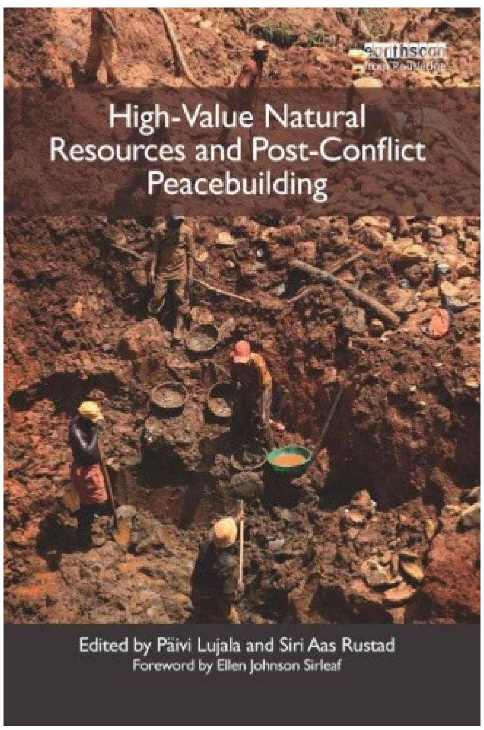

The capitalist civil peace: Some theory and empirical evidence

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Post-conflict societies are often characterized by weak economic and political institutions and domination by entrenched interests. The end of violence creates an opportunity to put a stop to the "institutional sclerosis" that results when rent seeking holds back socioeconomic progress (Olson 1982).[1] But the question of how best to take advantage of this opportunity remains controversial. In a 2008 publication on post-conflict economic recovery, the United Nations Development Programme (UNDP) described recovery as "building back differently and better" (UNDP 2008, 1). But what, exactly, should be done "differently" and "better"?

The reality is that aid has generally failed to deliver development; instead, as many have argued, development is driven by entrepreneurial activity. And the extent of such activity is largely determined by the structure of incentives that motivate investment endogenously (Easterly 2006). While multilateral organizations (such as the UN) and many nongovernmental organizations (NGOs) pay homage to building markets and encouraging private economic activity, there is generally a visible bias in favor of "getting the politics right," as opposed to encouraging free markets (Collier 2009; Paris 2004). And most of the post-conflict peacebuilding literature emphasizes improving coordination among donor countries and making the delivery of aid more effective; there is generally little focus on identifying and nurturing endogenous sources of domestic peace and recovery (Call and Cousens 2008).

One consequence of the emphasis on state building and on undertaking reconstruction from the "outside" is a failure to examine the role of free markets in establishing social peace. This chapter argues that free markets matter, and

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1 *Rent seeking* refers to attempts to capture economic benefits without contributing to overall economic production. For example, producers seek rents when they lobby governments for higher tariffs, and monopolists seek rents when they try to prevent competition.

that they can both spur and support endogenous efforts to build functional states and institutions. The approach is both theoretical and empirical: what are the arguments and evidence for a relationship between free markets and social harmony?

Many liberals believe that systems that discourage the formation of monopolies and entrenched interests escape perverse political and economic outcomes; correspondingly, they believe that systems that encourage individual liberties and free market transactions improve welfare and increase social harmony.[2] But the efforts of the international community to promote more open economic systems have recently come under question (Cramer 2009; Paris 2004); the argument is that fragile societies cannot handle the competitive, conflictual situations bred by democracy and free markets.[3] Nevertheless, post-conflict recovery has to start somewhere. It is precisely this issue of where to start—and why—that is the focus of this chapter.

The chapter is divided into four major sections: (1) a discussion of the theoretical basis for establishing economic freedom in post-conflict settings; (2) an explanation of why peace fails under autarkic economic environments; (3) analyses of data that illustrate a strong connection between economic freedom and social harmony; and (4) a brief conclusion.

WHY ECONOMIC FREEDOM? SOME THEORETICAL EXPLANATIONS

How might market institutions, the more neglected aspect of the liberal peace, matter? In the eighteenth century, classical liberals such as Adam Smith, David Ricardo, and Bernard Mandeville argued that when individuals pursue self-interest, they serve a higher social purpose "as if by a hidden hand" (Stilwell 2006). Free markets thus provide the basis for prosperity—while other desired outcomes, such as peace, arise from cooperation among people who are acting out of self-interest. In this view, cooperation stems from the expectation of gain, rather than from religious (or other) ethics or from inherent feelings of sympathy for others.

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2 For the purposes of this chapter, *liberalism* refers to the classical liberal position on free markets, political liberty, and individual freedoms. Classical liberals such as John Milton, Montesquieu, David Hume, John Locke, Adam Smith, Immanuel Kant, and adherents of the Manchester School believed that individual freedoms, particularly in the economic realm, would lead to vibrant markets that were free of interference from politics—and that such freedoms would therefore be good for prosperity and peace (Hirschman 1977; Holmes 1995). (For further discussion of classical liberalism, see Hall [1987]). The mountain of empirical evidence that links democracy and trade dependence to peace at the international level has rekindled the idea of promoting open trade and democracy in order to promote civil peace (Russett 1993; Russett and Oneal 2001).

3 In this chapter, liberal economic systems, free markets, capitalism, and economic freedom are regarded as similar both conceptually and operationally and are used interchangeably. See Berger (1993) for an extended discussion of these terms.

Such arguments were expanded by political philosophers—including John Locke, Immanuel Kant, John Stuart Mill, and Norman Angell—who saw the expansion of trade, or the "spirit of commerce," as the triumph of exchange and civility over plunder and predation (Kant 1991). Commercial liberalism advocated free markets; republican liberalism called for the creation of representative states, to ensure that the rules of the free market would generally be impartially enforced and could not be subverted by the powerful. Economic and political freedom were thus inextricably linked, because people who were free to engage in mutually beneficial economic activity would form associations to check the power of states and vested interests.

