THE POLITICS OF PEACE AND PROSPERITY:
ECONOMIC INTERDEPENDENCE AND NATIONAL SECURITY IN THE MIDDLE EAST

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Introduction

Writing about the economic consequences of Middle East peace has become a growth industry in recent years. While most studies have focused on the economic benefits of peace, some recent writings have considered the political externalities of economic interdependence.\(^1\) In a paradigmatic statement of the consequences for a durable peace of increased economic contact between Israel and its Arab neighbors, two well-known economists wrote,

Peace in the Middle East will be secured only when it takes root in the everyday lives of the people of the region. That will happen only if the peace brings open economic relations and economic development to the peoples and countries of the region—as it did in Western Europe after World War II.\(^2\)

This statement is a particular expression of the liberal approach to international relations, which holds that unimpeded economic exchange maximizes prosperity while creating webs of interdependence that mitigate against conflict. In the strong liberal case, economic interdependence actually modifies states' interests, altering the goals pursued in international politics and eliminating conflicts of interest that might disrupt peaceful exchange.\(^3\) In the weaker version, conflicts of interest continue to be important components of interstate affairs, but they will not cause eruptions of armed conflict because states will rationally calculate that the costs of war, in terms of disrupted trade, would outweigh potential benefits: economic interdependence, in other words, raises the opportunity costs of war.

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One critical assumption common to both the strong and weak versions of the liberal argument is that the key to peace and prosperity is the displacement of politics by economics. In many of the works, politics is conspicuous by its absence; in more sophisticated versions, politics is understood to be a potentially potent, albeit atavistic, obstacle to peace and prosperity, but this recognition of the importance of politics is not accompanied by detailed analysis of political dynamics. Consequently, the interdisciplinary exchange between politics and economics is characterized by a stark trade imbalance; the economics of peace are detailed while the politics of peace are barely treated. The resulting supremacy of economics over politics is to be expressed in the domestic economy, where the free movement of supply and demand will supplant government regulation; in the international economy, where the free movement of goods in response to relative prices substitutes for mercantilist controls over trade; and in interstate affairs, which will in the future be governed by the pursuit of shared interests and mutual benefits rather than by concerns with national security.

My counter-argument, based upon realist approaches to international politics, is that arrangements expressing and helping to realize mutual economic interests do not reflect the end of politics, for they are themselves the products of ongoing political conflict and conflict resolution. Thus, the political preconditions and implications of Middle Eastern economic cooperation must be considered in more detail. I pursue this line of reasoning by considering three issues. In the first section, I investigate some recent trends in the global economy and some domestic political conditions that potentially mitigate against the establishment of a liberal economic order in the Middle East. In the second section, I question whether such a liberal order would secure economic prosperity in the Middle East. In the final section, I survey the national security implications of a liberal economic regime in the Middle East.

I confine my comments to the strong liberal case, involving the liberalization of domestic and international economies. I recognize that there are potentially fruitful domains of economic cooperation that fall far short of full liberalization and integration, but I shall omit
discussion of the economic and political implications of these arrangements for two reasons. First, most economists writing about project-specific ventures recognize that the full benefits of economic cooperation will only emerge after large-scale, comprehensive policy reform to liberate market forces. Second, if the liberal argument is that economic interdependence raises the opportunity costs of war, then project-specific ventures will not suffice to deter war, for their opportunity costs will also be project-specific, and therefore more tolerable.4

Creating a Liberal Order

In this section, I examine the political obstacles to the establishment of a liberal economic order in the Middle East. A liberal economic order has an international and a national component. The former refers to the removal of impediments to the international flow of goods in response to relative prices,5 while the latter refers to the reduction of government regulation, the liberalization of financial markets, the expansion of the scope for market forces to determine relative prices and hence the allocation of scarce economic resources, and the privatization of state-owned enterprises. Two issues need to be addressed in assessing the likelihood of establishing a liberal economic order in the Middle East. First, do recent trends in the global economy constitute a hospitable environment conducive for realizing a liberal regional economic

4 Would these project-specific ventures lead to prosperity? Israeli economist Eliahu Kanovsky suggests that they would not. First, he notes that many of these projects are dependent upon projected financing from Saudi Arabia, whose own finances are in parlous shape. Second, he notes that the threat of hostilities is not the only deterrent to large-scale foreign investment: economic reform will be necessary to convince foreign investors that they can receive returns comparable to what they would earn from investments elsewhere. Third, Kanovsky notes that talk of a Middle East Common Market overwhelmingly comes from Israel, while the Arab press expresses fears of Israeli domination. Furthermore, he notes that the size of potential export markets in the Middle East are not large enough to justify such extravagant claims about the wonders of economic interdependence. See his "Will Arab-Israeli Peace Bring Prosperity?" Middle East Quarterly 1 (June 1994): 3-10.

5 More specifically, the constituent elements of a liberal trade regime are generally understood to be low average levels of protection; protection is realized through tariffs, not quantitative restrictions, granted through nondiscretionary and transparent procedures; industry neutrality, i.e., the same level of protection applies to all sectors and to all industries within a sector; and trade neutrality, i.e., all industries and sectors confront the same incentives to sell at home or abroad.
order? Second, to what extent do domestic political relationships present obstacles to greater economic liberalization? I conclude the section by suggesting that under a pervasive set of conditions, the requisites of trade liberalization conflict with the requisites of domestic economic liberalization.

Obstacles to International Economic Cooperation. From the standpoint of orthodox economics, any impediments to the free movement of supply and demand result in inefficient resource allocation and suboptimal economic performance. From a narrow economic perspective, digression from liberal economic practices reduces social welfare and is hence "irrational." Government controls over trade must be a function of either misguided adherence to mistaken economic ideas, or the self-serving behavior of politicians.\textsuperscript{6} Mutual economic interests, in other words, should spontaneously and automatically evoke cooperation; when cooperation is replaced by discord, policymakers have either misperceived their mutual interests or have allowed their myopic political interests to interfere.

Political scientists in the realist tradition, on the other hand, tend to see the transition from mutual interests to cooperation as inherently problematic.\textsuperscript{7} Several aspects of international


\textsuperscript{7} This point has been well-stated by Robert Keohane, who locates himself within the realist tradition, but whose research focuses on the conditions under which the tenets of realism do not govern international relations. He writes, "Since common interests are sometimes associated with cooperation but sometimes with discord, cooperation is evidently not a simple function of interests. Especially where uncertainty is great and actors have different access to information, obstacles to collective action and strategic calculations may prevent them from realizing their mutual interests. The mere existence of common interests is not enough..." \textit{After Hegemony: Cooperation and Discord in the World Political Economy} (Princeton: Princeton University Press, 1984), pp. 12-13.
trade present collective action problems. First, an open international trading system shares the properties of a public good, namely noncompetitiveness and non-excludability. Rational individuals or states will not contribute to paying for goods that can be consumed for free. Alternatively, international trade can be analyzed as a standard Prisoner's Dilemma Game. Consider two nations that have erected barriers to trade. Although both nations would be better off under free trade, each country confronts the dilemma of cheating. If one nation unilaterally lowers its barriers to trade, but its trading partner does not, the terms of trade turn against the free-trading nation. In this situation, the dominant strategy of both nations is to retain trade barriers, regardless of what its counterpart does, leading to an outcome inferior to the cooperative outcome.

