Chapter Nine

A Market-Capitalist or a Democratic Peace?

Michael Mousseau

"History has proven," said George W. Bush, "that democracies do not fight their neighbors," aping his predecessor, Bill Clinton, who claimed that they "don't attack each other."[1] Yet history has not been kind to this view; just as the Clinton administration began promoting democracy as a strategy for global peace in 1993, the first clear-cut war between two democratic nations began: the Kargil War between India and Pakistan, initially a dispute that eventually escalated to war in 1998. Nor has the accumulating evidence been kind to the democratic peace. Studies have shown that a capitalist peace may supersede the democratic one, and that it is far more substantial; while the democratic peace achieved fame with its claim of an absence of wars between democratic nations—with "wars" defined as militarized conflicts with at least one thousand battlefield-connected fatalities—the capitalist peace can boast an absence of any battlefield-connected fatalities among capitalist nations (Mousseau 2009).

This chapter reviews the literature on a capitalist peace and explores the prospect that the capitalist peace may supplant the democratic one. Earlier chapters in this volume by Sara McLaughlin Mitchell and Douglas Gibler have covered important events and challenges in the democratic peace research program, so this chapter begins with what may be the next stage in this research program: the capitalist peace. Two kinds of capitalist peace theories are distinguished: free-market theories equate "capitalism" with freer markets and are in the neoclassical liberal economic tradition (Weede 1996, 2005; Gartzke, Li and Boehmer 2001; McDonald 2007, 2009); social-market capitalist peace theory suggests that advanced capitalism may be a product of state intervention (Mousseau 2000) and has roots in traditional critiques of the liberal tradition (Polanyi ([1944] 1957). The divergent causal mechanisms of the capitalist peace theories are then applied to the case of the Falklands/Malvinas War fought between

Argentina and Great Britain in 1982. This case shows considerable discrepancy among the theories on the meaning of "capitalism." The subsequent section finds that only the social-market definition of "capitalism" has the potential to account for what most observers usually think of when they think of "capitalist peace": the peace among the wealthy democracies of Europe, North America, and the Pacific Rim. Finally, the insignificance of the democratic peace is corroborated: from 1961 to 2001 about half of all democratic nation years did not have advanced capitalist economies, and these democracies had their normal share of deadly conflicts; the advanced capitalist nations, in contrast, had none.

The implications of the capitalist peace are far from trivial. The democratic peace drew widespread attention when it emerged a generation ago in part because it presented itself as the foremost stylized fact of international politics. It thus offered the most promising clue for scholars seeking to crack the puzzle of war. If the capitalist peace subsumes the democratic one, then scholars of war must revise their research bets: rather than explore how governing institutions might affect war and peace, we must set our sights on economic institutions.

CAPITALISM, DEMOCRACY, AND WAR

Comparative research has well established that wealth and democracy correlate (Lipset 1959), so early investigators of a democratic peace—the observation that democratic nations rarely fight each other, even though they frequently fight other nations—were careful to examine the possibility that economic factors might account for it. Influential studies by Stuart Bremer (1992) and Zeev Maoz and Bruce Russett (1992) tested for wealth as a potential confounding variable; yet both found democracy significant even after controlling for development. Later Russett and colleagues tested for international trade (Oneal et al. 1996), finding that it too did not overturn the democratic peace, and then launched a series of highly influential studies identifying what they called a "Kantian peace" of democracy and trade, named after eighteenth-century philosopher Immanuel Kant (Russett and Oneal 2001).[2] Russett and Oneal (2001) firmly placed their research program in the classical liberal tradition, arguing that the benefits of trade reduced the gains from conquest, and the impacts of democracy and trade on peace were *complementary*: each factor contributed to a decreasing probability of militarized conflict among nations.

A complementary relationship must be contrasted with a confounding one. In a confounding pattern, the third variable is offered as accounting for the second as well as the dependent variable (Blalock 1979: 468–74). Whereas Russett and Oneal offered trade as *complementary* to the democratic peace, Erich Weede offered it as *confounding* (Weede 1996), dubbing the impact of trade on democracy and peace a "capitalist peace" (2005). In the tradition of Weede, and in contrast to Russett and Oneal, most theories of capitalist peace posit capitalism as a confounding variable in the democratic peace—a factor that may render the impact of democracy on peace spurious.

There are two main kinds of capitalist peace theories. Free-market theories equate "capitalism" with freer markets and link peace with trade (Weede 1996, 2005), fewer regulations on foreign investment (Gartzke et al. 2001), or smaller government (McDonald 2007, 2009). Social-market capitalist peace theory, in contrast, defines a "capitalist economy" as one where most citizens regularly use the market for jobs, goods, and services, and does not equate capitalism with less regulated markets or smaller government (Mousseau 2000). The two kinds of capitalist peace theories also have quite divergent core assumptions: free-market theories tend to have roots in classical and neoclassical liberal theories of politics and economics, such as Norman Angell (1911) and Friedrich Hayek (1989), and the neorealist bargaining theory of war (Fearon 1995), which assumes an anarchic and inherently competitive world. Social-market theory, in contrast, is more closely rooted in Karl Polanyi's ([1944] 1957) critique of neoclassical liberal theory and treats preferences, anarchy, and conflict endogenously.

Free-Market Theories of Capitalist Peace

The Trade Model

The correlation of economic development with stable democracy is well established (Lipset 1959), and neoclassical liberal theory has long claimed that free markets promote economic development (Hayek 1989) and, as such, increase the incentives for peace among nations (Angell 1911). Linking the two trends, Erich Weede offered that since trade may promote both peace and development, trade might account for the peace among democracies (1996, 2005). The state of evidence has not been kind to this viewpoint, however. Economic development does not appear to be highly correlated with trade (Mousseau 2010: 186), and democracy remains a significant force for peace after consideration of it (Russett and Oneal 2001).

