

# A Road Map to Middle Eastern Peace? - A Public Choice Perspective

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\*I have received useful comments from Bryan Caplan, Nathaniel Paxson, Matthew Stinson, Alex Tabarrok, Gordon Tullock, and commentators from the Volokh Conspiracy blog.

Why is peace between the Israelis and the Palestinians so difficult to achieve? Does Bush's "road map to peace" stand a chance?

To address these queries I will step back and ask some fundamental questions about war and conflict, from a public choice point of view. I will consider why we have wars in the first place and why countries negotiating for peace often fail to capture gains from trade. Commentaries on the Middle East, or many other questions of foreign policy, typically look at the trees rather than the forest. Being an economist, I do not seek to match the institutional expertise of a historian or Middle East scholar, but instead focus on some basic conceptual matters.<sup>1</sup>

### Trade and the Coase theorem

For an economist, the central question in any foreign conflict is why the Coase theorem does not hold. The Coase theorem suggests that war should be unlikely. Rather than fighting, the two sides could strike some mutually advantageous bargain. After all, the relevant parties could live at peace with a higher standard of living and fewer deaths. Or if the would-be conflict is truly lopsided, one side should surrender rather than fight.<sup>2</sup>

With this in mind, let us consider why the Coase theorem might fail to hold, with some speculation as to how those reasons might apply to international conflicts. Keep in mind throughout that conflict, not peace, has been the more common condition throughout human history.

### Transactions costs

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<sup>1</sup> Since commentary on the Mideast is so fraught with controversy, let me state some of my starting points up front. I am a strong believer in a market economy, and in Western civilization. My foreign policy instincts tend to be dovish, in recognition of the imperfections in governments, but I am not, like some libertarians, in principle opposed to American intervention abroad. I am not religious, and the Middle East holds no special theological significance for me. I have followed events in the region, and read widely on its history, but have no literacy in either Hebrew or Arabic.

<sup>2</sup> For perspectives on the Coase theorem and foreign affairs, see Friedman (1977) and Cowen (1990). For a general treatment on the causes of war, see Blainey (1988).

The classic rejoinder to the Coase theorem notes that transactions costs often are high. If the two parties cannot get together to trade, no bargain can be struck. In the case of the Middle East, however, this does not appear to be the fundamental problem. The parties to the conflict have the option of meeting frequently.

#### Lack of binding enforcement or commitment

The Coase theorem can fail if the two parties cannot write binding contracts. Poland, for instance, could not have paid off Hitler not to invade. Hitler could have taken the money, and then broken his promise and invaded anyway.<sup>3</sup>

This problem is a real one, but it is not obviously central to Israel and the Palestinians. First, if the parties really do face a mutually advantageous agreement, an outside party may be able to enforce the deal. Arguably the United States has fulfilled this role with Israel and Egypt, including the necessary side payments. Second, "tit-for-tat" behavior often substitutes for a literally binding contract. Yet the history we observe in the Middle East does not match the model of parties trying to cooperate around a mutually beneficial tit-for-tat game.<sup>4</sup>

#### Infinite compensating variations?, or not everyone wants peace

Trade can be difficult when the parties are unwilling to make marginal trade-offs. Many people, for instance, would not give up their ideals, their country, their family, or their religion for any amount of money. Many parties may feel this way about Jewish settlements on the West Bank, the status of Jerusalem, or the "right of return" for the

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<sup>3</sup> Fearon (1995) considers related issues.

<sup>4</sup> It might be argued that the parties are stuck in a tit-for-tat equilibrium, with alternating punishments, based on disagreement about which side was first to defect from cooperation. In this case, however, a single round of cooperation or compromise should restore cooperation, which is not what we find. Alternately, at least one of the parties might be using an infinitely long trigger strategy, but that still would require explanation, given the obviously destructive results.

Palestinians. Almost everyone wants peace on his or her terms, but for many sets of preferences the offer curves do not intersect.<sup>5</sup>

The values need not always be infinite in importance. Sometimes the compensation variation will be infinite (or undefined) because the parties do not like the idea of paying cash for certain values, or do not like the idea of trading those values through a more complicated form of barter. Perhaps many Palestinians feel this way about the right of return. The right of return is not literally of infinite value to them (suicide bombers aside, most of them will continue to live without such a right). Yet at the same time they may be unwilling to trade away that right, as they do not like the idea of selling their perceived birthright.

