Consequences of Rent-Seeking and Mercantilism: An Institutional Approach

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Abstract

This study investigates the effects of mercantilism on various aspects of governance, including political institutions, freedom of expression, civil rights, the rule of law, the judiciary, and the media. We document widespread detrimental effects of mercantilist policies. These effects are large in magnitude, statistically significant, and robust to various econometric specifications including panel data models and instrumental variables, even after controlling for factors such as education, inequality, openness, and economic freedom. Meanwhile, we find that the rule of law mitigates mercantilism and virtually nullifies its associated harms. Policy implications involve promoting the rule of law and economic freedom.

1 Introduction

The scarcity of global data on modern mercantilist institutions has hindered the application of formal econometric methods to investigate the institutional origins of trade-related welfare costs. However, the recent data compiled by The Information Technology & Innovation Foundation has been instrumental in this regard. Their comprehensive dataset, which ranks 60 countries based on 18 variables that span from 'market access and forced location to currency manipulation and property rights protection,' has enabled the creation of the Global Mercantilist Index (Wein et al. 2014), providing a robust foundation for this research.

Applying regressions in panel data allowing for country and time-fixed effects, and two-stage least squares (2SLS), this research discloses novel evidence of mercantilism's detrimental impact on political institutions, embodying contemporary societies' foundational pillars. Specifically, mercantilism exerts a detrimental effect on various measures of democracy and several democracies' critical foundations, such as the Rule of law, equality before the law, individual liberty, and electoral accountability. Additionally, mercantilism deteriorates a handful of support variables linked to

the judiciary's quality, including a greater tendency to pack the court, less high and lower court independence, and diminished compliance with the judicial system.

Furthermore, the unveiled evidence indicates that mercantilism diminishes the protection of civil rights for the population. More precisely, freedom of expression, alternative sources of information, academic and cultural expression, and equal protection measures are reduced. Finally, this study reveals a deleterious effect of mercantilism on the independence of the media, mainly, among others, the harassment of journalists, media corruption, and government censorship efforts.

Three relevant implications emerge from our findings. First, the damaging effects of mercantilism unveiled in this study occur mainly in the political sphere. Unsurprisingly, this negative effect on political institutions stems from the rent-seeking dialogue between representatives of the private sector and high-ranking members of the polity. Moreover, the extent to which the political process determines economic institutions, as indicated by Acemoglu and Robinson (2012), and the institutional political deterioration unveiled in this study are likely to further reduce the quality of economic institutions, a vicious circle.

Second, the vicious circle may explain the absence or negligible levels of economic growth and concomitant poverty observed in Latin America and most of Africa [1]. Finally, to the extent that mercantilism and rent-seeking are intertwined, our study contributes to the institutional origins of rent-seeking and how to dampen its incidence by implementing inclusive economic rules of the game and, in particular, establishing the Rule of Law. In addition, mercantilism is an extractive institution, [2] capable of igniting a rent-capturing and distributional impact process.

The empirical literature on government failures and attendant social costs driven by trade barriers originated with Harberger (1954), who found measures of deadweight loss arising from trade barriers. Notwithstanding, the welfare costs stemming from Harberger's triangles and decreasing consumer surplus are empirically small.

Contrariwise, Tullock's (1967) pathbreaking article argues persuasively that valuable resources are wasted establishing monopolies, protectionist tariffs, and engaging in criminal activity to obtain rents. More specifically, Tullock propounds that social costs are substantially higher than those unveiled by Harberger (1954), accounting for the resources spent to capture rent transfers by interest groups from trade barriers. "Rent-seeking thus embodies a social cost in terms of the forgone product of the resources employed on rent-seeking." (Tollison 2012, 74). In addition, the lost product is the opportunity cost of resources misallocated to seek a transfer [3].

Another source of social costs is the likely defensive reaction of those who benefit from existing trade barriers, which are contested by lobbying groups negatively affected by the trade barrier, for example, sugar producers who spend resources protecting existing sugar quotas. Thus, assigning resources to defend a privilege bestowed on some production sectors is aptly named rent protection. Moreover, those who contest trade barriers also waste resources, exacerbated the problem of social costs. In other words, offense engenders a demand for defense, i.e., if a buyer hires a lawyer, the seller does the same (Murphy et al.,1993).

The rest of the paper is structured as follows. Section 2 presents a literature review of rent-seeking, emphasizing institutional issues and trade protection. Section 3 describes the data and empirical methodology, while Section 4 discusses the findings. Finally, Section 5 concludes the investigation.

[1] See, for example, Faria and Montesinos (2024) and (2016); Faria et al. (2016) and Faria (2008).

[2] The term extractive institutions was coined by Acemoglu, Johson, and Robinson (2001) and popularized by Acemoglu and Robinson (2012).

[3] Tullock (1967) posits a more general definition of rent-seeking: resources consumed in the process of competition or conflict. Another intuitive definition of a rent by Tullock (1989) is the benefit derived from privilege

2 Brief Literature Review

Several empirical papers have addressed the critical issue of measuring rent-seeking social costs. Krueger (1974) made an early attempt at estimating trade protectionism, evidencing that 15% of GNP in Turkey and 7% in India was squandered by rent-seeking. Magge et al. (1998) reviewed this empirical literature on the consequences of trade barriers and reported, generally, higher social costs than Krueger. In a theoretical piece, Murphy et al. (1993) adduce that the misallocation of resources incited by rent-seeking explains the difference in countries' growth rates. The culprit for varying worldwide growth rates is differences in the judiciary measured by the quality of property rights protection, suggesting for some countries the existence of extractive institutions.

