

**Postwar Reconstruction:
Some Insights from Public Choice
and Institutional Economics**

TYLER COWEN AND CHRISTOPHER COYNE^{*}

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Postwar Reconstruction: Some Insights from Public Choice and Institutional Economics

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I. Introduction

Postwar reconstructions stand among the most difficult policy achievements. Capitalist liberal democracy cannot simply be manufactured, as illustrated by failures in Cambodia, Bosnia and Angola. It is an open question whether these ideas will win indigenous acceptance and trust. How then is a successful reconstruction to be undertaken?

Reconstruction is a vast topic, both theoretically and historically, and we do not pretend to cover all of its nuances or angles. Nonetheless we seek to provide some basic conceptual categories. In particular, we seek to outline under what conditions a reconstruction achieves peace, stability and growth. Toward this end, we apply some simple ideas from game theory to a topic that has received little theoretical attention.

We define reconstruction as involving the rebuilding of both formal and informal institutions (Kumar 1997). In particular this involves the restoration of physical infrastructure and facilities, minimal social services, and structural reform in the political, economic, social and security sectors.

The reconstruction process usually begins with rebuilding the government and political order. While parts of the previous political framework may remain in place, the main goal of reconstruction is a major shift of the ideology and operations of the political structure. Here we see the difference between reconstruction and economic development. Economic development typically involves working within the given political and economic structure to bring about growth. Reconstruction, in contrast, involves a drastic change – often a complete change – in the pre-war political structure. Reconstruction is therefore a problem in "public choice."

Although economic issues are at the center of war reconstruction, little has been written on this topic in recent times (Carbonnier, 1995). Reconstruction was a popular topic among some prominent twentieth century economists, including Keynes, Ohlin, and Mises. Nonetheless few modern theorists of public choice have turned their attention to this problem. Some general writings have explored the topic. Lake and Harrison (1990) stress the importance of relying on local planning and initiative. FitzGerald and Stewart (1997) discuss the importance of political science, anthropology and economics in understanding post conflict reconstruction. Stewart, et al., (1997) discuss the difficulty in the economic modeling of war-affected countries. These writings, however, have not generated many specific insights into which variables assist successful reconstruction.

We employ a simple analytical framework to illuminate reconstruction. In particular, we build on the work of Schelling (1960), who pointed out the difference between games of conflict and games of coordination. We envision a spectrum with pure coordination games on one end and games of pure conflict on the other with many possible combinations in between. Coordination situations are those where interests fundamentally are aligned, while situations of conflict are those where interests are at odds. Languages choices, for instance,

or which side of the road to drive on, provide examples of coordination games. If everyone can form the same expectations, or adhere to the same conventions, everyone will be better off. The well-known prisoner's dilemma, in contrast, is a classic game of conflicting interests, as is the "chicken" game.

Our core thesis is the following: reconstructions go well when they succeed at turning potential games of conflict into games of coordination. Furthermore we outline some specific institutional mechanisms that allow reconstruction to come from within in this fashion. Whether a game is one of coordination or conflict depends critically on conjectures and expectations, so we consider how institutions affect the relevant beliefs in this context.

Reconstruction is a difficult topic to handle formally. The number of interacting variables is large, it concerns the histories of many different cultures, and there are no systematic databases. Any approach therefore will be relatively informal, compared to most other fields of economics. Nonetheless we feel that the importance of the topic militates in favor of study rather than neglect, thus this paper.

The course of the paper proceeds as follows. Section II outlines our analytical framework in more detail. In section III we consider some possible paths that allow games of conflict to be turned into games of coordination. We consider informal, indigenous institutions ("*mētis*"), expectations management, and the consensus on the nature of the political order as some of the relevant factors here. Section IV explains how some historical examples fit into our framework. We consider successful coordination (Germany, Japan), continued prevalence of conflict (Bosnia), and coordination but around bad political norms (the Stalinist "reconstruction" of Eastern Europe after the Second World War). Section V discusses the testable implications of our hypotheses. Section VI closes with some

recommendations for how to think about pending and future postwar reconstructions, such as the United States must deal with in Iraq.

II. Theoretical Framework

We start with the prisoner's dilemma, which illustrates part of the basic dilemma behind postwar reconstruction. As Figure 1 illustrates, individuals do not generally find cooperation with reconstruction to be a dominant strategy, at least not in the absence of coordination-enhancing institutions. Many individuals will cooperate less than is socially optimal, hoping to reap personal gains while others contribute to public goods in their stead.