In either case, the installation of a free-trade regime requires the successful resolution of myriad collective action problems. Drawing on the work of the economic historian Charles Kindleberger, political scientists have analyzed international trade through the lens of hegemonic

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9 See Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987), p. 74, and Richard Rosecrance and Jennifer Taw, "Japan and the Theory of International Leadership," *World Politics* 42 (January 1990): 186-190. Noncompetitiveness refers to the property whereby X's consumption of a good is in no way diminished by X+N's consumption of that good. Nonexcludability refers to the property whereby it is infeasible, if not impossible, to exclude X from consuming a good whose production he or she has not contributed to. There is some debate about whether an open international trade regime is truly a public good. Specifically, it has been argued that free trade is not a public good because free riders can be excluded. See John A. C. Conybeare, "Public Goods, Prisoner's Dilemmas and the International Political Economy," *International Studies Quarterly* 28 (March 1984): 5-22. For a persuasive response, see Joanne Gowa, "Rational Hegemons, Excludable Goods, and Small Groups: An Epitaph for Hegemonic Stability Theory?,” *World Politics* 41 (April 1989), esp. pp. 324-316. Specifically, Gowa concedes that it is possible to sanction a free rider, but because applying sanctions is generally costly, policing and enforcing compliance are themselves public goods.
stability theory.\textsuperscript{10} Briefly, proponents of hegemonic stability theory claim that a stable system of international trade requires the presence of a hegemon that will take the responsibility for supplying indispensable public goods.\textsuperscript{11} Basically, the hegemon--defined as the dominant economic power, based upon the absolute size of its economy and its competitive strength in leading economic sectors--equates its interests with a liberal trading system, so that it practices free trade regardless of the trade policy of its partners.\textsuperscript{12} Furthermore, the hegemon fulfills a number of functions indispensable to the smooth functioning of the international economy, including sanctioning behavior that threatens the stability of the system, regulating foreign-exchange rates, ensuring liquidity through countercyclical flow of capital, and keeping its markets open for the surplus goods of smaller economies.\textsuperscript{13} According to this theory, the creation and stabilization of the postwar international economic order was secured through

\begin{itemize}
  \item \textsuperscript{12} In some versions of the theory, the hegemon is benevolent, and allows other states to free ride. In other versions, the hegemon attempts to force other states to share the costs of an open international economy, or even tries to pass the costs onto other states. For discussion of these variants, see Lake, "Leadership, Hegemony, and the International Economy."
\end{itemize}
American hegemony. American economic dominance was important because America kept its markets open to imports while underwriting economic recovery in Europe and Japan by tolerating developmentally important departures from free trade and transferring extraordinarily high levels of finance and technology to Europe and Asia.

In the absence of a state that is both willing and capable of assuming the role of hegemon, a liberal international economic order is likely to undergo destabilizing conflicts, while the establishment of a new international system characterized by free trade is unlikely. This conclusion is critical for our purposes, for there is widespread, though by no means unanimous, consensus that American hegemony has been in decline for more than two decades. America's economic power, expressed in terms of shares of total global output, worldwide production of manufactured goods, world trade, and exports of high technology products have all diminished, while America's position as the unquestioned leader in technological innovation has been substantially eroded. Even American military supremacy is being diminished by a worldwide diffusion of military capabilities, and American technological dependence upon other economies for crucial components of weapons systems. The decline of American hegemony, in turn, poses a critical threat to the maintenance of a liberal economic order. Aaron L. Friedberg, for example, argues that

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14 The postwar system was not a system of free trade: it was a system of managed multilateralism, based upon the principle of non-discrimination, that permitted wide latitude for violations of the principles of free trade.


Changes in the distribution of power will lead to mounting disputes over the legitimacy of existing rules and institutions and as a result to a protracted period of international instability. This turmoil is likely to give rise to a set of separate, competing subsystems, not to a new, unified world order.\(^{17}\)

This rather bleak conclusion has been contested by advocates of a "neo-liberal," or "institutionalist" approach, who argue that economic interdependence spawns a set of institutions that can manage cooperation even in a period of hegemonic decline or absence.\(^{18}\) Collective action problems in the form of the Prisoner's Dilemma can also be successfully resolved by iterated plays of the game.\(^{19}\) But even those scholars who are sanguine about the possibilities of cooperation in a post-hegemonic global economy restrict their analysis to the continuation of previously-instituted patterns of cooperation; the presence of a hegemon remains necessary for the origins of cooperation. Therefore, conditions in the international political economy are not conducive to the creation of a liberal trade regime in the Middle East.

Two associated developments also augur poorly for the successful integration of a newly established Middle East Common Market into the emerging global economy. The first trend is the proliferation of nontariff barriers to trade. As overall tariff levels have been reduced through successive GATT negotiations, countries have continued to protect domestic industries through the implementation of various quantitative restrictions. Between 1980 and 1983 alone, the share of restricted products in total manufactured imports rose from 6 to 13 percent in the United States, and from about 11 percent to almost 15 percent in the European Community. By

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1983, 98 percent of the all internationally traded products met quantitative restrictions in at least one country.\textsuperscript{20}

The second trend in the global economy associated with the decline in American hegemony is the emergence of three regional trading blocs: North America, Europe, and East Asia.\textsuperscript{21} Between 1958 and 1989, there has been a tremendous increase in both intra- and inter-regional trade. Between 1958 and 1989, intra-North America trade as a share of total North American trade increased 25 percent, from 28 to 35 percent; intra-EC trade as a share of total EC trade increased from 30 to 58 percent; and intra-Asian trade as a share of total Asian trade also increased by one-quarter, from 34 to 42 percent. In the same period, inter-regional trade, i.e., the share of total North American with either other North American countries, the EC, or the Asian states, has increased even more dramatically; for North America, this share increased from 49 to 82 percent; for the EC, from 45 to 74 percent; and for Asia, from 63 to 87 percent.\textsuperscript{22} International trade, in other words, is increasingly concentrated between and within three regional blocs.

Middle East participation in the post-war international economy was largely confined to oil, and there is no indication of any improvement in that situation. If anything, the share Middle East exports in world exports declined in the 1980s. As Doug Henwood has pointed out, "In this world, the only thing worse than being part of the evolving economic hierarchy is


\textsuperscript{21} The North America bloc is Canada, Mexico, and the United States; Europe refers to the six European Community states in 1958, and the 12 of 1989; Asia refers to India, the ASEAN states, and Northeast Asia.

being excluded from it. So far, the Middle East is largely excluded. 23 The Middle East has 
over the past two decades achieved some level of integration with Europe, but recent 
developments have placed that relationship under considerable strain. 24 Several Middle Eastern 
states have signed economic cooperation agreements with the EC, but according to Rodney 
Wilson, these agreements violated GATT norms and were heavily biased in favor of Europe. 
These agreements, furthermore, have done little to reverse the decline in Middle-East-EC 
trade. 25 

Ultimately, the fate of the Middle East in the emerging global economy will depend 
upon how the three regional blocs come to regulate relations between themselves. Three 
arrangements are possible. 26 The most promising scenario for the integration of the Middle 
East into global trading networks would be a continuation of the current system of managed 
multilateralism, consisting of three basic principles: concessions will be made on a 

23 Doug Henwood, "Global Economic Integration: The Missing Middle East," Middle East 

24 For a comprehensive survey, see Rodney Wilson, "The Economic Relations of the Middle 
The title of Wilson's articles suggests that the Middle East has options, but his conclusion is less 
sanguine. He writes, "Although commercial relations with Europe are declining in significance, there is 
little sign of promising regional economic cohesion in the Middle East." Citation on pp. 286-287. 

25 Ibid., pp. 270-271. The EC has expressed its willingness to open new dialogues with 
countries in the region, aimed at establishing bilateral free trade zones. Concrete proposals now on the 
table, however, largely revolve around aid for the Palestinians. See Francois D'Alancon, "The EC Looks 
to a New Middle East," Journal of Palestine Studies 2 (Winter 1994): 41-51. Ominously, the last 
sentence of this article begins "The Europeans will have to demonstrate both generosity in opening access 
to their own markets..." as should be clear by now, I am highly skeptical that international economic 
relations can be stabilized when governed by mutual interests, let alone by generosity or other 
manifestations of benevolence. 

26 Steve Weber and John Zysman, "The Risk that Mercantilism Will Define the Next 
Security System," in Sandholtz, et. al., The Highest Stakes, pp. 172-177. The concepts of benign and 
malevolent mercantilism were first discussed by Robert Gilpin, "Three Models of the Future," 
International Organization, (Winter 1975): 37-60. See also Susan Strange and John Stopford, Rival 
States, Rival Firms: Competition for World Market Shares (Cambridge: Cambridge University Press, 
1991). The authors see growing interdependence as resulting in heightened inter-state rivalry for market 
share.
nondiscriminatory manner, governments will negotiate only the rules of trade, and compliance questions will be handled through established routines. Under the continuation of this system, competitively-priced Middle Eastern goods would be able to find international markets. A second alternative is benign mercantilism, whereby pursuit of welfare considerations would lead each of the three blocs to reduce interdependence without entering into open conflict. Extra- and inter-regional trade would be regulated by agreements, not markets. This arrangement would surely reduce the access to global markets of non-oil Middle Eastern exports, but competitively priced goods in declining sectors of advanced industrial countries would find markets. The worst-case scenario would be a revival of mercantilist policies centered upon the three regional blocs. Here, the drive for autarky would be provoked by concerns over state power, not welfare considerations. This scenario would largely rule out further integration of Middle Eastern economies with the world trading system. Note also that either of the mercantilist scenarios holds out the possibility that Middle Eastern nations will be forced to compete amongst themselves for access to European markets. This competition would have unfortunate side effects for regional cooperation.