The Capital Openness Model

To explain the peace among the wealthy democracies (Mousseau 2000), Gartzke (2007) offered the existence of what he called three "pillars" of "capitalist peace": development, foreign policy preferences, and openness to foreign investment. However, only the third pillar of capital openness, originally explicated by Gartzke, Li, and Boehmer (2001), is actually "capitalist" by most definitions of the term, and most attention has been focused here (e.g., Dafoe 2011; Dafoe and Kelsey 2010).[3]

Gartzke and colleagues (2001) showed how open capital markets can avert war. Because investors see risks in war, a nation on the brink of war with open capital markets is likely to face capital flight. Leaders in a dispute that bear this loss of capital thus signal their resolve, yielding information for adversaries with which they can choose to back down. In fact, it seems that interstate dyads with higher levels of capital openness are less likely to have militarized conflicts (Gartzke et al. 2001). Gartzke has also reported the democratic peace as insignificant after controlling for his three "pillars" (2007), but this result has been shown to be erroneous (Choi 2011; Dafoe 2011). It is also unlikely that capital openness might explain the democratic peace because neither Gartzke nor anyone else (to my knowledge) has shown how capital openness might cause democracy. Absent some explanation for how a third factor (capital openness) might explain the second (democracy), we cannot interpret a relationship as confounding because our observation could just as well be a result of reverse causation, with democracy causing capital openness (Blalock 1979: 474).

The Public Sector Model

The bargaining theory of war has shown that, under certain conditions, a dispute will escalate to war if, among other things, there is a lack credibility of commitments to peace (Fearon 1995). If nations in dispute could somehow improve their credibility, war could be averted. Patrick McDonald (2007, 2009) has shown how governments whose revenues are comparatively dependent on domestic taxation may have more credibility than those more dependent on revenues from the public ownership of property. Governments of nations with large portions of their economies owned by the state are less dependent on raising taxes to wage war and thus may be less constrained by their publics from waging it. If all foreign policy decision makers know this, the commitments of nations with smaller public sectors should be more credible than the commitments of those with larger ones. In fact, it seems that nations with large public sectors are more likely than others to have militarized conflicts (McDonald 2007, 2009). McDonald (2009) claims that his capitalist peace is stronger than the democratic one, though it does not fully account for it.

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The free-market theories of capitalist peace share several characteristics. First, all equate "capitalism" with free markets and adopt—sometimes only implicitly—the economic liberal assumption that smaller government, lower taxes, and deregulation cause economic development (Hayek 1989). Weede assumes that free trade and development are strongly linked (1996); Gartzke seeks to explain "the absence of war among states in the developed world" (2007: 166); and McDonald introduces his private sector peace with reference to entering the debate linking peace with "modernization and economic development" (2007: 569).

Second, all of the free-market theories of capitalist peace are firmly in the mainstream neorealist/neoliberal tradition in the study of international relations that treats anarchy exogenously and assumes an inherently competitive world where states are the primary actors. Because war is costly, liberals assume war does not pay and thus explain the fact of war as occurring by mishap, resulting from weak information or an inability of nations to credibly commit to peace (Fearon 1995; Keohane and Martin 1995). In this way capitalist nations are assumed to be in perpetual conflict like everybody else; they are just better at avoiding militarized conflict because with trade the cost of war is greater than its gains (Weede 1996), free markets signal resolve (Gartzke et al. 2001), or small public sectors make the commitments of nations more credible (McDonald 2007). Violence is averted not because of common interests but because it is not profitable, and free markets make this calculation clear to all. As we will see below, the social-market model of capitalist peace makes none of these assumptions.

Social-Market Theory of Capitalist Peace

One of the primary weaknesses of realist and liberal theories of international relations is that they treat preferences exogenously. Since actors—states and citizens—are assumed to want the same things (whether it is money or security), variance in war and peace tends to be explained by such things as miscalculation, misinformation, and mistrust rather than divergent preferences. Economic norms theory departs from this realist-liberal tradition in the field of international relations by identifying how preferences can vary among states and individuals, and how these divergent preferences can explain war and peace. This is achieved by drawing on the well-known fact of two kinds of economies in history—contract intensive and contract poor (Polanyi [1944] 1957; North, Wallis, and Weingast 2009)—and deducing bounded norms from these divergent socioeconomic ways of life (Simon 1955). In so doing, economic norms theory shows how the neoliberal viewpoint—that war is not rational—may apply only within and among contract-rich societies; war can be quite rational among contract-poor nations and between contract-rich and contract-poor ones.

By definition a contract-rich economy is one where most citizens normally contract with strangers in the market to obtain their incomes, goods, and services. In contract-poor economies, in contrast, citizens are more dependent upon favors reciprocated among friends and family. The primary insight of economic norms theory is that because bigger and wealthier markets offer more opportunities to contract compared with smaller and poorer ones, citizens in contract-intensive economies must have common interests in each other's equal rights (to contract) and welfare (to buy things). They must also have an interest in the government ardently protecting free choice in contracting, at home and abroad, and their government continuously doing whatever it takes to promote market growth, at home and abroad. The latter can include government spending and redistribution policies, as well as foreign aid. To trust strangers in contract, citizens also have an interest in their government enforcing private contracts and the rule of law reliably and impartially. As a result, in contract-rich socioeconomies, the liberal democratic rule of law is legitimated from below.

While many theories of democracy assume that preferences for equal rights, the impartial rule of law, and economic growth are inherent and universal, economic norms theory identifies how these preferences may be *learned* in a contract-rich economy. In a contract-poor economy, individuals are far less dependent on an impersonal market than they are on good relations with friends and family, who are in turn linked with various groups. Citizens thus have interests not in the welfare of strangers but in the welfare of their groups. Organized along patron-client lines, groups can take a variety of forms, including neighborhood associations, gangs, mafias, labor unions, religious sects, political parties and movements, ethnic groups, tribes, and clans. Clients rely on the goodwill of patrons for physical and economic security, as patrons distribute these securities according to the level of loyalty of each client. Patrons, in turn, look to the state as they seek physical and economic security for their clients. Because a gain in state rents for one group is necessarily a loss for another, groups are in constant conflict over distributive gains, and this may explain why contract-poor states are often weak, corrupt, and dysfunctional (Mousseau 2002–2003: 2012).