		Player 2	
		Cooperate	Defect
Player 1	Cooperate	4,4	-2,6
	Defect	6,-2	0,0

Figure 1: The Prisoner's Dilemma

The logic of the PD has numerous institutional analogs in a postwar setting. Cooperating might consist of deciding not to loot, deciding not to be a terrorist, deciding to follow orders of the occupying power, or deciding to work to support a democracy to name a few readily apparent examples.

We then move to the "folk theorem," a well-known result in game theory. The folk theorem suggests that a multi-period prisoner's dilemma always has a cooperative solution, provided that time horizons are sufficiently long. The logic here is straightforward. If

individuals hold the appropriate conjectures, cooperation will be a dominant strategy. For instance, non-cooperators must expect to be punished, and for this to be enforced, non-punishers of non-cooperators expect to be punished as well. If the appropriate conjectures exist, they will be mutually reinforcing and can be shown to enforce cooperation. Defecting now will yield a current return but will be followed by many periods of punishment, with those punishment threats backed in turn by other threats of punishment. In essence everyone is expecting a very long chain of consequences for any failure to either cooperate or punish.¹

We do not take the folk theorem as descriptive of reality, given that it typically cites highly complex trigger strategies and long chains of punishment over time. Nonetheless the folk theorem illustrates a fundamental fact about non-cooperative games: they have significant cooperative elements, provided that individuals hold the right conjectures. A game of conflict can become much more like a game of cooperation if expectations and conjectures are sufficiently healthy and constructive. We place this simple relationship at the core of our theory of reconstruction.

In other words, if individuals can coordinate upon the appropriate conjectures, the PD portrayed in Figure 1 above can be transformed into a multi-person coordination game, as shown by Figure 2 where players must choose between good and bad conjectures:

¹ Interestingly, dictatorships commonly use a perverted form of this logic to enforce compliance and support. Those who do not cooperate expect to be punished or tortured. Those who do not report non-cooperators can expect the same treatment, and so on. For a discussion of this logic in the context of Iraq, see Makiya, 1989.

		Player 2	
		Good Conjectures	Bad Conjectures
Player 1	Good Conjectures	4,4	0,0
	Bad Conjectures	0,0	-2,-2

Figure 2: The Coordination Game

Coordinating on healthy and constructive conjectures yields positive payoffs to both parties, as illustrated by the upper left corner payoff. It is also possible, however, that individuals may coordinate on destructive conjectures, which yield negative payoffs, as illustrated by the lower left corner.²

To visualize the argument, imagine a reconstruction that has turned into a game of cooperation and coordination. In such a world, all individuals would be searching for cooperative solutions and a new and beneficial political order. It will remain important for individuals to coordinate their expectations around the best equilibrium, but such an equilibrium would prove self-enforcing once in place. No one would be tempted to respond with terrorist attacks, crime, or political subversion. The overall task of reconstruction will be eased greatly.

Of course only rarely will games of conflict turn into games of pure coordination. More commonly, individuals face decisions with elements of both conflict and cooperation. For instance, if an individual decides to lobby for democracy, this will be viewed cooperatively by some of his allies but perhaps as a sign of betrayal by some of his other affiliations. We can think of social settings as lying along a spectrum, depending on the

² When we talk about “good” and “bad” conjectures we refer to those policies which either increase or decrease social wealth as measured in dollars. While certain individuals may benefit from “bad” norms, social wealth does not.

relevant elements of conflict and cooperation. It is easiest to get better outcomes, the greater the cooperative elements in the relevant games.

Note that this framework is consistent with at least two stylized facts about reconstructions:

1. Very rapid reconstruction is in principle possible, as illustrated by the cases of post-War Germany and Japan.

In both cases, external military forces imposed a democratic order in a short period of time. Rapid growth and democratization were underway once people knew to expect good outcomes. Physical capital, while always scarce, did not provide the relevant binding constraint.

2. Some countries seem never to reconstruct or turn the corner.

These countries cannot exploit the technologies and beneficial institutions found in other parts of the world. As long as citizens fail to coordinate on good outcomes they remain stuck in a trap of underdevelopment, non-cooperative behavior, and unhealthy institutions. That is, their initial problems do not set self-correcting forces in motion and we do not observe convergence.

