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Chapter 3

Markets, Democracy and Peace

> *There has been no country with a democratic political sphere, past or present, whose economy has not been dominated by private ownership and market coordination.*
>
> Janos Kornai [1]

The force of the protests against globalization derives from a now age-old hostility to the liberal market economy. But what are the underlying features of a liberal economy? What does such an economy imply for democracy and for international relations?

Freedom and property

The fundamental value that underpins a free society is the worth of the active, self-directing individual. It is a belief in individual freedom. This is not a belief that the individual is somehow outside or above society. The individual, being human, is always embedded within society. Human beings are cultural animals. But the particular characteristic of the free society is that the forms of social engagement are as much chosen as imposed, at least for adults. The central feature of such a society is voluntary action - the freedom to choose.

It has long been argued that such a society requires a distinct culture - one that puts intrinsic value on all individuals, equally, and moulds them to accept personal responsibility for their actions and fate. The German sociologist Weber famously argued that Protestantism was a powerful contributory cause to the success of the countries of north-west Europe in making a free society and economy work. This no longer seems quite so plausible now that Catholic Europe and east Asian countries have also been successful in promoting a modern economy.[2] Nevertheless, it is easy to accept that some cultures are more readily adapted to making a success of a free economy and society than others.[3] Unfortunately, culture changes slowly.

The bedrock of a liberal society is, as John Locke argued in the seventeenth century, the right of all individuals to own and use property freely, subject to well-defined, law-governed constraints.[4] A liberal society is therefore a commercial society. But freedom to seek one's own way in life, outside the boundaries of caste, class, community or, more recently, of gender, cannot be restricted to economic activities alone. The culture of a liberal society is, for this reason, inimical to established hierarchies of power or opinion.[5] It is no accident that commercial societies came to consider freedom of thought and expression of great value. A merchant is a practical man who must make rational judgements about the world, not least of the risks he runs.[6] He learns from experience, not from authority, and relies on his own judgement, not those of others. The combination of practicality, rationalism and freedom of inquiry became the basis for the west's greatest achievement - modern science. It is, again, no accident that science reached its greatest flowering in a commercial west.

A liberal society is endemically restless and, for those who treasure the unchanging and the traditional, consequently insecure, however wealthy it may become. It does not merely accommodate novelty, but welcomes it. The merchant makes profits by seizing an unperceived opportunity for gain, thereby changing the economic world. The intellectual makes a reputation by arguing something new, thereby changing the beliefs of the world. Traditional hierarchies, deference, ways of life and beliefs are all subject to the solvent action of liberty. Liberalism means perpetual and unsettling change. Most of its enemies have, at bottom, hated it for that reason.

If individuals are to be free, they need protection both by - and from - the state. The importance of the combination of a strong and beneficent government cannot be exaggerated. In his last book, published posthumously, Mancur Olson argued that 'we know that an economy will generate its maximum income only if there is a high rate of investment and that much of the return on long-term investments is received long after the investments are made'.[7] Perhaps the most important single

difference then between the societies that became rich and those that did not was the ability of people in the former to make long-term contractual arrangements. They need a high level of trust in one another and, still more important, in the political authorities.[8] People will make such investments only if they are reasonably sure that the fruits will not be seized. All modestly complex societies have a wide range of markets for immediate transactions. The bazaar is a developed feature of Middle Eastern societies, for example. But the bazaar does not make countries rich. Only rather special societies have markets with a rich web of long-term, prosperity-enhancing contracts. These are the defining feature of what Karl Marx called 'capitalism' - a society in which people can make and own long-term investments with reasonable safety through a web of abstract paper claims.

The condition for such confidence is normally expressed as freedom under the law or, more simply, as the rule of law. Anarchy and liberty do not border one another, but are polar opposites. Under anarchy every man's liberty is bounded by the predatory activity of everybody else - the world where life is 'nasty, brutish and short', as described by Thomas Hobbes in his classic book *Leviathan.* Under liberty, the state protects everybody from predators, not excluding itself. But this seems to be a contradiction. If the state succeeds in establishing a monopoly of force over a given territory, why should it accept a rule of law that curbs itself? This is a question that the Chinese party-state asks itself today. So far, it can see little reason why it should, which may prove a decisive hindrance to China's long-term development. Why then would any state be simultaneously potent enough to protect its citizens from one another and restrained enough to protect them from itself? This is Gulliver bound by Lilliputians. It looks to be a miracle - and historically it has been a rare event.

Towards a beneficent state

In a famous fresco in the town hall of the Italian city of Siena, the medieval artist Ambrogio Lorenzetti painted allegories of good and bad government. The Italians of his era had experienced both, as do the peoples of the world today. In the Allegory of Good Government, a figure of the Common Good presides, with Wisdom, Peace, Justice, Faith, Charity, Magnanimity and Concord. Where then were these virtues to come from? Historically, a strong and beneficent state has emerged from a combination of three forces -regulatory competition, internal representation and moral reform.