Laband and Sophocles (1992) looked at the consequences of rent protection by lavishing resources on the purchases of locks, police, military, and insurance. They concluded that the resources wasted amounted to 50% of the US GNP in 1985. Revealingly, Laband and Sophocles (2019) argue that measuring the dissipation of resources in rent-seeking "...remains an under-studied topic. Why is this? In our opinion, the answer is that, for a variety of reasons, measuring rent-seeking turns out to be difficult." (p. 49). Interestingly, Tullock (1997) was also aware of the complexities associated with measuring rent-seeking costs: "...I have been perturbed by the difficulty in finding any actual measurable cost of that rectangle." (Page 149).

Mercantilist institutions are extractive, aided, and abetted by rent-seeking groups in connivance with the government, favoring the consolidation of political power. However, an institutional approach can overcome the elusiveness of estimating the social costs of rent-seeking. Our research plausibly identifies how rent-seeking is costly by quantifying its mediating effects on democracy, the judiciary, civil rights, and the media. Our results indicate that an improvement in the quality of institutions, from mercantilist to market-inclusive, could plausibly abridge social losses.

Congleton (1980, 1984, and 2015) pioneered institutional reforms to reduce rent-seeking from wasteful intra-organizational conflict. Further, Congleton (2015) claims that the innovations altering organizations' institutional design to curtail rent-seeking over time can account for "the architecture and procedures of all formal organizations, including governments, firms, and others." (p. 488). More to the point, applying rigid rules is the most expeditious mechanism to ameliorate counterproductive disputes within an organization (Congleton, 1980). Another salient institutional issue that Congleton (1980 and 1984) addresses is the structure of committees to adopt decisions and their impact on rent-seeking. Interestingly, Congleton demonstrates that more resources are consumed in conflict procuring the approbation of one administrator than when rent seekers face a committee comprising several members. Although the cited articles by Congleton and our study are institutionally driven, the former object of study is organizations. However, our central unit of analysis is countries.

The government's endorsement of mercantilist institutions is generally justified by questionable beneficial state goals, such as power, national security, higher revenues, and independence from other nations' exports, among other lofty nationalist objectives. For example, increasing import tariffs to restrain imports will save on hard currency, potentially increasing jobs and augmenting international reserves [4].

However, this rhetoric misses that the government is extending privileges to some entrepreneurs who could have lobbied for trade protection. Put differently, the government's reasoning obscures the role of rational self-interest and interest group behavior in obtaining a costly benefit concerning

[4]Anderson and Boettke (1997) documented an instructive case, compellingly arguing that the Soviet Union was closer to mercantilist institutions of European economies during the XVI and XVII centuries than a socialist centrally planned economy. The Soviet Union's example indicates the pervasiveness of mercantilist institutions.

resources spent and the injurious consequences to political institutions, not to mention the price elevation to consumers of the imported goods and the misallocation of resources by government dicta thwarting market forces and creative destruction. Self-interest is ubiquitous and ancient and can be distorted by the sanctioned institutional arrangement. For instance, Jaaidane, Musy, and Tallec (2023), Ekelund Jr., and Thorton (2020) document that the end of the Ancien Regime and its venality was driven by the French Revolution, which was incited to a large degree by the private interest that suffered from mercantilist practices prevailing under Louis XIV, and surviving under Louis XV and Louis XVI who was executed during the Revolution.

Considering the natural trait of self-interest and humans' deeply rooted sensitivity to incentives, our results suggest that the institutional design should stimulate competition and creativity in a framework that protects private property. Specifically, self-interest cannot be overridden. Consequently, extractive institutions induce participants' decisions to cause general societal harm. In contrast, inclusive institutions instigate well-being in most societal actors while impairing companies that may endure the consequences of creative destruction [5].

3 Data and Methods

3.1 Data

The data used in this paper comes from the Global Mercantilism Index (GMI), published by the Information Technology & Innovation Foundation (ITIF), and the V-Democracy project. We built a panel dataset comprising two years, 2014 and 2019, and 60 countries: Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Kenya, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Mexico, Netherlands, New Zealand, Norway, Peru, Philippines, Poland, Portugal, Romania, Russia, Saudi Arabia, Singapore, Slovak Republic, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, United Arab Emirates, United Kingdom, and Vietnam.

The independent variable is the GMI. The ITIF defines mercantilist policies as those that "seek to expand domestic production capacity by unfairly limiting imports and promoting exports in ways that subvert the intent of free trade" (Foote and Stephen, 2019: 3). This index is built using 18 indicators classified into nine categories: 1) forced localization, 2) intellectual property protection, 3) open market access, 4) benefits for domestically owned enterprises, 5) currency manipulation, 6) preferences for domestic production, 7) tariffs and import discrimination, 8) digital barriers, and 9) NTE Report ranking. The higher the score obtained by a country in the GMI, the stronger the mercantilist policies that country exhibits.

The dependent variables come from the V-Democracy project (Coppedge et al., 2023a and Pemsten et al., 2023). We have classified them into four groups:

i) Democracy encompasses indicators that assess political participation and rights. It includes the Liberal Democracy Index, which evaluates institutions protecting individual and minority rights; the Electoral Democracy Index, which measures the strength of democratic systems; and the Deliberative Democracy Index, which gauges political dialogue. Additionally, the Egalitarian

[5] For a broader discussion on state capitalism and rent-seeking, see Aligica and Tarko (2012). For a discussion focused on worldwide comparisons among high-income countries, Latin America, and Venezuela, see Faria and Montesinos (2024).

