

Capitalism, Socialism and Dictatorship: Outgrowing Communist and Capitalist Dictatorships

Conference Proceedings

*Washington, DC (12-13 April 1996)
and Luxembourg (24-25 January 1997)*



**Luxembourg Institute for European and
International Studies**

Copyright © 1999 Luxembourg Institute for European and International Studies. All rights reserved. No part of this book may be reproduced or utilized in any form without permission in writing from the publisher.

Luxembourg Institute for European and International Studies
21, rue Philippe II
L-2340 Luxembourg
Phone (+352) 466580 / Fax (+352) 466579

ISBN 2-919989-08-1

Contents

Introduction	v	
Part I	Conference I, held in Washington, DC, on 12-13 April 1996	
Session I	Comparing economic and social performance under autocratic and representative governments	3
Session II	Is there a connection between lasting democratic or representative government and the security of property and contract enforcement rights?	23
Session III	Must special-interest groups for lobbying of governments and cartelization of markets become more numerous in any lasting representative government?	44
Session IV	Are new democracies and new autocracies relatively free from special interests?	63
Session V	Communist autocracies	83
Session VI	Why was economic performance so much poorer than expected after the collapse of communism?	120
Session VII	Managing the transformation from communist autocracy to a market-oriented democracy	131
Session VIII	The lessons: How can the societies of the West enjoy both stable democracy and economic dynamism?	151
Conference participants	168	
Index of the contributions to the discussions	171	

Part II	Conference II, held in Bourglinster, Luxembourg, on 24-25 January 1997	
Session I	The “Logic of Power”	177
Session II	How representative government emerges and survives	204
Session III	The sources of wealth	227
Session IV	The decay of prosperity in societies with freedom of organization	245
Session V	The special theory of the Soviet-type autocracies	267
Session VI	The long decay and ultimate collapse of communism	295
Session VII	The transition from communism to markets and democracy	321
Session VIII	Markets are ubiquitous in all countries but prosperity is rare	343
Conference participants		361
Index of the contributions to the discussions		363

Introduction

Mancur Olson had become acquainted with the project on “The Vitality of Nations” through attending a number of conferences organized by the Luxembourg Institute for European and International Studies, particularly those taking place at Harvard University. He was also present at the very first meeting in March 1990 in Luxembourg together with scholars such as Michel Crozier, Iring Fetscher, Ernest Gellner, Paul Kennedy, Philip Windsor. In earlier publications he had already shown a keen interest in issues dealing with rise and decline of countries. In his manuscript on “Capitalism, Socialism and Dictatorship: Outgrowing Communist and Capitalist Dictatorships” he has been trying to look more specifically at the relationship between various political and economical models on the one hand and the long-term economical success of those models on the other hand above all against the background of the emergence and the breakdown of the main autocratic experiences of the outgoing century.

To discuss his ideas the Luxembourg Institute for European and International Studies organized two meetings on different questions arising from Professor Olson’s manuscript. The first of those meetings took place at the Carnegie Endowment for Peace in Washington DC on 12 and 13 April 1996, the second in Luxembourg at the Castle of Bourglinster on 24 and 25 January 1997. For both meetings we had managed to find a group of excellent scholars from various disciplines but also experts working for governments and international organizations. At the first meeting there was, of course, a greater number of Americans, among them many high-level representatives of the World Bank and the IMF, at the second meeting there were obviously more Europeans. Both meetings were intellectually very intense and certainly produced a number of new ideas, which Mancur Olson promised to integrate into a new draft of his manuscript. Unfortunately, he died, totally unexpectedly, before being able to give the book its final touch.

We want to publish the proceedings of the two conferences also as a tribute to Mancur Olson who was a unique conceptualizer and had certainly one of the sharpest minds of contemporary economic studies, who was a relentless worker and a warm-hearted man. He also was one of my best friends.

The manuscript which has served as the basis for the discussions of the two meetings is being published now by Basic Books under the new title “Power and Prosperity”.

I would like to thank all those who helped us to prepare and implement the two meetings, to transcribe the discussions and to edit them, the collaborators at IRIS (the Center for Institutional Reform and the Informal Sector), the superb research center Mancur Olson had built up, and the staff of my Institute, above all Anemone Thomas, then also Christina Ferreira, Anne McManus, Antti Kunnas, Abey Hailu Senbeta, Aline Palige, Joep de Roo and Denise Schauls.

Luxembourg, November 1999

A. Clesse

**Part I: Conference I, Washington, DC,
12-13 April 1996**

Session I: Comparing economic and social performance under autocratic and representative governments

M. Olson: It was poet Olden Nash who said that you should not worry so much about sins of commission, but rather worry about sins of omission. The very fact that you committed a sin, he said, means there has got to be something to be said for it. But you have to worry about the sins of omission: you can not have any fun from things you have not done. Now, I would suggest that the problem of economics today is that, well, there are not many sins of commission. The economics that has developed over more than two hundred years of cumulative research is an economics, I believe, that is mainly right and profoundly useful. But nonetheless, this economics, I believe, is guilty of many sins of omission. It leaves out many things that are indispensable to understanding the world we live in, and even essential to understanding many of the things that economists have worked on for a couple of centuries. One of the most important omissions of economics, it seems to me -- an omission at least until fairly lately, the last few decades, the last generation -- is the omission of what we might call the economics of behavior in government and politics. The people in government and politics have purposes and interests just as the people in the market have, and economics has been too tardy in taking this into account. Repairing to some slight degree these sins of omission is, in some sense, the task of this manuscript that has been sent around to you.

I start with the simplest of all political systems, I think, the dictatorship, the autocracy. The system with one man wholly in charge. A key thing that led me to think about the dictatorship is looking at and reading learned historians about, what happened in many situations where various kinds of dictatorship emerged. For example, we find that what happened during the War-lord Period of Chinese history, from about 1915 to 1930, is that in some places there were roving gangs of bandits who went around and plundered; but sometimes the leaders of the bandit gangs would set themselves up as war-lords or kings. Hence the “stationary bandit” model is in the first chapter of this manuscript. So the idea that crime, a kind of banditry, would have a role even in the formation of some governments is what I started with. But once one is thinking about crime, then, of course, one gets into other kinds of crime besides the crime that captures an

area and subjects it to the will and taxation of a given leader. There is also the sort of crime that is so prevalent in this city of Washington: all sorts of individual criminals who are preying on the population. But of course, these individual criminals are unlike the stationary bandit autocrat who has an interest in the productivity and tax receipts of his domain. The typical individual criminal takes everything in any purse he steals. And the difference, I claim, as you know, is due to the fact that whereas the stationary bandit who captures an area has an encompassing interest in his domain, the individual criminal is such a tiny part of society that in essence he ignores the damage that he does to society.

Now, looking at autocracy and the problems it posed and what happens when autocracies break down led to the model of power-sharing and democracy, and the idea that a majority in a democracy has a more encompassing interest than an autocrat. This view also led to the idea that a lasting democracy inevitably must have extensive rights, and that means, in turn, that it must have substantial property rights and contract-enforcement rights. Now, that, in turn, led to looking at the sclerosis in the democratic societies in the way I have done in *The Rise and Decline of Nations*, and that, in turn, led to asking whether there was a similar sclerotic process in the East, in the Soviet-type societies. From this followed the argument in the later chapters about the system that Stalin set up, and that, in turn, led to the study of the transition. This, together with the study of democracy and rights, led to the last chapter, on how a society can have markets that bring a cornucopia of prosperity rather than, as happens in many societies, markets that are consistent with continuing poverty.

A. Clesse: Then let us see, if there are any comments on comparing economic and social performance of various forms of government and of regimes in more ancient times -- Italian city-states, the Low Countries, Britain at the Glorious Revolution, nineteenth-century United States, and then also after World War II mainly Latin American autocracies: why they finally more or less failed.

W. McNeill: Well, let me respond first to what Mancur Olson just said. Your picture of the bandit and the single person as a controller of a political system is, of course, a schematization. There is no public exercise of authority which is a single person: he has a clique of people who serve him and interact with him, a ruling element,

which has a dynamic of its own. Your writing makes a drastic schematization of human reality. If I were writing it, I would want to point out that no monarch, even the head of a Disciples gang in Chicago, works by himself. He has a clique, and often the clique is quite diffuse and internal strains within it can be exceedingly important. The management of such an exploitative clique is an art in itself and takes all kinds of skills on the part of the leader. A book I recommend to you profoundly is by Franz de Waal called *Chimpanzee Politics*, which describes the behavior in the zoo at Arnhem of a group of chimpanzees across something like twenty years. This is a very excellent model of human politics. Seriously,. If you have not read it, read it, and you will see the dynamic. One human being is not in a position to compel others to obey him. He must cultivate support in such a fashion that a group of them can exercise power and abstract resources from those around them. That is just the nature of the physical and psychological constitution of the human animal. So that would be my first comment.

I do not think you want any real discussion of North Italian city-states, the Dutch Republic, Britain after the Glorious Revolution, do you? You hardly touch these countries in your manuscript, and I do not suppose that many people round this room are interested in such far-off history. It is a very complicated, and interesting, and fascinating story: how certain parts of the world managed to start multiplying their wealth. It began in Sung China; it did not begin in Europe. And that is missing. I do not suppose it matters. There were 500 years in which China was leading economic development, not Europe. Circumstances are different in every case.

My most general observation would be this: the trick of having capital accumulation work so that you have larger and larger, more organized economic activity means that You have got to be able to do two things at once. You have got to be able to protect the possessors of that capital -- your remarks about property rights and so on -- but it is not just property rights, you have got to be able to enforce the property rights. There is a problem of power, a problem of alliance with, or conversion of, or replacement of, exploitative politics with a politics which is prepared to accept the idea that some men can get rich, and the proven wilderness, oddly, refrains from taking it from them. This is a very unusual posture for human beings to take. It requires a sort of long view. And it is a rare circumstance that allows

this to continue. It did not go far in China; it went much further in Europe for very interesting reasons, partly legal, and basically, I think, because the merchant class in late medieval Europe, actually attended to its own defense to begin with, during the first century or so Venetian and Genoese expansion. The merchants got on board those ships; they carried their own crossbows; they carried their own weaponry. And there was a particular constellation of military circumstances which made it possible for them to protect their ships more efficiently than ever before. Basically, the crossbow and the crow's nest and new naval designs meant that a few men up in the crow's nest could safeguard that ship from a crowd of people coming on board very effectively. The merchants were on board the ship and doing the work. They were fighting: they provided their own protection. They got back home to Venice; they went ashore on islands, and they ruled those islands, and the capital was theirs. They saw no reason not to protect it, multiply it, and so a single man in a single lifetime could become a big operator if he had a few fortunate voyages. But it took a very special protection situation for this to be feasible, and it went from there. I wrote a book about this. You can read it if you want to, and it will tell you more of the very fascinating way in which the Venetians later organized land defense, not just on the sea, and the devices they developed to make it safe to have professional soldiers who would not want to carry out a *coup d'Etat* as happened in Milan, as happened in Florence, as happened in nearly all the other cities of Italy. But protection of capital was still a very iffy situation, and this was not stabilized until the Dutch in the seventeenth century developed the modern system of military recruitment and discipline and drills, as I explained in another of my books.

As I say, this is a long and very complicated story, and it passes through some extremely narrow gateways, where, had the political history of Europe gone differently, you would not have had this multiplication of capital in the hands of private citizens who then began to develop various new kinds of enterprises operating at long distances, across the oceans. It is a very remarkable story, and it does depend on geography -- those islands in the upper Adriatic are easy to defend if you have ships, and Holland was easy to defend because you could flood it. It is absolutely remarkable: what defeated the Spanish was the fact that Holland was below sea level, and

inhabitants were willing to flood it in order to save Amsterdam. Antwerp could not be flooded, and so after 1579 the free growth of capitalism in Antwerp is crushed by the Spanish good government, i.e., a government that took all it could. So entrepreneurs went north to Amsterdam, behind a moat. In case of need they could flood it, they did flood it, to hold against the Spanish army. So a very fascinating story and very tortuous. The development of capitalism worked as it did by a series of narrow squeaks. And quite surprising, because most of the time the accumulators of capital are vulnerable to two kinds of exposure: one is to the people at home who think: Why should that man have so much money? Why is he so much more successful than I? Thus, capitalists have to have safety from the poor; and safety from the powerful at one and the same time. And that is a very narrow gate to pass, so it is not surprising that there were very considerable upheavals in Venice, tremendous explosions in Genoa, and clashes in Holland, and even in England. The Gordon riots -- well, never mind about the Gordon riots: they came close to toppling the English system in the late eighteenth century. It was a remarkable series of coincidences and narrow gates that led to eighteenth-century Europe. So, I would emphasize the *exceptionality* of the kind of social system that permits effective protection of the accumulation of capital in private hands. It is very exceptional.

L. Gordon: I can not speak with the authority of Mr. McNeill on this subject, but I was struck by what seemed to me an elegant logical superstructure based on a very frail, and unhistorical, foundation. Let me give a couple of examples. I read in this manuscript that autocracies are inherently short-lived because of the succession problem, whereas democracies can be long-lived. And I look at what I know about world history, as an amateur. As far as I know, the oldest genuine democracy in the world is Iceland's, a very small and peculiar case, and the second oldest is our own -- we're roughly 200 years. Then, I think of centuries of pharaohs; of the Roman empire, 400 years more or less; the Ottoman empire; various dynasties in China; and, more recently, the Valois and Bourbons in France; I think even of Wilhelm I of Germany -- that is shorter than 200 years, of course, but it looked pretty stable until World War I. There are two or three others which escape my recollection at the moment -- the Habsburgs would be another. Those were long periods of time -- longer than 200 years in most of the cases -- in spite of having terrible

succession problems. The Roman government survived having Nero and Caligula as emperors for a while, and yet the institutional structure was sufficiently strong, so that there was continuity. Similar things are true of the other autocracies that I have mentioned. That is one major problem which bothers me.

A second major problem that bothers me -- perhaps this is the fundamental one -- is the unspoken assumption that there is a kind of rationality to all these people who hold power and to their activities. When I read that the Cultural Revolution in China was really just a way of dealing with institutional sclerosis, I ask myself about Pol Pot. *There* was an autocrat who really wanted to get rid of institutional sclerosis and so he murdered all the people with any education in his country. At some point there seems to be an encompassing interest which does not encompass everything that one might want. And indeed, in the Chinese example, I can see that it takes some strain to regard the Cultural Revolution in the fashion that it is regarded in Mancur's discussion here. But it would take even more strain to include the Great Leap Forward, which resulted in something like 20 million people dying of famine, the worst famine of this century, as somehow representing an "encompassing interest" of Mao Zedong at the time.

I will make only one other comment to show the serious troubles I have with the structure as I understand it. That has to do with the concluding notion that if you have the rule of law and respect for property rights and democratic structure, you will automatically have strong economic growth. That says nothing about the problem of capital formation, or it assumes that somehow or other those institutions are bound to result in capital accumulation. I do not see that. I look at Latin America, where legal institutions and the notion of property protection have been built in. They are not always respected, to be sure, but that is true even in this country. The Roman law systems inherited from Spain and Portugal included professional judges and lots of lawyers -- probably not as many as we have in this country, but still probably too many. The notion of rule of law, of respect for property rights at least, is very widespread. Yet in the case that I know best, which is Brazil, their respect for property rights has not avoided inflation in most of Brazil's history; it has not produced a consistent record of very rapid economic growth, though they have had periods of substantial economic growth. Rapid growth does not

take place simply because of institutional arrangements which are described in the last couple of chapters of the manuscript. So there, again, it seems to me, the effort to attribute a kind of rationality, encompassing interest, concern for what is the public welfare, fails to fit with the historical record.

One other problem: I noticed a discussion of externalities and public goods in an early chapter, but then they seem to be forgotten almost completely toward the end, where everything good is attributed simply to successful private markets. There is one footnote on externalities, but it is not enough to compensate for this weakness that I mentioned.

S. Webb: As an economist, I can appreciate the importance of an elegant model and simplifying assumptions. I think that a lot comes out of the fairly simple contrast between dictatorship and democracy that underlies the structure here. More explanatory examples would be useful to show how the model's structure can be applied. Thus, I wanted to follow up on Mr. McNeill's point about how dictators do not rule alone, because I think that can also help explain some of the historical development. Some of the democracies, like the city-states -- with property rights and their defense of democracy against the poor and against the predators -- evolved from that side, but I think that some democratic evolution also took place within the gang supporting the dictator. Think of the problem of a king who conquers some territory and gives it to his nobles, and then you see the process in varying degrees -- the most full-blown example, of course, is in England, but you see it in Poland and a few other places where proto-democracies develop. In order to run the place smoothly, the king grants rights to these nobles, which evolve into what we know as property rights. These nobles also get varying degrees of control over who runs the country, and you see them electing kings in Poland. In England, there was the House of Lords, and the House of Commons, which was pretty much held by the landowners before 1832. So you can see a democracy developing from within the bandit is gang. That may be another way to help bring more historical flesh onto the good theoretical skeleton You have got here.

W. McNeill: The difficulty is “democracy” is simply not the right word for what happened. Democracy is the wrong word for Mr. Webb to have used. It is not democracy; it is oligarchy that was

running these societies before the eighteenth century. And it is not really democracy in Britain until 1885 -- that is the first time there is universal suffrage and, then, only male suffrage. So this is a group of people who own property and defend it through the legal system, and through the political system, with great effect. And I think the point that it grew out of the *Gefolgschaft*, the following of the king, is also quite well taken. But the king protected people who were not nobles - - Jews first and then Italians, then, finally, when there gets to be an English capitalists class, homegrown, making a deal: "You pay me taxes, and I will protect you." Perfectly self-interested, but not democracy. It is us, our property, in cahoots with an extractive political structure. The delicate balance is what made the English so successful in the seventeenth, eighteenth and nineteenth centuries.

A. Lanyi: I also wanted to comment briefly on Professor McNeill's point about dictators not ruling alone. It seems to me that one of the questions here is the contrast between rapid economic growth under capitalist autocracies in East Asia after 1960 and Chile after 1973, and the failure of most Latin American and African autocracies. Surely, if you incorporate Professor McNeill's point in your analysis, I think that by looking at the cliques with which, or in the interests of which, different autocrats ruled, you would find clues to the differing experiences among these autocratically ruled countries.

J. Oppenheimer: I want to add a little of fabric on the point that was started by McNeill, and that is, is it the case that one has, what you might want to call, a single-bandit, strong-man kind of regime? The classic strong-man regime, that, I guess, we all have in our mind is like a pharaoh. A good story to think about, when we are thinking about that as a story, is Akhenaten, which is the story of a pharaoh that forgot that he was actually representing a certain group of people. He tried to change the religion in certain ways the priestly class did not like and then got a rather grisly end because of that. The issue of who one represents as a political leader is a serious question except in very, very rare cases. Stalin might be somebody who was able to end up representing himself in a sense. But it is not often in history that that occurs.

In particular, I would say that the story that William McNeill indicated, regarding the one ruler, can be pushed further if you are really interested in the bandit model, by looking at the mob. That

leads to a pretty serious critique, I think, because if you look at the mob you realize that the issue of stabilizing one's own position goes beyond the issue of succession. It goes to the issue of how do you hold together a coalition that you are trying, to some extent, to maintain by distribution of the pay-offs, of tax receipts and so on. To notice that there is no core in that game is, I believe, an extremely important point. Therefore, when you are looking at the issue of what an autocracy or oligarchy has to do -- and I think that Webb's comment was slightly off on this -- it is that they have to look at what are the tools for protecting against competition. And there, I think, McNeill's last comment is wrong. It is not the case that politics is primarily, or necessarily exclusively, properly thought of as an extractive structure. Politics is in fact about a supplier of public goods. As Mancur has pointed out time and time again, this is a serious benefit side that is part of the stabilization of the extractive structure. That is like saying that the only way to view a company is in terms of the profit stream. The fact is that they are producing something for the market. And to understand it only as some kind of profit stream in fact reduces you to an accountant rather than an economist. I think that you have to look at the collective goods, and the taxation, and the side payments, as a package having to do with how you compete and how you stabilize your own position in a competitive situation where there is no core.

S. Haggard: Mancur, as you gathered, several of us are uncomfortable with your conception of autocracy. It seems to me that it violates the economicistic project that you are involved in: the autocrat is not subject to any kind of personal budget constraint. He can command, and people follow him, and it is not clear why they follow him. In that sense, it also violates the idea of extending an incentive-based kind of model to the polity.

To me, authoritarian governments are governments in which there is a restricted set of individuals to whom the leaders are accountable. If you look at it that way, there is not such a sharp divide between authoritarian and democratic governments; it is just that the set to which the leadership is accountable is different. Now, why is that important? It is important because asking how autocracies perform economically depends on who it is they are accountable to. Some autocracies historically have been accountable or responsive to private sectors, as the Chilean government was after it overthrew

democracy in 1973, or the East Asian governments; others have been responsive to rent-seeking groups; others have been responsive to their own political apparatuses. A communist party, for example, is a system which is accountable to the party apparatus. If you look at communist systems, they in fact have quasi-democratic structures that make the top leadership accountable in various ways to the central committees which they themselves select. So it is not that the autocrat can do whatever he or she wants; it is that the set of individuals to whom they are accountable or responsive is narrower. When you ask the question, "How do autocracies perform?", it is like asking "How do cars perform?". The answer is, "It depends". It depends on who they are accountable to, and the groups that they see as forming the base of their coalition. Unless you ask that question it is impossible to answer how autocracies perform: they perform variously. They have done well, and they have done poorly, and they have done disastrously. The differences in performance have a lot to do with the social basis of the regime.

D. Mueller: It is in a way on the same point though more on the conceptual side. So much of the argument hinges on the permanence of property rights, in particular in the capital market, that, given the importance of these property rights, I think, one has to develop more the idea why it is that an autocrat or autocratic government can not guarantee those property rights, despite the obvious benefits that come from protecting them. You sort of say: the succession problem, but it really needs to be developed, buttressed up to some extent. I think the notion of an autocracy having many potential leaders in competition helps solve this problem. Once you have created an army, you have many generals, and all of them are potential successors to the autocracy. So, in some sense, developing the multi-person nature of autocracy will help solve this question of why autocracies are less stable than democracies in terms of their protection of property rights.

From a conceptual point of view, if you simply looked at the public-choice literature, and you said, "Mancur Olson has written a book, and he argues that, for economic success you need stable property rights, and he compares democracies and autocracies. Guess which ones have more stable property rights?" The public-choice literature would say, "Gee, probably autocracies." What do we know from public choice? We know that democracies use majority rule,

which leads to cycles in Lund's kind of story, which seems to suggest a lot of instability. The second kind of story, is the one which worried people like John Stuart Mill who did not want to extend the franchise to almost anybody, because once the poor get the franchise, they are going to take everything away from the rich. So the second long-run danger of democracy is: that the poor tax away the rich. I think you see these things historically. On Latin American problems of development: I would not argue that it is not all cycling that is going on in Latin America so much as its constitutions. As with our constitution in this country, you have the separation of powers between president and parliament and so you have a certain deadlock problem which often results in shifting over to dictatorship. But be that as it may, the Latin American democracies have not been stable, and, therefore -- even though property rights might be stable -- you get inflation, you get changes in the rules: first we protect capital goods, and then we do not protect capital goods and so on and so forth. So there has been a lot of instability in the democratic development of Latin America.

On the other side, I think, perhaps pushing the argument a little further, one sees, let us say in Sweden, the other aspect of democracy, in the sense that the majority rule continues to "go after" the rich, which means that capital moves. I think, in your 1982 book, Sweden is one of the good guys in performance; if you wrote that book today, it would be hard to use that country as an example of successful economic performance. I think, this is not so much a question of interest groups *per se*, but the long-run working out of the logic of majoritarian rule democracy, as they keep going after the better-off as in my new country, Austria. Every time they want to balance the budget, they say, "Let us get after the rich guys." Who are the rich guys? Anybody over median income is the rich guys. If you look at Sweden's current proposed budget package, it includes a wealth tax as well as some cutting-back of the welfare state. The result has been that a lot of capital has moved, and a lot of people with human capital have moved. And the per capita income in Sweden has been dropping quite dramatically. The trick, it seems to me, and this, I would argue, moves us into constitutions, is how democracies have been able to remain democratic and yet protect property and provide security. And again, these are a very few among the set of democracies. I would argue this has something to do with constitutional institutions.

K. Soltan: The difference between autocracy and democracy is not simply the size of the group to which you are accountable. The type of accountability, and its degree of formalization, matter as well. I am making here a standard political-science comment. We have two dimensions: one is the development of constitutional rights, and the other is the expansion of the electorate. This second dimension has to be considered in addition to the expansion of the group to which the chief bandit is accountable.

N. Tith: I just want to comment on two points on property rights and economic performance, especially in regard to Asia. One point that I want to make is that of the concept -- instead of talking about autocracy and democracy, I would rather talk about legitimacy: how these regimes use power. In Asia, the notion of property rights is not as structured as in the West. As you know, there are not as many lawyers; the legal system has always been very weak; the judicial system also is weak. Nevertheless, if you look at the autocracies in Asia, despite these weaknesses -- democracy, of course, is not as strong -- if you look at the recent economic performance, it is nothing short of a miracle. Why is it so? It seems to me that the legitimacy issue here is important. Now, whether in Indonesia or Singapore or Malaysia or Thailand, legitimacy is not based on votes alone but rather on delivery of high economic performance and how it is distributed. That is why these countries are called "Singapore Incorporated", "Malaysia Incorporated." It seems to me that this is important, to distinguish between the performance in the West and the rest of the world, especially Asia.

C. Coker: I wanted to pick up William McNeill's point about self-help because I think it illustrates one of the crucial differences between authoritarian and non-authoritarian regimes in terms of human agency and in terms of responsibility. Authoritarian regimes claim full responsibility or most responsibility for their own actions, and, of course, restrict the element of human agency in a society -- for obvious reasons.

You mention the Italian city-states, that are obviously the first quasi-democratic polities to contract out to the private sector, and in fact it is very useful and profitable to look at the phenomenon of mercenaries and mercenary armies. The problem with contracting-out to the private sector is that in the end the private sector in some cases

replaced the state. Many *condotierri* decided to stay rather than go back to Switzerland or wherever.

One of the other concepts which I think is interesting today is that we have societies that are not only beginning to contract *out* once again. But of course, if one takes the formal logic of this situation to its conclusion, one is talking about the private sector contracting *in* to government. And that, I think, is what makes authoritarian and non-authoritarian regimes different at the end of the twentieth century, or will make them different at the beginning of the twenty-first century, from what we have seen before. I will just take as an example of this, the two Bentham brothers. Here you have Jeremy Bentham whom we all know, but his brother, who most people would never know existed, Samuel, was the first management consultant and the first person who was interested in privatizing the armed forces, as opposed to privatizing the prisons, which is, of course, what Jeremy was interested in. This marvelous concept of the new prison in which the governor was a man of substance: recycling prisoners in other activities as well as ensuring that there would be prison labor, re-hiring many after they had been released. This was a very liberal prison system in which alcohol was going to be used as long as the prisoners could pay for. I suppose that we could do this with drugs in our prison system today and that the state could actually be responsible for supplying drugs as long as the prisoners could pay for them. But Samuel Bentham looked at the Navy and decided, "Well, why not go the whole hog in this respect as well". And here you have a marvelous example of the British Navy at the end of the Napoleonic Wars that considered self-help very important. You have private corporations like the East India Company with about 122 ships of the line which could sink any Royal Navy ship because they have better designs, and they have proper management, and they built better than the public sector did. Here you have a marvelous system in which there was prize money as a concept. Every ship you boarded and captured the crew or the captain or the commodore of the squadron -- got a share of the reward. Here you have a system: the British were taxed more than anybody else during the Napoleonic Wars -- but there was a limit to how much tax could be taken -- but also you had private companies. Ten thousand letters of marque were issued to those corporations during the Napoleonic War to capture and board enemy vessels. The ships were in fact merchant ships, not warships,

but they happened to be so much better equipped with cannon that they did not need convoys, and they did not actually require any help. They could more than help themselves. Samuel Bentham decided that these would be excellent principles to take beyond the Napoleonic Wars into the post-Napoleonic War period. But of course, governments did not find this particularly attractive. So, the concept, I think, which this illustrates is that, in a period where we are turning professions back into trades and we are transforming vocations into interests, we have not only a return to some of those historical verities that we have seen in the past, beginning with the Italian city-states, but we actually have an old phenomenon in a new guise. There are new aspects to this whole contracting-out and contracting-in business. And it is just something that I thought might be worth a couple of pages in your manuscript.

M. Blejer: I want to make a couple of comments on the issues that were raised by Stephan Haggard and Professor McNeill and to tie these to the Latin American references that are in the program. In fact, I think that what Mr. Haggard said, that the difference between autocracy and democracy is, to a large extent, the issue of to whom you are accountable, sounds extremely plausible. The question is really how this accountability is reflected. And I think that this ties very clearly to what Mr. McNeill said, that it is important to determine where the autocratic, or for that matter, the democratic, government allows the accumulation of wealth to take place -- whether it is allowed to take place in the government sector or in private hands. This could largely explain the performance of Latin American autocracies. The program takes as a fact the failure of most Latin American autocracies. Actually, if we look at the history, Chile is not the only place where growth was produced by a Latin American autocracy. In fact, the first period of Perón in Argentina, the period just after World War II, was very conducive to economic growth. And there are other examples of economic growth that took place under a dictatorial government in Latin America: Argentina in the nineteenth century, Colombia, and Brazil had periods of high economic growth under autocracies. I think that the difference is in the ideology: whether you are talking about an autocracy which has a populist ideology or an autocracy which has a market ideology, or in other words, the difference is where do you allow the accumulation of wealth to take place. The free-market autocracy of Chile is a good

example. The idea was to allow the private sector to accumulate wealth, in contrast to the populist autocracies which wanted to accumulate wealth in the hands of the government. It is more an issue of what is the underlying ideology guiding the autocrat and guiding this type of government.

I want to make an analogy, since we are in the historical section -- you mentioned I come from Israel, so I would like to make a comment related to that area, particularly since pharaohs have been already mentioned. A place you can look is the second book of the Old Testament. Look there at the description of how the pharaonic system in Egypt was able to prosper and become the most developed power of the time. And that would fit extremely well in Mancur's first chapter here. For it makes it very clear that the fact that the Pharaohs prospered at that time was because they highly respected the property rights of their subjects. There is an account of a *tête-à-tête* when the Pharaoh hired an economist, Joseph, who explained to him really how to conduct economic policy. Joseph told the Pharaoh, "In the good time tax the barley; in bad times, you can sell it, even profitably". Only under those two conditions, was he able slowly to accumulate the wealth of the population since he really was implementing an economic policy of accumulation and extraction. What happened after that, we know: the Pharaoh accumulated practically all the wealth of the population. And at a certain point, the peasants came to the Pharaoh and said, "Look, why do you not take our land as well and give us something to eat, because if you take our land and do not give us anything to eat in next period, we will be dead. We are taxed too much." He complied. And I think that this very much fits Mancur's first chapter.

A. Batchelder: I would like to go to the last line on this morning's agenda which is the African case, and I am looking for a model that explains medium-term political failure and longer-term economic failure. The two ideas that now occur to me have come together -- the two premises are Mancur's description of the objective of the autocrat, as trying to maximize the proportion of output taken; and then the Webb, and if I may say so the McNeill, premise that autocrats who obtain support necessarily exchange privileges for support. Putting these together, the model suggested to me that with the newly independent African states, the political leaders who moved themselves toward autocracy obtained support simply through

hiring. Thus guarantee was given, I think, by all of the newly independent states in Africa that they would hire all graduates of middle school, high school, and universities, and they extended hiring beyond that. And this was the method, going with Mancur's hypothesis, on the one hand, of maximizing the portion of total output that the government was able to take and then, on the other hand, this was a method of obtaining public support. The difference was between the medium term and the long run. In the medium term this was a method of maximizing the share of output that the governments were able to take for themselves. Initially, it worked with what in the long run turned out to be a modest effect on the total output, but over the longer run -- we are now moving along Mancur's hypothesis -- this resulted in large reductions in total output because of the extent of the taxation. The governments have been left in the longer run with economic failure, as the output fell because of this high taxation, and then they are stuck with all these government employees that the IMF and World Bank people here have been trying to help them reduce.

N. van der Walle: I was most struck by the complete absence of any kind of international factors both in your description of the rise of the state and in your description of transitions and of the failure of the Soviet state. I think that this is a serious omission in at least two ways. It is not only that in Charles Tilly's famous aphorism: the state made war and war made the state. If we look at Europe, for example, war is intimately linked to the rise of taxation and changes in the mode of political representation throughout the last thousand years. But I think it is also significant in terms of the discussion that we have had about accountability and the need for states to build support. Certainly, modern autocracies since World War II have often substituted international support for domestic; the international community in all sorts of ways has helped buttress states and autocratic leaders that could not gain support, in part because of disastrous economic policies. In Africa, for example, there has been considerable political stability combined with a great deal of economic failure. Most notably, I would advance the somewhat clichéd case of Mobutu who over 30 years in power has sustained a negative growth rate of two or three percent a year and yet, after 30 years in power, his personal fortune is roughly equivalent to the national debt -- I should say the international debt -- of the country. Now, I think this is important finally for your thesis in the sense that,

even if international factors have always mattered, the impacts of these international factors have changed over time dramatically and the international environment constrains and alters the incentives for political leaders in very, very different ways in the twentieth century than in an earlier period. So I would suggest to you that international factors have to be much, much better integrated into the argument in some way.

D. Mueller: It seems to me Africa is a good illustration of the reason that democracy is not a sufficient condition for these stable property rights. Arthur Lewis, 30 years ago, wrote a very interesting article arguing that Western African democracies should not adopt the kind of two-party winner-take-all models so popular in the Western form of democracy, because these are societies where you have constituent groups which are tribally based. Winner-take-all tends to be very much redistributional: one tribe gets in and they take from the other tribe or the other coalition of tribes. And he argued for proportional representation and consensual voting rules in Africa. This has not been adopted, but I think you see it: even if you had somehow a guarantee of democracy, you are still going to have the worry of which coalition of tribes is going to be in the government and the tendency, if you are on the losing side, for your property rights to be insecure, even though the democracy may be stable in some sort of institutional sense. So you need somehow to combine democracy with these stable property rights, which is hard to do in a majority-rule system.

Merle Goldman: I would like to address the topic mentioned at the beginning, comparative economic and social performance under autocratic and representative governments. What has been said is based on the Western view of history. I study Asia, particularly China. If one studies China, the basic propositions that are here presented are not appropriate. I will give an example: the Confucian system lasted for two thousand years, within that time there were dynasties that lasted for 400, 300, and 250 years. The question is, what made that possible? There are many reasons. There was a high level of taxation; Confucianism co-opted the intellectuals, the literati. They were able to rule at the centre and down at the village level, so even when a dynasty fell, local government continued for those 2,000 years. In this pre-modern era, China had no rule of law; no rights of

the individual; and no property rights. In fact, Japan began its economic development in the nineteenth century without any of these, particularly property rights, individual rights. They began without any of these fundamentals that you said to be so important. And it is only in the twentieth century that they moved toward democracy and introduced the ideas of the rule of law and individual rights. But their high rates of growth really began before they had any of these fundamental characteristics that the Western societies consider necessary for economic growth.

N. von Kunitzki: Professor Olson starts from the idea that one can apply economic analysis and economic standards to politics, and he comes to astonishing results. But this does not alter the fact that his approach is a gross simplification, and he of course knows that. If you say that government, as the expression of the majority, belongs to a group, and that each political group pursues its own interests, so that government does nothing else but defend its group interests, this neglects the fact that the government's activity is not only about economics.

Historically, the economy of most communities consisted of agricultural units that were almost self-sufficient, had little contact among themselves and practically no contact with government. At that moment, his description of government acting like a bandit probably fitted reality, as practically the only contact government had with the economy was to extort money from the citizens, like the mafias that exact "protection money" from their economic communities, Chinese, Italian or Russian.

To do primitive governments justice, one has to admit that, in contrast to the mafia, they also gave real protection to the economic community against outside enemies or internal threats from criminals. In that context, it should be pointed out that Adam Smith still restricts government activity to protection from outside and inside enemies and to some tasks in the construction and maintenance of infrastructure.

So, one can say that in the beginning government was external to the economy, just playing the role of a guardian in order to permit the real actors of economic life to work safely. Whether they asked too much for this task or not distinguishes Mr. Olson's bandit government from the good head of the household. There is scarcely any room for the application of economic concepts, standards or rules at that stage.

This changes, of course, with the growing sophistication of the economy, which necessarily gives government a greater range of tasks, and forces it willy-nilly to be present in many aspects of the economic life, as a supplier of services as far as infrastructure, education, research or sometimes transport and more directly economic activities are concerned, and as a customer for a great variety of goods and services. Even in a capitalistic economy, the state with all its ramifications and outlets will easily be the biggest employer and the biggest customer in many domains.

The wooing of that customer, by the competing suppliers, will quickly take the form of lobbying and lead to the formation of strategic pressure groups. But even then, this -- of course purely economic -- activity is normally no more than a marginal aspect of politics.

As I said, the government is not -- or should not be -- chiefly about economics, but reflects the moral ideals of the population, the social and ethical rules under which the population wants to live and the role that the community will want to fulfill in the international community.

A striking example of my thesis has been shown recently in France, when the new rightist government wanted to further free choice in education, by giving to private (in practice Catholic) schools the same financial support as to the state school system.

Although, admittedly, modern Western governments are chiefly, if not entirely, preoccupied with economic questions -- or social ones, which amounts very much to the same -- this purely political, religious and moral question immediately mobilized the French population: The separation of state and church was one of the great conquests of the French Revolution and the laicization of schools was one of the outstanding symbols of the Republic. As a matter of fact, the struggle for power was represented in every village by the quarrel between the curate and the teacher. So when government intended to touch the sacrosanct separation of church and state, the whole country rose to its feet. Not only socialists and other leftists, but even good Catholics and members of the rightist party protested and obtained the capitulation of the new government.

Yes, probably, the action of government was that which the mafia now exerts over large parts -- not only of Russia, the mafia is everywhere -- or what Chinese triads in every city around the world -

- just taking away some money. The biggest task of government was protection -- protection of itself, of course, as in the case of the mafia, but also protection against real dangers from outside. Now, this was true in the beginning and something which, of course, is missing in that little essay, which has only 150 pages, is that as the economy becomes more complicated, there is more room for government to have contact with the public. This is an aspect that should perhaps be developed. Mr. Olson touches on the question when he speaks about rights. But rights are only won at the beginning, and afterwards come the structures and all the institutions. The more that structure becomes sophisticated, the more room there is for government activity.

Now, I would like to develop two points from there. One is that in principle -- that might be, of course, pure hypocrisy, but it is not -- in a modern democracy, with all its complicated institutions, economics is only one duty of the government and not the biggest one. That must not be forgotten. If you take the French economy, for instance, it functioned very well with an almost public, socialist economy where everything was nationalized, while it was a democracy which had no idea of being socialist. And it comes out sometimes, Mancur. Very recently in France there was a vote about schools -- whether private schools should be subsidized by the government, and that was against the old French idea of the mayor of the village against the curate. And then came up the old Republican feeling, and this is relevant to what you say in your book, which is the idea of the "rational ignorance". Now, in this case in France, people were not ignorant about those things and they were absolutely not divided along party lines. People voted against the project. At that moment, Mitterrand had less than one-fifth of the vote in France, but he got a big victory over the Right because it touched a subject which people were not ignorant about. I will just say that in principle it is still the case that government's main activity is not economic, though *how far* this is true is something else. But what you -- not explicitly, but implicitly to people who do not know history -- are in danger of suggesting is that pure pursuit of profit, of personal group, etc. profit, is normal behavior, which it is not. You know that even a business man is not a *homo oeconomicus*. No, much less, of course, in politics. Two interesting points should be made. One is that if today we look at Europe, we see that the old parties which had chiefly ideological

differences are now more and more replaced by parties which only represent group interests. Take the farmers in Luxembourg. We have a party, with as the only point of the program is a 5/6 pension for the people. You have the ecologists who openly have one and only one goal. That is not the normal function in governing democracy; that is a perversion of a democracy. And when you come to the last point tomorrow, which is what are the chances of our democracy to be efficient, that is the way to be not efficient, and then we come to your system of perversion of everything.

The second point I wanted to draw out of this is that if you should develop more the influence of the sophistication of the economy, and of the increasingly complex resolutions between the institutions, which become more sophisticated as the economy becomes more sophisticated. Russia is a fantastic and, hopefully, only, example in history where the bandit comes into a sophisticated economy. The bandit's ability in the first place was highway robbery, you are quite right. All institutions we have, came from bandits. It is a rare example in history: in a very sophisticated economy room is made for a simple bandit. And we come to the question, afterwards, why some communist countries have those big difficulties in their transition from one system to another. You will probably see, or we might come to the conclusion, that the bigger the economy and the more complicated the institutions, the bigger was the void into which the bandit could come in. That is why small economies like Hungary, then fewer Czechoslovakia, then Poland -- I go from the small to the large -- have difficulties than the biggest of all, which is the Soviet Union -- and I do not mean Russia, I speak of the Soviet Union. So the difficulties of Latvia or Estonia will be the same because there is the big void in which -- a unique fact, I think, in history -- the bandit can replace the institutions.

Session II: Is there a connection between lasting democratic or representative government and the security of property and contract enforcement rights?

A. Clesse: The second session is basically on the connection between democratic or lasting government and security of property and contract-enforcement rights. We had already some discussion on this.

But first, perhaps, Mancur Olson would like to react briefly to what has been said so far, and at the same time raise a few issues for the second session.

M. Olson: One way to illustrate that, is to think of what is perhaps the single most emphasized point in the discussion this morning: the idea that very often we have a group of people that are operating as an autocratic clique rather than a single person with people carrying out his orders. I think that idea is completely correct, and one of the things that I have been trying to do is start always with the simplest aspect of the matter, and such an aspect of the matter that if you got it, you can add the other things and they will fit on naturally -- the way the limbs of a tree grow out of the trunk. And in that sense, the autocratic clique grows out of the idea of the single autocrat much as a branch grows out of a trunk of a tree.

In one of the papers, that Chris Clague, Phil Keefer, Steve Knack, and I have done at IRIS, we test -- with formal econometric tests -- not only the idea that an autocrat who is in power a long while is more likely to bring good property and contract rights than one who is in power for a short time. We test not only that theory in the book - - but we also look at whether there is an autocratic group that is in power a long while, and will it do better than autocratic groups or autocrats in power for only a short while. And the answer is, yes.

S.M. Lipset: I would like to talk briefly not so much on the substantive aspects, but in a certain sense to raise a methodological question of what we are doing here. There is a big difference between the way economists approach problems in their area and the way in which most of the other social scientists and historians do. Economists very consciously and deliberately abstract from reality. They make models. And the models are not supposed to be -- though they may deny it -- pictures of reality, but rather are derived from taking a limited set of variables, sets of assumptions, and setting up interrelationships. In fact, today, as you know, prestige among economists really goes to statisticians who are econometricians. Now, what Mancur has given us is not that kind of model. But it is an economist's model. And he has had the courage to face an audience of historians and social scientists. Somebody said there are only three economists here. And what happens in this case is that all of us, given what we are working on -- the three economists perhaps excepted --

engage in a multivariate analysis, which often requires dealing with an infinite number of variables. We all look for correlations and regression analyses. Hence, I think, the discussion, while it is fruitful, is also inherently wandering. And I am really not sure, even though Mancur said he has learned a lot, I am not sure how valuable it really is to him because, if he were really to take into account the kinds of things that people here are saying, he would have to write like David Landes. Landes is a historian. And his new book is probably, at least, ten times as long as Mancur's, even though both deal with the same subject. If Mancur were really to listen to us, he would write a book like Landes's. Mancur gives us a good take-off point, but he will not be very much smarter than he is by bringing in all these examples, such as autocracy control. Max Weber once said that autocrats have less power than democratic rulers because in an autocracy, when the autocrat wants something done, the bureaucracy can ignore him. Because of the absence of free communication, the autocrat's proposals can be ignored if they go against the interest of elite groups within the system. Weber's example, or one of his examples, was Frederick the Great's land reform. Frederick the Great planned a land reform; but it was not carried out. Why was it not carried out? Because the top civil servants were all Prussian nobility, they were landowners, so they just ignored Frederick's land reform. Frederick never found out because no one told him that this was going on.

Some years ago, I happen to have noticed that Gorbachev, on two separate occasions, made comments to the effect that "we have problems here because we only have one party". He said that explicitly. He did not go on to advocate multiple parties. What was the problem of a one-party system? According to Gorbachev, it was that he gave orders and bureaucrats did not listen, that his orders were not carried out. And he said, in other systems, where you have many parties, the function of the opposition is to expose, and to criticize. But we do not have anybody doing this in the Soviet Union. He was not calling for a revolution. What he advocated as a solution was that the press and the intelligentsia take on the function of the opposition, that they should be uninhibitedly critical. Which, of course, could not work. But it illustrates the error of saying that an autocrat is dictatorial and can boss everybody around, while a democratic leader can not. Take another interesting Weber point. In dealing with the relation of religion or values to economic developments, Weber, of

course, did not only discuss Protestantism in the West, but dealt with the East -- India, China -- and Confucianism. Weber's discussion of Confucianism considered why Confucianism inhibited, prevented economic growth. Today, of course, we talk about the Confucian miracle. There is a completely new literature which treats Confucianism like Protestantism, and asks what it is about the value system, the structure of Confucianism that encourages economic growth. Weber's conclusion stands on its head. And some of these people do not want to overthrow Weber, so they say Weber was right, he just missed some points. But nobody noticed them until development happened, until the change.

What I would like to see more of, and Mancur may have done it in his articles, is more correlation, regression, analyses, in relation to some of the propositions that can be tested. When we start talking about individual countries, and individual events, even in one period -- such as the transformation from communism -- we are dealing with a broad topic whose causal process is multivariate.

Looking at Eastern Europe in historical perspective, we must recognize that, except for the American case, no revolution, no effort at transformation to democracy has ever succeeded. Maybe it did in Britain, though the British transformation was a much more prolonged process. The French Revolution was a flop, the Revolution of 1848 failed, the Russian Revolution produced totalitarianism. How, then, did we get democracy? We got democracy, in every country which succeeded, through a long, slow process. That was true even here. We went from the two-party to a one-party system in the United States in the beginning of the nineteenth century, and we did not really attain an institutionalized party system until 75 years after the Revolution. But if you are in Moscow, and somebody comes and says, "Look, it is only ten years or five years, you have made a lot of progress if you look comparatively", this will not impress Russians. One of the things about looking at it historically is that we squeeze the past into periods that can be handled conveniently. When we try to look at transformations in Russia and other places, we get upset because things have been going in the wrong direction for five years. Well, developments moved in the wrong direction dozens of times in many of the countries which succeeded. To repeat, we are dealing with a multivariate universe. And the economist's efforts to lay down generalizations, and draw policy implications, when there are so

many different factors which can affect the rules, are just impossible. Obviously, one has to work in the real world, to make policy in the real world, and draw operable conclusions. But as scholars and analysts, we have the luxury of looking comparatively and historically, and in that context have to recognize how complex social change is, whether it is economic or political. All of the things which concern us, which have activated us, in relation to development or democracy in recent years, involve trying to deal with developments which from the point of view of historical time occur in an instant, in no time at all.

D. Mueller: It strikes me that there are two sets of issues which have arisen as themes in this conference and to some extent are raised by Mancur's book, and which are brought out by this historical compression. One set of Doug North kind of questions: How did the United Kingdom evolve over seven centuries, or however many centuries? Why did not China, with its great start, become one of the leading economic powers by now? Since it had a tremendous economic lead on everybody where did it fall by the wayside? Why did Argentina not continue on the path that is seemed to be on? And here one would get into various stories, Olsonian type of stories, about how, at some point in time, property rights became unstable; investments that could have been made did not take place, and so on. But there are obviously a lot of other details going on here, and whether the Olson simple schematic will explain a lot of these cases is a difficult question.

A second set of issues arises, if we just start with where we are and look at the present -- and this goes back to *Rise and Decline of Nations*. Think of the Asian Miracles, most of these countries are doing what? They are playing catch up. We now have technology sitting out there and any country, if it just adopts the technology which is there, can raise its economic standard of living tremendously. So the second question is, why do India and Japan go in different directions. Even though India has had stable democracy for a very long period, it has not been able to grow as rapidly as Japan and some of the other Tigers have done. Why did China wait so long? Why do not the East European countries shift over and pick up this tremendous increase that can take place in a short while? This is, it seems to me, perhaps a related question, but quite a different question. I think the preface suggests this, and we are going to come

back to it, I guess, tomorrow. But I think it is quite a different question or, at least, not obviously the same question.

C. Graham: Just a quick point, but it comes out of both the earlier discussion on different kinds of autocracies and, then, from Seymour Martin's comment. One theme that there wasn't a lot of emphasis on, and yet I think, is critical to the differences between democracies and dictatorships, and then among different kinds of autocracies, is that of information and the role of information and how free information is. A certain amount of information, public information, is critical for markets to operate properly. It is something I thought could be brought out, and used to distinguish different kinds of autocracies and why some perform well economically and others do not. The extent to which there is a free press, or some elements of a free press, or at least an element of public information is something to consider.

S. Haggard: I wanted to open a second front, and it was stimulated by the morning session. Let me first reiterate my objection to your claim that the idea of an autocratic group can grow naturally out of your notion of a dictator. I do not think that is correct. Your portrait of the dictator assumes the power to command. It therefore assumes what you are trying to explain. What we want to know is why it is that some dictators are capable of commanding others to follow. Once you expand beyond a single dictator, who is assumed to have the power to command, to explaining why others follow, you enter the realm of exchange and other sets of relationships between the dictator and the band, which are not explicated in your model. So, I do not think that it is true that you can start with this simplifying formulation and get to the relationship between dictators and the followers -- what you call the clique.

I wanted to turn this in another direction, which has to do with your conception of democracy, which is very much wrapped up in your notion of interest groups, as you have articulated it in your first two books. I have just never understood why you think interest groups are necessarily rent-seekers. The reason I do not understand it is because, although you apply economic techniques to the analysis of interest groups, there is no economy in the model. What do I mean by that? Your starting point, your state of nature or *tabula rasa*, if you will, is an undistorted market economy in which interest groups are introduced, and those interest groups create distortions. But that view

is singularly unhelpful in understanding the transitions you are trying to explain, because the starting point is not a market, the starting point is a system of distortions. In that setting, interest groups, in fact, may be carriers of property rights and the market. Their narrow interests are not rent-seeking; their narrow interests may be precisely in overturning an existing set of distortions. The process of economic reform virtually everywhere is a process of interest-group carriers of liberalizing norms and the protection of property rights. For example, bourgeois revolutions in the West were revolutions against a mercantilist system of distortions. Free-trade interests are narrow interests, quite specific interests, which are the beneficiaries of free trade policies, and which lobby for those free trade policies against a system of protection. One could go on. I get to that standpoint by beginning with the assumption that there is an economy in which there is a set of heterogeneous interests, some of which benefit from market-oriented policies, others which do not. The question of whether an interest group is going to be engaged in rent-seeking depends on what advantages they have in the market. If they have advantages in the market, then they are going to be pro-market, and they are going to organize around market-oriented principles. If they do not, they will organize around rent-seeking seeking or introducing distortion. So, unless we know something about the distribution of those preferences, and how they are articulated through the political process, we can not say anything about whether interest groups are going to yield distortions or going to yield the market.

A. Åslund: I follow the line Stephan Haggard picked up. Looking upon the former communist world, you see that the more interest groups there are, the less rent-seeking. If you look upon one particular group, for example, the coal-miners' union in Ukraine, you can argue that it indulges in rent-seeking amounting to a few percent of the GDP. But that is tiny money in comparison with the rent-seeking that prevails in the former Soviet countries. It is more relevant that the coal miners in Ukraine brought down President Kravchuk, and forced elections and imposed, in this way, popular representation, leading to radical economic reform, which was in their interest. More strikingly, in Poland, the original concerns of Leszek Balcerowicz were the trade unions and the workers' councils. In addition, the Church and private peasants were against radical reforms. However, in hindsight we see that these interest groups, that

were all against reform, saved reform in Poland by creating much more of a civil society.

In Russia, the government had no problems, worth mentioning, with the trade unions, which meant that the enterprise managers were unhampered. Few other interest groups constrained the managers. The more interests, the more checks and balances there are and the less rent-seeking.

I.M. Destler: One of the things I thought was not perfect in Mancur's book -- and therefore will be improved, I am sure, when it is published -- was the final two or three pages. After developing and emphasizing the problem of demosclerosis or the capture of policy by interest groups, he has an exhortation of about one page which says, "Maybe if people listen to the intellectual elite, and the intellectual elite listens to economists, then somehow all of this is going to be reversed". So the framing is: sort of greedy interests on one side, and enlightenment on the other; but maybe these interests are so narrow that enlightenment is going to succeed after all.

The intellectual elite is hardly that strong. But it gets a lot of help, as others have suggested, because the political process involves competing interests, some of which will, in particular instances, be in favor of liberalization, as Stephan Haggard pointed out. I did some empirical work a decade ago with John Odell on some of the greedy, selfish interests in trade policy, which (in this case) wanted to make money by liberalizing trade or by blocking protection. Or you can just look empirically at the evolution of US trade policy over the past sixty years or so. On average, despite persistent efforts at capture from many groups, and sometimes successful efforts of capture of particular policy pieces, US trade policy overall has moved in a progressively liberal direction. You have governmental actors who are able to pursue liberalization, and to play off one group against another, who are able to mobilize support. And finally, you have the dynamic of internationalization, the international flow of capital, the international flow of goods and communication. In the United States, and certainly in a lot of other countries, this dynamic is pushing liberalization, limiting the strength of rent-seekers. So, I think, if Mancur turns out to be right on the democratic nations having the best hope for the proper legal institutions, there may be more hope than the manuscript currently suggests about the evolution of politics

and interest-group interplay toward a more open, long-term economic future.

C. Clague: I thought Haggard made a very interesting point. I just wanted to mention another example to support him on how we often get liberal institutions arising out of the selfish actions of particular interest groups. A dramatic example of that is the medieval guilds. There has been recently some work by Avner Greif and others showing how the medieval guilds permitted an expansion of long-distance commerce in the period 1100 to 1300 -- one example is the Champagne fairs. I was used to thinking of guilds as being interest groups that repressed technological change and kept out competition. They, of course, did do that. The Champagne fairs were a club which they created, and in order to be a member in good standing of the club, you had to have paid your debts, or if you had not paid your debts, you had to make compensation. Thus a good club was created by selfish interests which facilitated quite a remarkable expansion of trade. So, I think, that is a very useful model to keep in mind.