Within and among contract-rich "capitalist" nations, wars cannot happen because it requires the harming of others, and citizens in these economies are always better off when others in the market are better off: there is not much opportunity to be had from those who are dead or poor. Since each nation's economic growth contributes to a larger global marketplace, and citizens reward and punish their leaders according to how well they produce market growth at home rather than according to how well their economy is growing relative to other nations, there are few relative-gains concerns within and among contract-rich nations. In fact, because all are better off with a stronger rather than weaker global economy, compared with contract-poor nations, contract-rich nations easily cooperate on trade issues and on the defense and promotion of global law and order.

In contract-poor political economies, in contrast, war, civil and foreign, can be rational. Because citizens are loyal to their groups rather than their states, it is relatively easy for group leaders to organize insurgency and rebellions, and they are obligated to their clients to do so if it appears that their group is not getting its preferred share of state rents. As a result, states are not only weak, but terrorism is also made possible because the terrorizing or genocide of an out-group is a cost-effective means for deterring it from competing over state rents (Mousseau 2002–2003: 2011). Foreign war serves two purposes. First, it can be in the economic interests of the ruling coalition of in-groups, with the cost of war imposed on disenfranchised or repressed out-groups. Second, foreign tensions can help unify disparate in-groups at home, reducing the costs of buying their loyalty or repressing them.

While the economic norms model as presented thus far has assumed instrumental rationality—that citizens identify their interests based on the information available to them in their everyday life—the theory works just as well, perhaps better, with the recognition of bounded rationality. Introduced by Herbert Simon in the 1950s, bounded rationality draws on the fact that it is not rational to be rational; many goals can be reached more efficiently by forming decision-making habits, or heuristics, for situations that arise routinely (Simon 1955). As applied here, individuals routinely dependent on trusting strangers in contract will develop the habits of trusting strangers and preferring universal rights, impartial law, and liberal democratic government. Individuals in contract-poor economies will develop the habits of trusting and caring for others within their in-groups, abiding by the commands of group leaders, and distrusting those from out-groups, including their states. In this way, citizens in highly capitalist economies will perceive an interest in freedom and democracy and promoting these institutions for everyone, even though most, acting on bounded norms rather than on instrumental rationality, do not know why they have these universalistic liberal values. Individuals in contract-poor economies, in contrast, will be comparatively more susceptible to the appeals of those who offer strong in-group identities and warn against the threats of outsiders, even though most, acting on bounded norms rather than on instrumental rationality, do not know why they are susceptible to such fears or why they place such great value in loyalty to their groups and group leaders.

Comparing the Social-Market and Free-Market Models

The social-market theory of capitalist peace, as deduced from economic norms theory, is quite unlike the free-market models. Foremost, "capitalism" is not equated with unregulated markets or small government. A capitalist economy by definition consists of profit-maximizing actors linked in free and voluntary contracts, but this in no way precludes the state from regulating contracts or from propping up market growth with heavy spending. Indeed, rather than advanced capitalism being assumed to emerge spontaneously (Hayek 1989), it is allowed that contract-intensive economy may arise most often when political authorities make the decision to promote and sustain market growth with government spending, redistribution, and regulation. In fact, nations with contract-intensive economies have a long history of government interventionism aimed at propping up their markets (Polanyi [1944] 1957; Gurr, Jaggers, and Moore 1990).

Second, while the free-market models treat preferences exogenously in the tradition of mainstream neorealist and neoliberal theories of international relations, economic norms theory treats preferences endogenously: capitalist citizens and leaders perceive interests in equal law and order; contract-poor citizens and leaders perceive interests in having power over others. Third, while the free-market models are state-centric in the tradition of mainstream neorealism and neoliberalism, the social-market model predicts preferences across levels of analysis, including individuals, groups, and states. Fourth, while the free-market theories define peace negatively, as the absence of militarized conflict, the social-market model defines peace positively, as actual friendship among citizens and states rooted in common interests.

Fifth, perhaps the greatest difference between the models is in their scope. The free-market models are medium- or small-sized theories: they offer explanations for how nations may avoid militarized conflict in a presumed competitive/conflict-ridden world where anarchy is taken as a given. The social-market model, in contrast, deduced from economic norms theory, is a far larger theory of global politics and does not treat anarchy as a given. Economic norms theory informs us that the very concepts of government having a monopoly on violence, the rule of equal law, and even the system of sovereign states are all possible outcomes of the rise of capitalism (Mousseau 2000, 2009).

In this way, economic norms theory is not just a theory of relations among nations; it is a theory *of* international relations. As used to describe contract-intensive economy, “capitalism” means to engage in contracting, with parties enjoying free choice. This is the opposite of imperialism, which means to take through coercion. Just as individuals and firms in capitalist nations need an impersonal, impartial, and reliable enforcer of contracts at home that protects the freedom to contract, in order to trade outside their borders individuals and firms need an impersonal, impartial, and reliable enforcer of contracts in other countries that protects the freedom to contract. Citizens and governments of capitalist nations thus prefer other peoples to have governments that also hold the monopoly on violence, and the very concept of sovereignty as used today—government with a monopoly on the use of force over a geographic space whose legitimacy is recognized by outsiders—may be, like liberal democracy, an epiphenomenon of capitalism.

