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Preface: What Can Economics Do for Foreign Policy?

“Almost all the defects inherent in democratic institutions are brought to light in the conduct of foreign affairs.”

— Alexis De Tocqueville¹

INTRODUCTION

For more than ten years after the fall of the Berlin Wall, I followed a course of unrelenting travel around the globe. Working as a policy advisor to developing countries and international organizations on a range of economic and administrative reform projects, I visited almost every country in Asia, many parts of the former Soviet Union, and some regions of Africa and Latin America. Because I worked primarily with economists, I assumed that the forces shaping our major international policies were ultimately economic, and that economic rationale was a universal criterion by which decisions were made. Then in 2001, I was invited to Washington to participate in the making of international economic policy for a presidential administration in its formative stages, an experience that opened my eyes to the overarching importance of foreign policy and the role that perceptions of national security had played in many of the very programs and policies with which I had toiled.

As a senior policy advisor, I became aware of how frequently foreign policy decisions, such as loading more debt onto countries already crushed with existing debt, deviate from models of optimal resource management depicted by economic models. My experience in government has also helped me to understand why economic institutions insufficiently transferred uncertainty into risk in developing nations: put simply, powerful constituencies benefit from perpetuating the uncertainty, and some of these groups are the partners of our government or of large international corporations. In this book, I will explore how conceptions of national security influence such deviations from economic optimality, explain why they occur, and consider some of the unanticipated costs. I ask questions that are not being posed in the literature on international relations.

I begin in Part One by challenging the conceptual and strategic tenants that have guided the definition of U.S. national interest since the Cold War. Part II I is an

¹ From *Democracy in America*.

analytical narrative of U.S. relations with six Asian nations that explores the defining events that continue to frame how almost one half of the Third World's population views the U.S. Part III offers reasons to shift the sources of knowledge and models of thought that condition our policies.

Throughout the book I attempt to bridge economics and international relations. Economic ideas deeply infuse our rationale for international relations and those commitments in turn, rationalize the perpetuation of those very ideas so that self-propagation occurs in a closed system. The goal of this book is to question loop of self-justification that links ideas to policy and even military interventions in developing nations.

The inability of U.S. forces to make progress in Iraq will eventually punctuate the need for an intellectual revolution in how we perceive our own security in the 21st century. First we must accept that the heft of the world's economy will shift increasingly to the former nations of the Third World. Then we must acknowledge how a psychology of triumphalism guides current foreign policy to dubious conclusions. That psychology has a corrosive effect by rationalizing policies inconsistent with our values; it leads us to inadequately assess our own experience and to disregard how different our situation is from much of the world's poor, young, and emerging nations. The narratives that shape our views of recent global history are rarely shared by others. For example, the bipartisan consensus that interprets the decline of communism as an automatic validation of America's culture and institutions and by projecting Cold War triumphalism into the War on Terror actually marginalizes support for American models of markets and politics.²

THE DIVERGENCE BETWEEN ECONOMICS AND POLITICS

Economics plays a dual role in this book. Within economics as a discipline are many ideas that if applied to foreign relations would generate policies that differ in

² The breakup of the Soviet communism is frequently misconstrued as a victory of capitalism over communism. Yet a number of former communist countries have successfully transitioned into market economies, and some have evolved into flourishing democracies without shots fired. In fact, communist regimes are among the most successful democratizers of the past thirty years, often outperforming their authoritarian neighbors in important areas of human development, such as education for females, basic health, and recreation — a contrast underscored by comparing the non-communist and former communist Islamic populations of Central Asia. Communism's demise is still far from producing a global consensus that America's political and economic model is the best alternative for everyone.

fundamental ways from habits of thought that are deeply entrenched among foreign policy specialists. But there is a much darker side to the role of economics in contemporary foreign policy making. It offers many rationales to continue the status quo and this darker side will be addressed at the end of this chapter.

Greater sensitivity to economic thinking can improve foreign policy in number of ways. Business schools teach the importance of bankruptcy clauses and the need to restructure distressed portfolios or investments. In foreign policy, the issuing of new loans on top of bad yields a gain of political leverage. Bankrupt regimes are easy targets for favors like base rights or votes in the United Nations. When loan payments falters, or loan conditionality is evaded, strategic rather than economic optimality will determine the exercise of forbearance, and if fresh loans rather than discipline will follow.

Economists understand that money already spent is “sunk” and has no relevance to future decisions. They teach their students to walk away from unrecoverable costs. But in foreign policy, different rules apply: the greater the investment — be it an alliance, an intervention, a war — the fewer the exit options, no matter how ill-conceived the investment may be. Even when controllable costs exceeded the benefits of staying in Vietnam, the Nixon administration argued that withdrawal without victory would damage U.S. credibility and undermine relationships with other regimes. To critics of continuing the engagement of U.S. forces in Iraq, President George W. Bush frequently alludes to U.S. lives already lost in Iraq.

Economics distinguishes between total and marginal utility, a difference that has important implications for understanding peasant movements, Third World nationalism, and revolution. People rank preferences according to the costs of fulfilling them, and when they stop believing they can alter their economic opportunities at a reasonable cost, they select instead to gratify their need for self-esteem through actions that express their sense of community or loyalty to a group whose identity they share. They may gain greater marginal utility from exercising allegiance to their group, especially if measures to transform their economic well-being are out of reach. But in foreign policy circles, it is frequently assumed that oppressed citizens of underdeveloped countries will wait to satisfy the need for self-fulfillment, self-esteem, or self-expression until after their more basic needs are met. By assuming that people fulfill their needs according to their total

utility rather than their marginal utility, we have underestimated the appeal of nationalism in developing nations. This error led to the belief that materialism could subdue nationalist impulses in client regimes such as South Vietnam and Iran.

Costs understood in terms of foregone alternatives are an important economic consideration when choices are made among competing objectives. Yet practitioners of foreign policy disregard opportunity costs in declaring an all-out war on terror, which jeopardizes the quality of diplomatic relationships with Islamic nations as the United States wields its military might to ferret out potential terrorists from the societies that sustain them. Economists must ask if it pays to reduce the number of potential terrorists to zero if this 1) means alienating the majorities whose support is essential to build viable alternatives to terrorism and 2) ignoring the burden we are imposing on the very societies we need to win over. A redeployment of resources used to fight the War in Vietnam might have reduced the dangers of communism through efforts to combat Third World poverty and to improve the terms of trade for developing economies.

When foreign-policy decision making defies the most elementary rules of financial management the long-term consequences can be very costly. Decisions that diverge dramatically from economic rationality are generally politically unstable or have consequences in practice that damage America's reputation as an honest broker for the causes that will provide a sustainable international environment.

FINDING A UNIFIED APPROACH TO THE POLITICAL ECONOMY OF INTERNATIONAL DEVELOPMENT

Perhaps the most costly miscalculation in American foreign policy is a failure to appreciate how the private interests of politicians affect their choice of public policies. One body of literature in economics known as Public Choice teaches that foreign policy serves the same electoral objectives to an incumbent administration as domestic policy. Public Choice allows us to view the president as the first customer and principal consumer of foreign policy and apply the utilitarian calculations that we apply to consumer behavior. By linking the alignment of the private interests of the chief executive with his or her choice of public policies, we gain a useful perspective on the political constraints that impinge upon and shape U.S. foreign policy, the insights gained

may even help illuminate the sources of the most expensive miscalculations in American foreign policy.

A traditional approach common among historians and political scientists is to seek the origins of the Cold War conflict between the U.S. and Soviet Union in the clash of divergent ideology inherent in national politics. Odd Arne Westad for example in his magisterial historical account of the Cold War attributes the motives of both the U.S. and the Soviets to a desire “to change the world in order to prove the universal applicability of their ideologies, and the elites of the newly independent states proved fertile ground for their competition.”³ In this view the ideological pattern of U.S. involvement with the world reflected colonialist proclivities that originated in the mindset of the eighteenth century republic and that was first expressed in devastation to indigenous cultures in North America. The Cold War, Westad asserts, U.S foreign policy continues the tradition of European imperialism. Westad makes a good point, but if we can broaden our approach to include incentives we can examine the motivations of leadership of all the relevant actors, the Soviets, the Americans and the leaders of Third World nations from the same lens.

The alignment or misalignment of public and private incentives of political leadership is among the greatest policy dilemmas we face. Few would be surprised by the statement that autocrats, backed by ruling-class elites, have few incentives to implement domestic reforms for the benefit of their citizens precisely because private and public incentives are out of alignment. Ironically, when those incentives are aligned with large coalitions as in Western democracies the commitment to democracy promotion in the Third World is undermined. We mistakenly assume that as the world’s greatest advocate of democracy, America is also the most convincing example of the system’s success. However, democratically elected leaders in the United States have little political incentive to align themselves with democratic reform movements overseas. American rhetoric about democracy promotion reflects misconceptions about the relationships between political incentives, institutions, and foreign policy outcomes — and it disregards that people define democracy in ways that depend on their national history.

³ Westad, 2005: 4

The successful politician recognizes and satisfies the economic, political, and military needs of his or her backers. It matters little whether the regime is democratic or autocratic, no leader can survive in office in either autocratic or democratic regimes without delivering legislation and services for their constituents. But there is great variance in the size of winning coalitions enjoyed by democratic as compared to autocratic regimes. In a democracy, backers are the large majorities that reward politicians who manifest competence in providing public goods and advancing public policies. By contrast, in numerous developing countries, that backing comes from key elites who require private goods rather than policies that would spread benefits widely. Ironically, the very exclusivity of these autocratic regime constituents makes them targets for alliance-building by wealthy democracies: enriching a handful of influential families is the best and easiest way to ensure the political loyalty of such governments. This regularity of Third World politics is generally not the result of U.S. machinations; but U.S. policymakers have learned to manipulate local politics to keep autocratic regimes in power and be assured of dependable allies when America needs favors, such as military bases, U.N. votes, or scarce natural resources. Ensnaring foreign elites in a web of entitlements that secure their loyalty and dependency is a proven way to gain the policy concessions Americans covet. In contrast, the fledgling democratic governments of the Third World are less reliable alliance partners because they depend upon coalitions that are too heterogeneous and too broad to payoff.

This manipulation of Third World political vulnerabilities comes at a price. Accommodating odious regimes:

- causes economic conditions to deteriorate, increasing the dependency on external assistance and making the country more prone to crisis and reduces the accountability of leadership to their own citizens;
- leaves U.S. overseas assistance with few channels to reach broad segments of recipient populations, forcing it instead to be disseminated as consumption to supporters of the regime;
- creates a legacy of resentment and bitterness, making it likely that reformist leaders will be constrained to prove themselves through anti-American postures;

- allows autocratic partners to dictate their interests to the United States, playing on national security fears;
- discredits both the U.S. and its economic model because our uncritical belief in the efficacy of private markets makes us party to the entrenchment of regime cronies;
- reinforces the powers that established oligarchs can exercise over weak institutions of emerging economies.

These outcomes occur because Wilsonian rhetoric and ideology blinds us to a very inconvenient reality; the private incentives of democratically elected politicians in the U.S. align with the private incentives of autocrats overseas. The results are alliances that sustain small, winning-coalition systems facilitated by the assistance America gives to their police and armed forces. Another misconception follows: The democratic values we espouse raise hopes among Third World populations that our actions offset. Yes the democracy we preach arouses aspirations and attracts immigrants and visitors, but those same individuals become our sternest critics, having learned to admire American values they end up by deploring U.S. policies toward their own countries.