J. Oppenheimer: I want also to build a little bit on the comments that have just been made. They tie back to what William McNeill said at the beginning when he pointed out that there was a particular constellation of interest groups in the Venetian city-state and some of the other small mercantile systems. I did want to indicate that I believe that Professor Haggard is correct. But he did not draw the next step, which is that the constellation of interest groups that is going to coalesce or will look like a coalition structure behind a regime is not usually going to be stable. That is a very important point to notice. When we talk about the instability of these things; let me first point to the literature, so we are clear that I am not just saying it historically; I am saying it theoretically: Bernholtz, Kadane, myself, and then the generalizations and the proof -- those were all having to do with democracy -- by Schwartz: his general instability theorem. This literature shows that when you have to make a trade, and I would argue that all politics has to do with trades of interests and the pay-offs that are being made to various interest groups -- when you have to make those trades, there is no core in that game. I believe that this is an extremely important point to raise, and it is important precisely because what looks like, what you might want to call a carrier of a market constellation of interest groups that sits behind a

regime, can tomorrow become a carrier of a rent coalition merely by a few elements being switched in the program in order to stabilize what is inherently an unstable high-wire act. I will give you some examples of wrong-headed arguments that have been clearly stated and are fundamentally flawed. Example one: Buchanan's argument that you can explain the growth of democratic governments in terms of this kind of rent-seeking by majoritarian coalitions of interest groups. It is interesting that if you look at the data -- I think it was van der Walle who pointed it out, that it is true in democratic government's as well -- the growth of governmental sectors is almost completely a function of war. It is true that there has been this little blip that occurs in between business cycles having to do with entitlements, but if you look at the United States, and you ask how has the tax bite out of GNP gone, it is strictly a function of war. That's not only in the United States. As you pointed out, it is true in other countries in Europe, democracies in Europe.

Other arguments like that, that have been incorrect, have had to do with the fact that -- as in your previous book -- you can look at such cases as Japan as having low rent-seeking or only very broadly defined rent-seekers, that is, rent-seekers that had interests in the whole economy. As we can now see, that coalition of rent-seekers, in fact, had very narrow interests. It just looked, for a short period, like it was broad. Watch it break apart by the democratic process, as occurred in the United States when the Republicans were able to say, "Why are we paying all these special interests?" Now, notice as that bill comes to be paid some of the special interests are able to say, "You do not want to get rid of us". And people are saying, "No, we do not want to get rid of you". The cyclical pattern is very important to notice, and it definitely is at the heart of a lot of political issues that both McNeill and Haggard have raised.

A. Tsipko: I agree with the main ideas. There is a gap between classical economic theory and the theory which you present to us. I agree with you: there is a problem how to change our Russian bazaar into a real market. It is understandable without any theory. We need two main preconditions: security for private property and the absence of predation of any kind. What is the reality? In our reality, it is a society which cannot work without respecting the interests of the military complex or the miners or other big entities. But in reality there are big contradictions between all these interests, if you try to

imagine our reality and the absence of predation of any kind. It is the radical and very quickly introduced reforms which destroy all our big state-sector economies: military complex, miners, and so forth. And what is the result? It is our reality of today: it is unemployment; Russians who hate democrats, who hate reformists. Russians who now support the Communist Party. It is the feeling of instability, the feeling of the fear, which contradicts your first precondition. That is why for us it is a problem. Of course, we need all of these prerequisites. But how in reality can we achieve them? All these real problems have a real context in our reality, in our real law of transition. Your problem in our reality is the problem of connection between radical reforms and gradual reforms.

The second problem, and here I agree with Professor Lipset, is the problem of the evaluation of these reforms. It is very interesting that the Western vision of Russian reform has from the beginning been very contradictory. On the one hand, you worry all the time about the dangers of a restoration of communism. That is why you always support radical reforms which very quickly destroy the Soviet system. And this produces our Russian public. On the other hand, you really want a real market, a real law, and so on. If you look at our reality, you must, to my mind, use more humanitarian criteria. I am studying at the moment the criteria which the West uses to analyze our realities. It is very interesting. The West is using typically Marxist criteria. Do you know the difference between the Marxist criteria of progress and the humanitarian criteria? For humanitarian progress it is a problem of personality, a problem of values, of happiness, of self-realization and so on. According to the Marxist criteria progress happens according to the laws of history. But, as I see it, the Western criteria now and the old Marxist criteria are the same. With one difference: the Marxists say that with the law of history one builds communism; the Westerners say that with the law of history one builds the market economy and democracy. So the West says, Chubais is a good man because he is for quick reforms. He has organized very quickly the privatization which gave us 60% of private property. This is a typical Marxist criterion, very artificial. But of course, it is a real criterion. It is your criterion. The sanctity of private property represents real stability.

In order to understand the real process two problems must be addressed. First, there is a methodological problem. There is the

understanding of the specific nature of this process. You tend to put all the countries in the same basket, Eastern European countries and Russia. But they are different countries, and these are different processes from the beginning. In the Eastern European countries it was a revolution from the bottom against the Soviet communist system. In Russia it is another story. It is the typical Russian revolution from the top. From a historical point of view, in 1985, everything was possible. If Andropov were still alive, he would probably be First Secretary of the General Party. Now, Russia and China may go together in the next century. You must understand, we do not fulfill any precondition for a typical reform. Therefore, as I have explained, we must start more carefully. It is a specific feature of the Russian revolution; the problems of the subject and so on. The second problem, of course, I repeat, is this problem of the still divisive philosophical paradigm. It is not the value of democracy by itself, or Christianity, or something else that is important. It is the humanitarian value that counts. Maybe then we have the key to understanding what really happened in this country.

A. Kortunov: Just a very brief methodological comment. I think that one of the problems that we face in the discussion is that we are really trying to develop a very general theory. And our discussion shows that the picture that we are trying to have is a static, not a dynamic picture. We try to compare very different periods, very different cultures, very different societies. And that is why we end up with being rather superficial. At least, that is the impression I have. I think that we are running the risk of being trivial, I would like to propose that we should analyze the notion of dictatorships in different societies with different social and economic needs. For example, a dictatorship in a traditional agrarian society is one phenomenon, and if we study medieval kingdoms, we should keep it in mind. It has very particular functions: economic, social, security functions. These are mostly paternalistic types of regimes. The key function is still protection. Now, if we go to modern times, then there is a different type of dictatorships there. And now, the major function is not protection, is not only protection, but also mobilization of resources, formal organization. That's why dictatorships from more or less paternalistic monarchies turn into totalitarian systems, because these can provide for mobilization of resources better than traditional monarchies.

Finally, when we enter the post-industrial society, the post-industrial world, where the currency of power is information, then, of course, the role of the state, the role of the government, is changing completely. And it is an open question whether one can really imagine a dictatorship in a post-industrial state, whether it is feasible at all. Can we imagine that any country can combine political authoritarianism with successful economic competition on these markets? So I suggest that we should probably slice this whole issue into more or less organic historic patterns.

Marshall Goldman: I do not mean to anticipate the discussion of tomorrow. But some things were said that I would take issue with, while I would agree with others. I would agree to some extent with what Mr. Tsipko just said. Russia is peculiar, and I think we have to understand more about its culture, and its lack of Western institutions. And of course, you can say that about countries in Asia too. But one of the things that I have been concerned with very recently is the fact that the guild system did not exist in Russia; the Renaissance did not occur; the Reformation did not occur. As a consequence there was state control for 70 years, as well as a rigid form of state control before that. This goes back to some of the things Mancur was saying in his earlier chapter. You did not have that sense there should be self-governing from the bottom. What you had was control from the top. In response, the Russians developed an ethic which applauded cheating the state. This was the thing to do, and you were not chastised for it. This was where you made your living, basically. So what happens when Russia switches to the market? Suddenly the Communist Party is gone; the General Secretary is gone. In their place, you will be guided by self-governing principles. But the problem is that in other societies the self-governing principles facilitated introduction of the market and there were mechanisms for self-governing: the guild system, certain quality conditions. Cheating took place but it was not right to cheat. But in Russia there were no such restraints; instead the standard in Russia today is dishonesty. Under the circumstances how can you expect people to pay taxes in a self-disciplined way? It is just not going to happen. Before, individuals in Russia, in effect, did not pay taxes: it was deducted from their salaries before they got their pay envelop, or it was paid through a sales tax, a turnover tax. But the individual never saw a tax. Suddenly, you tell people, "Well, communism is gone now. It is your

own government, and you should support it". That does not mean people are going to pay taxes. Such an environment is also made to order for the mafia. If you talk to Western businessmen who are now involved in trying to work out legal arrangements, they regale you, or they depress you, with stories of cheating, and misunderstandings and the need to pay off the mafia. You sign a contract, and the conditions change; and the contract is simply no longer in existence -- it may have legal standing, but it is not going to be enforced. I wouldn't say that the mafia is more likely to flourish in a large country. I would say the mafia flourished because there was a vacuum, a vacuum which developed when the society disappeared. What happened is that a series of cartels took over during the move to the market. This was made easier because the reformers did not emphasize the creation of start-up or brand new businesses. Instead they stressed the privatization of the state monopolies. But when you privatize the state monopoly, you end up with a private monopoly. And you will not have that underbrush of service activity that is essential for a functioning market. You can not create a market by simply saying "We have privatized a few things". You have got to have enough competition. There was no competition, and so that's why prices rose, and you got all the other different problems. Economists argue that privatization is better than state control. I agree with that, except there has to be competition in the privatized sector; if not, you get the mafia and the criminality that did indeed develop. Nor is it just the mafia. There is also great anger because of the appearance of the new plutocrats. They have taken over what before were state industries. 61% of the owners of these new state enterprises, now private enterprises, were former members of the Communist Party elite. They just simply changed hats. Many of these newly transformed private businesses are more of a burden for the economy than were some of the state enterprises.

Merle Goldman: China never had the Reformation and the Renaissance, and never had a real guild system. It had guilds but the guilds were controlled by the state. Yet, as we all know, China has had it much easier in moving to the market than Russia has. What are the reasons for that? Why was it so much easier? Despite what Marx said, China had a very short period of feudalism, early in its history. For most of its ancient history, down to the present, except for the communist revolution, peasants worked their own land. When Deng

Xiaoping gave the peasants back their own land after Mao's death in 1976, he had a very entrepreneurial peasant there. It was a peasant who remembered what it was like before the collectivization. He had had only twenty years of collectivization; the Russian peasant had sixty years; there was no one in Russia who knew how to be entrepreneurial. So that, in China, the move to the market really came from below and Deng Xiaoping's leadership affirmed what was already going on on the ground. Therefore, the reforms in China began in agriculture, where the major stimulus and the major impetus of the reforms lay. Nevertheless, Chinese farmers have no real property rights; they have no rule of law, no individual rights, all those things. One of the questions I would like to ask here: Does moving to the market necessarily mean that a country necessarily moves to democracy? I would agree that you need to have the market to have democracy. But an economy based on the market does not necessarily mean establishing democracy.

A. Tsipko: In Russia there was a guild system before the Revolution. It developed at the end of the eighteenth century.

Marshall Goldman: I am sorry. You are right. But it wasn't so much a handicraft merchant guild system. It was more business, commercial guild. The guild system I was referring to really had to do more with handicraft activity. I stand corrected there. But I still think the point stands.

A. Kortunov: I think that this discussion about Russia and China is a fascinating subject. I cannot miss an opportunity to jump in. I think that the difference is that, basically, what China faces are initial development needs. China has to develop; Russia has to reconstruct. It would be not, I think, correct to compare the China of 1996 with the Russia of 1996. You can compare China today to the Russia of 1917, because China, like Russia before the Revolution, is a predominantly agrarian society, a society which is being modernized. However, Russia, in many ways, is already a post-industrial society -- if you take into account the level of education, the level of social mobility; if you take the demographic trends in Russia. So, basically, it proves the point that I made earlier that you cannot really compare because different countries are stationed at different levels of economic and social development. Otherwise, it would be very

difficult to understand why some countries are more successful up the road than others.

S. Webb: Going back to the topic of this session -- the connection between lasting democratic representative government and the security of property and contract-enforcement rights -- in both the democratic and the authoritarian context, the government faces two sorts of challenges. One is the challenge of populism; which threatens to break down the rules and expropriate property in order to give it back to the poor, through some sort of redistribution. And the other is the corruption of, or predation by, the bureaucracy. In both authoritarian and democratic contexts you have that challenge. For example, the Cultural Revolution can be seen as a populist kind of an authoritarian measure. Or Chile before 1973 shows a similar violation of property rights coming about through a democratic society. Alternatively, the corruption of the bureaucracy arises sometimes with democratic structures and sometimes with authoritarian. Which source of authority, a democratic source of authority, a right-of-kings or some other authoritarian source of authority, makes a system that is better able to fight against these forces or to purge itself and to reconstruct the core so that neither populism nor the predations of the gang will eat up that core? For only then do you get strong growth either under authoritarian or under democratic systems. The model does not have to explain everything, but if we can get a model that will explain some of what is going on, it would be more interesting.

L. Gordon: I wish to make one very small point. Mrs. Goldman raised the question as to whether you could have substantial capitalist progress without democracy. It seems to me that the answer is clearly yes. One rather dramatic example was the German experience between Hitler's assumption of power and the outbreak of World War II, when there was a very substantial revival from the severe recession or depression that Germany had gone through. And it was looked at by a lot of people with respect. One forgets easily. I happened to be at Oxford during the critical years, 1933 to 1936, and traveled on the Continent a great deal. Democracy was in very poor repute at the time. France was struggling to maintain it -- and not being very successful with her governments. There were lots of people who were trying to develop new models of political development, but somehow or other they all ended up with fascist

regimes. And that outcome was taken for granted -- partly, because of the German example. Italy is a little more uncertain. Of course, Italy had fascism for longer. Whether the Italian experience in the 1920s and 1930s was a successful economic experience, I do not know. But it was successful enough for there to be no doubt about Mussolini's grasp on power, until he foolishly joined the alliance with the Nazis. So the answer to Mrs. Goldman's question is "yes".

C. Clague: Well, I think many people have made the point in this discussion that there is a tension between the economist's desire to create a simple model and the attempt to come to terms with the complexity of the world. And I am sympathetic to both. I wanted to emphasize one variable that, I think, is important in order to understand the differences among countries: whether people accept and obey the rules. I use the term "rule obedience" to refer to this. Some societies have rule obedience, and some do not. The underlying basis of this can be very different. In past historical times, in Europe there was widespread acceptance of property rights based on a narrow distribution of that property. The nobility had to beat the peasants into accepting their rights. That was accepted. Of course, that changes with the development of society. As the franchise is extended, what used to be regarded as the rights of the elite often get eaten away.

With regard to the question of whether you can have sustained economic growth under autocracy: yes, I agree it can go on for some considerable time. But the trouble modern autocracies run into is that they lack legitimacy -- they do not fit into the philosophical *Zeitgeist* of the time. They may lack an intellectual support: communism is no longer valid, the divine right of kings is no longer valid, guided democracy is no longer valid. It seems as though autocratic governments, as in Korea and Taiwan, feel compelled to follow our lead to democracy -- a thesis that Seymour Martin Lipset has proposed, and I think it stands up extremely well. There is a very strong tendency for a country, as it develops economically, to evolve into a wider sharing of power and into democracy. That is one stable form of interaction between the people and the government, which leads to, or sustains, rule obedience, where people obey the rules, respect property rights, pay their taxes. I think there is a close connection between whether people obey the rules and whether the government bureaucracy functions properly. I think this is another

very important distinction among different kinds of countries. There are some countries that have very strong bureaucratic traditions. And it is not just a matter of what social class the bureaucracy represents. It is a question of whether the bureaucracy itself functions well; and that is a big difference between countries like Japan and France, where there are very strong bureaucracies; and Latin America, where there was an elite, land-owning group, but which did not have an efficient bureaucracy that could provide public goods and remain free of corruption, which would have tended to prolong its rule. So, actually, when we are thinking about how to reform less developed countries -- ones where rule obedience is very low -- I think that one of the important wedges by which you try to rectify that type of situation is to develop an efficient civil service.

I just want to mention one other example of how societies develop in different ways; therefore, we must be somewhat modest about what we ask our economic models to do. We must take certain things as given. In some societies we should take as given that there is rule obedience, and in others we should recognize that there is not. An interesting example illustrating both of these points is Botswana. Botswana is a country that some people call a democracy because they have free elections, and they respect the rules of democratic procedure. However, since the ruling party has never lost, some people do not consider them to be a democracy. They also have a very effective civil service, an elite civil service of the Weber type -- very high salaries, high prestige. And they deliver the goods. Japan is another example of where a very efficient bureaucracy which has an encompassing interest, by providing a public good, and by not being corrupt, reinforces the longevity of the regime; perhaps the legitimacy of the regime. The point that Tith made is very valid about some of the East Asian societies: there is an equilibrium of rule obedience where the regime is providing economic growth and an equitable distribution of income and is avoiding corruption. I think a highly corrupt bureaucracy makes the regime vulnerable. So, the connection between democratic regimes and authoritarian regimes and economic growth is a complex one. However, I think we can say that there does seem to be a sort of a high state of development of the rich democracies of the world, where democracy is very well entrenched -- I do not think that there is any doubt about its continuation. And I

also happen to think that economic growth is well entrenched in those countries.

N. Tith: I have two points to make. One is on the terms of approach, methodology: that I think this subject is not a static subject. It is a dynamic subject. So stages of development, stages of political development, economic development will have to be taken into consideration.

The other point is China and Russia. A very important point: that it is true that we cannot analyze these two countries because they are in two different stages of development, very different. Now, in China, as we all know, there is the beauty of being underdeveloped. Now, why do I say that? It is simply that China does not have that many industries to privatize, for instance; and that the country is so underdeveloped, and its bureaucracy was so quickly destroyed by the Cultural Revolution. However, entrepreneurship was still there, dormant but existent. Once the constraints were removed, those people were immediately able to come into focus.

The second point is that China is different from Russia because China has overseas Chinese. The overseas Chinese -- you do not have that in Russia, overseas Russians. Overseas Chinese are a very important point in terms of market opening, in terms of technological transfer, in terms of, also, ability, management ability, and so forth. These are absolutely not found anywhere else in Europe.

Marshall Goldman: I am going to take issue with Mr. Tith. You know, we look back at it and we say, "My God, it was inevitable that the Chinese would do a very good job". But I suggest, what we should do is look at it as if we were back in 1970 or 1975, before the Chinese began their reforms and ask the question, "If you were to compare China and Russia, at the time, which country do you think would develop more rapidly in a market environment, assuming we do away with communism and central state control?" I do not think you would pick China, primarily because it was a nation that was made up of 90% peasants; it had no experience; no exposure to the industrial market. Remember China had periodically gone through starvation; had been politically disrupted; had no political system. I would agree that the fact that China was homogeneous seemed to help, but not just because there are overseas Chinese. In the contrast, you look at Russia; what do you find? You find a society that had

indeed industrialized; people were familiar with machinery, knew what to do with it; and, presumably, could have taken their experience and exposure to industrialization and set up their own shops and begun to produce. But the Chinese had no experience, no exposure, basically, to industry. Of course, one of the things that's so striking about China now is that it has become industrialized. The countryside is filled by new township industries that are growing, and have developed an export surplus of industries, not agricultural products.

Now a word about the overseas Chinese. It is true that the overseas Chinese were important. But not at the early stages of development, not until the mid-1980s. In the beginning, when the reform process began in December 1978, and then 1979 and 1980, the overseas Chinese, like everybody else, were staying out because they did not know what was going to happen. It was too risky. When the overseas Chinese came in, boy, they came in big numbers. What is interesting is, now you are beginning to see the same thing in Russia: some of the overseas Russians are coming in. Most of the big investment banks are run by Russians who have returned to Russia. This has not had as large an impact, I would not disagree with that. We just had a conference where we brought representatives from the investment community in Russia. And almost all the major banks, investment firms are headed by Americans who were born in Russia. The overseas Russians, now, are beginning to come back in the same way. There are not as many; they are not as rich as the overseas Chinese were. But again, I think the important thing is that in the very early stages, the overseas Chinese stayed away from it just like everybody else.

S. Holmes: I simply have a question of information, a clarification. There has been a great deal of discussion here of the distance between historical richness and theoretical parsimony, but there is also a problem about the relation between parts of the book which, I think, is unclarified so far. Are you trying to explain the emergence of stable property regimes? Stephan Haggard and I were talking in the intermission; we were wondering about this: If historians showed that stable property-rights regimes emerged only from special-interest group lobbying, would that be refutation of your theory? Would it?

M. Olson: Yes.

S. Holmes: That is interesting already. So you are not immunized against historical evidence as I had thought you might be. How to explain the emergence of stable property-right regimes? It looks like you have a theory which says it is hard to create them because it is hard to create a government capable of repressing force and fraud that won't use force and fraud for its short-term interests. So there *are* special-interest groups -- unlike what Steph said a few minutes ago -- which are the bearers of liberalization on your theory. These are the revenue-enhancing autocrats, who have an incentive to limit themselves because they can get a larger chunk of the social output and property. The problem is that those two explanatory factors are universal through history. While examples are rare, as Mr. McNeill said. That is, stable property-right regimes are rare. So, you have an example which would explain the emergence of these stable property right regimes anytime and, therefore, you do not have an explanation. That's my intuition.

M. Olson: Could you elaborate a little bit more on that? I would have thought that the argument in Chapter 2 about power-sharing and how you could only get it with the accident, the improbable accident, of a stalemate, a balance of power among contending groups would be exactly to the point. So, you must have a deeper...

S. Holmes: Well, I mean, the relation between your different attitudes towards pluralistic stalemate is baffling because sometimes pluralism is the source of social irrationality and then at other times it is the source of emergence of valuable social institutions. So, under what conditions -- that is just another question I had reading your manuscript -- are these forms of pluralism productive and under what conditions are they destructive? You use phrases like "encompassing" or "narrow"; I am not certain that that is not just verbal. If the outcome is good, you re-describe the interest that led to that as encompassing. Perhaps, maybe.

M. Blejer: A very short point, a footnote actually, on the overseas Chinese. I think that as Marshall Goldman said, the question is not really: overseas Chinese or not. I think there are overseas Armenians; there are overseas Croatians, who are much, much more numerous than the people living in the country. There are overseas Hungarians, some of them are very rich, as we know. There are overseas Poles; for that matter, there are overseas Mexicans. The issue is what is the

environment in the country that allows these groups to take the initiative. This is an environment of respect for their property rights. The overseas Chinese will not invest in China if they do not have any security that their property rights are going to be respected. It is not so important to have overseas communities. The important thing is to have capital overseas owned by residents. There is a lot of Russian capital abroad, as a matter of fact. There is a lot of overseas capital owned by Argentineans and Brazilians and Mexicans and so on. This point is: What type of regimes will promote capital inflows? The question is really a question of respect for contracts or property rights, more than a question of where the communities are.

N. Tith: I am sorry; I have to answer that quickly. The point you missed is that the Chinese community -- I know their nature -- it is not just the Chinese overseas, it is *the Chinese Period*. It is the overseas Chinese network. And with Asia, it is important to have a network.

Session III: Must special-interest groups for lobbying of governments and cartelization of markets become more numerous in any lasting representative government?

M. Olson: There was one question from this morning that seems to me especially well suited to introducing the discussion this afternoon, with its different topic. This is the one that grew out of Stephen Holmes' question, which I have discussed a little bit with him over the lunch hour. You recall he asked toward the end of the morning: If the special-interest groups were so bad as I claim in this manuscript -- and in the *Rise and Decline of Nations* -- if special-interest groups are bad, if they have a narrow interest, and because of that narrow interest they act in a way harmful to the dynamism and efficiency of society by introducing diverse distortions -- if they are so bad, why do we get, according to my argument, the good chance of a good outcome when we have a group of individuals -- let us say a group of leading citizens like those who made the American constitution or the magnates and leaders who made the Glorious Revolution in Britain -- why do not each of these leaders or families, if each of them also represents an interest that is small in relationship to the society, and is

therefore a narrow interest, why does this not also lead to a bad outcome? Well, I would argue that you can best see that by thinking of the difference between a vote on a package of measures as contrasted with a series of separate decisions on each one of a set of individual measures. Suppose we think, to make the case most frighteningly -- suppose we imagine that the President should persuade all the lobbies in Washington to sit around one table. (Of course, this table would not nearly do, Armand. It would take a gigantic table.) Suppose we imagine it happening. And suppose the President, as it were, should propose to the lot of organized special interests that the distortions or privileges of each of them would be done away with in one fell swoop. Now, I would argue that it is entirely possible that the special interests would vote in a package deal for doing away with all special interests, let us say. Obviously, each special interest's best outcome would be to retain its own privilege and get rid of all the rest. But if that's not an option, because it is a package deal, each special interest then has to ask itself: Is what we lose from the special interests given to all of the others maybe larger than what we gain for the special interest that we have for ourselves? In many cases the answer will be "yes". Of course, this is not the whole story: there are lots of groups in the country that are not organized at all, and the gains and losses to them wouldn't even be hard to calculate. Nonetheless, this kind of decision on a package measure does bring out different sets of incentives than when you have narrow interests taking things one at a time.

Now, as Dennis Mueller and others know, I think the idea that all sorts of evils of government can be stopped by having a constitutional convention which outlaws them is an argument that can be pushed too far. Nonetheless, I must definitely be a plus for the constitutional setting, you see. That is to say, you can think of a constitution at its best, as votes on rules or packages of measures which will affect everyone, and so there is some incentive for them to vote for efficient constitutional rules. And something like this is behind the Rawlsian decision on moral rules, as well, behind the veil of ignorance. So, then, one can think of the kinds of things I talk about in Chapter two, where I describe how a power-sharing arrangement can emerge when you have this accidental evenness of power of different interests -- one can think of that as leading to efficient outcomes in many cases, and that is not, I would like to think, inconsistent with the idea that

narrow special interests, in general, will introduce distortions and make for inefficiency.

Now, one of the reasons I hope that we will look at that sort of logic, and that sort of problem is that it seems to me that, by and large, the United States and the other developed democracies of the West, and the other countries we could talk about too -- by and large, they do not have arrangements which bring up a package deal. We do not see very often the leaders, Presidents or Prime Ministers, in any country having this kind of context where there is an overall vote to make things more efficient. Sometimes it happens, when there is a crisis. Say, the IMF comes in and intervenes because there is a crisis. They have to have a package of measures, or there will be a disaster, and they will not get an IMF loan. Sometimes, things like that happen. But in the United States and in Western Europe, it seems to me, this is not what is mainly happening. When one looks at countries like Germany and Japan after World War II, one sees them working very well at first after the war. But then, as time goes on, gradually they accumulate more special-interest organizations; their encompassing organizations devolve, and the economic miracles gradually change into eurosclerosis. So, one of the things I hope we would think of is the evolution of societies over time, and this should also be thought of in terms of Mat Destler's criticism of the end of my manuscript: he points out that in only a paragraph or two, I deal with the role of ideas. But, of course, ideas are immensely important, and, of course, it is disproportionate to give them only a paragraph or two. So, if we could also deal with the struggle between the social learning -- the advance of knowledge, of societies coming to understand a little better what their situation is -- and the accumulation of special-interest organizations, if we could see that tension, in my judgment it would be very valuable.

R. Cooper: An example of what Mancur is talking about is trade negotiations. The most recent example is the Uruguay Round. An extremely complex package was negotiated by relatively few parties, and then put before Congress on an up or down basis. Congress explicitly recognized that such a package could not be gotten through Congress piecemeal, for the reasons Mancur suggested. A comprehensive package was put to an up or down vote; and in the case of both, the Tokyo Round and the Uruguay Round, the vote was up.

L. Gordon: A similar logic applies in this country for selecting military bases to be closed down. If you try to do it one at a time, it would be impossible; so it is done as a group. And Congress has agreed to a self-denying ordinance under which it votes them all up or down simultaneously. It is exactly the same as the Uruguay Round for the tariff arrangements.

I.M. Destler: One more example of that is our Congressional budget procedures that establish overall ceilings. Once they do so for spending or tax revenues, a member can no longer simply propose to add a benefit, he must also propose to cut something, to take something away, or to provide additional revenues. The Congressional budget process forces attention to the whole of the balance of taxes and expenditure.

D. Mueller: I think it is questionable how much of the economic success of the United States is attributable to the Constitution *per se*, though one can point to things like the commerce clause, which created free trade within the United States -- protected free trade within the States, the protection of contracts, and so on. If one could argue to some extent that the US's economic success and the stability of property rights and all that, in the Olsonian framework, had something to do with the Constitution, then, I think, again, this notion of consensus, although there was not a unanimity rule at that Convention, but in fact, there was this fear -- over-exaggerated -- of not going back to the articles of Confederation and the perceived instability, under the articles of Confederation, had much to do with it. And again, of course, the anti-Federalists were not at the Convention, which helped promote consensus. But, throwing those details aside, it was the case that there was really a threat of veto, if you will, or at least of opting out. The Colonies were sufficiently autonomous that if a Constitution had been chosen that many of them really felt was bad, they could have simply walked out. The South, if they had been able to see further into the future -- could have just walked out and stayed out. So there was a kind of consensus there.

One might argue the same about the Glorious Revolution. I am less familiar with that, and certainly there was no Convention or anything similar. But there had been a rather nasty century that preceded it. I could well imagine that people thought, "We have to do something to try and avoid this happening again".

Closer to home, in time at least, closer to my home, people have argued, and I am not sure how far I would push this, that the economic success of Switzerland and Austria -- in avoiding, at least, a lot of labor friction and so on -- is attributable to cooperation among the various interest groups, and, particularly in Switzerland, to consensual decision-making. This is very conservative, and so Switzerland does not do lots of things that maybe some people think it should. But it does focus much more on positive-sum games. And Austria has also had much lower unemployment rates, perhaps in some ways only apparently, and much less social disruption than other countries. That is now breaking down. I think the consensus decision-making in Austria has broken down, but not in Switzerland. So there are examples where I think this happens.

J. Oppenheimer: This is going back to that point that was raised a few minutes ago by Mr. Cooper. The question is not, can we come up with examples that are treated differently: military base closures, GATT, tax and budget rules, and so on. The question is, why are some treated one way, and others treated the other way. If one wanted to argue that, it is inevitable that you have this sclerosis, then you would say, "Gee, you know, I guess we could say that we should never be getting issues like GATT treated in any way other than industry by industry". You have to ask why is it that you get a coalition as a whole agreeing: This is the way we are going to handle it up or down. You have to ask "why", because it is the same party system; it is the same representative system as that which decides everything else. Then, in thinking about that, you have to ask, what is the coalitional basis for this. Why is it that in 1994, I guess it was, GATT is handled that way, but in this other year GATT would not be handled that way. So, for example, notice how you can have an interest group move perfectly smoothly from one coalition to another coalition, or from one coalition to being isolated. Thus, for example, labor was relatively isolated in the late 1980s; tobacco moved from the Democrats to the Republicans quite naturally, without ever really being isolated. So, when you are asking the question about which interest groups are going to play into the sclerosis story, or how, I think you have to ask yourself, is any coalition of interest groups stable? And the generic answer to that is "no".

D. Mueller: Could I add one sentence to that story? It is not unstable if there is an exit option, and that was true with the Philadelphia Convention, and so forth. If it is really a constitutional convention then the people can walk out and there is no public order at all.

J. Oppenheimer: Especially if then it is going to be voted up or down.

D. Mueller: And trade negotiations are the same thing: people can walk out. And therefore the trade negotiations have to be consensual.

S. Haggard: I only had three comments on the manuscript: One has to do with autocracy; one has to do with interest groups; and the third has to do with democracy. I am going to say a bit about democracy. But first, before we get tyrannized by certain stylized facts, let me give you a different interpretation of the story about the package deal which you just outlined. It is not that the logroll yielded an ideal benefit; it is the fact that the President in your story was granted by you the veto power to override a partial package which kept some of the special-interest provisions intact. It is not the logroll which generated your outcome; it is checks on the logroll from the Executive. And I can tell plenty of stories in which you have unhappy logrolls in the trade area, like Smoot-Hawley, which was also a logroll in which the tariff schedule was farmed out to Republican sub-committees in the legislature and then aggregated in a way which compounded protectionism. But that did not happen the next time around, because of fundamental institutional changes which shifted power to the Executive. The advantages of encompassing coalitions depend on how those coalitions are put together. If they are put together through logrolls, it is not clear to me that they produce a positive result. They may just simply string together all of the particularistic interests that you are worried about.

But let me get to my main point, which has to do with the role of institutions. You note that there is frequently no core, bringing tremendous instability in committee voting. But what political scientists did in the face of that finding was not throw up their hands and say, "Anything is possible!" Rather, they moved in the direction of understanding how institutions generated equilibria. Under the instability theorems You have got an agenda setter who can push

things anywhere in the issue space. But it is clear that that does not happen; there is more stability.

What struck me about the book is that you discuss democracy, but you do not discuss democratic institutions at all. In fact, there are no institutions in the book. There are no constitutions; there are no legislatures; there are no courts; there are no executives, none of the things which make up a democratic political order. I would argue that whether you get specialized interest groups or encompassing coalitions is not exogenous; they are endogenous to some set of institutions. This gets us back to the broader question about whether anything meaningful can be said about differences between autocracies and democracies. And I would make the same point that was made earlier with respect to democracies: we have got all kinds of democracies. Alan García and Juan Perón operated in democracies, while the advanced industrial states have managed to do reasonably well by world standards (though not as well as some authoritarian governments). The differences have to do partly with interests, as I suggested in my comments on autocracy, and partly with how the government is structured, and whether it encourages rational responses to economic distress. There is plenty of work in that vein which would suggest that the variance among democracies is likely to be just as large as the variance among autocracies, and probably larger than the difference between the two in aggregate. And so the question is whether the focus on the difference between autocracy and democracy is the right intellectual bet. Or whether we should be trying to figure out why you get some democracies that are disasters and others which are successful.

J. Oppenheimer: One very quick point. I do not think that coalitions are endogenous to the institutions, or the institutions endogenous to the coalitions. Both of those relationships exist at all times, and that is what makes it really so difficult. So that you do have some kind of institutional shifts that destabilize what should have been a stable condition and you have fundamental coalitional shifts which destabilize what looked like a stable institutional situation. And both also stabilize situations. It is difficult to predict which one is going to occur when.

W. McNeill: It is not simply the coalitions and the institutional setting, but other variables as well, including ideas and even

individuals. History is a very complicated scene in which any scheme is an imperfect approximation to full understanding of what happens. This is the trouble with social science. You try to fit human behavior into a series of Procrustean beds.

S. Webb: I wanted to come back to this interest-group idea, and the question of whether the sclerosis of excess demand by interest groups is more likely to be a problem in democracies or in authoritarian governments. It seems they can arise in both kinds of governments; you can get interest groups eating up too much of the pie in authoritarian governments as well as in democratic ones. The question is, which is more likely to prevent these groups from growing too large, and which is more likely to be able to cut them back once they start to grow. For example, in the area of trade legislation, you do something like GATT, but then special deals creep in, and eventually you need another round of reform to clean things up. There are many examples of democracies that pass rules which recognize that there is sufficient encompassing interest. And there are also examples of authoritarian regimes: Tokugawa in Japan; Turkey under Atatürk and maybe Peter the Great in Russia, which undertake reforms based on encompassing interests. But I think one can make the argument that you are more likely to get this cleansing process in a democracy, precisely for the reason that was raised this morning from the example of Russia. In a one-party system, you do not have any one outside to criticize: you do not have any one to push the system. Whereas you get that in a democracy. Yes, democracies can give you the destructive populism of Alan Garcia in Peru, but he did not stay there for a generation, a dynasty. There is a cleansing process when the democracy gets too far out of line. I think Stephan Haggard overstated the case when he said that we do not see any difference in the quality of policies within an authoritarian regime and democracy. I think we see a bigger variance in authoritarian regimes: you could not have Ceaușescu's Romania with a democracy. Something would force change sooner. And the extreme to which bad policies can go is a lot farther in an authoritarian regime because no one can challenge it. Yes, you get South Koreas with authoritarian regimes, but you are not going to get a North Korea with a democracy.

J. Nelson: I want to pick up the point that someone made a few speakers ago. He pointed, I believe, to Switzerland and Austria. One

could point actually to a larger collection of mainly somewhat small, western North European countries which after World War II developed a set of arrangements which in a way seem to fit in very nicely with your argument. These so-called social corporatist arrangements included large, well-disciplined labor unions, broadly structured representations of business interests and of government: these three groups worked out deals on policies and social programs. These arrangements illustrate both your point regarding larger interests likely to be more encompassing and your point about package deals. This was a mechanism for rolling package deals, if you want to put it that way. But one has got to bring the story up to date, and ask what has been happening and why, and what light this sheds on the theories that you are trying to develop. We all know that many of the West European countries with social corporatist systems have been facing very difficult issues for at least the last decade. These issues are not getting any easier. But the reasons for growing economic difficulties do *not* seem in accord with the theory being proposed. I do not believe the unions have gotten any narrower. I do not believe the business interests have gotten any narrower. And I do not believe the basic framework of governmental institutions has changed in dramatic ways. The larger international pressures -- coming back to a point which Nic van der Walle raised early this morning -- have changed. One could point to a number of other things that have changed. These are interesting cases which might help to pin down more precisely what is valid and what is not in the approach.

One more general short comment. The manuscript argues that large interests are likely to be more encompassing. And therefore, more supportive of policies that make for economic efficiency. I am not sure that a poll or survey of the array of economic interest groups in a number of countries across time would support that argument. There are certainly lots of examples of fairly small groups which are pushing policies that economists regard as constructive. And the reverse is also true: so many large interest groups oppose such policies. Though the logic is rather compelling, I am not sure the empirics hold up that well.

Finally, we need to come back to the question of the role of interest groups in consolidating and sustaining a democratic system, as distinct from their impact on economic issues. In fairly new

democracies (I am thinking mainly of transitional countries), consolidation of democracy requires convincing major interests that they have got to play by democratic rules; that they are more likely to get more of what they want that way than by any other means; and that other major groups will also respect those rules. Returning to Steph's [Haggard's] point: rather than seek to destroy organized interests or to minimize their role, we need to arrange institutions -- by which I mean constitutions, laws and informal arrangements -- to guide the behavior of interest groups in ways which are more, rather than less, constructive. Moreover, we have to recognize that those institutions are going to have to be constantly modified -- to cite the Scandinavian cases. You get a fix that works for a while, but it is not likely to work forever.

A. Clesse: Does anybody want to go on on this? For example, regarding the Scandinavian countries.

A. Åslund: The question here is, do the Scandinavian institutions function differently now than they did twenty years ago. Yes, I would argue that they do, not so much by constitutional change as by sheer degeneration. The degeneration has been caused by public expenditure, with an increase from about 35% of GDP in the late 1960s to 65% of GDP at present in Sweden. And by the fact that there are few counterweights to the government. Since the Swedish constitution was adopted around 1970, there has been no formal constitutional change, but in reality the constitution has evolved in Sweden. There is no constitutional court, there is nothing that can stop a law that is against the constitution. You can say that the situation is similar in Britain, an old stable democracy. However, if the institutions are exposed to a test -- 65% of GDP going on public expenditure -- they do not stand the test. I think that Sweden is a serious example of institutional sclerosis. Hence, basic laws that previously were not exposed are becoming much more important over time and the effect is that the function of the state and its institutions has deteriorated particularly badly in Sweden. The government is trapped. A majority favors larger public expenditure, the government does what the majority of the population wants, the exchange rate falls. If the government does what the currency market favors, then 30% of the electorate goes to the left of the Social Democrats. A majority of the population (at least 55%) benefits from

public expenditures and voted for more. Thus the Swedish society is locked into an entitlement trap to quite another extent than any other society. Therefore I do think the Swedish society has gone through a fundamentally institutional change.

C. Clague: I just wanted to make a logical point, a language point. We should distinguish between organizations and a redistributive institution. There are many organizations whose function is not to redistribute income to themselves; they simply produce a public good for themselves: choral societies, sports teams and bird-watching societies. Then, there are redistributive coalitions, which are also called special-interest groups. And in some cases, the public good which that group seeks is something which will raise the price of what they sell, and will limit entry into the field where they are producing. I find this distinction is often not as clear as perhaps it could be in Mancur's earlier writings: that there are two fundamentally different kinds of organizations. And of course, there are mixtures of the two. There are the ones that produce public goods for themselves without harming anyone else, and there are those whose public goods solely redistribute income to themselves and, as the logic of encompassing groups makes clear in Mancur's work, they are willing to impose costs on society many times larger than the benefits they produce for themselves. But the well-functioning society -- the modern, Western democracies -- has lots and lots of organizations that not only do not do any harm, but probably do a lot of good, anyway in terms of reinforcing constitutional, societal institutions

D. Mueller: Briefly on the corporatists' success and lack of success. I think part of the answer goes back to Mancur's point, which is fundamental to this constitutional approach, about short-run decisions in a parliamentary context and choices of rules. The corporatist countries were successful, I think, in an environment in which, partly, European countries were playing catch-up, and were growing by catch-up with the US; partly, you had an expanding world economy and the economic growth that that produced. And so the decision to avoid strikes and to have modest wage increases, etc. allowed everybody in the active work-force to benefit in this good economic environment. The people who were not invited to the meetings were the iconoclasts: the entrepreneurs, the people that were introducing

new products, the immigrants who were going to come in and start new businesses, and so on. What happened, now that Europe has caught up -- and, perhaps, gone too far in enjoying the benefits of economic prosperity in terms of pensions and taxes and so on -- is that they do not have an entrepreneurial environment. If only they sat down and wrote a constitution, which would create an economic environment which would encourage new business and entrepreneurs and so on. They might do that because, again, at this point everybody would benefit from it. One of the reasons, I think, the US is going to be more successful in the future economically than Europe -- it has been very successful in the past -- is that, whether because of our constitution or just because of the economic cultural background, we have always encouraged entrepreneurs, and iconoclasts. Witness Montana and the sometimes negative effects of these iconoclasts. But this is much different from Europe. There is the difference: whereas Europe succeeded in having consensual short-run decisions about prices and wages, it is being hurt now because it really has not got an environment where the outsiders have good incentives.

C. Gerrard: I would like to go right back to Mancur's introductory comments in relation to the process of politics and institutional reform. How do countries (societies) actually succeed in putting in place institutions that are beneficial to economic growth? That is, how do they achieve positive institutional reforms?

I agree with the logic that it is generally better for the government to assemble all the various coalitions (or stakeholder groups) around one table and give them the task of recommending a package of positive institutional reforms, rather than for the government to talk to each stakeholder group individually and to try to arbitrate a solution among the competing coalitions. I would refer to the former as a "collaborative" policy reform process and the latter as a "consultative" process.

I would agree that collaborative processes are generally superior under certain conditions, for example: (1) when there is the proper assembly of all the legitimate stakeholder groups around the table, in which no identifiable group has a majority and which would enable it to determine the outcome by virtue of having a majority; (2) when there is a mutually agreeable policy framework which establishes workable and effective boundaries on the deliberations; (3) when decision-making is by consensus on an entire package of

recommendations; and (4) when the government has made a credible commitment to implement the gathering's recommendations if the gathering is able to come up with a consensus. Under these conditions, collaborative processes are generally superior, because, among other things, they bring policy-relevant information to the table, they facilitate an open and transparent discussion of trade-offs, they establish the government's credibility with various stakeholder groups, and they deter rent-seeking activities.

It also helps if these processes are repetitive, rather than ad hoc, and become part of the accepted way of doing things -- institutionalized, if you will, for the purpose of addressing a series of related policy issues. Then you are more likely to get consensus in favor of an ongoing package of positive institutional reforms that are beneficial for economic growth.

I would disagree, however, with the observation that such collaborative processes are not commonplace. In my experience they are very commonplace. What may be preventing us from seeing that collaborative processes are commonplace is the distinction between what I would call "Big P" political issues and "small p" political issues. "Big P" political issues are those which define political parties (or governments) and on which elections are fought, while "small p" issues are those to which only the immediate stakeholder groups pay much attention. While the media, of course, pay more attention to "Big P" issues because these are more controversial, the vast majority of public policy issues are "small p" issues that are dealt with routinely at the interface between the government and the immediate stakeholder groups out of the glare of the media.

In Canada, from where I come, collaborative policy-making processes are very common. As demonstrated in the research of Ed Campos, Hilton Root, and others, they are also very common in the high-performing East Asian economies -- the so-called "Asian Miracle" countries.

Others in this room may pass judgment on how commonplace collaborative processes are in their own countries. I suspect that they are rather commonplace in the United States, and Western Europe as well, but primarily for addressing "small p" political issues that are of concern only to the immediate stakeholder groups involved -- not for addressing the "Big P" issues that define political parties and on which elections are fought.

A. Clesse: Two aspects we had in mind for this session were varieties of eurosclerosis and the other regional variations in the United States. I do not know whether there might be some comments on these aspects.

L. Gordon: A brief comment. It seems to me the question now is whether we are re-inventing the wheel, the rudiments of what one studies in any elementary political-science program. Look at the organization of legislatures; look at the American constitution with its House of Representatives and its Senate. The idea is that -- and it was certainly true at the foundation of the Republic and it is still true in 1996 -- different geographical sections of the United States represent different interests. In the days when there was slavery in one portion and non-slavery in other portions, there were sharply conflicting interests. Somehow or other, between 1789 and 1861, it was possible to compromise just enough so that civil war did not break out. But it seems to me that having the same people represent a variety of different interests, leading to conclusions which might be compromises between these interests, was what made the system work. And they were safeguards to prevent temporary majorities from overriding completely the interests of the minorities. They are a very important part of an effective and durable constitutional democracy. I do not see much difference between the kind of bargain we are talking about in a larger sample of economic interest groups, non-governmental, on the one hand, and the formal institutions for what limited government does in well-organized constitutional democracies, on the other.

Marshall Goldman: I would like to say something about New England in terms of regional variations. I have actually done a little work on this. It is intriguing to watch New England, which in the 1950s and 1960s and probably through the 1970s, was one of the most economically depressed regions in the United States. Because I think Mancur should consider the question of technology. The unions made it a high-price production area and so the textile industry basically went south and then, ultimately, outside the country to a substantial degree. The same thing happened with the shoe industry. And these were the mainstays of the region's industry. But what happened was that, for a variety of reasons -- some having to do with defense contracts; some having to do with the presence of MIT in the

area -- the computer industry became a growth industry, an industry in which there were no unions -- your kind of interest groups -- to obstruct the growth. There were lots of technicians and technology, no unions. It flourished in the mid-1980s -- the Miracle of Massachusetts. Which then came crashing down again because technology changed. These were minicomputer manufacturers, digital. And they did not catch the shift to PCs, personal computers. So the economy went through another dip. By the beginning of the 1990s the Miracle had disappeared. It turned into a disaster, a mirage, as some now say. But it was real at the time. And now the area is coming back again. It is coming back again, not in the way so much of computers, hardware, but it is coming back in the way of software, and in the way of biotechnology, and now, more recently, with a form of software having to do with the Internet and video-programming. One of my colleagues has written an economics textbook and, today, with a textbook you no longer have just the workbook, but you also have to have a video program and interactive computer stuff. And so Prentice Hall sent it out for bids -- a multi-million-dollar bidding arrangement -- and it turned out that there were five companies that bid, none of which existed three years ago, which do this kind of thing. My point is that I think technology has a lot to do with the change. And while it is true that there are these obstructionists there, and the legislature and, everything else, yet in terms of this change in the regional area. There was one point: we were growing faster than anybody else. And I think the same thing, you can see it in Silicon Valley in California.

A. Clesse: Some regional variations in the United States? Joe Oppenheimer.

J. Oppenheimer: There is a theoretical or methodology point relevant to what has been stated about this regional variation. If you look at a 5-person prisoner's dilemma game that is repeated, let us say, fifteen times, you get a very nice apparent convergence to, say, 20 % spent cooperatively. And it looks like you can explain everything in terms of communication and the structure of the game. But that is totally wrong if you look at the individual level. If you graph what each individual is doing in a prisoner's dilemma game over fifteen rounds, you find that it looks like frogs in the middle of the night, you know, croaking from one place to another, trying to find out where their

mate lives. Here you have a blip; there you have blip, and so on and so forth. People struggle towards some kind of cooperation that they are hoping to induce, and they fail. So, looking at a regional variation that you see up and down and then up down: sure, it indicates that there is the freedom to have entrepreneurial behavior. But it also shows exactly what William McNeill was saying, that our theories are telling us nothing about the individual behaviors. And one of the problems in the criticisms that are being made about Mancur's book is that we're all taking about individualistic events rather than the pattern of a class, a large class, of events. What is being said, perhaps, is that we do not really know whether the large class of events has been studied enough to enable us to say anything about it, and breaking it down to individualistic statements is going to create a tremendous amount of variance without necessarily making any generalization possible. Prisoner-dilemma games work, certainly, substantially better than any of the theories like those Mancur is developing very courageously here, when you have much more variability. So it is not surprising that we can all think of falsifying cases.

Marshall Goldman: Maybe I did not make myself as clear as I wanted. It may be exceptional in individual cases, but I do not think that Mancur allows enough for the impact of technology. Technology played a major role in the economic growth of Massachusetts, which was a source of much of our innovation. In 1930, MIT did not make that much difference, because technology was not changing that rapidly. But as technology began to change, we began to benefit. And it is also where we lost because we did not always keep it up. That is what I am saying.

M. Olson: Could I very quickly respond to Marshall's point? I think you are completely right about Massachusetts, and a lot of other examples where new-technology industry thrives in areas where other industries, like textiles and shoes, have whipped out. Indeed, I think you could make a similar proposition about the United States as a whole. Note that the United States, for a long time, led the world by a huge margin in the production of automobiles, steel, consumer appliances. These things were, in some sense, mass produced here. But the United States fell behind in these areas and was able to keep its prosperity through high technology. Now, let us look at that in

terms of the logic of collective action. If organizing a lobby or cartel is difficult because of the free-rider problems, the benefits go to those firms in the industries or those workers in the labor market, whether they pay dues or not. That suggests, then, that organization for collective action is difficult, and it takes a long time to get it going. That means that whereas in industries like steel, automobiles, consumer appliances, and farm machinery, the United States has lots of special-interest organization by now, or had them even by the 1960s and 1970s, it does not have a lot in new industries that did not exist five years ago. So, suppose we look at the trade between countries like the United States now, and, say, South Korea and Taiwan; or, especially a little earlier, trade between the United States and countries like Germany and Japan, in the 1970s, let us say. Well, I think that, in essence, the United States as the older, more stable with lots of problems of organization for collective action -- the United States was getting out of -- (or the market was chasing it out of) -- the lines which were dense with special-interest organizations and we were concentrating on exports of high technology and other new products. And, of course, we see the same thing happening across parts of the United States. So I think that example is generalizable and fits in very widely.

A. Clesse: Is there something else in terms of regional variation? When it comes to special-interest groups in the United States, we have somebody from the West Coast here. I do not know whether Charles Wolf would like to say something on this, but let us give him a chance to think about it. Professor Destler, perhaps, meanwhile.

I.M. Destler: Just two points. One is just a brief response to Mancur's interesting comment. If, in fact, the United States has had increasingly effective rent-seeking collective action by large industry, one would have thought there would have been more effective resistance to the displacement of the steel industry in the United States by imports and technological change. There was quite a lot of political move and eventually a fair amount of protection, but the industry was pretty much transformed by the time the protection came. This was good for the economy, and good for the general welfare, but not for the vested interests that suffered.

My second comment addresses the question of catch-up or convergence. If you look at differential growth rates within the

United States, and Mancur knows the data a lot better than I do, a lot of that is presumably catch-up or the reduction of inequalities, especially between the South and other regions, inequalities that had persisted for a set of historical and social reasons growing out of the US Civil War. This was convergence toward a level of productivity already achieved elsewhere in the nation, with the aid of lower wages which gave certain incentives to interested firms to move south. Or, in the case of Germany and Japan versus the United States -- or Western Europe generally versus the United States -- convergence has brought them close to, though not yet, by most measures, up to, the US level of productivity. Now, you can ask, "Why did convergence occur?" And you may argue that certain things about social organization within those countries facilitated that. People might have different views about that. But you would expect that, other things being equal, these countries would grow faster than the United States, not because they had different interest-group structures or encompassing -- or non-encompassing-interest group organizations, but simply because they had farther to go, and they had comparable levels of human capital development.

A. Clesse: Perhaps, before the end of this session, it would be interesting to hear something about interest groups and economic development, comparing various European countries. But, first, on various interest groups in the United States.

C. Wolf: On the regional variations: my quick reaction to that is very similar to Marshall Goldman's. I think the California economy has been up in the past, especially with aerospace and defense; and in northern California especially with computer chips and the computer industry. And then, of course, the aerospace industry diminished in cohesion, size, and clout as the international situation and the domestic defense budget circumstances changed drastically. Of course, the entertainment industry has waxed monotonically. It has grown and accelerated in different ways: as a consequence of the revolution in telecommunications technology and for other reasons. There are the ups and downs that Marshall referred to, relating both to changes in technology and changes in the structure of domestic and international demand.

One thing that I think is missing in the discussion of the cartelizing of long-enduring states and long-enduring industries is the degree --

the question of whether and how there is an element of pluralism within the same industry or the same potential cartel. Now, what I am thinking of is in the aerospace industry: under the pressure of diminished demand and increasing budget constraints, there is the phenomenon of mergers and acquisitions and downsizing and streamlining that involves coalitions across companies that, on the one hand, would seem to increase their cartelizing propensities and, on the other hand, because those mergers are bi-coastal, to pervade the country -- that is, you got Lockheed-Martin consolidation, and the elimination of General Dynamics, and others. On the one hand, there is a tendency toward increased calcification and cartelization, because there are fewer players since mergers and acquisitions have reduced their number. On the other hand, the size of the pie that they are competing for has diminished, and so the intensity of competition among them has grown. Also, because they are bi-coastal, they have different regional influences and regional economic interests. In combination, they inject some degree of pluralism into the cartel. So, on the one hand, there are fewer competitors; but on the other hand, the competition among the fewer competitors is intensified because the pie is smaller. On that same hand, because they are transcending regions, with different economic conditions and environments in the regions that have emerged, the diversity of interests within the members of the same industry may be growing.

One other point about regional differences. I was at a meeting that, among other subjects, was addressing the issue of performance assessment in various fields, in the sciences and in law. And the observation was made by someone who has been looking at Bar examinations in different parts of the country that there is a multiple-choice part of the Bar exam in each state that is very similar, but not identical. But then there is an essay part of the Bar exam that reflects regional differences, so that in Texas, gas and oil is the part of the exam that reflects regional differences; and in California, product liability is part of the exam. So, there are regional differences that grow out of different resources, different industrial concentrations -- and this, I think, relates to another comment made earlier, and adds an element of pluralism, diversity, mobility and differentiation in the American economy which other economies do not have. This is a source of regeneration that has been mentioned before.