The decline of American hegemony and its attendant threats to the integrity of an open global economic order do not preclude the possibility of the creation of a liberal regional Middle East system. But these trends create an inhospitable economic environment that mitigates against the creation of such a system. Furthermore, were that system to come into existence, multiple obstacles would have to be overcome in order to be successfully incorporated into the emerging global economy.

Despite these developments, it is still possible for a number of Middle Eastern states to enhance regional economic integration en route to the formation of a regional common market similar to the EC. Stanley Fischer, for example, has noted that the EC began on a
smaller scale with the Coal and Steel Community; he proposes cooperation on water and power projects, tourism, and the formation of a development bank as initial steps in this direction.27

There is theoretical justification for relatively spontaneous and voluntary compliance in overcoming the collective action problems inherent in international trade. Collective action theorists refer to $k$ groups, a subgroup of actors that solve collective action problems because their prospective gains are high enough to justify bearing high costs, even unilaterally.28 But there are two problems with applying this theoretical insight to our case. First, as Gowa points out, small-group theorists have treated their subject as an empirical rather than an analytical issue; we do not have a set of criteria for assessing systematically whether Israel and several Arab countries constitute a $k$-group. Second, even if spontaneous compliance with an open economic order emerged, the problem of regulating that order would continue. All economies, after all, traverse both secular and cyclical trajectories which in turn present regulatory problems that will have to be confronted. Absent a regional or international hegemon capable of bearing some of the costs of adjustment, we should expect pervasive collective action problems and attendant policies of economic nationalism that force others to bear the costs of adjustment, not spontaneous compliance to realize mutual gains from trade.

Finally, there are a number of reasons for impeaching the credibility of using the European Economic Community as a model for the Middle East. First, with the exception of the Benelux agreement of 1944, the negotiations and treaties forming the European Community

27 Stanley Fischer, "Prospects for Regional Integration in the Middle East," as cited in Henwood, "Global Economic Integration," p. 8. Shimon Peres has also used the EC as a model for the economic future of the Middle East.

took place under the American security umbrella.\textsuperscript{29} There were independent European interests favoring the formation of this community, but in the absence of American hegemony, these interests might have stumbled over collective action problems. Second, there is a tendency to read the free-market arrangements emblematic of later stages of the formation of the Common Market into its earlier stages. The economic community that emerged in the 1950s certainly reduced internal barriers to trade, but it did not eliminate those barriers. Furthermore, in its first decade, the nascent community continued to tolerate extremely high levels of national economic intervention, was largely limited in scope to managing retrenchment in declining industries and easing dislocations in the rural sector, and joined economies together through trade, not joint ventures or foreign direct investment.\textsuperscript{30} Finally, the European Community initially joined together economies at roughly similar stages of industrial development, allowing less-disruptive intra-industry trade, that did not threaten entire industrial sectors with competition, to knit together economies.\textsuperscript{31}

The observations I have made in this section do not rule out future economic relations between Israel and Arab countries based upon the free movement of goods, capital, and labor. There is good reason to believe that the creation of this order would increase regional incomes over their present level, and this alone might suffice to induce its creation. But as we have seen,\textsuperscript{29}

\textsuperscript{29} Wayne Sandholtz and John Zysman, "Europe's Emergence as a Global Protagonist," in \textit{The Highest Stakes}, p. 83, write, "The European bargains--internal and external--were made at the moment of American political and economic domination. A bipolar security world and an American-directed Western economy set the context in which the European bargain appeared necessary."

\textsuperscript{30} Ibid., p. 84.

\textsuperscript{31} The major exception to this statement was France-German economic relations. French industrialization had preserved large numbers of small-sized family firms, and industrial output was not internationally competitive. In the early 1960s, De Gaulle opened France up to German industrial exports, as a spur to a period of intensive industrial (and agricultural) reorganization subsidized by both the French state and the German economy. See John Zysman, \textit{Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change} (Ithaca, NY: Cornell University Press, 1983), pp. 100-104. The disparity between French and German industrial development is dwarfed by the disparity between Israel and its neighbors. Furthermore, the Israeli economy cannot afford to finance Arab industrial restructuring even if it had an interest in doing so.
even the creation of a liberal order is based upon a particular set of political conditions, not the negation of politics.\textsuperscript{32} And the current trend of global politics suggests that even if a Middle Eastern regional bloc is successfully created, it will have to overcome serious obstacles to participate fully in global trade.

*Obstacles to Domestic Economic Liberalization.* There is widespread consensus that regional economic integration will not bear fruit unless it is accompanied by substantial liberalization of all of the domestic political economies. There is no gainsaying that all Middle Eastern governments have intervened widely in their economies in ways that have led to inefficient resource allocation, wasted resources, and cultivated corruption. Future economic development will require major policy reform (although, as we will see below, this reform need not take the form of orthodox liberalization)). But just as the existence of mutual interests is not sufficient to induce international economic cooperation, recognition of policy-based distortions in economic performance--and this is widely recognized throughout the region--is not sufficient to prompt that reform. This is because of the deeply political nature of state economic intervention.

In the post-war period, all Middle Eastern governments have intervened deeply in their economies. State economic intervention spoke in part to the requisites of development, a goal to which all Middle Eastern regimes afforded high priority. But economic intervention also served political purposes. Political control over the economy allows state elites to distribute the costs and benefits of economic change in ways consistent with the needs of eliciting political support from major social classes. Throughout the Middle East, we find elites regularly

\textsuperscript{32} Clawson and Rosen, "The Economic Consequences of Peace" p. 49, write, "The fact that the Benelux option maximizes incomes by no means assures that it will necessarily be chosen by the parties; income is not the only desideratum in life. It is quite possible that the peoples of the region would prefer an option with lower incomes but politically preferable, e.g., an economy from neighbors whom one doesn't particularly like." I have tried to suggest that the political obstacles to cooperation are more strategic than emotional in nature, but the basic conclusion remains the same.
exploiting this advantage to build durable political coalitions by linking political allegiance to economic gain.\textsuperscript{33} Unfortunately, achieving political stability through economic intervention frequently conflicted with the imperatives of development. Middle Eastern states regularly allocated scarce economic resources in ways that maximized political, not economic, returns, with corresponding debilitating effects on economic performance. Even under the best of circumstances, the subordination of technocratic decision-making to political concerns produces suboptimal economic performance. By the end of the 1970s, rampant corruption and flagrant mismanagement had chimed in to completely disrupt normal economic activity in almost every Middle Eastern economy.\textsuperscript{34}

From this perspective, it becomes clear why economic liberalization is such a difficult process; economic liberalization basically entails the deliberate and sustained erosion of the political-economic pillars upon which regime stability rests. This is true in democracies like Turkey, which instituted its first of a series of unsuccessful orthodox stabilization programs in 1958, and dictatorships like Egypt, where the first reform measures, introduced in 1968, have still not produced a liberal economy. The failure of these reform programs is not due to ignorance or lack of political will; it is due to the lack of a viable and feasible political alternative to current political-economic arrangements. Absent such an alternative, liberalization risks serious political instability.\textsuperscript{35}

\textsuperscript{33} For more details on the construction of political coalitions through state economic intervention, see my "The Formation of Precocious Keynesian States: Class Coalitions, State Building, and Economic Development in Syria and Turkey," (Ph.D. Dissertation, University of California, Berkeley, 1996).

\textsuperscript{34} Several recently published surveys discuss the various economic manifestations of the process I have described. See Iliya Harik and Denis J. Sullivan, eds., \textit{Privatization and Liberalization in the Middle East} (Bloomington, IN: Indiana University Press, 1992); Henri J. Barkey, \textit{The Politics of Economic Liberalization in the Middle East} (New York: St. Martin's Press, 1993); and Tim Niblock and Emma Murphy, \textit{Economic and Political Liberalization in the Middle East} (London: British Academic Press, 1993).

