Title

The Economic Consequences of Permanent Neutrality: Leveraging Economic Sovereignty Through Neutral Profiteering

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Abstract

This paper asserts that the Belgian status of permanent neutrality had important economic consequences. From a law & economics-perspective, permanent neutrality constrained economic sovereignty through a system of beliefs. At the same time, perpetual neutrality incentivised commerce by enabling “exploitation of the great by the small”, facilitating free riding and institutionalising neutral profiteering.

Keywords

History of International Law, Rational Choice, Permanent Neutrality, Economic Sovereignty, Republic Of Beliefs, Customs Unions, Collective Action, Free Riding, Transaction Cost Economics

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The Economic Consequences of Permanent Neutrality: Leveraging Economic Sovereignty Through Neutral Profiteering[1]

1. Introduction and Historical Background

At the Congress of Vienna, the Great Powers (Great Britain, Russia, Prussia and Austria) redrew the map of Europe and called into existence the United Kingdom of the Netherlands as a buffer against Napoleonic France, after decades of revolutionary warfare and widespread turmoil. However, the newly created state was short-lived (1815-1830). The catholic south and its Francophone elite revolted against the Dutch protestant king, quickly gaining an independent state: Belgium. However, the Great Powers were only persuaded to grant independence to the Belgians on the condition that it would remain "perpétuellement neutre". If not, the balance of power would be at risk, which was unacceptable to the members of the Quadruple Alliance.

For scholars acquainted with the history of international law, neutrality is hardly an enigma. Even scholars in the field of international law & economics have deemed neutrality an interesting case study to prove their conjectures on customary international law.[2] Even so, as the concept has lost most of its contemporary relevance, a short history and definition of neutrality is desirable for the non-specialised reader. In essence, the laws of neutrality were concerned with war and peace, more specifically the rules of wartime maritime commerce. In principle, war and peace have always existed at the same time: luckily, for most of history a state of war on a global scale has been the exception. Indeed, belligerent parties were usually at the same time at peace with other states. As an example: war between France and England need not necessarily involve the Netherlands, the latter which thus remained *neutral*. Usually, a neutral country continued trade with both parties at war, often reaping huge wartime profits.

[1] The author would like to thank Prof. Dr. Frederik Dhondt (VUB-University of Antwerp) for his critical comments and suggestions. All remaining errors are my own.
[2] Goldsmith, Jack and Posner, Eric. *The Limits of International Law* (New York: Oxford University Press, 2005), 45-54.

Thus, before the 19th century, neutrality was merely a temporary legal status which defined the rights and duties of third party states vis-à-vis two (or more) belligerents. More in particular, the laws of neutrality were crucial with respect to trade between a neutral and other state(s) at war (i.e. the belligerents).

As such, the "classical" status of neutrality is known as early as 1495 and continued to develop over the centuries.[3] The culmination of this process is without doubt the Declaration of Paris (1856), when "the free ships, free goods"-principle was generally recognised. Following this treaty, neutrals could uninterruptedly continue trade with other belligerent countries, on the exception for contraband goods.[4] Before 1856, enemy property was often seized by a belligerent, even if the property concerned were non-contraband goods. After the Declaration, only contraband goods remained liable for seizure.[5] Throughout history, we thus see a shift away from broad belligerent rights of search and seizure at sea vis-à-vis neutral ships to restrictions of such rights, and thus to extensive neutral rights (i.e. protection against search and seizure).

Before the early 19th century, neutrality had always been a temporary status. At one point in time, states would act as belligerent, at other times, they would remain neutral. However, in 1803 the Hanseatic Cities for the first time received a status called "permanent neutrality". The Vienna Congress of 1815 then permanently neutralised Switzerland and the city of Krakow, amongst others. Belgium followed suit in 1839, when it finally gained international recognition as an independent state after nine years of intensive diplomacy and Dutch resistance. However, in each of these cases "permanent neutrality" was considered as having a different meaning. There was no consensus as to the content of this regime under international law. It was generally

[3] Neff, Stephen. *The Rights and Duties of Neutrals: a General History* (Manchester: Manchester University Press, 2000).
[4] Lemnitzer, Jan. *Power, law and the end of privateering* (Basingstoke: Palgrave MacMillan, 2014).
[5] Goldsmith and Posner, *The Limits* (2005) 45-46.

recognised that the status of Belgium was a *sui generis* one, incomparable to either Switzerland, nor Krakow or the Hanseatic Cities. Despite the importance of the concept of "permanent neutrality" for the balance of power, the Great Powers did not define the rights and obligations of the forever-neutral Belgian state. The consensus amongst scholars and diplomats was that state practice would elucidate the rights and obligations of the "état perpétuellement neutre".[6] Hence, state practice would have to flesh out the concept of "neutralité permanente", which in the meanwhile remained shrouded in mystery. However, for the sake of clarity, the definition by Neff can be taken as a working definition: "[perpetual neutrality means] the removal of certain countries or areas from *eligibility* for war by means of an internationally recognised legal status".[7] We will see how this status at the same time constrained the Belgian state in its commercial policy (in terms of economic sovereignty),[8] but also incentivised commerce and free riding (in terms of collective action and public goods theory). As such, we conclude that the Belgian state, given the constraints and incentives it faced, was led to leverage its limited economic sovereignty through neutral profiteering.

2. Methodology

This article blends mainstream international law & economics with contextual legal history. As applied here, the first seeks to explain international law, in particular the rules of neutrality and the status of permanent neutrality (the *explananda*) from a rational choice perspective (the

[6] Dhondt, Frederik. 'Permanent Neutrality or Permanent Insecurity ? Obligation and Self-Interest in the Defence of Belgian Neutrality, 1830-1870'. In *International Law in the Long Nineteenth Century (1776-1914): From the Public Law of Europe to Global International Law?*, eds. I. Van Hulle and R. Lesaffer (Nijhof: Brill, 2019), 159-185.

[7] Neff, Stephen. *The Rights and Duties of Neutrals: a General History* (Manchester: Manchester University Press, 2000), 29 and 101.