Session IV: Are new democracies and new autocracies relatively free from special interests?

A. Clesse: The main question is whether new democracies and new autocracies are relatively free from special interests and from what they imply, i.e. the negative consequences. One could look at some examples from recent history, like Germany and Japan, and then at, I think you called them dictatorships, but I would prefer to call them authoritarian regimes -- Singapore, South Korea, Taiwan, and others.

Merle Goldman: I just want to restate something I said earlier about Mancur's whole volume, which is very impressive. But as an historian of China, I feel that the economic model Mancur is using applies to a Western society; it does not really apply to Asian societies. Some people say there are models that fit everything. Well, I tend to disagree. As I mentioned earlier, the rule of law, private property, and individual rights were not necessary to China's economic development. Some experts attribute the economic development in East Asia -- in Taiwan, China, Hong Kong, and so forth -- to families rather than to any kind of property rights or individual rights, so it is a very different way to development. The overseas Chinese networks represent a totally new aspect on the economic scene. There is also a static quality to the model; but dictatorships are constantly changing. The one in Taiwan was changing even under Chiang Kai-Shek. Democracy in Taiwan emerged in that period so that when his son came to power and allowed these democratic tendencies to flourish, Taiwan had democracy. Moreover, an opposition party existed in South Korea even under the dictatorship. I think, Stephan Haggard who made the point here that the variety in dictatorships is extraordinary. For example, the dictatorship of Mao Zedong is very different from the dictatorship of Deng Xiaoping. When Deng Xiaoping came to power, it is a qualitatively different government. The Communist Party still rules; the old revolutionaries are still there. But having gone through the Cultural Revolution, Deng Xiaoping was a very different person than Mao Zedong. He did not think of himself as a great visionary who was going to lead China to the promised land; he opened up spaces that gave opportunities to the entrepreneurial instincts of the ordinary Chinese. And they really went with it. They engage in all

kinds of business without laws, without property, without any real rights. They are tremendous risk-takers; they did not need to have a lawyer to protect them or property rights to protect them. If something did not work out, they would go to the next thing. If that did not work out, they go on to the next thing. And they lost money, but they also made a lot of money. One overseas Chinese told me on a plane going into China, "The problem with you Westerners is that before you do anything You have got to bring in your lawyer, you have got to sign your contract." He says, "We come in, we shake hands, we lose some money, but we make much more. And we do it much more efficiently than you." And I tend to agree with him on that. But let me deal with the specific issue we are talking about, which is interest groups. Even under Mao Zedong, who was certainly a dictator, and perhaps, the second greatest dictator China ever had -- the first one was at the beginning of China's history -- there were interest groups. The interest groups were the leftists, the ideologues, on the one hand, and the military-industrial establishment on the other hand. Under Deng Xiaoping, there is a whole slew of interest groups. One very interesting item in the Chinese newspaper is a warning to officials, "You must not continue to pay attention only to the rich. You have got to take care of the people that are not so rich." But what is going to make these officials, who are getting pay-offs from the rich, pay attention to people who are not rich? That is where democracy comes in. What may lead China, very gradually, towards democracy, are those who feel that the reforms are hurting them, whether they are the inner provinces or the poor people in the townships who feel that they are being discriminated against. And even under Deng Xiaoping, there are the beginnings of a parliamentary system, the National People's Congress is where the representatives of the inner provinces get up and complain about their treatment. So the National People's Congress is turning very gradually into a parliamentary system. It is not like the British parliamentary system; it is more like, perhaps, the Supreme Soviet before it turned into a more democratic parliament. So I guess my point here is that interest groups exist even under the worst dictatorships, but that the dictatorships themselves are very, very different.

A. Clesse: I think that we should extend our analysis to Latin America. Would anyone in the group like to take into account Latin

American countries and also autocratic regimes in Africa? We may come back to this tomorrow. I know van der Walle and, certainly, Stephan Haggard would like to talk about this. Of course we should also bring in the Europeans, at least Germany.

N. Tith: I would like to make a few comments on what Mrs. Goldman has just said. I would like particularly to just keep that perspective that in the dynamic analysis, the Taiwan of today is not the same Taiwan as it was ten years ago or five years ago. The same thing for South Korea, for that matter. Things evolved. Singapore probably remained more or less the same model. There is a reason for that. Let me start with Singapore.

Singapore, the interest group here, as I define it, is a major category of interest group, such as labor organizations and business groups. And I am talking about organized interest groups now, not haphazard interest groups. Labor in Singapore is organized according to Lee Kwan Yew's concept of what labor is all about. In other words, labor is fully integrated, in symbiosis with the government and with business. So there is no confrontation between labor and government. This is a feature of Asia and, to some extent, Germany, if I understand it well. The interest group is taken into consideration formally, therefore, there is no confrontation. When the government came up with a policy for growth, everybody understood and carried out the program. That is why there is no staleness in the Singapore kind of system. It has been that kind of autocracy for over twenty-five years, and yet functioning very well. That is one of the reasons why it is functioning: there is no sclerosis in the Singaporean system, at least from the economic standpoint. Democracy, that's another issue. Democracy, as understood by Lee Kwan Yew, is to guarantee, first of all, against any kind of disturbance of law and order by riot, or whatever. But, also in terms of freedom; we should not forget that. There is a variety of democracies, as Mrs. Goldman has stated, like ice cream has many flavors. Democracy in Singapore -- yes, there is a certain degree of democracy. These people can leave the country if they like; in China, we do not have that, for instance. In China, you have to have permission to move within your own country. So we have to differentiate a great deal. You can say certain things, but you cannot speak in an elevator. Is it good or bad? Is it democracy? Sure. These are the kind of things where we should be careful about what

we mean by democracy, and what we mean by interest group, as well.

With regard to South Korea: I think here, again, we have the same kind of evolution. Taiwan, the same kind of evolution. In my opinion, there is convergence with the European system instead of divergence. That is, I believe, the case, even in China, mind you, even in China. There is more convergence if we are not concerned about the systemic detail.

L. Gordon: I would like to speak on the subject of Latin America, as you requested Mr. Chairman, particularly Brazil which is the case that I know best. If you take the emergence of Brazil -- basically in 1985, after 21 years of military rule -- the question is whether what emerged was a new democracy, and was it relatively free from special interests. The answer to that question is an overwhelming negative one. Brazil was indeed, and indeed is still very, very far from being free from special interests. On the contrary, the new constitution that was written in 1988, which I think has 230 articles in it compared with seven in the American constitution, is crammed with special-interest provisions of one sort or another, from which the country is now trying, against considerable odds, to get free. That requires mobilizing, somehow or other, 60% of the membership of both houses of parliament in two successive votes by each house.

It is an interesting question whether you can call Brazil in 1964, when the military regime came in, a new autocracy. Was it really an autocracy? It was certainly not a one-person autocracy. It was not like Pinochet in Chile; it was not even like General Onganía in Argentina in 1966. They were one-person dictators, who wanted to remain for life if they possibly could. The Brazilian military regime was a kind of collective oligarchy. There were five successive generals in charge. Each of them was carefully chosen a few years before his compulsory retirement under the rules of the military hierarchy, precisely to avoid having a single-person autocracy. Some special interests were indeed very strongly represented in the authoritarian regime, as I call it. Brazilians call it a "dictatorship", but I have always resisted that term because to me that implies a single dictator, which they never had. Certain special interests were reduced in power, some eliminated entirely, by the military government; others, of course, remained very strong. The military special interest, the

interest of the military class as such -- which is an important special interest all over Latin America -- was certainly not curtailed.

As I look at this question, I keep wondering whether defeat in war is not more important than being a new democracy. That created the fresh start which West Germany and Japan had to have, both politically and socially. And in several of the other Asian cases, they were new regimes which were freed from long periods of Japanese occupation, like Korea and Taiwan. So they had an opportunity for new starts and institutions of all kinds. In the German and Japanese cases, as Mancur has pointed out in his earlier writings, the systems that were imposed on them by the occupying powers in effect curtailed the potential influence of special-interest groups. After they became democratized, new special interests began gradually to grow again and develop, at least partial, sclerosis, which we see in those cases today. I think the circumstances under which new democracies arise are at least as important as the fact of being new democracies as such.

A. Clesse: I think, Professor Wolf, that you have some doubts about the concept of, or the term of "capitalist dictatorship". I do not know whether you would like to voice that.

C. Wolf: Yes, I wrote something to you about that. That was not the comment I had in mind in terms of this particular session. The comment I had in mind that is germane, I think, to this session, relates to a dissertation that has just been completed at the Rand Graduate School by a quite remarkable young man. He was an astronaut and then had his leg amputated and has become a scholar. The dissertation is on telecommunications connectivity and democracy. And, basically, while it starts with other modes of connectivity and organization, it focuses on the Internet. Using the Freedom House indexes of democracy, and, after allowing for things that are collinear with the Internet and universal e-mail and so forth, like per capita GDP and longevity and other indicators, the author finds a very strong correlation between connectivity, the growth of Internet nodes, and the spread of democracy. To relate connectivity to interest groups -- it seems to me there is a potential connection, Mancur, which might be worth reflecting in the book: that is, ways in which the Information Revolution, broadly construed, facilitates the organization of interest groups within countries, and also

internationally between countries. On the other hand, because it facilitates and lowers the transaction costs of interest-group formation, it also facilitates the proliferation of countervailing interest groups. In other words, interest group A can connect with other potential acolytes within country and sources of support out of country; but interest group B, which may have interests countervailing to those of A, is also able to organize and counter the rent-seeking behaviors of interest group A. So I think connectivity contributes to the proliferation of interest groups, lowers the transaction costs of any given interest group; and contributes to the emergence of interest groups that can countervail other interest groups.

J. Nelson: I have first a couple of comments on interest groups in new democracies based on work that I have done with colleagues, both in Latin America and in Eastern Europe. I certainly concur with what Line (Gordon) said. More generally, the extent and nature of interest-group activity in countries which have recently turned or returned to democratic forms of government is going to reflect, first of all, the nature of the prior authoritarian regime and the degree in which it squelched interest groups. Pinochet did a lot of squelching; a number of other Latin American governments did far less squelching, and indeed at various points in time collaborated with both business groups and unions. Secondly, one wants to look at the sharpness of the break between old and new regimes. In general, there is certainly a very dramatic contrast between the limited discontinuities of most of the regime changes in Latin America, and the much sharper discontinuities in most, but not all, of the former communist world. Third, it is useful to distinguish between the prevalence and nature of interest groups in general and a somewhat narrower point that you dwell on a great deal in your manuscript: the ongoing strength of the particular groups that had strong vested interests in the old system. Those two concepts are not exactly the same thing.

Finally, I would like to emphasize the important differences among nations within the broad categories we have been discussing. Polish unions are one thing, or perhaps I should say two things -- Solidarity, and the old communist system as of 1989, 1990; Hungarian unions are quite a different thing at that point. One could elaborate on reasons for the differences. There is considerable path dependence in the evolving patterns in different countries. Broadly, I

am endorsing the skepticism others have expressed about generalizing about the absence or weakness of interest groups in new democratic systems.

I want to switch to a second set of ideas, following up on Charlie Wolf's comment. I have been sitting here all day wondering what the effects will be on the nature and role of interest groups of the profound changes under way in the structure of production and the nature of individual work careers. Fewer and fewer workers are likely to stay in one factory or even in one industry all of their lives. More and more industries are fragmented, fluid, spread among a number of countries. The whole structure looks very, very different from a generation ago, leave alone two generations ago. I find myself wondering what that will do to the structure and degree of organization of interest groups. Unions as we have known them are certainly greatly weakened, and they are changing in nature: What are they going to look like 25 years from now? What are business associations and business-interest groups going to look like? We must add to Charlie's point about the revolution in communications, the dramatic shifts under way in the organization of production and of work. I do not pretend to know what the implications are, or even whether they are important for the kind of theorizing that you present in the book. But it seems to me important to consider these factors.

W. McNeill: Well, I will try to address the question as put: Are new democracies and new autocracies relatively free from inhibiting special interests -- inhibit interests that change, inhibit transformation? And my answer is to say it all depends on what "new" means. Sometimes the fact there is a new government and it is oligarchic, I would say, rather than autocratic, or let us say, authoritarian -- does not necessarily mean that it has removed special interests. It can be a new consolidation of special interests, or some special interests against other special interests, as we all know.

When you get a serious disruption of existing special interests, it encourages, permits, and makes conditions propitious for, a burst of change. But this seems to me nothing more than a special case of other provocations to change with which we are all familiar. One is a new technology, which we talked of earlier this afternoon, which can open up a new series of transformations, as happened in Massachusetts after World War II. Or it can be institutional change, not just in government, but in the manner of organization of an

economic enterprise or other structures: the rise of limited-liability corporations, or the invention of joint-stock companies in early modern Europe made an enormous difference to the way things were done, as we all know. And it can even be a moral and religious transformation: think what happened when Islam arose! The new religion reorganized a very large part of the civilized world because it was a revelation from God and offered a new set of moral injunctions and moral directions to human life. So all of these can provoke very sudden bursts of change, and they all interact with one another. Commonly, I would suggest to you, they are unleashed by some encounter with foreign danger, or attraction which makes the old way of doing things no longer as easy to maintain. Very frequently it is, as one of you said, defeat in war that triggers this kind of very sharp reorganization of society. When such reorganizations are successful, the first thing that happens is that success alters the stimuli that led to the original response. In other words, new vested interests arise very quickly.

Human society ought to be conceived as a sort of rolling equilibrium, an equilibrium between diverse groups. Such groups -- all human groups, and human society (any dimension you care to take, whether it is national or global) -- are the creation of communications nets.

Humanity is the creation of communications: the messages in, the messages out, that make us humans different from all other creatures on the face of this Earth, so that forgetting communication nets, is the wrong way to go at understanding human society. Any major rent, any major change, anything that tears apart the ways of use and wants that a given group has been accustomed to, takes a while to be repaired, to settle down. But there is always a strong push to settle things down. Human beings are very uncomfortable with open-ended uncertainty. They prefer fixed routines where you can push the button and you get the response from the machine, or you work in the field and you get your harvest. Or other kinds of routines where your input and the results are predictable in as narrow limits as are possible. The effort to repair a situation in which innovations come in, disrupt people's lives, enrich them maybe, also inflicts this terrible cost of uncertainty. The upshot is a rolling balance. Society is never in stable equilibrium; never has been, since human beings began to walk the Earth. It is always moving in various directions, moving in the

direction of stability; then broken apart by some change, provoked in a multitude of ways. New democracy and new government is one of the powerful things that will change a society -- people at the top with coercive power do matter for everybody else who is possibly subject to their coercion -- and a very likely occasion for this kind of burst of change, but not inevitably and not always. Many times the old patterns of society are very little changed by a change in regime. One set of thieves is about as good as the next set of thieves. So, it all depends. If you think of this as a case of provoking social change you have to think of something put into this tumultuous, transformative equilibrium, created and sustained by messages in and messages out, what people say to one another, symbols. Dealing in symbols, that is what makes us behave the way we do, allows us to behave the way we do. And it is a very complicated process indeed.

N. von Kunitzki: You must be sure what you mean by "new". I was shocked several times this afternoon, that you put West Germany and Japan into the same box. I do not know so much about Japan, but I know a lot about Germany. And if you speak about something new, Germany after the War was new, because the structures that they had before World War I had gradually, one after the other, been destroyed. The big inflation had destroyed the bourgeoisie, the middle class. Then Hitler liquidated the Left, the real socialist party, the real social citadels. Then came the fall of Hitler, and what he had built up was destroyed -- and we should say not so much, certainly not physically, not even morally, by the occupant, but just because he had so utterly failed that nobody could hold any belief in that direction any more. And, most important, Prussia that potent structure, before World War I, Prussia that had disappeared because of the separation of East and West. So, when you take West Germany in 1945, that was entirely new territory. Even if you take the parts which had not been touched by war action so much, like Bavaria. After the War, you had -- and still have -- a socialist Munich, which is something out of this world if you remember it is in Bavaria! Because so many people, millions of people, had fled to the American zone, you could say that really there were no structures any more: no political structures, no institutions. There were educational structures; there were structures in industry. But there was no institutional or social structure any more.

I am not very knowledgeable about Japan, but I am convinced that you cannot say that about Japan. In Japan, the old structures were still there, totally. The Emperor was there, and the *keiretsu*. If the question is as put here: Are new democracies, new systems -- democracies or autocracies -- relatively free from special interests, then the answer would be "yes". But it is almost a truism to say "yes" because special interests need time to construct themselves. And if there is nothing, there are no special interests.

Then I would say a second thing, which Professor McNeill introduced. As I said this morning, the economy is not all. And you must not forget that, usually -- I say usually, there are exceptions -- but usually a new government enters on its business not under an economic, or not only under an economic slogan, but under a moral one or a political one, or a social one. And, usually, for some time the new government believes that; and then, of course, afterwards, there come the special interests which that government necessarily awakens and even the opposition joins the new game and reorganizes. But certainly, each time that you have a new regime, the old structure is not destroyed, but seriously hindered -- and the new structure is not yet there, because they do not come onto the ground to play economically immediately. They come onto the ground with a moral pretext or some political pretext or other.

Then, I would say something which has been introduced also this morning: that if a government is to be efficient economically they must beware of -- it was Professor Webb who said that -- they must keep out of two dangers; one is populism, the other corruption by bureaucracy. Chile is certainly a case in point. Because there the structures, with all the difficulties they had with Left and Right, the structures, economically, were still there. But when Pinochet came, I am not so convinced, although Pinochet was a dictator, that he -- as was said half an hour ago -- decided alone. I know enough about Chile, about that society, to believe that if there was anybody who reported to a gang -- let us not call it a gang -- to a social class, it was Pinochet. Pinochet was the big families, the big proprietors, and he had somebody to answer to. When decisions were to be taken, they knew what he would do, and he knew what he had to do. So, in Chile, when it came, first, to breaking the populism that had been there before and, secondly to breaking the old bureaucracy, it was really the possessing class that took things in hand. They had an immediate

success because they had the means economically to do so, and they got rid of some of the handicaps resulting from the populism of leftist governments and the bureaucracy that had spontaneously, or with the help of those leftist governments, come up. And afterwards, when they had things in hand, they could, and they did almost spontaneously, give things back because they came all of them, to think that they could afford to let democratic government come in. For how long? Probably until things got out of hand again.

A. Lanyi: I just wanted to make a brief point, which may depart somewhat from the questions as you posed them. But with regard to the general question of new democracies or new autocracies, and whether they are relatively free from special interests, looking at the whole range of countries, I think of particular classes of new democracies or new autocracies. The particular class I have in mind are the democracies and autocracies that arose in the post-colonial countries in the 1940s, 1950s, and 1960s. For these post-colonial countries the answer to the question of whether they were relatively free from special interests would probably be "no". Because, first of all, special interests existing under the colonial regime tended to carry over into the post-colonial period. But more importantly perhaps, a lot of new special interests immediately arose that had been suppressed by the colonial regime. Perhaps these cases might be considered as a further application of Mancur Olson's theory.

Marshall Goldman: This has to do with Japan and Germany being similar. In many ways, I agree: they were not similar. But in one way they were similar -- and this also leads into the discussion about Russia for tomorrow. All three countries lost a war: World War II, obviously, and then came the Cold War. Unfortunately for Russia, her industries were not destroyed. The similarity between Germany and Japan was that their industries were destroyed.

N. Tith: Also the same point on Japan. Besides the similarity that the industries were practically destroyed, another point which helped the quick rebuilding was that the human resources were not destroyed. And that is important. You can destroy all the physical things, but if you do not destroy human resources you can start over again fairly quickly.

Another point on democracy and interest groups in Japan. Before the occupation by the Allied forces in Japan, of course, there was the

institution of the Emperor. But there is a world of difference between the Emperor as an absolute monarch before World War II, and the new Emperor whom you can see from very far. You still can not wave to him, but before you could not even look up at him. It is a lot of difference. The Allied forces also introduced new institutions such as the labor unions. Unfortunately -- or fortunately -- the Allies introduced the national labor union concept. By doing so they almost started a class struggle. But the Japanese turn it around, and prevented this from happening: As in the German case, labor representatives sit on the boards. Those are important similarities, it seems to me, to be pointed out between Germany and Japan.

Marshall Goldman: Also land.

Merle Goldman: Land reform.

N. Tith: Also land reform.

Merle Goldman: The important point was that Japan had begun to industrialize in the early decades of the twentieth century. And when it was destroyed in World War II, everything physically was destroyed, but as Tith said, there still were businessmen, the bureaucrats and the scientists and engineers. And so there are similarities, I think, with Germany.

C. Wolf: A brief comment. I may be missing something, maybe this is semantic confusion, but it seems to be that a new autocracy cannot be free of special interests. That is, it is the special interest that constitutes the autocracy. It may be that the number of special interests is diminished, but the power of the special interest is almost coterminous with the new autocracy. So, I would say, fundamentally there has to be some special interest to undergird the new autocracy. Point one.

Point two is on new democracies. Maybe it is the case, reasonably the case, that they are free, relatively free, of special interests on day one, but on day two through today, given the transaction costs production and the ease of communication, I think they do have, and will proliferate, special interests. But not necessarily ones that are impediments to growth.

M. Olson: On the new autocracy as a special-interest group. Note that if you have a real autocracy, you have it with a monopoly of tax collections. So that means, let us say they can collect a third or half

the national income in taxes, that means that they could not have a very narrow or special interest. It must be a relatively encompassing interest, simply by virtue of the fact that they have power over the whole country and a monopoly of tax collection.

C. Wolf: I recall the discussion of this in the manuscript. But you can think of the autocracy as undergirded by one or more interest groups. The autocracy does not imply that it is a single person or group. It may be a coalition of groups. Collectively, they are exercising a monopoly over tax collection. And there is a process by which they distribute those resources to maintain the coalition of special interests undergirding the autocracy. I am not sure how you can generalize about that. In China, you know, it may depend on whether the PLA becomes stronger in the succession process. Circumstances may affect how much of the tax collections the PLA gets for military modernization.

N. van der Walle: I have missed the first bit of this discussion. But I must say that in the interventions I have heard since coming back from my office, I think people have used the terms “special interests” and “interest groups” as if these were somehow the same thing. It seems to me that they are quite different. Interests, I think, are best thought of as economic or social interests that derive from the structure of the economy and from its functional specializations and so on. Whereas interest groups are organizations. It would seem to me that the genesis of the two and the relationship of the two to new regimes are quite different. Now, I do not know whether, when people say “special interests” they mean interests groups or not, but I would not confuse those two, different, it seems to me, concepts.

Now, on interest groups, on organizations. It seems to me that the most important variable determining how they are at the beginning of a regime, whether it is autocratic or a new democratic regime, is what existed before the transition. Interest groups are much likelier to be strong after the transition if they were strong before the transition. Look at countries like Argentina, which have had extremely long authoritarian interludes. When Argentina really becomes democratic in the mid-1980s, all sorts of organizations which date back to the beginning of the century reappear, because they have a history and managed to survive, very often, clandestinely, the autocratic period. My own research on Africa suggests that how strong interest groups

and various social civic associations and social groups were in the 1960s and 1970s has a very, very profound impact on the nature of democratic transitions in the 1990s. In fact, one can establish quite a strong correlation between, for example, the number of business associations in 1970 and the emergence of political liberalization in the 1990s. So it seems to me that looking historically at these organizations is very important.

A. Batchelder: On Africa. The change in the vested interests that were trying to influence the government after independence -- What do we have? Several dozen cases of post-French, post-British colonies -- was a change from private-interest lobbyists to predominantly government-interest lobbyists. Beforehand, the particular government interventions for the British and French had been mercantilism, the Brits trying to keep out the French, and the French trying to keep out the British from their colonies. Afterwards, partly in reaction to that, government employment -- my point this morning -- expanded enormously and the para-statals multiplied and the powerful vested interests that grew within most African governments came from those para-statals and from government and, generally, urban employment.

M. Blejer: I wanted to make a general point on interest groups and then to give two examples. I thought that somebody this morning very persuasively argued that not all interest groups are bad, and that interest groups could be performing a very useful role. In fact, we could divide the theory of interest groups between rent-seekers and market-oriented interest groups. When you have a policy of opening up, well, domestic producers may be against, but importers and exporters will be in favor. For that reason I think that the question, as it is posed here, is not very appropriate: Are new democracies or new autocracies relatively free from special interests? I think that the question is, in general, whether democracies or autocracies, new or old, can balance better the interest groups or can lean more toward the influence of the interest groups which favor good policies against those that favor, what we would consider bad policies. I think that we should be more careful about identifying interest groups with negative forces in the economy or the development. And the two examples I wanted to give are one in Europe, one in Latin America.

One case that we have quite forgotten, is a very interesting case in relation to this subject, and, I think, bears out some of Mancur's hypothesis in his book very well. It is the case of Spain. It is a very interesting case because it is really a country that went from an autocracy to a democracy, and it is very interesting to look at the role of interest groups in Spain during the Franco government and after the Franco government. In fact, the Franco government was a government based on interest groups, it was a corporatist government in which interest groups were given a clear and obvious role. Now, what happened in that particular government? What is interesting is that Franco was able to manipulate the interest groups to attain the type of outcome that he really believed was appropriate at the time. In the 1940s and 1950s, Spain completely stagnated, and he was balancing the interest groups that were against any sort of opening of the economy with those that were more in favor of integration. But when the economy really collapsed, Franco opened up: the Eisenhower basis and then the booming consumerism and so on. Up to the 1960s, Spain completely stagnated. But in the 1960s, there was a boom of growth, and this boom of growth was related to the opening up. And during that period it was very clear that there were groups that lost and groups that won. The genius of Franco at that point was that he knew how to compensate the losers and let the winners to an upper hand. Now, maybe you could say, that this could not have been done in a democratic government. You needed an autocratic government. It is very tempting to go in that direction. The only problem is that Spain stagnated again in the 1970s, after that period. And there, I think that one of the predictions or one of the comments that Mancur has in the book can explain that very well. I really did not think in that direction before, but it is really more clear now. It is the issue of taxation. Why did Spain stagnate again in the 1970s? Because it started to be extremely uncertain about the succession of power. There is a famous joke, and it is not really a joke. I think that it was circulated on purpose in Spain. Franco never wanted to receive a turtle as a present because he said, "Well, turtles only live 200 years, and you get attached to them and then they die." There was this idea that after Franco, there would be no peace in Spain, and this is the only modern case, that I know where you go from a sort of republic or presidential system back to a monarchy. It is because the issue of the succession was so important and prevented

any sort of new investment. I think that case is a very good example of what Mancur brings out in this manuscript. The second example I wanted to give is the example of Mexico in Latin America. Now, what is Mexico? It is a democracy? What was Mexico in the last 50 years? A democracy or an autocracy? I do not know. I think that Stephan Haggard made this point: there are many types of democracy; there are many types of dictatorship.

I think it is a very interesting case because Mexico, in the last 50 or 60 years, went over periods of very, very strong growth and also through great periods of very deep recession with the same system and with the same type of interest groups. But there were governments that were more able to balance into the direction of those interest groups that favored what we call good policies, or growth policies. And there were those governments that were less inclined towards these interest groups and more towards the interest groups that were in favor of protection only. Now, it is also interesting to see that part of the collapse of the Mexican growth in the last five years, again, has to do with the succession problem, again has to do with the fact that doubts started to emerge about the survival of this system -- about the PRI being able to remain in power. If you want go to the extreme, you could say that the real crisis started when the successor was assassinated; that would be a little bit of a caricature, but that is the case. I think that the question then is really what sort of system can balance the interest groups better. On the face of it, it is easier for less democratic regimes to keep balancing groups. But they suffer from the problem of the succession, of the transition, of the continuity.

H. Etienne: Let me address, first, the question of the intervention of interest groups. Mention was made of the approval of the WTO agreement by the US Senate. On that occasion quite a few side payments were made. I do not want to use the strong word bribery. The pressure groups achieved that a ruling by the WTO dispute settlement body could be enacted in the United States only after the confirmation, by a panel of US legal people, that the WTO panel had acted in accordance with WTO rules.

A speaker referred to the situation which would arise if all the representatives of all the pressure groups agree to disappear. He felt this would lead to an ideal situation. Let me just remind you that we know of such a situation. During the night of 3/4 August 1791 the

French *Assemblée Nationale* made the *Loi Le Chapelier* which did away with all the intermediary bodies intervening between the citizen and the elected representatives of the people. What happened afterwards was the *Convention*, then the *Directoire*, and finally the Empire. This seems to demonstrate that pressure groups are inevitable if we want to uphold parliamentary democracy.

One speaker has raised the question of whether capitalism and market economy were compatible with autarchy? He answered: yes. I want to raise the complementary question: Is democracy always compatible with market economy? Here I must say: no. If in a democracy you have a situation of “we” and “they” and a majority vote takes place, putting into minority a group of actors in the marketplace and depriving them of the fruits of their labor and of their risk, then the market economy is in trouble. This situation is almost inevitable when “democratic” votes take place in a situation of “haves” and “have nots”. If we are in such a situation, the market economy as well as democracy itself are in danger. How can such a situation be prevented or remedied if it has occurred? That is exactly where pressure groups may introduce the necessary checks and balances.

The last point that I wanted to make is the following: that our democratic life has become extremely complicated, especially in situations you mention in the book. The “sovereign people” has only one possibility every four years to rebuff the people in power. In the meantime, the government has to be controlled, and it can be controlled only by the people who can follow the government professionally, that means the vested interests. Your positive interests in the whole machine can be protected only through your vested interests, because in the election you can only rebuff or confirm.

M. Hirsch: It struck me that this whole discussion we had about special interests has been dominated by what I would call an American perspective, and that includes also Mancur's manuscript. Now, if you look at the way Europeans deal with that issue; it is first of all noticeable that, when we speak about specialized interests, we mean visible ones, and the visible ones in the European situation are more likely than not to be the organized labor interests. The invisible ones you mention are also relevant for European big industry, and so on. But they are hardly being mentioned at all when the talk is about

vested interests in Europe. That is a quite different perspective and it has some implications.

The second thing which characterizes the European debate -- by European debate I mean now the political science debate -- is the relationship between the dealings of vested interests in parliamentary democracy, not just "democracy", but parliamentary democracy. I insist on that precision because it seems to me that we have reached the point where we have to define what we mean by democracy. That has not been done for the whole day, strangely enough, but I think it must now be done. If only for the reason that in Europe we tend to think that the action of specialized interests runs counter, runs contrary, is opposed to what are understood to be the rules of parliamentary democracy, especially if you have a tendency, which we have in some countries -- Austria has a long tradition of that -- to institutionalize the role that vested interests can play. I mean institutionalized, corporatist ways of going about things. Of course, in such a situation parliament plays a negligible role. That is why, I think, we have to define what we mean by democracy, and especially what we mean by parliamentary democracy.

B. Milanovic: I would like to make a simple point which I think was not mentioned so far. It is that, when we discussed the interest groups, we have always discussed so far, and so does Mancur in his book, interest groups organized for some economic or social objective. There are also interest groups, and Mancur mentions them obliquely in one of the prerequisites for democratic regimes, that can be organized regionally or ethnically. These interest groups have very different dynamics, and lead to different outcomes from the interest groups that we have been talking about so far. Specifically, I would like to address the issue of interest groups not in the new countries but in the non-existent countries. There were four communist federations: China, the Soviet Union, Yugoslavia, and Czechoslovakia. Three of the four do not exist any more. Now, obviously, we can say it was an accident of history. But I think there must be some deeper reasons. I would submit that one of the reasons for their disappearance, for the break-up, was that in communist regimes any kind of interest organization was banned except at the regional level. You had regional communist parties; you had all kinds of regional organizations. I have a very good friend who is a Tunisian and worked as a *chef de cabinet* for the Tunisian Prime Minister, and

he told me that what he learned from his boss was that there are no such things as empty shells. So, although during some periods these regional organizations were empty shells -- and I would argue that they were not always empty shells -- they eventually took a life of their own. So you had the interest groups, which were in this case ethnically based, on republican levels, and these interest groups led, I would argue, to the outcomes that we have seen. In one case, in the Soviet Union, these oligarchies were able to come to some kind of agreement, and they broke the country up peacefully, that is, relatively peacefully. In other cases, these oligarchies could not come to an agreement on how to divide the spoils, as in the case of Yugoslavia, and they went to war.

Now, why is this point important? For two reasons. First, because it leads us away from the narrow economic perspective of interest-group formation, and, second, it opens up many other questions, for instance, on China's future. We have heard today that China's democratization is proceeding through interest-group representation at the provincial level. But whether it would lead to the same outcome as in the other three countries we do not know. Of course, China is ethnically a more unified country (even if Tibet and Sinkiang account for a large chunk of Chinese territory), but China also has a very long history of existing as a sort of a conglomerate of countries, i.e. of being divided into a number of independent (and often warring) states. So our conclusions should be relevant for China too. They are also, and very much so, relevant for a number of African countries, for example Nigeria and Ethiopia. Ethiopia, in particular, which has an explicit ethnically-based policy like the former communist federations; and then Nigeria, which has an entirely different policy precisely in order to suppress the ethnic element.

D. Mueller: My point is related to Mario Blejer's point and to what was said elsewhere. For Mancur's purposes, or for purposes of economic growth, the interest groups that are relevant are essentially all cartels. We're talking about labor cartels or professional cartels or producer cartels. But they are the ones that play zero-sum games or negative-sum games that tend to slow up growth. We know that cartels are inherently unstable. You look at OPEC; you look at the diamond cartel. All international cartels where there is no government to enforce them have been unstable. To have effective

cartels within a democracy, the government has to legislate. Almost semantically, if we mean by a new democracy a country which starts with a clean slate of legislation, then, given the problems of unstable coalitions and so on, it is going to take a while for the cartels to organize themselves and to get the parliament to institutionalize their cartels through legislation: be it minimum wages, or entry barriers, or whatever. It seems to me the answer to the question, do new democracies have interest groups -- if we are talking about these effective interest groups -- the answer has to be, no, they can not. If they are really new democracies, it is going to take a while for them to form.

Then a sort of footnote on the point that you made about Germany, Japan, and Russia. This is essentially the point that Mancur makes in his book, I think. The problem with Russia is not that the capital was not destroyed, but because the capital is sitting there, and there are collections of workers and managers which are tied to that capital, there are effectively interest groups that have not been destroyed. So, if you could go in and blow up the capital, then these people would have nothing to huddle around and form their interest groups. So the key thing about it is not that the capital survived. The capital is probably worthless. The present value of the capital is probably negative, but as a coalition-forming device it is very important.

Merle Goldman: I just wanted to say that China is not a conglomerate of nations. It might have different dialects, but 90-92% of China is made up of Chinese.

N. von Kunitzki: So much bad has been said about interest groups that I have to just remark a curious thing -- I wouldn't like to judge it morally. But Mancur, in his book, also mentions, what he calls the rational ignorance of the big public as to their own interest and that it is non-problems, scandal stories, etc. that monopolize public opinion.

Now, the habit has come to Europe that if there is really a predicament, then one explicitly calls up the interest groups. That is called the Economic and Social Council. There is one at the European level; there is one at the national levels. And that is an open admission of the fact that a lot of problems are not discussed at the political level because they are too emotive, and so politicians who want to be re-elected do not lose time discussing them publicly, but

would rather treat those problems behind closed doors. And if they run into trouble, mostly because they have committed themselves to one side and they have also committed themselves to the other side, then they call upon what is the *nom de guerre* of lobbying or interest groups -- the "living forces of the nation". Then, as in modern Russian times, come the people that are *really* concerned and they are then supposed to solve at a different level the problems that are not solvable any more in the political game, because of that large rational ignorance that Mancur mentioned.

B. Milanovic: Just a clarification. I did not say that China was a conglomerate of nations. I said a conglomerate of countries, by which I meant that there were periods during which there was no central Chinese government and there was war-lordism instead. That was my point: it was not that China is as ethnically heterogeneous as the Soviet Union was.

A. Clesse: For myself, the most reassuring, at the end of this long day of discussion, is what you said, Branko Milanovic, that there are no empty shells. That is certainly a very good insight and very important for meetings like this one.

Session V: Communist autocracies

W. McNeill: I am not sure I should have priority because I am no great expert on Russia or on China, nor on anything in particular. But still, I rush in where angels fear to tread. I found the essay on the whole to be eloquent and persuasive about sclerosis and also about the taxing devices by which Stalin's regime collected such a large proportion of the resources of the people through government channels. But it did seem to me that there was one dimension of Russia's early success which Mancur just did not touch upon, and it has very interesting parallels -- exact parallels -- with Peter the Great's mobilization of Russian resources in the late seventeenth and early eighteenth century, and interesting resemblances, though they are not as close, with what Ivan the Terrible did in the sixteenth century.

The basic circumstance -- when Stalin took over, when Peter took over, when Ivan took over the government -- was that there was an

enormous pond of manpower in the villages and unused natural resources: mineral resources, timber In the villages of Russia, for six months out of the year there was nothing that a villager could do but sleep on the stove and hope for the spring. They were almost completely idle. Now there *was* a certain development of handicraft, work done in the winter, but it was done on a very small scale with hand tools and there were obstacles to marketing -- the communication system did not allow easy marketing. So they were not totally out of work in the winter, but they were pretty close to it.

This meant that if you could pull people off the land and put them to work on industrial or construction projects, they could work nearly all the year around. In the severity of winter it was pretty hard to build St. Petersburg, but they did. And people died while the frost bit their hands. But Peter could hardly avoid increasing the total productivity of the country. That is, if for six months out of the year almost nothing is produced by something like 80 to 85% of the population, and you shift a portion of them to a different kind of year-round occupation, you get an increment which is very substantial. Peter and Stalin got comparable pay-off from going into mines, getting lots of coal or lots of iron or something else, even by using very primitive and very inefficient methods.

No matter how inefficient the machines utilized, or how great the waste of manpower compared with what was being done in the more intensely market-disciplined parts of the world, they were still adding to the productivity of the country. These Russian systems always were wasteful because mobilization was by force. Peter said, "Come and march. Come and build St. Petersburg.". The entire effort was quasi-military. And the relationship between military mobilization and this kind of construction or industrial mobilization was very close. The interchangeability of civil and military ranks under Peter is very significant.

Yet, under Peter, it worked like a charm for about two generations and made Russia a great power. There is a place where Mancur said that Russia was never a great power, superpower. But it *was* in 1815. On the continent of Europe, Russia was *the* dominant power. The Prussians and the Austrians had been defeated by Napoleon, and the Russians defeated Napoleon. This is a very close twin to the situation after World War II, where an off-shore power known as the United

States, and a continental power known as the Soviet Union, jointly defeated Hitler. The parallel is very close.

It is not true that Russia was never a superpower. It *was* a superpower by 1815 and kept that status until 1854. Then the Crimean War showed new surprising weaknesses in Russia, of course. But until that time, the Austrian government and the Prussian government felt themselves, to some degree, the captives of, the puppets of, the allies of -- and always dependent upon -- Russia. In 1848, the Habsburg monarchy was saved by Russian troops sent in to suppress the Hungarians, and so on, and so on. Russia had been the dominant power on the Continent for two generations. So, this has happened before. And it is the pay-off from Peter's mobilization, the development of new technology, which was abreast of the military technology of the Western world, where the larger-scale human resources -- the larger number of people -- made it possible to bring the resources from a very wide part of the Eastern European plains into a common command system.

In Stalin's time there was the propensity to go further than Peter had done, because the communist master could extract more and more from the population, more and more men were forced from the countryside. Fewer people could still cultivate the same amount of land with the same degree of effectiveness. So, once you put a tractor factory in Stalingrad, you have the possibility of continuing this process of extracting manpower from the countryside with very little, or no any effective diminution of the agricultural productivity. Now, there was resistance to the collectivizations, the famine of late 1932. But the system was simple in principle: by using compulsion, Stalin could push a far larger proportion of the entire population from field to factory - or construction gang.

There is a second dimension to this. Most of those who left the villages in these forced-draft circumstances suddenly found themselves living in a more exciting, and certainly more promising, environment than their native villagers. The villages were dark and dismal indeed. The bulk of the peasantry led a pretty miserable life, especially for the six months of winter. Those mobilized for Stalin's purposes had the sense that they were doing great things -- things you could look at and admire. The sense that "we are building communism" had a very persuasive appeal because, in fact, they were doing something that had never been done on such a colossal scale

before. Peter had done almost the same in his day, but had to leave far greater proportion of the population on the land - having no tractors!

Now, what went wrong with this system after World War II was that the abundance of manpower disappeared and the best natural resources had been skimmed off. Increasingly, what mattered was the efficiency with which labor and other means of production were applied to production. And the system forced managers to *resist* efficiency. Any sensible manager hoarded manpower and hoarded material resources because, when an emergency came along, he would have the extras to put into production. So these managers, being rational, hoarded and resisted any kind of efficient application of these resources. It was built into the system. They could not be efficient. They had to sabotage efforts towards efficiency in order to save their own skins, as they tried to meet the plan.

Hence the Russian system of moving people from semi- or total idleness into productive work breaks down when there was no more raw help available in the countryside. The supply of ready and strong-backed laborers dried up. The system confronted new compulsions which it could not respond to. And that, I think, seems to be a dimension of the curve that you might add to your essay.

J. Oppenheimer: I just have a question. You started by saying that you basically found it an elegant argument. But it seems that actually what you're saying is that this notion of inframarginal taxation, for example on the basis of very good information, in fact, is not what it was. It was forced labor out of agriculture -- sort of off-season mobilization which very crudely just dumped people into anything that was obviously productive and useful. And then, as soon as you needed more information that was better, you did not have anything better than a normal bureaucracy that was scared out of their heads.

W. McNeill: Well, the word "forced", I did use that. I also tried to explain that workers engaged in the system, once started, thought it was worth doing. So there was a certain voluntary element in the pattern, a kind of an ideal. And on account of this, men certainly dug tons of coal willingly -- a sort of Joe Henry. "I am going to do better than that fellow", that kind of competitiveness and self-assertion. So there was a strong voluntary element and pride in what they were doing. A sense of "we are leaving the rest of the world behind" in the Great Depression.

When I was young, it was an impressive phenomenon to the rest of the world. Very impressive to my generation because so many of us could not get a job. There were 15 million people unemployed in the United States. And look what the Russians were doing!

Marshall Goldman: Well, I would agree with most of what Mr. McNeill has said, but, Mancur, I want to go back to something that we studied as graduate students. It is true that there was an element of voluntarism there, in the collectivization, but what we also came to learn was that the collectivization was at the end of the chain and the people underneath were not so "voluntary". And so there was a lot of resistance during the suffering. The purges resulted in an enormous loss of life. But the comparison between Peter and Stalin is, I think, an appropriate one. If you look at what the strengths of the system were under both Peter and Stalin, but particularly under Stalin -- what happened is more or less what you described.

The system had two important strengths. One, it could gather capital, or what passed for capital in Peter's time. And the second thing is that it could then direct it in a forced-march kind of way, some of which involved voluntary action, most of which involved: either you did it or you were imprisoned or shot or something equally severe. What happened is that in the process of gathering those resources, there was an element of intense compulsion. Peasants in Peter's time basically became enserfed. It started before that, but under Peter it was made much worse.

In the case of Stalin's time, collectivization was the equivalent of serfdom because the peasants were denied the ability to move into the city unless they were invited. They did not have the internal passports that Stalin began to require of everyone. And so, in effect, it was a return to serfdom. Now this, again, allowed Stalin to accumulate capital resources. Where else could they generate the capital resources they needed to build industry, as Peter did in the Ural Mountains, and as Stalin did throughout the country, except from agriculture? That was the only thing they had access to.

But after a while, that advantage turns out to be a disadvantage because serfs become a drag on society. And one of the things we know about Russian agriculture, particularly under Stalin, is that agriculture suffered. Now, it is true that Stalin got more out of agriculture. But not because agricultural production increased. What happened was that Stalin simply extracted more out of agriculture,

starving the peasants. He took that surplus out of agriculture and initially used some for exports.

Such a strategy was important for World War II, because it allowed Stalin to build up the heavy industrial sector. He took resources from agriculture and built up heavy industry from scratch. Before Stalin, there was basically very little industry -- very little industrial activity going on in the Urals, except from Peter's time. There had been almost no change in technology in that region. Stalin transformed the area, built up industry.

So when did Stalin's policies become counterproductive? The problem was that the two advantages of this system: gathering capital and building up this heavy industry, worked as long as that was the center of technology and industrial growth. In other words, it works as long as the main source of industrial power is steel mills and the machine tool industry. But by the time we get into the 1970s or even the 1960s, heavy industry becomes a real burden. And, more importantly, central planning, which was also central to the stalinist system, did not lend itself to the most recent industrial revolution that took place in the last few decades. If you look at what Khrushchev said when he came to the United States in 1959 and 1960, he was sure Russia would overtake and surpass the United States in terms of the industries he was talking about. They produced more steel than we did, at least until Yeltsin came along; more steel, more machine tools, more oil -- all of those things. But in terms of electricity, in terms of electronics, in terms of sophisticated things, the Soviet Union just did not match up to that. And so, economically, they fell behind.

And the same thing happened after Peter. In the nineteenth century, the reason that Russia fell economically behind is that they lost the Industrial Revolution. The Bessemer steel process did not come to Russia until 20, 30, 40 years after it came to England. Russia was producing more steel than anybody else in the world until about 1805. But after that, the Industrial Revolution came to Western Europe but not to Russia, again because it was constrained by its system of serfdom.

S.M. Lipset: I would like to continue this discussion and raise an issue about the historical context. You say that the situation in Czarist Russia was pretty similar. One of the interesting sociological descriptions of this can be found in Volume I of Trotski's *History of*

the Russian Revolution. The Czarist system was growing rapidly prior to World War I. In fact, Trotski explains the growth of the working class revolutionary movement by the strains of rapid industrial growth, and the increase in factories and working-class houses. If this rate had continued without the war and the Revolution, Russia, 20, 30, 40 years later would be much more developed economically than it became under the communist regime.

There is a second aspect of the Czarist regime which is very important for our comparison of the two. It was not totalitarian. There were opposition groups. I can testify because my father belonged to one. He was a printer, and he told me that in 1910 or 1911 he had heard Stalin talk to a small group of printers in Kiev. When I asked him how he could remember Stalin because Stalin was a nobody at that time, he told me that Stalin was different from all the others. All the others, Mensheviks and Bolsheviks, came down and talked revolutionary theory, but Stalin sounded like an AFL business agent. He talked about money and opportunities. He told them that if they supported the Bolsheviks, they would get more, since the Bolsheviks had better organizational tactics.

Sure, Czarism was an authoritarian system, but it was nothing like the Soviet Union. And therefore, the development of revolutionary movements could take place in a loose autocracy, while it could not in the kind of totalitarian system that the Soviet Union was.

There is another aspect to this. The Soviet Union was defeated in World War II. The Germans drove deep into the country. Look at things in perspective. Remember, in 1940 when the Russians invaded Finland, they could not beat the Finns. It was like Afghanistan. The morale in the Soviet army was bad, and the morale after the German invasion in 1941 was bad. Stalin himself personally admitted this in a speech he gave in 1942 to explain what had happened, why they lost so much in 1941. He said that the Russian people did not understand the nature of Nazism, what Nazism was like. Only when Germany occupied their territories and started to act like Nazis, Stalin said, a great hatred swept the Russian land and they started to fight back. In fact, he was implicitly admitting that until that time the Russians were not fighting strongly. The only mass Quisling army was a Soviet one, with millions of Soviets joining the fight against their own government.

Fascinating things are reported in the Smolensk diaries. The US captured detailed records that the Germans had in Smolensk. These included reports by the German soldiers of how they were greeted by the Jews in Ukraine, how Jewish villagers would throw flowers at the German soldiers. They could not understand this. How could this possibly happen? They investigated and they found that many Jews did not believe what they were told about Hitler and the Nazis because the reports came from a regime which always lied. Back in World War I, the Germans had been much better to the Jews than the Russians. So, their image of the Germans, based on historical experience, was a positive one. They would not believe this information about what the Nazis were doing from the mouth of a regime which they could not trust.

We forget how miserable this system was. Not just after Brezhnev, but particularly in the 1930s under Stalin. Certainly they had economic growth under forced measures. How does this fit into Mancur's analysis? It is like the issue of the productivity of slavery. Bob Fogel argues that slavery was profitable in the South. They could get slaves to work, not as well as free labor, but certainly far above zero.

A system of forced labor, which the Soviet Union was in a large part, was able to produce a lot, particularly since it started from a very low base following World War I, civil wars, and various famines in the early period. But it may be argued that it was never really a successful system, particularly after World War II.

L. Gordon: Just to point out, confirming what Professor Lipset has just said, that the late Alexander Gershenkron, who was one of the great historians of pre-revolutionary Russian economy, was totally in agreement. His writings demonstrate quite clearly that Russia, although a generation behind Western Europe -- Germany in particular -- in the second half of the nineteenth century was moving in precisely the same direction and was modernizing its economy and substantially industrializing in the early stages. There was a considerable record of growth in that period until World War I.

A. Kaminski: One of the insights that might seem to be most helpful to understand Russia's success and ultimate failure under communism was a chapter in Montesquieu on the essence of despotism, which I can quote because it consists of two sentences. It says that if a despot

wants to eat a fruit, he cuts the tree at the root and picks up the fruit. That is the emblem of despotism. This means that it is a system under which only natural constraints operate. There are very few trees with fruit. Thus, communism as an economic system is wasteful. This idea was also explored by Janos Kornai in *The Economies of Shortage*, where he describes two kinds of economic systems: one constrained by supply and another by demand.

I also remember the prediction made by Alexander Weisberg, an Austrian physicist in a KGB jail in 1938: he and his colleagues extrapolated the escalation of political arrests -- the purge. They assessed that by the beginning of 1939, the whole society would be composed of jailed and jailer. Because such a society cannot operate, they predicted that the purge had to be stopped at the end of 1938, which turned out to be an accurate prediction. Communism was a system constrained mainly by natural factors. Indeed, other constraints have developed in the post-stalinist period, but they had never fully developed. Because of the nature of constraints, the more effectively was communism rooted in a given country, the more difficult the liberal-democratic transition.

This explains why the transition is easier in Poland, Czechoslovakia and Hungary -- those countries in which communism was implemented after World War II, and is very difficult in those countries in which communism was implemented immediately after World War I.

There is one more point. I remember from my childhood, that the ideological factor under the stalinist system was very important and, surely, the economy interests were fully subject to political interests.

A. Clesse: So you would say that Mancur Olson underrates the importance of ideology?

A. Kaminski: Yes.

K. Soltan: I begin with a question about Mancur's manuscript. Mancur writes that ideology is a kind of ad hoc explanation here. But as I read it, the alternative he presents is that Stalin was a combination of lucky and clever and came up with a system of extraction that others had not thought of before. But *this* seems to me completely ad hoc. Why was Stalin so clever and lucky? That is even more of a difficult thing to explain than ideology. I agree that going strictly by ideology does seem to be ad hoc. So I wouldn't agree to

what some people here would want to suggest: the strategy of simply adding on ideology.

I think at the very least one has to take into account the destructive goals of the system -- the revolutionary goals. The destructive objective makes it easier to develop a military-like system of organization. There is a logic to developing a military-like system of organization, which, when applied to the economy, has the kind of properties that you describe. And obviously it is a revolutionary regime, a revolutionary regime whose goal is to destroy the world system of capitalism. It seems to me that, at the very least, you need to bring in that objective function of destruction. It might at least provide in a less ad hoc explanation, because you can connect it up with the other parts of the manuscript where destruction enters in more systematically.

At the moment it seems to me that, to put it sharply, what you are giving us here is even more ad hoc than ideology would be. It is a combination of "wasn't Stalin clever?" and "wasn't he lucky?" He was not all that clever. Lucky?

A. Tsiplko: This is a very interesting question. It is the question of the viability of the communist system. One aspect we must study is the psychological causes of this communist system. It is an unusual system in the history of humankind. When you compare the Old Russia and the New Russia, you must see that it is a different system, with different rules from the beginning. That is why, for me, the main question is: What is the main precondition for the system? Was it the expectation of paradise, or the expectation of equality among humankind, or was it fear?

I was born in 1941. When Stalin died I was 12. I was a child at the time of World War II. Earlier on, I was confronted with the troubles my family experienced and I remember the constant *fear*. That is why, from my point of view, fear is the main motivation. *It* is the system. Fear. Fear. Fear. This constant fear from the beginning. If you study the beginnings of the Soviet system, it is the heritage of World War I which destroyed all normal values of life and thinking. If you study the situation at the end of 1917 and early 1918 you discover that the average human being had lost all fear of death. That was the Bolshevik type. It was the first time in the history of humankind that we encounter violence without limits.

Then they institutionalized this system which organizes and produces fear. In the beginning, it was the main rule of mobilization of this system. Of course, there are additional factors, like the Russian habit of long suffering. And of course the expectations of paradise may have also played an ideological role. But it was a very strange combination. On one side there was fear, on the other side there was this belief in Stalin as a god. When I was a student in the 1960s, every autumn I had to help the peasants with their harvest. I experienced then the last Russian generation of peasants who worked well without any incentive. Stalin exploited the heritage of peasant psychology which is: "I must work well without any payment." This psychological precondition may not last more than one generation.

World War II helped Stalin. It gave Stalin the legitimacy for his system. For the first time in the history of the Soviet era Stalin received legitimacy. He defeated the fascist system. This gave him an additional second generation, or about 45 years of legitimacy. But from the beginning of the 1960s, this system started to collapse. All this motivational power began to crumble and was finally destroyed. Now we are faced with a changed motivation. People need to do well, they need safety, need time for a private life. It is very interesting: the first time this need of independence and of more private life appeared was during the Brezhnev era. Of course, it was a precondition for the *perestroika*. The Brezhnev system destroyed the old communist system. Many needs now became normal, like wealth, security, and prosperity. It was the end of the Soviet system. There is a psychological root for the communist system: namely extreme fear. Fear that was the precondition for this type of mobilization.

J. Oppenheimer: I wanted just to make a comment on Seymour Lipset's point where he talked about the productivity of slavery. Slavery, according to the more modern economic historians, was perhaps slightly less profitable than it might have been, because the slaves as property required upkeep. And after Reconstruction, in the United States there was a forced labor system that was very similar to Stalin's system throughout the South, or in many places in the South. There, in order to maintain the large cotton plantations, Blacks were randomly rounded up to be worked, basically, to death.