Regulatory competition

One of the reasons why Europe outstripped China, India and the Islamic world, all of which were considerably more advanced a thousand years ago, was competition among rulers or, as it would now be called, 'regulatory competition'. In his classic analysis of western technological advance, *The Lever of Riches,* Joel Mokyr of Northwestern University argues that,

> from its modest beginnings in the monasteries and rain-soaked fields and forests of western Europe, Western technological creativity rested on two foundations: a materialistic pragmatism based on the belief that the manipulation of nature in the service of economic welfare was acceptable, indeed, commendable behaviour, and the continuous competition between political units for political and economic hegemony.[9]

Similarly, in a lecture delivered in 2001, Charles Calomiris of Columbia University summarized this view as follows:

> political fragmentation in medieval Europe decentralized authority and spurred continuing competition among rulers. European civilization was unique in this respect - a fact that reflected climactic and geographic factors peculiar to Europe. That political fragmentation and competition, combined with the cultural inheritance of Roman, Christian and Germanic traditions, fostered the concepts of private property and individual rights.[10]

Regulatory competition is an important (and controversial) force today, not least because it is one

of the complaints of critics of globalization that the beneficent plans of governments are being undermined by such competition, via capital flight or emigration of labour. The most telling answer to this worry is that governments are not necessarily wise and beneficent. In medieval and early modern Europe, competition among rulers kept freedom alive. In China, in contrast, there was no such competition: the state was a monopolist and behaved as one.[11] But when the French king decided to drive out the Protestants in the late seventeenth century, the English were happy to accept these hard-working people, to the benefit of their country. Similarly, when the Church suppressed Galileo, his ideas promptly took root elsewhere. Earlier, princes gave charters to cities to encourage commerce, aware that the communities of merchants might otherwise move to the realm of some rival. These merchants were particularly useful to monarchs, because they paid taxes in money. With this money, kings could afford armies of their own, freeing themselves from dependence on their unreliable feudal vassals. As the Nobel-laureate Douglass North notes:

> there was continuous interplay between the fiscal needs of the state and its credibility in its relationships with merchants and the citizenry in general. In particular, the evolution of capital markets was critically influenced by the policies of the state because, to the extent that the state was bound by commitments that it would not confiscate assets or in any way use its coercive power to increase uncertainty in exchange, it made possible the evolution of financial institutions and the creation of more efficient capital markets.[12]

Regulatory competition continues to be a powerful force today. Indeed, it is one of the chief reasons for the spread of economic liberalization in the 1980s and 1990s. Deng Xiaoping was influenced by the economic successes of Hong Kong, Singapore, South Korea and Taiwan in his decision to introduce market reforms into China. Similarly, the success of Chile in the 1980s and 1990s influenced reformers throughout Latin America. Back in the 1970s, when I worked at the World Bank, we were influenced by the successes of the more market-oriented and outward-looking economies of east Asia.

Constitutional democracy and the rule of law

Regulatory competition is not enough. An absolute monarch may still seize the wealth of his subjects or default on his debts when his dynasty is threatened. Secure freedom requires governments interested in the long-term health of their countries. The best solution is a constitutional democracy with representative parliaments - government accountable to the governed. Such a democracy must be constitutional, that is, law-governed. It is not enough to move from the tyranny of one person to tyranny of the majority. A constitutional democracy entrenches individual freedoms and the rules of the democratic process. As Olson points out, a big step was taken in the seventeenth century when two revolutions created a special form of government in the United Kingdom, one in which, for the first time, the state's creditors, through parliament, controlled government. They were interested in their debtor's credit-worthiness and, by creating a sound structure for the national debt, both strengthened the state and established sound financial markets.[13]

This emergence of parliamentary government built upon earlier progress in both parliamentary representation and the rule of law. From the seventeenth century English settlement emerged the idea of the division of powers subsequently embodied in the American constitution. This was transmitted from England to the nascent United States by a Frenchman - Charles Montesquieu -in his classic, *L'Esprit des Lois,* published in 1748. As an intriguing recent paper observes:

> both the English and the American conception of freedom are based on a common notion that the will of the sovereign - even a democratically elected sovereign - must be restrained. Both reject the idea - articulated most clearly by Rousseau - that the democratically elected sovereign can, on behalf of the people, legitimately act without constraints. Both the English and the American conceptions of freedom deal with the limits on government, but refer to different limits.[14]

The English version of freedom started from the independence of the judiciary in applying the law. The common law itself was ancient, while trial by jury went back to the twelfth century. From this foundation and the seventeenth-century parliamentary revolution, the Americans built the idea of checks and balances. It grants the courts the right to review the constitutionality of legislation. As one would expect, analysis of today's world shows that the independence of the judiciary on the English model contributes to both the economic and political freedom of a country, while American institutions, on their own, contribute mainly to political freedom.[15]