Democracy Index measures equal opportunities for participation, while the Participatory Democracy Index evaluates citizen engagement. Other variables in this group, such as the Political Rights Index, the Liberal Component Index, and the Clean Elections Index, further contribute to tracking democracy's progress and identifying potential risks. These variables offer valuable insights into the quality of political participation, the protection of electoral rights, and the integrity of electoral processes.

ii) Judiciary and the Rule of Law: encompasses indicators that assess the judicial sector and the enforcement of the Rule of law, including variables such as Compliance with the Judiciary, measuring government adherence to court decisions; Judicial Constraints on the Executive Index, evaluating executive respect for the constitution and judiciary independence; Lower and High Court Independence Indexes, assessing the alignment of court decisions with government preferences; Rule of Law Index, measuring government adherence to the law and respect for citizen rights; Equality before the Law and Individual Liberties Index, examining equal treatment under the law and protection of individual rights; Accountability Index, evaluating government responsibility to citizens; and Equal Protection Index, measuring the equitable safeguarding of rights and freedoms across social groups. Together, these variables provide insights into the functioning of the judiciary, the adherence to the Rule of law, and the protection of individual and collective rights within a country.

iii) Civil Rights: In this group, we classified variables that assess the rights of individuals to equal treatment under the law, irrespective of their race, religion, gender, or sexual orientation. These variables include the Political Civil Liberties Index, Private Civil Liberties Index, and Civil Liberties, which evaluate different aspects of civil rights and liberties. Additionally, the group includes indicators such as Freedom of Expression and Alternative Sources of Information and Freedom of Academic and Cultural Expression. These variables measure and provide insights into protecting and promoting civil rights.

iv) Media: The media can play a role in supporting or opposing mercantilist policies. Media outlets owned or controlled by the government or businesses that benefit from mercantilist policies may be more likely to support these policies. However, media outlets that are independent or critical of the government may be more likely to oppose mercantilist policies. Considering this, we classified four variables related to the right to be informed: Harassment of Journalists, Government Censorship Efforts, Media Corruption, and Respect for Counterarguments [6].

3.2 Identificaction Strategy

Our analysis employs the 'colonial past' and 'continental effects' as instrumental variables (IV) to address potential endogeneity concerns. The choice of 'colony' and 'continent' as IVs is grounded in their historical, geographical, and exogenous nature, potentially making them suitable instruments (theoretically valid and econometrically strong). These variables capture the colonial origins of the countries in our dataset, presumed to influence current mercantilism through historical and geographical pathways and only through mercantilism affecting democracy today. The colonial state and mercantilism persisted even after independence. By leveraging the 'colonial past' and 'continental past and present' as IVs, we aim to isolate the exogenous variation in our endogenous regressor, average mercantilism, thereby obtaining a potentially more reliable and less biased estimate of its causal effects. This approach helps mitigate the biases that might arise from omitted variables

[6]The V-Democracy Codebook provides a more detailed description of each variable (Coppedge et al., 2023b).

correlated with mercantilism, reverse causality, or measurement error, improving the quality of our empirical findings.

The 'colonial past' and 'continental past and present' help identify and explain mercantilism because countries have a persistent legacy of rent-seeking through trade. Colonial powers established economic structures and practices that prioritized their own gain through controlled trade and resource extraction to benefit the metropoles. This historical context has left a lasting imprint on these countries' economic policies and institutions, influencing their current trade practices and economic behavior. By accounting for this legacy, we can better understand the underlying factors driving economic and political outcomes today.

The model can be summarized as follows:

$$\text{Colonial past} \rightarrow \text{Early Mercantilism} \rightarrow \text{Current Mercatilism} \rightarrow \text{Current Democracy}$$

We hypothesize that the colonial past of countries (outside Europe) created rent-seeking institutions; rent-seeking institutions promoted early mercantilism; and early mercantilism persisted and formed the basis of current institutions.

3.3 Method I

To investigate the potential ramifications and widespread effects of mercantilist practices on various outcomes, we use two research designs: i) Panel Data and ii) Instrumental Variables. We designate the specific outcome of interest as Y. Moreover, we group them into our four main categories: Democracy, the Judiciary and the Rule of Law, Civil Rights, and the Media.

Econometrically, our underlying specification is a two-period panel data model given by

$$Y_{it} = \alpha + \beta M_{i,t-1} + \mu_i + \delta_t + \epsilon_{it} \tag{1}$$

where Y_{it} is our dependent variable or outcome of interest for the country i in period t. The index $i = 1, 2, \ldots, 60$ represents the potential 60 countries in our sample, and period $t = 1, 2$ denotes 2015 and 2020, respectively. The independent variable of interest, $M_{i,t-1}$, is mercantilism, lagging one year (i.e., in 2014 and 2019, respectively). To reduce endogeneity concerns, we lagged mercantilism one year relative to the dependent variables. The terms μ_i and δ_t are country- and time-specific fixed effects, and the term ϵ_{it} denotes random noise unexplained by the model.

To estimate equation (1), we use the first differencing and fixed effects methods. After taking the first differences over five years, equation (1) becomes

$$\Delta_5 Y_{it} = \alpha' + \beta \Delta_5 M_{i,t-1} + \Delta_5 \epsilon_{it}, \tag{2}$$

where $\Delta_5 Y_{it} = Y_{it} - Y_{i,t-5}$. That is, after taking differences, the new dependent variable, $\Delta_5 Y_{it}$, represents the change in the original dependent variable from $t - 5 = 2015$ to $t = 2020$. Similarly, the new independent variable $\Delta_5 M_{i,t-1} = M_{i,t-1} - M_{i,t-6}$ represents the change in mercantilism from $t - 6 = 2014$ to $t - 1 = 2019$. Because only 55 of the 60 countries had mercantilism data in $t - 6 = 2014$, we have only 55 observations to estimate equation (2), but we have 115 observations to estimate equation (1). The term $\Delta_5 \epsilon_{it} = \epsilon_{it} - \epsilon_{i,t-5}$ is still assumed to be random noise, and the new intercept $\alpha' = \delta_t - \delta_{t-5}$ stems from incorporating the time effects in equation (1). Note that

the country fixed effects, μ_i, vanish after time differencing, ensuring that time-invariant omitted variable bias is eliminated.