In contrast, contract-poor orders have relations among actors that are inherently imperial: most everyone is in a hierarchy, with inferiors perpetually owing tribute to superiors in exchange for protection. Sovereignty can have no real meaning because there is little perceived interest in legal equality among units or in the state holding the monopoly on violence. If imposed or influenced from outside, the norm of sovereignty is copied but not internalized. This may explain why the problems of civil and interstate war, terrorism, and failed states plague the developing world, as this region has comparatively fewer contract-rich economies, and, as such, the very idea of sovereignty is widely misunderstood (Mousseau 2012).

This insight is supported in history: most if not all anarchic-like systems of states that have existed—the Classical Greek, Renaissance Italian, and Westphalian European—emerged, and the first two fell, with the rise and fall of capitalism. Today most of the less-developed nations have contract-poor economies, and in many of these the government does not hold the monopoly on violence. Externally, many governments act as clients to more dominant states, offering loyalty to their metropoles or Washington in exchange for financial aid and then distributing this aid domestically on a personalist basis according to degree of loyalty to the ruling in-group. This suggests that efforts to fight corruption in many developing countries are impractical absent a transition to contract-intensive economy.

Finally, the social-market model has accrued a much larger list of successful novel predictions compared with the free-market models. The evidentiary successes of the free-market models have been limited to predicting fewer militarized conflicts among nations that trade (Weede 1996), have open capital markets (Gartzke et al. 2001), and have larger private sector ratios (McDonald 2007). The social-market model has successfully predicted the economic conditionality to the democratic peace (Mousseau 2000), the overturning of the democratic peace (Mousseau 2009), and cooperation (Mousseau 2002) and common preferences (Mousseau 2003) among nations; within nations it has successfully predicted variance in social trust (Mousseau 2009: 61), state respect for human rights (Mousseau and Mousseau 2008), public support for terrorism (Mousseau 2011), and civil war (Mousseau 2012).

THE FALKLANDS/MALVINAS WAR

The centuries-old dispute between Great Britain and Argentina over sovereignty of the Falklands/Malvinas Islands in the South Atlantic escalated to war in 1982 when the government of Argentina forcibly occupied the islands, and the British government responded by sending a naval task force to reoccupy them. The war has been called an enigma to capitalist peace theory, since it was unprofitable for the British (Gomsrud, Gates, and Strand 2009). It is true that the war itself could not have been profitable for either country, but whether it poses a challenge to the capitalist peace depends on what we mean by *capitalism*.

The trade model (Weede 1996) defines *capitalism* as trade dependency—total foreign trade in a dyad divided by a nation's GDP—with high levels of interdependency causing both nations in a dyad to refrain from fighting. Thus whether the Falklands/Malvinas War poses a challenge to this model depends on whether the countries had above-average levels of trade interdependency. In fact they did: the level of trade interdependency in the Argentine-British dyad over the five-year period prior to the conflict (1976–1981) was 0.52 percent, a bit higher than the global mean over this period of 0.25 percent.[4] While this difference is not statistically significant, it is clear that if "capitalist" dyads are defined as having above-average levels of trade interdependency, this is an anomalous case of intercapitalist war. The trade model also assumes that nations will fight only if the gains of war are greater than its costs. Most agree that the costs of the war for the victor, Great Britain, were far higher than the potential gains from this war, which has been described by Argentine poet Jorge Luis Borges as "a fight between two bald men over a comb" (Rees 2006: 98).

The capital openness (Gartzke et al. 2001) model relies on signaling facilitated by open capital markets to prevent war among capitalist nations. Thus whether the Falklands/Malvinas War poses a challenge to this model depends on whether both countries had comparatively open markets. In fact they did: the Argentine-British dyad had significantly fewer regulations on foreign investment than other dyads during the five-year period leading up to the war, and this difference is significant (.05, one-tailed test), meaning that the odds of this result being due to chance are less than 5 percent.[5] Indeed, both governments were pushing deregulatory and free-trade policies at the time of the onset of the war.

Dafoe and Kelsey (2010) offer that the Falklands/Malvinas War offers a specific test of the capital openness model. This is because the long distance from the British Isles to the South Atlantic meant that the British task force could not arrive and actually start the war for several weeks, allowing for a period of negotiation and, given the visibility of the impending conflict, what they call "market-mediated" signaling. Yet while the British bore the economic costs of stock market variability and some decrease in the value of the pound during this period, the Argentine junta, led by Leopoldo Galtieri, seems to have failed to read these as signals of British resolve (Dafoe and

Kelsey 2010). The Falklands/Malvinas case thus appears as an anomaly for the capital openness model.

The public sector model (McDonald 2007) suggests that the commitments of nations with large public sectors are less credible than others, and these nations should be in more militarized conflicts than others. Thus whether the Falklands/Malvinas War poses a challenge to this model depends on whether both countries in this war had comparatively small public sectors. In fact both had large ones: over the five-year period prior to the war, the global average size of public sectors was 11.4 percent; Argentina's was 23.2 percent, and Great Britain's 12.2 percent. Since neither country was capitalist by this definition, the Falklands/Malvinas War does not pose a challenge to the public sector model: neither country's economy could have rendered the foreign policy commitments of their governments particularly credible.

The notion that Great Britain lacks a capitalist economy raises the question of whether the size of the public sector genuinely indicates "capitalism," given that Great Britain is normally thought of as the epitome of a capitalist state. It is also questionable whether lack of credibility played any role in this war, given that most historians would consider the war a function of the lack of indivisibility of the issue involved rather than a lack of credibility of commitments. The war happened not because either country distrusted the commitments of the other; it happened because the countries disagreed on a fundamental issue: the British insisted they could not reward the use of force; the Argentines insisted they must (Freedman and Gamba-Stonehouse 1991).