Classical liberalism also held that self-interested economic activity produces wealth more efficiently than autarkic systems, which are designed to increase the welfare of rulers and states. The goal of mercantilism, the dominant economic system at the time that classical liberalism emerged, was to increase the wealth of kings. Arguments that capitalism was superior to mercantilism were based on the premise that markets could create and distribute goods and services (i.e., wealth) more efficiently, increasing the welfare of *all*—including the king. Consider the following observation, made in the 1830s by Alexis de Tocqueville, a keen observer of how democracy, rather than chaos, was taking root in the newly formed United States of America:

> You have some difficulty in understanding how men so independent do not constantly fall into the abuse of freedom. If on the other hand, you survey the infinite number of trading companies in operation in the United States . . . you will comprehend why people so well employed are by no means tempted to perturb the state, nor to destroy the public tranquility by which they all profit (de Tocqueville 1956, 118–119).

Those who invest money wish to avoid war because violence would disrupt profits. Thus, the growth of commerce apparently made war—which would damage the interests of everyone—unnecessary.

In keeping with classical liberal theory, several contemporary studies report a positive relationship between economic freedom, properly functioning markets, and civil peace, and describe a number of different channels through which good market institutions, such as respect for property rights, can temper social conflict (de Soysa and Fjelde 2010; de Soysa and Binningsbø 2009; Eriksen and de Soysa 2009; Mousseau and Mousseau 2008; Steinberg and Saideman 2008). David A. Steinberg and Stephen M. Saideman (2008), for example, found that the less the state is able to manipulate economic policies in favor of ethnic majorities, the less fear and mistrust will be generated among minorities. In other words, economic freedom matters: more open markets dampen the fear and mistrust associated with ethnic nepotism. This suggests, in turn, that the primary concern of ethnic groups might be economic, rather than political, well-being.

Other researchers, including Michael Mousseau and Demet Yalcin Mousseau (2008), argue that people who are free to engage in contracts respect the rights of others and promote the welfare of others. Using the density of life insurance contracts as a measure of market norms, Mousseau and Mousseau found that high levels of contracting lead to respect for individual rights, regardless of caste, creed, ethnicity, or other characteristics.

The explanation of the link between free markets and social peace offered in this chapter complements the broadly social explanations of Steinberg and Saideman (2008) and Mousseau and Mousseau (2008). The theory presented in the following section seeks to explain why economic autarky sets the stage for rebellion rather than for peace—and, by implication, why peace may be more likely under conditions of economic freedom.

WHY ECONOMIC AUTARKY ENCOURAGES REBELLION-SPECIFIC CAPITAL

The theory that free markets encourage social peace is founded on a single observation: *violent armed conflict has to be feasible to occur*. The question is, what renders armed conflict feasible? First of all, war is a costly endeavor; it will not occur if those who invest in it do not expect the returns from war to be higher than the returns from peace. Thus, grievances alone are unlikely to bring about armed conflict: challenging the state requires significant financing and relatively large numbers of volunteers. But if people are capable of sufficiently organizing human and financial resources to launch a rebellion, why wouldn't they channel that energy to obtain relief from grievances *without* engaging in violence?

Theoretical and empirical analyses conducted by two sets of researchers—Paul Collier and Anke Hoeffler (2004) and James D. Fearon and David D. Laitin (2003)—show that *opportunity*, rather than grievance, explains the onset of civil war: that is, conflict will occur where organizing for violent purposes is viable (Collier, Hoeffler, and Rohner 2009). Viability, in turn, is shaped by many factors, including the size and nature of the payoffs for investing in violence rather than in other potentially "profitable" enterprises. In the "loot-seeking" model of rebellion, for example, in which high-value resources render rebellion both attractive and viable, loot is the expected payoff for the "investment" in rebellion.

But the argument that rebellion is opportunistic behavior fails to take into account the opportunity costs associated with organized violence: in a globalized world with ample opportunity for profitable investment, any potential rebel could just as easily be a "corporation"—exporting natural resources and paying taxes to the state—instead of a warlord who has to invest much of the loot in continued conflict (not to mention the discomfort of living in the bush). In an environment that provides incentives for investment and enforces rules that safeguard profits, investing in production will be more attractive than investing in war. In fact, in a number of advanced market economies, the high costs of remaining illegal have led many "loot-seeking" groups, like the Mafia, to move into the quasi-legitimate business world.

On the other hand, if the state monopolizes all economic activity and expropriates the surpluses that are created in an economy—serving, in Mancur Olson's terms, as a "roving" rather than as a "stationary" bandit—there will be few incentives to invest in taxable enterprise and "go legit" (Olson 1993).[4] Where property rights are insecure and capricious political processes govern economic life, productive enterprises are at risk, and there is motivation to organize in the shadows, by capturing rents and defending them (Skaperdas 2003).

Although shadow economies are often thought to emerge during war and its aftermath, in all likelihood they exist before war even begins. Consider the Mexican drug cartels, for example, which are engaged in a lucrative trade that lacks a legal infrastructure for handling transactions. The groups organize and fight in Mexico because violence is more viable there, but the impetus for the killing is the high demand for drugs across the border. Globally, such shadowy groups are now responsible for a large part of violent conflict (Mueller 2004).[5] These groups survive and thrive because they have "rebellion-specific capital": that is, organizational advantages over states, from armaments and tunnels to sophisticated command and communications networks.

Stergios Skaperdas (2003) holds that because the incentives that govern markets shape the behavior of *homo economicus* (economic man), the economy cannot be divorced from its governance—a perspective that is in keeping with the thesis of this chapter. The conflict that plagues northern Mexico, for example, cannot be solved without governance-based efforts to alter the payoffs that accrue to those who invest in conflict-specific capital. In practical terms, there are two ways to address this issue—either militarily (that is, by suppressing the violence), or legislatively (that is, by legalizing drugs in the United States and thereby eliminating the payoff for smuggling).

Ultimately, bad—that is, incompetent—governments are the primary source of violent conflict, not the ethnic and cultural clashes that are often held responsible (Mueller 2004). Thus, the peacebuilding initiatives currently in fad might have to focus more intently on how to build economic and political institutions that support economic competition and ensure low barriers to entry for legitimate business. All too often, however, post-conflict peacebuilding efforts are designed to remove broad societal grievances, rather than to promote markets by removing the risks of investing.