III. How Does a Game of Coordination Evolve?

Since we do not have faith in the exact mechanism of trigger strategies behind the folk theorem, we must look for imperfect institutional approximations that achieve similar ends. In other words, we are looking for institutions that increase the payoffs for individuals to perceive themselves as facing games of cooperation and coordination, rather than games of conflict.

Here we have in mind three factors, which we refer to as *mētis*, expectations management, and the workability of the political order. Let us consider each in turn, focusing on how it can give rise to conjectures that help transform conflictual games into games of coordination.

a. *Mētis*

The first factor cites informal, indigenous institutions and specifically the notion of *mētis*. *Mētis*, a concept passed down from the ancient Greeks, is characterized by local knowledge resulting from practical experience. It includes skills, culture, norms and conventions, which are shaped by the experiences of the individual. This concept applies to both interactions between people (i.e., interpreting the gestures and actions of others) and the physical environment (i.e., learning to ride a bike). The notion of *mētis* is not one that can be written down neatly as a systematic set of instructions, but rather is gained only through experience and practice.

In terms of a concrete example, think of *mētis* as the set of informal practices and expectations that allow ethnic groups to construct successful trade networks. For instance, orthodox Jews dominate the diamond trade in New York City (and many other locales), using a complex set of signals, cues, and bonding mechanisms to lower the cost of trading. The trade would not function nearly as well if we simply dropped random traders into the same setting; that difference can be ascribed to *mētis*. The informal institutions of the current traders allow potential prisoner dilemma games to be transformed into games of coordination, where an overwhelming majority of traders are better off by sticking to the established rules.

Mētis assists the coordination of activities. In terms of our analytical framework, *mētis* is closely linked with the concept of focal points (Schelling 1960, Lewis 1974). Namely, if

we are to get to a coordination scenario, one must ask, “how do agents coordinate on a cooperation-inducing set of expectations?” *Mētis* can contribute to the proper notion of saliency. Local and common knowledge about how things are done allows individuals to remove uncertainty and understand how others will act. This helps people coordinate on a superior focal equilibrium. Furthermore it also makes it easier to organize punishments for non-compliers, given the commonly accepted notion of compliance. Given these tendencies, if individuals are able to coordinate their activities on ‘good’ conjectures, they are both made better off, as illustrated by the previous Figure 2. *Mētis* provides the knowledge necessary for individuals to interact toward these mutually beneficial ends (Boettke 2001).

Situations of conflict also are affected by *mētis*. People learn with whom they can interact profitably and generally how to get things done. When conflicts arise, violent or non-violent, people learn how to resolve the problems through formal or informal mechanism, shifting from conflict to cooperation. In many instances of reconstruction, where *mētis* exists, it makes less sense to loot, terrorize, etc. because the individuals realizes that he is better off cooperating with others. Where *mētis* is lacking as a coordination-enhancing mechanism, conflict may result (see for example Bernstein 1992).

Mētis is not static in nature. Obtaining and acting on knowledge should be viewed as a changing process over time. As knowledge travels between groups and international borders, new *mētis* is created, and old *mētis* fades away and loses relevance. War and the reconstruction process is a shock to *mētis* whether through the destruction of psychical goods or through changes in the social make-up, such as wealth or land redistributions, migrations, or deaths. A key problem in reconstruction therefore is whether *mētis* has adapted to the new and changing circumstances.

One example of this is the land reform and redistribution that took place in Japan in the post-war period. The Land Reform Bill of 1945 called for the compulsory transfer of land from absentee landlords to tenants as well as the tenanted land owned by landlords in excess of 2.45 acres. *Mētis* adapted slowly to the new structure as illustrated by the fact that it took six years for agricultural production to reach its pre-war levels. The redistribution and adaptation process did not go smoothly as there was protest from landlords and inefficiency in the registration process of transferred land which took approximately three years to complete (Bailey 1996: 46-7; Fearey 1950: 94-5). With the drastic change in the structure of ownership and operation of agricultural land, the populace had to update their understanding of how to get things done within the new system.