\textsuperscript{35} The most famous incident of political instability resulting from economic reforms was the bread riots that shook Cairo in January 1977. Let us also not forget that in late 1989, as Yugoslavia was
Although economic liberalization is composed of economic policies and reforms, it is a fundamentally political process. Successful liberalization is predicated upon implementing a new political formula supportive of redeployed state economic intervention. State elites will have to forge new constituencies, groups of people who see their own material interests as tightly linked to more liberal political economies. At the beginning of economic reform, the number of people who would benefit from liberalization is far smaller than those people who will see their standard of living decrease in the short term. Therefore, an explicit component of any liberalization package must be a strategy of compensation that provides benefits to people whose interests are harmed by liberalization, while simultaneously binding their interests to new arrangements. This imperative implies that liberalization is a sequential process, with the benefits of each stage distributed in a way that will allow further progress to be made. Conceivably, proceeds from relatively discreet projects, like cooperation over tourism or water management, can be channelled into special funds for this purpose.36

There is an important implication of this discussion of the political nature of liberalization and the need to build an alternative coalition supporting liberal economics: successful reduction in state economic intervention requires several major digressions from orthodox prescriptions. In particular, state administrative and regulative capacities may have to be strengthened, not eradicated, in order to supervise successfully a market economy. Furthermore, the need to construct a coalition supportive of reforms requires the retention of heading towards political disintegration, Western bankers and diplomats announced that they were very optimistic over the government's adherence to their "shock therapy" program. For a survey of incidents of political instability prompted by policy reform in the Middle East, see David Seddon, "Austerity Protests in Response to Economic Liberalization in the Middle East," in Niblock and Murphy, eds., *Economic and Political Liberalization in the Middle East*, pp. 88-113.

36 The model for the creation and employment of extrabudgetary funds that were then used for compensating some of the losers of economic restructuring in order to fabricate a supporting governing coalition comes from Turgut Ozal's liberalization strategy in Turkey in the 1980s. See John Waterbury, "Export-Led Growth and the Center-Right Coalition in Turkey," *Comparative Politics*, (January 1992), pp. 127-145. The failure of Ozal's strategy also highlights the pitfalls of this approach.
significant levels of state economic intervention, albeit in a modified and redeployed form. Economic reform programs that do not recognize this basic paradox and strive only to reduce state economic intervention are bound to fail.

Indeed, we can broaden our discussion of the orthodox paradox to indict further some aspects of standard neoclassical prescriptions. Not only does domestic economic liberalization require substantial levels of state economic intervention, but creating market economies open to international trade may have the same effect. There is substantial quantitative evidence, derived from both advanced industrial economies and developing economies, that maintaining open economic borders creates domestic political tensions that can only be assuaged through substantial levels of government activity. In a comparative analysis of the causes of increases in the size of the public economy in European countries between 1960 and 1975, David R. Cameron concluded that maintaining open economies produced a set of vulnerabilities and uncertainties threatening the welfare of citizens. Government intervention and expansion of state activity was designed to protect citizens from fluctuations originating in world economy.

Similarly, Robert Bates and his colleagues found that protection is a response to the risk emanating from terms-of-trade instability; only those governments that have been able to maintain internal transfer programs to protect citizens from risk have eschewed autarky and

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37 Miles Kahler has referred to this need to strengthen the state and retain important forms of intervention in order to make liberalization work as the "orthodox paradox." See his "Orthodoxy and Its Alternatives: Explaining Approaches to Stabilization and Adjustment," in Joan M. Nelson, ed., Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World (Princeton: Princeton University Press, 1990), pp. 33-62.

38 David R. Cameron, "The Expansion of the Public Economy: A Comparative Analysis," American Political Science Review, 72, 4, (December 1987): 1243-1261. See also Peter J. Katzenstein, Small States in World Markets: Industrial Policy in Europe (Ithaca: Cornell University Press, 1985). The author argues that for small European countries forced to maintain open economic borders, economic change in response to fluctuations in the world economy are a fact of life. Elites let market forces prompt economic adjustments, but compensate for subsequent costs with a variety of economic and social policies that prevent the costs of change from causing political eruptions.
maintained free markets.\textsuperscript{39} Thus, there is significant evidence of severe tension between the requisites of trade liberalization and of domestic economic liberalization, such that achieving both simultaneously may be infeasible.

Basing their analyses on well-established theorems of neoclassical economics, numerous authors have recently prescribed liberalization of domestic and international markets in the Middle East as a necessary precondition to maximizing economic welfare. These prescriptions basically call for an increase in market forces to the exclusion of political authority. In this section, I have pointed out a number of political obstacles to the creation of a liberal economic order in the Middle East. I have noted the irony of scholars calling for free markets in the Middle East at a time when the maintenance of free markets in the developed world is experiencing serious strains. I have suggested that the political conditions undergirding open markets have undergone significant alteration, calling into question the feasibility of creating a new liberal order. I have suggested that domestic economic liberalization is profoundly implicated in domestic political arrangements, casting doubts on the ability of governments to maneuver their way through the minefield of policy reform. Finally, I have suggested that discrete components of the liberal package may conflict with each other.

None of these observations are designed to deny the possibility of creating a liberal order. My goal is to highlight the politics of that transformation, while suggesting why reaching that goal may be less feasible than would seem by restricting our analysis on the objective gains to be realized by liberalization. This has two implications. First, we should not be surprised if liberalization does not proceed as quickly or in as linear a fashion as some might like. Second, it might be prudent to open a debate about what kinds of political-economic arrangements might be more feasible.

In this first section, I have assumed that the creation of a liberal order is the first-best option for Middle Eastern economies, and examined some of the political obstacles to the creation of such an order. In the next section, I examine more critically neoclassical prescriptions, suggesting that some forms of state-directed economic change might have greater developmental implications and produce greater levels of wealth in the medium and long-term than would strict adherence to neoclassical formulations.

*Politics and Economic Development*

The liberal approach to economic development is basically an extension of the principle of comparative advantage. Comparative advantage is a measure of the relative efficiency of different productive sectors within the same national economy. All economies can, in principle, produce all the goods they consume; but all economies will produce these goods at different levels of efficiency. Furthermore, an economy that transfers factors of production from wine to cheese will suffer opportunity costs in the form of foregone production of wine. The theory of comparative advantage counsels allocation of scarce resources into the production of goods with the lowest opportunity costs. If the country then trades its surplus output for goods it wishes to consume but does not produce, it will not only have maximized its own output, but by taking advantage of differential relative prices in world markets, it will consume more than it produces, and world welfare will be maximized. Thus, if Middle Eastern states reorient their economic activity consistent with their comparative advantage, and engage in extensive trade with one another, all parties will be better off.

Recent scholarship has extensively criticized economic analysis based upon comparative advantage. Critics have noted that the doctrine is not a robust predictor of patterns of international trade, and that recent cases of rapid development have not been based upon adherence to comparative advantage. For the purposes of this essay, we do not need to explore
fully these criticisms. Instead, we need only to understand the likely consequences for economic development in the Middle East if all states were to pursue international specialization based upon comparative advantage. My argument is that if Israel and its Arab neighbors conduct future economic policy based upon adherence to the principles of comparative advantage, they will traverse starkly different developmental trajectories, with important consequences for both economic prosperity and calculations of national security. This is because, unlike the European countries that formed the EC while at comparable stages of industrial development, Israel and its Arab neighbors are at very different stages of development.

Consider the contemporary Israeli economy. Since the early 1970s, industrial exports have increased at a faster rate than domestic industrial production, a larger share of these exports is taken up by the chemicals, electronics, metal products, military equipment, and transportation equipment sectors, and products of high-technology industries based on original designs and research have represented an increasingly larger share of Israeli exports. Over the past two decades, in other words, Israel has come to compete in international markets based upon technological and knowledge accumulation, not factor costs.\(^{40}\)

Arab economies, on the other hand, are expected to continue allocating resources based upon their comparative advantage, not in knowledge-intensive industries, but in labor-intensive industries and activities. This division of labor will essentially lock Arab economies into the production of labor-intensive goods that are almost universally of lower value added, compete in international markets based upon low wages, and hence yield far lower returns. Israeli-Egyptian cooperation, for example, would create what is undoubtedly a mutually beneficial division of labor. According to some scenarios, Egypt would export to Israel its high

value, long-staple cotton, with which Israel would produce fine goods for the high-end of the market, while Egypt would use Israeli-produced medium-staple cotton to produce inexpensive clothing. In joint ventures, Israeli and Egyptian firms would divide up production, with Egypt assuming responsibility for low value-added, labor-intensive operations like sewing, while Israel concentrated on the high value-added operations of design, printing, dyeing, and finishing. In terms of overall industrial trade, Israel would export electrical and metal goods, while Egypt would export cotton and cotton goods, nonferrous metals, cement, ammonia, and sugar cane.

