Peace or War: An Economic Approach to Appeasement

by

Jack Hirshleifer*

Working Paper Number 817
Department of Economics
University of California, Los Angeles
Bunche 2263
Los Angeles, CA 90095-1477
Feb. 1, 2002

*Published as "Krieg oder Frieden? Eine spieltheoretische Analyse der ‘Appeasement‘-Politik” in the Neue Zürcher Zeitung (Zurich), March 30/31, 2002. German translation and editing by Christoph Eisenring.
PEACE OR WAR: AN ECONOMIC APPROACH TO APPEASEMENT

Abstract

At Munich in 1938, Britain and France attempted to appease Germany by sacrificing their Czechoslovak ally. The internal debate among western policy-makers as to the wisdom of that policy involved different beliefs about German preferences. Was Nazi Germany really "peace-loving", or was she unequivocally aggressive? Under either of these assumptions, analysis reveals, appeasement will not work. In the former case there is no need to grant concessions, in the latter case concessions will only strengthen the aggressor. Appeasement can be rational only if one's opponent becomes less hostile in consequence of being strengthened or enriched, i.e., if her hostility is a kind of inferior good. This is the essence of appeasability.

Although the historical policy debate concentrated upon German preferences, also involved are the opportunities and the perceptions on each side. To be worth appeasing, the opponent must have an effective yet costly threat: she can punish you, though at a cost. Her underlying hostility backs up the threat to employ the punishment opportunity if she does not get her way; her appeasability guarantees she will not exercise the threat if she does get her way.

As to perceptions, though the western powers erred in believing that Germany's hostility was appeasable, they were correct that Germany would not be able to exercise her punishment opportunity without undue cost to herself. The war occurred because the German leaders – skillfully playing upon western misperceptions of their intentions – were themselves mistaken about their military opportunities.
PEACE OR WAR? AN ECONOMIC APPROACH TO APPEASEMENT
J. Hirshleifer

Economic analysis is not limited to the study of markets. It is applicable in all contexts where resources are scarce, if there is scope for rational decision-making, and when the parties' separate choices interact to create a societal equilibrium. In recent years economists have been achieving significant results dealing with many non-market interactions — among them crime, law, international relations, domestic politics, and family relationships.

An important area of economic research deals with war and peace [Boulding 1960, Tullock 1974, Hirshleifer 2001]. Among the issues are: Who goes to war with whom? When are wars limited, when all-out? On what terms are conflicts finally settled? Nor is economics precluded from dealing with the "intangible" considerations that importantly influence the decision for war or peace. Writing on the causes of the American Civil War, for example, Gunderson [1974] balances the material advantages to the South against the ideological considerations that impelled North to fight for abolition and for preservation of the American Union.

An increasingly important development in economic analysis, game theory, is particularly helpful in shedding light upon some of these issues [Schelling 1960]. I will be showing here how game theory helps us understand what went wrong in the attempt to "appease" Hitler's Germany at the 1938 Munich conference before World War II.

Choices by decision-makers with regard to peace and war, like all economic choices, involve the parties' interacting opportunities, their preferences, and also their perceptions of their opponents' situation in this regard. At Munich the western powers (Britain and France) on the whole correctly perceived these opportunities — the advantages of peace and the costs of the war — whereas Nazi Germany did not. However, the western powers misjudged Hitler's preferences. To disentangle just what specific errors lead to the Munich outcome requires careful analysis, however. What was it that made Nazi Germany "unappeasable" in 1938?

I. Perceptions and Preferences at Munich

At Munich Adolf Hitler threatened war unless the Sudetenland (German-populated territories within Czechoslovakia) were ceded to Germany. Although the demanded transfer would destroy the military viability of Czechoslovakia, for the leaders of Britain and France it seemed possible that sacrificing their Czechoslovak ally might actually achieve genuine peace. In that belief or hope, they reneged upon their commitments to defend the territorial integrity of Czechoslovakia.
Table 1 illustrates a game-theoretic approach to the Munich situation facing the western Allies. The rows indicate their options: Appease (A) -- that is, agree to the dismemberment of Czechoslovakia -- or Oppose (O). As for Germany, I will be assuming that the personal attitudes and judgments of Adolph Hitler were what determined German national policy. Taking a very simple view to begin with, Germany's options in 1938 were War (W) or Peace (P). Keep in mind that at Munich the western powers had the first move: They could choose A or O, after which Germany would respond with W or P.

The cells of the matrices indicate possible preference orderings of the two sides, ranked from best (4) to worst (1). In each cell the first number describes the preferences of the Row player (the western powers) and the second number the preferences of the Column player -- Nazi Germany.