And though I have not read any of the statistical comparisons, it would be interesting to look at that and ask whether or not you can get higher productivity. The book that I am thinking of is by Kaplan,

Louisiana State University Press, *Politics of Punishment*. There is actually a lot of documentation on that. The same system appeared in east Texas, and a tremendous percentage of Black males were rounded up and worked to death on the ex-plantations once the Federal soldiers left. What I would like to point out is that I do not know what the statistics were in terms of working to death people in the labor camps. I do remember reading them in the beginning of the 1990s when they really came out. They were astronomical figures. And you can get a lot of productivity for very little if you are willing to work people to death.

It would be interesting to look at the following statistical indicators: what was the average life-span of people in the Russian labor camps; how did productivity in Russia compare to US labor after slavery was introduced in these forced-labor situations which were the precursors to the Southern chain-gangs. It would appear to me that the real issue is not the brilliance of Stalin in being able to figure out a system which gave him information, but in fact the utter cruelty of slave labor. The productivity of forced labor -- how much you can actually build if you have enough guns on your side to force people to build -- is the root to Stalin's record. I think we can look at that whether we are looking at pharaohs, where there is a limited supply of slaves, or whether we are looking at stalinist Russia or whether we are looking at China.

C. Wolf: Just a brief comment that I think is implicit in what has been already said, but is already made explicit as a fundamental part of Mancur's question about why the Soviet Union became a superpower when Czarist Russia did not. And it is the military component. The superpowerdom of the Soviet Union in the international domain was fundamentally based on its military power. It was not an economic power internationally. There is a lot of statistics about physical production of more or less homogeneous products -- steel and oil and so forth -- but its superpower status was fundamentally based on its military power. The statistical basis for these proportions of GDP is subject to controversy and differences in judgment, but CIA's open estimates over the last 20 years before the collapse of the Soviet Union varied from about 6% to 11% to 16% at a time when the proportions of GDP allocated to defense in the US and the West were half of those percentages and where the actual soviet allocations of

resources to the military were probably twice that was estimated by the CIA.

In other words, if you talk to people who were in the defense establishment and the defense industry in *Gosplan* now, or since 1981, they are very forthcoming in emphasizing the extent to which the military resource mobilization was much larger than the estimates which were made in the West. So I think the superpowerdom of the Soviet Union was fundamentally, if not exclusively, based on its military capabilities, not on its economic capabilities.

N. von Kunitzki: I think that we are giving way here to an attitude that is deep in our minds: we associate military power and riches. And you know the famous answer of the Minister of Finance that in order to make war, you need three things: money, money, and money. We have a similar association about culture, that without money there is no culture. But money, of course, is a necessary, but not a sufficient, condition for culture, especially in this country. I think with the military, it is even worse because if we take military power on the ground in history, it was usually the other way around. It was usually the poor nations that had nothing to lose and so many of the people there were almost ready to die because life was so miserable. That has been true in the Greek time and everywhere.

And, in every country, the strongest military power was in the poorest parts in France, Lorraine, the valleys of Prussia, etc. We have a recent instance where a little country like Vietnam did not really overcome America, but America was not able to win the war. I also remember the other war against North Korea where the West was almost defeated without the moral difficulties that accompanied the war in Vietnam. In Vietnam, the war was lost in Washington. But on the ground in Korea we see the difficulties of overcoming a small nation. Yet if you look at that nation now, today, the miserable state of North Korea, you'll certainly wonder how that country could even overcome Luxembourg.

So, to say, "How can a poor nation win?" is just a nonsensical question. I should say we should turn this thing around and say "How could Russia be a superpower in the military world of today in the Cold War, when there was no war on the ground, but where, through technological standing, she was a superpower?" You do not become a superpower through fighting. You are a superpower due to your technological power. And how is it that a poor country, badly

managed, demoralized, anti-motivated, gets to such a technological level that it becomes equal to everybody, including perhaps the United States, and was sometimes ahead of the United States? That is the real question.

The answer is to be found partly in the industrial field, where it is a very different problem to organize mass-production of high-quality knives or high-quality ball-pens from constructing a supersonic plane. Just look at the experiences of Germany and France. France has always been much better at prototypes than Germany. But Germany has, usually, much better consumer products than France, at least the French think so. Perhaps in Russia one must look at who was demoralized and who was anti-motivated. Not the scientists in their scientific studies, so they were well able to build those prototypes in the nuclear field and their nuclear submarines. And I am sure that the comfort of those marines that were living in those submarines was miserable, but the technological performance was good because that was done by a class that did not undergo the general disease of rationing.

As we look at China, it is quite clear that there is a class of workers and a class of white-collar workers that are absolutely able to build up the steel industry in the same time that they do in Belgium. But if you go through the whole countries, it is another matter. Now this is a whole other formulation of what it means to be a superpower. A superpower is economic. A superpower is military. Even in the military you are not a superpower unless you are a superpower in the technological realm. Something that is much more comforting than being a superpower killing people in fields.

A. Kortunov: I think it was a very interesting and stimulating discussion and if I am allowed to generalize, I would venture to say that it rotates around one fundamental question, which is "What is really the difference between an authoritarian regime and a totalitarian one?" We heard basically two opinions expressed on this subject, if I reduce the discussion: The first opinion is that, basically, there is no great difference. After all, Russia had its historic tradition of forced labor and mobilization by cruel rulers, starting with Ivan the Terrible and maybe even earlier. Therefore what Stalin actually did, was to use the heritage; he used the traditions, and he just exploited them and put them in a more or less concise system. Therefore, no matter who came to power in Russia in the early twentieth century,

this person would have at his disposal all the vast resources of the nation and Russia would be a great power, if not a superpower, anyway.

And the second view is that in fact there is a difference. Czarist Russia would never have made it, because Stalin developed a system which had some quantitative, not just qualitative, differences from the Czarist regime and it was a radical rejection of the old Russian traditions, the old Russian values and of the old Russian system. And I think, dependent on how we answer the question, we can speculate about the transition. I tend to believe that Stalin, of course, had some legacy and some heritage to exploit, but there is a difference between authoritarianism and totalitarianism. And I will say that if you consider the historical experience of the two types, there is a more or less natural trade-off between the rate of growth on the one hand and the regime's sustainability on the other.

Again, if I can make a comparison, an authoritarian regime, economically, is, at least for some time, a balanced-income mutual fund. Now a totalitarian regime appears like a pyramid-type speculation. Indeed, if you compare the Soviet Union with Russia, you will see that the Russian economic growth and the Russian development back in the eighteenth and nineteenth century and the early twentieth century, was in a way sustainable. Indeed, urban areas absorbed some rural population, but the village could renew itself. Sociological research supports that. Yes, Russia was an imperialist country in early twentieth century, but Russians clearly knew where their limits were. And under no circumstance did they attempt to project their influence to the Caribbean or to places like South Africa. They realized that they had limitations.

Yes, Russia claimed that it had a special mission in the world. However, it still believed that it belonged to the European family of nations. So, in a way, there were some limitations and there were some rationalities that made these economic and social developments sustainable. However, if you go to the stalinist regime, it was not sustainable from the very beginning because it really destroyed the Russian village, which used to be the source of the development. It always stretched politically and economically. Neither under Peter the Great, nor later, was the level of militarization as high as it was in Soviet times. And under no circumstances did Russia try to impose itself on the whole world like the Soviet Union did.

The living space for a totalitarian regime is by definition much more limited than that of an authoritarian regime. And the only reason why in Russia totalitarians lasted longer than in some other countries is because the country was wealthier, because there were more resources to exploit, because there were more opportunities to use them. Moreover, the luck of Stalin was that he was able to introduce his regime at a very particular stage of economic modernization, when the goals and the means of totalitarianism coincided with the assembly-line technology that was being developed in the early twentieth century. So I think that we should probably draw a line between authoritarianism and totalitarianism and we should consider totalitarian regimes as implicitly unstable.

S. Haggard: This is the strangest conversation I have ever heard about communist systems; it makes no reference whatsoever to their distinctive feature, which is the dominance of the party organization. This gets back to my general quarrel with Mancur, and the centrality of institutions in understanding autocracy. What is distinctive about Lenin as a political theorist, is not his links to Marx, whose economics he totally rejected, but his commitment to, and his belief in, the power of modern organizations.

Lenin is all about organization and, particularly, about party organization and the way that party organization can be used as an instrument not only of revolution but for organizing all of a modern society in hierarchical form. It is not just the state and the state centralism, but it is the dominance of the party over the state and the incorporation, through the party, of virtually all of society into party-dominated organizations. Party organization is an extremely powerful and distinctive tool because, coupled with the control of the means of production, it locates every individual in a society in a hierarchical form of organization. Which means that everyone's incentives are basically aligned upward and there are very few exit options.

If you look at other autocracies, virtually all other autocracies -- whether they are traditional autocracies like monarchies, or modern military autocracies -- came to power confronting very powerful asset-holders, whether they be landed interests or private-sector interests. Economists tend to view the distinctive feature of communist systems in terms of a command economy, but from a political perspective, the distinctive feature is the dominance of the

party. Now what is interesting is that party-dominant autocracies, in fact, are much more long-lived than military ones.

Now that the Soviet Union has collapsed, everyone talks in teleological terms about how the system was bound to fail. This autocracy lasted for 75 years. That is substantially longer than most military autocracies, which is the dominant contemporary form of autocracy.

The handful of non-communist party-dominated autocracies appear to be longer-lived than the military ones, too. I am speaking here of Singapore, Mexico, Taiwan, Indonesia. The party organization imparts certain controls and a capacity to mobilize resources which is absent from other forms of autocracy, whether they are traditional or military forms. The puzzle of the Soviet Union is not why it lasted such a short time, but why it was the longest-lasting autocracy. It has something to do with party organization.

A. Kortunov: I just think that we should distinguish between collapse of regimes and collapse of nations. New autocracies might change every decade, like in Latin America. In the Soviet Union we see not only the collapse of a nation, or the collapse of a state, but also the collapse of the regime. In a broader historical perspective, these cases are not that frequent.

A. Tsipko: From my point of view, it is very easy to find ways to distinguish autocracy and *communist* totalitarian systems. There are different totalitarian systems -- fascist and communist. There is a big difference. If you define this to mean “communist totalitarian system”, I agree with you. This is the regime in Russia. But from the beginning you must understand it is a system that was built according to marxist ideas on the possibility of changing man’s nature. If you study the socialist thinkers, you will find that they also wanted to build a socialist system as a collective system. But they combine it with normal natural human needs. They did not want to change the nature of man. For them it was a problem of combination.

But Marx wanted to change the nature of man. He wanted to make a new man. What I call a collectivist type of man. From an ideological point of view, the totalitarian communist system wants to change the nature of man. Authoritarian systems which appear in history are worse than democracy, but they do not want to change the

nature of man. The communist system is the first system in the history of humankind that wanted to change the nature of man.

B. Milanovic: One point regarding what Mr. von Kunitzki said, and on which, I must say, I disagree. You have, even if you look at the simple figures of the Soviet production during World War II, under obviously very difficult circumstances where a third of the country was taken over by the Germans, an incredible increase in the production of weaponry. Tanks and airplanes and so forth. So the question is how a regime can mobilize resources and use them under such difficult circumstances.

It is obvious that you do not beat the Nazis by producing prototypes. And you do not beat them either by making ball-point pens. To beat them you needed technology. And you need the technology to compete with the United States and to send a man around the earth. So it is a real technological development there, not prototype-making. And just one other example to show that the communist regimes were very good in single, specified tasks. An example that very few people quote or care to remember today is that of the 1976 earthquake in Bucharest. Romania was then already in dire straits. Obviously, Ceausescu's was a very bad and inefficient regime. But the reconstruction of Bucharest was quite efficient, reasonably fast, generally devoid of stealing and corruption. At about the same time there was an earthquake in Nicaragua and everybody knows what happened in Managua. Incredible amounts of money were stolen. Reconstruction was never completed. It seems a good natural experiment to show that the totalitarian regimes are good in single instances where the objectives are very clear and you need simply to mobilize resources.

C. Coker: I just wanted to make a couple of points to follow up on this morning's discussion. First, the interesting discussion about slavery. Slavery in the twentieth century is entirely the experience of war, war communism, and it proved exceptionally successful. The Hindenburg program in 1916 when at one time something like 500 Belgian workers a week were being seized by the Germans and being put into forced labor camps to work. This system caved in under international protests in 1917. But of course, under Albert Speer you had 13 million slave workers who turned around the nation and enabled it to practice total war in a way that it could not until 1944.

And then, of course, you have *gulag*. The industrial production rates for *gulag* during World War II were higher than they were in Soviet industry as a whole. Why? Because most of the people in the *gulag* were patriots and they were prepared to build and to work harder against the German enemy. The problem in all of this is that -- well even in the 1950s the *gulag* was instrumental in technological innovation. The first intercontinental bombers that the Soviet Union built were built by scientists forcibly conscripted in the *gulag*.

The problem of slavery is that it will sustain a war economy, but of course a war economy cannot be sustained for any length of time. The upshot is that you have to end up emancipating your slaves. The Confederacy was coming very near to that point in 1865. And in Russia that is exactly what we saw in 70 years, that the Russian people had to be progressively emancipated in order to try to maintain some form of modern economy at all. Now, at the risk of being a social scientist, what I suggest is the key to why the Soviet economy collapsed is that it was a war economy from the first day to the very end. Norman Stone in his book suggests that the first strike against Stalinism, as he called it, was implemented by the Russian army in 1917, even before Stalin was in power.

The breakdown of agriculture in the last two years of the war, the massive movement of people into war factories and into heavy industry to pay for the war, all of this was not designed by the Stalinist system; the Czarist system presided over that phenomenon. The Russian army went on strike in 1917 and refused to fight. What happened in the course of the twentieth century is that the Soviet people went on strike against the regime. It begins in the peasant communes of the early 1920s. Sheila Fitzgerald's work is very interesting about how Soviet agriculture was breaking down as early as 1921. Why did the first war campaign by the Bolsheviks begin against the peasants, and in what way did they go on strike? They simply under-produced for the next 70 years. The Soviet Union became a nation of peasant Oblomovs.

In the 1930s, the emphasis was on heavy industry. One sees a state trying to maintain its war status and trying to survive. And you have, for example -- it was referred to earlier this morning -- the economics of "planned shortages". This was very popular among economists in the 1930s. You had to ensure that there were not enough goods in the shops to corrupt your people. If you made them too materialistic, they

would become lazy, they would cease to be ideologically motivated. In essence, you had to ensure that you had an economy that produced soldiers and warriors. An entire nation of soldiers, an entire nation of warriors. And consumerism was not the way by which you did that.

Then, in the 1960s, in order to win the Cold War, the Soviet Union suddenly discovered consumerism, specially under Krushchev in his last years. It seemed as though it was going to win because it actually outproduced the United States. When Kennedy visited Macmillan after he became President, he told him that he believed the Soviet Union was going to be a more successful economy than the United States. And that was effectively what lots of people thought in the late 1950s and early 1960s. If they had not thought so, the Russians would not have gone down that path because they were changing the grounds of their conflict with the West.

They were moving from ideology to consumerism because they felt they would win. Where they might fail ideologically, they would be able to win in appearing to be a more successful economy than the United States. And a lot of people generally believed that was the case. Of course, it was fateful because once You have changed the grounds of action and the grounds of war and you fail miserably to outproduce anybody, and your own production rates in fact became smaller and smaller, then You have lost any further reason for being at war, any further reason for maintaining a war economy, any further reason for maintaining the Soviet Union as a state.

Now this brings me to one last point, which is a problem that I have with the manuscript, which I enjoyed very much, is that I think “democracy” is a very unsatisfactory term. “Civil society” is a better term, because civil societies are not war economies. Civil societies cannot be at war with the rest of the world. Nor, of course, can they be at war with themselves, which is what the Soviet war economy actually required. It declared war on its own citizens.

And if you look at the features of late civil societies which can be consistent with an authoritarian, totalitarian regime, you have three major things. You have a law of contracts, contractual obligations; that is, the state contracting certain responsibilities to its citizens, the citizens, of course, contracting to the state. You have the idea, secondly, of dissent and pluralism. Dissent is allowed. Criticism is perhaps not encouraged, but is not suppressed because the system has to be aware of where it is failing. And thirdly, there is no ideology for

a civil society. A civil society is the basis of increasing and maximizing the wealth of its citizens. The citizens will determine how that wealth is used. It is not up to the state to remake humanity and recreate Soviet man or anything of that kind.

And I think this is important -- and this is my last point -- because Russia seems to me different from every post-communist regime in the element of crime and criminality in the society. And I think that crime and criminality have been there in Russian history for most of the twentieth century. Criminal regimes in the 1930s, as Stalin was essentially a criminal. There is a nice passage by Jean Genet in the *Prison Journal*, he talks about Nazi Germany. How this man who spent his life stealing and preying upon the weak was shocked by what he saw when he went to Berlin. He said he'd discovered a whole nation that was "on the index". Therefore, he could no longer steal because it was like stealing in a void. There was no way in which he could be proud of himself as a criminal.

Now the KGB began going into criminal activity in a very big way in the last years of the Soviet system. They began going into businesses involving extensive movements of their personnel and, of course, that is one of the reasons why the old apparatus is still there from the KGB side. Because they bought themselves into that business, often at the criminal level, some years before the system finally collapsed. Why is crime important? Because crime is inconsistent with the principles of civil society. The key, I think, is contract.

And what makes the criminal, in a sense, an enemy of civil society, is that you cannot enforce the contracts in the law courts. If you are a representative of a criminal gang or mafia organization, you cannot take to court people who have broken their agreements with you. You either maim them or you murder them. In order to do this and get away with it, you have to buy judges, you have to buy the law courts, you have to buy politicians. You have to ensure that the constitution of the country gives you the widest possible margin of initiative. And that, I think, is one of the key threats to Russia's becoming an effective economy in the early twenty-first century, if the extent of criminality in Russia continues. I think this is an absolutely fundamental factor that makes Russia absolutely different from every other society -- with the one exception of China, which also has a criminal culture on an extraordinarily large scale. But that

criminal culture seems to be, or tends to be, extremely entrepreneurial. And part of the Chinese “economic miracle”, if we can use that term. I am not a sinologist and there are others in this room who would probably take issue with that.

A. Clesse: Yes, we have not really talked at all about China, but we will come back to this.

K. Soltan: There has been a strong theme in the discussion of the importance of war economy, of destruction, of the military, of fear. All this seems to me a kind of unifying theme. I was shaking my head when you said “party regime”, because you gave the counter-examples. The Soviet Union and Soviet communism were really unlike the rest of the world. The purpose of the party mattered. The Bolshevik party was a terrific instrument for a particular purpose and that purpose was revolutionary, that is destructive.

S. Haggard: It lasted for 70 years. I mean everyone is treating the puzzle as if the Soviet Union...

K. Soltan: What I am saying has nothing to do with that. Its purpose was revolution, which means that you have to destroy the remnants of the former regime, and the organization that is good for that is the kind of organization that focuses on military purposes. So the objective is destruction.

To go back to Mancur's manuscript, here is how I would put my objection to it: you have here a very naïve theory of banditry. This is a book about banditry. It is not a book about capitalism and democracy. It is a book about banditry. And You have got a naïve theory of banditry. You have got only two kinds of bandits. Some are sitting. Some are walking around. But they are all interested in booty. They are all interested in getting wealth. Well, those are the nice bandits. The really nasty bandits just want to kill you for the fun of it, or for whatever other purposes. They are not interested in booty. They're interested in destruction. That's their goal. And they can get their way quite effectively because they generate all kinds of dangerous organizations. Maybe if you expand your theory of banditry in accordance with the empirical fact that there are other kinds of bandits that you do not allow for, then you can also account within your system for these destructive, fear-producing aspects of stalinism and communism.

M. Olson: First, I like the characterization of getting down to something simple like banditry. Getting down to simple unifying ideas is, I believe, very desirable. So, I take that as a compliment, though I am sure many would see it differently. But, now let us ask, in the specific case of the communist countries, whether the idea of the sadist criminal versus the idea of the stealing criminal is really better. This is a good question.

I find, when I give talks on the ideas in the chapter that relates to this session, that fairly often people say, with respect to Joseph Stalin, that their interpretation of him is that he was truly bloody-minded. And that he had a lot of killing done because he liked to have it done, not because it achieved other objectives. And this particularly comes up when I say, as I do in the manuscript some of you have seen, that the purges may not have been entirely harmful to the Stalinist system because the purges -- the idea of punishing people, maybe even killing them on faint suspicion -- that idea *worked* against the collusion that ultimately undermined the system.

So then the argument is that the purges were not necessarily counter-functional for Stalin and a lot of people say that that was not right, that Stalin was simply some kind of cruel sadist that killed for the fun of it. Others come back and say that is too ad hoc, and I am not sure where one should come out here. But can we say that of the Soviet-type system as a whole? Of course, by my argument, Stalin created it, but after all it did exist for a long while after Stalin. Were the people after Stalin just out to kill and destroy? My sense is that you could not conceive of Brezhnev that way, or Krushchev that way. But maybe you could do better with Hitler under this caricature. He would hold up his own war effort in order to kill some more Jews. But my sense is that, by and large, you could not treat the Soviet system, at least after Stalin, as out to think again about what is a key more to destroy than to take.

D. Mueller: Some of the discussion before the coffee break got me issue, I think, in Mancur's argument and, perhaps, one that needs developing -- and maybe some of the discussion this morning was moving in that direction -- which is the succession problem in a dictatorship or autocracy, and its role in Mancur's story. If you think about it, as Mancur talks about, tribal societies and the fact that they are more or less democratic, an obvious explanation is that they are

so poor and have so little property that there is little incentive to becoming a dictator.

As societies become wealthier, the incentive to become a bandit gets greater, and presumably, the investments of potential bandits become greater and, therefore, the potential cost of crime and war grows large. And so, if you extend to the modern society, with its great wealth, one would say, "My God, there is going to be so much bloodshed by potential bandits to try to take over a rich country and destroy it that it is going to be very costly". I think Chris Clague mentioned about South Korea that one of the bandits there had got caught with 650,000,000 dollars. And Chris Clague said, "Well, that's nothing". But for most people that is a prize worth a certain amount of investment.

One obvious question then becomes: How do you control the amount of investments that will take place in these very rich societies? And here it seems to me, going back to Steph Haggard's point, one of the advantages of the Soviet system, the party system, is that the party is -- or was -- a kind of democratic meritocratic way of selecting, at least, the potential successors and so one of the explanations, perhaps, why it did better, or the Soviet system did better, in longevity than military dictatorships is, that Stalin just lasted a long time. And, of course, he started off by taking care of Trotzki and some of these other obvious rivals for leadership, in the traditional way that dictators take care of their rivals. But once he was established, he just happened to live a long time, and then you have this party system which, without creating a lot of bloodshed, was a system to select other dictators. I am no student of that history, but I do recall every time there was a change, there was this period of who is going to be the next leader of Russia. And there was always a lot of speculation about what was going on in back rooms. But it did not result in a lot of tanks on the streets and people being shot.

In contrast, in military dictatorships, it is usually going to be another general who has an army to support his case and, therefore, the danger of bloodshed becomes greater. Therefore, for people who do not like playing negative sum games, at some point switching to a more democratic form of transition is going to save a lot of resources and money. In some ways, perhaps, this feeds into why countries eventually, if they get rich enough, will have to shift to democracy, because the alternative ways of transition become too expensive, and

also why the Soviet Union, perhaps, was as lasting as it was, because to some extent it had solved this succession problem in a quasi-democratic fashion.

A. Clesse: Under session number 5 on China's Cultural Revolution and the years under Deng, we have such questions as "the Cultural Revolution and the post-Mao market-oriented dictatorship"; and "whether the Cultural Revolution destroyed the vested interests in mainland China"; and "why Deng was able to enforce market reforms that communist leaders in Europe were not able to impose", for example.

Merle Goldman: I want to say that I agree with Haggard on the role of the Communist Party; Mao would have never been able to come to power in China without the Communist Party. There is no question about that. But once Mao comes to power, he then disregards the Communist Party. So the Communist Party in the Soviet Union and in China became the totalitarian regimes of Stalin and of Mao Zedung. As Deng Xiaoping himself said, Mao was not a bad guy; it was the system that made him bad. It gave him so much power, without any limitations, that he thought he could do anything, as happened under Stalin as well. And during the time when Mao was really supreme, from the late 1950s all the way through to the time he died in 1976, he disregarded and he decimated the party. The Communist Party played no role at that point.

As Mr. Coker said, we should not be talking about democracy; we should be talking about civil society. Today China has a civil society, But unless there is the rule of law, which I believe is part of democracy, civil society is not going to solve any problems. It may even lead to greater problems, because all kinds of movements arise that the government has trouble controlling, whether they are criminal movements or whether these are right-wing militias, private militias. They can not be controlled without the rule of law. So I am not sure civil society is the answer to the problem, without the rule of law. Chinese entrepreneurs are involved in all kinds of corruption, because China has rules, but no rule of law. Criminals are something else. The old Chinese gangs are involved in a very particular area in the Chinese economy, having to do with prostitution, gambling and drugs. They do not control the markets, as, perhaps, the Russian mafia does in Russia. There is a tremendous amount of corruption --

there is no question about that. But the kind of violence and criminality you see in Russia, is just beginning in China.

I would agree that there is a difference between totalitarianism and authoritarianism. Mao was totalitarian. And totalitarianism lasted quite a long time. But it was certainly unstable. Deng Xiaoping and his successors are authoritarian leaders, and I am not sure how long that is going to last. Authoritarian rule is inherently unstable. But certainly, it is a much more balanced regime than that which existed under Mao.

Now, let me get to the point that Mancur is asking. Why was the Communist Party much more formidable militarily than the military was in pre-communist China. No matter what Mao says, he did not come to power on the backs of the peasants. He came to power with the Red Army. The Red Army was what gave him his ability to take over power and establish the Communist Party power in 1949. The Red Army was made up by peasants, but the leadership was a bunch of intellectuals or people that rose from peasantry to be the top of the army -- the faithful long-marchers. In the civil war with *Guomindang*, the *Guomindang* had the technology and the backing of the United States. But they could not win the war because wide-scale corruption totally destroyed the KMT military. It was also ineffective in terms of strategy, leadership; and because most of its supplies were being siphoned off for personal causes. Corruption can be helpful until it gets to a certain point, where it undermines a whole system, then it is destructive. That is what happened to the *Guomindang*.

When the Communist Party came to power under Mao's leadership in 1949, in the early years it followed a Stalinist model. It built up a military industrial complex. The Russians poured in money, technology, advisors. There is just no question in those early years that the Soviets played a very important role in building up China's infrastructure. They built up the transportation system and the coal and steel industry, though they first took it away in Manchuria. But at the end of the civil war, in 1949 they helped rebuild again. In addition to building up an infrastructure of heavy industry, and transportation; the Soviets build a system of schooling, and health care, where China, one of the poorest countries in the world, was able to achieve life expectancy close to that of a developed country. Those, I believe, were the great accomplishments of Mao Zedung. And in the early years, China's economy grew at a rate of 8 to 10% a

year, and that is a very fast rate of growth especially in the first part of the 1950s.

Towards the middle and the late 1950s, that rate of growth began to decline, and falter. Mao began to think that maybe the Stalinist way was not the right way. There were all kinds of problems with the collectives that they set up, and this is when Mao embarks on trying to produce a new Chinese man, a revolutionary man as Stalin had tried to produce, a new Soviet man. Mao had this vision of producing communes where everyone was going to live collectively, and would reach communism before the Soviet Union. That utopian policy of the Great Leap Forward led to the death of 30 million Chinese peasants. Then in the early 1960s, Mao allowed the Party to come back in, to rebuild the country; it began to grow again very slowly, but then Mao began to think the Party was subverting him, turn against him, because of the failure of the Great Leap Forward. And so then he launched the Cultural Revolution in 1966-1976 which utterly decimated the Party itself.

It was that experience, when the Party leaders were sent to the countryside and to the factories, and saw how destructive their policies had been -- no rich, happy peasants out there in the countryside, and the workers were not producing all these great things -- that convinced them, particularly Deng Xiaoping, that there had to be a change. So that when Mao dies in 1976, Deng Xiaoping comes with his fellow leaders back to power and they decide they had to try something new.

As I said Deng is very different from Mao. He has the "cat theory" of history -- it does not matter what color the cat is, as long as it catches mice. He is a leninist, but he is also very pragmatic. He does not care about ideology, he only wants the economy to produce.

I went with a group of American university presidents, one of the first groups to go to China in 1974, when we had a long, long talk with Deng. He said all the Maoist campaigns going on were "not going to help us in our country." He said, "We are going to go to see God" -- in other words, we are not going to have enough to eat; we are not going to have a roof over our heads -- "unless we do something about the economy". That is all he really cared about. That was during the Cultural Revolution. And for saying those things, among many other reasons, he was purged again.

When Deng returns to power after Mao's death, he looks to the East Asian economies. That was his model after the Cultural Revolution. Eastern Europe played a role, especially the reforms in Hungary. But he was very much frightened by the Solidarity movement in Poland. And he turned increasingly to the East Asian model of the Four Little Dragons, plus Japan. Therefore, the Party was able to launch the reforms because the whole leadership went along with them in the beginning because they all suffered, in the Cultural Revolution. And secondly, because the example they were trying to follow was that of East Asia.

And the reason I believe they have been successful in this is because in very poor societies, especially in labor-intensive societies, it is much easier to do than in the former Soviet Union, which was a much more developed society. I also think that while the Confucian political system was repressive, the Confucian values really lend themselves, as we know in East Asia, to economic development. They emphasize pragmatism, education and hard work. And in the modern era, they put great emphasis on science and technology.

The fastest growing sector of the Chinese economy in the last ten years has not been urban areas but the townships, and the village industries. They are growing at a rate of 30%. They have small-scale factories -- producing for the international market and the consumer market -- in the villages. I just want to reiterate what I said yesterday, that East Asia does things in a very different way than we have seen in the former Soviet Union and in Europe. That is why I feel that it is very difficult to have an economic model that includes the whole world.

M. Pillsbury: In his manuscript, Mancur notes China, as the exception that proves the rule, and he states what I believe China experts would not agree with: that the Cultural Revolution wiped out vested interests in China and therefore Deng Xiaoping -- because of this destruction and chaos that preceded his changes -- was enabled to do this. Or, perhaps, that it even was both necessary and sufficient to do this. What has happened in China is not well known. But certain parts of that are known. It is in a book by Susan Shirk; it is also covered to some degree by Steph Haggard himself. The Chinese seem to have studied their neighbors and decided that a command economy, Soviet-style, could be modified while maintaining all the basic premises of Marxism and Leninism. Now, this is not just a

minor case study of a small country -- I am sorry to insult any Hungarians or small countries in Europe -- this is 1.2 billion people growing five times faster than the United States; eight or ten times faster than Europe, over fifteen years. If the World Bank forecasts are right, they will be the largest economy in the world in purchase power parity in twenty-five years. Can we just see this as the exception that proves the rule? And ignore what the Chinese did? I do not think so. I do not think so.

The Chinese also, in a very strange way -- this is a strange comparison -- did what the Agency for International Development -- and the Treasury Department too, actually -- has been doing for thirty or forty years in terms of trying to find a set of policies that could be forced upon a country from the top, if I can use that word. Policies that, when they have been tried, seem to work. They seem to produce eight to nine percent growth rates for ten to twenty years. The Chinese got on to this idea from some World Bank publications among other things. In the experience of AID, especially of a Professor named Arle, or Al, Harburger, these seven policies could be actually written down on a piece of paper and implemented by the president of the country, if the president of the country was personally involved in the matter.

And I learned a lot about this from Steph Haggard's book. In the case of Chian Kai Shek's Taiwan and Korea, after the coup in 1964 the presidents had a lot of power already. They then took a personal interest, in the sense of monthly meetings, for example, on the export drive: what can my country do to become an exporting nation, to get the GNP share of trade from, say, one or two percent up to twenty or thirty percent or more. In Taiwan now, the major part of the GNP is from exports. And it then turns out that the president of the country, especially if he is a military president, has a lot of power to cut red tape; to get his banks to subsidize activities, when the system is that people bring to him problems that are occurring with the export drive each month. He has the power of death, if he wants to, about say export-drive strategy work.

And when you look back at these cases, what did the Chinese find? What did AID actually find? There are people with PhDs from certain universities who know this set of seven or so policies who talk the president into doing it. And it happens. In most places in the world, it does not happen. There is no natural sort of Max Weber's

spirit of Protestantism that somehow causes the presidents of countries to choose these policies. (By the way, letting prices go free is another one.) It is a conscious decision by the leader of the country. Now I come back to Steph Haggard's point about the Communist Party: I think he said he was surprised to hear a discussion go on for a long time without mentioning the Communist Party in the Soviet Union. Can it mobilize; can it do things in a country? Well, the Chinese had a debate about the collapse of the Soviet Union. The Chinese assessment of the Soviet Union's collapse is very different from what I have heard today and what I have read in the Western literature. The Chinese do not say that communism failed. Every time in your outline you have this term about "communism failed", or "communism did this", "communism did that". They say *they* are communists. They have a communist party; it is against the law to speak against the Communist Party in China. So their assessment of why the Soviets collapsed is quite interesting. And they do not blame it on ideology.

Now, we could ignore this. We could say, well, the Chinese have strange views: they are over there in China and, you know, they are not important because we are in America, we are in Europe. But it seems to me, it matters a lot if a communist party, still alive today, with a hundred million members or more, has a different assessment of why the Soviets collapsed, from ours. So we owe it to ourselves to include their argument, their assessment. I will not give it to you today, but it is quite different from ours. They preserve the role of ideology and the Communist Party as a mobilizing factor in bringing about what we would call an export drive, high savings rates, almost market-free prices, and yes, even beginning to dismantle the state-owned sector in China. That is on the agenda now. Starting from two months ago, they have begun to lay out plans for how they are going to privatize the state-owned sector.

And my final exhibit in this is a wonderful paper Jeffrey Sachs wrote, which was just delivered in New Delhi a month ago at a conference of 100 Indian economists, paid for by the AID mission in New Delhi. Jeffrey Sachs spent quite a bit of time with the young Chinese economists going around the countryside in China and asking -- using Western concepts obviously -- what has happened. How can we explain a country that grows five times faster than the United States and seems to have no contract law; seems to have no

courts where you can take people and get settlements for property rights? Seems to have a state-owned banking system still. We all know state-owned banking systems are bad. Here is one; yet, it seems to be part of a country that grows so rapidly. Sachs lists all these anomalies in China, that, frankly, Mancur, would be hard to account for using your approach. But then -- thank goodness, I think I'd have to say -- he explains how Western economic theory can in fact account for the Chinese success. To my knowledge this is the first time a dyed-in-the-wool Western economist has gone out to the villages. And then, in a very gentle way, he does say toward the end of the paper that, perhaps, our own Western economic theory is not as universalist as we thought; perhaps, there are other ways of organizing economic growth -- a command economy from the top -- that produce better results than our previous work has suggested.

I would be surprised if Chinese economists would read this in translation and then agree with you without saying, "we do things a little differently here", and then providing you some examples. I think it is a mistake to ignore Steph Haggard's point about the role of the mobilizing party. When a party in the Soviet Union says "heavy industry", and makes a series of very, really very bad, inefficient economic decisions. It is not wrong to have the Communist Party be there; it is wrong that they made the policy decisions that they made.

So, what the Chinese are saying is that a communist disciplined mobilizing organization can in fact choose different policies and succeed better than Europe or the United States over a 50-year or 100-year period. And that should be taken into account, I think, somehow.

N. Tith: I would like to put up a framework for the analysis of China in a broader perspective and while looking at a multidisciplinary way at the Chinese "success" story.

I would like to start with Deng Xiaoping himself; and interest groups. Why did Deng Xiaoping succeed in imposing his reform mentality? First of all, as the Chinese themselves say, it is not a dogmatic kind of thing. The Chinese reform has no blueprint. And that is important to notice. It is a back-door kind of reform. Now, why do I say back-door kind of reform? Simply that it is not intended to make a *tabula rasa*, to erase everything, but to take everything into consideration. As I said, in the case of China underdevelopment is an asset in the sense that you do not have that many industries to

destroy; so in the face of transition you have a destructive phase, a consolidation phase, and a reconstruction phase.

The Chinese made a very, very deliberate effort to minimize the destructive phase. The reason is that they looked around, even at that time, in 1978 and thought. Any civil disturbance would be absolutely intolerable from the Chinese standpoint. So for them, stability is the key for any kind of transition. Looking back, as I said, the Chinese are not dogmatic. They do not view communism as an end product, rather as a means to reach some goals. Although they call themselves communists, they are more market-oriented people than real communists. That is also important to recognize.

Deng Xiaoping suffered a lot during the Cultural Revolution. As you know, he was tortured and so on. That was the motivation to change. I agree with Professor Olson that the Cultural Revolution destroyed the mandarins -- communist-type mandarins, of course, otherwise known as the bureaucracy. And that precisely allowed Deng Xiaoping to be much freer, because there is no real interest group -- particularly no *apparatchiks* or no equivalent to the *nomenklatura* -- in China. But also we should remember is that in China the military establishment is very, very important, powerful; at least they do have a lot to say in China.

Deng Xiaoping himself was the president of the military commission, therefore he had a lot of connections with the military. Once he could convince the military that the reform was necessary, there was no bureaucracy as such, no *nomenklatura* as such, which could counter these. Therefore, he had a fairly free hand.

The third fact that we should know about China, as I said before, is that there is a dormant entrepreneurship class which has always been there, even in the countryside. And particularly in the South. Guangdong, Hunan, Fujian provinces -- those are the hotbeds of capitalism, of entrepreneurship. That, Deng Xiaoping knew very well. He definitely counted on that dormant entrepreneurship to bring about the reform. And the most important thing from the ideological point of view is that he turned the tables, in the sense that, under their communism, consumption, and consumers at large, were ignored. Whereas he realized that if you want to have some kind of broad support -- legitimacy, if you will, not vote, but legitimacy -- you have to provide consumer goods. If you allow the Chinese to be comfortable, to have enough to eat first of all, of course, and then

have their own transistor radios, maybe TV, maybe a refrigerator, maybe all these things, it would help a great deal to convince the people that the reform is not just for the few. That was a smart move. Consumerism came to the fore, there is no question about that. Anyway, these are the elements that, it seems to me, are very different from what Eastern Europe or Russia is doing. It is the Chinese model -- but I will not call it model, because, as I said before, there is no blueprint.

Finally, I want to conclude by saying that the Chinese start from a small project and then, once you have tried it and you succeed, you extend it to the whole sector. This started with agriculture, of course. They went in by the back door, started with some project, succeeded, then extended it to the whole agricultural sector: releasing prices, releasing allocation of production. Immediately the Chinese entrepreneurship knew what to do. Although the property class has been eliminated. The Chinese know-how of how to take care of agriculture is always there. But once you had that released, then you had the agriculture immediately coming to the fore, and it contributed to stabilizing the economy, because this sector was able to provide food. You maintain the population in the countryside. You do not have to give the peasants a lot, but they can provide food -- and cheap food -- for the city. And that allowed the Chinese government to continue to drag out, to a certain extent, the privatization of the industrial manufacturing sector.

Meanwhile, again through the back door, the so-called informal sector was allowed-- I would call it the non-state sector, because there is no such thing as recognition of private property in China. It consists of townships and villages, cooperatives and enterprises. So it is extended beyond the village level. Meanwhile, using the overseas Chinese resource capability, the network and so forth, a start was made on a real export-oriented policy, on the Korean, the Taiwanese model, but based only on the coastal areas, that is, Fujian and so forth. Later on it was extended to the north, towards Shanghai and is pushing more inland, being even allowed to go westward. So that's basically what the so-called Chinese model is all about.

It seems to me that it is pragmatism. The Chinese use all the resources at the disposal of China, including the overseas Chinese -- and that is not a negligible quality.

F. Braun: I would wish to follow up on Professor Tith's presentation and share with you an experience, and what I took out of it. I am not an academic, but I had been asked, together with some other twenty people from America, Europe, Korea, India, and of course, Chinese from outside China, to give advice to the government regarding the changes needed to be made in state-owned companies in order to improve their performance. We did give some recommendations and I do not want to expand here on them in detail. I sometimes wondered if the Chinese government really wanted so much our advice, or did they want our ideas to sell them later as their own. And I think it was both. Because we discovered that most of the proposals we made somehow appeared in the resolutions of the following meetings of the Party and of the People's Congress. One of our proposals regarding the banking system was introduced six or eight months later. So you could see what indirect influence we had on giving new ideas to the system. It was an interesting experience for me because we talked with ministers, vice-ministers, directors, and managers.

Irrespective of the age-groups, the reception of our ideas was best among the directors. The ministers and vice-ministers were careful not to speak any language other than the official language. On the lower levels, you would see that most of the ideas were going to be taken in, not necessarily at once, but over a certain time. And here I would like to underline what Professor Tith said about the way new ideas are introduced by the back-door. This was also discussed quite openly with us. They told us that the privatization could happen in several different stages. The utilities were, of course, the last to be privatized, because even in our own countries, in many cases at least, utilities are still state property. They are going to privatize them more and more in the Western countries, but still, they are facing problems in the sector of utilities that are different from other sectors.

And then, of course, China had the problem of state-owned companies that were now facing competition from the new private companies and were losing money. So the need to correct the system of the state-owned companies was simply a consequence of the competition coming from the private-owned companies. And you could see this if you went to the street-market in Beijing or somewhere else. People preferred to buy on the market, with all its price variations, rather than in the state-owned shops, even when the products were practically the same. So the clients behaved more and

more freely, much more so than the personnel. This was in 1992, and I think this must also have changed in the meantime.

One must also say that the state-owned companies in communist countries are all not used to competition: this applies also to their management. They are responsible for pensions, health assistance, schooling which are mostly provided within the large compounds of the company. They are mostly large companies. So you would have, if you really moved out of the system, to devise a different system for pensions, for health, for schools, for all those services which would be affected by the change. So the opposition, indeed, does come from those people who have a vested interest in holding on to all these guarantees: schools, health, pensions, housing. How can such a system be changed? This would have, indeed, a revolutionary element. Some of us, who were more specialized in that field, came up with the idea of a gradual change towards a different system over, let us say, a period of ten to fifteen years, so that one discharged the state-owned companies of this burden gradually. Those companies then would also more easily become eligible to form joint ventures. I must say that, at this stage, joint ventures, which are also a way of privatizing, were not excluded in China. Only time will tell about the success of such joint ventures. We have talked here much about the importance of Japanese investment and not so much about the investment of Americans or Europeans, which are smaller but still represent an important element. And you can see presently that all substantial extensions of their commitment in China may be regarded not only by businessmen with a favorable eye. Especially, when we speak about growth rate of 9 or 10%. But we should be aware of the dangers that could arise.

A. Tsipko: I have personal experience connected with the problem of collapse of communism and China. It started in the beginning of 1989. I had just published some articles as open messages to Gorbachev, and explained to Gorbachev that it was impossible to change the Communist Party to a social democratic one. I explained that there was only one way the Party could survive and that would be to change its legitimacy from Marxism to the legitimacy of statehood or nation.

The next day, I received a call from the Chinese Embassy, and the Ambassador invited me for dinner. And he said me, "Alexander Tsipko, you had a brilliant idea. In China we are communist and we

know very well that communism will collapse. But we want to survive. So please explain to me more carefully and in detail, what you meant when you speak about a change in legitimacy from communism to the idea of statehood."

Two months later, I was invited to China. And during the following three years I stayed on good terms with the Chinese officials. During that time, 1991 and 1992, I was a lecturer in West Virginia and I was at this time the most popular anti-Communist in the world. All my articles were published in the West and regarded as anti-Communist. But during that time, I was a guest of the Communist Party of China.

If we limit ourselves to discussing only the problem of how to change, it is easy. And now you already know the answer: the Chinese switched from Marx to Confucianism; they switched from the idea of communist revolution to the idea of the history of the State, and so on. This is only one, my personal example. I repeat, the Chinese communists understood the collapse of communism very clearly in the beginning of the 1990s. And they understood that they needed to change and that they could change. But this was the Chinese way, not Gorbachev's way. From my point of view of today, China's way was the better way.

A. Lanyi: I should say first of all that I am not an expert on this subject. But I felt that since the questions are posed in terms of communist autocracies in the plural, there should be some mention of the numerous other countries (besides Russia) in which communism has, in one form or another, collapsed. I think somebody -- and I am sorry, I can not remember who it was yesterday -- said that one of the problems in Mancur's discussion and our discussion generally is that there's not very much mention of international aspects.

A. Clesse: That was Nicholas van der Walle.

A. Lanyi: Yes. And there has been very little mention of nationalism. But of course, one fundamental fact about the Central and Eastern European communist countries is that, with the possible exception of Yugoslavia, these were not countries where communism came to power as a result of an internal revolution. It was a system that was imposed on these countries by the Soviet Union. And that, of course, gave these regimes a fundamental weakness, namely that they were associated in the minds of the people with the imposition of Russian

power. Anyone who doubts this need only recall the day the last Russian soldiers left countries like Czechoslovakia and Hungary. The church bells all over the country. I apologize to my Russian friends for having to mention this, but I am sure they are aware of it. Since it was intervention from outside that created these regimes, it follows that as soon as the imperial power was itself crumbling, then these regimes had no future.

It may be that recalling this fact addresses one of the problems that is being raised here, namely why the transition has been so difficult in these countries. On the basis of the origin of the communist regimes in Eastern Europe, the Soviet Union created a system of international trade that supported its empire. And once that system of international trade among them, on which their economies depended in a large part, collapsed, they have had to look abroad for new trading partners, which takes time, particularly if you have an industrial base that is inefficient and producing poor-quality goods.

Perhaps this observation addresses also another problem, which is: why market socialism, if you want to call it that, has succeeded in China and has not succeeded in Eastern Europe, or had not succeeded even before the collapse of the communist regimes and the reforms that were being carried out in Hungary and Poland. The reason is simply that even Hungary and Poland were tied into the so-called socialist division of labor represented by Comecon, whereas the Chinese, quite dramatically, were looking to global markets for trading partners. And that is, surely, a very important reason why the Chinese have been more successful than the Eastern Europeans.

One other point I wanted to make is that perhaps some of the questions that are posed in this outline may be mistargeted for the Eastern European countries: the concept of youthful vigor of early communist regimes does not correspond to the gloom that hung over the captive nations of Central and Eastern Europe in the 1940s and 1950s. And that also brings up another point that has been raised in connection with Czarist Russia, namely that most of these countries, where you had well-established market economies before World War II and who were tied largely to the Central and Western European markets, would have been better off in the long run without the imposition of communism. So, the question of "youthful vigor" hardly arises for these countries.

Finally, just one last point about the difficulties in transition. Obviously, the communists were able to destroy market institutions, and such institutions take time to rebuild. The collapse of Comecon, of course, creates another problem. But I am not sure whether it would be correct to say that in Central and Eastern Europe there has been political fragmentation in the sense that there has been in Russia. Of course, there are problems. But I think we find in general that, certainly in Poland, Hungary, the Czech Republic and the Slovak Republic, the political problems have not been any worse than they are in a number of Western European countries. You have several major parties; there are coalitions. And considering the fact that the communists were the only well-organized party up to 1990, it is not surprising that, under the guise of "social democrats", they have come back to power in some of these countries. But in general, the power is shared, and I doubt - although I am not sure about the answer - whether a communist government coming to power in Poland or Hungary now has the same implications as it would in Russia. That is, perhaps, an interesting question.

Session VI: Why was economic performance so much poorer than expected after the collapse of communism?

A. Clesse: Thank you, Tony Lanyi. We come to the topic number six though we have already touched on it. As you are aware, it is formulated in a biased way. And some certainly will dispute the evidence for the way it is formulated, namely that the economic performance was really poor after the collapse of the communist system. But we will hear about that -- whether it was poor; how poor it was -- certainly from Anders Åslund, also perhaps from Stephen Holmes.

S. Holmes: Well, Mancur, maybe when you fully contemplate the Chinese example of growth without juridically enforceable rights and you have a village conversion like Jeff Sachs', you're going to toss your manuscript into the dustbin. But I somehow doubt it. So let me suggest some ways to improve the argument as it is, rather than throwing it out. The argument is that what accounts for wealth is secure title to property. At least, this is the third leg of the stool:

enforceable anti-fraud law, contract law, trespass law, bankruptcy law and all those things contained in the books on the shelves outside my Law School office. Those interminable shelves outside my office.

This kind of secure title to property and so forth can produce long-gestation investment and long-term loans and so forth: all the gains from trade we discussed. Now, I have an illustration of this. There was a manager of a refrigerator factory in Ekaterinburg who became a property owner. And I asked him, "Do you feel like a property owner?" And he said -- it was a wonderful statement that all economists should ponder -- "Property is meaningless if you do not believe in the future." More or less, the point you are making. So rights produce wealth, secure and enforceable rights produce wealth.

Now there is a footnote I just want to add; that you need to take care of. You lump all rights together. And I do not think -- I am not certain -- that you would say that protecting the rights, say, of the perpetrators of acquisitive crime; preventing the third-degree interrogation by police of thieves and so on is necessarily going to produce the kind of wealth accumulation that you expect. There are many different kinds of rights; people have different sorts of rights. You need to include a more discriminating approach to rights and their relation to wealth than the one You have developed so far.

But the real point, the implications-for-transitions point, is: What are the existing array of forces (for or against) the establishment of an enforceable-property-rights regime in various countries, in post-communist countries, let us say? Now, what are the real forces there? Perhaps they are not only interest groups, as you intimated. Maybe some of these obstacles are ideological. Others know more about this than I do; I am simply going to make a few general points. It fits very well in your basic argument that it is hard or maybe impossible to produce public goods in anarchy. Property rights are a public good; titles and deeds cannot be produced by a market alone. You need actors that have encompassing interests, have long-time horizons to do this. And in post-communist Russia, for instance, such actors do not seem to be available. Or, to put it another way, this is a kind of Hobbesian question: How do you impose order on a disorderly society when the officers of government are full of disorder? Or, in the Olsonian version: How can government impose longer time-horizons on economic actors when the actors in the government office have such short time-horizons. The Russians sell the weapons

to the Chinese or to the Iranians and so forth and so on. It looks like the government itself has such short time horizons that it is not capable of doing this, of lengthening the time-horizons of private economical actors.

So what are the forces involved in creating a secure-property-rights regime? One component that you may have left out is the ideological one. That is, there is a kind of pervasive illegitimacy of property in a system where people perceive the assets accumulated by *nomenklatura* privatization or by that consumer-squeeze system that you describe. Property was simply scooped up by people who were located in a certain position just by chance. Others resent it, and they think of property as illegitimate because they see how it originated. Now, of course, property originated in the West that way too in many cases, but we have forgotten about it, so the origin of ownership in force, fraud, and happenstance does not have the same legitimating effect that it has in countries where you actually can see that the first property rights are created by theft or chance -- are unjust in any case.

But you are going to focus less on ideology than on interests, so therefore I just want to encourage you, to push it a little further on this. You say, for example, that people may shun ownership because ownership -- this is my formulation but it captures your point. -- ownership involves not only assets but also liabilities. And in a society where so many things you could own are actually debt-ridden, they are not desirable at all. That is an interest-based argument for the unattractiveness of a property-rights regime under post-communist conditions. But if I were you, I would focus more on the constituencies, the weak constituencies for property-rights regimes themselves. A system in which the bankers do not want good banking law, because they can steal more with a bad banking law, is not conducive to the creation of the rule of law. A system where leases, the rules for leasing housing, are so vague that You have got to pay bribes to the officials who control housing, is in the interest of the bribe-takers. There are officials, in other words, who have a strong interest in keeping the rules very vague, contradictory, incoherent. There are officials who have an interest in a confiscatory tax-rate, even one over a hundred percent, not that anyone will pay that amount, but because, if a tax rate is so high, you have to bribe the officials, and the corrupt officials have an interest in continuing this absurd system. These are obviously examples, everyone knows about

this, but you need to focus on that, and try to develop that kind of model in the area of property rights. Why are the "spoiler elites" who have an interest in postponing the emergence of clear rules of the game not involved?

Now, if you are dissatisfied with thinking just about interests and interest groups -- as you are, and I take as proof that you are dissatisfied with at the end of your own book, because, at the end, you uncharacteristically leap into idealism. Kaminski is wrong: it is not that you give no role to ideas: you give them a great role. The last page says, "Ideas will win. Good ideas will beat bad ideas", and that will change the world maybe, or at least you hope so. That is the only place you deviate from your rather hard-headed approach. I do not take that so seriously, however, I think you should probably get rid of that last page. But the dissatisfaction I take seriously. What is it that you can add? In the end, I would just chime into the great Haggard chorus: look at the organization, look at the political system. What are the forms of political organization which can give extra leverage to groups who have an interest in a secure-property-rights regime? And so it can be said that Olson's book is great except that he leaves out people, events, and ideas. Well, you are welcome to say that, but please do not say that he left out institutions.

A. Åslund: I would like to give a criticism of the transition chapter, I find serious problems with this chapter. To begin with, the problem is not tax collection, as is rather strongly stated there. Tax collection is one of the few things that has not been a serious problem in the post-communist transition. If you look at Eastern Europe, tax revenues are at the level of 40 to 50% of GDP; in Russia, it is still over 35% of GDP, if you add up all the budgets -- regional and federal -- and extra-budgetary funds. So the problem is not there.

It is also argued that gigantomania is a major problem of the old system. That is not true either. This has been a long-prevailing myth. A World Bank paper by Annette Brown, Randy Rytermann and Berry Iches a few years ago showed that. The twenty biggest industrial companies in Russia in 1989 had fewer employees, in absolute terms, than the twenty biggest companies, not only in the US and Japan, but also in Germany, Italy, Britain and France. You have to go to the Netherlands to find fewer people in the twenty biggest enterprises. The problem in Russia was not gigantomania, but irrationality and the fact that there were small enterprises.

Privatization is a big issue, but it is given exaggerated emphasis here. It is stated on the first page of this chapter, "The essence of a transition is privatization of state-owned industry." Hardly anybody has argued this, and I just wonder where it comes from. It should be justified, and it is certainly not correct. Stephan Haggard pointed out, yesterday, that a lot of the systems were missing in the manuscript: the economic system, the political system, the legal system. Norms of all kinds are persistently ignored in this chapter.

On the debate, here we have a complaint: "It is troubling that the debate about the speed of transition should be conducted in such a substantial part through metaphors, through a rather simplistic part of the debate." There is no reason to focus on the poorest part of the debate. I am rather struck that there are only four references in this whole chapter, which says more about this chapter than about the state of the debate.