The economic norms social-market model (Mousseau 2000) of capitalist peace defines capitalism as contract-intensive economy, the condition when many citizens normally contract in the impersonal market to obtain their incomes, goods, and services. Direct data on contracting in life insurance have been compiled under the auspices of the World Bank (Beck and Webb 2003), and a high level of life insurance contracting indicates a highly institutionalized norm of contracting in a society because, compared with most other sectors, to contract in life insurance requires a great deal of trust that the other party will fulfill the terms of the contract after death (Mousseau 2009: 65; North, Wallis, and Weingast 2009: 159).

Table 9.1 lists all nations with above-median levels of life insurance contracts in force over the period of available data from 1960 to 2000.[6] As can be seen, defined in this way the United Kingdom appears to have had a contract-intensive economy throughout this period. Argentina, in contrast, does not appear in the table. While it approaches the median in the year 2000 and may have a contract-intensive economy today, it almost certainly had a contract-poor economy in the 1980s. It thus appears that the Falklands/Malvinas War of 1982 pitted a contract-rich nation against a contract-poor one.

Table 9.1. Nations with Contract-Intensive Economies, 1960–2000

Australia	1960	Austria	1973
Belgium	1960	Israel	1973
Canada	1960	Ireland	1979
Denmark	1960	South Africa	1979
Netherlands	1960	Singapore	1982
New Zealand	1960	South Korea	1983
Norway	1960	Taiwan	1984
Sweden	1960	Spain	1986
Switzerland	1960	Italy	1987
United Kingdom	1960	Cyprus	1988
United States	1960	Portugal	1991
German Federal Republic	1961	Greece	1992
Finland	1963	Chile	1993
Japan	1963	Malaysia	1994
France	1965	Slovenia	1995

Note: Years after 1960 indicate transition years to contract-intensive economy.

Economic norms theory predicts that governments of nations with contract-poor economies have particular incentives in foreign policy. Recall that these governments are often coalitions of in-groups, with each group having some force capability and thus an ability to threaten the state, with state rents allocated among coalition members according to relative power (in democratic contract-poor nations, the ability to use force can be augmented with seats in the legislature). Out-groups, receiving few if any rents, must be repressed by the ruling in-groups. However, some segments of society can be in the middle—neither highly repressed nor bought off with state rents. This stratum often includes a small, frequently urban, middle class, many of whom may not be well connected with any group. This is particularly likely when a nation is in the middle range of economic development, as Argentina was at the time. As a means to hold power, loyalty is far cheaper than repression. Because citizens in contract-poor economies habitually fear outsiders and grant loyalty to their group leaders, the leaders of contract-poor nations have particular incentives for convincing their citizens that their nation *is* their in-group. This is most easily done with nationalist discourse reinforced with foreign tensions.

At the time it initiated the conflict, the Galtieri regime was widely unpopular, with Argentina in the midst of a devastating economic crisis and large-scale civil unrest (Levy and Vakili 1992). Most historians agree that by occupying the islands, the Galtieri regime hoped to gain popularity by drawing on Argentine patriotic feelings, which "dared the Military Government to use force in support of valid national 'aspirations' related to 'territorial integrity'" (Freedman and Gamba-Stonehouse 1991: 4). Considering the poor economic value of the islands for Great Britain, and the great distance involved, the junta calculated that their temporary military advantage could enable a settlement resulting in Argentine sovereignty.

However, the Argentines grossly misestimated how the British would perceive their interests. While sovereignty over the Islands was negotiable, Prime Minister Margaret Thatcher could not be seen to "reward Argentine aggression" (Freedman and Gamba-Stonehouse 1991: 240). This attitude was shared by the United States, another nation with a contract-intensive economy, which desperately wanted to avoid a war, but not at the cost of a settlement that "could be widely read as any kind of significant reward for the use of force" (Freedman and Gamba-Stonehouse 1991: 166).

The Falklands/Malvinas War is entirely consistent with the social-market model of capitalist peace (Mousseau 2000). The war was launched by the regime of a contract-poor nation seeking popular domestic support during a time of crisis. While the diversionary theory of war literature has long emphasized such motives in war making, economic norms theory informs us that contract-poor nations are far more susceptible to this malady than contract-rich ones, particularly when facing internal crises. Indeed, it is hard to recall a case where popular opinion in a contract-rich society can be said to have favored the use of force for "national aspirations" related to "territorial integrity."

Economic norms theory also explains the British decision to fight. While some might think that "capitalist peace" means that capitalist nations are averse to war, economic norms theory makes no such claim. Rather, this theory informs us that contract-rich nations perceive their interests differently from contract-poor ones and, like everyone else, will fight for their interests. Contract-rich nations perceive interests in, and will fight for, global law and order. Readers with contract norms might interpret this goal as idealistic or even altruistic—and thus perhaps not credible—but this is because these readers share the value of law and order. Economic norms theory informs us that not everyone benefits from law and order, and the capitalist nations will fight for it not because they are altruistic, but instead because global law and order lies at the backbone of global markets and thus sustained economic growth at home. I suggest that this is one of the core motivations of the United States and other capitalist nations for rallying the coalition that fought Iraq in the Persian Gulf War of 1991: annexation of a sovereign nation and the taking of its property put at severe risk the countless commitments, contractual and public, that are at the core of the global capitalist economy.

In this way Great Britain fought the Falklands/Malvinas War for economic growth at home, even though the war itself cost far more than any conceivable direct gain from possessing the islands. Indeed, Margaret Thatcher was perfectly willing to negotiate sovereignty over the islands; she just could not be seen to reward the use of force, a view shared by the United States. The important audience that might "see" Britain rewarding the use of force was not the British public; it was the global business community and authorities in contract-poor nations—otherwise why would the United States share the same concern? British and US leaders feared that to be seen rewarding the use of force would signal that taking things by force was allowed, and this could result in major disinvestment from developing countries, a possible collapse of global markets, and ultimately less economic growth at home. No leader of a contract-rich society can lead a war rally cry for preventing an economic recession, but they can rally support for a war on the capitalist principle of not rewarding the use of force, which is a core value in contract culture and which lies at the core of capitalist economics at home and abroad. In this way the British fought the war on behalf of all contract-rich nations, and this is why no contract-rich nation could conceivably side with Argentina in this conflict, and why many of them assisted the British in various ways.