A vast literature addressing the "resource curse" demonstrates that rulers of resource-rich states fail to build good institutions (Jensen and Wantchekon 2004;

4 In the view of Mancur Olson (1982), capricious governance is analogous to roving banditry, where the arbitrary nature of theft (i.e., high tax rates) gives producers an incentive to hide their goods and to underproduce. A stationary bandit, in contrast, will avoid stealing because if producers believe that their goods are safe, they will produce a surplus that will increase the absolute value of the bandit's takings (i.e., the tax base). Thus, a stationary bandit provides a predictable tax rate that elicits optimal production—a win-win situation.

5 For a comparative view of warlordism, see Marten (2006).

Olsson and Congdon Fors 2004; Ross 2001).[6] But this raises a question: if resources provide lootable income, and resource-rich nations tend to have weak governments, why haven't rulers used the resource wealth to increase state capacity? The most convincing argument is that rulers fear being replaced, and therefore will resist building institutions that would create alternative bases of power (Acemoglu and Robinson 2006). If capitalism, which is one such institution, builds alternative sources of economic power, then the rulers of resource-rich countries have little incentive to create the kind of open economy that would eventually lead to reform—and, ultimately, to the loss of rents (Congdon Fors and Olsson 2007). A large body of literature on the "rentier state" is based on similar arguments (Beblawi 1990; Bellin 2004; Ross 2001).[7]

Countries with high-value resources—oil and diamonds, in particular—are at very high risk of conflict (Fearon and Laitin 2003; Lujala 2010). How might greater economic freedom moderate this risk? Knowing that there is a resource curse does not break the spell. Poor countries that are blessed by nature cannot ignore their largesse and "keep it in the ground." Over the past several decades, a number of schemes to manage the resource curse—such as state ownership, development funds, and various revenue-sharing schemes—have been tried, with mixed results (Weinthal and Luong 2006). After reviewing the evidence, Erika Weinthal and Pauline Jones Luong (2006) offer one solution that they believe may be the best: allowing competitive private ownership of resources. With illustrative evidence from Russia, Weinthal and Luong show that what prevents rulers from mismanaging wealth is ownership structure; therefore, assigning private ownership to extractive activities leads to the demand for better—that is, impartial—institutions to manage the transactions between private actors.

Although most of the internal wars being fought today are devoid of political content (Collier, Hoeffler, and Rohner 2009; Mueller 2004), the notion persists, particularly among global governance agencies, that war is "politics by other means." As this section has made clear, however, where countries are rich in natural resources and booty makes it possible to organize and maintain violence, war is more likely to be "economics by other means." In other words, when state institutions are weak or unwilling to adjudicate fairly, warlords are essentially businessmen for whom engaging in organized violence is an occupational hazard; mafias, after all, have historically begun as private protection rackets (Gambetta 1993).

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[6] The term *resource curse* refers to economic, political, and social maladies that stem from the perverse incentives that resources provide for anyone who wishes to capture them. For a more detailed explanation of the resource curse, see Paul Collier and Anke Hoeffler, "High-Value Natural Resources, Development, and Conflict: Channels of Causation," in this volume.

[7] The term *rentier state* refers to states that are dependent on rents rather than taxes.

ECONOMIC FREEDOM AND CIVIL PEACE: EMPIRICAL EVIDENCE

Capitalistic—that is, production-friendly—environments may be capable of breaking the link between natural resources, weak states, and civil war (Fearon 2005), but there is a dearth of evidence that effectively ties free markets to peace and demonstrates how the two can work symbiotically. In fact, because of the risk that the state will be captured by private interests, free markets are typically viewed as weakening, rather than strengthening, the state (Cramer 2009; Paris 2004; Stiglitz 2007).[8] The few studies that have addressed free markets in post-conflict settings have found that economic freedom does have short-term destabilizing effects (Paris 2004): privatization of the economy, for example, can be dangerous without good institutions. But what remains unclear is how one gets to long-term stability without starting somewhere, particularly if it is unclear whether capitalist institutions are worth building in the first place.

This chapter argues that free markets produce viable civil societies, which act as a counterweight to the capture of democracy by vested interests that have access to state power (Bermeo and Nord 2000). Economic institutions that ensure economic competition and low barriers to entry for legitimate business increase the motivation to organize openly and legally, rather than in the shadows. The next task is to present evidence for the connection between free markets and civil peace.

The broad trend: A bivariate analysis

Since the end of the Cold War, the world has become much safer in terms of armed conflict (Gleditsch 2008; Hewitt, Wilkenfeld, and Gurr 2008; Human Security Report Project 2005). The question is, can the growth in free-market capitalism account for the change?

Figure 1 compares global trends in civil armed conflict with scores on the 2010 Index of Economic Freedom. (The index assigns scores to ten categories of economic freedom—including labor freedom, business freedom, trade freedom, investment freedom, property rights, and freedom from corruption—which are then averaged to create an overall score.)[9] The contrast is quite stark. In countries with below-average levels of economic freedom (not shown in the figure), the risk of civil war is over twice that of countries with above-average levels of economic freedom. In fact, low performers on economic freedom accounted for much of the spike in civil wars that occurred during the early 1990s (Economic Freedom Network n.d.).

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[8] This is an old debate that goes back to Adam Smith and Marxist critiques of capitalism.

[9] For detailed explanations of the Index of Economic Freedom, see Gwartney and Lawson (2005). The data are available at Economic Freedom Network (n.d.).