Usually, though not always, a democratic electorate has (if they understand this) an interest in choosing institutions and policies that make society as a whole richer rather than in seizing wealth from a minority. Where pre-tax inequalities in incomes and wealth are large, however, this may cease to be true. If a large majority earns much less than the average income, it may be easy to obtain a majority in a universal (or wide) suffrage democracy in favour of seizing the wealth or incomes of the rich minority. Democracy then becomes populist, as it has long been in much of Latin America. The outcome over time has been lower average post-tax incomes than would have been the case if less predatory policies had been chosen.[16] This is an important reason why the stability of a democracy requires some limits on the extent of inequality. This is likely to be particularly important when, as the American academic Amy Chua observes, the wealthy are members of an easily identifiable ethnic minority. Under such circumstances, she argues, democracy may prove inconsistent with sustained economic liberalism.[17]

As Olson notes, 'the establishment of a democracy and the conduct of an election do not necessarily bring secure contract or property rights'.[18] Internal faction-fighting or external enemies may destroy the democracy. Historically, this has happened to many republics, the outcome being oligarchy or despotism or, more often, a move from the former to the latter, as in the Medicis' Florence and in Rome in the first century before the common era. But if there is a lasting democracy, there must be a rule of law, by definition, because the government must both accept free speech and political competition and abide by the results of elections. Thus 'the only societies where individual rights to property and contract are confidently expected to last across generations are the securely democratic societies'.[19]

Private property is also a necessary condition for political pluralism. A political entity (be it an individual, family or party) that controls all a country's resources, through the state, is unlikely to allow any opposition access to the means of campaigning against it. Worse, if all economic decisions are political, loss of power threatens a loss of livelihood. Power becomes the only route to wealth. This is not just lethal for the economy. It is also lethal for democratic politics, which become a form of civil war. It is only when politics are not a matter of personal survival that a stable democracy is conceivable. For democracy to function, therefore, the domain of the political has to be circumscribed. The market economy, based on private property, achieves this.

It is possible for countries to offer economic but not political freedoms - to have market economies, but not democracy or civil and human rights. But the correlation between these freedoms is strong.[20] If the individual's autonomy is respected in one sphere, it will normally be respected in another. In the long run, market economies tend to become democratic, as recent experience in east Asia has made plain.[21] Moreover, even if all market economies are not democracies, stable democracies have market economies, as Professor Kornai says.[22] Social democrats too often ignore this intimate link between economic liberalism and political democracy, between the values of the merchant and those of the citizen. The market underpins democracy, just as democracy should normally strengthen the market.

The market supports democracy in another way - via growth. A modern market economy has, as the discussion in the following chapter shows, been the only system to have generated large and sustained rises in real incomes per head over lengthy periods. These rises have made the shift to a democratic system from what were, traditionally, more repressive regimes immeasurably easier. This shift followed only once the market economy had generated what has long been called the 'industrial revolution'. When the economy's output per head is rising, a society's life is 'positive-sum' - everybody can become better off. In a static society, however, social life is 'zero-sum': if anyone is to receive more, someone else must receive less. The politics of zero-sum societies are

fraught in a way those of positive-sum societies are not. The difference is large. Over a generation a society in which income per head rises at, say, 1.5 per cent a year, has over 50 per cent more income per head to spread around, if it wishes to do so. A safe bet is that if environmentalists imposed a zero-growth society, it would swiftly become authoritarian (even if it had not become so to impose the zero growth). Authority would presumably be exercised by priest-kings, worshippers of Mother Nature in her guise as Queen of Ecology.

It was no accident therefore that it was only in the early twentieth century that franchises became universal in the modern advanced economies. Economic freedom and a degree of political representation predate mass democracy. But there are strong pressures upon successful market economies to move towards universal suffrage and, with rising incomes and wider education, limited obstacles to it as well. The emergence of an educated, middle-class society interested in politics and desiring influence over political life is also decisive. So is increased acceptance of broadly liberal ideas, itself made easier by a growing economy. If one accepts the equality of citizens before the law, it is difficult to deny equality of citizens in making the law as well.

Moral reform

The third element in moving from a predatory state to a liberal 'service state' and a successful market economy can best be described as moral. Values matter. The rule of law is dependent on honest judges and policemen and soldiers who obey civilian leaders, however much they may despise them. There can be no Praetorian Guard in a stable liberal democracy. Today, any list of the states in which the army is most completely subject to civilian control is headed by the advanced liberal democracies. But how does an unarmed population achieve service from those with power over it? A part of the answer is that it pays them reasonably well, because it is prosperous enough to do so. A second part of the answer is that it provides a government made legitimate by popular consent. But the third part is moral. As the Canadian journalist and writer Jane Jacobs has noted, the symbiosis between state and market that is the basis of civilized society is matched by a symbiosis between two cultures or moral syndromes -commercial culture and guardian culture. Both are necessary. Together, they are sufficient.[23]