The Argentine junta, on the other hand, could not withdraw without some sort of reward. Aware of and sharing contract-poor habits and mind-sets, the junta leaders knew their leadership role depended on their image as protectors of the Argentine "in-group" and that withdrawal without preconditions would shatter this image and cause them to be forcefully removed from power.

The Argentine strategy of negotiation also fits the expectations of economic norms theory. In exchange for peace, the Argentines repeatedly offered the British access to minerals on the islands. This is expected from those accustomed to the zero-sum-like struggles that epitomize the domestic politics of contract-poor nations, where everything is assumed to be a crude struggle over material wealth. The generals could not seem to accept that the British were not fighting for mineral rights or other direct profits, as US secretary of state Alexander Haig had to stress "again" that "the attitude of the British Government had nothing to do with economic interests in the area" (Freedman and Gamba-Stonehouse 1991: 196).

The case of the Falklands/Malvinas War challenges some, but not all, models of capitalist peace. By the standards of the trade (Weede 1996) and capital openness (Gartzke et al. 2001) models, this war was fought between two capitalist nations—a clear-cut anomaly. By the standards of the public sector model (McDonald 2007), neither state was capitalist, so the case cannot be anomalous. The war does not pose a challenge for the social-market model, which also offers a full explanation for it: it accounts for why the Argentine junta attacked, how they miscalculated British reactions, why the British fought "over a comb," and why the junta leaders could not conceive of the British motive as anything other than a quest for natural resources.

WHAT IS "CAPITALISM" ANYWAY?

When asked to identify the advanced capitalist nations that might be in peace, most observers of global affairs probably think of the liberal democracies with advanced economies in Western Europe, North America, and the Pacific Rim. Yet the case of the Falklands/Malvinas War illustrates that at least some measures of capitalism may not actually capture it. The trade (Weede 1996) and capital openness (Gartzke et al. 2001) models identify both Argentina and Great Britain as "capitalist," while the public sector model (McDonald 2007) considers neither "capitalist." Only the social-market model (Mousseau 2009) seems to fit what is probably the most intuitive sense of "capitalism" in this case, identifying Great Britain, but not Argentina, as capitalist at the time of the Falklands/Malvinas conflict.

The most basic way to test if variables indicate a common underlying dimension is to test their correlations. Table 9.2 reports the pairwise correlations of the capitalist variables at the dyadic level. As can be seen, none of them are highly correlated. Private sector (McDonald 2007) is almost perfectly unrelated with all the other capitalist variables.[7] Trade (Weede 1996) and capital openness (Gartzke et al. 2001) are also unrelated (r = 0.16). Only contract-intensive economy is related with more than one other factor: there are moderate correlations with capital openness (r = 0.39) and trade (r = 0.32).[8]

The lack of strong correlations among the four factors purporting to indicate capitalism informs us that they are not measuring the same underlying concept. Factors that do not relate with each other cannot be reflecting a common dimension, so at least three of the four factors purporting to indicate capitalism are gauging something else. Because private sector (McDonald 2007) is least related with the others, it is the least likely measure to be representing an underlying dimension of capitalism. Conversely, because contract-intensive economy (Mousseau 2009) is most related to the other factors, it is the most likely factor reflecting the underlying dimension of capitalism.

Table 9.2. Pairwise Correlations of the Capitalist Peace Variables at the Dyadic Level

Pairwise Combinations	*Pearson Correlations*	*Number of Observations*
Trade and Private Sector	0.03	119,898
Capital Openness and Private Sector	0.01	81,882
Private Sector and Contract-Intensive Economy	0.13	120,852
Trade and Capital Openness	0.16	154,276
Capital openness and Contract-Intensive Economy	0.39	154,528
Trade and Contract-Intensive Economy	0.32	321,441

To gauge which factors, if any, mirror our intuition that the capitalist countries are the liberal democracies with advanced economies, I constructed an interaction term of economic development and democracy, in line with the way these terms are usually gauged in the democratic peace literature.[9] The "developed democracy" term can take on high values only if both nations in a dyad are democratic and have advanced economies. As can be seen in table 9.3, most of the capitalist variables are only weakly related with developed democracy, with correlation coefficients at or less than 0.20. It is hard to overstate the importance of these results: the dyads we normally think of as "capitalist"—the developed democracies—are *not* substantively more likely than other dyads to be trade interdependent (Weede 1996), have open financial markets (Gartzke et al. 2001), or have large private sector ratios (McDonald 2007). The only capitalist variable that appears to reflect the wealthy democracies is contract-intensive economy (Mousseau 2009), which correlates moderately with developed democracy at 0.51.

The association of contract-intensive economy with the advanced nations of Europe, North America, and the Pacific Rim is also supported by a look at table 9.1 above. The usual "capitalist" suspects appear in the table when the period of observation begins in 1960: Australia, Belgium, Canada, Denmark, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the United Kingdom, and the United States. In the 1960s, Finland, France, Germany (West), and Japan transitioned to contract-intensive economy, confirming that these states were not market capitalist when they fought against the market-capitalist powers in World War II (France fought on both sides in this war). After the transitions of Austria, Ireland, Israel, and South Africa in the 1970s, many of the remaining countries are those often identified as having gone through successful economic and/or democratic transitions in the 1980s and 1990s—in order, Singapore, South Korea, Taiwan, Spain, Italy, Cyprus, Portugal, Greece, Chile, Malaysia, and Slovenia.