PERVERSE CONSEQUENCES OCCUR WHEN LARGE WINNING COALITION SYSTEMS LINK FOREIGN AID WITH NATIONAL SECURITY

U.S. aid flows rarely correspond to needs, as revealed by human development indicators.⁴ Instead, the primary recipients of assistance are determined by their strategic importance, even if this means reinforcing small, winning coalitions.⁵ And within those countries, the smaller the winning circle, the easier it is to obscure the hand of a donor and keep information hidden about the distribution of benefits from foreign collaboration. As a result, foreign assistance has not gone where it performs best in reducing poverty, and those most in need rarely are the recipients of aid.

⁴ There is little direct correlation between aid expenditures by the United States and reductions in infant mortality and other basic indicators of human development. This failure can generally be attributed to public choices made in the recipient countries and could probably only be influenced by the outside if aid were directly targeted on the basis of its contribution to supporting liberal political regimes. The rules governing aid transfers generally prohibit such explicit political motivation (Boone, 1995). Boone found that liberal political regimes exhibit 30 percent lower infant mortality rates than the least free regimes.

⁵ For more information on the subject of the welfare effects of winning-coalition size, see Bueno de Mesquita, et al, 2003; and Bueno de Mesquita and Root, 2000.

Aid flows have been shown historically to fall short of benefiting the poorest segments of the global population as William Easterly has passionately argued.⁶ Even more disturbing is that the poorest segments within recipient countries such as Pakistan or the Philippines, to name but a few, rarely benefit. When public officials and bureaucrats are corrupted by incumbent leaders who represent a narrow social or ethnic class, they too, have no incentive to provide the populace with clean water, primary sanitation, adequate calories, and education. An unfortunate match occurs. Projects such as airports, dams, armaments, and power stations, which engender large kickbacks to regime loyalists and fiscal deficits among recipient nations, are consistent with the political incentives U.S. politicians face as well.⁷ Remember American politicians appear successful at home when they can trumpet concessions obtained overseas — such concessions are less likely from nations seeking loans for educational and health facilities for the downtrodden. And even if the President succeeds in successfully eliminating poverty in a client regime the reward is unlikely to be policy concessions the U.S. electorate is seeking.

When a recipient society at large benefits, no single agent exists with whom to barter for policy concessions. It is easier to allow a few dozen families to control the economy and the governments, even if they overlook deficits, avoid fiscal austerity, and deprive the poorest citizens of health, education, and social services. Frequently, this is why our alliances in the Third World leave behind bitter legacies of poverty, violence, and pollution, even in those countries where significant GDP growth can be measured, such as Iran, Indonesia, and Pakistan. Today the global deficit of good governance — often the residual effect of foreign policy during and after the Cold War — is a warehouse of grievances that destabilizes international relations. Our stance as guardian of global democracy creates expectations of citizen entitlement that we are unable to fulfill.

HOW MILITARY INTERVENTIONS REPRODUCE THE MOST ADVERSE EFFECTS OF SMALL-COALITION RULE.

⁶ W. Easterly, 2001.

⁷ Perkins, 2006.

The single most deleterious consequence of the democratic paradox described above and in greater detail in Chapter One is revealed in the strategies employed to overthrow foreign governments, as happened in Nicaragua, Guatemala, Honduras, Grenada, Panama, Chile, Iran, South Vietnam, and most recently Iraq.⁸ It is much less costly to win over small coalitions through pay-offs and threats than to gain the allegiance of large overseas majorities. However, such interventions to align foreign governments with U.S. policy goals inevitably reproduce all the undesirable consequences of small-coalition rule, especially its single most significant determinant: the capture of the state to dispense rewards to coalition members in the form of private goods. Regimes installed by means of force or violence have little potential to evolve into systems that nurture broad-based participatory governance, and they typically reinforce a cycle of instability.⁹ A major power can easily take out a corrupt and uncooperative regime, but it is much more difficult to change the pattern of rule to reflect the interests of large majorities through public policies that enhance general well-being.

Inexpensive coups seem initially successful precisely because they offer a cheap and efficient mechanism to bribe a small subset of a poor nation's population to do the bidding of a wealthy external power. For thirty years the U.S. foreign policy community thought that replacing Mosaddeq in 1953 with the Shah was a foreign policy success. We now can see that it was a disaster. The establishment of responsive and accountable governance is not the logical outcome of such interventions. Accomplishing regime change through the stratagem of the inexpensive coup is what brought the Shah to power in Iran, and General Thieu in South Vietnam; it also accounts for the long-term inability to transform such regimes into responsive democracies. Covert operations in strategic regimes has entrenched patterns of poor governance, and our aid helped leaders survive who might not have withstood popular pressures for reform and renewal.

Outside assistance allows autocrats to circumvent the need to gain financial support and leverage from their own populations, and in turn makes the United States dependant upon unstable individuals and regimes rather than popular support. Regardless of the ideological, political, or economic reason for overthrowing a foreign government,

⁸ S. Kinzer, 2006, *Overthrow: America's Century of Regime Change from Hawaii to Iraq*, Times Books, N.Y.

⁹ For more on this subject, see Bueno de Mesquita and Root, 2000.

putting into place a system that ensures durable large-coalition rule is unlikely, given the logistics of intervention.

And there is an inescapable lesson of U.S. foreign policy to ponder. So long as small coalitions in developing nations have more influence to sell to wealthy large coalitions in industrial democracies (relative to democratically elected Third World governments), the tendency will persist for both economic and military aid to reach regimes that fail to alleviate poverty or promote broad-based growth. Remedies are needed that will establish institutions, rules, and procedures for international relations that will reverse the tendency for high-income majorities in developed countries to link with high-income minorities in the Third World.

When misguided interventions fail, a common response is to hold intelligence services responsible for providing inadequate forecasting. When a major foreign initiative collapses calls for reorganization of the intelligence services follow but competent counterespionage is not the solution when failed mental models or systems of belief produce mistaken policies.

This book argues that it is not clandestine intelligence collection and counterespionage that fail us but rather inadequate models of socioeconomic development that, uncorrected, lead to flawed advice. And this, of course, is the far more intractable problem that cannot be overcome by eliminating incompetencies with data mining from telephone records and transaction orders. Many of the conflicts we face with Islamic populations reflect an inability to base policy upon dynamic models of adaptive social and economic processes.¹⁰ The absence of such modeling results in short-term interventions that diverge from long-term national interests.

ECONOMIC POLICY AS AN IDEOLOGICAL DARK FORCE

Then will the logic of economics be the salvation of foreign policy? Surprisingly when economic theory and foreign policy have converged the result is rarely propitious. In fact, our economic policies suffer from many of the same deficiencies as our foreign policies. Both fail to grasp the deep structural features underlying long term societal and historical change. Both artificially separate micro and macro factors and fail to see how

¹⁰ For analysis of policies that contributed to a potentially revolutionary process in the Middle East see Sheri Berman (2003) "Islamism, Revolution, and Civil Society," *Perspectives on Politics*, vol. 2, June: 257-272.

micro level transformations are linked to larger global patterns. Both shift the causes of major transitions to exogenous factors. Both fail to see the interconnectedness of downward and upward change cycles. Both fail to see the self-transforming dynamics of large social transitions. Both fail to anticipate the regularity of crisis, revolutions and great transformations that punctuate history and that conceptual shortcoming renders the liberal economic synthesis into an accomplice of global injustice.

Economics as a discipline along with modernization theorists in sociology have been participants, and even contributors, to the legacy of triumphalism that mars contemporary American nationalism. Many of the economic ideas that Americans consider objective laws of history or economics are viewed as self-serving doctrine rather than analysis – rationalizations driven by self-interest, national pride and intellectual prejudice. Manfred Steeger is one of many commentators who identify the core theorems of neo-classical economics as a “nineteenth century narrative of ‘modernization’ and ‘civilization’ that presents Western countries—particularly the United States and the United Kingdom—as the privileged vanguard of an evolutionary process that applies to all nations.”¹¹ Such critiques reflect a deep deficit of credibility due to the failure of the neo-classical synthesis that today dominates economic policy to answer the questions that developing countries are most likely to ask.

Economics has been unable to develop a scientific understanding of dynamic processes such as how and why did industrialization happen? How is complexity created from the bottom-up? Why does wealth grow in an explosive manner? How can societies in which patronage accommodates the asymmetry of power introduce liberal institutions or market competition without compounding inequality? Instead of answering such questions that developing countries are mostly likely to ask, the neoclassical synthesis of economics is designed to deal with systems in equilibrium. Not being equipped with adequate theories about growth and change, the highly unrealistic assumptions underlying international economic policy have limited its empirical success. Foreign policy that assumes the inevitable linkage of trade openness with the rise of pluralism is will fail to see that global economic power can link with illiberal governance by inducing

¹¹ Manfred B. Steger, 2002, *Globalism: the New Market Ideology* (Lanham, Md.:Rowman & Littlefield, : 12-13.

middle-class acceptance through consumerism. And the equilibrium based models of economics will fail to prepare Americans in the years ahead for the abrupt change in the relative wealth and economic power that will abruptly transform power relations between the United States and the emerging developing giants, including China, India, and Brazil.

Throughout the Cold War the greatest economic challenge posed by the Third World was teeming population that translated into global poverty on a massive scale. In the 21st century the newcomers will exert more influence over global resource flows, and the demands and preferences of their populations will determine global resource scarcity and prices. Their cooperation will be necessary to contain weapons proliferation, train human capital, preserve the value of the U.S. dollar, keep global financial channels and trade open, arrest the spread of new strains of deadly microbes, and prevent the destruction of the natural environment. And their scientific capabilities will be needed to solve some of these global risks. Thus, future security will depend on relationships and linkages with partners that lack equal standing or representation in the international system. A test of our wisdom and leadership will be to ensure a stable environment in which these shifts in global power are managed. Advocating global trade and commerce without erecting appropriate governing institutions we create a deficit of global legitimacy, easily exploited by the incumbent powers.

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CHAPTER 1

DEMOCRATIC PARADOXES

“The small state should avoid taking predetermined positions on all international issues on the basis of identification with one Great Power as against another, for the sake of fleeting material benefits or because its regime in power believes that it is being propped up by a Power without whose support it would be liquidated by its own people.”

— Zulfikar Ali Bhutto¹

When the United States engages in foreign policy, it must confront two paradoxes: first, that many people who hate the United States want to live there; and second, in contrast with the ideals and principles Americans profess, their government supports repressive, even brutal regimes that enjoy little popular support as reflected in the opening quote from Bhutto. The following chapters provide a theoretical and historical framework in which to examine both paradoxes through case studies of China, India, Pakistan, Iran, the Philippines, and South Vietnam. They also look at why foreigners who identify with American ideals are ready to resist U.S. political influence on their soil.

Other current approaches to U.S. security dilemmas of the 21st century tend to examine conflicts with emerging powers in the context of recent events, which is rather like watching the last twenty minutes of a feature film. This book will trace the character formation of the principal players to their sources. It will reveal that current U.S. foreign

¹ Bhutto (1969: 22).

policy dilemmas and America's consequent inability to sustain long-term security relations with developing countries are more often than not the unintended consequences of Cold War strategies and priorities. The failures of policy, organization and cognition that are responsible derive from institutional constraints central to the functioning of American democracy.

Many Americans, both political leaders and ordinary citizens, believe the United States embodies democratic ideals and is therefore a model of sociopolitical development. Those democratic ideals, they claim, form the moral basis for U.S. global leadership. Indeed, they are often stunned and confused by the visceral criticism leveled against this country from abroad.

