Postwar Reconstruction: Some Insights from Public Choice and Institutional Economics

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Abstract. A successful reconstruction is characterized by a widespread coordination problem, combined with potential pockets of conflict. We analyze the array of relationships that take place in the reconstruction process – political, economic and social – by considering under what circumstances they are situations of conflict or coordination. Historical attempts at reconstruction provide further understanding of how to achieve success.

1. 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. Reconstruction efforts can be categorized depending on the nature of the conflict that precedes the reconstruction. Categories would include civil wars (i.e., Kosovo) or international wars (i.e., Germany and Japan). Within the category of "international wars" one can further classify the role of the occupying power. At one extreme is long-term colonization while the other extreme is liberation, with a range of possibilities in between. These distinctions will influence the issues involved in the reconstruction process, and we will return to them later in the paper.

The reconstruction process usually begins with rebuilding a government and a 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 given political and economic structures 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" and constitutional political economy.

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 20th-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. Dobbins et al. (2003) have attempted to fill this gap by considering the various "controllable" variables involved in the reconstruction process. To date, this is the most comprehensive attempt to understand the factors involved in postwar reconstruction. However, it fails to offer a complete understanding of what a successful reconstruction entails. The study offers no framework for considering the postwar situation and focuses on general, aggregate variables. Moreover, it neglects culture or other indigenous institutions critical to the reconstruction process.

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. Language 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. If the rules of the reconstruction game can be defined in the appropriate manner, some scope exists for influencing whether interactions in social, economic and political settings will be cooperative instead of conflicting. We outline some specific institutional mechanisms that allow reconstruction to come from within. The rules of the game depend

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 2 outlines our analytical framework in more detail. In Section 3 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 4 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 5 discusses the testable implications of our hypotheses. Section 6 closes with some recommendations for how to think about pending and future postwar reconstructions, such as the United States must deal with in Iraq.

2.   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.

The logic of the prisoner's dilemma has numerous institutional analogs in a postwar setting. Cooperating might consist of deciding not to loot, deciding not to

Player 2

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

Figure 1. The prisoner's dilemma.

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.[3]

We do not take the folk theorem as descriptive of reality, given that it cites highly complex trigger strategies and long chains of punishment over time. Nonetheless the folk theorem illustrates a fundamental fact about games: they can evolve 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. In other words, in the longer run the rules of a game are up for grabs and subject to evolution. We cannot understand the reconstruction process by assuming that such games always remain fixed in their nature. We place this simple point at the center of our theory of reconstruction.

In other words, if individuals can coordinate upon the appropriate conjectures, the prisoner's dilemma 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:

Coordinating on healthy and constructive conjectures yields payoffs which maximize social returns, as illustrated by the upper left corner payoff. It is also possible, however, that individuals may end up with destructive conjectures, as illustrated by the lower right corner. Note, of course, that each equilibrium is self-reinforcing once in place.

<div align="center">

Player 2

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

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Figure 2. The coordination game.

The reconstruction process cannot be captured by any single game; instead we can think of a large number of overlapping games, with a variety of players over time. For instance Figure 2 captures the interactions between different citizens of the occupied country. To the extent they can coordinate on healthy conjectures, they will achieve a more stable and more prosperous postwar outcome. The same game matrix, however, also can characterize the relations between the citizens (or some subset thereof) and the occupying forces. Assume that both the citizens and the occupier would prefer that things go well, and have at least a partial common understanding of what this might mean. Parties on each side still require favorable conjectures for a cooperative equilibrium to come about. If citizens expect all their problems to vanish immediately, and the occupiers expect regular terrorist attacks, relations are unlikely to be successful.

Only rarely will games of conflict turn into games of pure coordination. More plausibly we can think of social settings as lying along a spectrum, depending on the relevant degrees of conflict and cooperation. For instance, individuals face decisions with elements of both conflict and cooperation. 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 other affiliations. Some games will become more cooperative but others will become more conflict-laden. But overall reconstruction will succeed to the extent that a preponderance of these overlapping games move into relatively cooperative modes.