[8] At the turn of the century, permanent neutrality took center stage in the discussion over the annexation of the Congo Free State (hitherto 1908 the personal property of the Belgian King LeopoldII) by the Belgian state. See Vandenbogaerde, Sebastiaan. "Une telle apathie est presque coupable' : how in Belgium's Journal des tribunaux the interest for the Congo Free State sparked off (1885-1908). *Clio@Thémis: Révue électronique d'Histoire du Droit* 12 (2017) 1-15 and Dhondt, Frederik and Vandenbogaerde, Sebastiaan. "La mentalité de nos confrères à l'égard de ce qui fut jadis et sera demain'. The Neutralities of Belgium, the Congo Free State and the Belgian Congo (1885-1914) seen through the Journal des Tribunaux'. *Journal of Belgian History-Revue Belge d'Histoire Contemporaine- Belgisch Tijdschrift Voor Nieuwste Geschiedenis* 48 (2018) 134–162.

explanans), on "the assumption that states act rationally to further their interests".[9] Contextual legal history is a broad concept and encompasses many approaches, but in essence considers that the law is part and product of society and at the same time constantly influences and changes society.[10] The combination of both is what Klerman calls "the economic analysis of legal history".[11] Different approaches abound within this field, which can be grouped roughly in the study of law as dependent or independent variable as well as bidirectional histories. The latter seeks the explain "the effect of law on society or the effect of society on law".[12] The present article adopts the bidirectional approach.

Blending history and economics is all but an evident exercise. Historians tend to direct their attention to the nitty-gritty details of past rules and occurrences, stressing their uniqueness, while economists seem preoccupied with generalisations and predictions of future events.[13] We can find traces in the literature of these attitudes. One the hand, there is the exemplary view propounded by Coase's view that the old institutionalists prime legacy was but "a mass of descriptive material waiting for a theory, or a fire".[14] He was far from the only prominent jurist-economist to propound such a view.[15] For (legal) historians on the other hand, abstract models seldomly do justice to the richness of the primary source material.[16]

Finding a middle ground between the two is therefore much akin to dancing on a volcano: quite exciting and potentially rewarding, but with a constant risk that things might blow up

[9] Goldsmith, Jack and Posner, Eric. *The Limits of International Law* (New York: Oxford University Press, 2005) 4-10.
[10] Heirbaut, Dirk. 'A tale of two legal histories'. In ed. D. Michalsen, *Reading past legal texts* (Oslo: Unipax, 2006), 91-112.
[11] Klerman, Daniel. 'Economics of Legal History'. In *The Oxford Handbook of Law and Economics*, ed. F. Parisi (Oxford: Oxford University Press, 2017), 409-438.
[12] Klerman, 'Economics of Legal History' 423-426, in particular 423.
[13] See Heirbaut, Dirk. 'Continental legal history: a neglected auxiliary of law & economics'. In *Vrank en Vrij - Liber Amicorum Boudewijn Bouckaert*, Ed. J. De Mot (Brugge: Die Keure, 2012), 335-344.
[14] Coase, Ronald. 'The New Institutional Economics'. *Journal of Institutional and Theoretical Economics* 140 (1984) 229-231, 230.
[15] Posner, Richard. 'The New Institutional Economics Meets Law and Economics'. *Journal of Institutional and Theoretical Economics* 149 (1993) 73-87.
[16] Heirbaut, 'Continental Legal History' 336-337.

underneath one's feet. Nevertheless, both disciplines may benefit from a confrontation. Arguably, legal history could do with more theory and abstraction; law & economics with more realism. An attempt will thus be made to reconcile both approaches.

The remainder of this article will be as follows. First, the economic consequences of permanent neutrality *as a constraint* will be sketched, starting with the economic proposition formulated by the German economist Friedrich List (1789-1846) that small states are doomed to dissolve into a larger whole in order to successfully develop their economies. It will be shown that List's theorem seems to have been applicable to Belgium. In the two following subsections, two case studies will be recalled in order to illustrate the Belgian *mentalité* concerning permanent neutrality, (economic) sovereignty and customs unions. These case studies demonstrate that permanent neutrality was *believed to* or *perceived as* a constraint on state behaviour with respect to commerce and economic development. Belgian policymakers were uncertain with respect to the sovereign capacity of the country to enter a customs union, and therefore desperately looked to alternative means to gain market access elsewhere for the large produce of its industry. As such, the third section shows how not only hard obligations restrain state behaviour, but how *beliefs* about such obligations do so as well. Indeed, states live in "a republic of beliefs". The fourth section presents a model of neutrality, introduces some insights from transaction costs economics and finishes with a collective action perspective. The fifth section concludes.

3. Permanent Neutrality as Constraint: Between Economic Sovereignty and Economic Survival

3.1 The Economic Theory of F. List: The Impossibility of Small State Economic Development

In the realm of 19th century economic theory, Friedrich List published his celebrated "Das Nationale System der Politischen Ökonomie" in 1844.[17] In this book, List asserted that a small country such as Belgium with its restricted territory and population would only be able to fully develop its productive forces by entering into a confederation with a larger neighbouring nation. This is no mere coincidence, as List adopted an inductive economic approach based on historic fact. As such, his observations were based on historical experience. Nevertheless, List's prediction never realised itself. Indeed, Belgium never became part of a confederation nor a customs union, but this was arguably due to the legal uncertainty surrounding permanent neutrality rather than a matter of economic expediency.

The course of historical events support List's theorem. Throughout the first half of the 19th century, Belgian policymakers decried the lack of access to external markets. On the continent, Belgium was the first country to experience the Industrial Revolution, but with its small internal market, it constantly found itself fighting for market access abroad to sell the large produce of its mechanised industry. Indeed, the size of the Belgian internal market was far from sufficient to profitably dispose of the by its many manufactures' mass-produced goods.[18] In addition, under Napoleonic rule (1794-1815), the Belgian economy had become closely intertwined with France, a fact which the French neighbour constantly sought to exploit.[19] As a consequence, on many occasions throughout the 19th century, Belgian policymakers seriously entertained thoughts of entering into a customs union or similar confederations. Each time, doubts over permanent neutrality stood in their way.