As a young man in the 1970s, I visited West Bengal and remember being similarly stunned by the anti-American sentiment I found. Almost daily, friends and colleagues treated me to rants about the evil effects of American power. At the same time, these same people welcomed me into their families. Many sought visas for themselves or relatives hopeful of working, studying, or even living in the United States. Later in graduate school, I met young Iranians who had stood before the White House shouting *Death to America!* while family members queued for visas at the U.S. Embassy in Tehran to acquire residency permits.²

In Paris, as a student I shared an apartment with an individual who later played a prominent role in the Sandinista insurgency in Nicaragua. An admirer of Thomas Jefferson, he was cooperative, helpful, and respectful of American democratic values.

² On November 15, 1977, the visit of the Shah and the Empress Farah to the White House sparked protests from thousands of Iranian students studying in the U.S. Former American hostages in Iran recall that the Islamic leaders who condemned America were the very the same ones requesting special favors and visas for friends and families. The long lines of Iranians seeking U.S. visas were often family members of the radicals who had seized power.

Several years after we met, his photograph appeared in *The New York Times* with four others, all wanted for violent anti-American activities in Central America.

It took me a long while to understand fully the source of these contradictions. Certainly, American political rhetoric did not provide the answers. Administration after administration has maintained that American ideals form both the paradigm for global development and the moral foundation for U.S. leadership in progressive policy change overseas. As a result of this unflinching confidence in America's benevolent influence on the affairs of others, presidents and their cabinets and advisers can only imagine one explanation for anti-American criticism overseas: envy. Indeed, they reason, even allies like Saudi Arabia or Egypt, or formerly allied nations like Iran and Iraq, rail against us because they envy our success, because America is rich and modern, democratic and powerful.

Democrats and Republicans use the same language. "Americans are targets of terrorism in part because we act to advance peace and democracy," said President Bill Clinton.³ Richard Haas, a senior State Department official in the administration of George W. Bush explained that "it's not anything we're simply doing. It is who we are. It's the fact that we're the most powerful country in the world."⁴ Such conventional answers that attribute the motive of envy to the actions of our critics are not only inadequate and dangerous; they inhibit true understanding and corrective action. The discrepancy between how Americans see themselves and how others see them has become an obstacle to the leadership America seeks to project and a threat to global stability. After infusing the colonized people of the Third World with enthusiasm for

³ Blum (2000).

⁴ Ibid.

controlling their own government and destiny, a failure to live up to the rhetoric and its attendant perception gap inflame anti-U.S. passions around the world.⁵

I knew my friends did not hate America because of its wealth. Nor did they resent America because, as both Presidents George W. Bush and Clinton have insisted, it stands for democracy and human rights. My friends were idealists, too. Their ambitions for themselves and for their loved ones were the same as ours: the guarantee of human and democratic rights. But their experience of American power was sharply at odds with the values America espoused and guaranteed for its own people. As they saw it, the way America governed itself was incompatible with its projection of power to make anti-democratic interventions in the domestic affairs of others. Liking Americans and liking America, although the current administration resists the distinction, were two different matters.

How did the ideals that hold American society together become so removed from the perception outsiders have of America's role in the world? Why do others see the United States as a threat to the very values it champions? Why do the majority of Egyptians, Jordanians, and Pakistanis have a negative image of America while being among the largest recipients of U.S. aid?

At the end of World War II, all parties agreed to focus U.S. foreign policy on the reconstruction of Europe and Japan. Later, as the Cold War progressed, both Democrats and Republicans were primarily concerned with containing Soviet communist influence abroad. They did this by building defensive military capabilities along Soviet borders and by ensuring that those nations with the industrial capacity to threaten U.S. security did not fall in with the Soviets. Later the focus to contain the Soviets shifted to the Third

⁵ Manglapus (1976: 60).

World and would-be Soviet allies — Angola, China, Cuba, Chile, Congo, Egypt, and North Korea, among others — received stern warnings that neither conventional nor guerrilla warfare, nor the encouragement of insurgency nor the subversion of pro-Western regimes, would succeed. Between 1949 and 1965 American foreign policy enjoyed a rare consensus across the entire political spectrum.

Although U.S. policy declarations always clearly supported and encouraged democracy, national independence, and the welfare of citizenry, Cold War presidents emphasized policies that subordinated the promises that America expounds to protect people living in Third World nations from the injustices of colonialism and social inequality. Friendly regimes, especially those near Soviet and Chinese borders (such as Iran, Pakistan, the Philippines, and South Vietnam), considered crucial to the containment of communism, received aid to strengthen their domestic security services in order to resist domestic or external challenges. The methods, both covert and overt,⁶ were in fact applied so indiscriminately to cement alliances that they corrupted the very regimes being protected.⁷ In many cases, autocratic leaders used domestic security forces strengthened with U.S. aid to repress or plunder their own populations. They also did so with full concurrence of their American backers. No wonder the populations in those countries grew embittered and mistrustful. And as we shall see, the dictators themselves frequently turned on America.

UNLIKELY PARTNERS

⁶ Stephen Kinzer: 2006.

⁷ South Vietnam's Diem can be viewed as a counter-example; he was eventually overthrown with U.S. acquiescence, but the shortcomings of South Vietnam's subsequent leaders were overlooked.

If we are to guard against unsustainable and often fatal partnerships (as with Iran, Iraq, the Palestinian Authority), it is essential to understand how they came about in the first place. Why did Cold War foreign policy depart from the principles of American traditions and ideals that shone brightly during two world wars?

Comprehensive constitutional or institutional reforms require long gestation periods. The progressive movement that created the meritocratic civil service in America required two generations of building up the public trust in government before the population was willing to allow it to directly tax incomes. Managing social security required an additional fifteen years after the introduction of the personal income tax.⁸

Jimmy Carter campaigned on a promise to restore faith in the integrity of government and championed the public good over narrow self-interests. Yet the post-Watergate distrust of government that helped elect him in 1976 was insufficient to support an agenda for institutional change during his term in office. He was unable to transform public cynicism about such institutions as the CIA and the FBI into a positive force for reform. When he failed to transform domestic institutions that seemed out of control and unaccountable, what did successive presidents hope to gain from their constituents by challenging the security forces of foreign nations that abused the rights of their own citizens?

Mobilizing comprehensive governance reform in overseas partners is a not a realistic policy goal. Such reforms succeeded only in already industrialized nations, road maps simply did not exist and still do not for building the institutions of liberal democracy in pre-industrial environments. Consequently, U.S. presidents perversely find they can provide the public goods their own various constituents demand — allies,

⁸ Root (2006).

intelligence posts, military bases, trade access, strategic raw materials, and votes in international organizations — by enticing autocrats with aid, even when this means that values back home are compromised. To satisfy the needs of various constituents an incumbent administration will prioritize partners overseas, knowing the demand for security and affordable natural resources is much greater than the demand to monitor democratic norms. Thus, being a good president at home does not necessarily mean the president is a good global citizen or an advocate of good government abroad. No one captured this irony better than Franklin Roosevelt, who remarked of America's friend Anastasia Somoza in Nicaragua, "He may be a son of a bitch, but he's our son of a bitch." In a similar vein, Roosevelt entered into an alliance with Stalin to defend democracy against Nazism. He entered into these alliances because Somoza and Stalin were willing to carry out the policy preferences of U.S. voters.

When formulating foreign policy, incumbents need not look beyond how their domestic audience values the consequences of their actions. Their ratings do best domestically when they are seen as effective at gaining policy compliance from foreign leaders. If a president believes or convinces Americans that national security is at stake, the malleability of a foreign regime is more important than its internal political structure. Throughout the Cold War, it was convenient to ignore the connections between the length of political tenure of client regimes, the nature of governance, and the flow of foreign aid. Data collected by Bruce Bueno de Mesquita and colleagues confirms that the survival prospects for autocrats that received aid but did not promote growth were considerably higher than democrats with below average growth. In fact aid helps corrupt dictators more than it helps corrupt democrats to stay in office. The survival prospects for

autocrats without aid and below average growth converge to the survival prospects of democrats with no aid and below average growth.⁹ U.S. assistance was often a reason that authoritarian rulers who exercise power unchecked by law or other institutions often enjoyed great longevity in office.¹⁰ The aid plays a particularly critical role if they have little popular support, since their political tenure depends on a small, exclusive coalition to whom they extend access to private goods and for whom disloyalty can be costly.¹¹

The prospect of ruling through the disbursement of private goods to select clients is often possible because democratic regimes in the West provide those autocrats with resources for which no domestic substitute exists. This improbable partnership occurs because democratically elected leaders in rich countries find that their counterparts in poor countries who rule at the pleasure of a small, exclusive group of loyalists are likely make policy concessions in exchange for aid so long as those concessions do not threaten their core base of supporters. Only when the pool of necessary supporters is allowed to expand, and more contenders for power emerge to put pressure on diminishing reserves, do autocratic systems become less effective and begin to break down. The geopolitical loyalties of successor regimes are likely to be unpredictable and difficult to influence.

Those who point out that aid constitutes a small component of a nation's total economy may find that argument counterintuitive. However, while aid may constitute only a few dollars per capita, small in terms of overall impact to the national economy, it is a political bonanza for autocrats, who have only to pay off a small following; the

⁹ Results reported in Bueno de Mesquita and Hilton Root (2000) and Bueno de Mesquita et al (2000).

¹⁰ The connection between political survival and good governance are discussed in Bueno de Mesquita and Root (2000) and Bueno de Mesquita et al. (2003).

¹¹ That foreign aid serves as bribes from rich to poor countries was stressed by Hans Morgenthau (1962: 301–9). Bueno de Mesquita and Alistair Smith (ms 2005) provide an analytical model that links the appeal of such deals to the size of a regime's winning coalition. They concluded that "the US was most likely to give aid to its friends during the Cold War. Alternatively, as our theory suggests, the US buys alignment through aid."

privileged domestic supporters they patronize in exchange for loyalty usually include those who control the military, the civil service, the communications and information infrastructure, and the economy. The more external support is allotted to these regimes, the easier it becomes to exclude the many from sharing in power, diminishing prospects for reforms and a more inclusive, democratic orientation.

Furthermore, receipt of early aid can stabilize a ruler's tenure because it frees up money to buy support. Even small amounts of aid can provide the novice autocrat the revenue to outbid political rivals, gain the support of essential partners, and deter defection. In this way, rulers do not have to raise wealth through an inclusive process.

In addition, a *quid pro quo* strategy can be effective only with dictators who maintain tight control by being able to claim strong loyalty from key supporters. To obtain concessions, it is advantageous to keep otherwise unacceptable partners in power for as long as possible. Thus autocratic regimes with little or no public debate or transparency in the collection or disbursement of revenues, no free press, and no civil liberties that allow people to express displeasure with regime policies and performance become the partners of choice for those Western democracies seeking to buy influence. Repressive regimes overseas can disperse aid selectively with little risk of public exposure or censure.

The incentives offered by external assistance will generally be insufficient to bring about an alignment of geopolitical policy when significant extraneous influences, such as the press, public opinion, personalities, and an inclusive bargaining process, are present. When foreign aid or public disbursement is subject to debate in legislatures, in the press, in the ballot box, public exposure can make it difficult for incumbents to

survive that accept aid but do not produce growth and popular public policies.

Democratic leaders in both donor and recipient countries gain constituent support by adopting policy positions aligned with majority preferences. Since uncertainty exists as to whether elected leaders of developing country democracies would support western security objectives (such as military bases, air routes etc)¹² leaders of wealthy countries with functioning inclusive political institutions rarely form alliances with democratically elected leaders of developing countries, as we shall see in the relationship between the United States and India.