The essence of the commercial syndrome is voluntary agreement, honesty in dealings, openness to strangers, respect for contracts, innovation, enter-prize, efficiency, promotion of comfort and convenience, acceptance of dissent, investment for productive purposes, industry, thrift and optimism. This is the attitude of the merchant through the ages. Guardians, on the other hand, shun trading, control territory, show obedience, bravery and discipline, follow precedent, respect tradition, are loyal, admire leisure and treasure honour. This is the ethos of the warrior. Today, guardians are servants of the state. Merchants are servants of the market. Because both are necessary and each is suspicious of the other, there is a permanent tension. But the symbiosis has proved fruitful. At its heart is the distinction in behaviour between business people who know they are entitled to sell their wares to the highest bidder, but not to use force, and judges and soldiers who know that they are not allowed to sell their wares to the highest bidder, but are entitled to use force. These patterns of behaviour are complex and tacit. That is just one of the reasons why it has been so difficult to spread the way of life of advanced liberal democracies.

The achievement

The relation between the state and the market, democracy and individual freedom, the sphere of the merchant and that of the guardian is complex and difficult and has been subject to constant renegotiation. One reason has been changing views on the role of governments. The fundamental role of the governments of free societies is to protect the liberties of the citizens. But they are also, increasingly, required to provide other public goods: health, education, infrastructure and environmental regulation. Democratic politics have also, inevitably, led to a huge expansion of the redistributive functions of the state. The revenues of the governments of members of the Organization for Economic Co-operation and Development have, on average, increased from

about 10 per cent of gross domestic product a century ago to an average of just under 40 per cent today. In some European countries, the share is over 50 per cent.

The collapse of state socialism between 1989 and 1991 has shown that liberal democracy is the only political and economic system capable of generating sustained prosperity and political stability. This is the sense in which the American analyst Francis Fukuyama was right to argue that this is the end of history.[24] As Leo Tolstoy might have said, all rich countries are rich in much the same way, but all poor countries are poor in their own different ways. This does not mean that all advanced democracies are identical. On the contrary, there is much legitimate discussion of the differences among them, some of which will be considered further below.[25] But these difference - even those between the United States and Sweden - pale into insignificance next to the diversity shown by the full range of human societies, past and present.

Consider the characteristics of the advanced liberal democracies. They are constitutional democracies, subject to the rule of law; they respect private property and the ability to make contracts; they protect freedom of speech and inquiry; they recognize fundamental human rights; they have elected governments; and they have independent and honest judiciaries, rational bureaucracies and armies subject to civilian control.[26] These are remarkably rare features of human societies, both in history and today.[27]

International relations of liberal democracy

Liberal democracy does not only have domestic virtues. It is also the only system of governance for which harmonious and co-operative inter-state relations are a natural outcome. This important proposition was put forward by the German philosopher Immanuel Kant in his tract *Perpetual Peace.* Liberal democracies may fight with other states, but have no reason to fight with one another. When Norman Angell, the British liberal, wrote in his subsequently derided masterpiece, the *Grand Illusion,* published in 1909, that a war among the great powers could only prove mutually ruinous, he was correct. That the war happened and was the disaster he foresaw merely show that stupidity is infinite, particularly among naive collectivists and self-proclaimed realists.

Liberal democracy is conducive to harmonious international relations because the prosperity of a nation derives not from the size of the territory or population under its direct control, but from the combination of internal economic development with international exchange. This insight is the heart of Adam Smith's *Wealth of Nations.* It was not just a point about economics, but an equally original and important point about international relations. Mercantilism - the view that the aim of trade is the accumulation of treasure - was worse than bad economics. It was also lethal politics, because it led to conflict where conflict was unjustified. The rapid growth generated by industrialization should have helped instil Smith's lesson quickly. Unfortunately, it took almost two centuries:

> Wealth based on land is a zero-sum game, so violent conflicts over turf were inevitable. Wealth based on industry, by contrast, is a positive-sum game -despite the fact that mercantilist and Marxist notions about competition for markets obfuscated this message for almost a century. It took two world wars to teach the lesson, but the notion that more territory equals more power has been firmly relegated to intellectual history, at least in the advanced industrialized nations.[28]

A country with secure property rights, scientific inquiry and technological innovation will become richer. But, since division of labour is limited by the size of the market, it will also benefit from trade, not just in goods and services, but in ideas, capital and people. The smaller a country is, the greater the benefits. Trade is far cheaper than empire, just as internal development is a less costly route to prosperity than plunder. This was the heart of Angell's argument. Germans would become no richer, individually, if they controlled Alsace. In similar vein, when promoting free trade in Britain in the first half of the nineteenth century, Richard Cobden, father of the Anti-Corn Law

League, argued that unilateral free trade would promote prosperity and peaceful relations with other countries.

