[Political Specialization]

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It is a commonplace to claim that the world has become smaller and there are fewer and fewer differences between formerly exotic places and the West. An unprecedented flow of goods and ideas has allowed emulation of faraway countries, resulting in a large increase in conformity across the globe. However, politics seem to be immune to this trend. While the rule of law can be taken for granted in large parts of the world, authoritarianism prevails in far too many places, in spite of its well-known negative consequences.

This paper presents a theory of political specialization to understand how an increasingly interconnected world can nonetheless sustain diametrically opposed systems of government. According to the theory, some countries will uphold the rule of law with commitment to property rights, while others will consciously choose not to do so. This political specialization is borne out of two key insights of the theory: (i) there is a diminishing marginal benefit of good government at the world level, but not at the country level; and (ii) there is a diminishing marginal cost of good government at the country level.

The first key insight is due to the impact of good government on economic activity varying between different types of goods. Some production can occur even in despotic countries where individuals have no protection against expropriation, for example, extraction of natural resources. However, production of goods that require long-term investments in physical capital or research and development relies on investors expecting property rights to be enforced. Hence, at the world level, the marginal benefit of good government is declining because the relative price of rule-of-law intensive goods falls when the supply of such goods increases compared to other goods less sensitive to a country's political system. However, at the country level, access to world markets means that the marginal benefit of good government is constant for a small open economy that does not affect world prices.

The second key insight is that the marginal cost of good government is decreasing at the level of an individual country. What is meant by the marginal cost of good government is the marginal loss of rents received by those who hold power as a consequence of marginally better government. The idea is that while improvements in governance such as the rule of law will increase economic activity, they will also curtail the rents that incumbents are able to extract. This cost is not a resource cost: it is how much those in power stand to lose from better government, which they will set against the marginal benefit when deciding whether to resist it. Those in power in economies where the rule of law is pervasive will receive only little in rents, while those in autocracies will extract a substantial amount. Consequently, better government is 'cheap' at the margin to those in power in countries where the quality of governance is already high because they have only small rents to lose, while better government is 'expensive' at the margin to those in power in autocracies because they have a lot to lose.

Combined, these two insights lead to political specialization. Owing to the diminishing marginal cost of good government combined with the constant marginal benefit at the level of an individual country, countries will either fail to provide any security to investors, or will have full protection of property rights. While this logic pushes individual countries to the extremes, the same reasoning does not apply to the world as a whole. The diminishing marginal benefit of good government at the world level means that the relative price of rule-of-law intensive goods is lower when good government is more widespread around the world. As the price of rule-of-law intensive goods falls in world markets, incumbents' calculations of the gains and losses from the rule of law tip in favour of autocracy, and this implies there will be a distribution of political regimes around the world in equilibrium.

The world equilibrium features a symbiotic relationship between rule-of-law economies and despotic regimes. By producing goods requiring protection of property rights, rule-of-law economies raise the relative price of other goods such as natural resources and thus increase incentives for despotism in other countries. Conversely, despotic regimes generate a positive externality in other countries because cheap oil makes the rule of law more attractive elsewhere in the world.