In a competitive democracy, a leader quickly depletes his budget by distributing public resources, including foreign aid, to large numbers of voters. Once the budget is depleted the loyalty that was purchased is dissipated as occurred to South Vietnamese leader Nguyen Van Thieu. He lost his ability to stay in power once he lost access to American aid. Successful democratic leaders end up competing for support by creating public goods that can assist the poor —health, education, and agricultural services and rural credit — that enjoy broad support. Such goods are difficult to provision through bilateral or multilateral overseas assistance since their dissemination is labor intensive, requiring extensive distribution and administrative linkages with the capital. Aid

¹² During the Cold War U.S. strategists,(after 1947), concluded eight mutual defense pacts with 42 countries by 1960, plus executive agreements and other formal pledges with 30-some others (table 23). Nearly 1,700 U.S. installations, large and small, eventually circled the Northern Hemisphere in locations selected especially to monitor military activities inside the Soviet Union, ensure early warning if Soviet Armed Forces attacked, and block the most likely land, sea, and air avenues of Soviet advance. The United States maintained no Cold War military bases in Africa, save two communication stations on Morocco's coast. U.S. installations in other Arab lands were limited to berthing privileges in Bahrain for a minuscule Middle East Force (MIDEASTFOR), which consisted of a flagship and two (later four) elderly destroyers (<http://www.ndu.edu/inss/books/Books%20-%201998/Military%20Geography%20March%2098/milgeoch12.html>). A National Defense University website.

bureaucracies have a weak track record in being able to support small or young firms or at directing government credit to innovators. Most foreign aid goes toward the government itself or to established incumbents. In both donor and recipient countries aid constituencies are beneficiaries of capital intensive allocations such as infrastructure or defense contracts. This means that both the poor along with the emerging or dynamic sectors of the population rarely benefit from externally provided assistance. Aid goes instead toward supporting incumbent interests, linking the reputation of the donor with the incumbent. No wonder the left has tended to critique aid for being bias towards the status quo.

It is cheaper to co-opt leaders who rule through the disbursement of private goods to small coalitions, thus the global powers of both blocs, America, Britain and France as well as the Soviets and the Chinese, found it cost-effective to back autocratic leaders who build support for their regime by selectively distributing aid to ensure that the well-being of an influential few depended upon connections to the regime. Since fewer concessions can be made by democratic recipients of aid, the motivations of democratically elected leaders at home are difficult to align with those of democratically elected leaders overseas. This mismatch underlies the preference of leaders of large winning coalition systems to form alliances abroad with leaders of small winning coalitions. The consequence is an enormous bad governance overhang in client regimes that frequently can be attributed to a history of external interventions and alliances that ensure that the many remain unimportant.

U.S. alliances with client Third World governments differed little from other donors, but its footprint was larger; by virtue of the scope and size of its aid programs it

attracts more recrimination especially in the Middle East where much of the divide between Muslim and non-Muslim communities is over strategies for empowerment. Historically, when anti-Western governments were expected to prevail at the polls, such as in Algeria and Lebanon, the United States and other Western allies, undermined democratic processes while U.S. aid has helped autocrats in Morocco, Tunisia, Saudi Arabia, Jordan, Uzbekistan, and Pakistan to remain in power. Military base rights and cheap resources acquired by the West from friendly tyrants overseas continue to create a perception that nourishes extremism and disillusionment: This perception barrier, that divides Muslim and non-Muslim societies nourishes much of the hostility to the West.

The external assistance that can still make an essential difference in securing an autocrat's hold on power would only marginally improve the fortunes of a democratic leader, who depends on broad-based support. An instructive case in point can be found in the deeply troubled relationship between the oldest and most stable democracy in the world and its oldest Third World counterpart. India has been historically the fourth-largest recipient of U.S. Overseas Development Assistance, but American economic aid has never been sufficient to gain substantial policy concessions from that country. India's elected leaders are beholden to a large winning coalition. If aid were dispersed as private goods to all Indian voters, it could never buy enough influence to make the broad electorate partial to American interests.

While espousing democracy, secularism, the rule of law, and development, American foreign policy-makers disseminated far more aid on a per capita basis to Pakistan than India and Pakistan's autocratic regimes received more support than was provided to its democratically elected leaders. India's democratically elected leaders

needing support from large electorates at home would not accommodate America's geopolitical objectives. By the 1980s, the economic and strategic preferences of the Indian electorate drew further from that being espoused by the U.S. and India voted more frequently against the U.S. in the United Nations than did the Soviet Union. Pakistan, on the other hand, as Bhutto's opening remark indicted allowed America to extract a large *quid pro quo* from its leaders in exchange for assistance needed to keep that leadership in power. In effect, foreign aid relieved the incumbent Pakistani regime from having to build institutional mechanisms for gaining the assent of political constituencies outside the government. Similar situations occurred with China before 1949, Iran and South Vietnam in the 1960s, and the Philippines during the 1970s. A long history of aiding autocrats who failed to promote the development of their own countries while ignoring all democratic processes and values is one reason America today finds itself confronting indignant populations all over the developing world. This will be explored in further detail in later chapters.

DEMOCRATIC NARCISSIM

This book argues that U.S. political ideals — its commitment to democracy and the rule of law — are not the causes of embittered relations with many Third World nations. Trying to understand why some of the worst enemies of the U.S. are in allied nations like Saudi Arabia or Egypt, or formerly allied nations like Iran and Iraq, this study finds that the range and depth of antipathy reflect a lack of convergence between American ideals and actions abroad.

Between 1972 and 1986, four administrations essentially collaborated with Ferdinand Marcos in the destruction of Philippine democracy, demonstrating to Filipinos

that good government and national development of the Philippines were of secondary importance to American security interests. As a consequence of that ethical disappointment, during the discussion with the civil society, Filipinos were clear about their feeling toward the United States. Amina Rasu-Bernardo writes “In general, we love the United States. We love the American people, and we love the American way of life. However, Filipinos are also becoming more critical and distinguish the difference between the American people and American policy.”¹³

Although the United States was finally instrumental in the removal of Marcos, this did not erase the memory of fourteen years of solid backing enjoyed by the dictator. Plus, the image of America offering a safe haven to Marcos, as it had offered the Shah earlier, rather than to allow the deposed dictator to be tried at home, further inflamed nationalist indignation. In 1991, the Philippine Senate ordered America to close its bases on Philippine soil, bases that had become symbols of the era of U.S. complicity in the destruction of Philippine democracy.

The deterioration of U.S./Philippine relations is only one more example of the gap between reality and ideals in U.S. actions abroad. It grows increasingly dangerous for the country to ignore this gap and the negative impact of U.S. policies overseas. Without a compact that provides obligations and rights to each side, American foreign policy is self-destructive and naïve.

The problem is that democratic narcissism, what author Richard Kerry has described as the “star spangled mirror,” prevents Americans from seeing themselves as others see them.¹⁴ Democratic narcissism and self-admiration prevent Americans from

¹³ Asia Foundation (2004: 11).

¹⁴ Kerry (1990: 87-99).

seeing the effects of their policies on populations beyond their borders. The continuing influx of foreigners seeking a better life in the States only reinforces national vanity and assumptions of moral righteousness, cultural exceptionalism, and the civic superiority that sustains them. International public diplomacy continues to focus on rhetoric that lauds the ways in which American institutions conform to democratic ideals and extol civic virtues, yet it ignores the impact of harmful overseas policies.¹⁵ It is not surprising that anti-Americanism in countries like India and Vietnam, Burma and Malaysia is less extreme than in countries Washington has helped finance and arm, such as Egypt, Iraq, Iran, Pakistan, and Saudi Arabia.

The democratic decision-making process — the most cherished feature of the American political process — is at the root of the country's poor performance in foreign policy and has extreme consequences for its capacity to sustain global leadership. What gets presidents elected and makes them successful at home, and the effects of their policies overseas, have become the source of hostile relations with many Third World populations. If U.S. policies are to change, we must recognize that the interventions overseas and the ideology that sustain them are inseparable from the incentives American leaders face to build viable coalitions to survive in office.

The real danger is this: policies that are democratically constructed at home and produce outcomes injurious to majorities in other nations ultimately and inevitably create risks to long-term security. Unless America's political leaders learn to appreciate and

¹¹ One misperception of Americans is the presumption that foreign visitors, once exposed to civic minded U.S. domestic politics will cease to be resentful and will return to their homes as friends. But the opposite often occurs. Visitors exposed to democratic values up close want to bring these values back with them, and will be doubly frustrated to find American foreign policy obstructing the realization of the very democratic aspirations their contact with the U.S. has nurtured.

manage the risks to long-term security posed by democratic narcissism, U.S. foreign policy will remain self-defeating. As improved relations with India since 2001 demonstrate, anti-American sentiments are not immutable, strategic coordination is possible once adjustments are made in U.S. policy towards accepting the emergence of alternative power centers. Trust must be based upon the durability of interdependency. Even former antagonists can learn to reciprocate based upon reciprocity.

At her Senate confirmation hearing, Under-Secretary of State for Public Affairs, nominee Karen Hughes apprised her mission as “helping others understand our policies and values.”¹⁶ Such a remark points exactly to the problem America faces overseas: the gap in moral perception and the clash between values and action. It is not the message, but the action that must be adjusted, and the task ahead is to reconcile the democratic practices of America’s domestic policies with the democratic aspirations of the world’s emerging populations. The challenge for American global leadership is to discover an intellectual basis for foreign engagement that allows future foreign policy to be steered by America’s moral compass and which leads a community of nations toward enhanced global citizenship.

To that end, the following chapters will explore some of the imperatives of domestic politics driving America’s leaders to adopt policies that have had deleterious overseas impact, and emphasizes the need to create enduring security by learning a new pattern of behavior that recognizes the durability of the relationship with the emerging powers of the Third World. A relationship of increasing mutual interdependency is likely to continue for a long time so that the conditions are ripe for enhanced cooperation.

¹⁶Vogel and Witte (2005: 8).

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CHAPTER 13

REDEEMING DEMOCRACY THROUGH THE MARKET: DO OPEN

MARKETS PRODUCE OPEN POLITICS

“No country can afford to have its prosperity originated by a small controlling class. The treasury of America does not lie in the brains of a small body of men now in control of great enterprises. ... It depends on the inventions of unknown men, upon the originations of unknown men. Every country is renewed out of the ranks of the unknown, not out of the ranks of the already famous and powerful in control.”

*Woodrow Wilson cited by Louis Brandeis (1914)
The Inefficiency of the Oligarchs, Chapter 10.*

Since its first formulation by Woodrow Wilson the notion that opening markets will drive countries toward democracy has animated U.S. international activism linking markets with open politics to produce the democratic peace. Since President Woodrow Wilson’s earliest proclamations, the concept that markets are one component of participatory universe, democracy another the concept has been unsurpassed for giving American foreign policy a mission. But the rapid pace of globalization has exposed a gaping whole in the theory, it lacks agent based realism. In this chapter we will consider the behavior of the key international agents such as multinational corporations in emerging regions. Based on those observations today it is fair to ask if the Wilsonian vision is obtainable? The following essay will suggest key building blocks of a participatory universe are lacking in the Wilsonian vision.

Political scientist and global democracy expert Robert Pastor asserts that Wilsonian liberalism has “made possible the flourishing of a transnational society in which the multinational corporations [MNC] in the private market ...can link arms with

their counterparts in other countries and can thus challenge states to alter their policies or make good on their promise.”¹ By encouraging business development, and improving the climate for domestic and international investment, Pastor believes Wilsonian internationalists in partnership with the multinationals can champion liberty abroad, strengthening the private sector to eventually rise up for political pluralism.

