4.08	0.000	-.0621523	-.0218108
GDP PP LO	-27.26214	11.93469	-2.28	0.022	-50.6537	-3.870583
Non Contiguity	-1.271483	.1660028	-7.66	0.000	-1.596843	-.9461238
Distance	-.2879046	.0581047	-4.95	0.000	-.4017878	-.1740214
Major Power	-.1630439	.16074	-1.01	0.310	-.4780885	.1520008
Allies	-.9802459	.1437991	-6.82	0.000	-1.262087	-.698405
Power Ratio	-.2446795	.0417438	-5.86	0.000	-.3264959	-.1628631
_cons	-.0806641	.5393076	-0.15	0.881	-1.137688	.9763593

Figure 2: West

MID	Robust Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Fin Open LO	-3.374504	.8684514	-3.89	0.000	-5.076638	-1.672371
Trade LO	-2.881867	1.26017	-2.29	0.022	-5.351755	-.4119786
Democracy LO	-.0693797	.018889	-3.67	0.000	-.1064016	-.0323578
GDP PP LO	2.012794	24.02547	0.08	0.933	-45.07626	49.10185
Non Contiguity	-.7843005	.2704708	-2.90	0.004	-1.314414	-.2541874
Distance	.0519188	.1446975	0.36	0.720	-.231683	.3355206
Major Power	-.1005734	.325398	-0.31	0.757	-.7383417	.5371949
Allies	.6285995	.278678	2.26	0.024	.0824005	1.174798
PowerRatio	-.281295	.1128669	-2.49	0.013	-.50251	-.06008
_cons	-9.439058	2.5245	-3.74	0.000	-14.38699	-4.491129

Figure 3: Asia

MID	Robust Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Fin Open LO	-.4211245	.1273841	-3.31	0.001	-.6707927	-.1714564
Trade LO	-3.280595	2.028758	-1.62	0.106	-7.256889	.6956982
Democracy LO	.0496316	.0267727	1.85	0.064	-.0028418	.1021051
Depen LO	-131.9447	47.36584	-2.79	0.005	-224.78	-39.10934
Non Contiguity	2.086747	.8363743	2.49	0.013	.4474834	3.726011
Distance	-.797352	.2217289	-3.60	0.000	-1.231933	-.3627713
Major Power	1.059103	.7827475	1.35	0.176	-.4750538	2.59326
Allies	1.117662	.5905316	1.89	0.058	-.0397586	2.275083
Power Ratio	-.237728	.1032904	-2.30	0.021	-.4401735	-.0352825
_cons	8.892738	1.902407	4.67	0.000	5.164088	12.62139

Figure 4: Africa

MID	Robust Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Fin Open LO	-.078343	.0339784	-2.31	0.021	-.1449394	-.0117467
Trade LO	-4.142012	.5926022	-6.99	0.000	-5.303491	-2.980534
Democracy LO	-.044534	.0104831	-4.25	0.000	-.0650804	-.0239875
GDP PP LO	-35.82447	16.3244	-2.19	0.028	-67.81971	-3.829223
Non Contiguity	-1.123947	.1720331	-6.53	0.000	-1.461126	-.7867682
Distance	-.3877666	.0642033	-6.04	0.000	-.5136027	-.2619304
Major Power	-.1227934	.1573785	-0.78	0.435	-.4312497	.1856628
Allies	-.6612927	.1490276	-4.44	0.000	-.9533815	-.3692039
Power Ratio	-.2801453	.044857	-6.25	0.000	-.3680635	-.1922272
_cons	1.130566	.6090468	1.86	0.063	-.0631435	2.324276

Figure 5: Middle East

MID	Robust Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Fin Open LO	-.0792987	.0369998	-2.14	0.032	-.151817	-.0067804
Trade LO	-2.597759	.5422513	-4.79	0.000	-3.660552	-1.534966
Democracy LO	-.0385977	.0105729	-3.65	0.000	-.0593203	-.0178752
GDP PP LO	-30.71063	13.53169	-2.27	0.023	-57.23226	-4.189006
Non Contiguity	-1.250181	.1665672	-7.51	0.000	-1.576647	-.9237153
Distance	-.2565189	.062439	-4.11	0.000	-.3788972	-.1341407
Major Power	-.2817906	.1649092	-1.71	0.087	-.6050068	.0414256
Allies	-.7831089	.1529229	-5.12	0.000	-1.082832	-.4833855
Power Ratio	-.2511508	.0431339	-5.82	0.000	-.3356917	-.16661
_cons	-.3891618	.5750764	-0.68	0.499	-1.516291	.7379672

Figure 6: Latin America

MID	Robust Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Fin Open LO	-.0907378	.0352247	-2.58	0.010	-.159777	-.0216986
Trade LO	-2.529978	.4759906	-5.32	0.000	-3.462903	-1.597054
Democracy LO	-.0385246	.0105484	-3.65	0.000	-.0591991	-.01785
GDP PP LO	-29.73544	12.73722	-2.33	0.020	-54.69993	-4.770943
Non Contiguity	-1.270018	.1660112	-7.65	0.000	-1.595394	-.9446419
Distance	-.287333	.0600839	-4.78	0.000	-.4050953	-.1695708
Major Power	-.2033408	.1641124	-1.24	0.215	-.5249952	.1183136
Allies	-.9862195	.1483032	-6.65	0.000	-1.276889	-.6955505
Power Ratio	-.2402475	.0425415	-5.65	0.000	-.3236273	-.1568676
_cons	-.0105524	.5574577	-0.02	0.985	-1.10315	1.082045

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