Peaceful international commerce and the market economy can generate a standard of living far above that of huge, economically closed and ill-governed countries. In 2000, for example, Hong Kong, with a population of 7 million and no natural resources to speak of, had a GDP per head, at purchasing power parity (PPP), of $25,600, Singapore, with 4 million people, had one of $24,900 and Denmark, with *5* million, had one of $27,300. Against this, China's 1.26 billion had an average GDP per head of $3,900, India's 1 billion one of $2,300, Indonesia's 207 million one of $2,800, Brazil's 168 million one of $7,300, and Russia's 146 million, sitting on a sixth of the world's land surface, one of $8,000.[29] Power does not beget wealth. That was a great collectivist delusion of the late nineteenth and first half of the twentieth centuries. But, in order to achieve high standards of living, small countries do need a great deal of trade. Hong Kong's gross trade (exports plus imports of goods) was 259 per cent of GDP at PPP in 2000; Singapore's was 294 per cent and Denmark's was 69 per cent. China's, in contrast, was 9 per cent, while India's was only 4 per cent.

Yet the interests of the country in peaceful development and international commerce are not necessarily those of all its inhabitants. A monarch or military class may benefit from plunder, at the expense not just of the plundered, but of its own society. This is far truer in pre-industrial societies. The king or tyrant of 50 million people can build bigger palaces than the king of 5 million and strut more magnificently on the world stage. But a Russian serf was no better off for the grandeur of his Tsar. Similarly, a military class can obtain big estates at the expense of its defeated rivals. But the costs of war fall on ordinary people. Russians were conscripted for 25 years. If such hapless people have no voice in public affairs, the state may be happy to go to war. But if those who will lose the most from fighting are in political control, they are likely to be unwilling to fight and particularly unwilling to suffer vast casualties for mere national aggrandizement. For this reason Kant predicted that war would cease once all countries had become republics or, as we would now say, democracies. Today, this idea, known as the 'democratic peace', has received a great deal of scholarly support. Stable liberal democracies that trade freely with one another are indeed pacific, at least with one another.[30]

When Thomas Friedman put forward his Golden Arches theory of international peace, that no two countries with a McDonald's restaurant had ever gone to war, he was advancing this thesis - that liberal democracies did not fight each other - in particularly graphic terms. Subsequently, NATO bombed Serbia. But, as he points out in the latest edition of his book, *The Lexus and the Olive Tree,* he was proved right by the outcome. The Serbs had to decide whether they want 'to be part of Europe and the broad economic trends and opportunities in the world today' or whether they 'want to keep Kosovo and become an isolated, backward tribal enclave'.[31] The Serbs chose the former. They disposed of Milosevic to do so.

The basis for peaceful relations derives not only from the objectives and internal political structure of a liberal democracy, but from its nature. A law-governed state is the only sort of state that can be securely bound by international treaties, because those affected can appeal to the courts against their government. A tyrant will repudiate an international obligation whenever that seems convenient. A law-governed state will find this far harder to do. Today, as one group of scholars writes, 'there is no longer a strict separation between domestic and international legal rules'.[32] The chief reason for this is that the agreements made by governments have become part of their domestic laws and, as such, are binding upon them. Many of these express conventions on how the state may treat its citizens. As such, they are an expression of the basic principle of liberal democracy - that the state exists to serve its citizens and is duty bound to protect them from harm, *including from itself.* The extent of the resultant treaty activity is extraordinary. Between 1946 and 1975 alone, the number of international treaties in force between governments more than doubled, from 6,351 to 14,061, while the number of such treaties embracing inter-governmental organizations expanded from 623 to 2,303.[33] Between 1909 and 1996 the number of inter-governmental organizations expanded from 37 to 260.

The second reason for peaceful relations of liberal democracies is the associations formed across borders among private citizens and organizations of private citizens. As the great French

liberal of the early nineteenth century Alexis de Tocqueville observed, one of the most remarkable features of American democracy was then - and still is - the number of associations. These have now spread world-wide. In 1909, there were 176 international nongovernmental organizations. In 1996, this number had risen to 5,472.[34] The growth of the anti-globalization movement is itself a testimony to the capacity for forming associations of citizens of liberal democracies. So is the creation and spread of the corporation and the private partnership in such activities as law, accounting, consultancy and investment banking.

Collectivist challenges to a liberal order

Liberalism is therefore far more than a purely economic creed. It is the bedrock of democracy at home and peaceful relations abroad. But liberalism is also fragile, as was proved towards the end of the nineteenth century and in the course of much of the twentieth. It is vulnerable to collectivist ideas -nationalism, socialism, communism, fascism and, last and worst, the creed that brought all horrors together in one disgusting package - national socialism. The connection between nationalism, mass violence and an intense sense of the people as a collective emerged with the French revolution. But it reached its full fruition more than a century later.

In his classic *Nations and Nationalism,* the philosopher Ernest Gellner argued that nationalism emerged for a practical reason.[35] The modern state needs a shared high culture, because it requires skilled, interchangeable people. That culture will normally (though not always) be rooted in a single language. Languages create a sense of nationhood in the people that speak them and that sense of nationhood, in turn, creates the demand for a state of their own.