“Citizens would choose their leaders in a free political market within their state, and consumers would choose their products in a free economic market that would expand as technology shrank the world. ... In the new epoch, leaders would be compelled to respond to popular preferences or lose elections. Citizens would be shareholders in the state, just as they might own stock in a business. To stay in business, firms would need to respond to their shareholders’ demand for profits and to the changing preferences of their consumers. The world of empires and monopolies would be replaced by one of democratic governments and private markets.”²

Yet, MNCs have a reputation for being a danger to the world’s poor. Why the adverse reputation? Why is there so much talk about the dark side of global markets and the threat they pose to disadvantaged nations?

Consider the fact that open market access has produced but a handful of newly industrialized countries, a far greater number of nonviable economies, and many ungovernable states with few prospects for self sustaining growth. In many countries trade openness has given entrenched interests increased capacity in collaboration with transnational capital to extract monopoly profits from advantageous positions they already enjoy, preventing the effects of competitive markets from spreading around the world for the benefit of all sectors.

The difficulty of aligning Wilsonian idealism with the incentives of private economic agents may explain why the motives of MNCs are so often the subject of

¹ Pastor (1999): 346.

² Pastor (1999: 342-3).

suspicion abroad. International traders maximize their positions in the global economy by gaining access to excessive returns earned by alliances with informed local traders. Regulatory distortion or political influence in the local market is often the currency of such trade.

The fallacy that links democracy with open markets and the private sector to enhanced political competition can be traced to the idealized notions of how markets function, taught in economic text books. The presumed linkage of market capitalism and the spread of Western-style democracy does not offer a realistic explanation for the incentives of multinational corporate actors, it ignores the information asymmetries that are intrinsic to the process of economic development and it underestimates the danger of entrenchment by incumbent interests that resist market competition.

Many of the business deals that benefit from a combination of foreign policy and government power involve insider trading between government officials and closely connected firms. The expectation that market capitalism will spread Western-style democracy fails to anticipate the capture of the weak institutions in emerging states by wealthy minorities collectively organized to exploit local market imperfections. This tendency challenges the viability of globalization.

GAPS IN THE LIBERAL VISION

The liberal model of market efficiency and Wilsonian idealism rest on the same foundation, both posit the efficacy of public institutions to motivate self-interested actors to gather and process information, monitor corporate managers, and disclose information needed to guide efficient capital investment decisions.³ This ignores barriers to trade

³ In the ideal democratic marketplace, all consumers have access to the same information; traders organize as if each had access to all of the economy's information. Large and liquid financial markets, broad

caused by information gaps that distort resource allocation in developing regions. Some information gaps are intrinsic to the process of under-development; others are deliberately crafted to protect the endowments of incumbents.⁴

In developing countries, inequality, ethnic polarization, and the discretion of political actors create uncertainty that prevents traders from attaining their optimal plans. Institutional devices to signal trust are inadequate but do not cause a complete breakdown of trade. Traders adapt, learning to form informal social organizations that internalize the missing structures of formal markets.⁵ Three critical adaptations to information gaps are family ownership of large firms, pyramids, and investments in political connections.

property-rights protection, corporate disclosure, and third-party audits allow individual traders to engage in profitable risk arbitrage: when efficient market conditions are met, the price system will guide the economy toward market efficiency. Open information access will allow competitive resource allocation to occur as if directed by an invisible hand. The small actors pool their capital and invest in the projects of strangers, often guided by institutional intermediaries. Pooling — by harnessing the power of the law of large numbers — allows optimally efficient financing of projects by directing capital to its highest value. As markets mature, the quest for outside funds leads corporate managers to submit to outside monitoring and control in order to raise capital from publicly managed institutions. The efficiency of capital markets motivates corporate governance to become more transparent. The stake holders — management, shareholders, labor, and consumers — have an interest in ensuring that the laws are enforced and that mandates exist to ensure adequate funding of public agencies responsible for enforcing the rules. In such settings, Adam Smith's intuition might be applicable and private wealth and social agendas could be complementary. Wilson's political ideals extend Adam Smith's economic vision.

However, much contemporary research has revealed that this simple view of competitive markets misrepresents managerial incentives. We know that markets are only responsible for a part of all possible economic exchanges; many of the most important contributions to growth come from the innovations by traders to surmount the informational gaps of the market. Joseph Stiglitz, for example, has argued that market economy models which focus on prices provide poor descriptions of actual economies because they inadequately treat information problems. Once informational asymmetries between market participants are recognized, we observe that the principals of competitive markets are destabilized by the gap between *de facto* and *de jure* rights; in no society are property rights perfectly assigned. Sanford Grossman has shown that if markets were completely informationally efficient, there would be no role for traders who specialize in market information. Intermediaries such as Merrill Lynch, Goldman and Sachs or Morgan Stanley would have no productive role to play, yet absent such specialization, trade would collapse. Since trade depends upon information that is privately collected, it is unrealistic to assume that market prices fully reveal all necessary information. Completely competitive market prices would reduce the incentives for the production of information, and many markets would simply close or not come into existence at all if uninformed traders could completely free-ride on the efforts of informed traders. Yet it is the gospel of such idealized notions of markets that inspires faith in economic growth as the stimulus for global democracy.

⁴ Root (2006: Chapter Three); Rajan and Zingales (2006).

⁵ Grief (2006).

The complexity of business organizations that flourish under conditions of uncertainty do not necessarily correspond with a country's wealth. Some rich countries have highly underdeveloped market institutions, like the oil economies of the Middle East, where state actors that control natural resources display little interest in encouraging private opportunities or championing strong market institutions.⁶ Where market institutions are rudimentary, traders depend on blood ties to organize trade. Illegal transactions often thrive because members of the same clan or extended family will rarely cooperate with state authorities against the interests of their kin. Mafias fill in where market formality breaks down, further voiding state institutions of legitimacy.⁷

Distortions over economy-wide resource allocation that both reflect and reproduce declining rates of innovation can be mitigated by family control.⁸ Family firms report higher than average returns in many countries for the reason that poor institutions produce incomplete markets in which unrelated traders can only with difficulty enforce contracts.⁹ Since external financing for long-term investments is feeble, family firms typically depend upon self-financing or upon financial organizations owned by family members.¹⁰ Family control can have a beneficial impact on company performance but rarely produces companies that achieve sufficient size or managerial sophistication to be

⁶ A strong correlation has been found between natural resource endowments and autocratic government. (Recently Thomas Friedman, *Foreign Policy*)

⁷ Root (2006)

⁸ Khanna and Rivkin (2001) explore the advantages conferred by family ownership, examining affiliated firms in fourteen nations. They emphasize the insurance or risk-mitigating logic of taking coordinated action, finding that affiliated firms share both benefits and costs.

⁹ Khanna and Palepu (2000) and Khanna and Rivkin (2001) explain that affiliation compensates for poorly functioning market institutions. In a similar vein, Nathaniel H. Leff (1976, 1978) wrote about how group organization reduces market frictions.

¹⁰ Efficient capital markets ensure that when family ownership occurs, as in the U.S. automobile industry, the Ford family controls Ford Motors, but not its competitors Chrysler and General Motors. Yet Ford is an exception. In the United States, "family firm" is generally the synonym for a small firm. Most large firms enjoy diffuse rather than concentrated family ownership. Typically one firm or family does not own shares in rivals, are not controlled by insider voting, and are professionally rather than family or state managed in sharp contrast to most emerging markets where concentrated family ownership is the norm.

players beyond the borders of their own country. One reason is that senior management is limited to the competency of family members, since an absence of institutional trust makes it difficult to engage outsiders at senior levels. Hence, family-owned firms are likely to lobby for protection from global markets. Most of Latin America's private sector, along with the private sector in China and in much of the Chinese Diaspora in East Asia (excluding Singapore), fit into this pattern. The ownership of large firms by a single family or network of families does not correct the underlying cause of an economy's bottlenecks; they are adaptations that help individuals succeed without reconfiguring the systemic sources of underdevelopment.

PYRAMIDS

A particularly effective way for private traders to overcome incomplete risk markets and to grow bigger than family owned firms is to constitute pyramidal control structures, characterized by cross shareholding, with control rights concentrated in special shares.¹¹ Pyramids arise to overcome intrinsic problems of resource allocation as economies scale up and increase their access to advanced technology. However, they pose many disadvantages.

By holding onto special company shares that bestow control over company decision-making, a small number of families can extract excessive private benefits from the firms they control without risking their own wealth. Pyramids also stifle competition by employing multiple voting shares and cross shareholdings so that firms in the same sector can be owned by the same families. Pyramids provide sources of capital that allow firms owned by insiders to outperform independent firms. They direct trade and investment away from producers outside the group and make credit available mostly to

¹¹ Morck, Wolfenzon, and Yeung (2005).

members thereby stymieing independent firms that seek to compete on account of managerial competence. Such constraints on competition, common before the Great Depression in North America, seem to be characteristic of the first stage of industrialization in almost all countries.

To avoid pyramids of control that reflect and then perpetuate high inequality,¹² India's first Prime Minister, Jawaharlal Nehru, promoted state ownership of India's industrial and financial wealth, protecting state-owned corporations from internal and external competition, and protecting small from large enterprises. He wanted to prevent a few families united by caste to spread their influence over the entire economy. However his approach to balancing competition and cooperation ended as a vehicle for politicians to funnel jobs and projects to their backers.

Today, pyramids gain opportunities from globalization because most capital that sloshes around in the international economy is concentrated in a small number of global funds firms that invest in a small number of industries controlled by a small number of families. The pyramids are often the first to drink deeply from these international wells of global investment capital. American pro-market policies during the Cold War overlooked these endemic problems of incomplete markets that besiege developing countries and often allow oligarchic capitalism to flourish under a liberal umbrella.¹³

Corporate assets that are to various degrees dominated by pyramids still proliferate among some of the world's most productive emerging economies. The financial crisis that tore through Asia's rising economies in 1997–1998 was caused by

¹³ Few developing countries are attracted by the American idea of regulating monopoly power in order to control it. Introducing U.S. style anti-trust laws is not feasible where strong vested interests will interfere with implementation. When faced with entrenched inequality, government commitment to maintain a competitive market place is rarely credible.

policy distortions protecting pyramids of control. The oligarchic practices that proliferated in pre-1929 America, subsequently made illegal, still enjoy widespread acceptance among the powerhouse economies of emerging Asia. The pattern was introduced to the region during the pre-World War II period by Japan. In most of Asia today, firm ownership structures vest control rights in the hands of a few minority owners who invest very little of their own wealth to command an overwhelming percentage of their nation's listed assets.¹⁴

Large controlling shares in the corporate sector transfer easily to political influence where rules prohibiting conflicts of interest between public and private spheres are weakly defined and poorly enforced. With greatly amplified political influence, the incumbents pursue policy distortions to protect their positions, manipulating public policy to protect their property rights and access to capital. The incumbency effect of economic control pyramids has repercussions for national productivity, stifling innovators who, by definition, lack political clout and typically operate on a scale too small to attract overseas capital. Although pyramids are frequently present when distortions in competition arise from lobbying, the challenge of political connectivity is more general and widespread than the formation of pyramids.

THE PREMIUM ON CONNECTIVITY

A strong tendency to become politically connected is typical among successful firms in developing countries. Preferential treatment may facilitate access to government-controlled financial institutions, government-controlled raw materials, government-owned industrial enterprises and government agencies, such as the army or the police that contract for services and equipment. Along with procurement contracts, government

¹⁴ Root (2006: 64–73).

connections can offer tax advantages and lax enforcement of regulations. Political agencies may determine how stringently conflict-of-interest laws are enforced.

