

## **Capitalism Does Not Rhyme with Conquest**

The end of the Cold War marked the triumph of market democracies over socialism and the ascendance of the United States to the position of the sole world superpower. While this occurred more than a decade ago, only now with Operation Iraqi Freedom are the geopolitical implications becoming clearer. The military power now enjoyed by the United States is similar to that of Western Europe during the second half of the 19th century. Back then European powers went on a hunt for colonies, partly because of economic self-interest, partly in an attempt to “civilize” the rest of the world. Some in U.S. policy circles genuinely believe that by deposing rogue regimes like Iraq and planting the seeds of democracy and capitalism in those countries, the United States can also infect neighboring countries and eventually remake the world in its own image. While these policy makers would reject any parallels in motives with colonialism, they exist nonetheless: a mix of self-interest – the world will become safer for the United States – and idealism -- it will also make the world more prosperous and liberal. But can these policies work?

The reasoning is not without merit. Dictators like Saddam Hussein hold such a grip on power that internal change is all but impossible. In such situations, an outside power that truly has the interests of the people at heart can effect a change that the people themselves cannot manage easily. Without foreign intervention, the Franco dictatorship in Spain lasted forty years. By contrast, military defeat brought Mussolini’s and Hitler’s regimes to a quicker end. If the United States can overthrow a bloody dictator like Saddam Hussein in the space of weeks and free his people, why not do it? This logic would favor an intervention in every dictatorial country, from Cuba to North Korea, from Venezuela to Zaire, constrained only by crass budgetary constraints.

Overthrowing a dictator, however, is only the first and easiest step toward building a democracy. If the United States simply left Iraq at this point after holding elections, or with a puppet government in place, there would be little to safeguard the Iraqi people from the emergence of a new tyrant. Countries do not fall prey to dictatorial regimes simply because of bad luck. Such countries often have power structures in place that facilitate dictatorships: typically, dictators are the face of a narrow elite, which has captured both political and economic power. Change is possible only if the power

structure is changed and becomes more broad-based. Without that, any political revolution will only replace the old tyrants with new ones.

Japan is often mentioned as a successful example of democracy imposed by outside forces. The origins of that success, however, have to be found in the sweeping reforms imposed by Douglas MacArthur. Before his reforms, land holdings in Japan were concentrated and economic power was held by a few large industrial and financial combines called the Zaibatsus. MacArthur saw these agrarian and industrial elites gave backbone to the Japanese Nationalist Government, which had taken Japan to war. For this reason, he tried to undermine their power. The post-war land reforms did expand and widen the land-owning class, in the process fostering an agricultural revival, and making Japanese democracy more stable. But even though MacArthur started to break up the Zaibatsus, he did not have the necessary time to carry it out. The need for reliable suppliers during the Korean War forced the government to compromise with the Zaibatsus. This failure explains in part why the Japanese domestic market is still so uncompetitive even though Japanese democracy is vibrant.

Nevertheless, MacArthur accomplished a lot. In part, he was helped by the complete collapse of Japan and the utter exhaustion of its people. There was virtually no armed resistance to the occupying authority. The Japanese held their domestic elites responsible for initiating and prolonging the disastrous war, and attempts to cut them down to size were not resisted, and even welcomed by the citizenry.

The problem with a situation like Iraq's is that the occupying forces face a people who are neither completely subdued nor completely convinced of the legitimacy of the occupation. Without popular legitimacy any major reform may not stick. Worse, the exigencies of an unpopular occupation can perpetuate (and even strengthen) the power of existing elites.

If it does not obtain the citizenry's support, the occupying authority will have to seek allies to control the territory – else the costs of armed occupation will become prohibitive. These allies are typically found among powerful local bosses, who are often the very same ones who made possible the previous regime. In return, these bosses will seek economic favors such as government contracts and local monopolies. In other words, if the occupying authority does not have widespread popular support – and few

foreign rulers, no matter how noble their intentions, will have such support – its natural tendency will be to allow mutually dependent concentrations of power to build up. If this seems much like the concentrations of power that surrounded the previous dictatorship, it is because of natural parallels: the dictator was also an unpopular occupier who ruled largely by distributing privileges to a supportive few. Under these conditions of concentrated power, it is hard for either democracy or markets to take root.

All this is not idle theorizing. Studies show that colonies like the United States, Canada, and Australia, where Europeans (typically the British) settled in large numbers, often displacing or driving out native populations, developed many of the institutions necessary for a market democracy. Government was relatively benign, and even democratic, in large part because it did not have to keep a native population under control. By contrast, in colonies like India where there was too large a population to be displaced, or where disease prevented large scale European migration, a small body of Europeans had to keep a large native population under check. Typically, this was done by co-opting the domestic elites, such as the native Rajas and big landlords, and supporting their power so long as they repaid the compliment. Under these circumstances, democratic and market institutions did not emerge. Studies show that regions in India where these arrangements were particularly predominant have, even today, underdeveloped social and market infrastructure.

In sum, the end of the Cold War gives the United States both the power and the interest to spread democracy and capitalism by force. But history suggests that democracy and free markets are hard to impose, no matter how beneficial they are. Rarely did an occupying outside power, unconnected by the bonds of ethnicity, culture, and national origin with the ruled citizenry, leave behind the conditions that would foster both democracy and markets. Even in the 21<sup>st</sup> century, capitalism does not rhyme with conquest!

Raghuram Rajan and Luigi Zingales

The authors are professors at the University of Chicago and authors of *Saving Capitalism from the Capitalists* (Random House, 2003).