Nationalism supports the modern state and economy: it increases the authority of the state; it enhances the state's ability to mobilize resources; and it increases the ability of the state to break down divisions that impede mobility and economic efficiency. The primary loyalty to the nation makes a nation state an extraordinarily potent form of social organization.

That nationalism exists because it is useful does not make the feelings it evokes less genuine. Human beings are gregarious, capable of extraordinary devotion to the social unit that claims their loyalty. Nationalism taps into these instincts. It offers us the idea of an extended family - a nation. At its limits, it promises the dissolution of the pangs of individuality in the broth of collective harmony. It is obvious therefore that nationalism is both useful and dangerous. It can be exploited by groups in society with a pre-liberal of anti-liberal ideology of plunder and force to turn liberal democratic societies towards war.

In practice, this happened among the European great powers - particularly in Germany - in the late nineteenth century. But extreme militaristic nationalism and later still its bastard child, fascism, did not emerge in the most advanced and stable liberal and democratic states, such as the United Kingdom, but in those in which pre- and anti-liberal ideas and interests were most powerful, partly because the shift to liberal ideas was recent and superficial. Germany had, after all, been united by the Prussian military caste under the direction of Otto von Bismarck. Thus the Marxist-Leninist argument that imperialism, militarism and fascism are a natural consequence of liberal democracy or of capitalism and bourgeois democracy is one of many big lies."[36]

Nineteenth-century nationalism coincided with a resurgence, in the last three decades of that century, of pre-modern imperialistic and protectionist ideas. The aim of countries became to create a protected sphere of their own. From the point of view of promoting prosperity, these shifts were an error. This is particularly true of the late nineteenth-century scramble for new empires in Africa. But, worse than that, the emergence of protectionism and imperialism changes the calculus of international relations: suddenly, being small and weak begins to look rather a bad choice, because one might be locked out of opportunities for peaceful exchange and prosperity. In a protectionist world, countries will try to become part of trading blocs or create empires. Imperialism and protectionism are, for this reason, self-fulfilling prophecies - they create the dog-eat-dog world their proponents believe justifies them. It is for this reason that, in recreating the liberal world order, the Americans, led by Franklin Delano Roosevelt's long-serving secretary of state Cordell Hull, placed great weight on the principle of non-discrimination, alongside that of liberalization. This was

an attempt to leave behind the world of hostile trading blocs. It is an understanding that the United States now seems to have almost lost.

Just as the dog-eat-dog world of nineteenth-century nationalism went naturally with resurgent imperialism and protectionism, so did it blend smoothly with socialism, notwithstanding the supranational values of the latter. International socialism was a slender reed. Nationalists argued that citizens shared a common blood and destiny. Socialists claimed that all property should be owned and managed in common. These two visions came together where they were forced, willy-nilly, to do so - in the state, the locus of power. The socialist state made the state a pseudo business enterprise: What was more natural then than for that enterprise to be thought of as the nation's family business? In multi-ethnic socialist states, the authorities tried to create pseudo nationalities - or even more pseudo nationalities than usually created by nationalists: the Soviet Union and Yugoslavia were the important examples. These two western ideologies, nationalism and socialism, swept across the developing world in the post-Second World War era, for much the same reason that they had swept across Europe in the nineteenth century. Socialism, in particular, had the advantage that it was an intellectually fashionable creed in the west but was not practised by it to its fullest extent. Thus it was possible for leaders of developing countries to be both modern and anti-western at the same time. But socialism did not work, while nationalism became an excuse for grubby tyranny. Saddam Hussein was an Arab Hitler. These are dead ends. By the 1980s, this had become obvious to all. An era of renewed liberalism was at hand.

Challenge ahead

Since the Second World War, the advanced economies have all become liberal democracies. Today's globalization is ultimately a consequence of that choice. Their governance has not been the same as nineteenth-century *laissez-faire.* States are far more interventionist. But acceptance of the basic logic and values of liberal democracy - elections, property rights, liberal trade and, increasingly, liberal movement of capital - has been common to all the advanced market economies. They have differed, however, on the role of the state in income redistribution, regulation of private transactions and provision of certain public services. All such differences within countries are negotiable, just as differences among them are manageable. Sweden, France, the US and Japan are all liberal democracies. As I will show, there is no overwhelming force inherent in globalization that will oblige them all to become identical. There is still room for difference, and such room must be protected.