The regression coefficients from equations (1) and (2) are numerically identical. However, the standardized beta coefficients vary because the standard deviations of the variables in levels (equation 1) differ from the standard deviations of the changes (equation 2). We are interested in the standardized beta coefficient β^*, from equation (2) for comparability purposes across dependent variables and to assess the magnitude of the economic impact of a change in mercantilist policies from 2014 to 2019.

We use robust standard errors for inference and statistical significance. In our case, robust standard errors vary minimally depending on the specific variance-covariance matrix estimator. We use the heteroscedasticity consistent covariance matrix (HCCM) estimator HC1 (Stata's default option for robust standard errors) for equation (2) and robust standard errors clustered at the country level for equation (1). We will report the robust t-statistics from equation (2) since those from equation (1) are virtually identical.

The R^2 values from models (1) and (2) are also different, but we are primarily interested in the R^2 values from model (1): Specifically, the within, between, and overall R^2. The within R^2 measures the explanatory power of mercantilism variations inside (or "within") countries, and the between R^2 measures the explanatory power of mercantilism variations across countries. The former comes from a regression of the variables in deviations with respect to their country means, and the latter comes from a regression of the country means. Finally, the overall R^2 is a weighted average of the within and between R^2. We report the R^2 values from model (1) using an unbalanced panel of 60 countries and 115 observations (55 in 2014 and 60 in 2019). The results of a balanced panel are virtually identical.

Panel A shows the estimated impact of mercantilism on democracy using eight key measures representing foundational dimensions of democratic political institutions. In all cases, mercantilism enters with a negative sign, indicating a detrimental effect on democracy. All eight coefficients are statistically significant and elevated in magnitude. The standardized coefficient of -0.37 for the liberal democracy index indicates that a one standard deviation change in mercantilism is associated with a 0.37 standard deviation reduction in the liberal democracy index. Moreover, the within r-squares range from 0.12 for clean election to 0.27 for deliberative democracy and the between r-squares range from 0.47 for participatory democracy to 0.62 for egalitarian democracy

Panel B shows the impact of mercantilism on the judiciary and the Rule of law. In all eight regressions in Panel B, mercantilism enters with a negative sign, indicating a deleterious effect on the judiciary. All coefficients are statistically significant and large in magnitude. Rule of Law and Equality before the law are significant at the 1 percent statistical level with standardized coefficients of -0.38 and -0.39, respectively. The magnitude of the coefficient estimates indicates that a one standard deviation increase in mercantilism impacts the Rule of law negatively by more than one-third of a standard deviation. The subsequent two salient cases are accountability and equal protection, both significant at the 5 percent level, with standardized coefficients of -0.35 and -0.43, respectively. The within r-squares range from 0.11 for lower court independence to 0.34 for Equality before the law, while the between r-squares are higher, ranging from 0.43 for high court independence to 0.70 for the Rule of law index. This indicates a strong association between mercantilism and the quality of the judiciary and the Rule of law, especially across countries.

Panel C displays the harmful effects of mercantilism on Civil Rights. All the regressions (seven out of seven) reveal the negative and statistically significant impact of mercantilism on civil rights dimensions, with robust t-ratios ranging from -2.10 to -3.33 in magnitude. The standardized

Table 1: Mercantilism's Impact on Various Indices

Dependent Variable ($\Delta_5 Y_{it}$)	**Mercantilism $\Delta_5 M_{i,t-1}$ (Standardized Coefficient β^*)**	**Robust t-statistic**	**R^2 Within**	**R^2 Between**	**R^2 Overall**
Panel A: Democracy Indices					
Liberal democracy index	-0.37**	(-2.47)	0.24	0.55	0.50
Electoral democracy index	-0.37**	(-2.50)	0.24	0.50	0.45
Deliberative democracy index	-0.38**	(-2.47)	0.27	0.49	0.44
Egalitarian democracy index	-0.38**	(-2.53)	0.26	0.62	0.56
Participatory democracy index	-0.34**	(-2.31)	0.22	0.47	0.42
Political Rights (Freedom House, inverted)	-0.25**	(-2.28)	0.13	0.49	0.42
Liberal component index	-0.34***	(-2.76)	0.17	0.58	0.53
Clean elections index	-0.27*	(-1.82)	0.12	0.60	0.53
Panel B: Judiciary and Rule of Law Indices					
Compliance with the judiciary	-0.33**	(-2.32)	0.13	0.48	0.43
Judicial constraints on the executive index	-0.31**	(-2.26)	0.14	0.54	0.48
Lower court independence	-0.30**	(-2.16)	0.11	0.49	0.45
High court independence	-0.26*	(-1.98)	0.09	0.43	0.39
The Rule of Law index	-0.38***	(-2.67)	0.18	0.70	0.64
Equality before the law and individual liberty index	-0.39***	(-2.75)	0.34	0.66	0.59
Accountability index	-0.35**	(-2.45)	0.22	0.51	0.46
Equal protection index	-0.43**	(-2.43)	0.28	0.65	0.62
Panel C: Civil Rights Indices					
Political Civil Liberties Index	-0.37***	(-3.33)	0.23	0.45	0.43
Private Civil Liberties Index	-0.36***	(-2.77)	0.44	0.55	0.48
Civil liberties index	-0.42***	(-3.21)	0.40	0.63	0.56
Civil liberties (Freedom House, inverted)	-0.25**	(-2.10)	0.21	0.68	0.56
Freedom of Expression and Alternative Sources of Information Index	-0.36**	(-2.52)	0.23	0.42	0.40
Freedom of expression index	-0.38***	(-3.07)	0.28	0.46	0.44
Freedom of academic and cultural expression	-0.31**	(-2.26)	0.28	0.45	0.42
Panel D: Media Indices					
Harassment of journalists	-0.39***	(-3.30)	0.25	0.52	0.48
Government censorship of media	-0.33**	(-2.59)	0.17	0.48	0.43
Media corruption	-0.41**	(-2.40)	0.19	0.57	0.53
Respect for counterarguments	-0.28**	(-2.65)	0.22	0.31	0.26