This framework may help to explain at least two stylized facts about historical reconstructions:

1. Very rapid reconstruction is in principle possible, as illustrated by 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.

3. 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 will focus on 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 changes in conjectures can help transform games of conflict into games of coordination. Of course the nature of these factors will vary depending on the context. To cite two examples, it may matter whether the situation is a civil war or international war, or whether the aim of the occupation is colonization or liberation.

3.1. *Mētis*

The first factor cites informal, indigenous institutions and specifically the notion of *mētis*, which recently has been revived by the anthropologist Scott (1998: 6–7). *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 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 in 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 mechanisms, shifting from conflict to cooperation. In many instances of reconstruction, where *mētis* exists, it makes less sense to loot, terrorize, etc. because individuals realize that they are better off cooperating with others. Where *mētis* is lacking as a coordination-enhancing mechanism, conflict may result (Bernstein 1992).

Mētis is not static, as the means of obtaining and acting on knowledge change over time. As knowledge travels between groups and international borders, new *mētis* is created, and old *mētis* fades away and loses relevance. The pre-war stock of *mētis* will depend on factors including the heterogeneity of cultures and languages the level of economic development and the type of conflict. A severely fractionalized country may be less likely to share a common *mētis* (Putnam 2001: 22–3; Putnam et al. 2003). In contrast, a society with a high level of economic development may be more likely to share a common *mētis*, given that an advanced exchange economy requires impersonal ties and trust. Moreover, a country engaged in civil war is likely to have a relatively heterogeneous stock of *mētis* while a country unified against an international enemy is likely to have a more homogeneous stock of *mētis*, given that the populace shares a set of overarching ends. War and the subsequent reconstruction process is a shock to *mētis* whether through the destruction of physical 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.

The relevance of *mētis* is illustrated by the land reform and redistribution of post-war Japan. The Land Reform Bill of 1945 called for the compulsory transfer of land from absentee landlords to tenets 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 6 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 3 years to complete (Fearey 1950: 94—5; Bailey 1996: 46–7). 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. Japan had a well-developed, relatively homogenous stock of *mētis*. A high level of development characterized the country and the people had been united against a common international enemy. This was a benefit from the standpoint that the society was interconnected through social networks and a shared stock of *mētis*. However, the

potential problem was that the occupiers had to ensure that the *mētis* aligned with the aims of the reconstruction. 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 creation of common knowledge and acceptance of imposed institutions (Coyne 2004). On the other hand, it was potentially harmful, as those who remained in influential positions in the reconstruction viewed developments 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.

3.2. *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 by 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 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. But 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 immediate benefactor, they may very well blame them for each and every mistake made during the reconstruction. Citizens' 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. The conquering forces therefore need to build realistic expectations through the dissemination of information and the signaling of goals.

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.

Expectations will be influenced by the aims of the occupying force as well. 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., overly 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 or long-term colonization, expectations will most likely be lower and overly pessimistic.

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).

3.3.   *Workability of the Political Order*

The establishment of political institutions is a key element for successful reconstruction (Fagan 1995). A good political structure will allow for general stability and provide a 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. Of course, this will tie directly to the state of the country prior to occupation. A country familiar with democratic political institutions will be easier to reconstruct than a country with an unstable history or civil war on its hands.

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 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 overlapping games. The key question is one of workability. A workable political order is one that provides mutually advantageous benefits to enough people such that it is enduring (Hardin 1999). The issue of the workability of the political order comes into play on two fronts. Initially, coordination around the political order is necessary to create a "working constitution." In subsequent periods, for the political system to be enduring, it must continue to coordinate the members of the populace around the aims of the order. Coordination here involves refraining from engaging in mutinous acts which undermine the workings of the political order.

A related issue is how many individuals must coordinate on the political order for it to be sustainable. Ultimately a political order must be robust enough to handle some dissent. In other words the views and ends of the populace need not align perfectly. However, they must be aligned closely enough on the fundamental conjectures underpinning the political order for it to be sustainable. 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 example, it is possible for the populace to coordinate on a democratic means of election while disagreeing on the suitability of various candidates. In this case, the underlying political order is sustainable and strong enough to handle dissenting views within the system. For these reasons, our informal institutions, as discussed directly above, do not have to mimic the folk theorem in all regards.