The main problem, as I see it, in the chapter entitled: "the evolution of Communism and its legacy", is to identify the key problem. I would say that the key issue to discuss here is the problem: Is it structural adjustment costs or is it rent-seeking? I guess that Mancur in his general sentiments would tend to focus on rent-seeking, which I certainly think is the major issue. And if we take the numbers here, gross rent-seeking in Russia in 1992 amounted to at least 75% of GDP: 30% of GDP in terms of credit issue; about 30% implicit export subsidies; 15% GDP import subsidies. This is the essence.

Privatization, however, which is given a great deal of emphasis as rent-seeking here, is pretty irrelevant for rent-seeking in Russia. The current market capitalization of the true 200 biggest companies in Russia, including Gazprom, and all the oil companies, is 6% of GDP. What we are seeing here is a complete confusion of debate. One mythology is added to the other. Chubais is accused of the enrichment of a few in Russia because people *saw* the privatization; meanwhile rent-seeking took place through financial flows that people did not see. This chapter reflects the ordinary methodology. The implicit question out here is: Are structural adjustment costs or rent-seeking more important? I think the answer is obvious.

Let me turn to the question posed under point 6 of our program: Why was the economic decline so big? First, the decline in output was substantial in all post-communist countries because of big

structural adjustment costs. Poland experienced the least fall, of 5 to 10% of the GDP. But then official decline was up to 80% in the case of Georgia, and the difference lies in rent-seeking. Decision-makers who were trying to seize the money by every means had little time to think of issues like production, public welfare, and so forth.

Let me turn to the election question. Recently, I did a paper together with Peter Boone and Simon Johnson for the Brookings Panel on Economic Activity. We took a close look at these election results, and they are completely different from what is normally said. By our definition, we find six radical reformers in the post-communist world: Poland, the Czech Republic, Slovakia, Estonia, Latvia, and Albania. Leave Slovakia out because it started this reform in Czechoslovakia and has a very unstable government. What do you see for the rest? You see that in only one of these countries you have an ex-communist government. That is the Polish government, which by any other standard would be considered a right-wing social-democratic government. This government won because of massive fragmentation of the center-right forces in Poland. In the other countries ex-communist parties are not dominant in government.

If instead, we look at the four gradual-reform countries that started with non-socialist governments: Lithuania, Hungary, Bulgaria and Russia, ex-communists have won elections and are in power in three out of the four countries. Non-socialist governments that pursued gradual reforms almost always lose elections. This shows that gradual reform is terribly unpopular. The ex-communist governments all pursued gradual reform. Out of these none is really a proper democracy, but even so in Belarus and Ukraine the governments were kicked out by the voters in elections in 1994. So the vote record of gradual reformers is awful. It is not too good for the radical reformers, but it is much better.

If we move on to public-opinion poll data, we will find even more support for radical reform. If you take the EU Eurobarometer in 1994, it is only in three of the radical reformers -- Albania, Estonia and the Czech Republic -- that people are really satisfied and think that the country is moving in the right direction. The conclusion of this is that rent-seeking is central, and rent-seeking is essentially not privatization but stabilization which includes the establishment of certain norms. The more normless a society you have started off with, the worse the transition has been. Why is the Czech Republic the best

radical reformer with the strongest popular support for the government? Because it has had the least rent-seeking since it has had the most radical reforms.

J. Oppenheimer: Just a very short point. Let us assume for a minute that what was just given statistically is accurate: that 75% of GDP in the Soviet Union *was* rent-seeking. And we assume for a minute that it was not fundamentally different in China. Then, I think, there is a parallel between the radical under-employment discussed earlier in connection with the Soviet Union -- structural unemployment in the villages that could be mobilized, and led to fast economic growth under Stalin -- and the situation that exists currently in China. If you can, by opening up markets to competition, get rid of rents, which is what would happen, you would be able, in fact, to create a tremendous possibility of growth very easily, without there necessarily being any long-term possibility of growth -- because you would not have created the secure property rights and so on that would be normally required for, at least, innovative investment.

Marshall Goldman: Anders and I have disagreed about some of these things for a long time -- the tax problem, for example. I had the impression from what others had said that tax collection in Russia was not a serious matter. Well, that certainly does not seem to be the case if you look at Russian material, where the tax collection, the tax revenue now is maybe 25% of expectations, and the deficit is growing. Even now, even after all these years, people do not pay taxes voluntarily -- income tax, personal income tax. It is simply not happening. Who is paying taxes? People who can not avoid it, and that means primarily the foreign community.

About *gigantomania*. He is right in terms of the numbers. But you look, let us say, at a company like IBM, it has places located all over the world. What was *gigantomania* in Russia was the fact that you had this one entity located in one place, in one city, and these were massive enterprises, with 125.000 employees in some cases.

As to the illegal sources of wealth, sure there were a lot of other factors there, but one of the things that is upsetting the voting electorate is the fact that this property has been transferred from state-ownership into the hands of the people who were for the most part the former directors. As I said yesterday, 61% of the old party *nomenklatura* are now back running these same factories. And before

they had no ownership, now they have assets and that relates to something in Mancur's paper that I will get to in a second.

As for the elections, it is true that these countries did not bring back the communists. But what is ignored here is the fact that these countries were primarily looking to the West, with the exception of Poland. If you look at the other countries, they were predominantly countries that had no experience with democracy, which were not interested in turning in this direction and where communism was indigenous. I mean, the countries that Anders refers to, for the most part, had communism foisted on them. And it did not stem from something home-grown.

I would like to go on to Mancur's manuscript. He asks, why was it that the management led the opposition to privatization? Well, because initially they thought that they were not going to be the beneficiaries. It would be foreigners or others that would come in. Once they saw that the laws had been jiggered in such a way that they were going to end up as the owners, they plunged in head first, and they changed their opposition. In fact, now they will not let anybody else get near them. Once they saw they were the ones who were going to end up the owners, they supported it.

You mention the old factories. Now what about those old factories? They are worth much more than scrap, in large part because the managers have now found that they can export metals, aluminum to foreign markets. What was the largest US import last year from Russia? It was aluminum. Where did that aluminum come from? Well, it was diverted from what used to be the military-industrial complex. Therefore, they could not do anything with it at home and sent it outside the country. So those factories actually now have some value, even though they are producing at a very high cost; even though they are polluting. Even though their machinery is outdated, they still have a value.

And finally, you write that "the peoples...surprised by their economic success." People in most of the post-communist countries have to a great extent been disappointed with the fruits of freedom. It is not so much that they have been disappointed with the fruits of freedom; it is that they have been disappointed with the economic reforms. The economic reforms have been a disaster. Mr. Tith passed out this morning a paper by Nolan. There is a very interesting last paragraph. He says, "What happens is, you are on the knife-edge of

reform. If you get it wrong, it is a disaster. If you get it right, it can go up." I would venture to say that after a while, we may see countries in Eastern Europe -- folks that are getting it right, like Poland -- have a growth rate of the order of what was seen in Asia.

And finally, when you are comparing Germany and Japan after the World War II with the formerly communist countries I just would like to day the following. As I see it, we should not forget that initially until 1947 Germany and Japan were having a terrible time. When they finally got it right, with the use of imposed reforms, then they started sky-rocketing. Now, it may very well be that there is a parallel here. In the case of Poland, in particular, it took a while to settle down, to figure out what was going on; then they began to sky-rocket. I do not think we are going to see that yet in Russia.

D. Mueller: It is just two quick points: one a disagreement, one an agreement. I was at a workshop in Budapest last December on tax reform in Hungary, mostly as a consumer rather than inpuuter. The entire discussion there by the locals was on problems of tax collection. They had the highest value-added tax in the world, I guess, within Europe, 25%. And, yet, it is a sieve because people forge rebates and other value-added tax deductions and so forth. The whole question was: How can we get more money out of the taxes we have already on the books? Or, if we put in new taxes, would we collect them better or not? Now, we can view this as a crisis due to the government being too big. But certainly, the tradition of hating government and not wanting to give to government seems so strong in Hungary that the compliance...

R. Cooper: Against that remark, we need some factual background. What is the share of taxes that they actually collect?

A. Åslund: 50% of GDP.

R. Cooper: Your comment needs to be evaluated against the background of actual tax collections. It is very hard, when a country reaches 50% or 60% of GDP, to collect incremental taxes. We know how hard it is politically in the United States to get above 31% of GDP. Really poor countries have trouble getting over 15% of GDP. 50% is very high. Not to be able to raise taxes from that level is completely different from not being able to raise taxes from 17 to 18%.

D. Mueller: I do not think it is 50%.

R. Cooper: I do not know the right number. Anders (Åslund) provided the number. My point is that the number is relevant to the comment.

D. Mueller: Mario says, it is 22 or 23%. All I know is what the tone of that discussion was: it was that the value-added tax, which should be 25% of value added, collects about 6% of value added. And it is because of all this cheating.

M. Blejer: Just one word on the issue of taxes. I think that the whole discussion here is a little misplaced. It is well-known, and it is absolutely clearly documented, that all the reforming countries have suffered a dramatic decline in tax collection, including China. The tax collections in China have dropped to one half in the period of the reform. But the important point is what happened to domestic savings, to the savings in the rest of the economy. And in China savings in the rest of the economy grew a lot. The only queues that you find in China are in front of the bank, people trying to buy the bonds the government is selling in order to finance the deficit. But the taxes have gone down. So the point is really not taxation alone, but it is the total savings of the country.

M. Olson: I think that it is important to distinguish two kinds of comments. Many, like, for example, Merle Goldman's comment or, Pillsbury's comment about China, are comments that I believe are resonant with the fundamental theory. That is to say, when Merle Goldman talks about the decimation of the Chinese Communist Party in the Cultural Revolution, I say, "What better evidence could there be for the argument." Some comments are entirely consistent with the logic and reflect the idea that there is a great constituency for arguments that are not so austere and logical as those that we are in the habit of putting forth in economics, and the preference for richer, more nuanced stories. And that preference, of course, is a most, most legitimate one.

What I must take very seriously and do take seriously is the kind of criticism that Anders Åslund has just made. Because if there is no problem of financing in the formerly communist countries, then that calls into question my analysis of communism itself; that calls into question the idea that Stalinism was in great degree a system of tax

collection, and one that initially took an extraordinary proportion of the national income; and it undermines my argument that this system ran down because, over time, the organization, often covert, of the enterprises enabled the people lower down to keep the surplus for themselves, so that finally the system went broke from lack of money.

Now, what I would be interested in getting help from Anders and others on, is the question, first of whether there is disagreement with the idea that in the *late* years of communism the regimes were running out of money. Now, I am not one-tenth as well-informed about this as Anders is, but I had the impression that most of these countries were borrowing abroad. That Poland was borrowing abroad and having trouble paying it back. That the Soviet Union was borrowing abroad and having trouble paying it back. That many of the countries were also having trouble borrowing new money, because the bankers were questioning their capacity to pay back any new loans that they might make. That fits in with my argument -- if that is really what the facts are.

And then we have the question: How do we understand the regimes in transition in this respect? Now, I thought the logic of my argument suggests that there should be a tax-collection problem in these societies in transition: here they are with this inherited system, with all these huge enterprises that are siphoning off the surplus -- so many of them uneconomic. Given that they inherited this, we should expect the inflation, the lack of resources that we seem to see...

But I think you would agree there is lots of inflation and that tax collections are not nearly those needed to meet their levels of expenditure. And, of course, many of these expenditures are wildly out of line. But what I would like to draw Anders (Åslund) out on is, how he would deal with the inflation; and how he would relate the tax-collections *now* to the devolution of the system before. And, finally, to ask him where I could go to really study the numbers on this, because I realize this is a fundamental point, and I want to get to the bottom of it, and I am agnostic on where that bottom would be.

A. Åslund: Sure, there is a problem with public financing, but it is more on the demand side. At the end of communism governments gave in to a lot of populist demands. So I think you are right on the last years of the Soviet Union. Then, tax revenues really fell sharply. However, MacKinnon and others have compared it with Latin

America, where tax revenues fell below 10% of GDP. In the main former Soviet republics tax revenues stay at the level of about 35% of measured GDP; in Central Europe at 40 to 50% of GDP, if we include all tax revenues and all the extra-budgetary funds and compare them with the GDP. The IMF has all the numbers, and it is quite easy to check them.

My argument is that rent-seeking takes place because of lack of control; and rent-seeking represents by no means necessary expenditures, or even traditional expenditures. Their cause is that the system just did not function, and we get a massive failure. Rent-seeking is to a very limited extent connected with actual privatization, which has been a comparatively controlled process, because it concerned physical assets that you can see, while the big issue is invisible financial flows. Thus, I think that your theory, in general, fits very well, but you would be much better served if you focused on financial flows, rather than on privatization, in this chapter and hence looked at liberalization and micro-economic stabilization. The logic of collective action is a forceful explanation of how a very small group can run against the State, and it makes it easy to explain the difference between China and Russia. The Chinese State was simply much stronger, as I think you have argued here previously.

Session VII: Managing the transformation from communist autocracy to a market-oriented democracy

I.M. Destler: Some time, I think, in the mid-1960s, I remember looking at a book by a man associated with the National Academy of Sciences, Harrison Brown. The book had something of an Olsonian title -- what we would now call an Olsonian title -- something like "The Prospect of Man's Future". In it was a chart of the GDP of Japan. The chart covered a period from about 1935 to the early 1960s, and it showed Japanese GDP dropping before, during, and just after the War, and then recovering, to surpass pre-war levels. The lesson that the author, an intelligent scientist and generalist, drew from it was: Do not lose a war. About a decade later he published a new edition of the book, and he updated the chart. In fact, he showed both versions of the chart as a sort of illustration. The second one, of course, incorporated Japan's fantastic economic growth in the 1960s.

And looking at that, he said, "Well, one draws a rather different lesson ten years later."

Now the post-communist societies are at a stage like that of Japan in the 1950s. They have had their post-Cold War adjustment, and are beginning to pick up. It is quite conceivable that by the year 2015 Poland, possibly, or the Czech Republic or some others might end up looking very much like Japan, with sharp decline immediately after the crisis, followed by rapid rise. Perhaps the decline in the Soviet Russian economy is worse in 1985-95 than was Japan's in, say, 1942-52, but it would be good to have some concrete data that did compare the two over comparable time periods. Otherwise, I think, we may be judging the performance of the post-communist societies over a particularly difficult time.

S.M. Lipset: In a certain sense, I only want to re-iterate a point made yesterday, on this whole question of transition -- revolutions generally -- namely that the standard pattern is that things get worse before they get better. And 1989 and 1991 were revolutions even if they weren't bloody, they were major revolutions. The disruption of social relationships, of the economy, inevitably means that the economy declines and, after a few years, people begin to long for the "good old days". They remember that before the revolution things were stable, that they could get bread, that they had a place to live, that they had pensions. This phenomenon of the economy declining is something which, I think, should have been expected. It is not an unusual or strange phenomenon. It only would not be expected by a pure economist who thinks that the only variables at work are the economic ones, that if they set up a free-market economy, conditions will improve, ignoring all the other changes which make things worse.

Again, on the question of corruption. If things do get worse and controls go down, one would expect people to be corrupt. Doing everything they can to advance their own position, they will accept corruption, and a rule-less kind of society develops.

I once had an experience in Moscow in 1990, where I visited a man who was described as a dissident: I visited him in his apartment, which looked like a place out of Berkeley in the 1960s given the furniture, the posters on the wall, etc. The only thing that differed from Berkeley in the 1960s was that this man's hero was Ronald Reagan. He hated Gorbachev; of course, hated the Party and the

regime. He pointed out that across the street there was some building project going on, that soldiers were working on it. He said, "You know, we have a mafia in this country. You have a mafia in the United States; there is a mafia in Italy." But he said, "There is a big difference. From what I read, your mafias, especially the Italian one, are composed mainly of Catholics who believe in something. But our mafia believes in absolutely nothing. You do not know what this means?" And then he pointed to these people across the street, and he said, "You know, I go around and talk to them. They have no values. I do not say good values, or bad values. They believe in nothing. They come from all over the Soviet Union. This is the problem of our society: that we so undermine everything, that people do not have a concept of good or bad or even what they want to do, or where they want to go."

This is an anecdote. But it illustrates the whole nature of the society: it was corrupt. A social movement did not overthrow it; there was not the equivalent of a revolutionary socialist movement or liberal movement or democratic movement seeking to bring about new values, a new society, a new way of life. And given the fact that conditions became so much worse, it is not surprising that many people after four or five years have turned to wanting the old system back. What is surprising is that most Russians will not vote communist, not that so many do.

A couple of weeks ago in London, I happened to meet a group of visiting Russian miners. They were anti-communists, they supported the alternative union. We were discussing the situation in Russia, and one of these miners said, "To understand what is happening in our country, you have to realize that we have gone through the equivalent of shock therapy. That is as if we have had an electric shock to cure us." "The effect of shock therapy," he said, "is to make you forget what happened before the shock." And he argued, "What has happened is that many Russian people do not remember. If you talk to people now about what went on, not only in the Stalin days, but five or ten years ago, they literally, you know, have forgotten. They have completely blocked it out. What they do know is that things are pretty bad, in respect of food, pensions, everything. The communists promise solutions. Nobody else does." Where all this leads, I do not know; but again, as I said yesterday, the standard pattern in revolutions is that things get worse before they get better. And

sometimes they get very much worse, and countries need two or three revolutions.

Now, I am pretty certain that even if, as has happened in some countries, ex-communist parties come back into power, they are not going to restore communism. They are not going to restore a system with a rigid party line, with Marxist ideology. Hence, they may create a much looser form of authoritarianism. I am hopeful in the long run -- though not for all the countries, but I am pessimistic in the short run, and my pessimism stems from what I think is the standard pattern of transitions. I would suggest to our hosts a conference on transition, which did not just primarily consider transition in the 1990s, but would look at transition in Europe and in America in the nineteenth century; with a series of examples of what happens when regimes are overturned.

We should study Latin America, which now, hopefully, is on a high road. But Latin America has been trying to get on a high road to democracy repeatedly since it became independent in the nineteenth century. Hopefully, Eastern Europe will do it faster than Latin America. But the record of transitions is not one that suggests that stable progress should occur within a few years, or that the major factors at work are economic. They are much more sociological and political.: I would like to reflect a little longer on the inter-linkages between democracy and success of transition. Something I was attracted by is, the preface which was circulated ahead of the conference. Certainly, this is not an area where I am an expert, but it is good to take advantage of a situation when I can speak for myself and not for any institutions. So whatever I am going to say here does not in any way reflect the views of the International Monetary Fund, where I currently work. For the reasons which you will soon discover, I believe.

When we think about the inter-linkage between economic transition and democracy, the question arises: How to measure the success of transition? I believe that such indicators as the level of output or the level income of the population are unsuitable. The reason for that is pretty well known, it is that the measurements are very, very unreliable, and so it is hard to say by how much output declined in the Soviet Union and elsewhere in Eastern Europe. There is a very interesting paper by one member of the IMF staff on how large the output decline in the Soviet Union was. It proves that this

decline is being exaggerated by at least one-third. Income also does not offer a reliable guide to how poor the country or how bad the conditions -- for different reasons. Firstly, the economy has developed a considerable sector -- which I can hardly call private but I know it is not public -- and the incomes earned in that sector are not, in most cases, accounted for or taxed. In Russia, I once saw an estimate that wages represent less than one-half of the population's total income. So, by wage statistics, it is very hard to judge how well or how badly off the population is.

At the same time, it is possible to have proximate measures of transition and to make tentative judgments as to where transition is well under way and where it is dragging. These include rates of inflation, budget deficits, and another one, for me, is being a resumption of growth after a certain turn-around point, when statistics become more reliable. Privatization is not something I would really look at as important because, as most of you certainly know, the proportion of the public-sector assets which stopped being public-sector assets does not really tell us much about how efficient this economy is. Thus, the fact that the country has given out 60% of state-owned assets does not really mean that you have a 60% full-fledged private sector. Sometimes it means something totally different.

Let us look at the empirical evidence of transition in the area. It is very mixed, to say the least. There is no single linear pattern. I can single out several patterns -- four, at least. One would be the one that is represented by several countries in Central and Eastern Europe, such as the Czech Republic, Poland, Slovenia, Croatia, Slovakia; the Baltics, maybe Albania, and maybe even Moldavia. Here all the countries have much in common. At the same time, the economic performance varies from case to case. For instance, the Czech Republic has a very low inflation -- a single-digit inflation, now -- and high growth rates. Poland has high growth rates -- it has already reached the level of output of 1990; however, it still has a relatively high inflation, over 20%. Another pattern is, to my mind, represented by the rest of Central Eastern European countries, such as Romania, Bulgaria; conditionally, I would also include Hungary in this group. Another pattern yet is the rest of the Soviet Union, including Russia. And something which stands apart from everything else is China, which sets a separate pattern.

In order to compare the successes in economic transition with democracy, we also have to look for proxies to measure democracy. And here, I am entering even less secure ground, because this is something even harder to measure. One thinks of the formal presence of democratic institutions, such as an active parliament, a multi-party system, presidential elections, and so. But another thing is substance, which may include things like the strength of democratic traditions, true public accountability of the government, and -- especially -- the rule of law. And these two things very often do not coincide. Or, I may say, seldom coincide.

Look at two large countries in the area, namely Russia and Ukraine, where, on the surface, there are institutional forms which are perceived to be democratic, such as parliaments, elections, a multi-party system, and so on. Both of them have a very mixed track record of stabilization and reform. At the same time, in certain countries in Central Asia and in Transcaucasia, where democracies are believed to be relatively more manageable, there is more stability -- at least, more financial stability. Just for the sake of illustration, I would mention such countries as Azerbaijan and Kazakhstan.

I would like to have briefly a look at Russia. In Russia, there is something which appears to be a democratic environment, in the sense that there is a parliament, there are elections, and so on. With regard to the parliament, the division of labor between the executive and legislative branches of power is a little bizarre. It is the government that has mainly been trying to impose financial discipline, while the parliament is acknowledged to be rather spending-oriented. If I understand correctly, the budget debate in the United States currently is exactly the opposite, namely, the parliament wants to impose more fiscal stringency on the government.

The second thing I would look at is the elections. Russia has already had parliamentary elections; however, those that really matter for everybody are the presidential elections. I am very often shocked to see from what angle analysts look at the up-coming presidential elections in Russia. Nearly everybody asks: To what extent will they affect Russia's economic transition? And interestingly, nobody perceives that this effect can be positive. Everybody only thinks in terms of how much harm these coming elections will bring to Russia's stabilization program. Everybody assumes that the campaign

itself can bring delays in economic stabilization and reform, because every candidate has to promise additional spending; also there are phenomena which lead to the erosion of the tax-revenue base and lower collection of taxes. This is, unfortunately, already happening, and the government has undertaken a considerable amount of what I consider to be unfounded liabilities, campaign promises. So, right now, the situation is that whoever wins the election, will face the dilemma: either to keep his own promises or break them. Keeping these promises can be harmful to the economy and especially to financial stability; breaking the promises can be harmful in the sense that market participants will again doubt the credibility of the government. So, both are bad. Very instinctively, every analyst looks at democratic forms in Russia, such as the presidential elections, only from the point of view of how much economic damage they can bring, and this is something we may have to think about.

I do not really have any answer or explanation, perhaps, I may offer a handful of rhetorical questions in this regard: Is there something wrong with democracy itself? Or is it wrong only for Russia? Or is it wrong for Russia only at this moment in time? I really do not know. Maybe the problem is the contradiction between the apparent shape of democratic institutions, and the substance of democracy. Or, maybe it is because governments have short time-horizons, as mentioned in Professor Holmes' interesting statement.

The manuscript also mentions one curious phenomenon: that Stalin did not really use open inflation as a tool because he was expecting to stay there forever. Now, the current governments do not expect to stay forever, so they can easily return to inflationary methods. This may be an explanation. The question commonly put, which has been answered by Stuart Mason, but still is topical, namely is: What political system is most appropriate for successful economic transition in Russia? I am not putting an universal question: there are different patterns, as we all know. But for Russia, I see no answer. On this, I rather expect to benefit from the collective wisdom of everybody in this room.

S. Haggard: Let me say a few things about some findings from a study that I have just completed that dealt with the democratic transition process in East Asia and Latin America and is called *The Political Economy of Democratic Transitions* (with Robert Kaufman). The central insight of the book is that there is a difference

between authoritarian regimes that exit in good times and authoritarian regimes that exit during crisis.

In the non-crisis cases, which in our sample include Turkey, Chile, Korea, Taiwan and Thailand, authoritarian governments are in a very strong bargaining position in structuring the post-transition order. Partly because economic circumstances are good, the authoritarian leadership is in a position to impose certain constraints on the way the new democracy looks. Moreover, the authoritarian government has support for the economic, if not the political project, that it has undertaken. The process of reform that they have undertaken over some period has created a new set of social facts or groups of supporters who may not like authoritarianism but are satisfied with the general direction of policy. They constitute a conservative bloc on the political scene and the new democratic groups, the opposition groups, have to deal with it. And so you see, for example, in Chile, the Left moving toward the Center over the course of the 1980s and then actually taking office and pursuing policies which basically continue the Pinochet project, with some modifications with regard to social policy. The political challenge for these democracies is to complete the democratization process, because, typically, the institutions of the new democratic order had been restricted in various ways by the influence of the out-going authoritarian actors. Thus, you see, for example, in the second democratic administrations in Turkey or in Korea quite substantial discussions on pushing political reforms further along.

The crisis cases in our sample, which are more relevant to the Eastern European and ex-Soviet Union examples, include most of the Latin American transitions and the Philippines. In these countries, the authoritarian regimes exercise virtually no control or little control over the post-transition political order. There are very few barriers to political entry. As a result, the post-transition order is very fragmented, often polarized; there is a tremendous resistance to granting central authorities substantial powers. The system is fragmented, with an aversion to the centralization of power, and plenty of opportunities for new groups to enter the political arena. Partly as a result, the economic situation typically gets worse, and you can trace this directly to political fragmentation. Four examples in Latin America are, of course, the failures of the first Brazilian administration, the first Argentine administration, the first Bolivian

administration, the second Peruvian administration -- all of which end in hyper-inflation, essentially for reasons having to do with political and institutional fragmentation. The problem for these regimes is how to reconcentrate authority in a way which will not undermine democracy. And you see in all those four cases, quite substantial powers being granted to the executives who then launch new reform packages, but with all the difficulties associated with that process of centralization and discretion.

There is one lesson: It is that if out-going authoritarian governments do in fact undertake reforms -- as the Chileans did -- it is quite likely that these will in fact be sustained under democratic auspices; if they do not, then things are a lot tougher, because new democracies have to confront both the tasks of political consolidation and of undertaking economic reforms.

M. Pillsbury: Just to re-state briefly my understanding of Mancur's conclusions. He says that there are two legs that come of the growth economies and success stories; he is going to add a third leg to economic understanding. And in the conclusion, he states very succinctly what the two most important parts of this third leg seem to be. One is the absence of predation; the other is secure individual rights, or property rights. Now, on my comment on China -- and I want to make a similar comment on Russia, I want to suggest that if Mancur will give a few more pages to Russia and China -- there is some very important material which he may already know; he just does not have it in there -- then it seems to me that it will strengthen his argument a great deal. The point is that sometimes, perhaps very rarely, but sometimes the leadership of a country behaves as though it has already read Mancur's manuscript. They seem to know somehow -- I am sure not in the elegant, economic terms that this is written. But they somehow sense: if we can reduce predation and enhance "property rights" we can have faster growth. Now, it is interesting that most countries outside of Europe and the United States do not do that most of the time, which makes it all the more interesting why some countries, some of the time, choose Mancur's path.

In the case of Russia, there is a very interesting book done by one of the young reformers in Anatoly Chubais' office, Maxime Boiko, partly with the help of Dimitri Vasiliev and Chubais himself, where Boiko describes the seminars and the thought process by which they decided to have the privatization auction system take place the way

that it did. He shows in the book, and Anders Åslund has this in his new book as well -- I went to Moscow for AID and interviewed these same people and had them just give me the book because this is the story of what they did -- how they very carefully calculated the exact vested interests that would exist in different kinds of firms in Russia -- small, medium, and large; the type of production; even the location in different regions, according to whether the regional government was more pro-market reform, in which case they decided to have the auction take place in that region first and put off auctions in more -- I hate to say repressive --areas. At any rate, those less enthusiastic about market reforms in some parts of Russia found their auctions carried out much later. They very carefully negotiated which defense-industry firms would be exempt, to head off trouble from the defense sector, that would say "We are not going to allow privatization in our large defense sectors". They made a number of compromises, but my point here is that they behaved as though giving property rights -- simply through stock purchases -- and reducing predation were two of the most important motives they had in the way they conducted the significant transfer of, *The Economist* magazine says, 70% of Russia's state-owned assets to the private sector.

I ask myself: Is this true in China too? Did the Chinese economists, the advisors to Deng Xiaoping, also think themselves: How can we reduce predation? How can we put property rights into the hands of hundreds of millions of potential entrepreneurs? And the answer is "yes". There is a very well-known economist in China named Ma Hong. Ma Hong, in interviews -- he will not write this -- has acknowledged it. And here I disagree with Professor Tith who was talking about how China groped, and did not know what it was doing, that there was no blueprint, and that they kind of stumbled into all this -- that is not the account the Chinese give in private. They apparently had a reason for saying that: to put the opposition off the scent. But in fact, they had a blueprint very early on. And it was to give a kind of property right to several hundred million peasants, while maintaining the Marxist-Leninist dogma that the state owns everything in China. It was a brilliant solution they came to. They did the same thing with foreign investment: they said, "You can come into our country -- on a 50 years'; in some cases 99 years' lease -- if you can lease it." So a "property right". By which we in the West understand: a law, an act of parliament, a court that can enforce it,

and a title -- somebody gives you a title that says you own your house. Or, when you buy something, a piece of paper is exchanged. They did not do this in China. They simply ignored the Western definition of property right. But as I understand Mancur's argument, they achieved the same functional result of giving the stimulation to the entrepreneurs as if they had a property right. As we all know, the Chinese economy behaved accordingly. Similar steps were taken *vis-à-vis* predation.

So my appeal, besides that for a few more pages on Russia and China in the manuscript, is that we consider whether or not practitioners, the leaders with their economic advisors, sometimes -- maybe only one percent of the time in terms of the total number of countries in the world and throughout human history -- behave as though they have read Mancur's manuscript and act according to it. But if that is the case, then we need to understand more why this does happen sometimes.

D. Mueller: Just a specific point, although going back to Seymour Martin Lipset's comments and actually to Andrei Vernikov's comments. Seymour Martin Lipset describes the modern Soviet man, as irreligious. If one just adds enough self-interest and common sense to come in out of the rain, he becomes the economic man. Even if Mancur's world does not apply to most countries where people have ideologies and religion, it ought to be appropriate for the modern Russian, ex-Soviet young man.

I think this goes to the root of the question about democracy: Should we expect it to work in Russia? If you look at *Public Choice*, which is simply economic man gone into politics, 99% of the theorems say, you are going to get disaster, or at least unhappy results. The Buchanan's describe *Public Choice* as politics without romance. And certainly, that is what you might expect with hodgepodge constitution, if you want to call it that, of Russia, where you have a very strong chief executive, a multi-party parliament with a rather odd distribution of powers. There is no theorem nor any reason to expect good outcomes to come from this. I think one of the things one gets out of *Public Choice*, given this rather cynical look at man in politics, is the need to constrain politics. And then here comes the constitutional pitch, the need to take into account the fact that people are both voting and getting elected, and one must put in constraints and establish institutions where you might expect this

self-interest to produce good outcomes. But there is no particular reason, just because you elect a parliament, to expect good outcomes, particularly in this kind of amoral, chaotic world where Russia is.

P. Swistak: Well, so, is there a connection between lasting democracy and the security of property rights and contract enforcement. I am just kidding.

What I want to say is a couple of obvious things, and I believe I will not be alone. There is nothing wrong about stating things that are obvious as long as they are true. Now, what bothers me about things that cross my mind is that I am not sure if they are true. That is why I decided to bring them up.

I want to make two kinds of observations, some inductive and a short deductive one. The inductive ones are a few anecdotes. And I will start with the one that is perhaps the most compelling. I would like you all to think very intensely about your body organs and your attitude towards them. I would submit that if property rights show themselves in an extreme form, this is one area where you would most want to have your property rights to be respected. Now, I say that because this matter actually is regulated. In the United States, as we know, or at least in some states -- I am not sure if it is so in all the states -- you can check a little box on the back of your driving license, and if you are willing to donate your organs to some other humans, you can do that. Now, there was legislation passed recently in Poland, where the *status quo*, or the default, is that if you do not object to your organs being passed to other human beings, they can be removed.

There would be nothing really interesting in the fact that there you have two solutions and one is a default solution in one system and another is a default solution in another system, except for one thing. That is, that in Poland -- you do not have a system of driving licenses in which you can check a box, "Do not remove my body parts" nor do you have a system of any other ID's where you have a box "Do not remove my body parts". And for some strange reason, when this legislation was passed, nobody thought about how one would object to that. So the only practical thing to do is to carry a letter of objection on yourself, so that if an accident happens to you, they will, hopefully, pull it out and say, "Okay, this fellow does not want his body organs removed". Now, I was just reading this information on my e-mail news and relating it to my friend, David Lalman, and he

made a very beautiful and simple observation: There you have the difference between the two societies -- between the American society and the Polish society defined in this simple little example. It is tacitly assumed in this other society, the Polish society, that government has rights on the parts of your body. This is the default. In the US we are a bit more on the libertarian side, assuming that one has the right to one's own body parts. Now, this is just one anecdote that I wanted to start with to illustrate that what becomes legislation differs across cultures. And some of these laws that become written, and many of the laws that stay unwritten, are driven by forces that are more basic than a simple transplantation of institutions from other systems. But these points will be made clearer in other examples. Here is the second one.

There is a city west of Warsaw call Lodz. Between the Wars, it was a big center of the textile industry -- perhaps the second biggest in Europe. And there was a kind of king of this textile industry; his name was Kon, an enormously wealthy entrepreneur, owner of probably more than half of the textile business in the city. He was a sort of a mythical figure. He made a fortune out of nothing, and the local community looked up to him and asked him for advice. He was very, very respected. Well, there was a famous piece of advice that he would pass on to young entrepreneurs and businessmen. (My father happened to be one of them, and that's how it was passed on to me.) Kon would say: "Business is an art. And I will tell you what sort of art it is. There is no art, young man", he would say, "in having a lot of money, taking a bank loan against this money, and making a lot of money out of it. There is no art in having no money, taking a bank loan and making a lot of money. It is an art, young man, to have no money, take a bank loan, make a lot of money and never pay back the bank". Now, father never followed this advice, unfortunately; he failed miserably, of course. What was more, he passed all his norms and values to me and ruined my life as well. I do not hold against him. But the point of the anecdote is, when you play against crooks, honesty is not an equilibrium strategy.

Third anecdote. You often deal with academics that come from Eastern Europe. By the way, I feel free to say what I have to say because I am from Eastern Europe, so I feel -- well, I would do it anyway, even if I wasn't. When you deal with academics that come from Eastern Europe, they obviously face a very different market.

You have to explain to them how it works, and what are the elements of the profession. One of the elements which is very alien to them is the CV. So I often find myself explaining what it is; how it should be written, structured, and so forth. In one case, I was explaining what it is and what to put on it, and the man looked at me and said, "So, you list all this. All right. And who certifies it?" I said, "No one certifies it really. It is all based on trust". "So", said the man, "if I were to list articles that I have never written, no one is going to check it". And I saw these sparks in his eyes that you sometimes see at the movies, the criminal movies that is -- when naughty ideas come to the mind of a criminal type. You can see them in undergraduates also, sometimes. I felt uncomfortable continuing this conversation with this person, so I stopped at that. And his mind wandered into the land of opportunities, obviously.

A fourth anecdote. I met a young lawyer, who came here to learn a little bit (at the summer school) about the American system of law. He looked bored and said, "It all looks like a BS to me. It has no application to what we are doing back in the Old Country". So I asked him, "What is it? What is it that you are doing? and how do you live off your" -- he was a faculty member in law school -- "salary for instance?" He said, "That is very simple. I just have my position at the law school to cover sort of, you know, my three letters. But basically, I am a judge, and I practice as an attorney." Well, here I got interested. So, I asked, "I do not believe it is possible to be a judge and an attorney at the same time." He says, "Of course it is not. It is illegal. It is all a silent arrangement that I have with a friend. He is really running the law firm. I just consult and participate in the profits. He is peddling the clients to my court." And he looked at me as if I have forgotten how, you know, how it all works -- too many years in the States you people have spent, forgotten how.

Okay, here now is the question. And an obvious observation, as I said, but one that I am not sure that I know the answer to. Take two countries. In one country, you have a set of laws and a set of institutions, which is identical to that in the other country. What is more, you have other factors identical, except for the set of norms and values that are not codified in the law. Now, which of the two is going to clear on some efficient economic output? Well, this actually is an obvious question, and I know the answer to it. But here comes another one. Let us suppose you have two countries, and one has a

well-established set of property rights and contract rights, and people think in the long term; and the other does not have it, but has norms and values that support efficient outcomes. Whereas, the first one does not have these norms and values that support efficient outcomes. Now, which one is going to do better? This is the question I do not know the answer to.

But I do know the answer to a very simple question, and this is my deductive observation. (It will not take more than another half-hour.) Deductive observation goes back, and this was unfortunately provoked by Mancur's manuscript, where at some point he writes about the prisoner's dilemma. Just to be annoying, my simple question relates to the prisoner's dilemma, too. This is one problem that I know the answer to for sure, because this is a deductive result. Let us model markets as a bunch of people interacting, playing games -- whatever these games might be. Take, for instance, iterated prisoner's dilemmas, since there is a possibility in these games that markets are not going to clear on efficient outputs. Since I am talking about groups in which behaviors are not regulated -- that is, they are regulated by norms and values. -- this is a good case to look at. And let us ask, "What are the equilibria in these games?" Well, we have many equilibria in iterated games that have sufficiently patient players, and they are all over the place. This is the Folk Theorem result and in principle, I never found anything wrong with a prediction that says, "Well, everything is possible." I know that some people, for some strange reason, do not like a prediction like this, but what the hell is wrong with a prediction that everything is possible? Hence you can have some economies which are in inefficient equilibria; you have some economies which are in efficient equilibria, and anything in between. Fine. And they are all in equilibrium. All right. Let us push this question a bit further, and let us ask, "What if there is some learning mechanism going on or if there is some dynamic in these games?" If we ask that, we are into evolutionary games, which has expanded greatly in the last years and has many interesting results. And ask then, "What are the equilibria in these markets?" It turns out, they are all over the place again. You have outputs that range from inefficient to efficient that can be supported in equilibrium. And finally, let us ask the question, "What kind of constraints can you put on these games that clear the market on efficient equilibria?" And it turns out that one of the conditions that

would allow for efficient equilibria only, is when players make their moves contingent, not only on what is going on between two of them, but also on what is going on between others. Say we have three players: A, B, and C. A may make his moves only contingent on what is going on between A and B. B may also make his moves contingent on what is going on between A and B and other parties, B and C, for instance. So, if you have someone defaulting against the bank, this person may be stigmatized by society: Or, he may be just left alone, and the bank and himself are left to take care of the problem, and society does not intervene. Now, it turns out, that what clears these markets on efficient equilibria are normative strategies. That is, strategies in which players make their moves contingent, not only on what is going on between them, but also on what is going on between other players in the society. Such is my little story on how sociology is proved to be useful. That is, what norms and values can add as mechanisms that establish efficiency.

Now, if we destroy the normative system and the value system -- now going back to my inductive observations -- as I believe has happened in Eastern European societies, these markets are going to slip back into inefficient equilibria. Whether they will remain there and what other institutions can bring about the efficient output is a question that I do not know the answer to. But I do know that norms do stabilize efficient outputs in these very simple games. You must understand that we are extremely childish people, and we deal with models that have two or three variables and do not include the 500 other variables that were brought to our attention at this conference. But that is the way we are: we are just extremely childish. However this childishness allows us to see how some simple mechanisms work in some non-obvious ways, in otherwise very simple contexts. This is my deductive observation, which, I think, links with my inductive observations that I began with.

F. Brechling: I will now break my Trappist vow. The reason for my silence has been my feeling of incompetence in the subject-matter under discussion. As is his customary practice, Mancur Olson has presented us with an extremely interesting and intellectually stimulating hypothesis. I would like to relate it to my experiences in a transition economy, namely Armenia, where I worked as a professional economist for a period of twelve months.

I was engaged to set up a research institute in Yerevan. The project was sponsored by USAID. Its purpose is to sponsor and undertake medium-term economic-policy-related research.

Let me start by summarizing a few important features of the Armenian economy. First, Armenia, which joined the Soviet Union voluntarily about seventy years ago, has relatively few basic resources. But under the Soviet Union a substantial industrial base was developed, mainly in light industries and the defense industry. As Tony Lanyi mentioned earlier, the Soviet planners did believe in specialization, but I doubt that it was determined by the principle of comparative advantage. Further, Armenia's economy was managed essentially from Moscow. Local managers fulfilled production plans and shipped their output to a post-office number. They had no idea who the recipients of their goods were. There were no marketing departments in enterprises because there was no need for them.

Second, an important feature of Armenian industry is that the factor proportions of its industrial structure are extremely resource - (especially energy) - intensive. With modern world factor prices, most of the factories are highly uncompetitive.

Third, over the past 20 years or so, investment in the infrastructure of the economy has been badly neglected. With the exception of country roads, which presumably were built and maintained for military purposes, all systems are badly in need of repair and replacement. On average, people in Yerevan have daily two hours of water supply, yet torrents of water from broken pipes flow down the hilly streets.

Against this background, the Armenian economy and people were subjected to three devastating shocks. First, in 1988 a severe earthquake killed about 25,000 Armenians and destroyed about one-third of its productive capacity. Reconstruction was begun under Gorbachev but was soon abandoned. Even today the earthquake zone is a moonscape and many people still live in railroad cars and other temporary housing. Second, there was the breakdown of the Soviet Union with an almost complete breakdown of the previous barter exchange arrangements. Third, there were the regional conflicts: that in Nagorno Karabakh, apart from imposing a huge direct resource burden on Armenia, led to a trade blockade by Turkey and Azerbaijan; and that in Abkhazia which severed an important rail connection with Russia. Even a reasonably healthy economy would

have been severely affected by these shocks. They sent the Armenian economy and society into a tailspin.

According to official statistics, GDP fell by about 60% over two years. In 1995 the process seems to have bottomed out and there may even have been some slight positive growth. But the statistics are flawed badly. Much of the reporting of activity by state-owned enterprises seems to be badly biased. Moreover there is a thriving “underground” economy which is unrecorded. Official and semi-official estimates of per capita GDP in 1994 vary between \$200 and \$2,000. Thus we are not dealing with small random errors. Other indicators show that hunger, malnutrition and general suffering are particularly severe among the elderly. High death rates and severe weight loss occur among the elderly especially in winter, when lack of fuel and very cold weather present special dangers.

Because of the depressed state of the economy, the rate of emigration, particularly to Russia, has increased. As one would expect, the best-trained young people are the first to leave. The government has not released official statistics on this emigration, but there is much talk about the “brain drain”.

There are some potentially positive features of the Armenian economy. First, the stock of human capital is relatively large. Despite the (aforementioned) brain drain, the remaining work-force has relatively high skill levels. But the current state of education is deplorable, so that the stock of human capital in the future may be in jeopardy. Second, there is a substantial Armenian Diaspora, mainly in France, the United States, the Middle East, and Russia. According to estimates, there may be as many as 5 million people of Armenian extraction who live outside the current Armenia (with 3.5 million inhabitants). These Diaspora Armenians have been extremely generous in supporting Armenia. But their help has been confined largely to humanitarian aid which, of course, has been badly needed to prevent starvation and deaths from hypothermia. Only recently have there been small amounts of private investment by Diaspora Armenians. Since Diaspora Armenians have accumulated substantial wealth and business experience, I hope that Armenia will benefit from the activities of the Diaspora (much like China has done in recent years).

Against this background I pondered the question: What can be done to alleviate the situation quickly? Since I usually had no

electricity in the evening, there was no street lighting, and no movie theaters, I had lots of time to ponder. The basic conclusion I reached was that much Western writing and advise on this topic is too simple: our search for the one silver bullet that solves all the problems of transition economies is illusory.

First, foreign advisors suggested price liberalization. In Armenia, most prices were liberalized in 1992 and the price of bread was freed in 1994, so that now virtually all prices are free.

Second, we suggested that they should privatize. Armenia, unlike Russia, privatized agricultural land in 1991. There are still some problems with titles to property and very little trading in land seems to be taking place. Further, about 80% of residential property are now private and there is an active (outdoor) market in this property. There are indications that the privatization of agriculture and residential property has had beneficial economic effects. As far as state-owned enterprises are concerned, the Armenian authorities have been making a start at privatization, but the process is painfully slow. The managers of these enterprises are reluctant to give up their power. They often build up parallel (private) enterprises, divert resources from the state-owned to their own enterprises. They dismantle the equipment of the state-owned enterprises and sell it as scrap metal to Iran. Naturally, the managers do not wish to yield their power to a private board of directors.

Third, more recently foreign advisors have been advising to pass new laws. Constitutions, commercial codes (bankruptcy laws) etc. are being passed by parliament after parliament. Since the World Bank and the IMF often make their aid conditional on passing such laws, the recipient countries usually oblige. In Armenia a very vaguely worded bankruptcy law was passed. But there are no bankruptcy courts and the entire idea of bankruptcy is totally alien to people who have lived in a Soviet-style economy for seventy years. While these codified laws clearly enhance the profits of the foreign legal corporations who advise governments, their short-run (and possibly even long-run) usefulness to the transition economies is in serious doubt. In my view, one cannot build a new economic order by imposing foreign laws from above. The development must come "from the bottom up". There should be a heavy emphasis on arbitration systems and the development of "common laws" which are appropriate to, and understood by, the society concerned.

Unfortunately, such a development may take a long time. To be sure, many legal advisors believe that the transition process may be speeded up by the imposition of codified (Western) laws.

Let me finally comment on “democracy” in transition economies. I think we need to be specific about what we mean by this term. If we mean simply more or less free elections, then most CIS countries are democracies. Armenia had parliamentary elections in July 1995, which were judged to be reasonably fair by an international observer team. But Armenia is far different from England or the United States (among many others) in democratic and legal institutions. These institutions may be much more important for transition economies than simply “free and fair elections” (though, of course, the latter are highly desirable). Indeed, as our previous discussion about China has shown, democratic institutions are not necessary for rapid economic development. Indeed, in Western countries we have deliberately developed some “undemocratic” institutions to whom we have delegated authority. In the United States, the Federal Reserve is such an institution. To the chagrin of many Congressmen, we have delegated the authority to operate an independent monetary policy to the Fed. The reason is that experience has shown that majority rule on monetary policy may lead to rampant inflation. We voluntarily restrict our “democratic” rights in order to control inflation. The policy of the IMF is to impose the same institutional structure on transition economies. In Armenia this has led to a substantial reduction in the rate of inflation.

Let me sum up: I think we need to try to find answers to the following questions: which democratic institutions are necessary, sufficient or simply helpful conditions for the economic transition of ex-Soviet countries. Our discussions today and my own experience indicate that there is no single sufficient condition. We have not even been able to identify a fairly general necessary condition. Hence we must search for combinations of conditions which are sufficient for several countries. Unfortunately, this would not be the end of the job. We must also worry about the implementation of the desirable institutional changes. In practice this is likely to be a very difficult and laborious task.

A. Clesse: An obvious lesson for the Chair is, certainly: beware of those who do not speak for a day and a half. I also have a question to you, Professor Brechling. The question is something I deduced from

what you said. I think that there should be a high birth-rate in Armenia because of the combination of three factors: namely no entertainment -- you mentioned that there is no cinema, for example -- a lot of vitamins -- you mentioned the fresh fruit -- and the third factor, no electricity. And no heating in the winter, so that's a fourth factor. But that goes with "no electricity", I guess.

F. Brechling: The birth-rate also fell. And furthermore, there has been substantial emigration because of the misery caused by the economy.

Session VIII: The lessons: How can the societies of the West enjoy both stable democracy and economic dynamism?

N. Tith: Basically, what I want to say is that I did not mean that not having a blueprint -- I did not mean that to infer any derogatory remark on the Chinese leadership, that they did not know what they were doing. Of course, not. What I am saying is that by blueprint I mean a comprehensive type of interrelated reforms. Of course, in this case you have the sequence of political reform, to be followed by economic reform, and comprehensiveness also means the inclusion of macro, micro, privatization, the legal system, the judicial system, and so forth. In the Chinese case, obviously they know what they were doing and they rejected that blueprint type of approach. They know early in the 1960s that, first of all, communism was not, as I said, an end in itself in China, and that communist system did not work. But the question is, how did they reform their economy once they have accepted that.

Merle Goldman: I would like to talk to this issue about how China will be able to sustain its economic growth. It seems to me that as long as you have the overseas Chinese pouring in their millions and billions of dollars into China, and there exists an almost infinite supply of labor, China will be able to sustain their economic growth. They will be able to do it without contracts, without the rule of law, and without individual rights.

What worries me about China is not their ability to sustain their economic growth without laws; China's problem is the lack of political institutions. In other words, China has gone through

seventeen years of dynamic change; it has new classes emerging, an emerging middle class that is now 100 million people. Now, that sounds like a lot, but that's less than one-tenth of the population of China. But it is growing very fast. And they're growing very rich. The problem with China today is its political structure: they are still ruled by a few old men. (I hate to say that, but that's what they are.) And the leninist structure is still in place, but it is bankrupt. Its ideology is eroding. And there is no structure to hold this country together. The move to the market led to the decentralization of China, economically and politically. Take the province of Guangdong in south-east China. Its economy is much closer to a south-east Asia and to Hong Kong than to Beijing. The province of Shandong is closer to South Korea, just to give you a few examples. Therefore there has been a decline in the power of the central government, even in terms of taxes.

Taxes are collected very efficiently in China at the local level; a portion then goes to the provincial level; then another portion to the central level; each level gets a cut, as it goes up. In a wealthy province, with strong provincial leaders that have political power not much then goes to the center. So what we are seeing in China is a diminution of the central power with the market and these economic and political decentralization.

There are all kinds of democracies. An Asian democracy is not Western democracy. Even within Asia, between Japan and South Korea, you have got different forms of democracy. But as I see it, the only way that you can hold this country together, and keep the order, the stability which made these dramatic changes possible, is some form of federalism, which means, in some way, a representative government. It seems to me that would be the only way that they will be able to hold on to Hong Kong and will be able to hold on to Taiwan. And unless they can develop a political structure that can hold this huge country together -- I see a problem. It has nothing to do with the other factors that you mention in terms of being able to sustain its economic growth.

Now, once they develop that political structure, then I think, you will see in China, as you saw in Taiwan and South Korea, and earlier in Japan, a move toward contracts, development of a system of rule of law. But until they can change the political structure, I do not think you will see those things emerging in China.

A. Clesse: We should have some discussion on the topic we chose for the last session. I do not know whether the topic, as it is phrased, makes a lot of sense to everybody: How can the societies of the West enjoy both stable democracy and economic dynamism? But before that, I would like to give the floor, first, perhaps, to Piroska Nagy, and then to Antoni Kaminski. And then we could move on to this last topic for this meeting.

P. Nagy: What I thought to do perhaps, not taking up too much time of this conference is to comment on some points which, I understand, were the subject of discussion this morning and in which I can, perhaps, be of some help. This is the issue of the deterioration of tax-revenue collection in transition economies, and whether this is a problem or not. First, as a factual point, I have to support Mr. Olson's understanding of the situation. It is, of course, correct that there have been enormous drops in revenue collection in all these economies, particularly in the FSU economies, but also in transitional Central European economies.

In the FSU, the ratios went down from something like over 60% of GDP to well below 20% in certain cases. At the lower end are some countries with peculiar situations, such as a war situation in Tajikistan, which does not collect more revenue than 10-12% of GDP. But I can speak also about my immediate responsibility, Kazakhstan, where there is now a relatively stable economy and a stable semi-democracy, where revenue collection is only about 16% of GDP (excluding social security contributions).

And these are not outsiders. On average, the collection is not more than 20-26% of GDP. Even in Russia the collection is around 20-22% of GDP. You can add some extra-budgetary funds to the collection, but you do not get more than 30% of GDP. And these are collected with tax regimes that are very similar to what you have in market economies (partly thanks to USAID help and IMF and World Bank technical assistance work). That is, it is VAT-based, and there is a relatively new personal-income taxation, excises, and smaller amounts collected from external-trade taxes. The system is very similar to that in market economies, but collection is much less.

Now the question is whether this is a problem or not. It seems to me that perhaps in some of these economies there is almost a *choice* to have a government which is very small in size, measured by the ratio of the revenue to GDP, or expenditure to GDP. Fiscal balance is

achieved and maintained at low revenue/expenditure levels. For example, in Kazakhstan the fiscal imbalance, at 2-3% of GDP, is not large. It is already the second year that this ratio has been achieved. And this is true for a number of other FSU countries: fiscal deficits have been reduced to levels which are not unmanageable. These definitely can be financed by not that much manipulation that, perhaps, Mr. Olson implies in his manuscript. Most of the financing comes from foreign resources or from other non-bank financing, like treasury bills. One can also take China's example, where one sees that the overall size of the government, as measured by the revenue to GDP, or expenditure to GDP ratio, is very small.

So the question is whether one would not say that there is a choice by these countries, or societies, to have as small a government as possible, to have a very limited but efficient provision of public goods that is reduced really to basic education, and very basic provision of health care, defense and some social expenditures which are necessary to finance the safety net. Old Soviet-type expenditures (subsidies, production and consumer prices) are cut back and there is very little welfare provision in addition to a minimum amount of social safety net.

In sum, there is a choice in these economies to have a very small government after many years of very omnipotent government. Maybe it is a case of "going to the other extreme" -- an extremely small government with a relatively strong balance position

A. Kaminski: I want to return to the debate that started this morning and somehow ended with Steph Haggard's intervention. This view according to which communism belongs to the same class of regimes with authoritarian dictatorship is in my opinion, highly debatable: it is a different kind of disease. Haggard mentioned that there are authoritarian systems whose transition ended with economic success and those that failed. Now, in the case of all post-communist countries the transition starts with a dramatic decline in GNP. This represents a major difference with post-authoritarian development. Perhaps China will make a difference. Perhaps China will be able to change its political system under conditions of a successful economy. If we live long enough, we shall see. But I think that the claim of Chinese communists, that communism in China has been a success, is unfounded. They gave up the centrally planned economy. They are moving to a market economy, and if everything turns out well, as

Merle Goldman suggested, they will have developed a liberal-democracy of some sort. That only confirms an old joke that communism is the longest road from capitalism to capitalism.