What can be said about these preferences? For the Allies avoiding war was an absolutely prior consideration, overshadowing their secondary preference for Oppose (that is, for maintaining the integrity of Czechoslovakia) over Appease. So in all four matrices the Western payoff rankings (the first number in each of the cells) was:

PREFERENCES OF THE ALLIES (all matrices)
   4: Oppose, Peace (best)
   3: Appease, Peace
   2: Oppose, War
   1: Appease, War (worst)

As for Germany, some western leaders appeared to believe that despite surface appearances her policy was really "peace-loving", in the sense of preferring peace given any western action. If so, her preferences might have been:

GERMANY (I): "PEACE-LOVING" PREFERENCES?
   4: Appease, Peace (best)
   3: Appease, War
   2: Oppose, Peace
   1: Oppose, War (worst)

Matrix 1 puts the western preferences together with this first hypothetical pattern of German preferences. Inspecting the matrix, we see that for the western powers, having the first move, the rational choice, is Oppose. Germany then chooses Peace. The payoff outcomes are (4,2), the best possible outcome for Allies. There is no need to appease Germany, because she prefers peace anyway.

The opposite view was that Germany's truculence was no mask, but rather a reflection of deep-
seated aggressiveness. I.e., regardless of the western strategy choice, Germany preferred war:

GERMANY (II): "AGGRESSIVE" PREFERENCES?
4: Appease, War (best)
3: Appease, Peace
2: Oppose, War
1: Oppose, Peace (worst)

The combination of the maintained western preferences and German preferences (II) is displayed in Matrix 2. Despite the reversal in hypothetical German attitudes, the best first move for the western powers remains the same: Oppose! True, now Germany responds with War, but she was going to make war anyway. The payoff outcomes are now (2,2).

Opposition to appeasement might therefore have been based upon either of two contrasting perceptions: that Germany was too peace-loving to make war, or that Germany was too aggressive to forbear going to war. But there was also a third possible ground for opposition:

GERMANY (III): "BLUFFING" PREFERENCES?
4: Appease, War (best)
3: Appease, Peace
2: Oppose, Peace
1: Oppose, War (worst)

The idea here is that Germany would attack upon a show of weakness, yet back down if resolutely opposed. A number of those engaged on the “Hawk” side of the appeasement debate did apparently believe that Germany was bluffing. When the western preferences are combined with these “Bluff” preferences in Matrix 3, the best first move for the Allies is Oppose, after which Germany folds and chooses Peace. The payoffs are (4,2).

So, it might appear, whether Germany was really peace-loving or really aggressive or really only bluffing, appeasement was a mistake.

Yet, appeasement can be rational. To make a persuasive case, a German spokesman might have said: “Our policy seems aggressive only of the unfair status quo. Give us what we ask for, and we will then become peace-loving. We are appeasable.” And in fact Adolf Hitler promised: “The Sudetenland is the last territorial claim I have to make on Europe.” (Sept. 26, 1938). So the Nazi leaders put themselves forward as having the preferences:
GERMANY (IV): “APEASABLE” PREFERENCES?

4: Appease, Peace (best)
3: Appease, War
2: Oppose, War
1: Oppose, Peace (worst)

Had Germany really been appeasable, the revised combined payoffs are as shown in Matrix 4. On this view, peace-lovingness was what economists call a “superior good” for Germany. A dissatisfied Germany would prefer war, a satisfied Germany would turn toward peace. With the western powers still having the first move, their rational choice is now indeed Appease, to which Germany responds with Peace. The payoff outcome is (3,4). This was of course the outcome that Chamberlain and Daladier anticipated.

II. A More Correct Reading of the Situation

But the preceding analysis omits something crucial. Germany had still another option, Peace then War (PtW). That is, to settle for peace in 1938, with the intention of making war a year or two later from a stronger strategic position.

In Matrix 5, on the German side, given Hitler’s plans and psychology, the cells in the new (last) column are better than all the others, hence have been given the numerical assignments:

6: Appease, Peace/War
5: Oppose, Peace/War

Germany would still like the Allies to adopt the Appease strategy, allowing her to go to war after having improved her strategic situation by the absorption of Czechoslovakia. (A conquest that brought not only important direct benefits but led to favorable shifts of alliance patterns, most notably friendly relations with the Soviet Union.) And even if the western powers had chosen Oppose, the rapid pace of German rearmament suggests that Germany would have waited until 1939 or 1940 before going to war. A breakdown of negotiations at Munich would have allowed Hitler to play upon German resentments, so as to begin hostilities later on with more united national backing.

As for the other four cells, it is fairly evident that Germany was indeed aggressive in the sense of Matrix 2. So the numerical German preferences in Matrix 5 are the same as Matrix 2, apart from the still higher numbers shown above for the new PtW column.