The existence of *mētis* does not guarantee a successful reconstruction (i.e. widespread coordination on 'good' conjectures). In the opposite case, *mētis*, to varying degrees, may conflict with the goals of the reconstructing power. This may, at a minimum, slow acceptance of the reconstructed institutions. At the extreme, one could envision the divergence in *mētis* and the goals of the occupying forces to result in the ineffectiveness of the imposed institutions. In Japan, there was debate within the occupying forces over the extent of the involvement of indigenous government agents in the reconstruction process. The occupying forces had to balance purging the members of the previous regime with using the current government structure to facilitate the reconstruction. Participation by indigenous agents was beneficial in that *mētis* developed under the old regime influenced the reconstruction process ultimately assisting in the acceptance of imposed institutions. On the other hand, it was potentially harmful in that those who remained in influential positions in the reconstruction viewed things through the lens of the previous regime (Bailey 1996: 26-8).

A key question is whether *mētis* can be shaped to align with the reconstructed institutions. Given that *mētis* develops through practical experience, and evolves through time, it cannot be imposed per se. To the extent that expectations influence the actions of individuals, expectations also influence *mētis*. Likewise the actions undertaken by the occupying forces, to the extent that they affect the populace, will have an impact on shaping *mētis*. For example, the legal structure imposed by the occupying forces will clearly shape *mētis* as will the way they maintain social order, etc. To illustrate this, consider that in Japan, the Allied forces screened textbooks for discussion of the previous regime and outlawed the teaching of ethics and Japanese history. In addition, compulsory education was extended to mimic the American model (Bailey 1996: 48-9). These laws shaped the expectations and knowledge of an entire generation of young Japanese students.

b. Expectations management

The second general mechanism that supports coordination is expectations and expectations management. While each reconstruction situation is different, there exists, in each case, a set of expectations where reconstruction is a coordination game rather than a prisoner's dilemma game. When the expectations of the defeated country are aligned, to at least some degree, with the actual process of reconstruction, coordination will result to a correspondingly greater degree.

The success of outcomes, relative to expectations, provides a critical feature of this problem. A good deal of behavioral evidence (Diener 1984, Frank 1989, 1997) suggests that individuals value their current state of affairs relative to their expectations. To put the point simply, a millionaire who loses \$100,000 in the stock market in a day may, at least for a while, be less happy than a middle class individual who finds a \$100 dollar bill on the street.

The expectations conducive to a successful reconstruction will vary with the situation. In some cases it may be better if individuals expect very little. For instance, if expectations in the defeated country are modest, coordination will often be easier to achieve. The Japanese, for instance, expected to be treated very harshly after World War II. When the Americans treated them relatively well, they responded with reciprocal cooperation. If the populace views the occupying forces firm in their commitment to maintaining social order via force, and does not expect quick prosperity, obstacles that arise may be overlooked without major resentment.

Think of the underlying game as having prisoner's dilemma elements, and the parties are playing some version of tit-for-tat. In other words, cooperation will be met with cooperation, and non-cooperation will be met reciprocally likewise. Individuals commonly define the strategies of their opponents with regard to their initial expectations. So if expected cooperation is low, an opponent's move does not have to be very cooperative to be understood as an act of unilateral cooperation. In this regard low expectations can assist in the building process.

If, on the other hand, the defeated citizens expect immediate reconstruction (i.e., they have overly optimistic expectations), it may be harder to establish cooperation. If the populace expects the occupying forces to be their benefactor, they may very well blame them for each and every mistake made during the reconstruction. The conquering forces need to build realistic expectations through the dissemination of information and the signaling of goals.

Consider the alternative case where everybody expects immediate welfare payments from the government. Given the lack of infrastructure following the war, if expectations are overly optimistic regarding these payments, the populace will be disappointed. Their

expectations will be at odds with what is possible and they will feel that they have been cheated, which will elicit non-cooperative behavior in response.

Given these scenarios, low expectations are best when the central question for success is whether the populace will blame the occupying power for every mishap. In other cases more optimistic expectations will assist the building process. For example, in the case of security and protection from violence, individuals in the war-torn country will expect that the occupying forces provide immediate property rights protection. In the absence of such property rights security, cooperation will be less likely. So the best net recipe involves low expectations concerning “benevolence,” but high expectations concerning stability of property rights. For obvious reasons this mix can be difficult to achieve.