Many firms invest heavily in political connections by contributing to political campaigns and by making direct payments, sometimes offering political allies shares in private enterprises. These effects may be strong enough that in many developing countries the informational role of prices is compromised by purposefully created opacity, benefiting traders who have specialized information derived from privileged access to the government. As political sponsorship increases among firms risk insurance and hedging through the market are restrained.

In the most corrupt nations, political connections facilitate the restriction of foreign investments entirely, such as Myanmar, which attracts little investment interest. In democratic countries, economic nationalism becomes a rationale to protect the power of incumbency which can inadvertently amplify the effects of connectivity. In both scenarios once an economy opens, already established firms have the resources and the information channels to monopolize access to new investments and new partners.

ENTER THE FOREIGN INVESTOR

In virtually all countries, high-level political connections are important sources of asset value although they vary from country to country. Nevertheless it is frequently the larger firms, the kinds most likely to be attractive to foreign investors that are the most connected. In Suharto's Indonesia where political connections contributed significantly to company value, opening the economy to private foreign investment enhanced the value

of connections to regime officials.¹⁵ Trade liberalism introduced investors who protected their investments by establishing connections with members of the leader's family.

Throughout the developing world, as economies are opened to foreign investment, transparently managed, publicly owned, Western firms seeking risk-adjusted returns for their shareholders seek out partners with ties to a top official. Management in the home country sees no difference between the right overseas connections and the right business models. Sometimes the relationship with the official is established before a private partner is selected. The retinues of business leaders that accompany U.S. presidents on overseas visits exemplify the role of finding high-level political connections as a precondition to investing in emerging markets.

When Anglo and American firms expand their operations overseas, Wilsonian rhetoric asserts that they would project the values and habits of the governance standards required in their home markets.¹⁶ However, the quandary of the American investor seeking overseas partners in under-institutionalized markets is satisfied by selecting well-connected partners. Such partners are often firms owned by entrenched elites with insider connections to political officeholders that offer impunity from public scrutiny and from the supervisory standards of competitive capitalism, such as sanctions against

¹⁵ Fisman, Raymond (2001): 1095–110. In Indonesia, an important component of the share price of well-connected firms can be positively attributed to political connections. Mara Faccio reports that the shares of companies increase noticeably when a shareholder becomes prime minister (Faccio, M., 2006: 369-386).

¹⁶ A number of cross-country studies reveal that Anglo and American corporations surpass their rivals around the world in accountability, predictability, transparency, and shareholder participation. Most Anglo and American corporations are owned by shareholders, not by wealthy families. Corporate boards are selected in a relatively transparent manner. They disseminate information about their activities, their liabilities and assets openly, and they are bound by rules that protect shareholder rights and ensure third-party audits of company accounts. One of the most important results of this activism is the creation of a democratic marketplace of information accessible to shareholders, labor, consumers, and the public at large, which includes access to essential data about firm assets, liabilities, and ownership. Transparent corporate governance practices reflect the interventions of several generations of political activism on the part of shareholders, labor, and consumers.

mismanagement or the seizure of collateral in bankruptcy cases. Such commercial alliances with politically connected enterprises offer access to prime investment projects and afford protection from interference by intrusive administrative protocol. Firms that lack the protection of connected elites are easy prey to the risk of expropriation which reduces their investment appeal, hence they fail to thrive.

Should we be surprised that democratically governed Western firms are behaving just the way undemocratically governed states do — seeking alliances with small winning coalitions overseas? Collusion in the entrenchment of small cliques of wealthy families is the unintended consequence of making the right decisions for shareholders, and it creates enemies for global capitalism. Although this enmity is out of the purview of firm management, as a negative global good, it weakens system-wide legitimacy.

In markets where, the courts cannot be counted on to protect property rights or where tax collection is discriminatory, for example, investors will seek out politically convenient partnerships. If managers of international capital were to act otherwise, they would disregard their fiduciary responsibility to their shareholders. In fact, in markets like China firms that disclose information about abusive practices can invite reprisal by powerful local actors.

As promoters of global public goods, Western firms are constrained by covenants with their own shareholders to seek investments with the best risk-adjusted rates of return. Their power to do good is circumscribed by their responsibility to make good for their investors at home. Should it be any surprise then that U.S. democracy activism is viewed by many outside America as a form of guiltless imperialism?

The investments in political connections by American firms can institutionalize distortionary policies and make asymmetric information profitable to insiders. Such investment can strengthen the influence of controlling families over poorly funded legal systems and political parties. Domestically owned private sector firms in China often dispute the privileged access to public resources obtained through political channels by foreign investors. Complicity occurs with the very constituencies that distort capital allocation, retard capital markets, hobble entry of innovators, and hinder growth and foster inequality during the process of globalizing the economy. The policy distortions that result are not only a cause of underdevelopment, they ensure its perpetuation.

CONCLUSION: Can Liberalism Foster Competition without Entrenchment

During the Cold War, virtually every American president declared that economic growth and democracy were so closely intertwined that more of one would inevitably produce more of the other.¹⁷ This concept still underpins the mission statements of U.S. intervention around the world and shapes the plans to rebuild Afghanistan and Iraq, mollify Arab radicalism and transform Chinese society. Its corollary is that commercial ties between nations nurture a freedom-loving, commercial middle class that will eventually rise up to confront tyranny and demand democratic reform.¹⁸ As evidence, optimists cite changes under way in China, where the Communist Party is welcoming wealthy business leaders into its ranks.¹⁹ This optimism about China draws upon the theory of democratic convergence that emphasized pro-market reforms first.

¹⁷ Harry Truman explained in his 1949 inaugural address that democracy is a condition to which all nations aspire.

¹⁸ The liberalizing role played by the commercial middle classes during modernization is a central idea of Martin Lipset's (1959) *Some Social Requisites of Democracy: Economic Development and Political Legitimacy*.

¹⁹ The fallacy of this perspective is well documented by social historians of the French Revolution which was once attributed to the rise of the middle classes. Yet patient historical analysis of the social origins of

Yet, a compliant middle class is a cornerstone of a repressive centralizing regime in both Russia and China. Bruce Bueno de Mesquita and George Downs have argued that in China, Russia, Kazakhstan, and Singapore, to name but a few, leaders have discovered that citizens will forgo venues for citizen expression and coordination in exchange for opportunities to consume.²⁰ An explicitly cynical trade-off has occurred which leadership averts the dangers of turn-over by eliminating channels for recruitment, organization and information dissemination by opposition groups. In turn citizens are permitted opportunities to acquire items that buffet their economic status. Evidently, as the marginal cost of political expression becomes unattainable, citizens accept consumerism as a substitute, trading the right to assemble and to speak out for access to the latest Gucci briefcase.

Observations are never enough to fully refute a theory, quantitative testing is needed. Some econometric confirmation is already available. The news for democracy advocates from econometric assessments of the pathway from market reforms to liberalized political expression is disappointing. First it has been discovered that the dynamic contribution of trade openness to institutional reform in non-democracies does not hold. Even more disturbing, Li and Reuveny have discovered that trade openness correlates negatively with democratic institutions: In a wide cross sample of regimes, the

the French Revolution has conclusively revealed that the commercial middle classes were not great catalysts of political change that modernization theorists predicted. The most studied democratic transition in history has revealed that the French commercial classes of the eighteenth century were not more responsive as a group to the drumbeat of democracy than were the nobility or the peasantry. The French monarchy itself triggered a demand for egalitarian social conditions by inadvertently inculcating democratic norms through the expansion of a kingdom-wide bureaucracy and court system, and by endowing peasant communities with the tools challenge traditional hierarchy by offering access to both the king's administration and his justice.

²⁰ Bueno de Mesquita and Downs (2005) argue that consumption of material goods can substitute for political freedom.

level of democracy decreases as levels of trade openness increase.²¹ Other studies have argued that increased inequality often associated with foreign direct investment disrupts democratic stability.²² Weak public finance diminishes spending on public risk management to protect households from downturns in the economy or from private misfortune. For democratic regimes to succeed at trade liberalization, citizens must enjoy protection from large fluctuations in income that occur when economies, especially small economies, open to global forces. The implication of such findings is that the development of stable government taxation and the administrative capacity to offer equitable risk insurance to vulnerable sectors of the population may be a prerequisite for democratizing regimes that are opening to international trade.²³ Without effective mechanisms for collecting and spending revenues democratic regimes that open their economy without providing adequate risk insurance to exposed sectors of the population are vulnerable to failure.

The theories that attribute a large role to markets or to the commercial classes have another shortcoming: they fail to provide a realistic or rational explanation for the behavior of individual traders or to identify how activism for a purely public good, such as democracy, is consistent with the interests of private agents. Policy goals that typically include political stability, the rule of law, balanced budgets, and broad employment are public goods, available to all traders, even if they do not commit private resources to obtain them. The commercial classes are more likely instead to engage their private resources to lobby for private goods.

²¹ Li and Reuveny (2003).

²² Boix and Gariciano (2001).

²³ Hiscox and Kastner (2004) have found democracies that open to trade without social insurance are prone to failure. Authoritarian regimes that open to trade but do not spend on redistribution are less vulnerable to political challenge and failure.

The words democracy and markets have aroused emotion, passion, and hope but our understanding of the linkages between these giant catch-all categories are rudimentary and primarily rhetorical. We should be very uncomfortable the next time some eminent public figure stands up to announce certainties about the close linkage among the great forces shaping our world. What made us confident when the Berlin Wall was torn down in 1989 should make us very uncomfortable today as we watch former communist nations excel as students of market economics among the world's emerging nations. Our static understandings are not very useful guides toward assisting would-be reformers that seek both market and political liberalism. We understand but a few of the essential properties of each and have little scientific basis to predict the likely effects that result when larger forces interact under the pressures of particular settings.²⁴ We know what markets are just as we know what democracy is when we see it. But we are very poorly informed at what causes their emergence and presently we have no consistent understanding of how they interact.

We must first adjust our lenses to better understand the links between the rational expectations of individual actors and the system-wide incentives that define their actions. Clearly, the principles of the international regime and the incentives of individual actions are out of alignment and are not producing either the outcomes our theories would predict or that our values find acceptable. We are becoming vulnerable to systemic failures that may arise in distant parts of the globe stimulated by the liberalizing tendencies our philosophies have unleashed, but that the actions of private actors frequently obstruct.

²⁴ David Epstein, et. al.(2006) stability of partial democracies (30% of all regimes) is unpredictable and countries with more inequality experience frequent coups that make democratic consolidation difficult. Conventional discussions rarely distinguish partial democracies as a category yet they exhibit tendencies that differ radically from fully democratic regimes.

Our vision that links open markets to global democracy has not given us the tools to produce winning forecasts of the global future. This overarching principle of American foreign policy suffers an absence of realistic agent based modeling. Part of the problem is due to the divergence between the moral premises of corporate behavior in first world setting when transferred to the Big Men patronage-based economies common to traditional Third World polities. The Wilsonian paradigm bequeathed to U.S. foreign policy a legacy of conservatism when needed are principles to make us comfortable with unstoppable, unending, multifaceted global change.