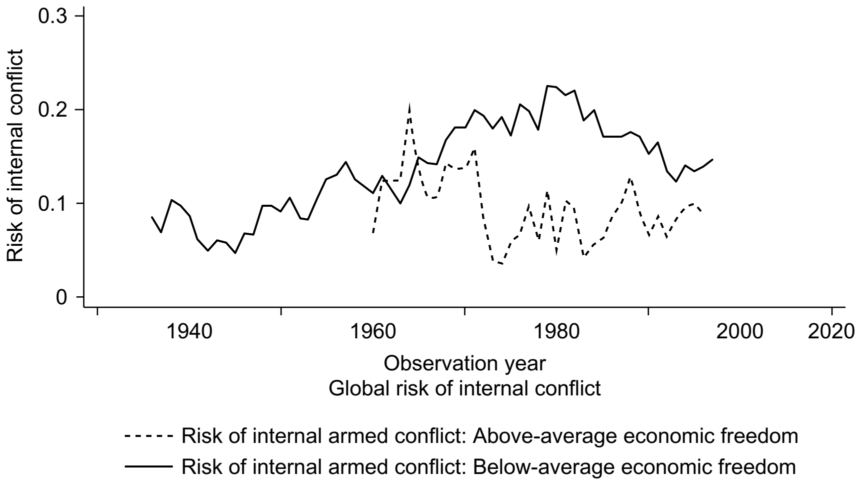

Figure 1. Economic freedom and the risk of internal armed conflict (>25 battle deaths), 1970–2008

Sources: UCDP (n.d.); Economic Freedom Network (n.d.).

Notes:

1. To compute the risk of internal conflict, the number of ongoing civil wars was divided by the total number of countries.
2. Above-average economic freedom was defined as anything above the mean value of economic freedom, which for the global sample was 5.88 points.

This simple, bivariate reckoning clearly demonstrates that peace and greater economic freedom have gone together. It also contradicts the claim—made by many who see the imposition of free-market policies through structural adjustment programs as destabilizing to social harmony—that it was the imposition of neoliberal policies by the International Monetary Fund and the World Bank that led to conflicts in the 1980s and 1990s (Abouharb and Cingranelli 2007).[10] The drop in civil war that has occurred since the end of the Cold War is also interesting: if the risk of civil war is largely driven by the resource curse, can it be that the shift toward neoliberal policies that has occurred since the early 1990s renders peace possible, even in resource-wealthy countries with weak governance?

The comparison of bivariate averages provides preliminary evidence that peace and free markets are positively linked, but this inference may be too broad and is perhaps unreliable. For example, the measure of economic freedom may actually reflect income or some other factor, such as European heritage. To determine whether the broad trends in liberalization and the end of civil war are connected, the bivariate correlations need to be tested more carefully and precisely, using multivariate models that can account for other possible explanatory factors. The

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[10] Structural adjustment programs were policies imposed by multilateral donors in an effort to open up closed economies.

next section will show that the positive correlation between peace and free markets holds even when several relevant factors are controlled for.

Free markets, organized violence, and human rights: Multivariate analyses

Figure 1 suggests that countries with higher levels of economic freedom are less likely to suffer from internal conflict. But this result could have been driven by a number of factors: richer countries, for example, may be less subject to civil war. To determine the net effect of economic freedom on civil war—that is, the effect of one variable considered independently of other (potentially explanatory) variables—one must use multivariate regression models, which make it possible to gauge the size and direction of the impact of any one variable while other variables are held constant. In the analyses described in this section, standard data sets, independently collected by other researchers, were used to measure the phenomena under study; this approach minimizes any biases the author may have introduced to the coding of data.

The two subsections that follow describe two types of assessments:

- The impact of economic freedom on organized violence.
- The combined impact of natural resource wealth and economic freedom on human rights.

The goal is to demonstrate, through more sophisticated means, that the results shown in figure 1 are not spurious—in other words, that economic freedom has a direct effect on civil peace and human rights, even when considered apart from "good institutions." The models employ several control variables, which were gleaned from the findings of Collier and Hoeffler (2004); Collier, Hoeffler, and Rohner (2009); and Fearon and Laitin (2003), all standard-bearers in the field.[11]

Economic freedom and civil war

For the main variable of interest, economic freedom, the analysis relies on data from the Fraser Institute that measure the extent to which an economy is (1) free from state interference and (2) allows private economic activity that is supported by impartial institutions (Gwartney and Lawson 2005). Economic freedom is judged according to twenty-two criteria, both objective (e.g., the government's share of the economy, trade openness, restrictions on capital) and subjective (e.g., the level of independence of the judiciary).[12] The index ranges from 0 (total

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[11] See the chapter annex for a detailed explanation.

[12] These data, which were obtained from the Fraser Institute, are available for five-year intervals until 2000 and at one-year intervals thereafter. For the period between 1970 and 2000, interpolations were made for the time between the five-year intervals. For full details on the data, see the Fraser Institute's web site, www.freetheworld.com.

autarky) to 10 (total freedom). In 2010, for example, the highest and lowest scores, respectively, were assigned to the free-trade port of Hong Kong (9.05) and Zimbabwe (3.57).

The main dependent variable (i.e., the outcome to be explained) in this analysis is the onset of civil war; the onset of conflict is relevant because one purpose of the analysis is to determine whether countries with high levels of economic freedom can maintain peace. The data used to measure armed conflict were obtained from the UCDP/PRIO Armed Conflict Dataset v4-2008 (Gleditsch et al. 2002; Harbom and Wallensteen 2009).[13] In the context of that data set, an intrastate armed conflict is defined as a contested incompatibility between a government and one or more opposition groups that results in at least twenty-five battle deaths in a year.

As shown in table 1, countries with higher levels of economic freedom have a lower risk of civil war (as is indicated by the negative sign of the coefficient); moreover, this result is highly statistically significant (indicated by the three asterisks after the coefficient).[14] Interestingly, per capita income, which is often touted as one of the most robust explanations for the onset of civil war (Hegre and Sambanis 2006), is not statistically significant, so the result is not explained by the fact that richer countries have higher levels of economic freedom. In robustness checks, which are designed to determine whether results are sensitive to changes in the models, the inclusion of measures of good institutions (such as lack of corruption), made no difference to the effects of economic freedom on the risk of civil war.[15]

But in real-world terms, how might economic freedom affect the risk of civil war? One way to explore this question is to ask to what extent economic freedom dampens the risk of civil war in a post-conflict setting. For a poor country (where the income is in the lowest 25th percentile) emerging from civil conflict, an improvement in the level of economic freedom from the 25th to the 75th percentile reduces the annual risk of civil war from 4.7 to 2.7 percent, a reduction of almost 60 percent.[16] The following three comparisons will help put this shift in perspective:

- Moving the level of economic freedom from the 25th to the 75th percentile is analogous to instituting Botswana's level of economic freedom in Sierra

[13] The UCDP/PRIO Armed Conflict Dataset is a collaborative project between the Department of Peace and Conflict Research at Uppsala University and the Centre for the Study of Civil War at the Peace Research Institute Oslo. For additional information, see the web site of the Uppsala Conflict Data Program, www.ucdp.uu.se.