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[17] List, Friedrich. *The national system of political economy: translated by Sampson S. Lloyd* (London: Longmans Green and Co., 1909). See also Hopkins, Thomas, 'The limits of 'cosmopolitical economy': Smith, List and the paradox of peace through trade'. In *Paradoxes of Peace in Nineteenth Century Europe*, eds. T. Hippler and M. Vec (Oxford: Oxford University Press, 2015), 77-91.

[18] For an excellent treatment of Belgian 19th century economic history, Baudhuin, Fernand. *Histoire de la Belgique contemporaine, 1830-1914* (Brussel: A. Dewit, 1928).

[19] For an illustration, see Volkaert, Florenz. 'De onderhandelingen over het Franco-Belgisch Verdrag van 1861 en de eerste *most-favoured-nation* clausule in de Belgische handelspolitiek'. *Pro Memorie: Bijdragen tot de Rechtsgeschiedenis der Nederlanden* 20 (2018) 234-261.

3.2 Permanent Neutrality, Economic Sovereignty and The Impossibility of a Customs Union

The many propositions by France to enter into a customs union with Belgium illustrate the genius of List's insight. Even before Belgium officially gained its independence in 1839, France already proposed a Franco-Belgian customs union in 1836. Once independent, French officials made a second attempt, to no avail. In the proposal of 1839, Belgium would have had to accept a common external tariff, common management of tariff revenues (to be divided according to population, not commercial traffic, a provision in blatant favour of France) and a commission in which French officials would have an overwhelming majority. Belgium would furthermore have to adopt the French tariff system and respect French intellectual property rights, while France would be competent for negotiating commercial treaties. The Belgian government would merely be able to accede to trade agreements already negotiated and concluded by the French. Last but least, the 'Court de Cassation de la France' would be competent for adjudicating any conflicts with respect to tariffs. Naturally, Belgium refused, but when France made third endeavour in 1840, the Great Powers finally intervened and made clear that a customs union would be found incompatible with the obligations of Belgium under international law.[20]

3.3 Abbé de Foere: Against Balance of Power or the Ultramontane Reassertion of Economic Sovereignty

In 1840, at the request of Léon de Foere (an ultramontane priest), the Belgian *Chambre des Représentants* instates a parliamentary Commission of Inquiry to look into the 'situation fâcheuse' in which the external commerce of the Belgian industry purportedly found itself. After consultation of the Belgian chambers of commerce, a report on the problems and

[20] Suetens, Max. *Histoire de la politique commerciale de la Belgique depuis 1850 jusqu'à nos jours* (Brussels, Librairie Encyclopédique, 1955), 19-23.

deficiencies of the enacted trade policy is published.[21] Unsurprisingly, the main finding is that the Belgian industry suffers from a lack of access to foreign markets due to protectionist tendencies in neighbouring countries and the proven difficulties in establishing trade relations with overseas regions.

However, much more interesting for our purposes is de Foere's proposed solution: joining the Zollverein (i.e. the customs union between the states of a not yet unified Germany) or a customs union with France. The priest is well aware of the difficulties fraught with such an enterprise: the Great Powers would in all likelihood not accept a customs union, especially not with France. However, according to de Foere, an independent state cannot lack the competence to conduct its commercial affairs as it sees fit: such a state would not be fully sovereign, which is anathema to public international law. In his own words:

> 'Le droit public de l'Europe, tel qu'il est aujourd'hui admis, reconnaît aux états de tout rang le droit de gouverner leurs affaires commerciales comme ils les entendent, et, par conséquent, de contracter des alliances qu'ils croient conformes à leurs intérêts. Un état sans indépendance nationale, ou un état auquel cette même force majeure, qui lui a reconnu cette indépendance, dénierait le droit de combiner les éléments de son existence, serait une cruelle dérision'.[22]

Whether such a view is indeed correct legally speaking is an open question, but we will see below that beliefs concerning rules of international law can equally constrain state behaviour, just as hard obligations under international law can. De Foere continues cleverly that in any case tariff barriers will not hold back an invasion. On the contrary, a prosperous Belgium would

[21] Rapport fait par M. De Foere, au nom de la commission d'enquête parlementaire, sur les trois questions posées par le Chambre des Représants, 22 december 1841, *Parl. St.*, Kamer van Volksvertegenwoordigers 1841-1842, nr. 96.

[22] 'The public law of Europe, as it stands today, recognizes that states of all ranks have the right to govern their commercial affairs as they see fit, and, as a consequence, to join alliances when they believe doing so serves their interests. A state without national independence, or a state which would be denied the right to combine the elements of its existence by the same major forces that have recognised its independence, would be a cruel mockery.'

be better apt to resist French encroachments, and thus Belgium should be allowed to enter a customs union with France. The final conclusion of the Commission of Inquiry is therefore that the Belgian state can freely enter into a customs union: a sovereign state necessarily has the sovereign capacity to freely pursue trade as it sees fit. In short, permanent neutrality does not override the right to economic self-determination, in de Foere's scheme of thoughts.[23]

3.4 International law as "a Republic of Beliefs"

In a highly original book, Kaushik Basu has proposed a new approach to law & economics.[24] As one of the leading economists from the Third World, he draws insights from his practical work with the government of India and the World Bank. One of the central theses of his book is that many "legal solutions" adopted in developed countries do not work when transplanted to developing countries, mainly due to widespread corruption and a corresponding lack of enforcement. In his own words, "a constant refrain is how the law is fine on paper but not implemented properly".[25] Enforcement issues render legal rules ineffective, something which he argues law & economics has largely ignored so far.