Let me be clear; this, and similar arrangements between Israel and other Arab countries, would be mutually beneficial. Productivity would be raised, volume of production would increase, and incomes would rise in both countries. But the distribution of these benefits would be highly asymmetric. Israeli benefits would come through access to new markets, access to cheap labor, and increased sales of products embodying high levels of capital accumulation—in terms of knowledge, skills, and human resources, not just machinery—that produce high rates of return. Arab benefits, on the other hand, would stem from increased employment in labor-intensive industries that can only compete on world markets through low wages. Indeed, Clawson and Rosen have noted that because wages in the region are kept artificially high, making products uncompetitive on world markets, wages might have to fall in order to penetrate

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global markets. As it is Arab countries that are expected to provide the inexpensive and relatively unskilled labor, while Israel takes responsibility for the higher value-added components of the production process employing more highly remunerated labor, this burden will fall disproportionately on Arab incomes. As a result, "Israeli incomes in the Benelux zone will remain at least three or four times that of Jordanians and Palestinians for some time to come."44

Indeed, the Israeli philosopher Shlomo Avineri was not exaggerating when he wrote, Moving toward uncontrolled economic integration between Israel's relatively developed economy and the West Bank would mean creating a new mode of dependency. It would be an unequal partnership, providing Israeli employers with cheap, nonunion Palestinian labor and a market for Israeli products.45

Arab economists are well aware of the disparity between the level of development of the Israeli economy and of Arab economies. They differ, not surprisingly, in the evaluation of the effect of that gap on future gains from trade. The prominent Jordanian economist Fahd al-Fanik, for example, has been an outspoken advocate of closer trade relations with Israel. In response, Mahmud `Abd al-Fadil argues that the important issue is not the existence of mutual gains from trade, but the distribution of gains from trade.46

The fact that the relationship is an unequal one is not an unmitigated bad thing. For many workers, low-paying jobs are preferable to unemployment.47 But in addition to

43 Clawson and Rosen, Economic Consequences of Peace, p. 51.

44 Ibid., p. 52.

45 See his "Sidestepping Dependency," Foreign Affairs 73 (July 1994): 13. A recent conference of Arab economists criticized the April 29 PLO-Israel Economic Accords for creating a customs union heavily biased towards Israel, making it difficult, if not impossible, for Arab countries to develop closer economic ties with the Palestinians. See the report in Middle East International, (July 9, 1994), p. 9.


47 Azmy Bishara points out, for example, that people in refugee camps "are concocting economic fantasies now about becoming like Singapore and Malaysia. People are dreaming of being a
considering the asymmetry of present gains from trade, we have to consider the implications of present arrangements for the future composition of production and the future distribution of gains from trade. I have suggested so far that economic exchange with Arab economies will hasten Israel's traversal of a developmental trajectory based upon high accumulations of knowledge producing higher value-added output and higher national income. Arab countries, on the other hand, are likely to move along a trajectory of labor-intensive manufactures. This disjuncture between developmental trajectories presents both advantages in terms of potential for exchange, and disadvantages, in terms of an unequal distribution of gains from that trade. The future problem is that there is nothing automatic about shifting from labor-intensive industry to capital-intensive industry in its traditional or current meaning. Market forces alone will not transform the structure of Arab economies. Indeed, market forces are perhaps more likely to produce an erosion in the competitive position of countries producing labor-intensive products.

As Michael Porter explains the dilemma of lesser-developed countries,

> Competitive advantage that rests on factor costs is vulnerable to even lower factor costs somewhere else, or governments willing to subsidize them. Today's low labor cost country is rapidly displaced by tomorrow's...Those industries in which labor costs or natural resources are important to competitive advantage also often have industry structures that support only low average returns on investment. Since such industries are accessible to many nations seeking to develop their economies because of relatively low barriers to entry, they are prone to too many competitors (and too much capacity). Rapidly shifting factor advantage continually attracts new entrants who bid down profits and hold down wages...Developing countries are frequently trapped in such industries.48

Real development in the region must be based upon Arab economies developing higher value-added production in the future.49 Exchange based upon free markets and adherence to principles of comparative advantage will not prevent current disparities in the cheap labor force--its unbelievable!" See the interview with him in Middle East Report (January-February 1994), p. 5.


49 See the interview with Charles Shammas, founder and project director of Mattin, an industry promotion organization in the West Bank, in Middle East Report (January-February 1994), p. 16.
composition of production and national income between Israel and its Arab neighbors from becoming even wider in the future. Neither, it must be said, will continuation of current political-economic arrangements produce real development. When we conceive of alternative political-economic arrangements only a minor variants on a binomial opposition of state-led or market-based development, the choice seems stark: state-led development in most Middle Eastern countries has been a patent failure, so market-based development becomes both the preferred option and the default option. But that opposition is misconceived: what we need to think about are the specific combinations of political authority and decentralized decision-making that move the production profile of an economy into higher value-added, higher productivity, and higher-wage output. As we have seen, there are serious reasons to believe that post-World War II Europe is not the appropriate model for the Middle East. Instead, we need to draw some lessons from the rapidly developing economies of East Asia.  

In both South Korea and Taiwan, extensive, market-supporting (not market-distorting) state economic intervention has worked to first ensure that labor-intensive goods will be competitive on international markets, and then to guide the economy towards the production of higher value-added goods. In both cases, the shift towards greater capital intensity was not a case of factor substitutions in response to growing wage bills, as neoclassical...
economists have argued. In the early 1970s, neither Korea nor Taiwan had exhausted surplus labor; the shift towards capital-intensive industries— not, as some claim, towards more capital-intensive techniques in established industries— was a response by the state— not by entrepreneurs— to American-imposed nontariff barriers to trade in textiles. Furthermore, throughout the period of heavy industrialization, both Korea and Taiwan protected their new, infant industries, compensating for this with the unprotected export competitiveness of downstream industries.

Constraints of space prevent me from detailing the mechanisms by which East Asian states have promoted economic development successfully; fortunately, there is now a well-developed literature on the subject. It is clear that East Asian states differ from Middle


53 Specifically, in 1971, the Nixon Administration requested Taiwan, Korea, and Hong Kong to "voluntarily" curb their cotton exports to the US. In 1973, these countries were signatories to the multifiber arrangements curbing exports on synthetic fibers. A further problem with Little's argument is that while Korea and Taiwan shifted into new industries, Hong Kong shifted into the production of higher-end apparel not covered by the agreements. So the shift into more capital-intensive techniques did not occur in any of his cases. For discussion, see Tun-jen Cheng, "Political Regimes and Development Strategies: South Korea and Taiwan," in Gary Gereffi and Donald L. Wyman, eds., *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton: Princeton University Press, 1990), pp. 162-164.

54 Overall levels of protection in Korea and Taiwan are low by developing country standards; but the low level of overall protection disguises high levels of protection on infant industries. See the discussion in Howard Pack and Larry E. Westphal, "Industrial Strategy and Technical Change," *Journal of Development Economics*, 22, (1986): 87-128.

Eastern states in terms of state structures, processes of interaction between state and society, and policies. It is not yet clear how tightly bound policies are to state structures and political processes; that is to say, it is not clear that any Middle Eastern state could simply adopt identical policies and hope for identical outcomes. Instead, more fundamental political restructuring might be needed. What is clear is that state intervention must work in accordance with markets, not to displace them, and that economic agents who receive state support must be compelled to reciprocate by meeting carefully specified performance standards, expressed in terms of meeting quantitative export goals, realizing incremental improvements in product quality, and achieving increasing mastery of the production process in order to enhance productivity. If states cannot hold recipients of subsidies and other forms of protection accountable, state economic intervention will result in "directly unproductive profit-seeking activities," not development.