The opposite holds on the Allied side. The two new outcomes are worse than any considered before. And of the two, Appease followed by Peace then War is worst of all. (Yet this is what
transpired.) In terms of Matrix 5, for the Allies the new cells are therefore evaluated as 1 and 2, so that all the valuations in the remaining cells move two levels higher.

Summing up, the western powers should have chosen Oppose, at which point Hitler would have subsided temporarily, choosing Peace then War. But he would have gone to war in 1939 or 1940 without all the diplomatic and strategic advantages gained at Munich.

III. Deceptions and Mistakes

A sophisticated defender of the appeasement policy might argue, contrary to the analysis above, that Hitler would have chosen immediate war if not given his way at Munich. If so, appeasement provided the Allies a year’s leeway for arming themselves. But of course Germany was also rapidly arming rapidly. Any Allied gain, doubtful to begin with, was surely secondary to the loss of Czechoslovak armaments and industries and the worsened strategic balance. That Germany might have chosen immediate war if opposed at Munich is perhaps consistent with Hitler’s later complaints that he had been “cheated” at Munich of the war he had really wanted [Taylor 1961, Weinberg 1994]. However, the Hitler of 1938 was more rational than that. Indeed, an attempt on his part to choose war, before his reputation was enhanced by the great triumph at Munich, might well have led to a revolt by the German military.

So the Allies committed two types of error. First and most important, in failing to realize that the very best outcome for Nazi Germany in Matrix 5 — and hence the worst for everyone else — was the combination Appease, Peace then War. Hitler pretended to be “appeasable”, as pictured in Matrix 4, because the Nazi leaders viewed the settlement at Munich as only a step in a march to conquest. Given his way at Munich, Hitler almost immediately demonstrated bad faith by initiating new demands, now upon Poland. Actual war ensued when the Allies refused to abandon Poland in 1939, as they had abandoned Czechoslovakia in 1938.

Although most historical discussion has centered upon the errors of Chamberlain and Daladier, they were right in one crucial respect. In the light of history, Hitler “should” have been willing to be permanently (rather than only temporarily) appeased. The prime error was Hitler’s, and that error cost millions of lives. Chamberlain and Daladier judged, correctly, that the impending war would not be profitable for Germany. Where they went wrong is failing to credit that Hitler believed the contrary.

IV. Conclusion: The Proper Scope of Appeasement

Although appeasing an enemy is often mistaken, as Munich demonstrated, economic analysis
shows that there are circumstances in which appeasement makes sense.

The question of appeasement arises, of course, only in facing a hostile enemy. Such an opponent cannot be appeased unless two conditions are met. First, the enemy must realize that in inflicting harm, he is going to suffer himself. Hitler, believing that the impending war would be profitable for German interests (or at least, for his interpretation of Germany’s interests), could therefore not be appeased.

The second somewhat subtler condition is reflected in Matrix 4. A hostile enemy can be appeased if his enmity – that is, his intention of inflicting harm on you – abates somewhat as he becomes richer or more powerful.

Thus, economics tells us, the way to deal with an appeasable enemy is to make him affluent enough to eliminate his desire to injure you. By contrast, the way to deal with a non-appeasable enemy is to keep him poor enough so that he cannot afford to injure you.
REFERENCES

TABLE 1

Matrix 1: IF GERMANY IS PEACE-LOVING
<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>W</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>3,4</td>
<td>1,3</td>
</tr>
<tr>
<td>O</td>
<td>4,2</td>
<td>2,1</td>
</tr>
</tbody>
</table>

Matrix 2: IF GERMANY IS AGGRESSIVE
<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>W</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>3,3</td>
<td>1,4</td>
</tr>
<tr>
<td>O</td>
<td>4,1</td>
<td>2,2</td>
</tr>
</tbody>
</table>

Matrix 3: IF GERMANY IS BLUFFING
<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>W</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>3,3</td>
<td>1,4</td>
</tr>
<tr>
<td>O</td>
<td>4,2</td>
<td>2,1</td>
</tr>
</tbody>
</table>

Matrix 4: IF GERMANY IS APPEASABLE
<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>W</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>3,4</td>
<td>1,3</td>
</tr>
<tr>
<td>O</td>
<td>4,1</td>
<td>2,2</td>
</tr>
</tbody>
</table>

Matrix 5: GERMANY'S "PEACE THEN WAR" OPTION
<table>
<thead>
<tr>
<th></th>
<th>P</th>
<th>W</th>
<th>PtW</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>5, 3</td>
<td>3,4</td>
<td>1,6</td>
</tr>
<tr>
<td>O</td>
<td>6, 1</td>
<td>4,2</td>
<td>2,5</td>
</tr>
</tbody>
</table>
Krieg oder Frieden?

Eine spiellothetorische Analyse der "Appreuements"-Politik

Von Jack Nicklifier