In sum, we do not 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.

4. 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 3 of this paper. Subsection 4.2 looks briefly at Bosnia as a case where reconstruction efforts have been unsuccessful due to the failure to develop coordinating-enhancing institutions. We then consider, in Subsection 4.3, cases where the coordination problem is solved, but people coordinate along bad norms and institutions; postwar Eastern Europe under Stalin is an obvious example.

4.1. 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). McArthur produced an English draft of the new Japanese constitution in 10 days. After 8 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 1950s), 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 postwar 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 postwar period.

Second, the translation of the imposed constitution from English to Japanese shows the potential value of ambiguity. While the native Japanese did not 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 *mētis* 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.[4]

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-Nazis 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 citizens can realistically coordinate their activities. Credibility and stability must be signaled, and the populace must expect that communicated policies and reforms 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 postwar 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.

4.2. *Unsuccessful Attempts at Reconstruction*

Bosnia is one case where reconstruction has failed to overcome the conflict of interests that characterize 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 8 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 9 months after the signing. The rushed elections prevented the development of grassroots support for democracy. The nationalist parties, which 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 no 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.

4.3. *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. Coordination took place around perverse ends requiring continual interference on the part of the government to maintain economic, political and social orders. The result was a kind of 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 market-style 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 Marshall Plan aid. 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 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 toward a kind of political order. But unlike in Western Europe, the coordination in Eastern Europe was centered on the fear of force rather than on rules and self-sustaining cooperation. American policy also used force (e.g., Hiroshima) to gain initial control of the populace. But unlike under Stalin, rapid moves toward freer institutions generated incentives for cooperative behavior and new liberal orders.

5. Testable Implications

To recap, 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.

It is true that the reconstruction process cannot be summarized in a single game which applies to all participants. Nonetheless, on the whole, fruitful cooperation begets further fruitful cooperation. The time horizon is admittedly up for grabs, but after some point we expect a reconstruction has either succeeded in generating good expectations or it has not.

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 Paldam and Svendsen 2001 for literature surveys). Fukuyama (1996) and Putman et al. (1994) and Putman (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 et al. and Putman analyze 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 postwar period. This would offer insight into the subsistence of *mētis* from the pre-war period through the postwar 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

postwar period to get indigenous input regarding the reconstruction effort. If the survey data were 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.[5]

6.   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 critical for shifting the rules of the games so that the cooperative elements of social, economic and political interactions outweigh elements of conflict. One major implication of our analysis is that emphasis should not be placed on achieving any one specific activity or outcome. Instead it is critical to focus on how these activities and outcomes are achieved, and what kind of behavior is being encouraged.

Benchmarks such as elections or the completion of infrastructure projects are often considered signs of success or failure in the reconstruction process. But achieving these outcomes does not guarantee that a liberal economic and political order will be self-sustaining over a longer run. For instance, democracy can be effective when citizens are committed to constitutional liberalism. But democracy deals with the method of selecting government officials while constitutional liberalism addresses the goals of government – protection of individual rights, rule of law, etc. In the absence of constitutional liberalism, democracy will not necessarily yield the desirable results. Emphasis should be placed on establishing the underlying conjectures necessary for constitutional liberalism prior to holding elections.

Likewise, the fundamental question in terms of infrastructure is not whether it has been established. Rather will 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. Realizing the importance of *how* outcomes are achieved, when compared with the speed of achievement, will be critical for success in present and future reconstruction efforts.

Notes

1. Tyler Cowen is Professor of Economics, George Mason University, Fairfax, VA.
2. Christopher Coyne is a PhD candidate in the Department of Economics, George Mason University, and a Social Change Fellow at the Mercatus Center.
3. 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).
4. 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.
5. Information on public opinion polling in Iraq is available at: http://www.taemag.com/issues/articleID.17697/article_detail.asp

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