In general, we suggest the following formula for expectations. When an individual in the occupied territory is starting a “new game” with some other individual or institution, low expectations serve useful functions. That is, low expectations make it easier to see the other side as cooperative rather than exploitative. When individuals have been engaged in an ongoing game, however, and already have a well-established context for judging each others’ behavior, high expectations can be more beneficial. High expectations will induce individuals to make the necessary investments in the peace process and in cooperative behavior.

When wars are waged, if the populace perceives that the underlying reason for undertaking the war effort is “liberation”, then they will most likely have high (i.e., over optimistic) expectations regarding the speed of the process. If the reconstruction does not proceed as expected, conflict is possible. If, on the other hand, the reason for the war is retaliation, expectations will most likely be lower (i.e., over pessimistic) and tensions will be

reduced. The populace will expect strong retaliation so their expectations as to rebuilding will be low.

Once the war has been won a fine line governs the use of force. On the one hand, the occupying forces must demonstrate that they are leading the reconstruction effort and enforcing order. The occupying forces must also be careful to check leftover “spoilers” – members of the previous regime – who can cripple reconstruction efforts through crime and general subversion. At the same time, those who have experienced the previous regime and are willing to assist in reconstruction efforts can be critical to success. For example, in Germany, native Germans were appointed and played key roles in villages and towns to help establish the Allied reconstruction plan (Boehling 1996: 271).

c. Workability of the political order

The establishment of political institutions is a key element for successful reconstruction (Fagen, 1995). A good political structure will allow for general stability and provide the framework for beneficial interaction. Return to our basic coordination-prisoner’s dilemma framework. A political order that dovetails with the underlying *mētis* and expectations should be preferable to one that imposes rules on unwilling participants. More generally, the new political order should seek to elicit conjectures that are favorable for economic progress and development. It will accelerate the reconstruction process to the extent the constitution supports certain elements: stability and generality of the rule of law, minimization of rent-seeking, well defined and enforceable property rights, economic freedom, and a basic commitment to core infrastructure. It is not simply coordination upon a political order but rather on an order that represents “good conjectures” as illustrated by the earlier Figure 2.

For any rule or set of rules there will always be some who disagree and potentially defect. Successful reconstruction however does not require a complete transformation of the game. The key question is workability and how many individuals must coordinate on the political order for it to be sustainable. In short, the order must provide mutually advantageous benefits to enough people such that it is workable and enduring (Hardin 1999).

The coordination of enough individuals to support an institution is usually sufficient to get others to follow and acquiesce as well. Individuals acquiesce because the political order serves their interests well enough to prevent them from defecting. From this standpoint, political orders can be seen as self-enforcing because they provide the framework for the right number of individuals to coordinate their activities toward achieving their desired ends. While these ends are not necessarily symmetric, they are close enough to allow for the maintenance of the overall order. In contrast, if a large number of people disagree with or do not coordinate on the underlying norms, one would expect large-scale defection and costly enforcement. For these reasons, our informal institutions, as discussed directly above, do not have to mimic the folk theorem in all regards.

In sum, we would not wish to argue that these are the only relevant factors for a successful reconstruction. Rather, they are a few of the major coordination-enhancing mechanisms – fitting together in a common overall framework -- that help transform games of conflict into games of coordination.

IV. Historical Examples

We find some historical support for the general categories outlined above. Let us first consider two successful reconstructions -- postwar Japan and Germany -- and show

how coordination games arose with relative rapidity, given the institutional mechanisms from section three of this paper. We then consider, in subsection b., cases where the coordination problem is solved, but people coordinate along bad norms and institutions; postwar Eastern Europe under Stalin is an obvious example here. Subsection c. looks briefly at Bosnia as a case where reconstruction efforts have been unsuccessful due to the failure to develop coordinating-enhancing institutions.

a. Successful reconstructions

Germany and Japan usually are considered instances of successful reconstruction. In both cases, there was an occupation by external military forces and a democratic political order was imposed in a short period of time. Americans played a key role in rebuilding Japan – notably, General Douglas MacArthur, the Supreme Commander of the Allied Powers for the Occupation and Control of Japan (SCAP). MacArthur produced an English draft of the new Japanese constitution in ten days. After eight months of negotiations in which minor changes were made, Japanese politicians presented the constitution, in Japanese, to the populace as their own innovation. Japan, following the reconstruction period (1945 through the early 1950's), then experienced a period of high growth lasting through about 1990.