*Notes:*Mercantilism's Impact on Various Indices. We report standardized beta coefficients from equation 2 (first-difference model, N=55) and r-squares from equation 1 (fixed-effect model, 60 countries, N=115). Robust t-statistics from equation 2 are in parentheses. Robust p-values: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Time effects (equation 1) and intercept (equations 1 and 2) are included but not shown. We inverted the political rights and civil liberties measures from Freedom House to range from 1 = Least Free to 7 = Most Free.

coefficients range from -0.25 to -0.42 (and most are above 0.3 in magnitude), indicating once again a sizeable harmful effect, the most prominent being on the civil liberties index. The within r-squares range from 0.23 to 0.44, the latter figure corresponding to the private civil liberties index. Finally, the between r-squares range from 0.42 to 0.68, the largest corresponding to civil liberties as measured by Freedom House.

Panel D displays the impact of mercantilism on the media. Again, all regressions (four out of four) show a negative, statistically significant, and large-magnitude effect of mercantilism on the media. Robust t-ratios range from -2.4 to -3.3, and the standardized coefficients range from -0.28 to -0.41, again indicating a sizeable harmful effect on the media. Two of the most salient cases are corruption of the media and harassment of journalists, with standardized coefficients of -0.41 and -0.39, and statistically significant at the five and one percent level, respectively. The within r-square is most prominent in the case of harassment of journalists (25 percent), and the between r-squared is most extensive in the case of media corruption (57 percent).

3.4 Method II

In the prior section, by construction, our method eliminated any potential time-invariant omitted variable biases. In this section, we aim to reduce any potential time-variant omitted variable bias. To achieve that, we employ an instrumental variable (IV) approach on the levels of mercantilism and our outcome variables. To reduce any potential measurement error bias, we average the mercantilism values of 2014 and 2019 for each country into a single value $\bar{M}_i$. To reduce any potential reverse causality bias, we leave the outcomes of interest in 2020 so that they are "led" a few years relative to the average mercantilism. We use a set of colonial and continental dummies as instruments for average mercantilism. Specifically, we use dummies for British, French, Spaniard, Dutch, and Portuguese colonies, as well as dummies for America, Asia, Africa, and Oceania. Our omitted category represents non-colonial Europe, representing the traditional metropolis of colonial power. We also add a set of potential control variables $\boldsymbol{X}_i$ that are included as robustness checks (see next section). The IV equation system looks like this:

$$Y_{i2020} = \alpha + \beta \bar{M}_i + \gamma \boldsymbol{X}_i + \epsilon_i \tag{3}$$

$$\bar{M}_i = \alpha' + \beta' \boldsymbol{Z}_i + \gamma' \boldsymbol{X}_i + \epsilon'_i, \tag{4}$$

We use standard instrumental variable routines to estimate and diagnose these equations. The goal is that $\hat{\bar{M}}_i$, the predicted value of $\bar{M}_i$ from (4), isolates the exogenous variation in $\bar{M}_i$ leading to potentially less biased estimates of the causal effect of $\bar{M}$ on Y_{2020}.

Table 2 shows the results of this identification strategy using the same outcome variables and structure as in Table 1. Again, we break down our 27 outcome variables into four categories: Democracy (Panel A), Judiciary and Rule of Law (Panel B), Civil Rights (Panel C), and Media (Panel D). All standardized coefficients of mercantilism are negative and larger in magnitude and statistical significance than the corresponding values in Table 1. The standardized coefficients range from 0.46 to 0.87, and the robust t-statistics range from -3.46 to -10.61. The Hansen J for over-identifying restrictions (OIR) test mostly supports the identifying assumption that the instruments are not invalid. While it is impossible to prove the instrument's unconditional validity, it is worth

noticing that the OIR p-values are unadjusted for multiple comparisons, and their Bonferroni-adjusted counterparts, which account for false discovery rates, yield all of them insignificant, lending some empirical credence to the validity of the instruments and the adequacy of the identification strategy.

The first stage (equation 4) results are the same for all outcome measures and are not shown as a table. The F statistic for excluded instruments in the first stage is 11.91, surpassing Stock-Yogo's weak IV critical value for 10 percent maximal IV relative bias. Also, the Kleibergen-Paap rank LM statistic strongly rejects the null hypothesis of under-identification. These results support the credibility of our identification strategy, which mitigates potential time-varying omitted variable bias and other endogeneity concerns.