While some of these cases might be surprising for some, overall they probably fit with the intuitions of most observers when thinking of the capitalist nations and those with recently emerged markets. It is also consistent with economic norms theory that none of these countries have transitioned

Table 9.3. Correlations of the Capitalist Peace Variables with Developed Democracy

Dyadic Measures	*Pearson Correlations*	*Number of Observations*
Trade	0.20	316,753
Capital Openness	0.16	154,304
Private Sector	0.20	119,830
Contract-Intensive Economy	0.51	318,230

backward, away from democracy, and only one country, Singapore, has managed to stay nondemocratic for a long period of time after it transitioned to contract-intensive economy.

CAN THE DEMOCRATIC PEACE SURVIVE?

Can capitalism explain the democratic peace? To account for the impact of democracy on conflict, capitalism must correlate with both democracy and conflict (Blalock 1979: 468–74). Table 9.4 reports the correlations of the four capitalist variables with democracy. As can be seen, most of them correlate only weakly with democracy: trade (Weede 1996) correlates at only 0.18, capital openness (Gartzke et al. 2001) at only 0.14, and private sector (McDonald 2007) at only 0.20. These low correlations make it clear that these free-market factors do not hold much promise of overturning the highly robust democratic peace. Only contract-intensive economy is moderately correlated with democracy at 0.47, and thus the social-market model of capitalist peace stands the strongest chance of challenging the reign of the democratic peace.

As discussed above, most nations with contract-intensive economies are also democratic, as economic norms theory predicts, but about half of all democratic nations have had contract-poor economies (when aggregated annually). So if we want to know if capitalism—contract-intensive economy—can account for the democratic peace, these contract-poor democracies are the crucial test cases; if democracy is a direct and independent cause of peace among nations, then these countries should be in peace. To investigate this question I collected data on militarized interstate conflict from the Correlates of War Militarized Interstate Dispute data set (Ghosn, Palmer, and Bremer 2004).[10] Since war happens between nations, the appropriate unit of analysis for this test is the nondirectional interstate dyad, aggregated annually.

Table 9.5 examines the onset of militarized conflicts with fatalities over the period that all data are available from 1961 to 2001.[11] The first column reports the number of each dyadic type: both democratic and both contract-poor

Table 9.4. Correlations of the Capitalist Peace Variables with Democracy

Dyadic Measures	*Pearson Correlations*	*Number of Observations*
Trade	0.18	316,753
Capital Openness	0.14	154,304
Private Sector	0.20	119,920
Contract-Intensive Economy	0.47	318,360

Table 9.5. Capitalism, Democracy, and Fatal Militarized Conflict, 1961–2001

Dyad Types	*Dyad Years*	*Fatal Conflict Years*	*Conditional Probability*	χ^2	*Significance*
Both Democratic, Both Contract Poor	11,267	9	0.0008	0.557	0.455
Both Contract Rich	8,897	0	0.0000	5.729	0.017
All Other Dyads	297,754	190	0.0006		

(11,267) and both contract-rich (8,897). The third row reports the number of all other types of dyads in the sample (297,754), which serves as the null set. The second column reports the number of fatal conflict onset years in each row, and the third column shows the conditional probability of fatal conflict for each row—the second column divided by the first. Column four reports the chi-square coefficient comparing each row with the null set, with tests of significance reported in column five.

The crucial test is in the first row: are dyads where both states are democratic and both contract-poor less likely than others to have fatal conflicts? It appears they are not; the probability of fatal conflict among contract-poor democracies (.0008) appears higher than that of the null set (.0006). While this difference from the null set is not significant (p = .455), it does indicate that, if anything, contract-poor democracies are *more* likely than other states to fight each other. In contract-rich dyads, in contrast, not a single fatal militarized conflict appears to have occurred, and this peace is significant (p < .017). From table 9.5 there is no support for the contention that democracy causes peace. Contract-intensive economy, however, is a robust force for peace.[12]

As discussed above, most nations with contract-intensive economies are also democratic, just as economic norms theory predicts. Indeed, with the exception of Singapore, all the cases of nondemocratic rule with contract-rich economy are cases of short lags from transitions to contract-intensive economy to transitions to democratic rule. Examples include South Korea and Taiwan in the 1980s. The rarity of cases of non-joint-democratic contract-rich dyads (only 17 percent of the contract-rich dyad years in table 9.5), combined with the rarity of fatal conflicts in contract-rich dyads, is exactly the pattern we would expect if the democratic peace is spurious. The confounding variable, contract-intensive economy, must account for the second variable, democracy, as well as the dependent variable, militarized conflict. So it is the very success of the theory that causes too few cases of nondemocratic contract-rich dyads from which to generalize their absence of fatal conflicts.

CONCLUSION

This chapter explored the state of theory and evidence on the capitalist peace and its prospects for explaining the democratic peace. Two kinds of capitalist peace theories were distinguished, the free-market and the social-market, yielding four observable causal mechanisms: trade, capital openness, and size of private sector as free-market theories, and contract-intensive economy as the social-market theory. Analyses of these causal mechanisms indicate that the free-market theories are not viable explanations for the democratic peace or the peace among the advanced industrial nations, primarily because none of them correlate substantially with democracy or developed democracy; they do not even correlate much with each other. Only the social-market measure of contract-intensive economy correlates moderately with democracy and developed democracy. Application of the theories to the case of the Falklands/Malvinas War yields similar results: this war appears as an anomalous case for the trade (Weede 1996) and capital openness (Gartzke et al. 2001) models, while the public sector model (McDonald 2007) identifies Britain as a non-capitalist state; only the social-market model (Mousseau 2000) offers an account for this conflict. Finally, analyses of fatal militarized interstate disputes from 1961 to 2001 corroborate that the democratic peace is spurious, with contract-intensive economy the more likely explanation for both democracy and the "democratic" peace.