Three potential explanations help explain the success of Japan and the Japanese political order in the context of our framework. First, a significant portion of the Japanese *mētis* remained intact in the post-war period. For centuries Japanese culture has been geared toward large-scale organizations and a positive view of trade and market exchange (Fukuyama 1996: 161-170). Such a culture aligns well with the incentives of a liberal political and economic structure. In the reconstruction process, while the *mētis* indeed changed, the key aspects of the commercial heritage remained intact. The practical knowledge that

allowed people to coordinate and get things done in the pre-war period allowed for similar results in the post-war period.

Second, the translation of the imposed constitution from English to Japanese shows the potential value of ambiguity. While the native Japanese didn't play a large role in drafting the new constitution, they did play a role in translating it into Japanese. The English and the Japanese versions differ because the two languages, in many cases, fail to have equivalent terminology (Inoue, 1991). While the Japanese adopted a constitution affirming their commitment to Western democratic institutions, much of the post-translation language expresses pre-WWII traditional Japanese social and political values. In other words, key elements of traditional Japanese *metis* were allowed to remain intact.

Third, the expectations held by the Japanese populace also played a role in the success of the new constitution. Japanese citizens had overly pessimistic expectations regarding the treatment by the Allied forces. At the conclusion of the battle the Japanese citizens did not find the Allied forces waiting to attack them as they had expected. Rather, they found the troops maintaining order while attempting to secure means of safety, health and sanitation. The Allied forces set realistic expectations regarding the reconstruction process. They projected an image of firmness and a commitment to maintaining public order. The Japanese did not view the Allied forces as their benefactor and hence did not hold mistakes against them. Given their low expectations, there was little conflict during the reconstruction process. For the most part, Japanese citizens could not be disappointed with the speed or particulars of the reconstruction process because the very result of reconstruction was better than they had predicted.³

³ Similar reasoning applies to Germany, whose citizens expected widespread destruction and death but were surprised to see Allied forces distributing opinion surveys upon emerging from their places of protection.

The three major mechanisms discussed in this paper played an important role in postwar Germany as well. A 1944 *U.S. Civil Affairs Guide* indicated that local politics was to be the springboard for political reform throughout Germany, given that governments at the local level had a strong tradition of self-government (Boehling 1996: 156). Writing on British plans to democratize Germany, Marshall notes: “It was recognized, however, that beneath the nationalist and aggressive policies perpetuated by German central governments, there had existed a healthy democratic tradition at the local level...” (1989: 191). Allied advisors, many of whom were experts in German history, recommended retaining particular indigenous traditions. The reconstruction process, for instance, included some native Germans. The military governments in the U.S. Zone appointed Germans in villages, towns and cities to assist in the implementation of the Allied policies. In choosing native Germans for these positions, emphasis was placed on past administrative experience and the perceived ability to cooperate with military authority rather than on pro-democracy/anti-Nazi leanings (Boehling 1996: 271). As a result, at least part of the German *mētis* was incorporated into the political rebuilding process, which in turn supported the workability of the reconstructed political order.

Expectations play a critical key role in the macro-economic order. If the expectations of economic actors are that macro-variables (i.e., fiscal and monetary policy, regulations, etc.) will remain unstable, they will shift their behavior accordingly. As with the political reconstruction process, expectations must be managed such that the populace can realistically coordinate their activities. Credibility and stability must be signaled to the populace that policies and reforms communicated will, in fact be undertaken.

In sum, both Japan and Germany illustrate central lessons about the possibility of the rapid evolution of cooperative games. The efforts of occupying forces provided the

framework that allowed for the evolution of coordination. The key aspects of the pre-war *mētis* or know-how remained intact in the post-war period. Further, the political order allowed key groups to coordinate around beneficial conjectures. Finally, expectations were set realistically and allowed the occupying forces to carry out their mission without large-scale resentment or disappointment on the part of the populace.

b. Unsuccessful attempts at reconstruction

Bosnia is one case where reconstruction has failed to overcome the conflict of interests that characterizes reconstruction. Instead, the efforts undertaken have perpetuated conflicts of interest, making coordination extremely difficult.