Let me turn to one problem that has been absent in this discussion: the conditions of the transition itself. Transition in a loosely structured game under a high degree of uncertainties. If we now take a rational actor assumed in this book, then I think such an actor will not be able to construct stable and efficient institutions. For such institutions to emerge, we will have to assume an actor interested in institution-building itself, without any other interest. Well, other advantages can accrue from this, but his business is to restructure institutions.

Look at those actors in the Polish system who were involved in the process of institutional transformation and who were really successful, like Balcerowicz. Balcerowicz was not interested in money. He was interested in the success of his work, which consisted in transforming the economy. There are some other people who instituted the local self-government. They were not interested in any financial success. They were interested in making the local government work. Those individuals who were effective transformers, who had a very clear agenda.

There have been several other actors managing in the process of transformation who were typical rent-seekers. I have studied, with a lawyer friend, several legislative acts. These legislative acts represent an effort to build institutions that would serve uniquely the interests of the authors and their political parties. What is more, because we still do not have a "permanent constitution", those legislative acts will define the content of important elements of the constitution. What is of key importance for the process of transformation are the actors who do not want to build into the new system opportunities for their own enrichment, but rather define their interest in terms of the success of the task before them.

M. Blejer: I thought that some of the discussion this morning was preempting any open debate, because if we ask why economic performance has been so much poorer than expected, we are already saying that it has been very poor and that somebody expected that it would be different. I thought that some people have already shown that, in fact, there was no reason to expect a much better performance, and that, as a generalization, is not a good

generalization -- we have to look at different countries in different lights.

Now, one important thing that I would like to mention -- a simple result that you can obtain if you want to see what is behind different performances. You can just look at the recent publication of the Transition Report of the EBRD, European Bank of Reconstruction and Development. They have a lot of data about 28 transition countries. They have collected very comparable data. Now, I do not want to repeat what Andrei Vernikov said, that the data are very doubtful. It is not very clear what a reduction in output, for example, of 80% in Georgia means. Obviously, if you can believe that output has fallen to 20% of the previous level, then, this place must have looked like Switzerland before. I mean, it is not credible that output could have fallen by 80%. It is quite clear that this does not measure the decline in welfare. Consumption fell by much less; that is what these data say.

Without going into these details, if you look at these data, and you build two matrices, it is very instructive: in the first one, you classify on the horizontal axis countries by their rate of inflation, let us say in 1995; and then on the vertical axis you classify these countries by their rate of growth of output. You will find, not very surprisingly, that those countries which have a low rate of inflation, below 20%, also have resumed growth. That is not very surprising; we assume that this will happen. In the other corner, you will find that those countries which have rates of inflation of above 100% a year, are still experiencing an income decline and rates of growth in the negative. This again, I think, is expected. You find no country with high inflation and zero growth, in that part of the matrix. But then you find a cluster of about six or seven countries, and that is the puzzling part, six, seven, or more -- eight countries, I think -- in the lower right corner. The corner in which countries have reduced inflation to less than 10%, or less than 15% a year, and still their income is declining, still their income is falling. So it looks like there is indeed a diagonal. Countries which have managed to reduce inflation also have managed to grow. But there are countries where inflation is low and there is no growth -- the opposite -- yet they continue to fall.

Now, if you can build another matrix, in which you have again the rate of growth, and you have an index of economic reform, structural reform -- not stabilization, but structural reform. Such an index is

built by the EBRD so I can get all the responsibility off my back and claim that this is a good index. In this they weight in different ways privatization, creation of market institutions -- judiciary, macro-economic institutions, and so on -- and then they also include structural reform measures. Now, you build this matrix, and it is quite incredible that it looks identical to the previous one. You will find that the countries which have managed to create institutions to instigate a certain degree of structural reform -- privatization and so on -- are these countries with low inflation that have managed to grow. And the countries which have not introduced structural reform -- privatization, restructuring of industrial production, institutions, and so on -- are those eight countries in this corner that could not be explained by stabilization alone. These countries have reduced inflation to very low levels, but they have continued to have output decline because structural reforms have not been in place.

I think that this is an important observation which comes just from organizing the data. Not too much power of explanation there. But it tells us quite a lot about the need not just for macro-economic stabilization, but to combine it with structural reforms. And I think that it is an important implication concerning the creation of institutions, because without these institutions, just reducing the rate of inflation has not got these countries out of their recession.

I wanted to mention two related points, just to make a small contribution, maybe, to the manuscript here. I think that in the chapter that deals with the transition from communism, it is very important to distinguish between Eastern European countries and those countries which came out of the former Soviet Union -- and Yugoslavia, for that purpose. Because these latter countries needed not only to create economic institutions for macro-economic policy, they also needed to create a government, to create a regime. So we see an interesting case for your theory here: why is it that the countries in Central Asia which came out of the former Soviet Union have a tendency to have a much more autocratic system, much more autocratic than the Baltic countries? I think that that is an interesting question. These are questions that I think could be answered to some extent using the model presented here.

My last point is to react to what Mr. Swistak said. I enjoyed very much his anecdotes. But I had the impression that he was talking about my country of origin, about Argentina, or about some other

Latin American country. Because these stories about corruption and lack of real function of the legal systems, they are not confined to transition countries. These are very common stories in countries where, for a number of reasons, the way that property rights are assigned and the way that the courts work give rise to this particular form rent-seeking. But I want to say that it does not at all necessarily follow that they are totally inefficient. I am not going to promote corruption here, but I do claim that they are not totally inefficient. For example, in Mexico, it is absolutely impossible to get a traffic ticket. No policeman will ever give you a traffic ticket. I stayed one year in Mexico: we had a standing bet in the office, \$50 for the first one that shows a traffic ticket. And it is absolutely impossible. You can bargain down the policeman to a quarter. But he will never give you a traffic ticket. And what is the result? Traffic laws are extremely well enforced, because every single policeman has a stake in enforcing the law. And the budget does not have to pay a very high salary to policemen. That is paid directly by the user. So it is not necessarily true that all these stories result in a relaxation of the environment. I do not want to end on pro-corruption note, I just wanted to make this point.

A. Clesse: Perhaps, Mancur, you could tell us what you had in mind when you proposed that formulation of this last topic.

M. Olson: Well, I am struck by how almost all the economics that have developed in a small set of countries that were the most prosperous countries in the world, and stable democracies with the rule of law. So the people who have been developing economics have mainly observed a tiny and unrepresentative fraction of reality, and that explains why the textbooks talk about capital intensity, but never about property-right intensity of production. They assumed the conditions that are necessary for a thriving economy because that's a natural assumption to take in the richest economies, and the richest economies are the richest because of these things that are taken for granted.

Now, it seems to me that this is important for how we go from places like the former communist countries and the Third World back to the developed countries of the West. We have got to be alert to the fact that if you have a truncated sample you are not going to get the information. Suppose we look at what it was that convinced the world

that Einstein's theory of relativity was right. It was not any ordinary event: it was an eclipse of the sun. Well, it is exceptional things like communism, Stalin's strange system and its collapse, and the failure in the Third World that we need to study, I think, to understand, fully to understand, even the laws of operation of the *developed* countries.

So I personally think that the distinction between narrow interests and encompassing interests, for example, is just as relevant to the rich countries as to the poor: water flows downhill everywhere, income-compensated demand curves, at least, slope down everywhere, and so these insights we can get by looking at these extreme and troubled countries are helpful to the West. For example, if we want to understand the gradual process of eurosclerosis as we look at a country like Germany, between the 1950s and the present, we have to understand the differences between narrow and encompassing interests. If we want to look at what's going wrong in the United States today, we have got to understand the tremendous dangers to the United States that come from the extraordinarily powerful lobby of trial lawyers, which lobby not only impoverishes the nation in a direct way, but even calls into question one of the great assets of the United States -- a good system of rule of law. The way things are going lately, a good system of rule of law can by no means be taken for granted.

So I am so single-minded that I think this analysis does indeed have implications for the prosperous countries of the West.

C. Coker: Something has come to my mind over the last two days that we have been here. And that is the extent to which the democratic societies, which have an experience of industrial economic growth, have grown slowly, while the societies that have grown fast have for the most part been un-democratic: the United Kingdom took about 100 years; the United States about 60 years; Germany 30; Japan 20; China 10. Who knows -- Brazil may do it in five years one day. Does this mean that democracies cannot grow quickly? Does it mean that high growth is inconsistent with democratic values? I do not know the answer to that question, but I would just like to look at one issue which is social unity. This, I believe, is undermined profoundly by rapid urbanization. And that is why I am firmly pessimistic about China: I think China in the twenty-first century will be what Germany was in the first 50 years of the twentieth century.

Here you have an economy, Germany, that within 30 years goes from a predominantly agricultural to a predominantly urban population. Nothing like that had been seen before. The social conditions in German cities were the worst to be found anywhere in the Western world. The only country where the conditions were worse was Russia, which was not part of the Western world. Russia was also expanding very fast indeed at the end of the nineteenth century. You had people crammed together in tenements in conditions that were so bad that they revolted or were inclined to be attracted by extremist politics, in particular by socialism. And then you had petty bourgeois and other characters who were so obsessed and frightened by the masses that they were also attracted to authoritarian solutions before 1940, to fascism in 1920s and 1930s.

Urbanization, rapid urbanization is the explanation for the instability of Germany -- the most dynamic economy in Europe, but also the most socially immature in terms of ability to maintain a stable political system; which could serve the interests of the great majority of the people. Seventeen million Germans died as a result of that insecurity in the course of the first 50 years of the twentieth century. Of course, many more non-Germans died for the same reason. Today in China, you have a society that is in the process of urbanizing, probably even faster than Germany: there are 200 million, at least, unemployed people in the countryside; 50 million migrants every year seeking jobs. And what this is producing is a polarization in Chinese society between a middle class that sees the peasants as a threat -- a source of cheap labor at best, a source of criminal activity at worst -- and the peasants who see a middle class essentially existing outside their own social reality, living in another social world.

Interestingly, the only time, I think, that the peasants were held up as an object-lesson in virtue, civic virtue, was during the Cultural Revolution, when all these people were sent off to the countryside for their own good, and to appreciate the rustic values that were supposed to be at the heart of Mao's system of communism. It was not the best way of promoting social unity. It did not promote social unity. But what is happening now is not promoting social unity, either. So if we do not throw out *everything* that Marx told us, and accept that alienation *is* a function of industrialization and economic growth, one has to say to what extent this growth in itself mitigates

social alienation, and to what extent it amplifies social alienation. That is why I am, as I said, profoundly concerned that we are seeing in China the source of the most extreme form of instability in the international environment for the next 20-30 years.

A. Lanyi: This is not on China, but it is on the question that Mancur poses about industrial democracies. It is a very short and simple-minded question: Is not it a fact that the United States has actually been doing better than the European countries in terms of growth over the last, let us say, 10-15 years? Is not it precisely because the United States has gone further in the direction of trying to reduce government regulation and reduce the kind of structures that, over time, special interests tend to erect for their own benefit? I hope that people who know more about this than I do, address themselves to it because I think that is the kind of question Mancur is asking.

N. von Kunitzki: I would continue on the idea of Coker about social unity. If we take the conclusions of Mancur's book, we see that stability in a country is a big advantage and is the basis of development, because of fiscal laws etc. and confidence -- and even the worst dictatorship, after it lasts long enough, would be good. On the other hand, we have seen that change is very important, because otherwise you fall into sclerosis. Well, is that not a contradiction: on the one hand, you must have stability; on the other hand, stability is bad because it creates an obstacle to development, all those resistances that a sophisticated economy develops after a time.

Now, this is an image we have in companies, too -- whatever you change in a company is positive. If you come into a company and throw out one-tenth of the personnel, it is positive, even if you have a very bad hand at it and throw out the *best* ten percent. And sometimes things do get better because everybody will have a new dynamism and fear and whatever. But you remember there was a book in America that had a big success, *In Search of Excellence*. It was a very nice book. It had one or two handicaps. One was that there was no single rule to be got out of that book, because one company said they were so good because they decentralized; another said they were so good because they centralized; the third said they are so good because we concentrate on the market; the fourth said -- etc.. The other handicap was that, two years after that book was published, one-third of those companies were in serious trouble.

So it looks that it may not be a contradiction to say that you need to have stability but you need shocks. Now, one could, perhaps organize those shocks, the shocks could come from outside or from inside. It is certainly important, I think, for good development of the developed nations that they stay open to the outside so that they get shocks from time to time and are awakened. And, on the other hand, you have to give free way, to internal shocks by giving a maximum of incentives to initiatives from their own people.

Now I come to Mr. Coker's idea of social unity. It seems to me, without being lazy and without being fascist, that the European countries, at least, that stay open run a danger in another way, which is the following. If I understand Mancur's book well, every rule has a price: a bad rule has a high price, most of them have a price because they want to get something out of the advantage they have of being in charge of the country. There is one rule which does not cost the country anything, and that is the rule of law. The rule of law is free: everybody sticks to the same rules, everybody has the same ideas, or the same mental structures to respect certain rules; there is no need to enforce that respect. That respect costs nothing. So it is very important that there should be social unity in a country.

If there is, you have few people that want to be free-riders, because practically everybody accepts the rules of the community. Now, if you stay open to the world, there will be people attracted by the nice way the country runs, whose natural idea is to be free-riders because they have a wholly different set of values. They have no reason to accept the values and conform to the ways of the country, because that is not in *their* book. Therefore I see a difficulty about steering one's way between, on the one hand, being open and, on the other hand, to maintain the purity of the rule of law that the community imposes upon society.

You know that in Switzerland all crimes, at least if one is to believe the Swiss, are committed by *Chalbe-Usländer* (terrible foreigner). It is never a Swiss that commits a crime.

A. Clesse: Before we conclude, I think I should give the floor to Mancur for the last time to hear what he learned. Can I use that word? What he "learned" from these two days? In a few minutes. In fact, somebody from Harvard - he did not come to this meeting -- said Mancur Olson always likes to hear criticism, but he never takes it into

account. I will not give you the name, but he is sitting about ten yards from Ray Vernon. If you know where that is in Harvard.

C. Clague: I will be very brief. We have a problem of social unity in the West, which is being aggravated by a change in income distribution. I just wanted to draw our attention to that fact, which is quite a new development. There is quite a rigorous debate going on among the international-trade economists as to how international trade is contributing to that. Everybody agrees that technology is the major factor. It is something that we need to think about. I think that we have a serious problem.

P. Swistak: All that I wanted to say is that I was in Cape May over the weekend. There is a house-painting establishment there. Apparently very successful because they put lots of plaques all over the place. And they have a motto, which I think is most suited for the first page of Mancur's book, and I wanted to see if we all agree. The motto is: We are not perfect -- just very good. Can this conclude this conference?

M. Pillsbury: Suppose Mancur is right. What are the consequences for the IMF and the World Bank and AID? Since Bretton Woods, the IMF has used some of its authority to get into Third World activities and created a very large research staff, which did not even exist in the 1950s, even into the 1960s. This is a new business for the IMF. It is also a new business for the World Bank. It was not anticipated in the 1940s and 1950s that either the IMF or the World Bank would negotiate policy framework papers of great detail on what Third World countries or transitional economies should do.

But if you examine this long history -- AID, by the way, has largely been a welfare agency in the last two decades. It was accused by our Congress, quite correctly, of having the world's largest supply of condoms in one warehouse. This is not meant to accuse AID of anything wrong, but they did feel that population control, population policy, was a major part of their mandate, as was providing food grains, direct health benefits, and so forth. If Mancur Olson is right, these delivery systems of the World Bank, and the IMF, and the AID, they're delivering the wrong thing to accomplish the goal of economic growth. They are not delivering a reduction in predation.

I have read a lot of IMF policy-framework papers. I have never seen a sentence that said, "Oh, by the way, priority three, before you

get the next payment, is to reduce predation in your country", or anything like that. It would be unthinkable. The same thing is true for more secure property rights. That simply has not been in the World Bank's business until recently. Now, the World Bank I can not criticize it as much as I can the IMF, because the Bank, at least, has a program in governance. But it has a hard time working into a large multi-million dollar loan governance. It is been funding a lot of research on governance to try and see how it could do that. But that's at least close to what Mancur is saying: it is one of the two most important things for economic growth. Now, AID has a slightly better record. At least since President Kennedy, there's been a small group of economists in AID who do the kinds of things Mancur would probably advocate they should do. But that is a tiny percentage. It is something like one-quarter of one percent of AID's overall international operations.

So a lot of us at this conference, and I myself, Mancur, have criticized some aspects of your manuscript, but let us just grant that you're right. It seems to me that there may have to be a fundamental re-thinking of the mission of these various international "assistance" agencies. That they are not focused on the most important factors that generate rapid economic growth.

I leave this as a question. There are four or five of you from the IMF. You could defend yourselves if you like. But I do not think many of the policy-framework papers IMF negotiates, or many of the activities at the IMF, would stand up under the theoretical scrutiny that Mancur Olson is proposing in his book. So what you really should be doing, if you want to be a narrow special interest, is to be attacking this book. You do not want it to get published because Mancur is going to change the nature of the debate about economic growth in the United States and elsewhere and it'll threaten the survival of the IMF -- in its current organization, shall we say. I am inviting you to attack him now, because that will prove his theory is correct: that a narrow special interest defends itself when it finds its survival in doubt.

M. Blejer: I do not think that at this late stage we are going to go into a debate, but I think that the comments by Mr. Pillsbury made purposefully: misread and misrepresent what the IMF-type of policy recommendations really mean. There are two things that I want to say. First, I think that one of the elements that form the base of the

IMF programs is increasing the transparency of policy. The reduction in arbitrariness, I think, appears as a performance criterion very clearly: the increasing clarity, the transparency, the accounting, the accountability of policies and policymakers. It is very difficult to lay down a condition which states that predation should be reduced by 2.3 or 4% each quarter -- and check it. But the overall experience of the policies has been extremely consistent with the idea that policy has to be transparent and understood, and the rules have to be clear. That's one aspect.

The second aspect is that a large part of the work of the IMF, and also of the World Bank, is constituted by policy advice and technical assistance which are not conditional: not parts of a loan, not parts of the policy packages -- they are based on the attempt to spread good policies, and not only to spread the theory of good policy, but also the implementation of good policy. There is a large amount of expertise and technical assistance which goes in that direction, reducing the incentives that exist in the system for corruption, for bad policies, for predation. The existence of good and clear policy will reduce the incentives and opportunities for robbery and predation and corruption. So I think that the policy conclusions of Mancur are extremely consistent -- at least, in general terms -- with the policies implemented by the IMF.

A. Lanyi: I think that is actually quite untrue. Incidentally, PFPs policy-framework papers are drafted jointly by the Fund and the Bank, not just by the Fund alone. And both the Fund's technical assistance and, at times, the PFPs, incorporates some of the institutional changes that you mention -- in bankruptcy laws, property rights, and so on.

As for predation, I think Mario Blejer is absolutely right. All we can do is try to reduce the incentives for corruption. It is obviously beyond the scope of international financial institutions to influence the way the police and the political authorities operate within countries. Perhaps that's beyond the ability of any outside agency. It is certainly unrealistic to expect us to do that. But equally certainly, we can work on incentives and to a large extent we do.

Merle Goldman: I'd like to make a comment on Mr. Coker's point and tie this to Mancur's views. I happen to agree with Mr. Coker on this. I painted a rosy scenario of the Chinese economy, but I happen

to think that the social forces that have been set in motion by the economic reform are potentially very dangerous. That is why I happen to agree with Mancur, that what is needed is a government that will promote social stability and a degree of order. And given the situation that China is in today -- becoming a highly pluralistic society with new classes developing -- it seems to me that the best bet for social order is a gradual movement to some form of democracy, because the present system whereby a few people from Beijing rule this huge country -- just will not work any more. Despite my criticisms of you, Mancur, I do agree with his conclusion that the only way to sustain China's dynamic economy is for China to evolve a political structure that is appropriate for its economy. And as I see it in the present world, that's some form of democracy.

H. Etienne: I notice that no one here in this room was able to give an answer to Professor Olson's question number eight. Well, that is not surprising because it is just the question that was put to President Jacques Delors, and he answered "If I could answer that, I should be the Emperor of the whole of Europe". So do not expect me to give you an answer to question eight.

What I can say, nevertheless, is that democracy would be endangered if we had a type of market economy which increased differences of revenue between the different categories of people. The market economy we have now is a market economy that is totally different from what we had before the collapse of the Soviet system, because in certain ways the market economy, at least in Europe but also elsewhere, was dominated and framed by the perspective that there was the other rival. Now market economy is abandoned. The consequence we see is that the differences of revenue between the participants in the market increase. We have also the differences between those who have jobs and those who have no jobs. And that, of course, endangers democracy. I cannot give you an answer to that, but if you mean by economic dynamism a market economy which is not controlled, I can only say: Beware of the dangers for democracy.

M. Olson: I am reminded of an academic administrator that I knew who was a pretty good academic administrator, but never produced anything as an economist. His field was economics. And I remember thinking of him once that he was decisive enough to be a fairly good administrator but not decisive enough to be a good economic

researcher. Now, of course, that is not the whole truth. But I really believe there is a sense in which, at least for certain types of economics, certain types of social science and scholarship, you need to be even more single-minded than you do in administrative roles. Napoleon said that to have success in the battlefield you need audacity, audacity, always audacity. To have certain kinds of intellectual advances, you need, it seems to me, the same sort of audacity.

Now, of course, as you may note, this is my answer to the person -- I do not know his name -- at Harvard who says that Mancur Olson listens but never takes account of the critics. Well, I *do* take account of the critics -- a lot. As a result of these two days there will be enormous changes in this manuscript. Every comment will be taken into account. But one thing will, I hope, remain. And that is a certain single-mindedness which does not flinch in the face of all of the other considerations that are there. I would, of course, point out that the world is complicated and that any mono-causal theory is wrong -- one must, as it were, have asides and footnotes that take account of all the richness of reality. But I want the main point to stand out loud and clear so that people can attack it and build on it. So if it should seem that I have not taken criticisms into account, I think a closer examination will show that I will take them very much into account, but that this may not be evident at first sight because of the desire to be clear, stark, and single-minded.

This leads to the last point: that I am profoundly grateful to all of you for your criticism, the most severe criticisms not least; and especially grateful to the Luxembourg Institute for European and International Studies, its steering committee, and Armand Clesse for having this meeting from which I have gained so much.

Conference participants

(professional positions at the time of the conference)

- Russell Anderson**, Director, Economic and Institutional Reform,
US Agency for International Development, Washington, DC
- Anders Åslund**, Senior Associate, Carnegie Endowment for
International Peace, Washington, DC
- Alan Batchelder**, Senior Economist, US Agency for International
Development, Washington, DC
- Mario Blejer**, Professor, Chairman, Department of Economics,
The Hebrew University of Jerusalem
- Fernand Braun**, President of the Steering Committee of the IEIS,
Luxembourg
- Frank Brechling**, Professor, Department of Economics, University
of Maryland
- Charles Cadwell**, Director, Center for Institutional Reform and the
Informal Sector, University of Maryland at College Park
- Chris Clague**, Professor, Department of Economics, University of
Maryland at College Park
- Armand Clesse**, Director, Luxembourg Institute for European and
International Studies
- Christopher Coker**, Lecturer, Department of International
Relations, London School of Economics
- Richard Cooper**, Chairman of National Intelligence Council,
Washington, DC
- Peter Coughlin**, Professor, Department of Economics, University
of Maryland at College Park
- I.M. Destler**, Professor, School of Public Affairs, University of
Maryland at College Park
- Henri Etienne**, Chargé de Mission au Ministère des Affaires
Etrangères, Luxembourg
- Chris Gerrard**, Agricultural Economist, The World Bank Group,
Washington, DC
- Marshall I. Goldman**, Professor, Russian Research Center,
Harvard University, Cambridge

- Merle Goldman**, Professor, Fairbank Center for East Asian Research, Harvard University, Cambridge
- Lincoln Gordon**, Ambassador, Guest Scholar, Foreign Policy Studies Program, The Brookings Institution, Washington, DC
- Carol Graham**, Visiting Fellow, Foreign Policy Studies Program, The Brookings Institution, Washington, DC
- Stephan Haggard**, Professor, Graduate School of International Relations and Pacific Studies, University of California, San Diego
- Mario Hirsch**, Social Scientist, Luxembourg
- Stephen T. Holmes**, Professor, Departments of Political Science and Law, University of Chicago
- Antoni Kaminski**, Visiting Fellow, Woodrow Wilson International Center for Scholars, Washington, DC
- Andrei Kortunov**, Chairman, Russian Science Foundation, Moscow
- Norbert von Kunitzki**, Industrialist, Gent and Luxembourg
- Anthony Lanyi**, Deputy Director, International Monetary Fund, Washington, DC
- Frank Leiber**, Professor, Financial Engineering Institute, Polytechnic University, New York
- Seymour Martin Lipset**, Professor, The Institute of Public Policy, George Mason University, Fairfax
- William McNeill**, Professor of History Emeritus, Colebrook
- Branko Milanovic**, Policy Research Department, The World Bank, Washington, DC
- Dennis Mueller**, Professor, Center for Economic Studies, University of Vienna
- Piroska Nagy**, Senior Economist, International Monetary Fund, Washington, DC
- Joan Nelson**, Senior Associate, Overseas Development Council, Washington, DC
- Mancur Olson**, Professor, Department of Economics, University of Maryland at College Park
- Joe Oppenheimer**, Professor, Associate Chairman, Departments of Government and Politics, University of Maryland
- Michael Pillsbury**, Political Scientist, US Agency for International Development, Washington, DC

Karol Soltan, Professor, Department of Government and Politics,
University of Maryland at College Park

Piotr Swistak, Professor, Departments of Government and Politics,
University of Maryland at College Park

Naranhkiri Tith, Professor, SAIS, Johns Hopkins University,
Washington, DC

Alexander Tsipko, Visiting Fellow, Woodrow Wilson
International Center for Scholars, Washington, DC

Andrei Vernikov, Advisor to the Executive Director, International
Monetary Fund, Washington, DC

Nicholas van der Walle, Project Director for Aid Effectiveness,
Overseas Development Council, Washington, DC

Stephan Webb, Senior Economist, Latin-America Department,
The World Bank, Washington, DC

Charles Wolf, Dean, RAND Graduate School; Senior Adviser,
RAND Corporation, Santa Monica

Index of the contributions to the discussions

- Åslund, Anders*, 29-30, 53-54, 123-126, 128, 130-131
Batchelder, Alan, 17-18, 76,
Blejer, Mario, 16-17, 43-44, 76-78, 129, 155-158, 165
Braun, Fernand, 116-117
Brechling, Frank, 146-150
Clague, Chris, 31, 39-41, 54, 163
Clesse, Armand, 4, 23-24, 53, 57, 58, 60, 61, 63, 64-65, 67, 83,
91, 104, 107, 118, 120, 151, 153, 158, 163
Coker, Christopher, 14-16, 100-104, 159-161
Cooper, Richard, 46, 128, 129,
Destler, I.M., 30-31, 47, 60-61, 131-132
Etienne, Henri, 78-79, 166
Gerrard, Chris, 55-56
Goldman, Marshall, 35-36, 37, 41-42, 57-58, 59, 73-74, 87-88,
126-128
Goldman, Merle, 19-20, 36-37, 63-64, 74, 82, 107-110, 151-152,
166
Gordon, Lincoln, 7-9, 38-39, 47, 57, 66-67, 90
Graham, Carol, 28
Haggard, Stephan, 11-12, 28-29, 49-50, 98-99, 104, 137-139
Hirsch, Mario, 79-80
Holmes, Stephen T., 42, 43, 120-123
Kaminski, Antoni, 90-91, 154-155
Kortunov, Andrei, 34-35, 37-38, 96-98, 99
Von Kunitzki, Norbert, 20-23, 71-73, 82-83, 95-96, 161-162
Lanyi, Anthony, 10, 73, 118-120, 161, 165-166
Lipset, Seymour Martin, 24-27, 88-90, 132-134
McNeill, William, 4-7, 9-10, 50-51, 69-71, 83-86, 86-87
Milanovic, Branko, 80-81, 83, 100
Mueller, Dennis, 12-13, 19, 27-28, 47-48, 49, 54-55, 81-82, 105-
107, 128, 129, 141-142
Nagy, Piroska, 153-154
Nelson, Joan, 51-53, 68-69
Olson, Mancur, 3-4, 24, 42, 43, 44-46, 59-60, 74-75, 105, 129-
130, 158-159, 167
Oppenheimer, Joe, 10-11, 31-32, 48, 49, 50, 58-59, 86, 93-94,
126

- Pillsbury, Michael*, 110-113, 139-141, 163-164
Soltan, Karol, 14, 91-92, 104-105
Swistak, Piotr, 142-146, 163
Tith, Naranhkiri, 14, 41, 44, 65-66, 73-74, 113-115, 151
Tsipko, Alexandre, 32-34, 37, 92-93, 99-100, 117-118
Vernikov, Andrei, 134-137
Van der Walle, Nicholas, 18-19, 75-76
Webb, Stephan, 9, 38, 51
Wolf, Charles, 61-62, 67-68, 74, 75-76, 94-95

**Part II: Conference II, Bourglinster,
Luxembourg, 24-25 January 1997**

Session I: The “Logic of Power”

A. Clesse: The first session is entitled "The Logic of Power." We put forward a few sub-questions: a) Do "encompassing" interests use the power more responsibly than "narrow" or "special" interests do? b) Is the "stationary bandit" theory of autocracy right? c) How do self-interested majorities behave? and d) How can we obtain more "super-encompassing" majorities? So these are a few of the questions. I give the floor without further delay to Mancur Olson for introducing this session and then I hope we can go on from there, Mancur please.

M. Olson: Well, well thank you Armand. Let me first say that I expect by the end of this session to be very greatly in debt to all of you. I would like to think that I have the rationality and self-interest needed to profit from criticisms, so I have two tape-recorders here so I can take advantage of your criticisms before the Center is able to complete its transcript. So I will be listening carefully and trying very hard to learn. Armand asked me if I would say something about what happened at the last meeting and many very useful discussions and I have spent a lot of time mastering and writing down the criticisms and thinking about them and have made great plans to revise the manuscript that you have in front of you in response to those criticisms. I had expected to have the manuscript revised by now but things take longer than expected so I will make the revisions growing out of this meeting and out of the previous meeting and out of the other criticisms in the immediately coming months, indeed I would be starting on it next week and so my next few months will be devoted as it were to trying to respond to your criticisms and I very much look forward to them and don't feel any necessity to be polite or diplomatic.

A. Clesse: One more thing I forgot to mention. We are just finishing the transcripts of the April meeting and I think we will distribute it this afternoon. So everybody should get a copy of the discussions of the first meeting later on because they have not been ready yet this morning, sorry. Sorry Mancur.

M. Olson: No problem! Well so at the last meeting I felt that above all I should not be defensive and so I made it a point to say very

little and Armand has asked me to be a bit more active this time and to say a word just to introduce this 1st session. And something that Mr. Sklair said would be quite relevant here. For those of us who are economists and have trained or spent a lifetime working in the theory of markets and market failure, have a feeling that there is a very impressive body of thought accumulated over more than two centuries and we economists are very proud of this body of thought. And one of the things that seems natural to some economists anyway and certainly seems natural to me is to extend this powerful intellectual machinery to the greatest problems that we face which are usually political problems.

And so I would like to think of this manuscript of mine as part of this effort to broaden economics to deal with the problems that have arisen because economists have defined their subject too narrowly. Now looking at it from the point of view of other social sciences, it's part of a joint effort involving people from all the social science disciplines to create a unified approach to social science -- an approach where the market and analysis of the political system and of social actors is all seen in terms of certain elementary postulates or axioms. We think of the same people as acting in the market, in the voting booths, in political careers, in business careers and this unified view is an important thing and an important part of economics and in many sub-fields of political science, sociology and so on.

Now one way to think of the first topic we have here is that I have tried to use the method of economics and apply it to politics as it were in the primeval forest. To try to see the most elemental, brutal, stark implication of the invisible hand on the left, the invisible hand that influences the use of force. And so I would say that if you wanted to criticize what I have done, the harshest criticism I could imagine getting from you is that you should say the work was nicely nuanced and rich and varied. I would like to think that the purpose of it is to set out an elemental idea in the starker possible way, and so the hope is then that such a stark statement would provide a basis as time goes on for further work which would get into the nuances which of course must be dealt with before we have a finally satisfactory analysis. But it is best to proceed one at a time, so I have tried here for the stark and the

elemental to see the way that self-interest guides the use of power in the primeval environment. That is all I have on that.

A. Chilosi: First of all a comment on the difference between economists and political scientists. My idea of a political scientist is that of an economist who is dealing with much more relevant issues than economists are usually concerned with. There is a common background in social sciences, especially between economists and political scientists, namely methodological individualism, which can be relevant to both areas of research. We can see here that through the approach of methodological individualism Professor Olson is able to reach a number of conclusions that are of great relevance for political science as well.

A second point: I want to make a comment on the distinction that Professor Olson makes between the autocrat and the population. You assume that the aim of the autocrat is in some way surplus extraction from the population in order to pursue his own interest, but in many cases the interest of the autocrat probably translates itself into provision of public goods which are wanted by the population itself. Also, the preferences of the population are changed by the autocrat, so that there is probably some agreement between the aim of the autocrat and those of the population. We have got a lot of examples of this -- the power of the Soviet Union and its military might, the accumulation which was supposed to lead to the construction of socialism, and the era of abundance -- all aims that may be shared jointly by the autocrat and the population.

Of course you cannot take the preferences of the population as independent of the preferences of the autocrat. Through a number of means, the aristocrat is able to change the structural preferences of the population in such a way that what is of interest to the autocrat positively affects as a public good the utility of the population itself. Here we are referring to a situation which justified some criticisms to the methodological individualism. Very often preferences are taken as independent from the social context, but in reality there is no need not to consider the preferences of the population as part of the wide social structure, and in this respect social scientists can make a contribution.

M. Ambrosi: I would like to start off with stating that I think this idea of the stationary bandit is very fascinating and very much

thought provoking. However, my question is and I think at the beginning we should discuss this paradigm which you set out and we should ask ourselves "are there alternative paradigms?" Because I believe you want to do an encompassing somewhat at least social sciences encompassing theory coming from the economist and for this we might ask ourselves what other theories of this primeval character are we aware of. And I suggest to look at the paradigm set by the German philosopher Hegel which was very much then taken up by Alexander Kojève who wrote, I believe, a whole book on this question of master and slave. And that is quite a different picture which we have there as a primeval situation of power. The master really wanting to subjugate the slave and the slave saving his life by doing everything for the master.

Now the question which you ask is: do the underlings prefer the roaming bandit or the stationary bandit? So there you have already quite a different perspective from the power perspective which was seen by the idealist philosophy of Germany and maybe which is quite a relevant perspective. And I think, starting from the Hegelian model one can develop some aspects of criticisms and some aspects of totalitarianism which are missing in your model I believe. Anyhow from this idea of master and slave, I would criticize your paradigm in the opposite direction from Professor Chilosi. Whereas he sees a common interest between the autocrat and the population, I would start from stressing more the will of the master's mind, the intention, the later frustrated intention of the master who systematically cannot, because of the specific situation, get his will as he wants it. So my suggestion is to compare a different paradigm, for example, this master-slave paradigm.

C. Offe: I was very impressed by the metaphor of the "invisible left hand". That is a metaphor, of course, which means that whenever you try to act in your own self-interest as a ruler, you cannot but serve the public good as a consequence.

But unless you have a future-regarding attitude towards present economic dispositions the whole model does not work. You need to assume that the ruler, the bandit, the criminal whoever has a natural propensity to act in a future regarding way. Why should he? And I think the time dimension that comes up in chapter 2 is very important and much under-researched and not fully understood. We have the problem that in democracies, rulers are often said to be in-

sufficiently future-regarding. As it were, accountable governments lack solidarity with the future selves of voters. The unity of the bandits is so to speak broken down into a sequence of different bandits that succeed each other, each following short term calculation. So the whole model depends on the future regarding behavior, but that is itself something that may vary across various formations of bandits or states.

N. von Kunitzki: I think that there is one point which Mancur did not mention. If the stationary bandit has interest in not killing the people that make him live, he has one superior interest, which is to stay in power. Even if he has an interest to make everybody rich because among the rich he would be the richest: he will, of course, avoid anything that can threaten his absolute power. So if an opening of the market entails even the slightest reduction of his power over the members of this community he will have to balance these two consequences against each other. More often than not, considerations of sheer power will get the better of economic interest.

R. Skidelsky: Surely Mancur Olson has an answer to the point made by Professor Offe, when he talks about the autocrat becoming king -- the point is that a hereditary dynasty overcomes that temporal problem. A hereditary dynasty has a long term interest and that would be a normal evolution if one can begin to think of this in historical rather than abstract terms and that is also the contrast between a hereditary monarchy and a democracy which is subject to very short-term perspectives because no political leader has a real interest in what happens after he leaves the political stage, whereas monarchs do. So the only point there is that as soon as one can translate some of these very abstract categories into institutions we are familiar with, we can start making a lot of sense of them.

I. McLean: It is encouraging to hear Lord Skidelsky defending the hereditary principle on Mancur's behalf, but I wonder if the weakness of Mancur's argument is not still there in a remark which you make somewhere in chapter 2 that the probability that the eldest son is the most competent person to be the next governor is to all intents and purposes zero. The hereditary principle looks a bit weak when there is a weak successor. The hereditary principle as it

operates in the UK for instance means that the next Duke of Marlborough, who is expected to succeed quite soon and who has a very elevated position by virtue of a vote by the parliament of Queen Anne, is somebody who is in and out of jail on fraud offenses. But he will take his place on the bench next to Lord Skidelsky in the near future.

U. Preuß: Well, I would suggest to make a distinction between self-interest as the owner of property and self-interest as a ruler. To be self-interested as the owner of property means that you exclude all others from your property; in the extreme case the self-interested proprietor has no social obligations vis-à-vis the others. To be self-interested means to maximize your utility and your assets without violating any obligations vis-à-vis others; that is the very sense of property -- to exclude others. But to be self-interested as a ruler has a different meaning. Ruling is necessarily, of course, a social relation. To be a ruler is to be the owner of power, but power is a social relation which means that even if you are self-interested and if you are egotistic you have basic social obligations which you have to deliver because otherwise your power will be undermined.

Self-interest in exclusionary relations is different from self-interest in inclusionary relations or in social relations which are based on inclusion. And power is a social relation which includes others. Some kind of other-mindedness is necessarily included in the very concept of power. I think what Claus Offe said is of course correct when he says, "You may have rulers which are not future-regarding and others who are", that is the question of the individual personality of the ruler, it is not a structural question. But I would think that there is also an inherent structural tendency of rulers to be other-regarding because it is the self-interest of the rulers to be other-regarding because otherwise they could not perpetuate their power. I therefore agree with what Mr. von Kunitzki just mentioned saying that the interest of a ruler to stay in power is in itself a motive to be at least to a minimum degree other-regarding and even future-regarding. Thus we should be less pessimistic than Claus Offe was, I think.

M. Olson: Well that is a very good point but are we really sure that a dictator, that all dictators are more other-regarding than say the

owner of a store? The owner of a firm must be very sensitive to the wants of potential customers, especially since those potential customers normally have competitive firms that they can go to, by contrast you do not see the same delicacy of concern when Saddam Hussein regards his subjects or when Stalin or Hitler looked at theirs and even when one looks at less heinous leaders, one sees less than intense other-regarding attitudes I often find.

L. Sklair: A very brief point. To follow on what has just been said, what is the answer to the question: is self-interest a social relationship, not simply the self-interest of a ruler? And this of course relates back to the old debate, the old argument about methodological individualism, which goes back hundreds of years but in its modern incarnation a famous debate between Gellner and Watkins and others and Popper about the necessity of the sociological as opposed to an individual psychologist's view of society on which, I think, the Olson thesis rests. So to go back to my original point, how do you answer the question: is self-interest a social relationship and can only be understood within a network of social relationships in which the interests of the individuals are not simply given on the individual level but only to be understood in terms of either class or ethnic or gender or other sorts of relationships. And I would just make one footnote and say that it is outrageous that none of our female colleagues is here and maybe we could analyze that in terms of self-interest. I do not know enough about the Luxembourgian social structure to make any definitive comments.

A. Chilosi: Simply the preference of females are different from the preferences of males. I mean in methodological individualism gives you some instrument to deal with the action of people having definite preferences. It is just an issue of rationality and consistency of behavior. How you acquire those preferences is a matter. If you believe the preferences are conditioned by your social and personal situation in society, it does not mean that you have to throw away the methodological individualism in order to consider the different issue of how people acquire their preferences. There is no contradiction, but complementarity, according to my understanding.

L. Sklair: I would start by saying that I entirely disagree with you, I think there is a contradiction. You see you can organize this discussion in two ways. The first way is the way I think it is going, and that is to generally accept the premise and this is an example of a well-known historical trend, academic epistemological imperialism, where one academic discipline claims that its methods and its rationale, its epistemology, its view of the world is generally correct and a model that we should all follow. And if we organize the discussion in these terms then I think frankly, maybe I am not the only person who would find this less than a useful event. The second way is to challenge the basic premises. Now if you argue that there is no contradiction between what I just said and methodological individualism then I think this is just avoiding the challenge to the basic premise, so that is the first general point I want to make.

I did not quite catch your point about males and females. My point is that there are plenty of female economists and political scientists and if we had them well represented here I am absolutely certain that some of them would be defending Olson's view and some of them would be attacking Olson's view. I am talking about economists and political scientists; there are few feminist sociologists and anthropologists who would be defending your view.

So it is not just a question of gender identity but a question of socialization, a question of educational background and so on. So this is just another one of these many specific categories that have to be grappled with outside the highly abstract analysis. I have not done an analysis of this, but it would be nice to get some exegetical experts to look at your text and see, for example, how many times certain phrases like "let us suppose" come in. And that is something else that seems to me to be rather worrying: the lack of the connection between the abstract and the concrete in the analysis.

I am sorry I missed the session last night because some of these things might have been explained but I was teaching my class in sociology of development, no doubt propagating many false theses.

A. Clesse: I think we do not have to stick to any dominating paradigm or premises laid down by the author of this manuscript which is just to serve as background for discussion. But then the ambition is also to move beyond this text and these premises, and

these hypotheses, and these theses and findings and conclusions to perhaps totally new ground. I think that was the ambition last time and certainly the ambition this time too.

A. Steinherr: I must say I am a little bit lost because it seems to me obvious that when you develop a paradigm you do not want to have a descriptive instrument that explains the different facets of life that have been suggested here. I think Olson's paradigm is very clear. The point is that rulers have a self-interest and they face constraints. So one implication of the self-interest is that rules do not want to destroy too much of the assets over which they have some power, be they human skills, or be they things. Depending on what the precise conditions under which the rulership takes place looks like, one gets different results.

A. Stepan: On the question of time, I think Mancur does address the question of time a bit. I mean the roving bandits that he starts with, which passed the stage of small groups that lived together peacefully and can trade but they have no time horizon. They'll steal anything that they can get and that is their logic. So it's logical for everyone else not to hold anything that is stealable. Stationary bandits are better in that sense because they can actually earn more money if other people invest and that is the reason why they do have some time horizon. So time comes in. Stationary bandits or pure ruling, hereditary rulers can not really solve high quality succession crises with any legitimacy.

Therefore, we begin to talk about the question of democracy. And then he throws in something else which is if democracy has been around for a long time and hasn't solved the question of encompassing majorities then you have better organized minorities and then they begin to stagnate. So that is a pretty powerful set of things, but I guess as a political scientist that leaves for me the two most important questions open which are actually political questions.

One is if you need socially augmented markets, anyone who has paid any attention to Russia knows that there are markets everywhere, but there is not a socially augmented market anywhere. A tiny country like Hungary with ten million people compared to Russia with a hundred and fifty million people got twice as much investments in 1991, 1992, 1993. This is amazing.

That is because there is a somewhat socially augmented market in one place and there is just a primitive market in the other. But the more important question for us is, "How do you get encompassing majorities?" In your other works you talked about how difficult this is, but that is really at the center and you say very little about that. So in that sense it would be a disappointing book unless you can explain that a bit more. There are some paragraphs where you give a hint at what you mean, but at least I am very unconvinced so far. For example when you write, "a democracy, like the United States or Switzerland, has checks and balances, implying that more than majority is normally required for major policy changes. Then the ruling super-majority will redistribute even less income to itself and provide an even larger supply of public goods than the majority that represents the smaller fraction of society's income earning capacity." There are costs of producing supermajorities that you do not analyze, there are two major costs. One is, a society may desperately need some policy, some decisions to be made. And it is so difficult to arrive at a supermajority that that decision is not made. I mean decisions, rules -- how certain types of decision -- making situations induce an equilibrium. Well, if you desperately need change you do not need a structurally induced equilibrium that makes decisions difficult. So you have to address that question.

And then the other question: I noticed that both of these countries, the United States and Switzerland are types of federal systems. And federal systems have two principles we have to look at very, very carefully. One is, they all need upper houses and some upper houses as in Germany or in India even more so do not have great powers vis-à-vis the lower house. Some upper houses, like the US Senate has greater prerogatives on advising consent for major nominations and the most important one: confirming Higher Court judges. In Brazil the senate has fourteen areas of legislative prerogatives and the lower house only has two. So it massively over-represents the principle of territory and under-represents the principle of people. Just to put that in stark, so you have a block, if you require a major bill to be passed by both houses, let's look really at what we're talking about. One vote in Rhode Island is now worth 70 votes in California. In Brazil, it's even worse. One vote in Rurahema, which only has a 125,000 electorate, is worth 274 votes in São Paulo, and the senate is precisely the group that does

everything on the state banks. Every bank in Brazil has a state bank. So it sounds nice, super-encompassing majorities, but there is a huge amount of fundamental issues hidden there and inequalities.

A. Chilosi: The remedy against the abuses of democracy of majorities -- there is some other way besides the super-encompassing majority, namely the compromise of democratic principles with some other non-democratic kinds of institutions, which is the main characterization of liberal democracy. You just set up a number of institutions and rules which are not democratic because they constrain the majority, such as an independent judiciary, a constitutional court, an independent bank management, a rule of balancing the budget, something like that, and then you remedy the abuses which in the short term the majority can inflict on the rest of the population. This is just a different kind of democracy, one that is the opposite of populistic democracy, where all the unconstrained power is in the people and in the representative of the people, be it the president-elect or a non-constrained majority in parliament.

K.H. Paqué: Mr. Steinherr has said that as an economist, of course, we like simple models, to start from, to organize our thought and Mancur Olson clearly delivers very stark models which give the whole thing structure and that is a great accomplishment, I think. I have two remarks, or criticisms, or comments on how he proceeds about it in this first chapter.

The first is once again, the time dimension, which is lacking, or it does not get the exposure which it probably needs in this respect, and I would suggest that he may adjust the terminology and not speak of the roving or stationary bandit because the geographic mobility is not really the point today anymore. Most of our societies are not nomadic societies where we have this kind of problem, but the issue has been raised a couple of times. One might make a distinction between a life-cycle bandit and a dynastic bandit, as has been pointed out and we have excellent economic models of intertemporal allocation which can deal with that and it would be a lovely exercise to go ahead and set up a model of applying these kinds of very sophisticated modeling to the decision-making of a dictator. So, I think that would really give the

whole thing a more relevant and to the point flavor if you look at today's problems.

Now, second, I think Mancur Olson can explain a lot with his very simple model, but he can also not explain a couple of major issues, and I would say that this is in particular, the question of big structural breaks, which we observe in history, and we really do not, I at least, do not see in this kind of theory why Latin American dictators in the 1960s and 1970s did an awful job in structuring their economies and then suddenly nobody really knows why in the 1970s and then with more and a whole sequence or domino effect happened, other countries followed, partly got democracy, and at any rate, went for more price stability, more kind of market-oriented policies. Now, I really think that there is no clue in the theory which tells us why they did so. I think that we probably need something like basic ideas or some basic challenges which come from a changing world division, economic division of labor on a global scale, which come from technological changes, and what not, which really somehow forces even the dictator to realize that he can't go on like that, if he wants to get down in the history books as somebody who did reasonably good for his country. And so we observe suddenly, a Pinochet changing track or a Franco in Spain changing track and we need a theory to explain that and I think that Keynes was right in saying that economic ideas or paradigms have a very important part to play.

And a related question in this respect is of course, if we really want to build a complete model of rationality of a dictator like Stalin, the question arises, well if he was such a smart economist to set up a regressive income tax scheme so not to strangle individual effort which you suggest in other chapters of your book. So, why didn't he go for capitalism right away. After all, it may have been a nice, relatively well functioning communist system, at least compared to what happened later. But, at any rate, capitalism was obviously much more efficient and he could have squeezed out a much higher rent if he went to a more market oriented system already by the 1920s and 1930s. So apparently, he didn't, and my explanation, a tentative explanation, would be that it was outside of the paradigm in which he was living at the time. And if you look at the Western discussion at the time among intellectuals you see the same thing, central planning, and a kind of Soviet-type system was

extremely popular among intellectuals in the West as well. So we have a very important role of basic ideas hovering around in politics and academia which do play a very important role in this process of decision-making, and that is, I think, still completely left out of your theory and I would love to see it included.

N. von Kunitzki: I think I am very much to the point, because it is a point that only appeared now in the discussion, which is not normally touched on by Mancur. Now please, Mancur, you invite people to be rude, didn't you, so don't be offended by my remarks. The first point in our session today is the logic of power. Here the word epistemology was mentioned : I think that some of the most fascinating and original parts of the book of Mancur Olson are those where he applies the methods of one science to another. That may be very interesting and now don't be offended, but one can ask oneself if it is serious. If I apply the methods of medicine to astronomy, I shall certainly get some striking results, but I can ask myself whether that is serious.

In the 19th century, Mancur, there was a German philosopher, an economic philosopher, Georg Simmel, who was something like an anti-pope to Marx and who has written a book called The theory of money. I can send you a text I wrote on that book. It's in German, but I will translate it for you. Some time ago, we discussed the book in Luxembourg and I commented the aspect "Money and power". We came to the conclusion that in Simmel's opinion, the big advantage of money is that it dissolves power; it dissolves the master-slave relationship. It relativizes something that is otherwise absolutely qualitative. I'll give you one example : In old Prussia, or in the Soviet system, there were restaurants per class: for members of the party and for ordinary people. The man who was not entitled to the first type of restaurant could never go there. Now anybody who has an income of \$500 per month can afford to sleep one night in the Plaza Hotel in New York if he saves the money during three months; he can do that only once every three months, while other people, as myself, can do that every night. So the difference between us is not of quality, you see, it is only a difference in quantity.

Thus, money quantifies things, while power is a factor of quality. I shall give you an example of our capitalist economy. In the last 10 years, France changed its electoral system 3 times. First from the

proportionate system to the majority principle, then from majority to proportionate, and then again back to majority, just because the people in power wanted to stay in power and chose the system that was most convenient for them. In the capitalistic company, which I head, we have an absolute majority system. I do not know if everybody among us is familiar with company law, but the man or the company who has 50.000.1% of the company can elect 100% of the representatives of the board. But they don't. They just ignore the law. If you have 60% of the total capital in our capitalist world, in Europe, in America, you will have 60% of the representatives in the counsel and the other party that has 40% gets 40. Although the law provides otherwise, just because capitalists cannot live with quality, they must have quantity. So they quantify a law that is not about quantity but about quality. You have the majority principle and you practice proportionate representation.

So if you say that the logic of power is not quantity, then the logic of power is not economy. Now much of the charm of your approach is, of course, that you come from the other side, epistemologically, and that you apply your axioms in other domains. I think you certainly hit the point in some places, but you should, before you publish your book, perhaps go through the text and eliminate those aspects that are certainly very striking, but essentially so because you apply a method that is not applicable.

You see that in economic practice all over the world, companies immediately understood that a law that is about absolute power, tried and tested in politics, is not applicable in the economic field because it will not work.

M. Forst: To the previous point, I very much liked the example of Stalin and Russia and the question why he didn't introduce directly a market economy or why the economic performance was so poor. We said before that there is a big cost of keeping power in some situations, the cost is maybe so high that from the point of view of the autocrat keeping the power means it is impossible to have a more efficient system for wealth creation. And the difference in the sizes of countries is important. Russia is a very big country and if an autocrat has a utility function with a satisfaction level in the Simonian sense, even if the whole Russia is very miserable, if Russia would do 10 times better for him he wouldn't really be happier. He is already at his satisfactory level. And so in this sense,

this maximizing of his personal utility will not bring so well this public happiness because he is at his satisfactory level; it destroys the whole mechanism of utility maximization.

K.H. Paqué: Very briefly on this last point. This, of course, means that in a way, in his utility function, you have something like his professional standard which is not a direct function of the per capita income of the country. Then of course I would say that Mancur Olson needs to endogenous the criteria for the professional standards, and here we go again, with ideology, with general spirit of the times, the ideas around that where simply per capita income may not have had the priority at the time for whatever reason, although, if Stalin were smart, he saw the US become much richer than the Soviet Union. So it's not, I think it's not really a contradiction to my point.

A. Volodin: I have four very brief comments. The first comment somehow concerns Norbert von Kunitzki's two statements and the statements of other scholars about the motives of the ruler, the motives of the autocrat as Professor Olson puts it. From my point of view, this relationship is very simple. It is the relationship between state and civil society: the more diversified the society the more complicated the relationship and the more limitations on the actions of the ruler or the autocrat. You use the term autocracy, autocratic which is with respect to the Soviet Union the more correct term than the word totalitarian, because if we just examine all the terms in a rigorous way, totalitarianism is a political system which came to light in Germany after 1933, after a certain kind of democratic beginning. In Russia, there was no democratic set up, only a very brief period between February 17 and August 17 before the actions of General Karniel.

The second point: you write "fabulously expensive prestige projects but also the arms and wars that mapped in a more imposing domain. It took a huge part of the national incomes of Germany and the Soviet Union to satisfy the tastes of Hitler and Stalin." I think this is an oversimplification. If we look at the architecture in Berlin and Moscow, Moscow's metro, Berlin's metro are grandiose underground systems. Moscow's architecture of the 20s and 30s and Berlin's architecture are imperial architecture. It was a function of the ideology to mentally suppress

the people and at the same time to show them that they have a very large territory, a splendid and powerful empire and so on. In this case, the ideology is more important than politics and economics.