The issue of today is whether liberal democracy can be as securely established in much of the developing world. It is going to take time. The democracies being established are, inevitably, highly imperfect. They often fail to respect the rights of minorities or the rule of law. Impoverished majorities are particularly threatening to the stability of liberal democracies. But movement has broadly been in a better direction. Yet one would never imagine this from the criticisms of the protesters against globalization. One might even suppose that the move to economic liberalization and democratization since the early 1980s has been a political and economic catastrophe. The opposite is the case. Not only has there been great economic advance among developing countries that have successfully integrated in the world economy, but a huge spread of democracy - a form of governance that was unheard of three centuries ago, was rare a century ago, existed in only thirty-five out of 147 countries in 1975, but had reached eighty-four countries by 1995.[37] Today is the first time in human history that a majority of the world's population lives in democracies. In 2000, the share of the total population in democracies reached 57 per cent. The collapse of the wasteful and oppressive Soviet socialist tyranny was a milestone in this desirable direction.

Against this background, the despair and anger of the critics of market-led globalization is unbalanced. If they succeed in halting the movement towards international integration, much of this progress is likely to be lost, as prosperity falls, a corrupting web of controls on economic transactions grows, resentments over barriers to commerce increase and international ill will expands. The task ahead is, instead, not to halt global economic integration, but to make it work for more people than ever before.

Endnotes

1 Janos Kornai, the distinguished Hungarian economist, wrote this in 'What the Change of System from Socialism to Capitalism Does and Does Not Mean', *Journal of Economic Perspectives,* Winter 2000, p. 36.

2 Yet in a fascinating account of the role of evangelical religion in Chile, Arturo Fontaine Talavera argues that this form of religion changes behaviour in ways conducive to greater material success. Thus 'the relation between a Christian life and economic success is central to the evangelical experience'. See Arturo Fontaine Talavera, 'Trends towards Globalization in Chile', in Peter L. Berger and Samuel P. Huntingdon (eds), *Many Globalizations: Cultural Diversity in the Contemporary World* (Oxford: Oxford University Press, 2002), p. 273.

3 In an important review of institutional economics, Oliver Williamson of the University of California, Berkeley, divided the analysis into four levels: first, customs, traditions, norms and religions, which change very slowly and are not directly governed by economics; second, the institutional rules of the game -property rights and the working of the political system, the judiciary and the bureaucracy; third, the play of the game, or the governance of institutions; and, finally, resource allocation. The discussion here concerns the first level, but the greater part of this chapter is concerned largely with the wider implications of the second level. The third and fourth are considered in the next chapter. See Oliver Williamson, 'The New Institutional Economics: Taking Stock, Looking Ahead', *Journal of Economic Literature,* September 2000, pp. 595-613.

4 The classical liberal trinity consisted of life, liberty and property, which Thomas Jefferson, in the Declaration of Independence, turned into life, liberty and the pursuit of happiness. Among the best accounts of the basic features of a free society and, in particular, the role of law is in Friedrich A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960).

5 This point is made by David Landes in *The Wealth and Poverty of Nations* (London: Little Brown, 1998), particularly in his discussion of the contrast between the seventeenth- and eighteenth-century progress of the Netherlands and Great Britain and the stagnation of Portugal and Spain.

6 See Peter L. Bernstein, *Against the Gods: The Remarkable Story of Risk* (New York: John Wiley, 1996) for the development of the theory of risk and its links to the development of financial markets in particular.

7 Olson, *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships* (New York: Basic Books, 2000), p. 25.

8 John McMillan insists, rightly, that 'a market works well only if people can trust each other". See his *Reinventing the Bazaar: A Natural History of Markets* (New York: W. W. Norton, 2002), p. 11.

9 Joel Mokyr, *The Lever of Riches: Technological Creativity and Economic Progress* (Oxford: Oxford University Press, 1990), p. 302. Professor Mokyr also writes that 'what made the West successful was neither capitalism, nor science, nor an historical accident such as a favorable geography'. This is a surprising statement. It is hard to accept that persistent technological improvement had nothing to do with market forces, if that is what one means by capitalism.

10 Charles Calomiris, *A Globalist Manifesto for Public Policy.* The Tenth Annual IEA Hayek Memorial Lecture. Occasional Paper 124 (London: Institute of Economic Affairs, 2000), p. 30. A seminal text on the value of the political division of Europe into enduring states is the masterpiece of Eric L. Jones, *The European Miracle: Environments, Economies, and Geopolitics in the History of Europe and Asia* (Cambridge: Cambridge University Press, 1981, second edition 1988). In his book, *Unintended Consequences: the Impact of Factor Endowments, Culture and Politics on Long-Run Economic Performance* (Cambridge, Massachusetts: MIT Press, 1998), Deepak Lal argues in addition that the legal basis of western property rights was provided by the Roman Catholic Church, in order to ensure bequests in its favour and extend its political power. The two revolutionaries who brought this about were Pope Gregory the Great in the sixth century and Pope Gregory VII in the eleventh century. The Church also provided a home for philosophical and scientific inquiry throughout the middle ages.