Bosnia's three and a half years of internal ethnic conflict ended with the signing of the Dayton Peace Agreement (DPA) in 1995 and then the arrival of international peacekeepers. Despite the coming of peace, the DPA and the efforts of peacekeepers have failed to put Bosnia on a path toward growth and development. For the most part the region remains a ward of foreign aid, and few have confidence that political order would follow a withdrawal of troops.

The DPA confirmed the existence of a single state but it created a multi-layered political structure, consisting of multiple entities with conflicting interests. The two entities created by the DPA – *The Federation of Bosnia and Herzegovina* and *Republika Srpska* – do share some common institutions. There is a general Council of Ministers. The tri-partite Presidency -- the top political institution -- consists of one Bosnian, one Bosnian-Croat and one Bosnian-Serb, who rotate power every eight months. These common political institutions are in charge of foreign affairs, monetary and fiscal policy, immigration and other social policies and regulations. The conflict in interests stems from the existence of yet

additional sovereign institutions. Below these common institutions, each entity has its own separate Constitution, president, vice-president and political system.

Finally, the conflicts of interest are yet more extreme. The Office of High Representative (OHR) has overriding authority in interpreting the implantation of the peace process. The OHR, who is external to the Bosnian government, is nominated by the Peace Implementation Council – which consists of 55 countries and organizations involved in the peace process – and approved by the UN Security Council.

The complicated structure of the Bosnian government, along with the outside influence of the OHR, makes it difficult for individuals to coordinate on one set of positive conjectures. The very structure of the government allows for a continued conflict of interests at virtually all levels. The existence of multiple Constitutions has allowed different entities to pursue different and often conflicting ends. For example, the Republika Srpska's Constitution recognizes only Serbs as citizens of the entity. Croats and Bosnians are considered "lesser" minorities and do not receive the same treatment as Serbs. This fundamental inconsistency with the rule of law makes it harder to have widespread coordination on good norms.

The reconstruction of Bosnia shows yet another problem: the democratic process was rushed before there was widespread coordination on the political order. The timetable for elections was set at the signing of the DPA and stated that elections should take place no later than nine months after the signing. The rushed elections prevented the development of grassroots support for democracy. The nationalist parties, which were already held power in the limited administrations, and which had access to media and financial resources, had a distinct advantage given the short time frame.

The issues outlined above do not justice to the complicated situation that characterizes Bosnian reconstruction. However, these few points do illustrate the difficulties involved in generating coordination-enhancing institutions. The current reconstruction efforts fail to allow cooperative mechanisms to put the country on a self-sustaining path toward either sustainable democracy or a market order.

c. Coordination on bad norms, or coordination without success

Coordination can take place on both 'good' and 'bad' orders. By 'good' and 'bad' we mean that not all orders maximize the production of social wealth. The Stalinist conquests of Eastern Europe led to fairly rapid political order, but people grew to expect a system of expropriation and ill-defined property rights. The coordination was not self-enforcing and self-extending over time, and thus required continual interference of the government into the economy and polity. The result was rapid coordination but under the umbrella of tyranny and the widespread fear of force.

At the conclusion of World War II, a settlement was reached between the United States, Great Britain and Russia as to what parts of Europe they would occupy. The basis of the agreement was that the governments of the countries would move toward a democratic political order. Russia was granted a free hand to interfere in many parts of Eastern Europe. Under the leadership of Stalin, Eastern Europe was reconstructed not following Western institutions but as a socialist system.

Stalin introduced a fourth 'Five-Year Plan' which tightened domestic controls over the economy, isolated the Eastern territory from the rest of Europe and refused U.S. aid through the Marshall Plan. He moved quickly toward government ownership through mass nationalization of private industries and a focus on heavy industrial development. Those deemed dissidents were jailed as prisoners of war, used as forced labor, sent to prison camps

or executed. Non-communist parties were banned and those who were deemed to espouse Western virtues were silenced.

While the outcome of the Stalinist reconstruction is well known, it serves as an interesting case study within our analytical framework. Certainly there was large-scale coordination taking place in Eastern European region toward the ends set forth by Stalin and a kind of political order. However, the coordination differed from that taking place in Japan and Western Europe. The coordination in Eastern Europe was centered on the fear of force instead of on rules that encouraged self-sustaining cooperation.