In concluding this section, let me reiterate that economic cooperation between Israel and its neighbors has the potential for significant economic benefits for all parties. I am not in any way advocating autarky. But the mutual benefits stemming from forms of cooperation ranging from specific infrastructural projects, to joint industrial ventures, to free trade arrangements, are not unmitigated goods. Real development for the Arab states may require substantial levels of government intervention in the economy that starkly conflicts with the dictates of neoclassical economics: unimpeded international trade and unfettered domestic market-based resource allocation. Rather than starting from a position of condemning


government intervention, we need to start thinking about how to encourage the formation of developmental states.

National Security and Economic Interdependence

Are there security implications of the asymmetrical distribution of benefits of economic exchange in the Middle East? That depends upon how we approach and resolve an issue fundamental to international relations theory: is international behavior based upon calculations of relative or of absolute gains?58 Briefly, there are two ways that states can treat the realization of gains from international cooperation. On the one hand, states may be concerned only with maximizing their own utility regardless of the size of the payoff to their partners.59 States are not concerned, in other words, with the issues of distribution discussed in the previous section.60 It is this view of international relations that has motivated most of the discussions of the political payoffs of economic cooperation in the Middle East. Ruth Arad and Alfred Tovias, for example, have developed the concept of vested interest in peace (VIP), suggesting that an economic transaction will have a positive impact on VIP if "it increases the


59 Keohane, After Hegemony, p. 66, asserts that realism, whose assumptions he shares, entails a definition of rational egoism which implies that "the preferences of actors in world politics are based on their assessments of their own welfare, not that of others." As Grieco points out, this is a clear misreading of realism.

60 In this case, the state's utility function contains only two terms: \( U = V \), where \( U \) represents the state's utility, and \( V \) represents the payoff from international cooperation.
welfare of those affected parties which have political clout."61 The implicit assumption is that any positive welfare gain helps to support and secure peace, regardless of the size of the partner's welfare gain.

Realist international relations theory counters that under many conditions, states will be concerned with relative gains, not absolute gains. As Kenneth N. Waltz argued in his classic statement of neo-realist theory,

When faced with the possibility of cooperating for mutual gain, states that feel insecure must ask how the gain from trade will be divided. They are compelled to ask not "Will both of us gain," but "Who will gain more?" If an expected gain is to be divided, say, in the ratio of two to one, one state may use its disproportionate gain to implement a policy intended to damage or destroy the other.62

This seemingly scholastic debate has significant implications for international conflict. The argument from absolute gains posits an inverse relationship between gains from cooperation and concerns for national security: as the welfare derived from international cooperation decreases, the likelihood of national insecurity and conflict increase. "If goods can't cross borders," warned Cordell Hull in an admirably pithy formulation of this position, "soldiers will."63 Thus, liberals can envision a world in which economic cooperation erodes the competitive bases of conflict. To paraphrase Fisher and Schelling, peace will only be secured in the Middle East if it is accompanied by open economic relations and development.

This argument has a long and respected intellectual lineage. Indeed, theorists of a liberal and peaceful world order can take ample inspiration from the writings of the founding

61 As cited in Seev Hirsch, "Trade Regimes in the Middle East," in Fishelson, ed., Economic Cooperation in the Middle East, pp. 270-271. VIP actually refers to the impact of economic transactions on consumers and producers, not states themselves, but the basic point remains the same.


fathers of modern political theory to support their analyses of contemporary trends. The argument that economic interdependence generates peaceful international relations was injected into policy debates in the 1850s by Richard Cobden, who defended his position favoring free trade policies and disfavoring a British naval buildup by claiming that the more any nation traffics abroad...the less it well be in danger of wars...[Free trade] unites, by the strongest motives of which our nature is susceptible, two remote communities, rendering the interest of the one the only true policy of the other, and making each equally anxious for the prosperity and happiness of both.

In contemporary international relations theory, there are two distinct arguments connecting liberal international economics and peaceful economic relations. In the first argument, the welfare benefits of trade produce absolute levels of prosperity for all partners, while decreasing the advantages of directly controlling territory and resources. Wealth is separated from control of territory. If a country can achieve higher levels of prosperity by engaging in international trade than it can by directly controlling resources while engaged in autarchic international relations, than there is no incentive to use force to capture resources. In this argument, economic exchange actually alters the incentive structure of states to use force.

64 In The Spirit of the Laws, Montesquieu wrote, "The natural effect of commerce is to bring about peace. Two nations which trade together, render themselves reciprocally dependent; if the one has an interest in buying the other has an interest in selling; and all unions are based upon mutual needs." As cited by Albert Hirschman, National Power and the Structure of Foreign Trade (Berkeley: University of California Press, 1980), p. 10. Kant's 1795 treatise, Perpetual Peace forms the basis for Michael Doyle's recent discussion of the implications for international relations of liberal economies and polities. See his "Kant, Liberal Legacies, and Foreign Affairs," Philosophy & Public Affairs, part one, 12 (Summer 1983): 205-235; and part two, 12 (Fall 1983): 323-353.

65 Richard Cobden, The Political Writings of Richard Cobden, as cited in Dale C. Copeland, "Economic Interdependence and War," manuscript, University of Virginia, June 2, 1994, p. 6.

66 See for example Rosecrance, The Rise of the Trading State. Rosecrance presents two, ideal-typical worlds of international relations, The Military-Political World, where at least some functionally homogeneous states use force to conquer territory, and the Trading World, where functionally differentiated states compete to maximize welfare through trade of goods and services. Rosecrance charts the changes in domestic politics and international relations that have modified the calculations of states about the costs and benefits of trade versus war.

In a variant of this argument, Goldgeier and McFaul, "A Tale of Two Worlds," argue that the great powers of the core are now engaged primarily in maximizing wealth, not security: as a result, they
In the second argument connecting liberal international economics to the end of war, international exchange enmeshes states in webs of interdependence. Once a certain, undefined threshold of interdependence has been crossed, states become mutually vulnerable on each other, as they depend upon access to foreign markets for imports of valued goods and export markets. In this scenario, vulnerability raises the costs of going to war: a decision to go to war would automatically inflict a high level of damage on the aggressor state. At this point, nonmilitary instruments that do not antagonize vulnerabilities become the preferred means of conducting international relations.67

Although in principle, the liberal argument is based upon a theoretical investigation of the impact of economic relations upon the calculations of states conceived of unitary, rational egoists, in practice, liberal thinkers invariably smuggle in ideas about the impact of domestic politics, often combined with a rudimentary evolutionary schema reminiscent of Herbert Spencer's late-nineteenth century stage theory of the transition from hunting-plundering societies, to societies where industrial sectors were subordinated to the needs of government-military structures, to industrial and hence peaceful societies like Britain.68 Indeed, in Kant's *Perpetual Peace*, the constraints of commercial exchange only produced peace when combined with constitutional constraint and international respect for human rights:69 this trinity has been will now settle conflicts and enhance their security through negotiation and compromise, not through the use or the threat of force.

67 See Robert O. Keohane and Joseph S. Nye, *Power and Interdependence* 2nd edition, (New York: HarperCollins Publishers, 1989), p. 16-17, 28-29. Note that the authors embed this discussion in a broader treatment of the disincentives to the use of force in a world characterized by complex interdependence. Unfortunately, the force of this argument is undermined by the definition of complex interdependence, which includes (p. 25) the component that "Military force is not used by governments toward other governments within the region, or on the issues..." At this point, the argument dissolves into tautology.


69 See Doyle, "Kant, Liberal Legacies, and Foreign Affairs."
reincarnated in the form of the argument that liberal democracies do not go to war with each other. Hence, Keohane's argument that interstate cooperation on economic affairs of mutual benefit produces interstate peace becomes diluted when he writes,

For liberal thinkers, economic incentives are important as well as concerns for security. Among republics, at any rate, military threats may be insignificant, expanding the potential area for cooperation... At this point, it is fair to ask whether it is the domestic political structure, economic cooperation, or some other factor that leads to the decline in the use of force.

But despite the impeccable lineage of this line of thought, it is not immune to criticism on empirical grounds. The fourth edition of Norman Angell's widely read treatise on how the evolution of the international economy had made war obsolete was published on the eve of World War I. Indeed, as Richard Rosecrance has pointed out, the outbreak of World War I

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70 Briefly, the argument is that governments elected by mass suffrage will not be able to justify to their citizens war against another democracy; major wars must be waged in defense of democracy to be popular and hence sustainable. See, for example, Randall L. Schweller, "Domestic Structure and Preventive War: Are Democracies More Pacific?" World Politics 44 (January 1992): 235-269.