The key insight formulated here is that Basu's critique can be readily transposed to international law. Indeed, there are interesting similarities between law in developing countries as envisaged by Basu and international law. A constant refrain in international legal scholarship is that the law on paper is often (albeit not always) ineffective at restraining states. One of the alleged reasons for the late engagement of law & economics with international law is the idea that the law of nations is not really law, if law is understood as "the ordering of relations according to

[23] Ernest Nys would later make a similar argument, see Nys, Ernest. 'Notes sur la neutralité'. *Revue de Droit International et de Législation Comparée* III (1901) 15-49.
[24] Basu, Kaushik. *The Republic of Beliefs. A New Approach to Law and Economics*, (Princeton: Princeton University Press, 2018).
[25] Basu, Kaushik. 'The Republic of Beliefs. A New Approach to 'Law and Economics''. *Policy Research Working Paper World Bank No. 7259* (2015), http://hdl.handle.net/10986/21991.

authority backed by the threat of force".[26] On many occasions the violation of international law need not lead to enforcement by force, and surely some states wilful and wanton break the rules knowing that coercion is unlikely to follow. However, this concept of law is much a eurocentric construct particular to the domestic legal systems of the developed West, Basu's work suggests. In developing countries, domestic law is often ignored for similar reasons as is international law. Sometimes, the rules are broken because the transgression is not deemed sufficiently important to bother with enforcement, or, sometimes, the rules are broken because the strong believe they can get away with it through bribery, intimidation or other forms of corruption.

In Basu's view, the fundamental issue is that (domestic) law is nothing more than "ink on paper". If all citizens collectively decide to disregard whatever rules are enacted, the law fails to change the payoffs of the players involved, leading to the exact same equilibrium outcome as if there were no such law. This assertion runs quite contrary to the conventional Becker model used in mainstream law & economics. The basic idea of the latter is that people respond to the incentives provided by the law, by changing the costs and benefits associated with different kinds of behaviour, ultimately leading to different (equilibrium) outcomes.[27] However, both the history of and contemporary international law is rife with examples of states blatantly ignoring whatever is jotted in treaties and memoranda's. If the members of the family of nations collectively decide to ignore a treaty rule or custom, international law will fail to change the payoffs of states involved, and thus international law becomes immaterial. Hence, Basu's critique is pertinent to the study of international law as well.

Nevertheless, there are plenty of examples, both in developing countries' domestic and the international legal system(s) where *law works*.[28] According to Basu, this is so because "[t]he

[26] Cass, Ronald. 'Introduction: Economics and International Law'. In *Economic Dimensions in International Law. Comparative and Empirical Perspectives*, eds. J. Bhandari and A.O. Sykes (Cambridge, Cambridge University Press: 1997), 1-42, 5.
[27] Basu 'The Republic of Beliefs' (2015) 10-14.
[28] Basu 'The Republic of Beliefs' (2015) 14-23.

law changes human behavior, or, in the context of games, the outcomes of games [i.e. game theory], by changing people's beliefs about what other people may or not do." Law is nothing but a "a structure of beliefs carried in the heads of all the people in society". Thus, law merely changes an actors' belief about what other actors may do, which is what ultimately determines human behaviour. Whether this is so on the domestic or international level does not strike us as pertinent. In short, "we are" all, since states act through individuals, "condemned to the republic of beliefs".[29]

This digression out of the way, we can return to our main point. Although the Great Powers showed themselves reluctant to accept a Franco-Belgian customs union, doubts remained over the sovereign capacity of the Belgian state to enter into such a union with either France or the Zollverein, as evidenced by the continuing French proposals for economic integration and the discourse of the ultramontane priest De Foere. The small state problem identified by List nevertheless constantly pushed Belgian policymakers towards a customs union, and indeed, many actors advocated for doing so throughout the 19th century. However, the fact that the Great Powers, and Britain in particular, "burned money" by putting permanent neutrality in the treaties recognizing Belgian independence, signalling their willingness to prevent any alienation of Belgian economic sovereignty towards France, or any other country for that matter. The belief about what other actors *may* have done is what ultimately restrained the Belgian state from taking a particular path (a customs union), not the hard obligation under international law to refrain from doing so, since it was never entirely clear that such an obligation existed.

4. Permanent Neutrality as Enabler: Institutionalising Neutral Profiteering and Free Riding

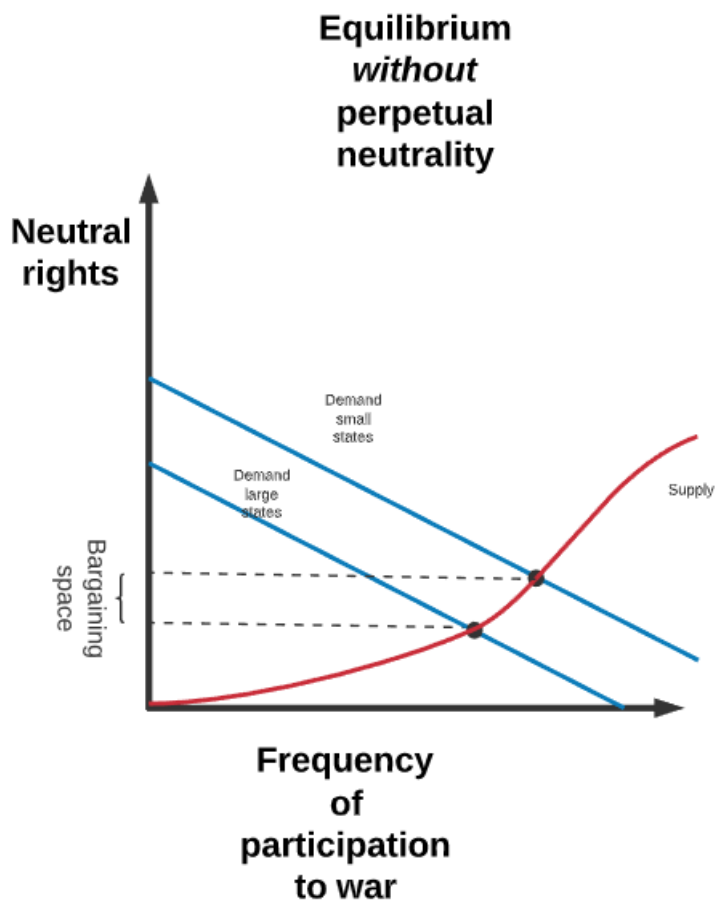
[29] Basu 'The Republic of Beliefs' (2015) 33.