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CHAPTER 14

TRANSFORMING THE METAPHORES AND REBUILDING THE RHETORIC OF U.S. FOREIGN POLICY

Finally we must the darkest question of all. "How much freedom does evolution allow for giving purpose to the game?" Wheeler: 236

Unlike more familiar approaches to diplomatic history, we have attempted to understand why the ideology of U.S. global interventions has been inert almost as if in equilibrium when the stimulus to which it must adapt has radically been altered. Major shocks – the unification of Europe, the rise of China, the awakening of India and the failure of neoclassical economics to spread wealth around the globe – have not disturbed that equilibrium.¹ Why have the best and most experienced minds badly misjudged the risks involved in using Cold War metaphors as a reference to deal with these geo-political changes? Why with massive physical and intellectual resources at its disposal did U.S. policy makers not see that nationalism, industrialization and state-building had much greater implications for developing nations than the terms that comprised Cold War debates with the Soviets. Why has the cognitive framework of U.S. foreign policy making come to rest when dynamic and complex changes have occurred throughout the world suggesting that the challenges of global economic development and stability have been fundamentally misclassified? Why, have governments that are allied with the U.S. been so ineffectual at eliminating inequality?

¹ Western thinking has portrayed the choices before developing nations as moving from one dichotomous equilibrium to another, from state to market based resource allocations, autocratic to democratic decision making and ultimately from socialism to capitalism. However emerging economies are dynamic and complex and have never settled into any one of these categories in which Western political thought has cast them.

A COGNITIVE MAP TO THE GLOBAL WAR AGAINST TERROR AND BEYOND

Just as the Cold War began the logic that guides current U.S. strategy for waging the global war on terror began by de-contextualizing the enemy. In official statements, adversary's words and actions are portrayed independent of his circumstances and capacity.² His identity is reduced to a few nouns from which it is easy to infer his political sympathies: communist, socialist, nationalist, terrorist.³ (As noted, Chiang Kai-shek's U.S. backers successfully presented him as a Christian and Democrat, for example, and Philippine Presidents Magsaysay and Marcos were labeled anti-Communist and pro-American, and became U.S. favorites, despite the fact that their governments were run entirely as personalized patronage machines.) When the labels are detached from their context, however, it is difficult to determine the relationships that shape individuals or the broader processes that frequently constrain their actions. The labels acquire a life of their own, transforming the domestic political debate into abstract

² The text of George W. Bush's address to the nation on the fifth anniversary of the September 11 attacks offers some examples of the rhetorical strategies alluded to here. For example, Bush states that "dangerous enemies have declared their intention to destroy our way of life. ... The attacks were meant to bring us to our knees." The comment disregards the actual capacity of the adversary.

³ President Bush reports "Since the horror of 9/11, we have learned a great deal about the enemy. We have learned that they are evil and kill without mercy — but not without purpose. We have learned that they form a global network of extremists who are driven by a perverted vision of Islam — a totalitarian ideology that hates freedom, rejects tolerance, and despises all dissent. And we have learned that their goal is to build a radical Islamic empire where women are prisoners in their homes, men are beaten for missing prayer meetings, and terrorists have a safe haven to plan and launch attacks on America and other civilized nations." See: <http://www.cbsnews.com/stories/2006/09/11/september11/main1999198.shtml>). From the President's account, we learn very little about the circumstances of the individuals and are left with little guidance on how to address those circumstances.

theories, such as Kirkpatrick's notion that a fixed trajectory exists for totalitarian regimes as opposed to that of authoritarian regimes.⁴

The probability of a theory becoming an assumption is more likely once the logical requirements for its existence are established. Such was the case with the popular domino theory during the Cold War. Once a single aspect of the general case was identified, the other propositions were assumed to be true. Theories about causality become self-reinforcing, making the discovery of errors difficult and leading toward overestimating the role of motives, instead of seeking realistic assessments of an adversary's specific circumstances and capabilities. Repeating the same conceptual error President Bush, has described America's adversaries in the war on terror as part of one entity, 'a single movement, a world wide network' united by hatred of free societies. This unified movement contains groups that are historic adversaries with divergent identities, grievances and capacities that fall far short of their stated intentions. The only thing that unites this highly diverse group of strongly divergent interests is the President's rhetoric and that of their would-be leader Osama bin Laden.

Once an adversary is identified by type, it follows that surgical interventions can eliminate it. Rather than identify the requirements that would encourage the behavior that we seek in others, swift surgical interventions such as overthrowing undesirable regimes are attempted in which we permit our behavior to digress from what is considered ethical at home. The results, as history has shown, are predictable: because the underlying causes of the offending behavior remain in place instability persists; and we inadvertently encourage unethical behavior among those we sustain overseas.

⁴ Policy dispersion among authoritarian regimes is much greater than among democracies because autocrats do not have to contend with the median voter.

When we derive grand abstractions such as the presumed links between markets and democracy from our own experiences, we miss particularities and contexts, and blind ourselves to the developmental processes that shape events or circumstances among Third World actors.⁵ We fail to see Third World political developments as self-transforming systems and we intervene with limited understanding of local environments or of the larger systemic forces at play⁶ in which a random phase leads to a growth phase. Believing that global trade openness will drive countries toward greater democracy we infer a liberal democratic utopia is upon us — instead of “the end of history,” in the words of Francis Fukuyama — we face another random phase which we attempt to simplify by placing the global war on terror at the center of global politics. David Rothkopf writes “even as we seek to remake history, it is remaking us.”⁷ The decision to invade Iraq may have unleashed a broader and deeper conflict, triggering Shiites to correct 700 years of Sunnis domination and that dispute has far greater meaning to its participants and far greater historical consequences than the issues acknowledged in the U.S. debate about the urgency of spreading multi-party democracy.

During the Cold War, the Soviets according to historian Odd Westad, acted as universalistic imperialists, and like the U.S. they tried to impose their conception of a just

⁵ “We are now in the early hours of this struggle between tyranny and freedom. Amid the violence, some question whether the people of the Middle East want their freedom — and whether the forces of moderation can prevail. For sixty years, these doubts guided our policies in the Middle East. And then, on a bright September morning, it became clear that the calm we saw in the Middle East was only a mirage. Years of pursuing stability to promote peace had left us with neither. So we changed our policies, and committed America’s influence in the world to advancing freedom and democracy as the great alternatives to repression and radicalism.” These terms, used by the president, offer no clue to the actual political conditions of the Middle East.

⁶ Industrialization and the process of urbanization in Europe and America triggered a process of re-norming and rebuilding of social capital. The shift away from agriculturally based communities to urban communities coincided with an initial incidence of crime and social disorder but a new set of norms emerged that mitigated the initial disorder and coalesced into what became known as the Victorian era.

⁷ David Rothkopf, 2006, “the Coming of Gulf War III”, The Washington Post, Outlook, December 10,

and equitable society on the world. Yet they altered their outlook and strategies, Westad posits, after withdrawing from Afghanistan, realizing that the outcomes of Third World interventions were rarely justified by the expense.⁸ The leaders they presumed to be fellow travelers were interested in little more than their own survival and aggrandizement disregarding the Soviet priority of building a Leninist-style party. Finally, Soviet leaders accepted that Third World conflicts were more about identity and ethnicity than about class, and that the strength of domestic patron-client loyalties prevented the emergence of a political order based on Western principles.⁹ Assessing the costs and benefits of Soviet interventions from new criteria, Gorbachev eventually demanded adherence to human rights and the principle of self-determination.¹⁰ A respect for these principles must be included in any complete explanation for why Gorbachev allowed an empire that took hundreds of years to assemble to disappear without a shot being fired.¹¹

Instead of taking credit for this considerable act of historical abdication, U.S. leaders might have been wiser to acknowledge and recognize the hard-won wisdom of Soviet leadership to disband the empire. Recognition from America of the other party's moderation in retreat would make less visible the offensive triumphalism that mars U.S. global activism. The Soviet retreat reflected a process of self-realization, not defeat alone. They saw the need to change and were willing to internalize the enormous costs of transition rather than spread chaos and disorder to their neighbors. According to Westad fundamental changes occurred in their perception of Third World development but U.S. leadership refused to consider a policy of non-interventionism.

⁸ Westad: 380-1. With a stagnant economy the growing costs of an interventionist foreign policy was meeting opposition at home.

⁹ Westad: 381.

¹⁰ Westad: 383.

¹¹ Westad: 387.

The United States has never had to learn from its mistakes in the Third World. And the Bush administration continues to follow the same cognitive pathways that caused those mistakes, waging his war on terror as he draws on the wrong lessons from the Cold War. Just like the New Right of the late 1970s that led to the election of Ronald Reagan in 1980, the George W. Bush administration views the radicals as the cause rather than the result of the region's discontent ignoring deep historical memories of oppression. Most disappointing, many in his administration confuse the attributes of development — industrialization, occupational specialization, social mobility, urbanization, mass literacy and public health — with the triumph of Western liberal values. But does being literate, enjoying wealth and having clean government make one “Western”? The rest of the world seeks to enjoy the attributes of modernization as projections of their own cultural values and historical experience. By seeking to impose modernization with a Western face, the United States and its allies alienate large majorities in countries like Iran, China, and Russia.

U.S. foreign policy is in need of cognitive reorganization: America cannot expect to alter the world and not also be transformed. Moreover, embracing its own idiosyncrasies, America must cease to project its history and beliefs upon the world as the universal template for modernization and for the transformation of other nations. Third World nations must be able to blend their own social systems and values with the demands of industrial and bureaucratic processes in order to underpin the framework for integration into the world economy.

POLICY MAKING ON THE EDGE OF DISORDER

Our perception of current threats and opportunities is framed within a mental model constructed to prevent the spread of Soviet power throughout Europe and, later, the Third World. Continuing to use this mental model to define our national interests, we are prevented from seeing a gap between our goals and the impact of our actions. U.S. globalism requires a new script. Before a new role for the U.S. on the world stage can be contemplated, however, we must learn to think differently about the dynamics of change. Once we learn to analyze development as a complex adaptive process, we will become more cautious about the large-scale stabilization packages as well as military interventions. Both suffer from unrealistic simplifying assumptions that underestimate large system wide effects that are inadvertently mobilized.

An example of policy stasis was the dispatch by the Bush administration of economic specialists to Iraq who believed all government regulations to be foolish and wasteful. Believing government to be the problem, they closed all government run industries and fired thousands of workers in short order. Contrary to their expectations, new investors did not suddenly appear to absorb the laid-off pool of state-employed workers, and the Iraqi economy sank to new lows of ineffectiveness. As students of economics, they knew how to describe the functions of self-organized economies like the contemporary American one, but they had few useful ideas about how the economy became a marvel of self-organizing complexity. They knew that a complex and structured economy works from the bottom up in a self-organized way, but not how the process begins. They knew that the complexity of an economy correlates with its wealth but not idea how that complexity emerged. Being that their perspective was ahistorical,

they did not realize that growth and complexity expanded in an explosive manner, tearing down entire systems of social order.

Policy planners have tried to motivate the process of modernization overseas by introducing technologies, government policies and business practices that are straight line projections from highly developed economies. One example of linearity widely adhered to in economics is Growth theory, it presumes exogenous factors such as political events or technology can jolt an economy from one equilibrium into another.¹² Growth, it dictates, can be stimulated by shifting the equilibrium of productive forces within a given polity through the enlightened administration of exogenous policy interventions.

After a half century of intervening around the world to liberalize and democratize other nations, we should realize that the traditional theories that motivate our interventions do not fit with the data. Both policy practitioners and thinkers alike conceptualize development/modernization as a linear process. Economic policy advice to developing nations is typically based upon predictions derived from linear models that assume the value for the whole is derived by adding up the value of its parts. But economic development is more appropriately represented as an outcome in which the whole is greater than the sum of its parts. We still have no answers to the question of how the interaction of agents produces a structure that is more flexible, adaptive and complex than the sum of all its parts. It is seeking answers to this question that will change and shape the future of thinking about economic development. Economics has attempted to reduce the system to parts that can easily be modeled but this approach has been inadequate. Just as knowing the complete set of genes encoded in human DNA

¹² In equilibrium theory the economy is like a rubber ball that rolls around in a large bowl until it settles. External shocks are needed to send the ball to a new equilibrium point.

does not help us to understand the program those genes specify so too understanding the properties of policies and institutions does not help us to understand the interactions of emergent phenomena that constitute growth. Understanding the properties of isolated institutions does not tell us how different societies put those institutions into play.