Table 2: Mercantilism's Impact on Various Indices: IV Approach

Dependent Variable (Y_{i2020})	**Mercantilism $\bar{M}_i$ (Standardized Coefficient β^*)**	**Robust t-statistic**	**Hansen J Statistic**	**Hansen OIR p-value**	**F Overall**
Panel A: Democracy Indices					
Liberal democracy index	-0.80***	(-7.98)	13.57	0.0937	61.55
Electoral democracy index	-0.76***	(-7.10)	15.72	0.0465	48.66
Participatory democracy index	-0.78***	(-8.08)	14.22	0.0763	63.18
Deliberative democracy index	-0.73***	(-7.22)	13.14	0.107	50.38
Egalitarian democracy index	-0.86***	(-10.61)	8.053	0.428	108.7
Political Rights (Freedom House, inverted)	-0.78***	(-5.94)	12.47	0.131	34.14
Liberal component index	-0.75***	(-6.50)	14.46	0.0705	40.88
Clean elections index	-0.75***	(-7.09)	16.25	0.0390	48.65
Panel B: Judiciary and Rule of Law Indices					
Compliance with the judiciary	-0.66***	(-5.32)	11.47	0.177	27.38
Judicial constraints on the executive index	-0.72***	(-5.34)	14.45	0.0707	27.54
Lower court independence	-0.76***	(-5.80)	18.56	0.0174	32.57
High court independence	-0.71***	(-5.45)	15.42	0.0515	28.72
The Rule of Law index	-0.80***	(-8.27)	9.135	0.331	66.04
Equality before the law and individual liberty index	-0.80***	(-8.09)	9.877	0.274	63.26
Accountability index	-0.73***	(-6.40)	16.89	0.0312	39.65
Equal protection index	-0.82***	(-9.25)	6.372	0.606	82.69
Panel C: Civil Rights Indices					
Political Civil Liberties Index	-0.71***	(-5.31)	17.64	0.0241	27.24
Private Civil Liberties Index	-0.70***	(-5.95)	13.29	0.102	34.22
Civil liberties index	-0.81***	(-7.98)	14.14	0.0781	61.53
Civil liberties (Freedom House, inverted)	-0.87***	(-9.01)	11.32	0.184	78.41
Freedom of Expression and Alternative Sources of Information Index	-0.68***	(-5.15)	17.07	0.0294	25.68
Freedom of expression index	-0.71***	(-6.00)	16.44	0.0365	34.78
Freedom of academic and cultural expression	-0.65***	(-5.27)	16.92	0.0309	26.89
Panel D: Media Indices					
Harassment of journalists	-0.74***	(-6.87)	11.76	0.162	45.59
Government censorship of media	-0.76***	(-6.76)	13.60	0.0927	44.15
Media corruption	-0.72***	(-7.00)	18.04	0.0210	47.38
Respect for counterarguments	-0.46***	(-3.46)	8.646	0.373	11.57

Notes: Mercantilism's impact on various indices using instrumental dummy variables for British, French, Spaniard, Dutch, and Portuguese colonies, as well as dummies for America, Asia, Africa, and Oceania. Our omitted category represents non-colonial Europe. We report standardized beta coefficients from equation 3 with N=60 observations. Robust t-statistics from equation 2 are in parentheses. Robust p-values: * p¡0.10, ** p¡0.05, *** p¡0.01. Intercept coefficients are not shown. The first stage (equation 4) F statistic is 11.91, which surpasses Stock-Yogo weak IV critical values of 11.46 for 10 percent maximal IV relative bias. Similarly, the Kleibergen-Paap rank LM statistic: Chi-sq(9)=36.26 (P=0.0000) strongly indicates that our system is identified. We inverted the political rights and civil liberties measures from Freedom House to range from 1 = Least Free to 7 = Most Free.

3.5 Robustness Checks

Our estimates for the impact of mercantilism in Table 1 are unbiased under time-invariant omitted variables such as culture and geography. However, they are not necessarily unbiased under time-variant variables correlated with mercantilism. Table 3 provides a selection of robustness checks to ameliorate this possibility. We estimated a multivariate version of equations 2 and 3 by adding time-variant regressors: educational equality, openness to trade, income inequality, educational quality, and economic freedom. We show results only for a selection of 9 of our original 27 variables (at least one from each panel), but the results are qualitatively the same for all variables. Despite accounting for educational equality, the coefficient of mercantilism remains negative, large in magnitude, and highly statistically significant in both panel data and instrumental variable methods.

Relative to Table 1, the economic magnitude and statistical significance of the coefficients remained largely unchanged in panel A of Table 3, showing strong robustness to the additional controls and highlighting the deleterious effect of mercantilism over a wide range of outputs. Relative to Table 2, the standardized coefficients of mercantilism in panel B of Table 3 reflect an even larger (and deleterious, i.e., negative sign) economic impact of mercantilism on our outputs. The exceptions are columns 4 and 5, corresponding to the rule of law (see next section about policy implications) and equality before the law, where the standardized coefficients are slightly smaller than in Table 2. In all cases, the impact of mercantilism remains highly statistically significant at the 1 percent level.

As before, in the first stage of panel B (equation 4, not shown), the instruments used are colonial dummy variables for British, French, Spaniard, Dutch, and Portuguese colonies, as well as dummies for America, Asia, Africa, and Oceania. Our omitted category represents non-colonial Europe, representing the traditional metropolis of colonial power. The first stage F statistic for the excluded instruments was 12.39, which surpasses Stock-Yogo weak IV critical values of 11.46 for 10 percent maximal IV relative bias. The Kleibergen-Paap rank LM statistic: Chi-sq(9)=27.84 (P=0.0010) strongly indicates that our system is identified. All Hansen OIR tests suggest conditionally valid instruments. Among the controls, economic freedom is the only one statistically significant in the first stage, with a standardized coefficient of -0.53 (t = -4.29), suggesting that greater economic freedom is associated with reduced mercantilism and can be part of the solution (see next section).

So far, our results are robust to various outcomes, balanced and unbalanced samples, different controls, different econometric specifications, estimation methods, and identification strategies. While worldwide data on modern mercantilist institutions has naturally delayed the empirical estimation of the widespread welfare costs of mercantilist practices, rent-seeking, and crony capitalism, our preliminary results indicate considerable and prevalent harm, especially on political institutions, the rule of law, civil rights, and the media. Our results also suggest that mercantilist institutions are a mediating mechanism towards further and more generalized welfare and societal costs.