4.1 Modelling Neutrality

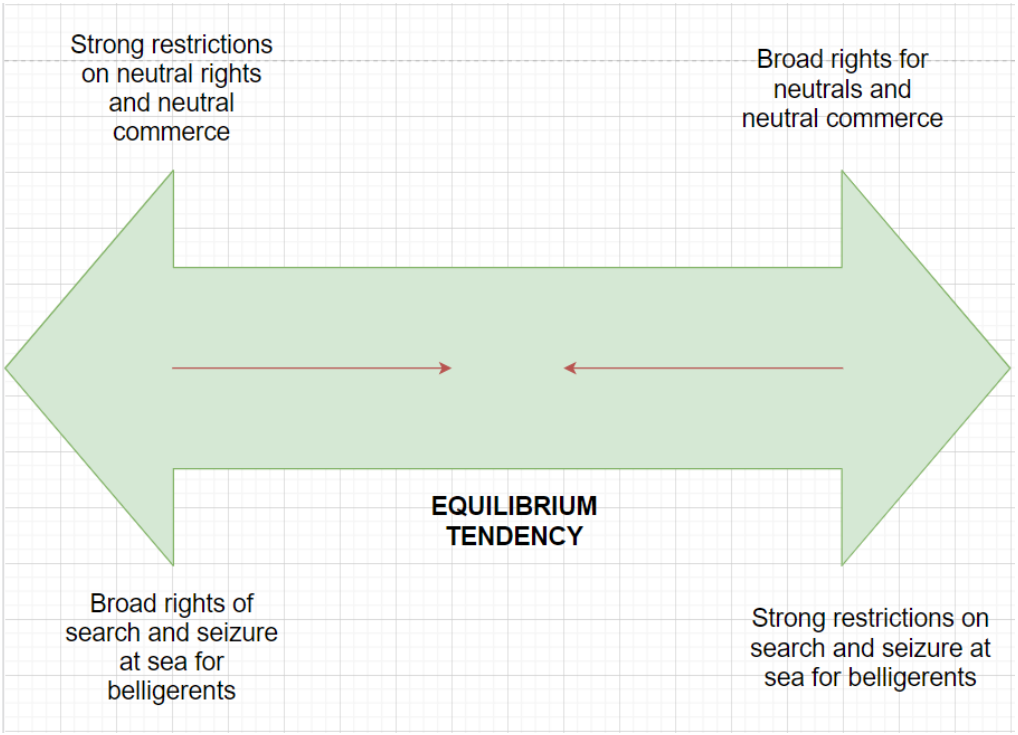
In the following paragraphs, we leave the republic of beliefs behind and return to the assumptions common in the field of international law & economics. Thus, it is assumed that (1) states are the relevant actors, rational and self-interested; (2) states have preferences (i.e. a set of goals) and maximize their interests; (3) their preferences are consistent, complete and transitive; and (4) resources are limited (i.e. states face a budget constraint).[30]

Let us furthermore assume that the costs of providing, monitoring and enforcing neutral rights by the international community increase as the *frequency of* and *the participation* to war grows (X-axis). Let us also assume that small states inherently have a greater demand for neutral rights (because they rarely expect to be involved in war) and that large states have a smaller demand for neutral rights (because they expect to engage in wars of conquest). As a state (small or large) participates in war more frequently, its demand for neutral rights will fall (blue curves).

[30] Goldsmith and Posner, *The Limits* (2005) 4-10; Posner, Eric and Sykes, A. *Economic Foundations of International Law* (Cambridge-Massachusetts: Belknap Press, 2013) 12-17.



As the incidence of war grows more frequently, the supply of neutral rights becomes more costly, which is illustrated through the upwards sloping supply curve (in red). The demand curves of large and small states are downward sloping: as they participate in war more frequently, their appetite for neutral rights falters. The intersection with the Y-curve is different for both: in fact, we have assumed that the preferences for war and thus neutral rights are qualitatively different for small and large states. However, for both the attractiveness of neutral rights decreases the more the state acts (or expects to) as belligerent. Later, we will come back to this when we add permanent neutral states to the picture. For now, it suffices to note that there is a bargaining space, i.e. states can bargain to certain extent over neutral rights, but there will be a tendency for the outcome of the bargaining to fall between the two points indicated on the Y-axis. Alternatively, this "equilibrium tendency" can be illustrated as follows:



4.2 A Transaction Cost Perspective

In a world of zero transaction costs,[31] the Coase Theorem suggests that there would be no need for neutral rights under international law: each time war breaks out, states would simply negotiate a utility-maximizing agreement on the rights and obligations of belligerents and neutrals. In the graph above, such an agreement would always fall within the bargaining space. However, this is obviously not the world actually inhabited by states. Quite the opposite, transaction costs in state negotiations are often rather high and even prohibitive (in the past even more so than today). If states take recourse to war as measure of last resort to resolve a dispute, it is unlikely they would be able to agree on a set of rules concerning maritime commerce. In effect, were states able to conclude such an agreement, one is pressed hard to see why war would be necessary at all. Thus, an internationally binding set of rules (treaties and

[31] Coase, Ronald. 'The Problem of Social Cost'. *Journal of Law and Economics* 3 (1960) 1-44. For the lawyer-economist, this imaginative exercise is quite familiar, but for legal historians this may seem strange. The zero transaction costs assumption is used to gain insights into a world with positive transaction costs (i.e. the real world). There is thus no suggestion that the real world would be one where transaction costs do not matter. On the contrary, the goal is to derive useful insights to gain a better understanding of the real world.

custom) becomes warranted in order to avoid a situation of lawlessness and disorder. Arguably, the latter would bring widespread ruin to international trade and leave all parties off worse. Thus, avoiding the Pareto pessimum (i.e. a lose-lose outcome) is the reason why states consent (through treaty or custom) to a binding set of rules for maritime commerce in times of war.