11 In a brilliant short account of the flourishing of the Chinese market economy after 1000, most notably under the Sung dynasty (960-1279), the American historian William McNeill argues that the decisive fact in bringing the market to heel was the continued power of the state. 'Capitalists in China were never free for long to reinvest their profits at will. Anyone who accumulated a fortune attracted official attention. Officials might seek to share privately in an individual's good fortune by accepting bribes; they might instead adjust taxes and prices so as to allow the state to tap the new wealth; or they might prefer preemption, and simply turn the business in question into a state monopoly.' William H. McNeill, *The Pursuit of Power: Technology, Armed Force and Society since A.D. 1000* (Chicago: University of Chicago Press, 1982), p. 49. In 1078, China produced 125,000 tons of iron. In 1788, production in England and Wales was still only 76,000 tons. *Ibid.,* p. 27.

12 Douglass C. North, 'Institutions, Transaction Costs, and the Rise of Merchant Empires', in James D.

Tracy (ed.), *The Political Economy of Merchant Empires: State Power and World Trade 1350-1750* (Cambridge: Cambridge University Press, 1991), p. 33.

13 *Ibid.*

14 Rafael La Porta, Florencio Lopez-de-Silanes, Cristian Pop-Eleches and Andrei Shleifer, 'The Guarantees of Freedom', National Bureau of Economic Research Working Paper 8759, www.nber.org, February 2002, p. 1.

15 *Ibid.*

16 A striking example of the self-defeating nature of populism is Argentina. In 1950, Argentina's real gross domestic product per head in 1990 international dollars was $4,987. By 1998, after decades of populism, it was $9,219. Byway of contrast, Italy, from which many Argentinians had come, had a GDP per head of $3,502 in 1950 and $17,759 in 1998. See Angus Maddison, The World Economy: A Millennial Perspective (Paris: The Development Centre of the Organization for Economic Cooperation and Development, 2001).

17 Amy Chua, *World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability* (New York: Doubleday, 2003).

18 Olson, *Power and Prosperity*, p.41.

19 *Ibid.*, p. 42.

20 La Porta et al., 'The Guarantees of Freedom', p. 7.

21 Consider the remarkable and encouraging moves to democracy in South Korea and Taiwan.

22 I have taken some of these points from my Orwell Lecture, given at Birkbeck College, London University in 2001. See Wolf, 'Nation, State and Globalization', mimeo.

23 Jane Jacobs, *Systems of Survival: A Dialogue on the Moral Foundations of Commerce and Politics* (New York: Vintage Books, 1992).

24 Francis Fukuyama, *The End of History and the Last Man* (London: Hamish Hamilton, 1992).

25 The literature on the different types of capitalist economy is large. See, for example, Michel Albert, *Capitalism against Capitalism* (London: Whurr Publishers, 1993) or, more recently, Ronald Dore, *Stock Market Capitalism: Welfare Capitalism -Japan and Germany versus the Anglo-Saxons* (Oxford: Oxford University Press, 2000). The differences are important, particularly in relation to corporate governance and the role of the stock market. But they can be and -1 will argue – often are exaggerated.

26 Some would argue that Singapore suggests the possibility of combining freedom of enterprise with traditional Asian hierarchical political values. It would be quite surprising if .the country's paternalism long survived the passing of the generation of the founders of its prosperity. South Korea, Taiwan and Japan are increasingly 'western' in their political values.

27 *The Human Development Report 2002* lists countries by political freedom, rule of law and government effectiveness and lack of corruption. The advanced liberal democracies are at the top on all these characteristics. See *Human Development Report 2002: Deepening Democracy in a Fragmented World* (New York: Oxford University Press, for the United Nations Development Programme, 2002), Table A1.1.

28 Richard E. Baldwin and Philippe Martin, 'Two Waves of Globalization: Superficial Similarities, Fundamental Differences', National Bureau of Economic Research Working Paper 6904, www.nber.org, January 1999, p. 3.

29 These data are from World Bank, *World Development Indicators 2002* (Washington DC: World Bank, 2002), Table 1.1.

30 See John Oneal and Bruce Russett, 'The Classical Liberals were Right: Democracy, Interdependence, and Conflict, 1950-1985', *International Studies Quarterly,* 41 (June 1997), pp. 267-94.

31 Thomas Friedman, *The Lexus and the Olive Tree* (London: HarperCollins, 2000), p. 253.

32 David Held and Anthony McGrew, David Goldblatt and Jonathan Perraton, *Global Transformations: Politics, Economics and Culture* (Cambridge: Polity Press, 1999), p. 57. Although far from elegantly written, this book is a superbly researched source of information on globalization.

33 *Ibid.,p.* 53.

34 *Ibid.*

35 Ernest Gellner, *Nations and Nationalism* (Oxford: Basil Blackwell, 1983).

36 This point is well put in Brink Lindsey, 'The Invisible Hand vs. the Dead Hand', in Ian Vasquez (ed.), *Global Fortune: The Stumble and Rise of World Capitalism* (Washington DC: Cato Institute, 2000), pp. 43-54.

37 See D. Potter, D. Goldblatt, M. Kiloh (eds), *Democratization* (Cambridge: Polity Press, 1997), p. 9.