The third point relates to the relationship between state and civil society. I think that you just have separated state and civil society. For the sake of the analysis this might be all right, but if we take the German philosophy and especially Hegel's paradigm this doesn't work. Hegel understood that civil society is the domain of disorder, of egoistic interests, therefore he elaborated the formula state plus civil society. It is a dialectic kind of relationship. Marx used the opposite formula: state versus civil society, an antagonistic kind of relationship. As far as Western Europe is concerned, Hegel's formula was very efficient, especially if we look at today's social welfare state plus civil society. Everybody criticizes the social welfare state but nobody is prepared to refute it. And, Marx's formula just was very efficient in the view of a disintegrating Soviet-type of system and of the re-emerging of new democracies in Central and Eastern Europe; those contradictions between the so-called state or superstructure and the social economic basis or civil society resulted in the revolution and the disintegration of the Soviet Union.

R. Skidelsky: There are two things I'd like to say -- the permanent point will come second. The temporary point, is that obviously, one of the key things that we're going to have to talk about is the role of ideology and how it fits into the way in which power is exercised.

My permanent point goes back to the logic of power. Mancur argues that the logic of power is rather different in the case of an autocrat and a representative system, and one of the differences is that the tax take of the autocrat is likely to be higher than that of a representative system because his interest is less encompassing. Two comments I would like to make on that. The first is, I think it is wrong to talk about an autocrat, I think you say, redistributing resources to himself. An autocrat is also a transfer mechanism, always, as Adam Smith said, one stomach isn't enough to consume all one wants, and an autocrat is always redistributing to someone - his retinue, his army, clients. So the autocratic state is a transfer state, it doesn't differ typologically from a representative democracy.

The second point is this, is it true historically, that the autocrat's take was higher than that of representative institutions? The evidence is that the classical autocratic state of the 17th and 18th centuries took about 30% of national income, of course this figure is subject to huge inaccuracies. In the 19th century where you had a representative system but a less encompassing system than a democracy the state took about 10% of the national income. In the 20th century, where you have universal democracy, the state's share has gone up to about 50% in a typical developed country. Now what does this tell you about the logic of these different systems? Is it that public goods were inadequately provided under less encompassing systems or is it that democratic governments are more likely to be rent seekers than other systems?

M. Olson: I see it's a great shortcoming of the manuscript that I haven't dealt with the historical data. It is certainly the case that the kings of earlier ages took a smaller percentage of the GDP in taxes than does the modern welfare state. No two ways about that. And it might seem at the surface that this contradicts my argument, but now note that one of the things that changes over time is the capacity of the center to tax and the percentage of output of a society that exceeds the subsistence requirements of the population. So suppose we go back to the early modern absolutists of Europe, to the kings of Spain and France for example. Now, while they didn't take such a large percentage as the modern welfare state, it's clear that they approximated the revenue maximizing tax take. In other words, they weren't able to get any more out. They took as much as they could. Because there wasn't so much surplus over subsistence because their administrators weren't as good at extracting it as modern administrators were, and so on, that they just couldn't get as much as the modern welfare state can get.

Now let's look at the modern welfare state. Let's take one case that's interesting here. The United States under Reagan, it was alleged by some economic journalists associated with Reagan that US tax rates were above the revenue maximizing level and that if the US had the Kemp-Roth-Reagan tax cuts there would be an increase in tax collections, but needless to say, that didn't happen. The US and I think most of the other welfare states, while they have very high levels of taxation, in fact, are not at the revenue maximizing levels of taxation. So, my argument in the manuscript

is incomplete on this very important point, and I've got to make revisions here, yet I think the fundamental logic is not contradicted by these experiences.

R. Skidelsky: I can see that deals with the difference between the 18th and 20th centuries, but you've left out the 19th century. The 19th century seems to be important because the organizational capacity of the state has undoubtedly gone up, but its tax take has fallen as a share of GDP. Its organizational capacity has improved, but its desire for revenue has declined and this despite the fact that it has a more encompassing system than presumably that of the autocratic despot. How does that fit?

M. Olson: Well, let's think of this 19th century government that you have in mind as a representative government with a very limited franchise. Say, in Britain in 1830 perhaps 2% of the adult population is able to vote, and while it's not very systematic, it's approximately the richest 2%. Now, what's in the interest of this richest 2%. Well, it's certainly not to do what the Swedish welfare state does, to tax at very high rates and distribute to the remaining 98% or the poorest 50%; they certainly didn't want to do that and they clearly didn't do it. What it was in the interest of these people was to have a system which did not let the monarchy extract much from them and on the whole they kept the monarchy on unreasonably short rations by historical standards and to organize societies in ways which are very favorable to the well-off. And that of course is a way that brings some benefits to others, these societies with their parket systems and so on advanced and as they advanced there were of course great gains to the poor. Also, I don't want to demonize these systems, but I think it is fair to say that these countries were run in the interests of the people at the top, that is to say that they were run in the interest of high income people and thus, this doesn't fundamentally contradict my argument.

L. Sklair: This is going to be an immediate question to Mancur Olson. In terms of your explanation of individuated self-interest, how is it possible then for this phenomenal transformation in the self-interest of this 2% that lead to the 20th century? This seems to me to be always the problem of explaining things in terms of self-

interest. If you can escape from a tautological explanation I'd be really interested.

M. Olson: Well, now you will find at some points in the manuscript like when I talk about the importance of judges and juries, I say that we can't have a model where we assume individuals are always entirely self-interested. If we had such a model we would not have judges and juries which presumably makes sense only on the assumption that if we take away the incentives that they might have through a relationship they might possess with one party or another, we assume that if we take away any stake in the situation then they decide in terms of a sense of principle or what is just. So I don't have as part of my view of the world the idea that there is only self-interest but I find it an immensely useful simplifying assumption that I think for certain purposes captures the essence of certain situations.

Now, lets look at the expansion of the franchise over this period, first looking at it with naked self-interest to see if I can get through that way even though I want to add in the idea that I think that was not the whole of the story. In terms of naked self-interest, what I see as happening is increasing urbanization, bigger factories and large numbers of males. Lots of these big factories did not have women in them either, muscular males and these had some measure of power so that therefore it wasn't within the capacity of the ruling interest to ignore the particular groups like large groups of male workers. So that they asserted themselves more and more as time went on and the franchise got expanded more and more as time went on, sometimes expanded by people like Disraeli who felt that by expanding at a particular moment they get an advantage from the vote of these particular people in the next election. Now having said that, I am sure that there was also some feeling that it wasn't quite right, that various things like Christian teaching and so on also had an influence and that probably worked in the direction of broadening the franchise too.

S. Magee: I have a point on this. It seems to me from landed wealth say in the 1700s to sort of more manufacturing wealth in the 1800s, even though you had a narrow franchise as the manufactured wealth accumulated political power and special interests into the ruling system, their interest would be for generalized purchasing

power which would be for essentially a broadening of the middle class and expansion of wealth in society generally in order to sell products so it seemed to me that here the self-interest model would continue to work to show governments working in more, increasingly generalized interest to increase the wealth of society as a whole. So I think that would help to partly address this question. I have four other points but I would wait till my general time unless you want me to do them now.

A. Adonis: I think a lot has to do with following up Lord Skidelsky's point, has to do with the number of people who are licensed as bandits. It isn't just the case when you have an autocracy with one licensed bandit, the autocrat himself licenses numerous other bandits too, who have very significant powers to extract rents. The classic case in pre-modern rations was of course the Church which was a licensed bandit by monarchs, which was able to extract very significant rents over and above those which the autocrat himself extracted. And to do so, if you extend that through to the military class and the autocratic, too, I mean even if you take the eighteenth and nineteenth century, the role of sub-national bandits, regional aristocrats with their own system of laws and so on to extract was very high.

On to another point which is that in most regimes you have a coexistence, it seems to me, even in dictatorships of roaming and stationary bandits, the two are side by side. We take the Church as much more of a stationary bandit whose interests tend to be territorial in regimes where it held sway, whereas monarchs and national orders tended to be much more roaming in their interest. And following on from the very interesting point from Mr. Volodin about architecture, it seems to be no accident at all if you look at the architectural inheritance of dictatorships in the past, it tends to be the most stationary ones, particularly the Church which has left us most of their architecture whereas the more roaming bandits have left very little, they had so much less interest in seeing that there was some temporal hand over.

Just one other brief point: taking up Karl-Heinz Paqué's point about ideology, it does not seem to me to be just a question of ideology, a lot has to do with, it seems to me, with information. And there is a straight-forward relationship, it seems to me, between the degree of autocracy and the degree of information

available to autocrats. Stalin and particularly Mao, if the stuff is now coming out of China, had very little information about what their own economic strategies were doing on the ground, in terms of maximizing their own wealth. They knew very little, in Trotsky's famous denunciation of Stalin he said Stalin never visited any villages so he had very little idea what was happening with collectivization, except the hugely manufactured information that was told to him by his own minions further down. So he wasn't able to behave rationally in the most basic economic sense in that the information available to him wasn't there.

Over time, this is where the time becomes very important, over time of course it becomes abundantly clear what was happening but it can be sometimes quite long periods of time, well beyond the life of the autocrat, before it becomes available and the degree of misinformation is enormous. In Britain, we were still being told and in the West our sources were still telling us in 1990 that East Germany had the 10th largest economy measured by GNP per head in the world. This was believed, you only needed to visit the country to see that it was patent nonsense but it was still remarkably tenacious. It can take a huge length of time for information to affect rational behavior particularly with autocrats.

A. Chilosi: A point to Skidelsky. In order to evaluate the change in taxation revenues as a percent of national income that has taken place in the course of the twentieth century, you must consider the huge improvement in the technology of taxation, especially after the Second World War.

A brief point to Paqué, it is not so obvious from the strictly theoretical viewpoint, even now, that capitalism is a better system. It was even less obvious in the time of Stalin, especially under the perspective of surplus extraction. The Bolsheviks had already tried the market approach from 1921 - 1925/26, but it did not succeed in extracting the amount of surplus which they aimed for.

A final point concerning Mancur Olson: you have to take into account that force also needs consensus and that all the paraphernalia of power and the control of the public opinion are also needed in order to create and maintain consensus.

H. Szlajfer: One a short point because I plan to take more time when we start the discussion on the next part of the manuscript

concerning communism. But let me go back for a while to the concept of stationary bandits as applied to the explanation or a paradigm for the explanation of communism. The first impression I got after reading this and also some examples or illustrations which were then quoted in the next part of the manuscript is that this is somehow a very over-rational theory of a stationary bandit, with the implicit assumption as far as communism is concerned that this stationary bandit is acting in the long-term perspective. I haven't found any detailed differentiation or analysis of the behavior of the stationary bandit's conduct under communism in the short-term perspective and long term-perspective. What is assumed here, it seems to me, is a long-term perspective.

Secondly, I have a feeling that this over-rational theory leads to an easy comparison and in my opinion a misleading comparison with the self-interested majorities under democratic regimes or non-autocratic regimes. So we are then in a trap of comparing or trying to find a common denominator or common logic in the stationary bandit as defined under the more pure Stalinism or communism, and in the democracies.

The third point is that the encompassing interest also is generalized into sense. What is lacking as far as I am concerned is the concept between the encompassing interest as defined by a rational scholar and the encompassing interest as defined by a stationary bandit. In a sense one can imagine that those two interpretations are not identical. So what the Stalinist ruler would define as an encompassing interest will include, of course, the element of public goods you are speaking about, but not exclusively.

There is some residual which is probably very important and this leads me to the last point, namely, I have the feeling that probably in this concept of stationary bandits, as applied to the communist regime in its pure form, not before the sclerosis starts, is lacking the concept of trade-offs.

In defining the rationality and encompassing interest and other important items on the list, what does mean the trade-offs? The question is whether the destruction of resources or the tax basis is a part of the logic of a stationary bandit action under communism. And you quote, a reliability of the stationary bandit or Stalin as far as the debt repayments are concerned, which is in the logic that the

stationary bandit acting in the long-term interest is not going to destroy the tax basis. At the same time practically, when Stalin was trying, and he effectively did repay short-term debts, at the same time, the destructions were going on an enormous scale in terms of tax basis, in terms of people, capital and other resources in Ukraine. Millions perished at the same moment. How can one put this destruction of resources in the concept of the definition of the encompassing interest, long-term logic and so on? There is probably some trade off built in from the very beginning in the very definition of the basic term encompassing interest, the tax collection capacities or the tax collection as a main aim and source.

A. King: I was going to make a little speech about utility and the concept of utility maximization, but, as you know, the concept of utility grew up in Britain early in the nineteenth century in connection with (appropriately) the utilitarians and they, or many of them, believed in the greatest happiness of the greatest number, and I think the greatest happiness of the greatest number would be best served if I did not make my speech given the lateness of the hour.

S. Borner: I would like to come back to the model of the stationary bandit from another angle. I think we have to fit this together with the other work that you have done and I think we really are hard-pressed to explain why certain countries are richer and others poor and why certain countries grow and others don't and if I look at the empirical evidence I think in cross country regressions all kinds of political factors have been used and all kinds of political variables thrown in to explain the differences in growth rates and we really don't find much. We cannot really say that democracies are better than dictatorships or autocratic regimes and all we can say is that the dispersion in the autocratic regimes is even greater than the total, so especially for the catching up countries it is kind of puzzling that many of them are rather authoritarian and there is a danger to make a short cut in your conclusions and say what we really need is a development dictatorship because that works.

The reason why I am so intrigued by the model is not so much because of its methodological imperialism or something of that sort, but maybe you are to blame yourself by placing too much emphasis on the utility function of the ruler because, as an

economist, I would rather look at the constraints because the constraints probably make the difference rather than the utility function. And this is not a criticism, but rather my motivation to work on this subject, but you ought to get some sort of an empirical or operational handle on those constraints. Why is it that certain autocrats are more restrained? Of course there is a methodological problem of how much is self restrained and how much is really, you know, forced by external constraints like being in an open world economy. I think that the idea of an open economy is very important because that sets constraints. All rather successful autocratic systems are very open economies, so they expose themselves to the external constraints. Other things have been mentioned already -- an autocrat needs some kind of elite to support him. He needs an army. He needs police. He needs friends. And these all cost a lot of money and maybe there are more or less efficient ways to do that. So my problem is not so much the basic idea of the model or the paradigm but rather its operational side. How can you go from this very creative idea to things that you can work on empirically.

A. Volodin: You know Professor Olson, you always exploit the term market economy. Do you insist on this or maybe is it possible to apply a more complicated, a more complex term: "competitive type of economy" because you try to generalize but if you take the examples of Western Europe and new industrializing countries -- the efficient models of the Far East such as South Korea and Taiwan, I think that the combination of authoritarianism and democracy, state intervention and representation system growing in both countries, in South Korea more speedily, are very vivid. Perhaps, you can just take into consideration this reservation. Competitive type of economy, I just borrowed this concept from Michael Porter's *Competitive Advantage of Nations*.

M. Olson: I can respond to, I think answer part of your question. When you talk about places like Taiwan and South Korea and the fact that these economies have had rather more government intervention than is the norm for a very rapidly growing economy, I would suggest that when you have a new strong fresh dictatorship as there was in Taiwan under the man we used to call in the United States, "General Cash My Check" and in South Korea under

General Park, you had a highly encompassing interest, that is to say the interest of the dictator, that didn't, and you had this dictator in environments where there were essentially no special interest groups. The Japanese had been the colonial masters of Korea and Taiwan and they had not allowed organizations of Koreans and Taiwanese and so these organizations didn't succeed and they didn't basically exist. So therefore you had an environment where the encompassing interest of the dictator was exceptionally important, more important than in many other dictatorships and in many other democracies. Now it happened that the dictators after about 1960 were well advised. Chiang Kai-shek on the mainland, had not been doing well at all, but I think that Taiwan and South Korea were deeply dependent on the West and especially on the United States and were very sensitive to American advice and this meant the set of ideas they brought to bear were different than they would have otherwise have been so you had some relatively good ideas about economic policy and a capacity to intervene in a wiser way than is likely to happen in a democracy with lots of special interest and even in a dictatorship with lots of special interest.

S. Magee: I would like to expand on my point earlier with respect to Robert Skidelsky's point on the percentage of government through the centuries. I think in some cases, well there have been major factors obviously in the 20th century affecting government size, World War I, World War II, two major factors. The other is interestingly the Great Depression. There are actually a lot of industrialists who supported the Keynesian views of increasing the role of purchasing power through the use of government spending as a way of trying to restore purchasing power and getting economies back on their feet. In fact, in 1932 when Roosevelt came in he was supported by some very large multinational corporations with major interests trying to push purchasing power and trying to have more general interest. In that case you had a harmonization of general and special interest all wanting to have government have a larger share in getting power up and get the economy going.

I have five other short points. One, Lindbeck has the reference in Mancur's on page 533 of that paper of mine that just came out in Mueller's book, Professor Hardin has a paper in there as well. Lindbeck has a nice distinction between the four major types of redistribution within democracies, and if that distinction helps you

in some of this work it maybe be useful. You have a broad horizontal redistribution, like between labor and capital, fragmented horizontal ones, like between general interests and special interests, life-cycle redistribution like social security versus folks that work and vertical redistribution such as rich and poor and sometimes those distinctions might be useful.

Second, let me suggest maybe some sub-sub-titles or sub-sub-sub-titles for your book. I think this is a wonderful thing, I would call it: "The Economic Micro-Foundations of Macro Politics" -- trying to explain major different types of governments, democracies, communists, communistic type autocracies and fascist autocracies. So you essentially have another one "The Theory of Endogenous Government." The whole government itself has become endogenous which is nice for economists. We like to endogenize everything and think we can use economic factors to explain those. In some extent I think you succeeded here doing that.

Third, I love your thing in chapter one about the invisible hand on the left versus Adam Smith's invisible hand on the right. I wrote a paper in 1984 with Brock called the "Invisible Foot and the Waste of Nations" which is about lawyers and the redistributive activities lawyers do across countries, following some of your earlier ideas. You might want to think about considering use of the word "invisible arm" or some other body part. The arm is bigger like government and the hand is smaller, these little fingers and you've got micro in the economy and macro in the arms and you know Stalin flexing his muscles and so forth. It's kind of a joke I guess.

Point number four: you had the comment on ruling super majorities, redistributing less income to themselves and larger supplying of public goods. That sort of implies there that the larger the super majority, the bigger your government deficits are going to be, and I am not sure you meant that. If they are going to redistribute less income and also provide more public goods, there is an implicit assumption there might be greater deficits, at the same time I don't think that you meant that. On the other hand, you may actually have a nice endogenous theory of deficits in this book, to the extent that the three major types of governments have

different factors affecting tax takes versus government expenditure. You may actually have a nice endogenous theory of deficits there.

Finally, on monopoly, footnote 7 on page 8 you talk about monopoly by autocrats is better than having a lot of competition among autocrats. In fact, I handed you a scatter diagram which shows, I have taken in page 543 of that same paper, there is a trade-off between the number of governments per decade and GDP per capita and it fits your model, I mean, just to a "T." So your idea doesn't just apply to autocrats, lots of competition among autocrats is bad and a single autocrat is good, that same idea works across democracies. High turnover of executives among democracies generally occurs in lower per capita income countries, this is all across Europe, in advanced countries. So there is, this may not be true, but it's a wonderful, wonderful empirical piece of evidence for you.

Session II: How representative government emerges and survives

A. Clesse: We have been joined as I said already by Professor Russell Hardin who is now at Stanford, at the Center for Advanced Study in the Behavior Sciences. And also by Charles Goodhart who just arrived from the London School of Economics, Professor Ingemar Stahl, Professor of Economics at the University of Lund. Herman van Gunsteren's plane again yesterday took off but he had jumped off. Today he was on again but it did not take off, but I hope he will arrive at some point. Robert Litan had to cancel because he had a problem with his flight which is a pity. Leslie Sklair just came to me and he said, he and Alfred Stepan or Alfred Stepan alone are preparing or we're preparing a list of excellent women scholars so if we get it before noon we can send some invitations by fax and tell them to import few, at least for tomorrow. We may find a few in Luxembourg. Alfred Steinherr you don't have a good female colleague, we must do something about this quota it's a disastrous situation, I have become aware of this. Okay that is exactly the kind of chauvinistic remark we don't need in the absence ... Sorry! So would Russell Hardin be prepared

to say something perhaps on the topic of the Logic of Power and move on to representative government, how it emerges and survives eventually, and then also Anthony King would like to add something at the beginning of the session, Iain McLean and then we would see from there. So Russell Hardin please.

R. Hardin: Yes, in fact, I would turn immediately to the second topic, to the rise of representative governments or democracy and the relation of that to economic power in the society. And I would start with some discussion of the US case because in the history of democracy it is obviously a very important one. And perhaps Tony or Iain would talk a little bit about the English case historically. In the US case, one of the interesting things is that, at the time of the constitutional convention, there were arrayed several groups of people who were quite powerful. There were three groups in particular who were represented at the convention who were very powerful. One was the Agrarian plantation owners, the southerners, with slaves on their plantations. One group was financiers of various kinds, bankers and proto-industrialists, but there wasn't much industry and there weren't real cities yet. And the third was a group which today is commonly referred to as Anti-Federalists although at the time they weren't a coherent group. They represented large-scale farmers who wanted local government and didn't want a national government.

And the irony is, they refused to take part in the constitutional convention. Hence, they were left out and the country was created and they just suffered the loss. They thought they could stop it because they thought the constitutional convention was to propose merely a technical revision in the "Articles of Confederation" that would have to go back to the prior government for ratification and the state of Rhode Island would have vetoed whatever they did. So these three groups were powerful groups, anyone of whom might have got control of government at that time, but the two that did get control had opposite programs and therefore made a weak government because neither of them wanted to turn the government over to the other interest. The two programs were essentially the support of Agrarian plantation interests, by people like Jefferson, the Virginians, and the southern states. And the other was the people behind Alexander Hamilton who wanted to create a

mercantilist society in which the state would support industry and the development of industry.

Neither of these two groups could get what they wanted because they needed each other. But the one thing that they really needed was literally co-operation with the other because they needed to have large-scale markets for either of them to succeed. So there was a sense in which what they really needed was a government that prevented government from getting in the way, exchanging together, working together. And that is what they got because what they created was a national government that ended the power of the state governments. The state governments previously had interfered with trade and had imposed tariffs in trade between the states, some of the states -- New York and Rhode Island -- had engaged in cheating on the international trade front by trading with England without tariffs and then reselling the things they got from England in New Jersey or Massachusetts, which were high tariff states that tried to block goods from coming in from England.

So the constitution got rid of all of that stuff without creating a very powerful government. Now 200 years later you would say the government is quite powerful but at the time, it was remarkably weak. There is a long tradition of claims that in England and the US most people never encountered government in their lives with the exception of the postal carrier and occasionally when they got into trouble of course, and when there was war, when they were drafted or in one way or another brought into armed service. But for the most part they lived their lives without bothering with government, that is how weak government was in their time. And the reason it was a good thing in the US for economic development is that the contest over what the policy of the government would be couldn't be won by either of these groups. The result was that each of them thought they would win in the long run anyway, so they created a government that was neutral. One of them lost very badly, the other won very big. Business won of course, very big, and agrarian interests declined steadily over time for the obvious reason that the production of foodstuff is not a plausible way to grow in the context of the industrial revolution.

So the agrarian sector of the economy more or less disappeared. Today it is less than 3% of the economy. At that time it was more than 80% of the economy. But it wasn't represented 80% because

the government was very elitist in the early years. It was the plantation agrarians, not the small subsistence farmers, who were represented in the government. The fact that the government was weak then basically left the economy open to whatever the natural forces would be. And the natural forces would probably have surprised everybody had they lived long enough to see what happened. The forces were such as to cause the spectacular industrial revolution that left the kind of society they had originally started with more or less behind. And throughout that period the government was too weak to control much of anything. That was the great fortune of the government and of its organization -- that it didn't in fact exert much power in the economy. The economy ran more or less free.

It did do some things. In fact government lived off the tariff. Most governments in the world lived off the tariff, that was their main source of income. The US government lived off the tariff. Steve probably can even say more about that than I could. Well into this century, maybe about 1905, 1906 or 7, finally tariff revenues began to be less than the whole of all other revenues, domestic revenues raised for the national government. So government was small because it couldn't be very big if it was just living off the tariff from international trade in a time when international trade was not even a very large part of a total economy. And that was the beauty of this thing. The power of these two groups prevented either of them from gaining control. They needed each other however because they both wanted a large market so they combined and created a government that would wreck the governments of the states. But they did not give power to this over-arching government.

My view is that something sort of like this is going on in the European Union. Now this is a group of people to whom it would be perhaps too bold to say this. In fact, despite all the claims in England and in other nations at various times that somehow we are giving power to the European Commission, the truth of the matter is we are reducing total government power overall and giving more discretion to individuals and firms and so forth. We are taking powers away from the nations but not giving anything like that much power to the central government. That is very much like what happened in the case of the US in the early years -- the elimination

of state powers and the creation of federal power that was much smaller, much less effective in the economy than the state powers had been before that. That is an issue that comes up again in a way later, I should probably not talk about it out of context, when we talk about implications for the transition in particular, which requires weak government.

S. Magee: I don't have a direct -- I can't give you the numbers directly on, through time for the United States government tariff revenues' percentage of total revenue. Of course the income tax did not come in until what, 1914, and so in almost all countries they all start out with tariff revenue the dominant thing because that is easiest to collect. I have got some data showing that back in the 1970s, like 100 countries in duties as a percent of total government revenue and like in the mid-1970s, 88% of India's central government revenue was duty collections so it is very high in very low income countries and drops precipitously down to 2/10 of one percent in the United States at the same time. So I think that's, that's a major point there.

I had a second point, oh! With respect to interest, Russell made a very interesting point just now that never occurred to me but you can use Mancur Olson's 1965 book to explain this phenomenon of the reduction of power when you go from states up to a national power you think when you went to, from state government to national government you have this very, powerful overweening force which would then start extracting revenue and doing all these kinds of things that Americans are afraid of governments doing. But in fact when you go from a state government to a national government each of the special interests is much smaller, the free rider problem gets much more severe for lobbies. I mean if you have two major industries say in a state, each of them is very powerful in the government whereas when you go to a federal system those two industries are now a small part of this huge group all lobbying the government. So in some sense, special interests drop off relative to general interest or perhaps when you go to the top, now that just occurred to me and could be wrong but I think.

A. Steinherr: Could I perhaps ask Professor Hardin to elaborate on his idea which certainly sounds very attractive to Europeans that he sees a certain parallel in Europe with respect to the initial historic

situation in the United States because I suppose indeed the Commission has very little power but at least our conception is that the power of the national states in Europe is extremely high. And I don't see where state power is taken away. I think many of us are having the impression that one problem of the European construction is that we just add layer over layer without taking something away at the lower level, even when it makes political and economical sense. I'll just give one example: every European nation has a development policy that could really be given to the Commission. And indeed we also have the development function of the European Commission, but no nation has given up its own: What I fail to see is a withdrawal of politic powers somewhere.

R. Hardin: I might be corrected by the actual facts of the case but it seems to me in the accounts that I read in the standard press and in the few articles that show up in political science and economics journals, that in fact what has happened to a great extent in a lot of areas is that individual national regulations have been eliminated. And the new standardized regulations generally are much less controlling than were the state level or individual national level regulations. And that's exactly parallel to what happened in the United States. Before the Constitutional Convention, the government of Pennsylvania circulated to all of the other states, the twelve other states, a statement saying, they were going to eliminate their tariffs vis-à-vis the other states, in the hope that other states would reciprocate and eliminate their tariffs vis-à-vis Pennsylvania. And then they added a little clause: they hoped that everybody would do that with respect to everybody. If everybody had done that, then they wouldn't have had the Constitutional Convention, because that is what the Constitutional Convention did do, with the Commerce Clause. It eliminated the kinds of inter-state barriers to trade. And I had thought that's the main accomplishment in the European Union so far: the elimination or the reduction of these inter-state barriers to trade and so forth. So in a sense it's created a much more uniform, larger market in which the individual actors, the firms, are much freer to do whatever they please. They can now deal with Italians or Danes or whoever without going through different legal systems to do all of that.

A. Clesse: Let me remind you about some of the sub questions for this session that, whether there is a logic of power-sharing and whether democracy is essential in the long run for securing property rights and for contract enforcement. This list is of course not exhaustive but gives just a few indications and among those who had proposed some presentations on this was Silvio Borner, on opportunities and pitfalls of direct democracy and also Ulrich Preuß on the quality and role of good citizens. There was also on this session Russell Hardin and Alfred Stepan. So Silvio Borner on the point.

S. Borner: I can withdraw my other comment on direct democracy because I think this fits better into the final session where democracy can go too far and in a way start to destroy what it achieved before. So I will save time and save this for later. I think that being Swiss, it may sound strange that I am rather in favor of what Russell Hardin had said, and I think that the test is really the size of the budget. And for me, this is the crucial question: can we keep down the budget of the Union? And I think if you look at the proportions now, the ability of the union itself to tax is really very small and I would consider this to be the crucial issue because all this talk about centralization, regulation is not so vital as long as you don't really have the power to tax. I am a little more puzzled with the weak government with no power because this is already in contrast with your statement that we need a strong government and I wonder whether Professor Hardin hasn't sort of mixed up big government with powerful government. I think a small government can also be a powerful government if it limits itself to the crucial or central functions a government should have. So I would question whether it was really weak. It was small but it may have been strong in certain crucial aspects.

R. Hardin: The US government was relatively strong in some areas -- foreign affairs -- but it was very weak in the economy and continues to be moderately weak even after the 1930s changes under Roosevelt that made economic intervention a lot easier and in fact made it a lot more common thing. It's still not anything like as strong in its interventions in the economy as most of the nations that Mancur has looked at that were totalitarian in one way or another, or authoritarian. Those nations had enormous power over

the economy that has never been exercised in the US and hasn't been exercised in England -- although the mercantilist era was one in which there was a lot of intervention that was not anything like as massive as the interventions of these later nations.

I. Ståhl: Observation involving the power of the different states: if you look at those states and put them on a straight line with a share of GDP going to government as a crucial or dividing point, we will find Switzerland at the low part, where they are around 30, 35, 40%. United States comes then, and up at the top almost all countries are monarchies. If you look at it, all the monarchies are in a way parliamentary democracies. And in some cases they are superparliamentary democracies. Where there is no power-sharing whatsoever inside government, the king has just a symbolic position, so that it seems to be a very strong relationship, and I can explain that later, between the type of constitution you have and how the share of GDP that goes to government, what one could expect from that. And they...I guess that the extreme parliamentary systems have also got strong party organizations where you buy interest groups which makes enormous fine market interest groups, buy a party wholesale.

While in the United States, Congress in Washington, you have to pick senator by senator. But if you have a party-based elections and you have proportional representation it's also an important variable for these superparliamentary countries. You get many parties and you are always in, and the government is always stuck into negotiations to form a majority coalition where interest groups would operate in that type of market. So there is a very strong correlation here between the type of government you have and the share of GDP going to government and the constitution.

I have a small remark on Russell Hardin's American description here. Sweden was a rather extreme country in the sense that the government had 4 estates and weaker and weaker kings after about 1865, but it didn't become a kind of modern democracy until 1865. Actually even later, by some accounts as late as 1921. And the interesting thing is that the liberalization period of Sweden happened during the period of 4 estates but the very weak representation from the democratic point of view, very weak representation and the house nobility being very important in the liberalization policies. Many interesting things happened if you go

back really to the 19th century European constitution of history. I wouldn't say that it is against your point, it might be a little bit of the same thing.

R. Skidelsky: I'd like to deal with this point a bit further because it links up with a question in the session outline: is democracy essential for the long run for secure property rights and contract enforcement? And the answer I would have thought, is no! It may facilitate those things under some circumstances. What you need is a constitution which prohibits extensive redistribution. Now democracy doesn't guarantee that at all, in fact in some cases it might actually promote those redistributions. So you have two sources of threat to property rights. Under autocracy, the arbitrary right of the ruler to appropriate his subjects' property; under democracy, a majoritarian rule, which allows considerable property redistribution to take place via the tax system. To link that up with what Professor Hardin and also Professor Ståhl have said: the constitution seems to be the crucial element which limits the powers of government even with democratic majorities. Constitutions themselves are not sufficiently strong dams to stop the on-rush of redistribution. The two crucial variables are the nature of the constitution and the nature and the strength of the ideas supporting the constitution. If a government is limited to tariff revenues, obviously its power to redistribute is much less than if it isn't.

A. King: This follows directly from what Ingemar Ståhl and Robert Skidelsky have just said. I think that Mancur Olson would be the first to agree that in chapter 2, although he is well aware of the distinction between representative and pluralist systems of government on the one hand and democracies on the other: He tends not to make anything of that distinction in his text, and he rather treats representative governments, pluralistic systems as though they were democracies, and I think everything that's been said in the last 10 minutes suggests that that's a part of that chapter that needs to be bolstered quite considerably. After all, to take an obvious example, England in the 18th century was clearly a system with representative institutions. It was a highly pluralistic system, but it was by no stretch of the imagination, as Mancur himself said

in the previous session, a democracy, and I think that does need working on in the context of the manuscript.

M. Olson: A couple of thoughts. Of course on the last point of Tony King's, the vast differences between the oligarchical representative government of Britain just after the Glorious Revolution and the universal suffrage governments of today and similar great differences if you go back and look at other countries like the United States and Sweden that have been discussed, so these are terribly important distinctions. But there's one thing that I think that is in common to all representative governments, however small or large the franchise, and that is that if you have an ongoing representative government and it continues, election after election, however few or many vote in the election, we know that the rule of law is followed to some extent. At least the defeated party steps down.

Moreover, if it's a continuing representative government, at least some people have the freedom to criticize the government in power. So you have some kind of freedom of speech and if it goes on, the people who oppose the government must have some rights to their property and to get their contracts enforced or no one would oppose the government and the representative government would then end. So every kind of representative government, universal suffrage or very narrow suffrage, needs something like a court system to maintain itself. Now, this means that some faint measure, at least faint measure, of property rights must then exist. And I go back to the thing from Madison, "just as a man has a right to his property so a man has a property in his rights."

So those rights that are needed to prevent autocracy from emerging in a representative government or more generally in a democratic government do provide some measure of property rights, so whether you go to Sweden with the welfare state at its maximum or the United States or other countries that have been mentioned there is still some property rights and some contract enforcement in these societies and that is the source, I believe, of much of such output as these societies come forth with. It seems to me that when we talk about strong government and weak government and economic growth, that the key to the best economic performance is a strong government in the sense that it's a government that's expected to last so the property rights under

that government are expected to be secure, the contracts written under that government are expected to be enforced but it's a strong government that abstains from mucking up the economy by excessive interventionism, and it's because strong governments that are so inhibited are rare, that's why good economic performance, alas, is so rare, according to my prejudices.

R. Skidelsky: Mancur, I think there is an uncomfortable confusion between security of property rights and some property rights. By security of property rights, we mean, in a common-sense meaning of the term that the state has no power to make you involuntarily surrender that to which you have legal entitlement. A system of taxation is an involuntary contract: you are obliged to surrender some of that which you own to the state, and how much of that you are obliged to surrender is absolutely crucial to the question of how secure your property rights are. If the state takes 70% of GDP, your property rights, in my terms, are much less secure than if it takes 20 or 30%. So of course, as between a communist system where no one has any rights to private property and democratic systems in which the state takes 50, 60 or 70% of that which you are entitled to by a process that only with some complication of language can be described as voluntary, there is a difference, but it's not that large a difference.

N. von Kunitzki: I was reminded of an obvious connection between taxation and constitutionalism by the famous slogan, which you all know, "no taxation without representation". At the time about which Mr. Hardin spoke, of course, government was limited; government had little power to interfere with the economic process. But, as you all know, in our times, no taxation without representation applies to big spending government. As democracy is the name of the game, people of course do not want to pay much taxes; but on the other hand, since they are represented, they have interests which have to be satisfied by government and that requires taxation, high taxation. So, in other words, the content of that sentence has completely changed, has been reversed into the opposite: instead of low taxes it means high taxes.

Now, the problem is, can we, as I meant to hear from one of the interventions, say that democracy and constitutionalism represent different ideas, maybe even opposite ideas. I do agree that there is a

tension between democracy and constitutionalism. But I do not think that it is in any sense serious to believe that we can conceive constitutionalism as a means of getting rid of democracy. To my mind, constitutionalism means, in our times, constitutional democracy or democratic constitutionalism. So, in other words, you cannot get rid of the people if you speak about constitutionalism and that also means, I think, that you cannot save the problem by strengthening property rights. Property rights, in a way, represent a defence against popular demands on your assets. And that's the way how rights have to be conceived, of course.

I think it's an illusion to believe that constitutionalism can be associated with the idea of limited government. I think that's an old-fashioned idea which was justified in, let me say, the 18th and 19th century but not anymore in the 20th. We cannot conceive of constitutionalism as a limited government, we cannot conceive of constitutionalism as basically and essentially identified with the idea of rights. If you look at property rights, today I believe that in our societies it is not enough, in order to enjoy your rights, just to have courts and a law enforcement system, which, by the way, is very costly and which by itself requires taxes, and ever more taxes, as we see in the US. But you need more, you need an activist and interventionist government in order to secure that you, as the owner of a factory e.g., can enjoy your property. You need infrastructure, you need international relations in order to be able to sell your goods which you manufacture in the country. You need social security systems, you need a host of preconditions which have to be fulfilled in order that you can enjoy your economic rights.

So, in other words, rights as a purely negative idea of protecting oneself against other people, against popular demands which also means against taxation, is an idea which was appropriate to liberal economic doctrine and maybe sometimes, also 19th century reality. I do not know if there even was such a reality, but I am convinced that it is not appropriate to our contemporary understanding. We must conceive of a concept of constitutionalism where the electors themselves accept that beyond a certain degree of taxation they begin to damage themselves. So, in other words, constitutionalism is to become not just a mechanism to protect owners against those who are non-owners, but an order that makes people understand that they have to protect themselves against a degree of taxation

which, above a certain level, I do not know where this level may be of course -- this is a matter of a debate -- you hit a point beyond which taxation becomes self-damaging. Now that's a different understanding of constitutionalism, I believe, which means a clever design of institutions where the self-interest of the people is more or less neutralized by their compliance with rules which themselves embody, let me say, the wisdom of a good polity. That, at least, would be the ideal.

A. Steinherr: I would like to follow up on that, because as has been pointed out, property rights are only partly determined by legal dispositions, after all there are a number of stake-holders in any firm, for instance, and taxes or wage earners can have a claim to the residual earnings by the firm. If that is the case, then obviously, it's not enough to say a constitution or democracy defines property rights in a certain way. There must be something else which, in my view, is potentially more important. If you look at European democracies, the United States and the constitutions, you don't see very important differences with respect to property rights, but in reality, you see vast differences.

I have asked myself the question, how come that you have highly-developed capital markets only in the United States and the UK? Everywhere else, you don't have a real well-functioning capital market as prime allocator of resources. I think the basic difference between the US and continental European countries is in the distribution of interest groups and the stability that guarantees property rights. For instance, take a very democratic country such as France, or Italy. At times, a governmental change on the continent meant that certain types of properties were nationalized. You have no history of nationalization and denationalization in the US. And I think for me, that is the decisive explanation for the existence of a capital market apart from the size of markets that grew out of, not just of a constitution, or a democratic country, but out of a consensus on property rights and the stability over time of that consensus.

M. Olson: Well these last comments are getting into a tremendously important and difficult issue. And I think that one way to think of it is to ask the question, given the high rates of marginal taxation in Western Europe and Britain, how can these

societies remain developed? We know as economists that high rates of taxation drive a large wedge between the marginal private return and the marginal social return, and if these wedges become more than 50% as they are for many people and as they at various times have been for practically everyone in a country like Sweden, we've got a problem then of saying, then why aren't the people starving to death? Why are these developed countries? Now, I think that one can see the beginnings of an answer to this question when one looks for example at the British capital market. There are high rates of progressive taxation in Britain, much more of the GDP in Britain is taken by government, I believe, than in Indonesia, or Thailand, but why didn't the capital markets move to Indonesia or Thailand? Well, because in Britain, if you have property, you have a right to it which right is protected but of course, it's true that maybe 50+% of the income is taken by the Exchequer, but you got a secure right to the remaining say 40%, and you say, well that's not so much, but it's enough to make the capital market a really big deal in Britain, it's enough to make Britain a developed country and it's something that keeps countries like Indonesia and Thailand and communist China from getting the gains they could get from a market economy. So there are property rights that have some meaning in the developed democracies even when they have very high rates of welfare state taxation and I believe these property rights and contract enforcement are central to explaining how these countries can remain developed, in spite of the high rates of taxation.

A. Adonis: I am very tempted, Chairman, to propose that we merge the lists. But just a quick opening remark goes, just thinking through from the discussion the opening quote, "just as people have a right to their property, so also they have a property in their rights." Historically, I think it's also true that if people have a property in their rights, so also they want a right to some property, and that has been the motive force behind the relationship between governments as political and as economic redistributors over the last two centuries. The debate then becomes how much property is necessary to sustain political rights, and that debate goes in cycles across generations. One thing you can say with absolute certainty is there is no representative system in the world that does not think

that part and parcel of having a property and rights does not give a right to some property.

And if you look at it in the phases over the last century of course, as the extension of political rights went much faster than the redistribution of economic rights, the whole debate about levels of taxation became very urgent for the great bulk of new electors. Now that we've got a situation where the great bulk of electors are themselves the people who hold most of the property, then of course becomes a radically different debate. I think that explains in large part the difference between 19th and 20th century debates about levels of taxation and demands for increased welfare spending.

A. Clesse: I'm sorry, it seems that my predicament as chairman is getting worse and worse, because there's to this point, and to that point, it's a bit of a mess now, but I'll try to keep it as coherent as possible. What would make sense now? Does somebody want to react to what Andrew Adonis said? Leslie Sklair.

L. Sklair: I think this is a very sensible way of running our affairs, because I think in a way that when people are speaking to the point, it suggests that that particular point is worth going into more detail, and we'll all have to be rather more patient before we give our own manifestos.

Several of the last speakers have made this point, that we're talking as if property rights and this whole question of democracy and representative government are really mostly relevant for the rich and well-to-do. But what Andrew Adonis has just said confirmed me in the view that I was going to bring up a few points ago, that we haven't really talked about the other end of the scale. For example, do we think that representative government and democracy suit everyone and we seem to be accepting a rather bland version of what democracy. Mr. Borner, in fact, said maybe there's too much democracy in the system and I didn't want to let that pass unnoticed, that that also bears further examination.

For example, nobody has mentioned unemployment, and it seems to me that unemployment is very crucial for this whole debate because in a very real sense unemployment is a way in which government can, by its actions, withdraw people's rights to property. Now, of course, we can argue about whether people

really want the jobs, or whether the government policy really did result in the creation of the unemployment, but if you take something like the recent history of the British coal industry, I think there is an extremely strong argument that government policy did withdraw peoples' property rights in the sense that we're talking about, not legally in the narrow, legalistic framework, but in a more general social and political framework, so I'd be interested to see what we think about this.

And to, as it were, address the balance by looking at the other end of the scale, one could also develop the point, in much greater detail, which I won't do here, and look at, for example, changes in exchange rates and changes in commodity markets which, again, in a formal sense, withdraw the property rights of export crop farmers in various Third World countries. The collapse of the tin market some years ago on the London metal exchange is a good example of this.

I. Ståhl: I think you could combine some concepts from Mancur Olson's idea of long-term governments and stable governments, constitutional economic powers, so to speak, and modern finance theory where you make a distinction between risk and return, or mean and variance, and in a way, I would rather live in a society where you might have 50% average tax rate, where it's certain, than a society where you might have 35% tax rate where the tax system works as a bomber fleet, bombing away some of your property in a rather random way. So what do I mean, your concept of stability, is in a way, low variance, low risk, in the financial economic sense.

C. Goodhart: I have a slight concern about the equation of taxation with redistribution and the equation of taxation with the abolition of property rights. First of all, much taxation simply involves transfer payments; it acts as a form of insurance for pensions, health, unemployment, and in many cases, we're simply using the state as an insurance bureau, whether that is a most efficient way of running those kinds of insurance, but there is no real redistribution involved. Equally, the argument that taxation is a major way in which the state actually redistributes power and ability to make earnings, hold property and so on, assuming that it primarily does so through taxation, is not necessarily clear to me, either. The way that the state impinges on many of us is through an enormous

variety of regulations of one kind or another, who can do what, who has got to have what kind of qualifications to do this, that and the other?

And the question of regulation, the appropriate level of regulation is important, not only public regulations but also private, because most of the long-term markets which you want to set up, are, as Ronald Coase indicated, very highly regulated, indeed. It is a question of how you get your regulation and what the right kind of regulation is. And, again, Mancur, the problem that you were raising is not that taxation was redistributive, but that it had adverse efficiency problems through very high marginal tax rates, and that undoubtedly is true if you get up to the ridiculous kind of tax rates that one had on higher rate income tax. But it is not at all clear at what point the Laffer curve tends to turn downwards. Where the top rates of income tax are 40% or so, it is not clear that that kind of marginal tax rate, or even 50%, that the effect on the willingness to work, willingness to take risks are actually that serious. If you talk about 80 or 90% you're right, but at the kind of rates that most of us, most countries now have, the empirical evidence is not that clear. You can't, you cannot find a significant cross-country regression, relating countries with higher tax rates to lower growth, if you take the western world.

And finally, on property rights, the country which I think is most difficult and most interesting is China, and the area in China which recently has been growing most rapidly are the township and village enterprises, the TVEs, and the identification of who owns what in the TVEs is at the very least muddled, fuzzy and indistinct. So you have certainly got that example of very rapid growth with no clear, stable, well-defined property rights at all.

M. Ambrosi: I think this discussion about taxes is rather intriguing. The basic question behind it seems to me to be: do you live more securely as far as you and your property is concerned if you pay a tax quota of, say 20% of your income but you have the roaming bandits, the robbers, the hold-ups on the streets, with which you might have to cope because the police simply does not work properly. Or do you live better in this respect if you give more of your regular income to the government and in return it gives you more security as far as the normal ways of life are concerned. In any case, in this discussion the correct comparison seems to me to

be between two societies with an identical level of personal security for their citizens in going about their normal activities of life and then you compare the tax rates. But you cannot compare, say, the tax rate in 1996 of South Africa with the tax rate of Sweden and then make any inferences about well-being from that. An important reason why that would not be sensible is because in the case of being in Johannesburg in South Africa you would have to use a considerable part of your resources if you wanted to have the same level of personal security for yourself and for your family which you would enjoy in Sweden without having to hire bodyguards, build fences and carry weapons.

But while I have the micro I would like also to speak from the position of the permanent list and to comment on the attempts to explain the absence of capital markets in large parts of the world. Could you explain that from income flows? I don't believe that that is the case, i.e. income flows do not necessarily have anything to do with the location of the capital markets. You see that, of course, with the emergence of the off-shore trading places which came about in the 60s. It is by no means certain whether that could not happen again, namely that you have some sort of exotic island -- or country -- where transactions in capital are done more cheaply and more clandestinely and that potentially markets could go there, not bearing much relation to the income flows which you find at the place where the capital market is going on.

K.H. Paqué: A very brief remark which ties back to what you said and Alfred Steinherr said about capital markets. I would warn a little bit against taking the structure and the characteristics of capital market of different countries as an indicator of the security of property rights. If you look at a country like Germany that has a very weak capital markets from the Anglo-American sense but nevertheless this did not really prevent the country from channeling savings into investment. If you look at the 1950s for instance, there was virtually no real capital market in Germany and everything went through the banking systems, and through retained earnings in firms which simply had very high profits and reinvested them and this did not really prevent growth from being at a spectacularly high level and I think that is true for other countries as well. It looks to me as if capital markets have a very strong historic tendency of traditional ways of organization and that the Anglo-

American way is simply different with a much stronger emphasis on shareholdership than in most continental European countries. So it's more, to a large extent, a matter of organization and not only of the security of property rights.

The second point I wanted to make has been made already, and I'll be very brief on that, is taxation. Taxation, the level of taxation is a very inadequate measure of the extent of expropriation, implicit expropriation of the people, and the example of Sweden is fairly nice, you know, if other countries, let's say, southern European countries or the United States would have put up the level of taxation for a long time as Sweden has done, everybody would have stopped working. But this didn't happen in Sweden. Why didn't it happen? We have to ask the question and that is simply because apparently the Swedish welfare state offers something in return, it may not be the most efficient way. The costs may have increased dramatically over the last 2 or 3 decades and so one has to think about reforming it, but certainly there was a strong element of getting something in return and this kind of implicit contract is realized by the people, recognized by the people, so I think that one should be extremely careful in using taxation, in particular because there are a lot of insurance elements involved. But that has been said, so I stop here.

A. Clesse: Iain McLean, you have waited patiently a long time, whether it's a short or long list, it's your turn now.

I. McLean: My property rights to a place in the permanent list seem to be a rapidly wasting asset. However, I don't claim any intellectual property rights over the points that I would have made that have been well made by others, so I can be shorter than I would have been. I wanted to talk about the section beginning page 35 of the manuscript, along lines which I have already written to Mancur because it seems to me that what he says here melds very well with a literature on credible and incredible threats which is quite big in political economy at the moment. First of all, to take the example that is here, and then to comment on one which isn't. The example which is in your manuscript is about limited government in northern Italy. Can I draw to comment to Mancur's attention, a paper by Marjorie Lines in *Theory and Decision* 1986, which talks about voting procedures for the election of the Doge of

Venice. What she shows is that the famous elaboration of the choice procedure had simply the effect that not only did nobody know who would be elected as the next Doge, but nobody knew who would be the electors. The effect of that is a sort of limited government device and similar effects to those listed in the text.

We return again to the contrast between the therefore, apparently weak because limited government of northern Italy and the apparently strong because autocratic government of among, many others, southern Italy of the time, and then we ask ourselves whether that has any resonance for Italy today. Compare then 18th century Britain and France and join that to the comparison which Russell Hardin introduced this session with for 18th century United States. France had a strong state, Britain had a weak state, in the conventional ways of measuring them. That is to say, the first was a royal autocracy, the second had the devices of limited government that were introduced in order to prevent royal autocracies in 1688 and onwards. The strong state could not make credible commitments not to expropriate property rights, the weak state could. The strong state defaulted frequently in international capital markets and therefore faced a higher rate of interest than the weak state. The strong state collapsed in 1789, largely through fiscal crisis; it could not afford having coming in on the American side in the American Revolution because most of its own property rights, or many of its own property rights in taxation it had subcontracted to tax farmers and it was unable to raise any more.

So, when we've been talking about strong and weak states we have felt some sense of paradox, but I think there is no real paradox, that there is a context in which a weak state is strong and this has come up in the discussion from time to time. A weak state may be better able to raise money in international capital markets. A weak state may be able to make credible promises not to intervene in some area where if it needs the co-operation of some social groups it needs to make that promise.

So finally, briefly, I want to say: can this be moved on to a 20th century context. It seems to me that it can. We've had the discussion about the different economic performance or the different taxation performance of federal and unitary states, now it's not quite clear where this points if only because as many people

have said the level of marginal taxation is not a good measure of oppression.

However, referring for instance to work being done by my colleague, Steward Wood, in the 1960s, an argument can be made that Germany was a strong state because it was weak and Britain was a weak state because it was strong, that Britain now is like France in the 18th century as Ingemar Ståhl was the first to remind us, that having a doctrine of parliamentary sovereignty which in effect means executive sovereignty most of the time, it can't make credible promises whereas Germany with its federal structure can. Germany, therefore, was able to introduce, when this was fashionable, effective corporatist arrangements, Britain was not. So that seems to me to be a way of extending an argument about strong and weak states when you are being careful about what it is to be strong and what it is to be weak through from the 18th to the 19th to the 20th century.

G. Reinesch: I only wanted to make one small point in relation to taxation, and it was already made by the speaker who intervened before me. You should not only look at the level of taxation, one should also look at what is done with the taxes. And I even could imagine from a given starting point an increase in taxes. If the taxes are well used this could give an impetus to growth. I could even imagine an endogenous growth theory model where through an increase in taxes I could get an impetus in the growth level of an economy, because if you use these taxes for public goods where there are positive externalities and so on that could be a very good thing for an economy. So one has to look not only at the level of taxes, but also at what are we doing with the taxes, and then our discussion is complete.

A. Chilosi: I want to make a comment on what Mancur Olson said before about introducing capital markets in Indonesia. I think you have too much faith in institutions. If you take British institutions and you import them in Indonesia, you don't certainly achieve the same results because you don't have the administrative capability, you don't have the human capital, you don't have experience in the working of those institutions. Under primitive or extraordinary circumstances, when you don't have the means or the ability to tax otherwise, so your tax rate would be weighted by the probability of

confiscation. Of course, it is inefficient, because it introduces a heavy risk premium on assets subject to confiscation. But an autocratic rule that leads to random confiscation could be better than no autocratic rule, no confiscation, no provision of public goods, no continuity of the state.

S. Magee: This is a comment on a couple of earlier points, and I think it comes down to Mancur's desire in his book to probably have some empirical correlates with property rights and let me suggest some. Charles Goodhart mentioned that there was no correlation, that he has seen, between tax rates and growth and he would be better put maybe to make this point, but I have seen something in the *Economist* or somewhere where there was a scatter on capital gains tax rates which would be somewhat closer to property, certainly financial property and growth rates that did show the kind of expected relationship. I don't know if that was a legitimate study or if it was representative, but there's capital gains tax rates.

Second observation, financial assets denominated in dollars moved directly with the US inflation rate, so when the US inflation became high, or variable, people didn't trust the dollar anymore as a measure of value and would switch out into Deutschmark and to some extent, the Yen. So there are also good measures, Mancur, you could put on a diagram, probably, relating the variance of inflation rates, over say a 30-year period across countries, plotted against GDP per capita or something. Obviously these two variables are highly inter-dependent and causation would be a problem, but nevertheless, I think that might be a good measure of sort of property rights in some general sense.

A. Stepan: Russell Hardin, if I heard you correctly, your remark was that one of the great things that emerged from the meeting in Philadelphia in 1767 was weak government. I just want to stress, that if you looked at some parts of the world, big parts of the world right now, and I am sure you would probably agree, Africa, post-Soviet, at least 12 of the 15 post-Soviet countries, and much of Latin America, we just have to insist again, if you don't have a state, and many of those countries don't, then there is no democracy. If you don't have a state there may be innate human rights, but you do not have protectable human rights. If there is no

state, there is no rule of law, and if there is no rule of law, in Mancur's statement, people may possess a bone but they don't have property. Property is legally defined and it comes from a state.