As such, the laws of neutrality can be considered a transaction costs-reducing device that fixes a situation of market failure on the international plane. Indeed, leaving things to the "market" is likely to lead to costly bargaining, opportunism and other forms of strategic behaviour. O. Williamson has shown that such problems may be remedied through choosing for hierarchy as opposed to a market. Developing a set of rules to which all states consent and vow to adhere is indeed very similar to the formation of what is called "peer groups".[32] Members of a peer group shift from a calculative state of mind to a quasi-moral one in order to overcome opportunism as well as to pool resources so as to enable effective monitoring against free riding or other forms of *ex post* malingering.[33] In short, in order to avoid the repetition of costly negotiations which are likely to lead to failure (a Pareto pessimum) as a consequence of prohibitively high transaction costs, states form a peer group by agreeing on an internationally binding set of rules for neutral commerce in times of war. In the next section, perpetual neutrality and the Belgian state take centre stage again.

4.3 Guillaume Arendt: Permanent Neutrality as an Incentive for Commerce

During the Orient Crisis in 1840, tensions with France were at an all-time high. For this reason, King Leopold I procured a study on a permanent neutrality which could be used as material for *lawfare* against a French invasion. To this purpose, Guillaume Arendt was hired, professor at

[32] A peer group is a form of hierarchy situated in between a market and what Williamson calls "simple hierarchy" (i.e. much akin to vertical integration with respect to firms). Such a hierarchical relationship is however irreconcilable with sovereignty and unattainable through mere treaty-making or custom. Under international law, simple hierarchy could only be attained through annexation of one country by another.
[33] Williamson, Oliver. *Markets and hierarchies: analysis and antitrust implications: a study in the economics of internal organization*, (New York: Free Press, 1975) 20-56.

the University of Louvain.[34] His *Essai sur la neutralité de la Belgique* ("Essay on the neutrality of Belgium", 1845)[35] is a remarkable piece of work and offers a unique contemporary view on the perception of permanent neutrality. For a more complete overview, the reader is referred elsewhere.[36] Here, the focus is on Arendt's arguments with respect to commerce and free trade. According to Arendt, besides obligations with respect to the defence of national territory[37], a state which is permanently neutral can and may only have a one goal under international law:

> 'Favoriser les progrès de l'agriculture, la maintenir à la hauteur de développement et de prosperité à laquelle elle a su atteindre, encourager l'industrie, lui accorder la protection dont elle peut avoir besoin, étendre et multiplier les relations de commerce et de navigation, voilà les fins, nous semble-t-il, que son gouvernement doit se proposer dans cet ordre de faits. Tous ces intérêts la guerre les compromet, si elle ne les ruine et les détruit, tandis que la neutralité les ranime et leur permet de prendre un nouvel essor.'[38]

Indeed, much of subsequent scholarship has reiterated such views.[39] In the introduction, we referred to the present day definition of permanent neutrality as "the removal of certain countries or areas from *eligibility* for war by means of an internationally recognised legal

[34] Dhondt, Frederik and Vandenbogaerde, Sebastiaan. ''La mentalité de nos confrères à l'égard de ce qui fut jadis et sera demain'. The Neutralities of Belgium, the Congo Free State and the Belgian Congo (1885-1914) seen through the Journal des Tribunaux'. *Journal of Belgian History-Revue Belge d'Histoire Contemporaine- Belgisch Tijdschrift Voor Nieuwste Geschiedenis* 48 (2018) 134–162, 138-141.

[35] Arendt, Guillaume. *Essai sur la neutralité de la Belgique, considérée principalement sous le point de vue du droit public*, (Brussels – Leipzig: C. Muquardt, 1845).

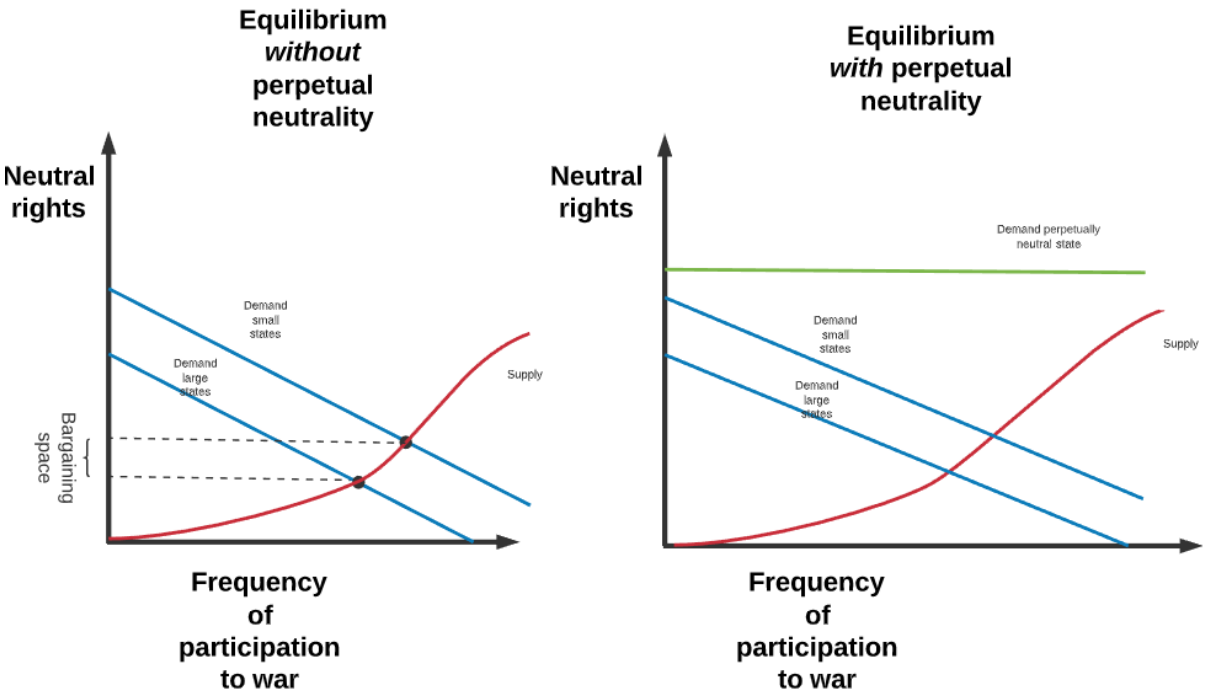
[36] Dhondt, Frederik. 'Neutralité permanente, interprétations mutantes: la neutralité belge à travers trois traités de juristes'. *Tijdschrift Voor Rechtsgeschiedenis-Revue d'Histoire Du Droit-The Legal History Review* 86 (2018) 188-214.