In some cases the value itself is incompatible with the idea of trade. Many people want respect, for instance, but by its nature respect cannot be traded.<sup>6</sup> A bought respect is no respect at all, and the gains from trade model will fail in cases of this kind.

That being said, while this problem is a real one, it is unlikely the fundamental obstacle to peace. First, even if many Israeli and Palestinian citizens hold such infinite values, leaders and decision-makers tend to be more pragmatic and flexible. Most Israeli and Palestinian politicians have changed their minds and public pronouncements more than once; witness Sharon's recent admission of the Israeli "occupation" of Palestinian territory, an expression he never would have used until recently.<sup>7</sup>

Second, there is arguably a "silent middle" among both the Israelis and Palestinians that favors peace above such partisan ends. The strength of this middle, combined with the pragmatism of leaders, would enable a peace agreement, even if a minority were to engage in terrorism in response.

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<sup>5</sup> Fearon (1995) considers this logic as well. But note that it does not suffice to argue "party X desires the destruction of party Y," as long as party X remains willing to make trade-offs. For instance perhaps I desire to enslave the rest of mankind, but in the meantime I trade with others.

<sup>6</sup> Thomas Friedman (1990) stresses the Palestinian desire for respect.

<sup>7</sup> The Ayatollah Khomeini is reputed to have said he would rather drink poison than sign a peace agreement with Saddam, yet he did.

Third, the general citizenry is often quite flexible, as time passes, as to what is possible and what is unacceptable. Both Begin and Sadat took steps that were once radical, perhaps regarded as "unthinkable," but rapidly became an accepted part of the status quo. The Palestinians today care greatly about Jerusalem, but as late as the mid-1970s did not devote much attention to the issue. Much earlier the conquest of Jerusalem by the Christian crusaders was met largely by Muslim indifference (Wasserstein 2001, pp.11, 250).

For these reasons, infinite compensating variations may be an exacerbating factor, when other preconditions for peace are not present, but I do not regard them as the fundamental reason why no bargain is struck.

So having downgraded some potential explanations of conflict, let us move to more plausible contenders.

### Reputation

Parties to conflict often invest in tough behavior to build up a reputation. They face a broader game than the particular struggle before our eyes. This broader game may involve future dealings with the current disputant, or may involve future dealings with other parties. In this case, it is often more important to stand tough than to cut a deal, even a fair deal.

Under this hypothesis, the difficulties in the Middle East resemble the difficulties in many marriages. We might ask if the Coase theorem is so applicable, why is the divorce rate so high? Why are so many marriages, whether they end in divorce or not, so acrimonious? For that matter, why do parents and children bicker so much?

Married parties bicker, in part, because they are concerned with their future share of the cooperative pie. For instance, assume that a husband and wife consider an agreement on some matter of dispute, but the husband would receive only an epsilon of the resulting

cooperative surplus. The husband might prefer to hold out and stop the agreement, even if he otherwise gets nothing at all. If the husband agrees to only an epsilon of surplus today, he is weakening his bargaining power for the future. Why not turn down today's epsilon for some chance of a greater share in the future? The wife of course may feel the same way. Even a fifty-fifty deal may meet with resistance. After all, why take fifty percent today, when you have some chance of getting ninety-nine percent tomorrow? So the two will bicker rather than settling all of their disagreements. Here the difficulty arises precisely because there will be future transactions, and not because transactions costs are too high (in fact we might get a better outcome if trading costs eliminated the possibility of future transactions). Similarly we get a bad outcome precisely because future gains from trade are high.<sup>8</sup>

Such a logic might apply to the current conflict. The parties could, in principle, reach an agreement today. And perhaps that agreement could be enforced. That being said, the two parties may try to hold out for a higher share of the total surplus. In the process both will act so as to shrink the total surplus available.

Note that this mechanism, taken alone, places a limit on how bad things can get. Return to the marriage analogy. No party will find it worthwhile to seize so much surplus that the other party walks away from the relationship, assuming that gains from trade remain in principle. But in the political context, total divorce is not so easy. We cannot imagine either the Palestinians or the Israelis moving en masse to Nebraska, so it is harder to define the relevant threat point for walking away. The mutual difficulty of walking away, however, tends to lower expected levels of cooperation, rather than to raise them.