The free-market theories also face problems of internal and external validity. Regarding internal validity, to account for a peace between developed nations, all of these theories critically assume that free markets cause economic development. Yet the scientific evidence tells us this is not so (Gurr, Jaggers, and Moore 1990). Regarding external validity, for all but the most myopic observers of global affairs it is clear that the peace among the advanced capitalist nations is much more than restraint due to the high cost of killing each other (Weede 1996), fear of each other's resolve (Gartzke et al. 2001), or the credibility in their commitments (McDonald 2007). These theories may be correct, but it is apparent that these nations do more than just tolerate each other; they are friends. This is evident from the fact that whenever a capitalist economy takes a turn for the worse, the other capitalist nations seek to boost it back up, overcoming collective action problems with negotiations enhanced by shared norms of equity and law. The capitalist nations are not better balancers: they do not balance. They do not simply read each other's signals better or send or receive better information: they know that other capitalist nations will never attack them. Indeed, the very image of war today between France and Germany is comical, yet until they became market capitalist only five decades ago these two nations slaughtered each with seeming zeal roughly every generation.

Once the origins and nature of capitalism are grasped, it is easy to see the direction this world may be heading in. Once capitalism gets a footing in a national economy, voters begin demanding ever-increasing market growth, causing capitalism to both endure and expand. At home the marketplace expands as greater portions of society are increasingly included as vibrant actors in the marketplace, as has been exemplified by the historical pattern of older capitalist societies making the shift from equal rights for only white male landowners in the eighteenth century to equal rights for everyone in the latter twentieth century. Continuing voter demands for market growth also cause capitalist states to fervently seek new markets, and thus these states prefer all other states to be both capitalist and rich. At the same time, capitalist states generally defeat clientelist empires in war, as capitalist economies are stronger, their citizens are more loyal to their states (rather than to groups or personalities), their bureaucracies are more effective (for enforcing contracts), and the norms of individualist and independent thinking in capitalist culture promote innovation and improvisation in citizens and soldiers. In this way, since it was exogenously triggered in fifteenth-century Europe, capitalism has been a cause of both states and wars, yet it is ultimately the surest cause of peace and friendship among individuals, groups, and states. If we can manage to avoid killing ourselves and our planet in the centuries-long process of global transformation, the weight of the evidence informs us that social-market capitalism will in the end bring us permanent peace and prosperity.

NOTES

1. George W. Bush, White House press release, "President and Prime Minister Blair Discussed Iraq, Middle East," http://georgewbush-whitehouse.archives.gov/news/releases/2004/11/20041112-5.html (retrieved October 2, 2010); Bill Clinton, "1994 State of the Union Address," *Washington Post*, http://www.washingtonpost.com/wp-srv/politics/special/states/docs/sou94.htm (retrieved October 5, 2010).

2. Russett and colleagues subsequently added a third leg of the Kantian peace, international organizations, but membership in international organizations proved to be less robust than the first two legs (Russett and Oneal 2001).

3. Another reason to focus on capital openness is that Gartzke's other pillars do not seem theoretically developed. Gartzke argues that industrialization (not development per se) reduces the incentives for conquering territory, since resources can be traded in free markets (Gartzke 2007: 172). But he does not explain why nonindustrialized economies cannot also engage in trade, why industrialized economies, such as the Soviet Union's, are assumed to have free foreign markets, or why it is not profitable to take territory that contains rich resources. For the pillar of preferences, Gartzke of-

fers only the unsupported assertion that "developed countries also retain populations with common identities, cultural affinities, and political, social, and economic ties" (2007: 172). In terms of theoretical innovation, Gartzke's "capitalist peace" is best understood as the capital openness model of Gartzke, Li, and Boehmer (2001).

4. Following Russett and Oneal (2001), trade dependency for *i* is gauged as exportsij + importsij, with the resultant divided by the gross domestic product of *i*. Trade interdependency is gauged as the lower of *i* and *j*. Trade data were obtained from Gleditsch (2002b).

5. Results obtained using the capital openness (the lower of both states in a dyad) variable kindly provided by Erik Gartzke.

6. Missing data are assumed to reflect contract-poor economy. Noncontractual clientelist transactions are customarily not recorded, since they are framed as favors, and governments of clientelist economies do not normally construct bureaucracies for collecting economic data, in part because there is little to record, and in part because their incentive is to conceal economic data since they are constrained to distribute state funds to supporters, often illegally. Governments of nations with contract-intensive economies, in contrast, are constrained by voters to collect and report economic data, in part because of the capitalist norm of recording contractual transactions (for enforcement purposes), and in part to pursue continued growth in their markets (Mousseau 2012).

7. McDonald (2009: 84) claims that an increased probability of militarized conflict should appear if only one state in a dyad has a large public sector. To be consistent with the directional expectations of the other capitalist variables at the dyadic level, I reversed the scale of McDonald's measure and test the lower of both states in the dyad, which I call "private sector." I thank Patrick McDonald for sending me his data.

8. In tables 9.2 through 9.5, contract-intensive economy is measured with the natural log of life insurance contracts in force, the lower of both states in the dyad, with missing values imputed using secondary sources. For details see Mousseau (2012).

9. Economic development is measured as the natural log of GDP per capita in constant US dollars (Gleditsch 2002b). Democracies are identified in standard form as states scoring greater than six in the Polity2 measure obtained from the Polity IV data set (Marshall and Jaggers 2003).

10. Specifically, I obtained the Dyadic Militarized Interstate Disputes Dataset, version 1.1 (EUGene corrected version dyadmid602) (Maoz 2005), to identify those dyadic disputes where the states confronted each other directly. Only the original (day 1) disputants in militarized conflicts are considered.

11. The 1961 to 2001 period results from lagging the independent variables one year behind the dependent variable to reduce the risk of reverse causality.

12. Of the nine fatal conflicts in democratic dyads in table 5, three are between India and Pakistan, two between Ecuador and Peru, two between Greece and Turkey, one between Cyprus and Turkey, and one between Mali and Niger.