Institutions are immersed in a complicated sequence of interdependent structures, rules protocols and expectations that modulate how a particular institution will function in a particular environment. But just like chromosomes that we believed set the master plan for the development of an organism, knowing their structure is insufficient to know how they create order, learn and adapt.

What makes countries develop may be independent of technology, government policy, and business practices. Development is something greater than the sum of its parts. It is an exponential jump characterized by the cooperation of millions of people. More may not only be better but is categorically different in the same way that water is different from a single molecule comprised of two atoms of hydrogen and one of oxygen. A few billion molecules are needed to make us feel wet. In the same way, in a developed society people working together provide functions that none of the individual parts could produce on their own. To foster the dynamic patterns of individuals and groups working together to perform higher level, more complex tasks than any subset of the population could perform working alone, first we must understand how specialization and cooperation originate, change and grow.¹³

¹³ The most intractable problem in development is to grasp the inductive rules people use as references for their own behavior in interaction with larger macro level structures. Although individuals do not frame their rationality and creativity in terms of the larger evolutionary process to which it contributes, individual actions matter as parts of the larger process. Behavior at the micro level must change in order for big emergent patterns to occur at the macro level, but this change is particularly difficult to orchestrate because individuals anchor their behavior to patterns or rules that emerge as responses to a previous action. These rules take their structure informally and once a new macro level institution has been introduced, a time lag

Several decades of outside tinkering offers abundant evidence that externally introduced rules, such as a modern regulatory system to protect competition, or institutions, such as a court system to enforce contracts, or training to enhance human capital, so that accountants can keep books and lawyers can write enforceable contracts, all fail to change the low-growth, non-convergent equilibrium. Perhaps developing countries were never in equilibrium at the outset. A more complete understanding of the deep structural features of an economy that cause consistent long-term patterns is required. Contemporary social science needs to reframe the upward climb towards economic sophistication as a far more dramatic story, punctuated by significant and abrupt transformations, rarely a linear progression. Long periods of stasis are frequently followed by massive reordering, like evolution, explosive innovation and massive extinctions occur simultaneously after long periods of stability.¹⁴ In the same way, the story of how America became incredibly complex and specialized is not linear. It began with a great rupture, a revolution at the macro national level and a personal conversion at the micro level.

Using American culture as a template for modernizing other nations is a highly problematic proposition because it ignores the radical transformation at origin when each

occurs before adjustments are made by individual actors. Whether it is restocking the refrigerator or responding to the need to get a license from government for importing a quantity of a given commodity or for applying for credit from a government or family owned financial institution, the past set of interactions references our conception of what is normal, the overall rationality or the sustainability of the organization or system gets overlooked. Breakdowns occur at the systemic level because every individual response is anchored to a pattern that seems normal locally even if its macro impact is to compel a pattern of societal interactions that are unsustainable and that will end in disorder. This anchoring to the most recent example of normal makes cycles of corruption or violence very difficult to stop once they begin. Altering corruption means changing the inductive rules that people use to pattern their household decision making to respond to endogenously emerging patterns from within the system. This is why interventions such as introducing as company (anti-trust) or an anti-corruption law such as anti-money laundering legislation rarely have the desired impact.

¹⁴ A punctuated equilibrium is a system that is never in equilibrium, rather one in which long periods of consistency are punctuated by periods of rapid and intense change

immigrant to America's shores loses physical and psychological contact with the past. That transformation is reenacted each time a person lets go of his own culture to accept the general rules of the larger society. People in developing countries do not leave their own culture to become modern. They have no mechanism to be individually released from the past. Geographically immobile, they are part of preexisting networks that are often so dense that every element of their social life is scripted by past events. Obligations to relatives and neighbors make dramatic deviations away from accepted norms very difficult. Changes in government recruitment or business organization require altering complex networks of obligation and reciprocity. We must finally ask how can Americans, a people who accept as a matter of faith that most efforts at large scale social engineering are doomed to failure, believe they can spearhead democracy throughout the world through massive prescriptive interventions into the macro-policy or institutional frameworks of other nations?

An externally initiated process of change, even if initiated by an enlightened external actor, may introduce greater inequality by equipping one subset of a population with far better survival tools than rival groups, which may polarize society and destabilize it. We have seen in our treatment of Iran's road to revolution that the injection of western economic rationality and weaponry gave Westernizers tools to start a cycle of inequality. Just as in post-colonial Africa, imported skill, if too narrowly distributed, will endow the recipients with the means to dominate less-well positioned citizens. The less well-trained fall further behind, initiating a downward spiral of recrimination and polarization that once begun makes a consensus on the future ordering of society difficult to attain. By biasing social outcomes in favor of the few early

adopters, Westernization in Iran marginalized those left behind. With the gains from development being so unevenly distributed, the marginalized, that included the economic network of the bazaar, the traditional method for distributing goods and services, worked to destroy the system they identified with the new inequalities. America's modernization was different; most white settlers were in the winning coalition once the British were sent home. But America is not different from other industrial powers in that the social technology of most modern industrializing nations were forged during periods of change and disorder that broke down traditional social roles. During the nineteenth century Americans that were not included in the reshuffling of property and rights could go westward to the frontier, but in Europe, without a frontier, class warfare erupted to disengage the structures of entrenched inequality.

One of the most misrepresented paradigms of development is the Marshall Plan, the mother of all blue prints for U.S. interventionism. When American troops arrived in Germany and Japan at the end of the Second World War, they contributed to a societal transformation begun several generations before their arrival. Protocols for industrialization and bureaucratic public administration began long before the American troops arrived. The introduction of rules by American administrators for an open access society complemented a change process that had begun locally with Japan's Meiji revolution and with Bismarck's unification of Germany almost a century earlier. In these two cases, enormous systemic changes to the traditional social order had occurred and deviations from traditional behavior were already in progress.

State building and democracy promotion, like economic development, can best be understood as a complex emergent process with behavioral adjustments occurring

simultaneously on three dimensions. The behavior of agents is transformed, underlying institutions are transformed, and often an exogenous shock serves as the tipping device. Unlike the abrupt interventions required to change equilibrium, however, that device may be unnoticeable at the time it occurred. Great changes may occur without headlines. No one noticed the beginning of the industrial revolution, no one day or invention can be assigned as the day of origin. There was nothing unique in the news the days before the stock market crash of 1929. The same newsless character is true of the Renaissance and the Reformation. When Martin Luther nailed his denunciation of the excesses of the Roman Church to the door of a local German church, it was hardly international news.

From contemporary growth theory, we have learned about exogenous shocks, and from the new institutionalists, we have learned about the importance of institutions, especially property rights. Little is known about the underlying regularities of changes in behavior like those needed to alter corruption. Current modernization theory has identified static qualities of institutional transitions but it has entirely missed the dynamic interactive relationship between actions at the micro level with events at the macro level. Before we can acquire the tools to better understand how these factors combine to alter the economic performance of nations, we must go beyond equilibrium-based assessments towards those that recognize emerging complexity. Growth is an emergent and endogenous process that occurs out of the interaction of the individual units, it is as different from a collection of institutions as musical notes on a page are from a symphony, and to be understood the relationship of the people to the dynamic structures of an economy, must be contextualized. My hope is to start such a shift in perspective by offering a glimmer of what a new approach would be like. We know what wealth is

and we know how a modern economy creates it, but we do not know how or why it happens. Within economics we have refined theories about how a modern economy functions and about the incentives that are needed to drive it to new levels of innovation but ideas about emergence--how we got there-- are highly underdeveloped, and concepts about dynamic change are rudimentary. We need a theory of how order and complexity emerge before we will know what to do when confronting global poverty, inequality and terrorism. We must transform how we think before we transform how we act.

REFRAMING THE PURPOSE OF U.S. GLOBALISM

We are part of the history that we create. Even if we are more powerful than our opponents we take actions without knowing how the others will react. Even our most astute statespeople have insufficient foresight to predict the web of interactions between multiple agents that will define the future. Despite a preponderance of force in our favor, our actions create a train of events that will come back to us in a form that is unknowable and present patterns that we did not foresee. Eliminating our Cold War rivals made us the target for international terrorism. Many unforeseen costs have arisen as a result of unipolarity, issues such as non-proliferation become uniquely U.S. burdens. The tools that make global economics easier to manage are easily exploited by criminals and extremists. Our actions in one arena were the building blocks for responses in another.

A tendency to see ourselves and the Third World as something different, casting ourselves as the history makers, disregards that we but one part of the system that will change us and to which we must constantly adapt. Before we can develop future policy with the Third World we must begin by accepting the notion that we are but one agent in

an international environment that is produced by interactions with other nations and that no matter how powerful we purport to be the environment is not fixed but is shaped by the constant play of competition and cooperation among multiple actors.

Ultimately no matter how forcefully we intervene to promote ideals we assume to be universally valid such as freedom and democracy, our actions will be building blocks for others to react and the outcome will be determined by decisions and responses made by millions of agents that alternatively compete and cooperate. No final or definitive form of society exists that optimizes human potential as the space of possibilities is too great for one group to ever fully imagine or control. Forcefully closing one option, the viability of socialist regimes for example in a world of private markets, we open another niche for new forms and new competitors to emerge. Whatever actions our own internal models compel us to take will be the new building blocks for others to construct with, guided by their own internal models. New opportunities and new insights are constantly required in a world in which all societies are transitional and the actions of one will open a niche for that of another competitor.

US foreign policy must be a mechanism by which we can seize control over our own fate in an indifferent and often hostile world. The purpose of our foreign policy must always be to ensure that the fate of America is to be determined collectively by what Americans choose, arrived at by what we and our fellow citizens agree upon. If we are to survive it must be in the name of our ideals. Ultimately our foreign policy is our moral commitment to our own survival and it is a blueprint for informing our foreign relations with purposefulness that comes from the values that unify our nationhood. Just as we understand that we must take control over our fate so we must help our allies to do the

same. Just as we seek power over the future for ourselves so we must grant it to others. Our most enduring contribution to the well being of our allies will be to allow education to provide the motivation for cooperation. When we raise the flag it must be to signal idealism and not our greed. Does our current foreign policy perform this role?

Supporting tyrants for our own short term gain we lose our sense of purposelessness.

In a dynamic and changing world we are a part of larger change processes. We certainly are not proclaiming that we should let history take a blind course or that regimes should be privileged entirely by the amount of physical comfort they provide their populations. Accepting the constraints of growing interconnectedness does not refute the importance of allowing our moral compass and our values to give meaning and shape to the future. Acceptance that the U.S. does not stand at the center of the solar system should not lead us towards passivity. If we do not set the goals for the kind of world we want to live in no one will do it for us.

Let us wake up and realize that we are in the minority in a universe that was not built for our own special benefit. Our present preeminent role results partly from accidents and the poor judgment of our industrial and colonial predecessors. Our relative decline is unavoidable. We have no way to overcome the constraint of being in the minority and unless we constructively work towards a larger unity we may like many minorities before us, face the risk of being surpassed. We must also consider that we will cease to occupy a central position on the playing field if the field itself ceases to exist. We must learn to cooperate with our competitors to attain objectives that are beyond our own capacity as unlimited as it may seem. The greatest privilege the U.S. enjoys today is the possibility of shaping the future when it will not enjoy the privilege of preeminence.