In Japan and the rest of Europe there was a mechanism of enforcement and force in place as well. In fact, the Allied forces first used a massive show of force (i.e., Hiroshima, etc.) to gain control of the populace. But after the initial show of force in Japan and Western Germany, further force was necessary to maintain control only in rare instances. Cooperation grew rapidly enough that people bought into the new order. In Eastern Europe, in contrast, the continued use of strong force was necessary to ensure coordination.

V. Testable Implications

To recap our main content, reconstructions succeed when they turn potential games of conflict into games of coordination. Therefore our first testable implication is that reconstructions will either work very well or not at all. There is some tipping point with individuals and groups (spoilers, interest groups, etc.) engaged in conflict on one side and widespread coordination and cooperation on the other. If this hypothesis is true, we should observe a bimodal distribution of reconstruction outcomes. That is, we should observe many reconstructions that are clear successes, many that are clear failures and relatively few cases in between the extremes.

Our treatment of the role of *mētis* (i.e., social capital) in the reconstruction process is testable as well. Many studies have attempted to measure social capital (see Paldam 2000 and Paldom and Svendsen 2000 for literature surveys). Francis Fukuyama (1996) and Robert Putman (1994, 2001) offer two measures of social capital that are useful for our purposes. Fukuyama posits that social capital can be measured by considering the number and size of private business organizations (1996: 29-30). He argues that the development and persistence of large-scale organizations can only take place with a sufficient stock of social capital, trust, and coordination. Putman analyzes social capital in terms of the degree of civic involvement, as measured by voter turnout, newspaper readership, membership in various clubs and organization and confidence in public institutions (1994, 2001).

The measures discussed above could be applied to past reconstruction efforts to test our hypothesis that social capital is critical to a successful reconstruction. Applying Fukuyama's proxy would involve measuring the number of large-scale, private firms. If our framework is accurate, we would expect to see a greater number of large-scale firms preceding cases of successful reconstruction. Likewise, applying Putman's proxy for social capital, we would expect to see more involvement in social groups and networks (i.e., greater voter turnout, newspaper readership, and various clubs and organizations) in cases of successful reconstruction. One could also trace involvement with such groups before reconstruction efforts and compare that with involvement in the post-war period. This would offer insight into the subsistence of *mētis* from the pre-war period through the post-war period.

Finally, the role of expectations in the reconstruction process could be measured. Survey data would be needed from those in the specific war-torn country regarding their expectations concerning reconstruction efforts. That data would then be compared with the

ultimate success or failure of the reconstruction effort. For instance, in Germany, the allied forces distributed opinion surveys in the post-war period to get indigenous input regarding the reconstruction effort. If the survey data was obtainable, the results could be studied to understand what role expectations played in the ultimate success of the German reconstruction. Similar efforts have been undertaken in Iraq to determine public opinion regarding the reconstruction efforts. A broader database would allow for actual testing of the hypotheses.⁴

VI. Conclusion

We have argued that a successful reconstruction is characterized by widespread coordination. Toward this end, the development of several mechanisms – *mētis*, expectations and the political order – are important for shifting games of conflict to games of coordination. We therefore can put forth some general guidelines for the achievement of a successful reconstruction:

1. Don't overemphasize infrastructure – Infrastructure is a good thing. However, the fundamental question is whether the reconstructed country will have the cohesion, social capital and know how (i.e., *mētis*) of how to get things done and maintain its investments. While large-scale public works may be necessary in some cases, they should not be taken as a sign of a successful reconstruction.
2. Don't overemphasize elections and democracy – Democracy can be effective when citizens are committed to a free society. Without those underlying conjecture however, democracy can bring tyranny and chaos. The political order, serves as the foundation and framework within which the economic and

⁴ Information on public opinion polling in Iraq is available at:
http://www.taemag.com/issues/articleID.17697/article_detail.asp

social order can evolve. Before elections take place social order, a market structure and the underlying cooperative conjectures must be in place.

3. Expectations are critical— Expectations are influenced by the information available to those living in a country as well as how they interpret that information. Even if they are happy about the removal of the previous regime, if their expectations are overly optimistic they will be disappointed with and come to resent the occupying forces. Expectations should be set at an “honest” level. If the inhabitants of the occupied country hold the occupier as their benefactor they will hold every mistake against them. An image of firmness with a commitment to public order must be put forth. Failure to do so will at a minimum prolong the reconstruction and at the limit result in its ultimate failure.

As economics and history teaches us, these guidelines give the best chance for a better peace and stability.

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