[14] A statistically significant result is one that is extremely unlikely to have occurred by chance; the smaller the standard errors (shown in parentheses in the table) relative to the size of the coefficient, the greater the statistical significance.

[15] A number of methods were used to check for robustness when the parameters of the models were changed, but the fundamental negative (and statistically significant) effect of economic freedom on the risk of conflict held up (see the annex for a discussion of this point).

[16] All variables apart from economic freedom, income, and conflict history were held at their mean. All substantive effects were estimated using Clarify software (King, Tomz, and Wittenbeng 2000).

Table 1. The effect of economic freedom on the onset of civil war, 1946–2005

Variable	*Effect on the onset of intrastate armed conflict*[b]
Economic freedom$_{t-1}$	–0.33***
	(0.11)
Per capita income$_{log,\ t-1}$	–0.27
	(0.20)
Growth in per capita income$_{t-1}$	0.02
	(0.02)
Population size$_{log}$	0.48***
	(0.08)
Oil exporter	0.14
	(0.28)
Ethnic fractionalization	8.98***
	(2.12)
Ethnic fractionalization squared[a]	–7.99***
	(2.29)
Democracy	–0.12
	(0.24)
Autocracy	–0.18
	(0.25)
Incidence of conflict$_{t-1}$	–0.31
	(0.29)
Brevity of peace	0.90**
	(0.41)
	(1.67)
Number of observations	3,028
Number of countries	117

Sources: Data were drawn from CSCW (2008); Gleditsch et al. (2002); and Harbom, and Wallensteen (2009).
Notes:
1. Robust standard errors are in parentheses. These standard errors are robust to statistical problems arising from heteroscedasticity (nonnormality of error terms) and serial correlation, or the correlation of the error term across panels.
2. The "log" subscripts indicate that the data were log transformed to reduce the effects of extreme values.
3. The "t–1" subscripts indicate that the independent variable was measured one year before the year of civil war onset.
4. Economic freedom data are available only from 1970.

*** $p < .01$; ** $p < .05$;

a. Ethnic fractionalization squared models the quadratic effect of fractionalization. (This is useful for testing whether conflict is dependent on ethnic fractionalization in a linear or nonlinear way. In a linear relationship, if one variable changes, the other changes by a corresponding amount.)

b. An intrastate armed conflict is defined as a contested incompatibility between a government and one or more opposition groups that results in at least twenty-five battle deaths in a year.

Leone: had Sierra Leone adopted Botswana's level of economic freedom at the end of its civil war, in 2002, it would have roughly halved its risk of reverting to conflict.

- In the absence of improvements in economic freedom, a similar reduction in risk would take a full eight years of post-conflict peace.
- In terms of the effect on the risk of civil war, moving the level of economic freedom from the 25th to the 75th percentile has the same impact as moving from the 25th to the 75th percentile in per capita income distribution.

Although the war-averting effect of greater economic freedom is comparable to that of higher per capita income, it is presumably much easier for a country to reduce the risk of war by improving policies and building institutions than by becoming wealthier.

Economic freedom and political repression

This segment of the analysis addresses the following question: Can economic freedom calm social dissent, as measured by state repression of people's rights? It also tests natural resource wealth in relation to economic freedom to see whether economic freedom can moderate the effects of resource extraction on the political repression of dissent.[17] In other words, given that resource extraction is supposedly associated with the risk of political repression, can economic freedom reduce that risk?

Although it is true that a state may successfully suppress conflict through repressive means, the very existence of such repression signals a high level of social dissent, short of all-out civil war (Poe 2004); this level of social and political upheaval can be captured by data on state repression. The analysis focuses on the most odious forms of repression: violations of "physical integrity rights" (disappearances, imprisonment, political murder, and torture). Scores on the Cingranelli-Richards (CIRI) index of physical integrity rights range from 0 to 8, where 0 represents total repression of rights and 8 represents perfect respect for all rights.[18]

As can be seen in table 2, economic freedom has a statistically significant dampening effect on political repression—a result that is unaffected by per capita income or other relevant controls. And, as in the previous analysis, the presence of good institutions had no effect on the interaction between economic freedom and political repression.[19]

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[17] "Testing interactive terms" means determining the effect that occurs when two variables are in play concurrently. In practical terms, it involves multiplying two variables to create a new variable.

[18] The CIRI human rights data and documentation are available at http://ciri.binghamton.edu/. The CIRI Human Rights Dataset, which is generated from the country reports created by Amnesty International and the U.S. State Department, is designed to capture the patterns and sequence of the severity of repression, freeing the researcher from making assumptions about various questions (e.g., whether torture matters more than death and disappearances) (Cingranelli and Richards 1999).

[19] Most of the results confirmed previous findings. Per capita income has a strong negative effect on repression, as do democracy, ethnic fractionalization, and the time since the last civil war. Population size and ongoing civil war, on the other hand, show positive effects on repression. These findings are highly consistent with those reported previously by others (see Landman 2005). While the British and socialist legal systems show negative effects on repression, which is consistent with the results reported previously, the effects are highly fragile.

Table 2. The effect of economic freedom on political repression, 1981–2006

Variable	*Effect on political repression*
Economic freedom	–0.286
	(3.71)***
Oil exporter	0.310
	(1.54)
Per capita income	–0.158
	(2.00)**
Growth in per capita income	–0.010
	(1.54)
Democracy	–0.628
	(4.84)***
Population size	0.293
	(6.79)***
British legal system	–0.015
	(0.10)
Socialist legal system	–0.246
	(1.09)
Civil war	1.132
	(7.27)***
Years of civil peace	–0.017
	(4.54)***
Ethnic fractionalization	–0.520
	(1.86)*
Number of observations	2,586
Number of countries	111

Sources: Data were drawn from World Bank (2007), Fearon and Laitin (2003), and Gurr and Jaggers (1995).