[37] Arendt, *Essai* 1845, 73-76.

[38] Arendt, *Essai* 1845, 45-46. Translation: 'To promote the progress of agriculture, to keep it at the level of development and prosperity which it has been able to attain, to encourage industry, to give it the protection it may need, to extend and multiply trade relations and navigation, these are the objectives, it seems to us, that his government must propose itself in this order of facts. All these interests are compromised by war, if not ruined and destroyed, while neutrality revives them and allows them to take on new life.'

[39] Winslow, Erving. 'Neutralization'. *The American Journal of International Law* 2 (1908) 366-386, 370-371. Compare to Robinson, Stewart. 'Autonomous Neutralization". *The American Journal of International Law* 11(1917) 607-616; Wright, Quincy. 'The present status of neutrality'. *American Journal of International Law* 34 (1940) 391-415, 392; Abbenhuis, Maartje. *An age of neutrals: great power politics, 1815-1914* (Cambridge: Cambridge University Press, 2014).

status".[40] This also entailed the right to refuse in interstate violence. Unable to wage war, a perpetually neutral state would by nature of its status have to focus on the material improvement of agriculture and industry, and thus be led to advocate freedom of navigation and free cross-border trade. While this may seem trivial at first, it is not. The absence of the sovereign capacity to wage war changes the preference of the perpetually neutral state so that it becomes indifferent to the frequency it wages war:



It is furthermore so that on multiple occasions, Belgium actually used its special status as constitutional shield to profit from war elsewhere by continuing exports and particularly arms, traditionally a large industry in Belgium.[41] As such, the demand curve for a perpetual neutral could be remodelled as upwards sloping: the more frequent war, the more opportunities to export weapons and reap excessive wartime profits. During the Austrian-Prussian War of 1866, Switzerland, another example of a perpetual neutral, gained the right for "Swiss" vessels to fare

[40] Neff, Stephen. *The Rights and Duties of Neutrals: a General History* (Manchester: Manchester University Press, 2000), 29 and 101.
[41] Dhondt, 'Permanent Neutrality or Permanent Insecurity?' (2019).

under its flag, taking over vast swaths of Austrian commerce on the Adriatic Sea.[42] Hence, even for a notoriously landlocked state the lure of wartime profits was too strong to resist. The consequences of such an anomaly in terms of sovereignty for the equilibrium is difficult to generalise in a model, but clearly the permanently neutral state would have no incentive *at all* to advocate for belligerent rights at sea and would *always* support the broadest interpretation of neutral rights possible.

4.4 Permanent Neutrality: Institutionalising Free Riding and Neutral Profiteering

According to Mancur Olson, "rational, self-interested individuals will not act to achieve their common or group interest", which constitutes much of the central thesis of his celebrated "The Logic of Collective Action".[43] He defines a public good as "any good such that, if any person X_1, in a group X_1, …, X_2, …, X_3, …, X_n consumes it, it cannot feasibly be withheld from the others in that group".[44] Exclusion from consumption must thus be impossible for a good to be properly considered public. With respect to neutrality, the non-interruption of trade and open seas in times of war are clearly a public good. No state can be excluded from the benefits of continued maritime trade and an open sea, once these goods have been provided for. In a similar vein, free trade and the institutions guaranteeing free trade are considered public goods.[45] By analogy, the same argument could be made for the rules of neutrality. Governments have a shared interest in the creation and maintenance of rules concerning continued trade during times of war. When such rules are absent, search and seizure would tend to excessiveness. As to the latter, the First World War serves as the prime example.[46] At the same time, it is hard to imagine

[42] Lemnitzer, *Power, law and the end of privateering* (2014) 154-155.
[43] Olson, Mancur. *The Logic of Collective Action: Public Goods and the Theory of Groups* (Massachusetts: Harvard University Press, 1965) 2.
[44] Olson, *The Logic of Collective Action* (1965) 14.
[45] For example: Petersmann, Ernst-Ulrich. 'International Economic Law, 'Public Reason', and Multilevel Governance of Interdependent Public Goods'. *Journal of International Economic Law* 14 (2011) 23-76; Mavroidis, Petros. 'Free Lunches? WTO as Public Good, and the WTO's View of Public Goods'. *European Journal of International Law* 23 (2012) 731-742, 734.
[46] See Turlington, Edgard. *Neutrality: Its History, Economics and Law, Volume III: The world war period* (New York: Columbia University Press, 1936).

why one trading nation would have the incentive to provide this public good. In absence of cooperation, enforcement of neutrality rules would be far too costly for one state to bear on its own.[47] At the height of its maritime hegemony, even Britain was unable to enforce a set of rules without consent or support from other states.