### Nested games

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<sup>8</sup> Or to put the point in other terms, the discount rate may be too low rather than too high. Conflict also tends to be worse when the number of plays is repeated and the parties know each other's identities. We are typically taught that these game features encourage cooperation (Axelrod 1984), but such an optimistic prognosis would be premature.

The marriage analogy illustrates only the intertemporal aspect of the problem. Both the Israelis and the Palestinians face a game with several potential opponents, not just each other. So the necessity to stand tough is greater. Both the Israelis and Palestinians have had to deal recurrently with various Arab nations, and not always on very friendly terms.<sup>9</sup> So each group may be investing in a reputation for toughness, again with an eye on its overall reputation with other parties.

More generally, the Israelis and Palestinians are far from united parties, but rather face internal conflicts about how to deal with the other side. We can see numerous games being played simultaneously: Israel and the Palestinians, Israeli politicians with Israeli voters, Israeli moderate politicians with Israeli extremist politicians, Israeli politicians with West Bank settlers, Hamas with Arafat, Abbas with Arafat, Abbas with Hamas, the Palestinian citizens with each leader, and so on. Various parties are involved in playing a game with the United States as well.

The resulting meta-game is too complex to allow for a simple solution or characterization. Nonetheless the nested or embedded mini-games may constrain the actors from settling the larger Israel-Palestinians game. For instance, Palestinians who defect to a peace movement face the risk of assassination from the more radical factions of the pro-Palestine movement. They may be safer confronting the Israelis than negotiating. Similarly, an Israeli politician who offered too easy a peace would lose support from the more extreme religious factions in Israel, and perhaps lose power in the process. In essence, various parties can shift the risk of their "defect" strategies onto other parties, at least for some period of time.<sup>10</sup>

### Behavioral economics

The standard economic model suggests that people are rational, and capture all available gains from trade. Yet this central postulate of economics has come under increasing

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<sup>9</sup> Recall that before the 1967 war the lands currently requested by the Palestinians were in Arab hands, and were not turned over to the Palestinians for the purpose of constructing a Palestinian state.

<sup>10</sup> Tsebelis (1990) offers a general analysis of nested games.

question. In a variety of contexts people appear to turn down gains from trade, instead following some (faulty) psychological model of how the world works.

For instance, economists have long wondered why there is involuntary unemployment in relatively free labor markets. Rather than laying off workers, why do employers not negotiate downward wage reductions with their employees? At a lower wage the employer could afford to keep the worker, and the worker would rather have less pay than no job at all. In other words, why not use gains from trade to solve the unemployment problem, just as we might use gains from trade to solve the peace problem?

Related questions have commanded an enormous literature, but we understand at least one reason why such wage reductions do not take place. Employers fear that workers, after their nominal wages are lowered, will engage in sabotage and uncooperative behavior. It is then better to fire the worker than keep him around.<sup>11</sup>

The relevance to international peace is clear. When people are forced to accept agreements that give them less than they had once expected, or less than what they feel they deserve, they sometimes behave very badly. Often they behave so badly that the other party will be reluctant to offer the agreement in the first place. Or each party may refuse the agreement out of spite. Rather than offering agreements with the equivalent of "wage cuts," both the Palestinians and Israelis (or at least one side) may prefer to have no bargain at all.

Returning to the labor market context, many workers will quit once they receive a nominal pay cut. In similar fashion, peace negotiators (or more generally the citizenries that employ them) may walk away from the bargaining table when they are hit with an unpleasant shock. Evidence from experimental economics shows a strong tendency to

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<sup>11</sup> Economists engage in long debates over whether this kind of behavior is rational (see the discussion of repeated games above, for an account of how it can be rational, although of course it need not be, we observe this behavior in many short horizon games as well). In any case the behavior appears to be present, whether it is rational or not, see Blinder (1998) and Bewley (1999) for evidence. For a more general treatment of the "economics of enmity," and its relation to the Coase theorem, see Farnsworth (2002).



"punish cheaters," even when the behavior is self-destructive. We may be emotionally or biologically "programmed" to react in this fashion, whether or not it is rational in each particular instance.<sup>12</sup> And of course various historical and religious beliefs can shape a context that makes these reactions even less rational.