72 I emphatically reject evolutionary schemas of international relations. But those who embrace this approach cannot take comfort in the way they have been applied to the Middle East. Edward N. Luttwak, for example, writes "In the train of history, the last wagons, such as the fragile states of sub-Saharan Africa, are still prebellic; they cannot yet wage war on each other, because regimes sustained only by the direct force of their armies cannot send those armies away to remote frontiers. The wagons at the head of the train by contrast are now postbellic because their ruling elites have become convinced that they cannot usefully fight one another. Only the wagons in the middle--countries such as India, Israel, Iran, Iraq, and a few others--are still capable of war with each other. See his "From Geopolitics to Geo-Economics: Logic of Conflict, Grammar of Commerce," The National Interest 20 (Summer 1990), p. 21. Emphasis added. Similarly, Goldgeier and McFaul argue that peaceful interstate relations will characterize the core countries. In the periphery, on the other hand, incentives for cooperation are less determinative of interstate relations then pressures for expansion and conflict. "A Tale of Two Worlds," pp. 469-470.

was not impeded by the fact that the period between 1890 and 1914 were probably the years of
the greatest economic interdependence in European history.74

Liberals argue that concerns for economic prosperity underly and precede calculations
of security. Realists argue the opposite: the value that states place upon economic gain is
predicated upon their prior evaluations of their security environment. Therefore, it is
inconceivable that economic cooperation can lessen perceptions of threats to security, for if
those perceptions exist, they are likely to be exacerbated by any form of economic cooperation
that does not produce relative gains. The paramount priority states place on relative gains thus
has major implications for the possibility of economic cooperation. If a state makes its
calculations about whether to cooperate based upon a calculation of relative gains, its utility
function becomes \( U = V - k(W - V) \), where \( U \) represents the state's utility, \( V \) represents its
expected payoff from cooperation, \( W \) its prospective partner's expected payoff, and \( k \) represents
"the state's coefficient of sensitivity to gaps in payoffs either to its advantage or
disadvantage."75 State's utility functions, therefore, are partially interdependent: as \( k \) will
always be greater than zero,76 even relatively small results of \((W - V)\), combined with high
enough values for \( k \), can result in a negative utility, even if \( V \) is very large. Even if cooperation
will provide a state with a large absolute gain, "a state will decline to join, will leave, or will

74 Richard Rosecrance, "Whither Interdependence," *International Organization*, 31, 2,
(Summer 1977): 432-434.


76 The coefficient \( k \) will always be positive because even if present relations between two
partners are perfectly harmonious, states are uncertain about future intentions, so they must be concerned
about how cooperation affects relative capabilities in the future. Robert Jervis captures this inherent
uncertainty well, noting, "Minds can be changed, new leaders can come to power, values can shift, and
dangers can arise." Cited in ibid., pp. 128-129. Michael Loriaux echoes this perspective in his
discussion of the future of French-German relations, writing "Is it so inconceivable that a demagogue
might arise in the heat of electoral competition in France--or even in Germany--and proclaim with success
that the French or Germans are getting nothing out of the European community but unemployment and
runaway immigration?" See his "The Riddle of the Rhine: France, Germany, and the Geopolitics
of European Integration, 1919-1992," in Meredyth Woo-Cumings and Michael Loriaux, eds., *Past as
sharply limit its commitment to a cooperative arrangement if it believes that partners are achieving, or are likely to achieve, relatively greater gains.\textsuperscript{77}

Realists do not deny that durable relations of cooperation exist; nor do they attempt to deduce a high concern for relative gains directly from the condition of anarchy, whereby the absence of supranational authority in interstate relations forces all states to be concerned with survival and self-help. The value of $k$, or the level of concern states show for relative gains, is contingent; it is a function of the strategic environment in which the state finds itself.\textsuperscript{78} One of the most important parameters of the strategic environment is the past relationship between two potential partners in cooperation. As Grieco states this variable, "It is very probable, for example, that a state's sensitivity to gaps in gains will be higher in relationships with traditional adversaries than with long-time allies."\textsuperscript{79} This factor, needless to say, does not bode well for future Middle Eastern economic cooperation.

The primary battlefield of this debate has been, not surprisingly, Europe. For liberals, the maintenance of an economic community, and the political superstructure that has been built upon it, are indicative of the power of economic interdependence to reshape political attitudes, processes, and structures.\textsuperscript{80} As Carl Kaysen states it, the necessary and almost sufficient condition for the disappearance of war was that all parties concerned have calculated a negative

\textsuperscript{77} Grieco, "Anarchy and the Limits of Cooperation," p. 128.

\textsuperscript{78} Powell, "Anarchy in International Relations Theory," p. 335.

\textsuperscript{79} Joseph M. Grieco, "Realist Theory and the Problem of International Cooperation: Analysis with an Amended Prisoner's Dilemma Model," \textit{The Journal of Politics}, 50, 3, (August 1988), p. 610. Grieco lists five other parametric variables, including the level of convertibility of payoff-gaps into influence within a particular joint arrangement; estimates of cross-venture fungibility of bargaining power derived from payoff-gaps; time horizon, which pertain to the long-term convertibility and fungibility of payoff-gaps, which may be much higher than in the short term; previous experiences of a state; and differences in issue areas.

\textsuperscript{80} The optimism of this approach is expressed by the title of one of the most important works of regional integration theory, Ernst B. Haas, \textit{Beyond the Nation State} (Stanford, CA: Stanford University Press, 1964).
cost benefit *ex ante*. Profound economic and political changes following the Industrial Revolution have made war unprofitable.  

Neorealists counter that liberals have made two fundamental mistakes: first, they have conflated the correlation between economic interdependence and the long peace with a causal relationship, and, second, they have omitted examination of the political bases of the economic arrangements constituting interdependence: a liberal economic order, in other words, can only be installed upon a previously constructed base of peaceful relations, and therefore cannot be said to have caused that base. The political base that caused the long peace was a combination of a bipolar world, which is inherently more stable than the multipolar world that had existed in Europe prior to World War II, and the American-led security system. Indeed, as Josef Joffe observes, it was not a foregone conclusion in 1945 that future interstate relations in Western Europe would be benign. Cooperative inter-European relations are a product of the essentially unilateral American security guarantee, which "removed the prime structural cause of conflict among states--the search for an autonomous defense policy." The American security

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81 Kaysen, "Is War Obsolete," pp. 87-88. According to Mueller, this lesson could have been learned after World War I, but future Axis leaders failed to learn the lesson.

82 The first point is made by John J. Mearsheimer, "Back to the Future: Instability in Europe After the Cold War," in Sean M. Lynn-Jones, ed., *The Cold War and After: Prospects for Peace* (Cambridge, MA: The MIT Press, 1991), p. 182. The latter point is advanced by Buzan, "Economic Structure and International Security," who notes (p. 607-608) "The case for the primacy of noneconomic explanations for the decline in the use of force is strengthened by the compelling argument that a liberal economic system requires, as a prior condition of its own creation, an environment in which the use of force is restrained...The fact that a liberal economy depends...on the the effect it is supposed to cause...reinforce[s] the claim to primacy of military and political factors as the major causes of the decline in the use of force. At best, the liberal economic arguments can be read only as reinforcing a decline in the use of force that is already underway for other reasons."