Notes: Panel-corrected z-statistics are in parentheses. Year dummies (not shown) were computed with all tests. *** $p < .01$; ** $p < .05$; * $p < .10$

The direct substantive effects of economic freedom are large. For comparison's sake, if all the nations in the world were frozen at the mean level of economic freedom (holding all other variables equal), and if economic freedom alone were changed to its maximum value, one could expect a 60 percent reduction in the risk of political repression.[20] Remarkably, this is twice the impact associated with a shift from the average level of civil war to a world free of civil wars.

The next part of the analysis was designed to address the following question: in resource-wealthy countries where the goal of peacebuilding policy

[20] Marginal effects were computed as follows: (1) starting with a predicted probability for the model (at the value of 5 on the CIRI scale, which is roughly the mean of the sample); (2) holding all the control variables at their mean values; (3) recomputing the original prediction, using the maximum value of economic freedom while holding all other variables at their means; then (4) examining the differences between the two predictions. Alternatively, one could pick the values of economic freedom for two countries, such as Sierra Leone and Botswana. (Incidentally, if the world had Sierra Leone's level of economic freedom in 2000 and then changed to the level of Botswana in 2000, a 60 percent reduction in political repression could be expected.)

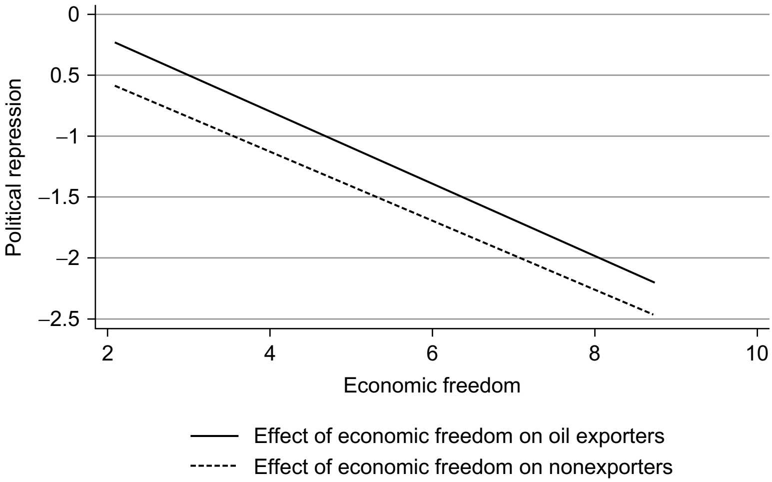

Figure 2. Effects of economic freedom on political repression in oil-exporting states and non-oil-exporting states
Source: Data were drawn from World Bank (2007), Fearon and Laitin (2003), and Gurr and Jaggers (1995).

is to improve governance and decrease dissent, should policy favor economic or political freedoms? To get at this issue, the analysis compared the effects of oil wealth and economic freedom on political repression with those of oil wealth and democracy on political repression, in order to determine whether economic freedom or democracy was the better moderating factor.[21]

As shown in figure 2, economic freedom dampens political repression among both oil-exporting and non-oil-exporting countries. Although oil exporters clearly experience greater repression, the risk of repression among oil exporters and non-oil-exporters converges slightly as economic freedom increases.

The results of this analysis clearly suggest that resource-wealthy states can avert dissent and repression through institutional reforms that support markets and economic entrepreneurship. Although democracy alone has strong negative effects on political repression—as reported by many researchers (Davenport and Armstrong 2004; de Soysa and Nordås 2007) and as shown by the negative sign of the coefficient in table 2, in the presence of oil wealth, repression increases as democracy moves from 0 to 1 (figure 3).[22] In non-oil-exporting countries, however, democracy has no effect on repression. Even if these results suggest only tentatively that it is economic freedom, rather than democracy, that tempers the effects of

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[21] Of course, peacebuilders could also use both, so the analysis also included a test of the combined effects of democracy and economic freedom, which may in fact be complementary. The results of this test are not shown.

[22] Democracy is a discreet variable that takes the value 1 if the Polity scale is above 6, and the value 0 if the Polity scale is below 6.

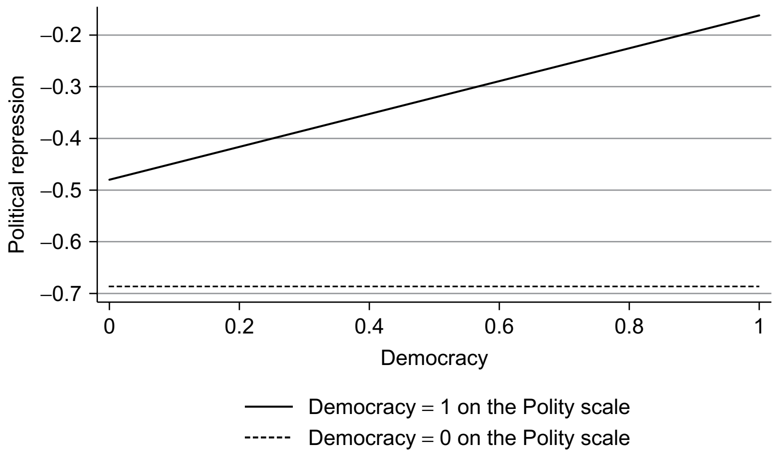

Figure 3. Effects of democracy on political repression in oil-exporting states
Source: Data were drawn from World Bank (2007), Fearon and Laitin (2003), and Gurr and Jaggers (1995).
Note: The Polity scale works as follows: if Polity is greater than 6, democracy takes the value 1; if Polity is less than 6, democracy takes the value 0. If Polity is greater than –6 but less than 7, semidemocracy takes the value 1; if not, semidemocracy takes the value 0. If Polity is less than –6, autocracy takes the value 1; if not, autocracy takes the value 0.

oil on repression, they do provide further confirmation of the power of economic freedom, as opposed to political freedom alone, to moderate capricious rule.