Table 3: Robustness Checks to Openness, Inequality, High-Quality Educational Provision, and Economic Freedom

	1 Liberal Democracy	2 Political Rights	3 Liberal component	4 The Rule of law	5 Equality before the law	6 Accountability index	7 Civil liberties	8 Freedom of expression	9 Harassment of journalists
Panel A: Panel Data Approach (Equation 2)									
Mercantilism	-0.35***	0.27***	-0.33***	-0.36***	-0.38***	-0.35***	0.23*	-0.35***	-0.40***
	(-2.31)	(2.26)	(-2.67)	(-2.56)	(-2.79)	(-2.41)	(1.77)	(-2.51)	(-2.96)
Openness	-0.04	0.02	-0.09	-0.08	-0.03	-0.02	0.08	-0.07	0.07
	(-0.44)	(0.17)	(-1.13)	(-0.89)	(-0.32)	(-0.18)	(0.68)	(-0.64)	(0.55)
Inequality	-0.16	-0.06	-0.13	-0.17	-0.19	-0.15	0.08	-0.09	-0.04
	(-0.89)	(-0.51)	(-0.92)	(-1.52)	(-1.01)	(-1.05)	(0.53)	(-0.47)	(-0.40)
Education Quality	0.15	0.09	0.04	0.15	0.09	0.13	-0.02	0.12	0.04
	(0.93)	(0.94)	(0.44)	(1.13)	(0.79)	(0.84)	(-0.15)	(0.94)	(0.17)
Economic Freedom	0.14	-0.16	0.27	0.22	0.14	0.15	-0.18	0.02	0.11
	(0.91)	(-0.77)	(1.63)	(1.27)	(1.01)	(1.01)	(-0.94)	(0.20)	(0.69)
Panel B: Instrumental Variables Approach (Equation 3)									
Mercantilism	-0.94***	1.03***	-0.90***	-0.68***	-0.73***	-0.96***	0.97***	-0.93***	-0.80***
	(-3.87)	(4.14)	(-4.22)	(-4.81)	(-4.27)	(-3.90)	(4.95)	(-3.49)	(-3.30)
Openness	0.01	-0.03	-0.01	-0.00	0.01	0.04	-0.01	0.02	-0.00
	(0.07)	(-0.40)	(-0.20)	(-0.11)	(0.22)	(0.47)	(-0.10)	(0.20)	(-0.02)
Inequality	0.13	-0.14	0.17*	0.25***	0.13	0.13	-0.17**	0.10	0.04
	(1.10)	(-1.13)	(1.66)	(3.59)	(1.27)	(1.08)	(-1.98)	(0.71)	(0.39)
Education Quality	0.06	0.11	-0.11	0.25***	0.07	-0.10	-0.08	-0.10	0.07
	(0.42)	(0.70)	(-0.77)	(2.83)	(0.55)	(-0.63)	(-0.67)	(-0.56)	(0.47)
Economic Freedom	-0.08	0.08	0.11	0.20	0.19	-0.01	0.03	-0.02	-0.01
	(-0.28)	(0.31)	(0.45)	(1.45)	(1.21)	(-0.04)	(0.16)	(-0.06)	(-0.05)

Notes: In Panel A, we report the standardized coefficients from Equation 2 (first-difference model). In Panel B, we report the standardized coefficient from Equation 3 (IV model). In corresponding Equation 4 (not shown), the only control that enters statistically significant is economic freedom, indicating that more economic freedom is associated with less mercantilism. The standardized coefficient of economic freedom is -0.53, with a robust t-ratio of -4.29. Instruments are dummy variables for British, French, Spaniard, Dutch, and Portuguese colonies, as well as dummies for America, Asia, Africa, and Oceania. Our omitted category represents non-colonial Europe. The first stage F statistic is 12.39, which surpasses Stock-Yogo weak IV critical values of 11.46 for 10 percent maximal IV relative bias. Similarly, the Kleibergen-Paap rank LM statistic: Chi-sq(9)=27.84 (P=0.0010) strongly indicates that our system is identified. We inverted the political rights and civil liberties measures from Freedom House to range from 1 = Least Free to 7 = Most Free. Robust t-statistics are in parentheses. Robust p-values: * $p < 0.10$ ** $p < 0.05$ *** $p < 0.01$.

4 Rule of Law Implication: Policy Recommendation

Table 4 illustrates that mercantilism is not a significant factor in explaining the quality of democracy when the rule of law is considered. The rule of law, which ensures that all individuals and institutions are accountable to publicly promulgated, equally enforced, and independently adjudicated laws, plays a more pivotal role in determining the quality of political regimes. This principle fosters transparency, accountability, and fairness, which are essential for the stability and legitimacy of a government.

Secondly, economic freedom is part of the solution as it enters significantly in the first stages, even after controlling for the rule of law. The standardized coefficient of economic freedom in the first stages (not shown) is -0.33 (t = -2.62), and the corresponding coefficient of rule of law is -0.32 (t = -2.02). This means that countries with one sample standard deviation higher economic freedom (and rule of law) have, on average, lower mercantilism by about one-third of a sample standard deviation. On the one hand, this indicates an indirect effect of economic freedom (and the rule of law) on our outcomes by potentially reducing mercantilism. However, the rule of law is an even better institution for eliminating mercantilist practices and their effects because it reduces the level of mercantilism in the first stage and then completely nullifies any remaining effect on our outcomes, mostly political institutions, in the second stage. These findings are congruous with Acemoglu and

Robinson (2012) on the importance of the rule of law.