At the same, Belgium (like most other permanently neutral states), as a small state with a limited military and maritime fleet, is unable to contribute to the provision of the public good. Maintenance of trade and an open sea in times of war requires extensive monitoring and enforcement activities. To this purpose, military power is required. Furthermore, in Olsonian terms, during the 19th century the European family of nations should be considered a "small group".[48] Olson argues that certain small groups are able to provide themselves with a public good without coercion (stick) or positive inducements (carrot) vis-à-vis group members by provision of the public good in itself. This is so because some members of the group personally gain more than the costs associated to providing the good for the entirety. Indeed, Olson notes that large group members are likely to disproportionally bear the burden of providing the public good. Since smaller members by definition benefit less from public goods, its incentive to contribute is likewise smaller. Thus, Olson concludes, in small groups "there accordingly is a surprising tendency for the 'exploitation' of the great by the small".[49]

The historical record confirms Olson's hypothesis. We find indeed that Belgium as small state did not contribute to the provision of the public good (maintenance of trade and open seas in times of war), but left this to larger states such as Britain and France. As a permanently neutral state, it moreover benefitted more from the public good than a "normal" small state did (recall

[47] The so-called "hegemonic stability theory" argues that the supply of a public good, such as free trade, "depends upon a distribution of international power analogous to that within a privileged group". See Gowa, Joanne. 'Rational Hegemons, Excludable Goods, and Small Groups: An Epitaph for Hegemonic Stability Theory?'. *World Politics* 41 (1989) 307-324.
[48] Olson, *The Logic of Collective Action* (1965) 22-36.
[49] Olson, *The Logic of Collective Action* (1965) 33-35.

the constant or upward sloping demand curve). Belgium was ineligible to go to war, and thus it did not have to bear a large part of the costs of provision of the public good to profit from it. The provisioning costs were left to belligerents. As neutral rights expanded over the course of the 19th century, belligerents had to accept that neutrals would keep up the supply of their enemies, reap wartime profits and take over their peacetime trade. A perpetually neutral state, like Belgium, would be the greatest beneficiary. As such, permanent neutrality was a guarantee to a free ride and institutionalised neutral profiteering.

5. Conclusion

The laws of neutrality concern war and peace, and in particular the rules of wartime maritime commerce. These developed over the centuries as the results of a constant struggle between shifting alliances of belligerents and neutrals. During the 19th century, the Great Powers created an anomaly: the so-called permanently neutralised state. Belgium is one of the prime examples of such a state. This article asserts that the rights and obligations of belligerents and neutrals had important economic consequences, especially so for a perpetual neutral country like Belgium.

First, permanent neutrality has been shown to impose constraints with respect to economic sovereignty. Under international law, it was unclear what was meant by the status of permanent neutrality. State practice was to flesh out the concept. However, it has been shown that despite the uncertainty over the precise content of the status, a customs union or similar forms of economic integration were perceived or believed to be problematic under international law. Two case studies were used as illustration: (1) the negotiations over a customs union with France and (2) the discourse of the ultramontane priest de Foere, preceded by a reflection on the theory of the German economist Friedrich List to demonstrate the economic logic steering the calls for a customs union.

As such, in order to successfully develop its economy, Belgium had to find other means besides intensive economic integration. One means to do so was to *leverage* its limited economic sovereignty through neutral profiteering. Perpetual neutrality was not only a constraint, but also provided a positive incentive with respect to commerce. Indeed, when one door closes, another one opens, or so a popular saying goes. First, a model of neutrality shows that normal states have a decreasing demand for the rights and obligations of neutrals as the *frequency of* and *participation to* war increases. Second, Williamson's transaction costs economics was used to explain the emergence of the laws of neutrality as a transaction costs-reducing device. The transaction costs concerning an ad hoc treaty laying down the rules for wartime maritime commerce would be prohibitively high, so that other means for solving disputes had to be found. Third, the historical record indicates that scholars perceived perpetual neutrality as an obligation for the state to promote commerce. Returning to our earlier model, permanent neutrality makes a state indifferent or even positive towards the frequency of war. Since it is ineligible to wage a war of conquest itself, it can only profit from war by taking over another state's commerce through neutral profiteering. Last but not least, recalling Olson's logic of collective action, the article demonstrates how permanent neutrality creates free riders and institutionalises neutral profiteering. As such, the Belgian state can be said to have leveraged its limited economic sovereignty by free riding and neutral profiteering.

6. Epilogue

Surely, there is more to be said and done on the economics of (perpetual) neutrality. However, there are not many examples to go by in the field called "the economic analysis of legal history", in particular with respect to *international* legal history. To our knowledge, this is a first attempt at intertwining international law & economics and international legal history. Nevertheless, we hope to show with this paper that the interaction between the two disciplines may advance both

fields. In addition, further engagement with the New Institutional Economics by (international) legal historians is especially likely to be rewarding.

While it is outside the scope of this paper to answer the question how Belgium became one of the most industrially advanced nations during the 19th century, neutral profiteering certainly offers one explanation. Thus, perpetual neutrality may have been an important cause for economic growth, a subtle point which economists are likely to miss. It furthermore suffices in this context to briefly point out that Belgium throughout the 19th century was an ardent advocate of free trade and an open economic trading system in Europe. Some prominent economists have asked why this was so.[50] The link to its permanent neutral status as a constraint on economic sovereignty is easily made. If economic integration proves impossible, free trade becomes the more attractive alternative. As a consequence, perpetual neutrality created a path dependency[51] towards the embedment of free trade. The insight that not all states face the same incentives due to the basic structure of international law is of great importance to the economic analysis of international law. As such, international legal history may provide answers where (lawyer)-economists falter.[52]

Similarly, it is not uncommon for (legal) historians to miss the bigger picture and get lost in details. There is some merit to Coase's critique vis-à-vis the old institutionalists. Further engagement by legal historians with economic theory is therefore likely to provide an overarching framework for the "mass of descriptive material waiting for a fire". Law often has a distinctive impact on the economic system, in the past as much as today. Legal historians would do well to take note.

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[50] Chang, Ha-Joon. *Kicking away the ladder: development strategy in historical perspective* (London: Anthem Press, 2003).

[51] North, Douglass. *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990).

[52] This is not to mention that economists can test theory by using historical data. A theory postulating a mechanism which has been observed in history is unlikely to be an adequate description of reality, even if parsimony is rightly considered important.

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