As shown in figure 4, as economic freedom increases, autocracies seem to lower their levels of repression (dotted line) as do democracies (solid line), although the decline in democracies is faster (shown by the steeper slope of the line). Interestingly, up to a threshold of roughly 4, economic freedom in autocracies is associated with a lower risk of repression than in democracies. In other words, at low levels of economic freedom, even democracies have higher levels of political repression, suggesting that democratic countries may have higher levels of social dissent when economic freedom is low, but as economic freedom increases, the level of political repression rapidly decreases. Thus, the figure clearly confirms that economic freedom and democracy are working in tandem.

Taken together, the analyses provide empirical evidence that resource wealth distorts relations between the state and society in violently repressive ways that do not reach the level of organized armed conflict. The results also suggest that resource-wealthy states are more likely to take repressive measures independently of macro political factors such as regime type—as is illustrated by the positive sign of the coefficient of the "oil exporter" variable in table 2. In other words, even when stability is defined as the absence of organized violence, the stability of oil-wealthy states may come at a rather high price. Nor does it seem that rulers of oil-wealthy states are "buying" stability without engaging in political repression—which suggests that many of the maladies faced by such states may be related to the repression of those who are calling for good governance (Jensen

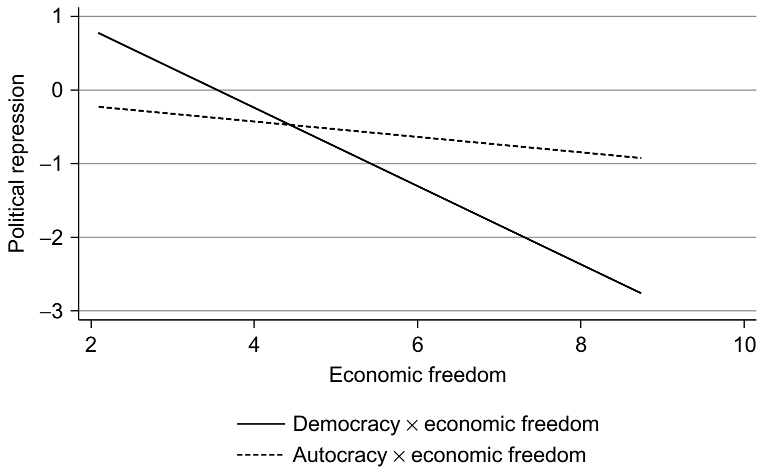

Figure 4. Effects of democracy and economic freedom on political repression
Source: Data were drawn from World Bank (2007), Fearon and Laitin (2003), and Gurr and Jaggers (1995).
Note: The Polity scale works as follows: if Polity is greater than 6, democracy takes the value 1; if Polity is less than 6, democracy takes the value 0. If Polity is greater than –6 but less than 7, semidemocracy takes the value 1; if not, semidemocracy takes the value 0. If Polity is less than –6, autocracy takes the value 1; if not, autocracy takes the value 0.

and Wantchekon 2004; Ross 2001). These findings concur with those of Collier and Hoeffler (2005), who have argued that democracy might not be the answer for managing natural resource-related problems. In sum, it is economic freedom, not political liberalization, that seems to moderate political repression in oil-exporting countries. Given this finding, peacebuilders interested in obtaining social peace should pay closer attention to building institutions that encourage markets.

CONCLUSION

Serious scholarly treatment of what it means to build back “differently and better” is just beginning (Collier 2009; Paris 2004; Paris and Sisk 2009; UNDP 2008). As noted earlier, a number of observers have rejected the idea of using economic liberalization as a blueprint for building better states, principally because such freedoms may be temporarily destabilizing, even if they are desirable in the long run (Cramer 2009; Paris 2004). The (quite legitimate) argument is that nascent state institutions should be allowed to become “institutionalized” before rapid economic liberalization occurs. The dilemma is that such institutionalization can occur only *after* institutions that would serve particular functions—such as ensuring the enforcement of the proper “rules of the game” within the polity and economy—are put in place. Privatization, for example, should *begin* at some point *before* it becomes institutionalized: it is the very success of nascent institutions that allows them to develop legitimacy—and, eventually, to become institutionalized.

Germany and Japan, for example, still cleave to many of the institutions that were imported (and even imposed) during the post-war years for one simple reason: they worked.

To determine whether capitalism weakens or strengthens states, this chapter measured two forms of social breakdown: the onset of civil war and the repression of human rights, particularly under conditions of resource wealth. The goal was to determine whether market institutions can help secure peace, or whether such institutions should simply be abandoned if short-term destabilization occurs. The results are clear: economic freedom—the proxy used for a market-friendly economic environment—promotes peace and decent governance. One possible explanation is that economic freedom is associated with strong states that are capable of protecting property: the more fair and equitable economic rules are, the more likely market actors are to invest in institutions and processes that cauterize both war and economic loss.

It might very well be that impartial, market-supporting institutions are hard to establish under the lawless conditions that characterize post-conflict societies, but to assume that market-supporting institutions should therefore not be established would be to confuse the symptoms of the disease with its cause. Where rent seeking is the norm, powerful actors will naturally resist the creation of impartial institutions that support markets, but the end of conflict certainly offers a great opportunity to impose such institutions from outside, as was the case with Germany and Japan.

It is precisely when the international community has the leverage to constrain powerful actors that such institutions should be created, with an eye to long-term gains. Markets seem to pacify, so they need to be built, and when it comes to reducing bad governance (defined as governance that elicits social dissent), markets and free political institutions seem to be complementary rather than at odds. The empirical evidence offered in this chapter shows that free economies promote peace and decent governance, particularly under the risky conditions of natural resource extraction. Future work might focus on the promises and pitfalls of the practical side: how to build markets in post-conflict societies where existing political forces have massive incentives to secure their positions and power, and those of their allies.