Table 4: Robustness Checks to Openness, Inequality, High-Quality Educational Provision, Economic Freedom, and Rule of Law

	1	2	3	4	5	6	7	8
	Liberal Democracy	**Political Rights**	**Liberal component**	**Equality before the law**	**Accountability index**	**Civil liberties**	**Freedom of expression**	**Harassment of journalists**
Panel A: Panel Data Approach (Equation 2)								
Mercantilism	-0.09	0.15	-0.03	-0.10	-0.07	0.01	-0.07	0.22**
	(-1.32)	(1.23)	(-0.40)	(-1.04)	(-1.08)	(0.11)	(-0.68)	(2.17)
Openness	0.01	-0.01	-0.02	0.03	0.05	0.03	-0.01	0.11
	(0.21)	(-0.04)	(-0.61)	(0.59)	(0.95)	(0.23)	(-0.11)	(1.00)
Inequality	-0.03	-0.12	0.02	-0.05	-0.01	-0.02	0.05	0.05
	(-0.26)	(-0.96)	(0.23)	(-0.41)	(-0.13)	(-0.18)	(0.35)	(0.58)
Education Quality	0.05	0.14	-0.08*	-0.03	0.02	0.07	0.01	-0.04
	(0.48)	(1.24)	(-1.85)	(-0.34)	(0.18)	(0.64)	(0.15)	(-0.23)
Economic Freedom	-0.02	-0.09	0.09	-0.04	-0.02	-0.05	-0.14	-0.00
	(-0.15)	(-0.65)	(1.15)	(-0.48)	(-0.18)	(-0.43)	(-1.67)	(-0.03)
Rule of Law	0.72***	-0.32	0.83***	0.80***	0.80***	-0.60***	0.76***	0.51***
	(4.06)	(-1.41)	(10.75)	(6.27)	(5.24)	(-3.64)	(3.73)	(3.05)
Panel B: IV Approach (Equation 3)								
Mercantilism	-0.24	0.32	-0.20	-0.14	-0.28	0.45*	-0.32	-0.26
	(-1.61)	(1.66)	(-1.53)	(-1.20)	(-1.71)	(2.39)	(-1.62)	(-1.21)
Openness	0.01	-0.04	-0.01	0.01	0.04	-0.01	0.02	0.00
	(0.19)	(-0.71)	(-0.22)	(0.52)	(0.70)	(-0.19)	(0.31)	(0.01)
Inequality	-0.12	0.11	-0.09	-0.08	-0.11	0.01	-0.11	-0.14
	(-1.50)	(1.30)	(-1.04)	(-0.87)	(-1.12)	(0.11)	(-0.84)	(-1.27)
Education Quality	-0.17	0.36**	-0.35***	-0.13	-0.33*	0.09	-0.31*	-0.09
	(-1.72)	(3.19)	(-3.75)	(-1.14)	(-2.53)	(1.12)	(-1.96)	(-0.65)
Economic Freedom	-0.25	0.27	-0.08	0.04	-0.17	0.16	-0.16	-0.11
	(-1.42)	(1.73)	(-0.64)	(0.52)	(-1.00)	(1.13)	(-0.77)	(-0.57)
Rule of Law	0.97***	-1.01***	1.00***	0.84***	0.94***	-0.72***	0.85***	0.70***
	(7.98)	(-6.26)	(8.26)	(6.59)	(6.37)	(-5.09)	(5.64)	(3.80)

Notes: We report standardized coefficients from equation 2 (first-difference model, panel A) and equation 3 (IV approach, panel B). Robust t-statistics from equation 2 are in parentheses. We inverted the political rights and civil liberties measures from Freedom House to range from 1 = Least Free to 7 = Most Free. Robust p-values: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. The first stage (equation 4, not shown) uses dummy variables for British, French, Spaniard, Dutch, and Portuguese colonies, as well as dummies for America, Asia, Africa, and Oceania as excluded instruments for mercantilism. Our omitted category represents non-colonial countries in Europe. The first stage F statistic for the excluded instruments is 8.01, which surpasses Stock-Yogo weak IV critical values of 6.65 for 20 percent maximal IV relative bias. The Kleibergen-Paap rank LM statistic rejects the null of under-identification. Finally, the Hansen over-identifying restriction test suggests conditionally valid instruments. The only controls (not IVs) significant in the first stage are economic freedom and the rule of law. The standardized coefficient of economic freedom in the first stages is -0.33 (t = -2.62), and the corresponding coefficient of rule of law is -0.32 (t = -2.02).

5 Concluding remarks

Scrutinizing the quality of institutions in countries marred by poverty, one is bound to encounter extractive political and economic institutions, typically portraying rent-seeking activity enacting a wealth transfer. Mercantilism is a classic example of extractive institutions dressed in a legal framework to cast an appearance of legitimacy, hiding its venality. The well-known direct consequences of mercantilism are the enrichment of a small group of company owners in cahoots with the government at the expense of consumers and of society as a whole, becoming impaired by the concomitant misallocation of resources working against the creative destruction process, an essential pillar of market economies. The mercantilist practice also erodes the social fabric, inducing people to accumulate wealth based on know-who instead of Know-how, e.g., political connections, while

diminishing the procurement of wealth through know-how inventiveness.

Estimating regressions in panel data and two-stage least squares (2SLS), using colonial and continental dummy and instrumental variables (IV) for mercantilism, controlling for country and time-fixed effects, we find causal evidence that mercantilism adversely impacts different measures of democracy, the rule of law, the judiciary, civil rights, and the media. These findings are robust when measures of education, inequality, openness and economic freedom are included.

Historically and revealingly, England, France, Portugal, the Netherlands, and Spain embraced mercantilism; however, England was the first to dismantle it, aiding in paving the way for the Industrial Revolution, Parliamentary Democracy, and the Rule of Law. Our findings show how mercantilism has interacted with political institutions after the Great Recession, documenting its corrosive effects on the quality of democratic institutions and the media.

Finally, mercantilism is not a significant factor in explaining the quality of democracy when the rule of law is considered. The rule of law reduces mercantilism in the first stage, completely nullifies any remaining effect on our outcomes in the second stage. As more data become available over a more extensive set of countries and spanning more extended time frames with more available periods, we anticipate that researchers worldwide will be able to document further areas affected by mercantilist institutions, such as nationalism, armed conflicts, polarization, civil unrest, economic and human freedom, and culture.

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