The literature on behavioral and experimental economics tries to isolate exactly which sorts of adverse changes set off destructive reactions. Workers, for instance, seem to mind small nominal pay cuts more than they mind small real wage cuts. Or a nominal wage cut offends less if it can be described as "fair," or if it is seen as part of an overall process affecting everyone's compensation. Many of these results are context-dependent rather than general, nonetheless they suggest that the degree of resistance will depend on packaging and symbolic values. It also suggests that experimental and labor market research may teach us something about the causes of war.

Note that terrorism interacts with behavioral factors. Imagine the Israelis and Palestinians moving toward some kind of peace agreement, whereby each side offers some painful concessions to the other. Just as each side is trying to accept what it must give up, some form of terrorism strikes. A Palestinian, for instance, might blow up a bus in Jerusalem. This kind of behavior makes it harder for the Israelis to accept their "wage cut" as they will feel more aggrieved than before. Terrorists, knowing this, may choose to strike at precisely at these times and aim to reopen the appropriate wounds, all to prevent peace.<sup>13</sup>

We might, at this point, be wondering why the Israeli-Palestinian relationship is more fraught with conflict than are most neighborly relations.<sup>14</sup> Here the behavioral implications of previous history play a role. Each party believes that the other has violated its rights repeatedly, and thus holds great suspicions.

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<sup>12</sup> See Glaeser (2002, pp.10-11) on these points. For instance when individuals play "ultimatum" games, they spitefully punish those people who try to take more than their "fair share," even when that punishment lowers the overall return of the punisher.

<sup>13</sup> Note that many terrorists make their living, and receive their funding, only when conflict is present. Congleton (2002) considers the economics of suicide missions.

<sup>14</sup> The factor of intertemporal reputation cannot explain this; taken alone it would suggest that the United States and Canada, or the various nations of the European Union, fight all the time.

### Lack of meta-rationality

The concept of meta-rationality refers to having a realistic assessment of one's prospects and abilities. Yet individuals are rarely meta-rational. For instance, most people believe that they are better drivers than are most others, or have better values than most others, yet we cannot all be above the median. Many people also refuse to defer to experts on various scientific matters, even when the expert has superior training and intelligence. Many experts believe their chances of winning a Nobel Prize to be far greater than they are, and so on. They simply refuse to recognize the relevant realities.<sup>15</sup>

Parties to war and conflict are unlikely to be meta-rational.<sup>16</sup> We do not know why, but non-meta-rational behavior tends to be especially prominent in certain areas. For instance, people tend to have especially stubborn and irrational opinions in the areas of religion and politics. Large numbers of people think they are the world's best judges of truth in this area, but few people have comparable opinions about their relative expertise in building bridges, or in thermodynamics.

Given this tendency, peace negotiators may expect the other party to defer to their positive view of the world. The Israelis will overrate their ability to judge what will work, and the Palestinians will do the same. The general tendency is to think that what benefits one's own interest also benefits the world at large (Klein 1994, Cowen forthcoming). The two parties will then find it hard to agree, since they do not share the same positive vision of how the world works. Note that only one party need lack meta-rationality for an agreement to be hard to strike.

### Summing up, in a nutshell

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<sup>15</sup> Cowen and Hanson (2002) survey the relevant evidence. Note that non-meta-rationality need not be a mistake. Psychological evidence shows that meta-rational people tend to be depressed rather than happy (Taylor 1989).

<sup>16</sup> In the context of war, Fearon (1995), Gartzke (1999), and Wagner (2000) all consider private information as a cause of conflict rather than settlement. But in the absence of non-meta-rationality, parties overcome private information simply by sharing their information and striking a deal.

Writing from my outsider's perspective, an economist might tell the following game-theoretic "just-so story" about the Israeli-Palestinian conflict. The two sides are locked into a long-run bargaining game, which leads them to struggle for power at each step along the way. Nested games and behavioral factors make it difficult for the parties to make the mutual sacrifices required for an agreement. Furthermore neither party is meta-rational about the points of disagreement. On top of those problems, the minority that does not want peace at all takes actions to exacerbate adverse behavioral and psychological reactions; we can understand terrorism as an attempt to manipulate such behavioral weaknesses. Periodic retaliations from each side then raise the stakes in the long-run bargaining game, and ratchet up the difficulty of earning subsequent concessions from the other side, thus making peace difficult.