83 Josef Joffe, "Europe's American Pacifier," *Foreign Policy*, 54, (Spring 1984), p. 68. The best discussion of how the search for an autonomous defense policy often prompts war remains Robert Jervis, "Cooperation Under the Security Dilemma," *World Politics* 30 (January 1978): 167-214. On the role of the Cold War in dampening economic conflict within the Western alliance, see Nicholas Bayne, "International Economic Relations After the Cold War," *Government and Opposition* 29 (Winter 1994), pp. 4-5. This argument was originally formulated by Benjamin Cohen back in 1974, when he noted that an implicit bargain had been struck whereby European nations ceded control over their own security in
guarantee not only secured Western Europe from Soviet threat, it removed the threat of intra-EC conflict. "With the United States serving as night watchman, relative-gains concerns among the Western Europe states were mitigated and, moreover, those states were willing to allow their economies to become tightly interdependent."84 Indeed, one of the major debates within international relations today concerns whether Europe will become more conflict-ridden now that the Cold War has ended.85

A couple of more concrete lessons can be drawn from this abstract discussion. First, cooperation on behalf of mutual interests does not preclude the periodic eruption of conflict. The question is, what form does that conflict take?86 Whether trade conflict becomes armed conflict is a function of the prior security relations between two trading partners. A second lesson turns on what has been called the security externalities of international trade. Because the increased prosperity that accompanies international trade also enhances a state's capacity to make war, durable trading relations are more likely to occur within, rather than across, political-military alliances.87

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85 Mearsheimer in ibid., p. 142, concludes that, "the prospects for major crises and war in Europe are likely to increase markedly if the Cold War ends and this scenario [the re-emergence of a multipolar structure] unfolds. The next decades in a Europe without the superpowers would probably not be as violent as the first 45 years of this century, but would probably be substantially more prone to violence than the past 45 years."

86 There is a long tradition of quantitative studies correlating economic interdependence with conflict. Most recently, Mark J. Gasiorowski concluded that many of these studies were flawed because they failed to incorporate the costs of interdependence into their analysis. When this correction is made, he found that increasing interdependence is correlated with increasing international hostility and conflict, though not necessarily armed conflict. See his "Economic Interdependence and International Conflict: Some Cross-National Evidence," *International Studies Quarterly* 30 (1986): 23-38.

A third conclusion is that international commercial relations may, under certain circumstances, contribute to wars. Economic interdependence, after all, is another way of saying mutual dependence: as that dependence will almost inevitably be asymmetric, the exploitation of ties of dependence can be exploited to create international advantage. All states, then, are at least partially vulnerable to the political decisions of other states to cut access to export or import markets. Fears of having this vulnerability exploited provides an incentive for states to directly capture economic resources controlled by other states, if only to secure continued access in the future. In a variant of this argument, Robert Gilpin has accounted for the origins of major wars in the uneven distribution of economic benefits of stable systems, resulting in the emergence of challengers to hegemons. These rising states face new incentives to alter the system—challenging the basic interests of dominant states—because such changes promise higher benefits and lower costs. Both states will attempt to alter the rules governing the existing system, with declining hegemons attempting to arrest their decline, and rising powers attempting to produce a new distribution of benefits reflecting the changed distribution of power. If neither state succeeds at producing a new equilibrium in the system, war results. This situation is especially ripe for preemptive war, with the declining hegemon facing incentives to launch a pre-emptive war while the distribution of power is still in its favor.

This discussion of the realist interpretations of the relationship between economic exchange and international conflict is emphatically not designed to argue that war is inevitable in

88 As Albert Hirschman put it, the capacity to interrupt commercial relations is a form of power. See his National Power and the Structure of Foreign Trade.


90 Robert Gilpin, War & Change in World Politics. Schweller, "Domestic Structure and Preventive Wars," argues that, with one exception, only nondemocratic states launch preemptive wars. That exception is, unfortunately, Israel. He writes, (267) "In short, continuous, intense systemic pressure and the tragic historical experiences of the Jewish people have shaped Israel's domestic structures in ways characteristic of authoritarian regimes, which explains why Israel has retained a preventive-war option unavailable to other democratic states."
the Middle East; on the contrary, my goal is to demonstrate that war is a function of a set of contingent variables. That said, it is clear that economic exchange will not eradicate concerns for national security. Instead, what should be clear is that economic exchange has to be constructed upon a firm and solid edifice of security arrangements. As Joseph Alper notes in his discussion of Israeli security concerns

From the standpoint of a large majority of Israelis, it is the preoccupation with security that will, for a long time to come, continue to direct the country's attitude towards peace with its neighbours. Indeed, peace will be essentially security. That this may disappoint many of Israel's well-wishers in the Middle East and the world who seek now to discuss Israel's economic and cultural integration into the region does not denigrate the reality.  

But it is not only Israeli security analysts who envision the continuation of security concerns into a post-peace agreement era. Consider, for example, the statement of a high-ranking Syrian official, who noted that "Les rapports de forces globaux entre nous et Israël sont aujourd'hui de un … trois, ils seraient de un … cinq en cas de paix, car l'Etat hbreu pourrait mettre la main sur l'économie arabe." This quotation amply demonstrates that concerns for relative gains do not simply reside in the imaginations of academics.

Ongoing national security concerns will not be eroded by economic interdependence. Indeed, as we have seen, under some conditions economic exchange might exacerbate national security concerns, resulting in outbreaks of violence. Even at thresholds far below this, the normal workings of the security dilemma might provoke war.  


93 The logic of the security dilemma is that actions taken by one nation explicitly to bolster its own security might be perceived by an opponent as aggressive measures threatening its security. The resulting spiral of actions might then produce a war that was not intended by any parties to it. See Robert Jervis, "Cooperation Under the Security Dilemma," World Politics 30 (January 1978): 167-214; and Janice Gross Stein, "The Security Dilemma in the Middle East: A Prognosis for the Decade Ahead," in Bahgat Korany, et. al., eds., The Many Faces of National Security in the Middle East (New York: St. Martin's Press, 1993): 56-75.
envisioning a peaceful, post-national security world, we should be devising institutions and arrangements that will transform national security concerns into a world in which inevitable conflicts of interests are contained within manageable boundaries.

Let me address this point from another perspective. For at least two decades, an implicit plank of American foreign policy in the Middle East was that a comprehensive peace in the Middle East was not possible due to the high levels of mistrust in the region. American policy was based upon aiming for second-order, confidence-building measures that would build confidence and momentum with which to attack less tractable issues. This position also explains the tremendous weight attached to symbolic moves like Sadat's trip to Jerusalem in 1977.

That strategy has much to recommend it, but it could easily have adverse consequences. Increased economic contact might have the result of facilitating subsequent negotiations over substantive issues. It is just as likely, however, that until all outstanding issues are settled, economic contacts will be looked upon with suspicion, increasing the likelihood that states will view economic interdependence through the lens of relative gains. Promises of economic gains cannot be used to lubricate negotiations over security issues; promises of economic gains have to follow from the resolution of security issues. If not—if states view their trading partners as pursuing aggressive trade policies as a substitute for war or a prelude to it—economic interdependence simply will not produce peace.

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94 The idea that the Middle East conflict was not ripe for resolution was explicitly made part of American policy in a policy statement of President Bush's "Presidential Study Group, headed by Dennis Ross. See William B. Quandt, Peace Process (Berkeley: University of California Press, 1993), pp. 385-386.

95 Did that trip really provide the psychological breakthrough claimed for it? The results of the December 1977 Isma‘iliyya summit and the long negotiations that followed suggest that after the psychological walls fall, conflicts of interest around real, concrete issues, remain.
Conclusion

In this essay, I have addressed the argument that the creation of a liberal economic order in the Middle East will produce both prosperity and peace. I have suggested that this position is based upon the deliberate containment of politics by new economic arrangements. And yet, in examining the three stages of the liberal argument--the creation of a liberal order, achieving prosperity, and managing inevitable conflicts of interest--I have suggested that not only do liberal economics not supplant political arrangements, but they are predicated upon those arrangements. Liberal international orders are based upon particular political conditions, namely the existence of an economic hegemon, willing and able to undertake unilaterally the costs of maintaining an open system; successful economic development may, in most cases, require far higher levels of state economic activity then imagined by orthodox economics, albeit state intervention of an emphatically different nature than that which is so prevalent in the contemporary developing world; and peaceful international economic relations are based upon prior security arrangements that reduce the incentives for states to view the economic gains made by their partners with fear.

The conclusion I have drawn from this discussion is that we have to stop hoping for a post-political, post-security world. Instead of drawing sharp dichotomies between politics and economics, states and markets, and economic interdependence and national security, we have to begin to investigate the subtle and complex ways in which these phenomena interact with each other, in order to devise new institutional arrangements that produce positive spillover effects for both politics and economics. I believe that the desire to cooperate on behalf of mutual interests is widespread in the Middle East. But until we recognize how potentially difficult it is to realize that cooperation, we shall continue to overlook the domains of human activity that may be necessary to replace discord with collaboration.