ANNEX

Data and Methods

Data and robustness checks for the civil war analyses

To estimate the effect of economic freedom on civil war and human rights, several confounding factors must be simultaneously accounted for in the models. Per capita income has proved to be one of the strongest predictors of civil war; thus, the effects of economic freedom were estimated net of the modernity and productivity of an economy, as measured by per capita income. Data on per capita income were obtained from the World Bank's World Development Indicators CD-ROM and log transformed to reduce the effect of extreme values (World Bank 2007). Because growth in per capita income is also thought to decrease the risk of an onset of civil war, it was included in the model, but the effect of the main variable of interest remained unchanged.

Countries with large populations also seem to have a greater risk of civil war, and size is an important control variable because the extent of a country's desire to be economically open and free might be a function of the size of its domestic market. To control for country size, total population was included in the model; like per capita income, it was log transformed to reduce the impact of extreme values (World Bank 2007).

Country size and the extent of social fractionalization are generally linked. Tests of the effect of social fractionalization on the risk of civil war have yielded mixed results and are subject to theoretical controversy (Collier, Hoeffler, and Rohner 2009; Esteban and Ray 2008; Fearon and Laitin 2003). The model included a measure of ethnic fractionalization obtained from Fearon and Laitin (2003) in linear and quadratic form (the quadratic term was added to model the nonlinear shape of the effect). The reasoning behind this approach is that moderate fractionalization, which corresponds relatively closely to polarization (two large groups), might matter more than low fractionalization or very high fractionalization.

Since politics can be vital to whether and how conflict develops, the model also controlled for regime type, relying on the Polity IV scale, a widely used measure of democracy that ranges from −10 to 10 and features a set of discrete variables (Gurr and Jaggers 1995).[23] Semidemocracies were left out as the reference category in the models, making it possible to estimate how perfect democracy and perfect autocracy explain the risk of civil war when compared with countries whose regimes fall between these two categories. Controlling for regime type is particularly useful when trying to estimate the effect of economic freedom on conflict, because democracies might be judged favorably by those who are coding measures of economic freedom. The models also include a variable measuring resource wealth by using a dummy variable coded 1 if the country exports more than one-third of its gross domestic product as petroleum and 0 if it does not. This measure was taken from Fearon and Laitin (2003).

To address the possibility that conflict may affect economic freedom, the models lagged the independent variables by one year and recorded the brevity of peace—that is, the time since the last conflict onset. Since the legacy of a previous armed conflict is likely to be nonstationary, this variable was specified

23 The Polity scale works as follows: if Polity is greater than 6, democracy takes the value 1; if Polity is less than 6, democracy takes the value 0. If Polity is greater than −6 but less than 7, semidemocracy takes the value 1; if not, semidemocracy takes the value 0. If Polity is less than −6, autocracy takes the value 1; if not, autocracy takes the value 0.

as a decay function.[24] Accounting for the proximity of conflict addresses potential biases that may have been created if coders of economic freedom had coded down the level of economic freedom when observing political tensions and violence, or if violence had in some way tended to constrain policies that were supportive of economic freedom. The model also controlled for conflict in the country within the previous year.

A number of robustness checks were conducted to determine the sensitivity to the testing method and to changes in the parameters of the model used to create table 1. First, because civil war will surely bias the coding of economic freedom, the variable measuring the brevity of peace was dropped, and the Fearon and Laitin (2003) method (testing onset with a lagged civil-war variable to indicate whether a conflict was ongoing the previous year) was used instead. This alternative specification produced almost identical results.

The rate of income growth was not statistically significant. Various insignificant variables were also dropped, but none of these specification changes influenced the effect of economic freedom on the risk of civil war. Even lagging the index of economic freedom by two, three, four, or five years made no difference to the results.

Data and methods for the political repression analyses

The control variables for the repression models were quite similar to those used in the civil war models and are from the same sources. Per capita income and political democracy are strong predictors of lower repression (Davenport and Armstrong 2004; de Soysa and Nordås 2007; Landman 2005; Poe, Tate, and Keith 1999), while population size (Landman 2005), oil wealth (de Soysa and Binningsbø 2009; Kisangani and Nafziger 2007), and the incidence of civil war (measured as conflict between a government and an organized rebel group resulting in at least twenty-five deaths in a single year) increase political repression (Poe, Tate, and Keith 1999). Surprisingly, in contrast to the civil war literature, most empirical studies find that ethnic fractionalization reduces political repression (de Soysa 2009; Lee et al. 2004). Given arguments about the detrimental effects of fractionalization on good economic policies, this term was included in the model (Easterly and Levine 1997).

Because there have been some findings that socialist legal systems and British legal systems reduce repression (Poe, Tate, and Keith 1999), the inclusion of these variables was important, since any effect of capitalism might in fact be an effect of a British legal heritage or of the absence of a socialist legal heritage.

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24 The function of time that has passed without conflict is given by 2 to the power of – (time since last onset of conflict/α), where α is the half-life parameter (Raknerud and Hegre 1997). After the log-likelihood of different models had been compared, a functional form was chosen in which the influence of the last conflict decays over time, with a half-life of two years.

Because these variables were included in the model, it was possible to estimate the effect of economic freedom without the influence of either legal heritage. Since it is also important to estimate the effects of economic structure, as measured by the rate of income growth, annual per capita economic growth was included in the model (World Bank 2007). A term for the history of peace, or a count variable representing the years of peace since 1946, was also included in the model; and, in order to account for any trending in the measures over time, year dummies were entered. (In other words, if human rights and capitalism both trend upward over time, each was separately accounted for.)

Because pooled time-series, cross-section data are characterized by complicated correlation structures between and within units (Beck and Katz 1995), they raise several thorny estimating issues. For the ordered probit estimations, the cluster option in the statistical software program STATA 11 was used, which computes Huber-White corrected robust standard errors with the assumption that observations are independent across units but nonindependent within (Wiggins 1999). These robust standard errors are robust to heteroscedasticity and serial correlation (Wiggins 1999). As an alternative, the repression models were also tested with and without lagged dependent variables, and by means of ordinary least squares with panel-corrected standard errors.

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