Again, I do not pretend to have the kind of evidence for this just-so story that a historian or Middle East scholar would expect. It is simply one way that an economist trained in game theory might view the core problem. It is a set of analytical categories for classifying what we read in the daily newspapers.

That being said, let us proceed with this just-so story on a tentative basis, and see what it implies about Bush's recent "road map."

### Bush's "road map"

In game-theoretic terms, how should we envision Bush's road map? Let us define that road map broadly, so as to include the invasion of Iraq, and the broader exercise of American power in the region.

I view Bush's road map as comprised of the following elements: 1) Signaling an American commitment to guarantee Israeli security against foreign invaders, most of all from Saddam Hussein but not exclusively so, 2) Insistence that Israel limit settlements on the West Bank, 3) Insistence that Israel recognize some form of a Palestinian state, 4) Insistence that the Palestinian authorities crack down on terrorism, 5) encourage

Palestinian democratization, and 6) postponement and obfuscation on some key issues, such as right of return and the status of Jerusalem.

The question is whether these policies will allow the Israelis and Palestinians to reach a stable, ongoing agreement. The case for optimism runs something like the following: the renewed American commitment to Israeli security makes it easier for the Israelis to make concessions to the Palestinians. The Israelis now know all the more, that in the long-run bargaining game, America truly will not tolerate fundamental threats to their security. Limiting West Bank settlements, and precommitting to a Palestinian state, arguably removes these questions from the future bargaining table. With less at stake in the future, current bargains might be easier to make. Furthermore, a Palestinian crackdown on terrorism might make the Israelis more willing to deal with the Palestinians. It may not stop or even limit terrorism, but at least the Israelis will feel that the terrorists are not the same people they meet at the bargaining table, again rendering an agreement easier. Palestinian democratization may ease some of the nested games, and make Palestinian leaders more accountable to their citizens. Postponement of some issues, such as right of return, reflects their insoluble nature at the current time. Perhaps those issues can be readdressed more fruitfully at some point in the future, once cooperative relations have been built up more successfully. At that point today's "political impossibility" may become tomorrow's "political reality." The Bush view, however, is to push ahead with the rest of the peace plan now regardless of the remaining (currently) insoluble elements.

So we can at least outline an "existence theorem" under which Bush's road map will work or at least will improve matters. Given an economist's view of the matter, the Bush plan at least tries to address the underlying problems.

That being said, we have no guarantee that the Bush plan will work. The Israelis may not feel enough extra security in the long run, knowing that a Bush presidency will not last forever. Both sides will still wonder whether, when push comes to shove, Bush will stand up to his right-wing Christian constituents and stay tough in opposition to West Bank settlements. Is the United States, given its domestic political realities, truly up to

the role of playing enforcer? Will the unsettled nature of the right of return question simply keep the whole long-run bargaining game open, thus motivating more non-cooperative behavior? Do the Palestinians have the ability to sustain a democratic culture? And finally we do not know just how many people in each camp truly desire peace.

The case for pessimism becomes stronger when we look to the past. Many previous peace attempts have failed, and the problem seems to be getting worse over time, not better. It is shocking, for instance, to read Milton Friedman's 1969 commentary on his visit to the West Bank: "Much to my surprise, there was almost no sign of a military presence...I had no feeling whatsoever of being in occupied territory...This wise policy [of the Israelis] involved almost literal laissez-faire in the economic sphere...To a casual observer, the area appears to be prospering." No one, no matter how naïve, could write such a commentary today.

### Broader lessons

Whether or not our understanding of the Israeli-Palestinian conflict can draw from public choice, I hope that public choice can draw from our understanding of the Israeli-Palestinian conflict. It serves as a more general example of why politics is not efficient, and why it is so hard to strike good political bargains. The Chicago school is overly optimistic when it applies the Coase theorem to politics. The Coase theorem is a useful foil for figuring out why efficient political bargains are so problematic, but it is not a good description of the real world. We do have unemployment and strikes -- not to mention wars and totalitarianism -- all because the Coase theorem does not describe the world we live in.

That being said, we can also see a possibility for reform and for political improvement. If the true problems are game-theoretic in nature, wise leadership can have a disproportionate impact on the world. Given that the Bush road map is already in the works, let us watch eagerly and hope for the best.

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