If there is no state, then there is no possibility of a socially augmented market which was the necessary left hand of Mancur's work. It may start with methodological individualism, but it ends up with the necessity of a state. And here there is just much of the world right now that has nothing like the institution and a set of norms we might want to call appropriate for a state. The state isn't really coextensive with the borders in most parts of the world. For example Zaire, if there is a state at all it is probably only in the home of Mobuto. Nigeria a state? It is a real question, or even places such as Argentina or Brazil. Actually, the state is shrinking in the sense that it has been accessible for citizens, and here I think Andrew Adonis' point is pertinent that there are really multiple regimes, there may be one or many stationary bandits. But in many of the areas, especially with the misinterpretation of neoliberalism, there just seems to be nobody, there is no effective state. More and more in the areas of Argentina, right now, there seems to be no state. It's amazing to see how there is a certain shrinking of the effectiveness of the state, and I want to ask Mancur again, I think that it would be a great contribution if your book could talk a bit more about how you really get an effective state because that's crucial for much of the world of today.

Then, the question, is why democracies emerge, you give the reason that it relates to equal dispersion of power and you quote Robert Dahl and Tatu Vanhanen. Take a look, it supports it, but it's rather nice if we're going to have a dialogue between political scientists and economists that this is the central argument of a very important article by Danquith Rostow in Comparative Politics in 1970. It's called the "Dynamic Version of the Emergence of Democracy" where he argues and goes through a number of cases that in the first instance, major power brokers could not destroy one another. They were trying to destroy one another but they couldn't. And then, there's a long agonizing feeling that I can't destroy you but the cost of continuing war is extremely high, and then democracy with a set of institutions and regulating devices that makes our world more predictable emerges as a sort of second best option. And over time, a democracy emerges from this. A rule of

law normally emerges before a democracy but this conflict orientation and power balance I think is important. When I did my own work with Juan Linz on the emergence of democracy in about 17 different countries decades after reading Danquith Rostow I was struck that something like this came up again. In Spain, in the 5 years before the death of Franco, much of the left really wanted a radical rupture with the system. But they felt they didn't have enough power to really pull it off. Much of the right wanted a continuation, but they felt they didn't have enough power. The settlement, the second best settlement for both of them was democracy.

In many other cases, something like democracy emerges out of cracks in the state apparatus. I think too much of our theoretical reference goes into looking at civil society against the state. In many cases, the power equilibrium is to some extent within the state apparatus itself. In Poland, for example, it was one fraction of the state that began to reach down and to mobilize some groups. This then created a crack in the state apparatus.

The same happened in the case of Brazil in 1973 when the opening really started when a crack appeared in the state apparatus. There hadn't been a strike in about 8 years, the economy was growing at about 9% and there was no apparent need for the opening. However, at that time, the militarist government came to the conclusion that the intelligence service was becoming relatively autonomous and institutionally threatening. So they started to support a free press and to embrace the liberation theology cardinals. This created a dialectic of regime and concession which turned into a societal conquest.

And I talked to Alexandre Yakolew in early 1989 in Russia and he had an amazingly similar assessment for the Soviet Union. He said, "this system is going to be nasty unless we can change the status quo. We cannot change the status quo, when the Nomenclatura is far too high, far too strong and so we're going to surprise them, we're going to have regional elections and this is going to really shake them." Well it did, it shook up the whole system, but it's a complex dynamic.

Session III: The sources of wealth

A. Clesse: The third session is about the sources of wealth and among others on the Coase Theorem. You have talked widely about it, yesterday evening in your lecture, Mancur and, in general, about transaction costs.

M. Olson: Well, I want to make sure that I don't repeat things that some of you would have heard last night, but it might be useful to point out that the insight, the very valuable insight that Ronald Coase had has been, as I did indicate last night, extended and exalted by other people into a proposition that I claim as false. And the basic idea is that whenever you have an inefficient situation, it is argued by the people who advocate the Coase Theorem, whenever you have an inefficient situation, it must be the case that by switching to some efficient outcome, there's more output, so therefore, everybody could be made better off, so therefore, if there are no costs of transacting, rational people would necessarily make any situation an efficient one. Therefore, transactions costs are the only thing that keep us from being in a perfectly efficient society.

Well, not only does that lead to the absurdities talked about last night, but it also has some other problems, and one of them, you might best see this way. This is not in the manuscript and I didn't mention it last night so that's why I mention it now. Let's suppose that we have some good that is just worth producing, some public good, let's say it's a levy that prevents a river from flooding on some houses. Suppose this levy is just worth building for five households, let's say. Well, if transactions costs are zero then these five would get just a small gain from building it, a small net gain, well then they will build it because they like that small net gain. Now, suppose that several more people should move behind this levy, say another half dozen people should build houses behind the levy, and let's say the levy has to be spent on, maintained each year.

Well then, each of the householders knows that a subset of the others would be better off even if they paid the whole cost of this public good so therefore, one of the strategies is to try to free ride. That is to say, if it's the case that some good is worth more than it costs and enough more than it costs so that a subset of the

beneficiaries would be better off if they provided it and picked up the whole bill themselves, then it means one of the things that rational people can do is try to free ride. But of course, everyone can try to free ride, and one of the possibilities is that the good is not provided at all. Another possibility is that you get an endless cycle of proposals and counter-proposals. Essentially you get what Avinash Dixit and I, who are writing an article on this, call "a game without a proper core." The traditional concept of the core is not exactly sufficient here. So, we claim that this Coase Theorem is wrong and that therefore, it's not enough just to assume that prosperity will be brought to a society merely because of the desire for gain of the people in it.

C. Goodhart: This is just a very short reaction to what Mancur said. I'm interested in tying this up with the discussions this morning, whether Mancur believes that representative government provides a means of reducing the number of effective players in reaching a decision, in order to overcome the problem of having so many people involved that the solution doesn't have a core, plus a follow-up to that same question, which is that, technically, it is now probably possible to have fully participative democracy in the sense that everybody could vote on everything by simply being linked up through the Internet. That would suggest to me that, if you see the problem of reaching collective decisions as being that too many people make it virtually impossible, (except for one who wants to be a free rider), that your own position would be that you would not advocate a full democracy, a full participative democracy, that you think that a representative democracy because it enables decisions to be reached more efficiently would be actually preferable, is that correct?

M. Olson: Yes, I think that is correct, that it seems to me to be to be quite a mistake to suppose that there's an improvement in governance arrangements to have everyone vote on everything and that's true not only for some of the reasons you mention but also true because of a rational ignorance of the typical voter which ignorance will be even greater if he and she has to vote on a huge number of issues than if they have to vote only rarely. So I definitely think that we need representative government. Now, the number in an average parliament or legislature, though, is a number

that in itself can generate a game without a core. So representative government wouldn't necessarily eliminate, and wouldn't usually eliminate the problem of the lack of a proper core.

C. Goodhart: But not if there were political parties, if you had a party framework, and the effective number of decision-makers were really fairly small within any parliament.

M. Olson: Yes, certainly for a two-party system, indisputably in that case.

A. Chilosi: But when you have got so many voters, you eliminate strategic voting, providing of course you vote about the majority, not about unanimity. The problem with strategic voting in the Olson example was that you require unanimity, but here you need the majority and you have a lot of participants, so the situation is rather different.

I. McLean: A question for clarification. Mancur, are you simply saying that what makes the Coase Theorem break down is that sometimes there are bargains among more than two parties and in those bargains free riding is possible which I'm clear is one of the things you were saying yesterday and again today, or are you saying more than that?

M. Olson: It's true that you have to have two or more victims of an external diseconomy or two or more beneficiaries of an external economy or public good for the problem to arise. But, I would add the further proposition that the many economists and others who've been saying that we can understand and analyze all aspects of social and political life by looking at transactions costs, that these people are wrong. Now, there are of course, transactions costs, and they are important, so I'm not saying these things shouldn't be studied and aren't of some importance. But in addition to the transactions costs, there are these problems that are specific to public goods and collective action, and these problems are not solved even if transactions costs are zero, so they're very serious problems then, and of course I like to call them collective action problems, but they could be labeled in other ways. And these problems can never be understood just in terms, or even mainly in terms, of transactions costs, and this has been gotten wrong by lots of very famous people and I think that when Avinash Dixit and I

get our paper out that no one will continue along that line any more.

K.H. Paqué: Only a follow up to this, maybe just a technical remark of an economist. I somehow, so far thought that the basic problem, when you read in a standard textbook about the Coase Theorem, then you get at the end almost a summary of the assumptions of the theorem, and one of the assumptions is it's basically a small number game of persons involved. So as soon as you move to a larger number game then you get exactly the problems you have been describing. Now, I perfectly agree with you that a lot of people just talk about transaction costs and apparently mean this kind of problem, but this is then a semantic issue whether you call the infinite reconstruction which you would need and renegotiation among these many people if you summarize that under the terms transaction costs, which I think is not a particularly good idea to do, or whether you find a different name for it, but the fact itself, or the theoretical proposition has been long around as far as I can see. That the Coase Theorem is just a valuable, theoretical statement with an empirical content and some normative conclusions to be drawn from it for matters of social coordination in a small number game. That's so far my understanding of it at least.

M. Olson: Coase, of course, focused mostly on small numbers. But the people who have stated the Coase Theorem, even the great George Stiegler, said that if transaction costs are zero it applies irrespective of the number. You see the idea is that they always recognized that with larger numbers you'd have more transactions costs, so that in practice, it was harder to get deals among larger numbers but if transaction costs were zero, irrespective of the number, they believed you'd get efficiency. And that's wrong and it's wrong because the very thing that makes Coase's initial article so attractive is the idea that he shows that the mother wit of the parties, by dealing, the mother wit of the rancher and the grain farmer who make a deal about a fence, this rationality showing mutually advantageous deals resulting is what's attractive about it, but the same rationality means that it doesn't work for collective action or a public good problem and it doesn't work even with zero transaction costs. You cannot maintain the concept of rationality

for the parties involved and get the Coase Theorem to go through, but if you leave the rationality of the parties involved out, Coase's original insight loses its attractiveness.

M. Forst: I hope I am to the point, and in fact I want to agree with Mancur, if the thing you disagree with is this very tautological approach of Coase and even more of Williamson, this approach, "whatever you see must be efficient", explains everything and nothing. Maybe everybody would even agree that this is not a very operational and helpful approach to conclude propositions, to make practical, better policy and in this perspective the Coase Theorem is just a reference point. It's a zero point in the best of worlds, to which with better policies, with better governments, with better institutions we should try to go in this direction, but we do not reach it automatically. I would agree just by common sense.

S. Borner: I shall try to throw a stone into the pond. I think it's a kind of a misconception to start with Coase for this type of problem. I think I remember having read an article that he wrote much later where he himself stated that he had never intended any such consequences at all. So I think we should instead go back to the fundamental question. We need a state, and if we have a state we have the problem of power wherever it comes from. And the fundamental question in my view is where do we go from here. So, if you don't mind, I think it's kind of a waste of time to ask why we need a state and why we need a monopoly of power because, I think, this is quite obvious, it would even be obvious for Coase himself.

K.H. Paqué: I would completely agree with this conclusion, but maybe for somewhat different reasons. The different reason would be that I think it is a semantic issue. Some people are inclined to summarize everything in the term transaction costs, and this is not particularly helpful, and I think, implicitly, you criticize that and I perfectly go with that. But the fact that you describe, that in a large number game there will be no social optimum by private efforts of coordinating and private negotiations that's I think perfectly the middle of the mainstream of economic thinking, of textbook public finance thinking. One should really not worry about it anyhow, and just go ahead and think about whether you call it transaction costs

or coordination failure in a large number game, we have to do something about it and then we are at the core of the matter.

I. Ståhl: Let me make a connection with the discussion we had at the last session, and let me start then with a kind of unanimity rule, which is very close in a way to the Coase concept of a transaction costs free world. If there were no decision costs, if there were no transaction costs, unanimity rule would in a way be an ideal rule. Of course, there might be some discussions about how the original distribution of rights, how property rights appeared. If you now introduce transaction costs as Coase did for the market, -- Coase was not very interested in the political field -- well then we have to make some approximations, if you have a constructivistic approach. We must have some representation groups, they can be election of parliaments in different ways, by proportionality or in singular vote or singular representations or districts.

There are a lot of possible representation groups. There might be representation by regions or representation by social groups, corporations. There are an enormous amount of different distributions if we go through history. There must be a decision rule, and the decision rule might be plurality, majority, super-majority as it is in the Finnish parliament. These can be combined in any number of different ways and there might also be a definition of the domain of the political decision process, for example, which in most cases is formulated as individual freedoms or rights, which means that we are going back to the veto of an unanimity rule for certain cases like freedom of speech.

So we could organize most of what is constitutional economics in those terms and my point is, there is one type of decision, for example representation is made by regional representation, by proportionality, the decision rule is simple majority, and the domain as in the Swedish case is defined as a domain for political decision-making, then the way to reach unanimity, if you have accepted these second rules and built up all the political organizations, the whole political system, then the transaction costs to go back to some type of unanimity which is the Coasean idea is extremely expensive, because then you have formed all the structure of the political systems, so the industrial organization on the political field is defined by the constitutional rule, and then, it's almost meaningless, then to go back to unanimity, because all these

rules, representation rules, decision rules, definition of domain were introduced to decrease transaction costs. So it's kind of a very complicated thing here if you want to get back to some type of Coasean bargaining situation where you have solved the bargaining problem by creating an industrial structure in the political field by these different types of rules. And of course you could say that most constitutions, even the Soviet constitution could be written in this way, giving enormous power to a single party. I would get back to that when we get back to the later chapters.

R. Skidelsky: I must say I agree very much with what Professor Borner said earlier about the doubtful relevance of the Coase Theorem to the central issue which Mancur has raised, which is why some states perform badly and others perform well, in terms of economic growth. It can be used to establish a case for government intervention if transaction costs are impossibly high. There are other cases for government intervention in terms of public goods, externalities, unemployment, and so on. The problem is, how do we ensure that government interventions augment and do not harm the process of wealth creation. Ib'n Kaldun, the Arab scholar who lived in 1377 had something opposite to say: "it should be known that at the beginning of a dynasty taxation yields a large revenue from small assessments. At the end of the dynasty, taxation yields a small revenue from large assessments." He goes on to describe a cycle of disintegration which precedes in five stages. First of all, government expenditure has a continual tendency to grow faster than the tax base. Secondly, the kinds of government expenditure he describes have no beneficial effects on the tax base. Thirdly, as a consequence of the growth of expenditure in relation to the tax base, the government has to resort to taxes which have adverse supply side effects. Fourthly, the economy's commercial and therefore taxable activity declines. And fifthly, the tension between a falling level of taxable economic activity and of growing government expenditure produces a structural economic crisis which destroys the legitimacy of the dynasty or the government which produced it.

This kind of thesis was really the basis for the attempts to limit the role of the state in the 19th century to the provision of pure public goods. Now, I think the interesting question is, how far can a state go in its intervention before it creates the supply side

problems which then demand ever increasing interventions? If you take a modern example, how far is the current crisis of welfare states exogenous -- the result of adverse external circumstances that have impinged on the welfare systems -- or how far is it the product of moral hazard, which is magnified by the systems themselves? I would have thought this is an important question to be talking about, and I'm not sure how Coase's Theorem leads you to it in any obvious way, because we've got the point of agreeing that government is necessary, but now surely we ought to be discussing what kinds of government intervention are good for economic well-being or what are bad, and what causes government intervention to be one or the other.

L. Sklair: Well, I'm not sure whether we do all agree what it means to say that governments in any meaningful sense of the word are necessary. Silvio Bortol said it's obvious that we need a state. Now is the state the same as the government? This seems to me to be an important question. Now you introduced this idea... you meant government, so we'll leave the state out of it, we're not talking about the state are we? Various people have discussed the conceptual coherence of the term "the state", it's very convenient, but in example after example after example, when we're talking about the state, what we really mean are different groups, with different capacities, and it's not at all clear that for the analysis of any sovereign area that there is an effective state in terms of the general consensus argued this morning.

You introduced this by saying that this is the fundamental question. It's obvious that we need a government or a state. Now, I would say that by saying that you are ignoring what in my view is the real fundamental point, which goes right back to Mancur Olson's point this morning. I think what Olson is really talking about, his starting building-block, is really a theory of human nature. And that's the only way in which you can interpret such a statement that self-interest guides the use of power. This is a theory of human nature, and it's a well documented theory of human nature which goes right back through the history of political philosophy. And, if we all accept that this is the theory of human nature from which we are formulating our arguments, then so be it, but is certainly no universal consensus that this is the theory of human nature which best explains what happens in the world and it

is certainly a theory of human nature that I would find difficult to reconcile with what goes on in the world.

M. Olson: Well, just on the last point. I opened the manuscript, I believe, with the idea that it would be useful to start with a criminal metaphor, and I think I justified that criminal metaphor by saying that it would enable us to think about the selfish, rational selfish use of power we are accustomed to think of thieves using their power selfishly. And that it would have the second advantage that it would remind us that we're abstracting from the richness and complexity of human nature. So it isn't the case that we're arguing here, I think, about human nature. I personally wouldn't believe that all human beings are always completely selfish. I don't think I've ever been lost and come on a local who wouldn't be willing to give me directions for free. People are injured on the street and everyone helps. Of course there are non-self-interested elements in human nature, and these can be very important and by my own argument they are decisive. Society recognizes they are decisive when society uses judges and juries, i.e. groups set up not to have any stake in the matter and to make decisions on the basis of some sense of law or principle. And so, I think we're not talking about human nature. What at least I'm trying to do is show the value of taking things one at a time, of looking separately at the implications of rational self-interest, seeing that these are not so simple, and that when you thought these things through, then you understand things you couldn't have understood if you thought of everything all at once.

C. Goodhart: In the first round of interest in growth theory in the 1960s, and more recently with the endogenous growth theory, as developed by Romer, one takes the different factors of production and technical progress, and you put them through a mathematical economic mincing machine. In virtually none of those models is much importance given to the key institutions within a country, particularly the political institutions. And I think that Mancur is absolutely right in bringing our attention back to the fact that what really matters in many cases, in most cases, is not the underlying factors of production. Capital is easily provided, quickly provided, particularly now with the development of capital markets all over the world. Human beings are, with some limited exceptions, pretty

much the same, so that we can get our human capital and our actual capital up to scratch. Many of the world's richest economies have lousy land. If you think of Hong Kong, Singapore, they have no land worthy of the name. So what's really making the difference? And the difference in some large cases is political institutions. Mancur, I don't think that you referenced Bob Barro's Robins' lectures last year, I don't even know if you know about them, because Bob has some quite interesting empirical results about differential growth rates. And the factors that clearly make an enormous difference are the education of the labor force, the number of years educated, and the political stability as measured by one of these indices of that, I think there's an American institution that develops some. You have minus 3 if you have murdered your president, and -2 if there has been a rebellion and +1 if there are regular or good parliamentary meetings. For each positive step change in that index, you get one and a half percent improvement in your growth rate.

A. Clesse: I am grateful to Charles Goodhart for bringing, hopefully, the discussion back to the basics. This session is on the sources of wealth; perhaps there is a gap between this general title and the sub-questions which are very specific and we shouldn't focus too much on the Coase Theorem, but continue in the wake of what Charles Goodhart did, if that is possible, for another 10, 15 minutes.

I. Ståhl: Let me just go back finally to the Coase Theorem. I think it is possible to formulate a corresponding theorem and put some political science to the Coase Theorem. The Coase Theorem is something about: "the property rights do not matter for the actual outcome of the game". And the corresponding theorem in political science would be: "constitutions do not matter". Of course constitutions do align rights over the whole field and of course it is not true, and Coase would never think about this theorem as being true for the political field. And my point is that constitutional rules are partly introduced to decrease transaction costs in the political system. Second they will also create new types of transaction costs, if you have developed a party system, for example, with a single communist party in power, the transaction costs to change for example, the planning and the steel industry, those costs are

enormous to organize in your group against military and the steel industry complex. That is impossible. So constitutions really matter and they are both a solution to transaction cost in a way and they create new transaction costs of changing the rules of the game.

S. Borner: I just challenge the view that the implication of Coase is that property rights do not matter. I think that the implication is that it does not matter to whom you allocate them but they have to be clearly defined and allocated. And it doesn't matter whether the rancher has the property right or the other guy has it but they have to be defined and protected. Isn't that so?

G. Reinesch: I want to make the same point, namely that it is not right to say, I think property rights do not matter. It matters that there are property rights, but it does not matter whom they are allocated to.

I. Ståhl: That's of course right. It's a matter of the distribution of property rights that does not matter. They have to be defined and what I mean now here is that the constitution is a definition of property rights in the political system. And the corresponding Coase Theorem would then be: it doesn't matter which constitution you have because you can always start bargaining to get a Wicksell-Lindahl solution to take that as an example. And that's not true because transaction costs are extremely high and my point is that constitutions are there a) to decrease transaction costs in the political system; b) they create new types of transaction costs because the industrial structure, political parties, interest groups, incentives for politicians are created by the constitutions. And that's why some systems differ from other systems when it comes to growth if we are going back to Goodhart's discussion.

U. Preuß: Well directly to this point, just one sentence. I want to remind you that property rights according to modern constitutions are subject to statutory definition. That means their content is dependent upon shifting majorities in the parliament, so there is no such thing like a constitutional definition of property rights which then are immune against majorities. Therefore I think the whole basis of the theorem erodes.

A. Chilosi: Olson was talking about the Coase Theorem, and was hinting that by enlarging the number of participants you introduce a

strategic decision-making. But even if you have only two participants there is always the discussion about who gets the surplus. How to distribute the surplus, this can block the decision even without transaction costs.

A. King: Can I just make a point about transaction costs which may or may not be frivolous -- and my economist elders and betters will tell me whether it's frivolous or not. One part is simply that transaction costs for many individuals are transaction benefits. I am very struck by the large number of people I know for whom the conduct of transactions is intrinsically a good, something to be desired and to be enjoyed. In contrast, I am somebody for whom transactions are an immense cost. I don't think of "transaction costs", I think of hassle, and I spend most of my life engaging in hassle-avoidance. And I take it that one possible useful function of the state under some circumstances is to benefit transaction-cost avoiders, hassle avoiders by providing a service that may at some level be inferior but which at another level saves an awful lot of us a great deal of time.

I had an accident last week that was minor in itself but spectacular in its consequences. I looked as though I had just murdered Macduff in Macbeth; there was blood all over the place. I was very struck by the fact that under that rather bizarre social institution, the British National Health Service, an ambulance appeared within about 3 minutes, I went to the hospital, I was sewn up and I was sent home to wash the blood off (they didn't provide that service). But what was striking to me was that at no stage did anybody fill in any form, did anybody chose amongst different health care providers. It just happened, and I appeared to be none the worse for wear. Transaction costs can be enormous, and one of the most, to repeat, useful functions of the state may be to benefit those of us who do not much enjoy engaging in transactions by relieving us of the need to think about some of the kinds of things we would need to think about in the absence of the state. Oscar Wilde is alleged to have said, that "socialism is a wonderful idea but it would take up too many evenings." When I spend time with market-oriented economists I arrive at the conclusion that free markets are a wonderful idea, too, but they can take up far too many evenings.

K.H. Paqué: I really leave Coase now on the side. I want to get back to growth and what I say basically takes off from what Charles Goodhart said about the issue of political stability. When we talk about international comparisons of growth I think we should look very carefully at the evidence which has been accumulated in hundreds of studies in the last few years using basically the same data set and introducing a whole bunch of variables. And, of course, as an economist one may start querying about the marginal productivity of this kind of research after a couple of years, but anyhow, there are some very robust, some basic robust results from that. And I try to summarize some of the results because I think they are extremely relevant for our discussion.

The first is: standard accumulation variables like physical capital, *human capital* do play an important part in economic development, especially for the so-called developing part of the world, that is for the poorer countries. We find in all these regressions that physical capital, a highly-endogenous variable, whatever it is and how it is influenced, plays a major part. Second, human capital, a little bit less robust but on the whole a very important part. So I would not quite agree in the way you formulated it before that, you know it is not a problem of accumulating human capital, it is a big problem you have to have an educational system which really does some basic services and this you cannot take for granted if you look at African countries and you take the secondary school enrollment or primary school enrollment rates, you get very large numbers but they are basically wrong. Any specialist in the state will tell you because nobody actually goes to school but officials provide these numbers and tell you they go to school but they don't. So getting people to school is a big issue in economic development. So I would guess that there is really something in these numbers that you need education and that is what economic historians tell me all the time that all those countries that took off in the 19th century had at the time or started to accumulate at that time human capital and had fairly good, by the standards of that time, educational systems and that's again the story we have in South Korea. Whatever happened to this country else, industrial policy, the openness off the economy, they had a fairly good educational system and in particular they succeeded in

educating the female part of the labor force which is extremely important to get the next generation educated and that proves to be for the kind of inter-generational transmission of human capital a necessary condition.

Now second, with this goes *physical capital* accumulation, we do not have to talk about this, since it is almost trivial. If you want to get rich you have to have good machinery and have good capital equipment. It is a highly endogenous variable but anyhow you have to have it. If you take it away, if you take all the capital in Germany or Luxembourg from one day to another productivity would be very low. So it is a basic fact that you need this kind of accumulation. Now, but it is obviously not enough, the Soviet Union had high saving rates, whatever, all these mechanical conditions were fulfilled but it did not grow. Why not?

Well, in the case of the Soviet Union, and that is the third point, you have to have something, something like an open economy which gets signals from outside which roughly translate it into signals inside the economy, which are basically correct from the international division of labor point of view, and if this does not work, if you have water-tight protection, all your accumulation does not really help. So we have another rough necessary condition for growth that is a roughly open economy. You can fiddle around a little bit with that and the kind of mercantilist policies that the Eastern Asian countries pursued were certainly not liberal in any purist sense of the word, but they did not fundamentally distort the signals from world markets and in particular they did not put up water-tight protection against capital goods as imports which are extremely important for the transfer of technology which you need in order to accumulate your human capital in a kind of endogenous process.

And then comes something like a summary set of a fourth condition, that is political stability. You cannot afford to have civil wars in the country as it happens in Africa all the time. You have to have a certain security of property rights otherwise things won't wash.

So now we have a set of conditions which I think fairly well describe the growth process in the developing world and if you look at the countries which grew then you can fit them into these slots and you will see that they basically fulfill all these conditions.

Now, this is the story, very stylized story, for the developing world. If you look at the developed parts of the world things are a little bit more difficult and much more, in a sense, much more interesting, because, to describe the difference for instance in growth performance in the last hundred years between the United Kingdom and Germany, it's not so easy. You cannot simply look at physical capital accumulation because it's so highly endogenous. You cannot look at human capital accumulation because schools are not much worse in Britain. The university system is certainly better, and there is something more subtle going on on the plant level, something -- apprenticeship system and this kind of thing -- which you really cannot measure in the raw data you get from international organizations. So political stability, well clearly, Britain has the edge in this respect, and open economy, Britain was always an open economy, with no protectionist leanings whatsoever. So the story then becomes one, in my view, in which you have to have a much more sophisticated theory of let's say the absorption of knowledge and the transformation of knowledge on the plant level into productivity. Then you may have good educational systems like Britain and the United States on the top at least, and you nevertheless, don't get the broad growth, you don't run away from other countries in the growth league because other things are lacking, and these are not simply the kind of variables you put in the production function.

And now I think, that's where you come in with your theories, because it's really getting interesting then. Because then we have to ask the question, how can the government contribute to this kind of social capital, very difficult to define and to grasp quantitatively, but which allows this kind of transmission of knowledge. And, second, how can we prevent organized interests from stifling this process? So this is really the point where, I think, we have to dig deeper and the whole ideas you set up have the highest marginal productivity in a sense.

R. Skidelsky: Could I make an intervention on that point? I must say that I think that what you just said was true, but it doesn't get you anywhere at all. You mention four conditions for good growth performance, the accumulation of physical capital, the accumulation of human capital, political stability and open economies. Well the Soviet Union had three of those. What it

lacked was an open economy, and it could accumulate, it could grow up to a certain point, it could industrialize up to 1950s standards and then it stagnated. So what does this mountain of econometric evidence that you extolled, these 200 or 300 studies, what has it delivered? It has delivered a mouse. And finally, you say well, of course, government has to find a way of making sure that the transmission of knowledge goes beyond an elite group and affects the whole population. Yes, we have to do that, how do we actually do it?

Does it mean that you come back finally to that oldest of fallacies, which is that the government emerges as the last actor in the whole process? Anything you can't find any other way of doing, the government finally has to find a way of doing it. Political stability must be a red herring here. I mean, we've had systems that have been immensely stable politically. What system was more stable than the Soviet Union? Yegor Gaidar used to say that nothing ever changed, production functions never changed, the political system, everything was very predictable, and it was a stagnant society. So I just want to put in my dissenting voice, because I think there is a great danger that a false kind of consensus will emerge.

C. Offe: First of all I welcome that we seem to have returned to the original question of this session, namely the sources of wealth. I think that the last two speakers have raised a controversy on which I want very much to take the side of Robert Skidelsky from a slightly more sociological point, if I may say so. Now, the argument is this. We know that not the same factors are responsible for economic growth and performance in highly-developed economies than those that are responsible for such performance in the developing countries. That is agreed upon. We learned yesterday that this is very likely. There is a lot of sociological, historical, economic and political science research looking at these non-economic pre-conditions or contributing factors to economic performance. And I think this is a major inter-disciplinary focus of attention and for good reason.

But then if you try to measure these and pin down these factors, it turns out to be remarkably difficult to do that in conceptual as well as empirical terms. One group of scholars focuses on the institutions that guide the transmission of cognitive variables, such

as information, innovation and research and knowledge and training and so forth. Others look at moral variables, primary education, community values, a lot of research on religious values versus secularism, and so on. Then you look at institutional settings, such as the media, education, local autonomy, labor relations, all play some role. One disappointing result you get is that very different institutional settings make for similar levels of economic performance and similar patterns make for different results. So it's not easy to attach any causal value to any of these institutional patterns. Suppose that we have resolved these very tricky and thorny questions.

And then comes the, if I may say so, praxeological problem, which is the following. Institutions are not easily designed. It is not clear who is in charge unless it is the government, which is in charge of adopting, introducing, or implementing institutional patterns, even if you knew which institutional patterns. This is the problem with the metaphor that is so widely used, symptomatically widely used now, namely "social capital". It suggests that like in physical capital or financial capital you can take it and invest it somewhere, put it in place so that it can work, but that is not the case with all the "soft" variables that are held responsible for economic performance. Because it is the very nature of institutions that they are not adopted for the sake of their consequences only. Instead, they are intrinsically valued, and not instrumentally applied in order to produce something. If you apply them instrumentally or copy them, you may end up with quite different results compared to those we observe in the original setting.

I think the instrumental language that we use concerning institutions and institutional patterns is very misleading. Institutions, if they are being introduced for instrumental purposes, may lead to something very different from what they originally performed, and the outcome-oriented adoption of such things as a free market economy or bankruptcy law or party competition or parliamentary government or whatever, is something that is not really copying the original, as many people in eastern Europe have found out. If you adopt something, copy something in a different situation, the result is very different from the original.

Also, institutions are not easy to disaggregate. What is the institution: a university, or its curriculum, or its examination rules,

or the higher education system? These are part of each other, and they are all in a contest with other institutions, decision-making rights and property rights and political rights, and so institutions are not easily isolated from their institutional context. The success that we observe in some institutional contexts is due not to particular institutions such as property rights, or industrial relations, but an entire setting of institutions, an entire landscape of different institutions with their unknown and irreproducible synergetic effects.

K.H. Paqué: I would like to come back to what Professor Skidelsky said. But first of all I have to apologize for some sloppy wording. With an open economy, I do not only mean open, vis-à-vis the outside world, it also means roughly inside a market economy which basically reacts to market signals from within and outside. So, when you give the example of the Soviet Union, that of course means, that in fact, "only" one of the four conditions was not fulfilled, but a very important one, you need basically, a market economy to grow. Otherwise you grow in a fashion which I once called "shabby growth." You end up growing under a watertight curtain of protection and that brings you some progress but it cannot really compare with the result of the world. Now, if you look at the situation of eastern European countries today, you will realize that they had to go through a period of very sharp obsolescence of capital when they opened up their economies, and that is exactly because their kind of accumulation was done in a protectionist system, but, and that's the important thing, they do not start at zero, they still have their human capital, and they still have a relatively stable political systems, Russia with a couple of problems, but with Poland, the Czech Republic, Hungary you can roughly say that. So they don't start where, let's say, an average central African country starts from, and so the variable "human capital" is apparently important and I expect way above average growth in Eastern Europe in the next 20 to 30 years. So that these countries will end up in income slots which are much higher than those of Central African countries.

In other words, the regressions and results which I have been hinting at may be a little simplistic, but they do tell, for developing countries at least, a very important story, that all these four variables are necessary conditions. You cannot just leave out one

and if you leave out one you either end up in a situation like the Soviet Union that is when you have a closed economy and no market or you end up in the African situation, no schooling, no human capital, and political instability, or you end up in a Latin American situation with the kind of populist regimes for a long time, so you have plenty of nice examples around the world, where one of the conditions was not fulfilled and the countries did not appropriately grow.

Now, what I wanted to say is, that these studies, as simplistic as they may be, and with a lot of trouble to quantify these variables, do contain a non-trivial message for developing countries, and what I wanted to say in addition is, that this message does not carry over so easily to the other parts of the world. So we have to differentiate the question, really look at these two different problems, but really to discard these studies as another piece of positivistic exercise is I think not the right way of really digesting the first really substantial set of empirical evidence that we really have got in a systematic effort of cross-country comparisons, that is really a non-trivial result of a whole research area in the last few years, and I think it has important implications. At least we know now that something has to be done about these factors. Of course, not saying that the only deus ex machina who can save the world is the government, of course, I'm not just saying that the government can improve these matters, one has to think very thoroughly about the institutional frameworks which the government may only set the basis for and others have to fill them which are growth-conducive in industrialized countries. So it's not, let's say, an old fashioned call for the government to take over and solve the problems.

Session IV: The decay of prosperity in societies with freedom of organization

A. Clesse: We'll continue our discussion with the decay of prosperity in societies with freedom of organization. Among the sub-questions, how do free societies age and also whether special interest groups prey upon rationally ignorant electorates, and then

about Euro-sclerosis. The last question, which is perhaps the more exciting one is whether Europe is falling behind Asia or North America but we are certainly not the only ones asking this question. Would you, Mancur, like to say a few words for the beginning, or is there somebody else? A number of people said they would like to say something on this, Silvio Horner, Stephen Magee, Norbert von Kunitzki, Michael Ambrosi. These participants have given some titles, others, Russell Hardin, Charles Goodhart, Claus Offe and Robert Skidelsky have just informed us that they would like to intervene.

M. Olson: I have one thought that might provoke some dissent. And that is, and it's a thought that relates just to Europe as a somewhat more elaborate story that would have to be told with respect to the United States and its regional variation and so on. But suppose we compare Europe now with the Europe of the late 60s. Now, when it comes to market distortions, I think most economists studying Europe would agree that market distortions, government and cartelistic distortions of markets have increased since the 1960s except of course with the notable exception of freeing up of international trade through the European Union and multi-lateral trade agreements of an international kind. Now, suppose we were to try to explain the, I think, generally agreed upon increase of market distortions in Europe since the 1960s in ideological grounds. We'd say, was it the case that the Europe of the 1960s was very free market oriented and now everyone in Europe is socialist, has there been a great shift to the left since the 1960s in Europe? I don't think so. If you look at the late 1960s you see practically rebellion in France, you look at Sweden, you see the social democrats solidly in control. You look at Germany, the Social Democratic Party was in power part of the time, for a long while now it's just been the Christian Democrats and their center party partners.

So as I look at Europe, I see in Europe a shift in thinking away from socialism and toward free markets, a reduction in radicalism, that this may be even have speeded up after the collapse of communism. But now you look at the wedge between the private marginal return on the marginal social return to labor and investment, it seems to be going up. We look at all sorts of distortions that lead to unemployment and they are going up.

There's a secular increase in unemployment in Europe and I can't explain it in terms of ideology. If ideology is relevant, it has worked in exactly the opposite direction. So of course, I toss out for your consideration the idea that some of the processes that I talked about in *The Rise and Decline of Nations* are operating in Europe and they are operating so that countries like Germany that had extremely dynamic economies in periods like the 1950s are now suffering some measure of sclerosis. That a country like France which was really quite an efficient country in the 1960s is now in some trouble. That continental Europe in general is doing much less well than it did in the 50s and 60s and that the reason for the deterioration is not any ideological shift to the left, it is rather the kinds of things that I've been talking about. That's just to provoke argument.

A. Clesse: I didn't follow everything, but you mentioned France and Germany, you didn't mention others.

M. Olson: I mentioned Sweden also.

A. Clesse: Yes, Sweden, what about the other cases, for example the Netherlands which is doing extremely well in the last 2 or 3 years compared to how it did 5 years ago, or even more so 15 years ago when people were talking about the "Dutch Disease". That's of course the more striking example, but Sweden seems to be recovering quite well, and Norway is doing well, but for other reasons than the Netherlands, of course, totally different reasons. You didn't mention Italy, but Alberto Chilosi may say something about this.

A. Chilosi: It doesn't seem to me that in the 60s the market was less regulated, rather it was much more so, especially in international economic relations

I. McLean: I don't know if it's a problem with the world or with the structure of Mancur's book but I felt that chapter 5 of the book, and the subject of this session, fitted quite uncomfortably with the rest and that in the lead-up to that point of the book, we get told a rather whiggish story about the advantages of limited government of a regime which protects long run property rights and so on. And on the whole that interpretation of history has had a fairly favorable run at this conference and then suddenly in chapter 5, of course it is

not unfamiliar to those of us who know The Rise and Decline of Nations, but suddenly it seems to go into reverse.

Now, Mancur may say that's the way things are and that it is good to have the institutions of limited government, property rights and so on up to a point and then you get a heart-shaped relationship where at some point the same set of institutions go into decline. I would like to know, whether that is indeed what Mancur thinks. If it is what he thinks, one of the things that would follow, seems to follow from that is that the sort of regression analysis that some of us have been talking about, around this table today is bound to fail unless it is done rather sophisticatedly because there is not a linear relationship between the existence of certain institutions and economic growth. The analysis is going to have to deal with U-shaped results and it is going to have to work interactively or with some other complication. But I am mostly left with the uneasy feeling that there is not only a problem with the world, there is also a problem with the organization of the book in the relation of this chapter to the rest.

K.H. Paqué: Very briefly and that is very similar to what Mr. Chilosi said already, but I don't talk about Italy, I talk about Germany. The extent of regulation in Germany has decreased in the last 25 years. There is no evidence whatsoever that there was an increase. You can go through all branches of economic activity, in particular the service sector where there has been deregulation. Transport was heavily regulated in Germany, it has been virtually deregulated since then. Of course it was not a voluntary process. It was due to the EU pressure and they had to adjust but they did adjust. Second, retail trade, not much has happened but as far as something happened, a famous German clothing house went in the direction of liberalization. Third, financial markets and banking, there have been reforms in the direction of deregulation. Fourth, telecommunications, the German postal monopoly has been virtually dissolved and there has been quite a bit of competition introduced, not enough I would say with my liberal inclinations but clearly in that direction. Fifth, the labor market, despite all you read in the newspaper, it is heavily regulated but as far as changes have occurred in the 1980s, they were in the direction of deregulation. So it is simply not true that in the late 60s, early 70s, the German

economy was less regulated than it is today. There have been injected quite a bit of elements of competition.

So then the question of course becomes why do we have the problems especially in the labor markets? I would agree with what was said before about the catching up issue but I leave that aside for the moment. I would put the main emphasis on what I sometimes call "passive rigidity" instead of "active sclerosis" as your story is told. "Passive rigidity" means that you have a lot of regulation, a regulated system, this kind of corporatist system we have in Germany and in other countries of Europe as well and it adjusts in the direction of more flexibility but does not adjust fast enough and the shock, the negative shocks which have hit this system had long-term hysterical effects in this sense. And when you watch carefully how the unemployment rate increased it was in two or three big steps so it's basically a story of hysteria after a negative shock.

Now, the conclusion would simply be that the system that we have in Germany and in other countries as well is a kind of "Good Weather" system which works nicely if you have no shocks at all or positive shocks. But if you have a sequence of negative shocks it has very long drawn out negative effects and the countries which have been relatively successful, the Netherlands, we mentioned, one may mention by the standard, its own standards of the past, one may mention Britain, where things have improved a little bit. And the United States has been more flexible as well, there you see standards of comparison and where there is enough flexibility for the system to digest the shocks although of course with other kinds of problems. You have the wage differentiation of the United States which is a concern to many people, which is a kind of mirror image to the unemployment problem in Europe. So but the basic story is, I think, if you take a stylized picture of the facts is not increasing regulation but slightly decreasing regulation at a slow path and negative shocks.

M. Ambrosi: If we look at the European situation, I think we should remember that there was this 1992 program for completing the internal market. It was connected with very many liberalizing measures: for financial services, for public procurement, for all sorts of other services like transport services. It is indeed astonishing that in view of all these liberalizing phenomena we

have this slackening of growth. You might remember that a prediction at that time was that, together with all these liberalizations, we will have over the medium time of about six years an increase in economic growth by about six percent. Thus we should have had one percent more growth every year and we should have had about one million more jobs every year for about six years. But what then really happened was that we did not have an increase but a decline in employment, and that we did not have very much positive growth, either.

You could say of course: if we had not had that "1992 program" the situation now would be even worse. Nevertheless, I do not think that that is very convincing, because there seems to be some basic misconception about exactly how "liberalizing the market" will boost the economy. If we look at Germany and at Great Britain, we find two countries where over more than a decade economic policies were pursued which were sold to the public as "supply side" policies which should boost the economies. But I do not find that we had many fruits which could be associated with that type of policy. We really must work at explaining these deficient results.

Let me give one suggestion in this connection, addressing the point why there was a wide-spread disillusionment with traditional expansionist economic policies in Europe in the first place. One possible reason why expansionist economic policies were perceived as not working anymore could be exactly because of these liberalizing effects. A supposedly expansionistic demand policy effectuated at the time of the beginning 1980s in France did not have the expected stabilizing effects on France but on Germany where much of the newly generated demand went due to the liberal access of French demand to the German market. Thanks to France's action, Germany increased her current account surplus to the detriment of France which had not only to shoulder the budget deficit but also the ensuing current account deficit. In this type of scenario it seems quite plausible that eventually governments consider it as being not a wise policy to pursue expansionist economic measures, as long as they have reason to believe that it is not their citizens who profit from that action but their neighbors or the wider world. In this sense I do think that there are indeed some fundamental issues with great relevance for economic policy

formation in that which you have addressed in your previous publications.

A. Clesse: Karl-Heinz Paqué, is sitting very near to me and smiling rather sarcastically and in an incredulous way; reading your face it was saying, this is naive and not very...

K.H. Paqué: This is not a very polite interpretation of what I... of my face.

A. Clesse: Okay then Karl-Heinz Paqué, very briefly you should perhaps express for the forum what your smile indicated.

K.H. Paqué: The smile indicated when you were talking, apparently talking about the Checcini Report, I think, that all serious economists took that as a piece of advertising. You know if you really look at the methodology how it was done, you can't take it seriously and nobody did actually. Of course it was sold in the public and it was sold for politicians for the liberal cause but it was simply to expect in a fully integrated area where you have already free trade that you get scale economies, it was based on scale economies, the whole thing. In the magnitude which we calculated it sounded to anybody with a little bit feeling for econometric numbers not really convincing, so nobody took that seriously.

A. Clesse: Andrew Tyrie has arrived. He is at the EBRD (European Bank of Reconstruction and Development), a senior Economist at the Department. So Andrew Tyrie please.

A. Tyrie: Well, I am not really going to talk much about Eastern Europe, maybe I would save that for tomorrow. But, perhaps drawing more on the experience I had when I was in the UK Treasury in the 1980s. I thought it was a little bit mean of the last speaker to suggest that Britain had improved a bit. Britain's growth record in the 1970s and most in the 1960s was at half the European average. In the 1980s and 1990s taken together it is just being around the European average. Now one might say that that is not so great but that is really quite a dramatic shift and improvement in performance. I think that the 4/5 doesn't fit into the Mancur Olson picture very well. The 1960s was characterized by import controls, price controls, exchange controls, very heavy labor regulation, and rising public expenditure every year and very high levels of government intervention in many aspects of the economy. In the

1980s, 1990s we have seen the removal of most of those controls and a stabilization, in fact, I think a downward trend in the long run public expenditure level in the UK as a result of a series of very tough measures taken in the 1980s which are still having their effect.

I think it is likely that the rest of Europe will have to go down this road, for several reasons. And in fact I think that we have already had allusions to some of these points by speakers in respect to the German economy. This is because globalization of markets is going to make borrowing very difficult and is going to make it increasingly difficult to service high levels of debt. And at the same time, international competition is going to grow for the location of industry. Economic activity and also labor has become more footloose. As a result of this there is increased competition to provide lower tax levels and therefore, countries will find themselves forced to reduce taxes, forced to make themselves more attractive in order to retain economic activity. The net effect of both of these, if you have restriction on borrowing and taxation, is, of course, that spending comes down. So government intervention, direct interventions through control of the public purse, will also fall. We have already had from several speakers a long description, a reasonably long description of how countries have deregulated and privatized, at least to some degree. I think the whole of Europe is responding to this potential sclerosis.

I'll end just by posing a few questions. Do we think that Europe is really responding quickly enough to be able to retain competitiveness in the face of what is going on in other parts of the world? For example, in Asia. I am very struck by the fact that Hong Kong, still just a colony of the UK, has an income per capita something like 25% higher than UK, which is just a little bit lower than Germany's and it is rising very fast and will overtake Germany within a few years. People can argue about these points and remarks, or bring in purchasing power parity arguments to argue that GDP is slightly lower than it may appear, I won't try to preempt those points, but take them over dinner. However you do the numbers, several parts of Asia are rising and growing at high rates and not in the long run just in some form of catch-up, but potentially I think in some form of overtake.

The second question I want to pose which is related to the first is "How much do we think that the European Union as a set of institutions has to contribute to trying to make sure we don't fall behind?" Here I think the picture is very mixed. We have the social chapter on the one hand, I think holding us back. On the other hand, for example, we have quite high levels of financial market deregulation taking place in Europe. We have the free internal movement of labor, capital, goods, really the near completion of the internal market in many sectors set against still quite high levels and rather sophisticated forms of protection, being exercised by the European Union. I am very struck and I'll end on this point, working where I do now, at the European Bank, by the incredibly sophisticated methods which the European Union uses to keep out crucial goods in key areas from the markets which we in the Bank are trying to build up in Eastern Europe. The ones that are customarily cited are some of the most important: agricultural, textiles, steel. An example is the selective and highly sophisticated use of anti-dumping duties. So the picture is mixed, I just leave you with those two questions "Are we doing enough?" and as countries at the European level "Do we think that the European Union has a net beneficial or net retarding effect on transition?

I. Ståhl: Concerning the Swedish experience of growth between 1879 and 1970, there was an annual growth rate between 2.5 and 2.7%, including five years of First World War, Second World War and the crisis in the 1930s, and that was pretty high. It has been declining heavily since then and the interesting thing, and this, I guess has something to do with Mancur Olson's interest groups explanations. All employment that has occurred, increase in employment since 1970 has been in the public sector. So in the industrial sector or the market sector employment has been constant, and there can only be some interest group explanation for that. I mean it is impossible that the public goods aspect would have increased that much because so little of the public sector is actually providing public goods. It is mostly private goods paid by the tax payers. So I think that is very important.

Another thing which I want to stress here is the general problem of employment. Sweden has now got up to the general European levels of unemployment and that means somewhere between 8 and 20%, it does not matter how you are measuring it, it depends on the

exact definition, but it is the level. And it's at least three times or four times the level of the United States with a much more regulated labor market. And I think the economists there are a little bit to blame. Look how we treat labor market and employment problems in our textbooks. It is still very much of the Keynesian stuff. We demand insufficient demand etc., etc. or there is very much of an old, old traditional, the institutional style going into some details of trade unions etc. Very seldom we will see trade unions treated and presented as cartels. And if you look to the European Union there is a rather tough competition policy, but the labor market is completely excluded. It is rather the opposite here, it is a cartel promotion, the directives on the employment side given by the European Union are cartel promoting, supporting cartels in the labor market. I think, it's a kind of moral problem for the economists how we treat this type of interest groups. The largest interest organization, or the group of interests, I mean it is a bundle of interest groups. I think Mancur was a little bit wrong when he wrote about Sweden, because the Swedish trade union is not that all-encompassing, it is a lot of fight between different trade unions which can explain that. And we are extremely soft when we treat these types of interest groups. We don't talk about them as cartels promoting very narrow interest for what could be called the insiders. And as I indicated, I think, economists have a moral problem here in how we treat this type of interest group. I think it is not much better with the political scientists because they think it is very nice to have the trade unions in support, I mean take the Putnam presentation of organizations of this type. They are very seldom presented as they should be, cartel groups trying to destroy markets and hence possibilities for other persons.

Mancur's idea, I think, was very important in discussing the interest group aspect of the unemployment problem. But this has not been accepted yet as conventional wisdom in the economic field.

N. von Kunitzki: Mancur Olson has mentioned yesterday and today again that in order to be successful, a society has to have collective rather than individual action. He also maintained that this collective action implies two steps, viz. that collectivity has to give itself institutions in the first place, and that secondly, they then have to function. This functioning implies negotiation in order to arrive at a

common decision, negotiations which imply a cost to society. This cost is visible when expressed in lawyers' fees, so the money is not necessarily lost for everybody, but there can be no doubt that time and other resources that society has to spend on negotiations represent cost. So the rules and the institutions that enforce these rules have a cost to society -- the only exception being the pure rule of law. This implies that, if everybody spontaneously and out of his free will follow the rules to the letter, there is no cost in negotiation, and efficiency of the collectivity is maximized.

Mancur's book rightly stresses this point, but also states that to have 100% consensus is practically impossible in any community, an optimum never attained because you always have "free riders".

On the other hand, there seems to be unanimity that, in order to maximize efficiency, a country has to be open to influences from outside, to admit ideas, people, goods and services from other communities in order to maximize general well-being and its own efficiency.

Now, as soon as you admit people from outside to more or less freely enter your community, you cannot expect them to spontaneously and out of their own convictions abide to your rules. It is a normal phenomenon -- without doubt, easy to verify -- that newcomers from outside will tend to take profit of all the advantages of the existing system, without necessarily feeling any compulsion to contribute to it -- which objectively makes them free riders.

Now I come to another point that has been made. It has been said that Germany was rather more regulated in the 1950s and 60s than today. But everybody agreed that -- at least in the eyes of outside onlookers -- Germany functioned perfectly, as everybody respected the institutions. In some way, institutions were the hardware frame, the general consensus the software necessary to make it work.

If under the shock of outside circumstances, the up to then almost perfectly functioning machine begins to stutter -- probably because the outside shocks influence the software -- people of course hesitate to abandon the institutional frame, which has rendered them such good services for so long. This is a natural reaction, just as it will be natural for people in other countries to entirely scrap a machine which never worked well and which has totally broken down since -- as most communist countries in

Europe did, like China presently does and like North Korea will probably do tomorrow. These communities quite naturally have the will to adapt 100% to the new situation and they have no reason to be hesitating to fully accept the rules that they find elsewhere.

I think that the harsh criticism that continental Western Europe and more precisely the European Union undergoes from the part of Anglo-Saxons and Asians has to be put in this perspective: For decades, Europe has been a universal object of admiration and of emulation because we had such a nice and stable growth and social equilibrium. There is nothing more normal than that Europeans themselves hesitate to give up ingredients of this system, as it is not always foreseeable whether these ingredients are not essential to the functioning of the whole edifice. On the other hand, these institutions were born out of a consensus omnium, so that the system had its roots in the convictions and feelings of a great part of the population. All this should make us a bit more comprehensive to the so-called sclerosis that seems to paralyze Europe and which is due to the difficulty to abandon a machine that worked so well before. Those who have nothing to abandon or who abandon a system that has utterly proven to give bad results don't have the same anxieties to overcome. But they should not necessarily rejoice in this, attributing their greater flexibility to inherent qualities of intellectual superiority.

H. Szlajfer: The first point I would like to make, agreeing with the voices which emphasize that it seems that there is no proof that the vested interests, especially the interests operating at the level of labor, that this problem starts to be much greater and the regulations much more numerous than previously when we looked at the national levels.

Secondly, the empirical proof as far as the trade unions are concerned or the organized labor is concerned, is obvious. It is enough to look at the figures concerning the members, the number of collective actions, more violent actions organized by the trade unions, it seems the proof is on the table. Probably we have also a problem which goes beyond the traditional organized groups like trade unions in which they operate exactly and directly as a part of the electorate. I think at this moment, for example, about old people and the pressure concerning their pensions. In the Polish case I would argue, taking this example, that this is one of the most

important pressure groups now operating in the country, not the trade unions.

Furthermore, if we look at the problem of increased regulation, and this is the dimension which is probably missing in the analysis, we need to look at its international level. With two simultaneously operating forces, the EU and the international competition. So the first one in Europe, the European Union, mentioned already, and the way the regulations are made at the level of the European Union, this is an intriguing question. And the second force is the increased international competition banging at the doors of Europe which somehow increases the incentives to make more regulations. So when we take into account those two elements it seems that they should be put methodologically into the framework of your analysis in this part of the book.

There is one interesting example, a small one but it seems to me very instructive how these regulations or new regulations at the level of the European Union, which combine both regulation and de-regulation in terms of increased competition, how they operate and force some actors to withdraw from the game. Look at the case of small Malta, which decided now to withdraw from the competition to be a member of the European Union because in their opinion the costs are higher than the benefits. To stay outside of the European Union is, in their view, better than to be member of the European Union. There are quite strong arguments.

The last argument which probably should be somehow strengthened, this proposition to bring this international competition and these regulations indirectly into the picture is the very fact that in Europe we are used to compare the countries with the two extremes, on the one side the Soviet Union and on the other the United States, where in both cases 65 % of GDP goes to the national trade. In these two countries we have a completely different situation. The European countries are strong market economies, but heavily export oriented and therefore much more exposed to international competition than the United States or the former Soviet Union.

C. Goodhart: Mancur, I think that everyone around the table has argued that you were wrong in the suggestion that regulation has increased in Europe since the 1960s. It hasn't and the UK is probably an extreme example. Exchange controls are gone,

financial regulations are gone, Thatcherism has occurred and we have a very much freer market. Now why then has...

M. Olson: Considering Great Britain part of Europe.

C. Goodhart: I am sorry to hear you say that, but let me try and suggest what you have left out of the equation, because I think it is enormously important. And that is a shift from an industrial economy to a service economy. Now that is a standard phenomenon of any economy that is growing wealthier, because the highest income elasticities are for the personal services. Now the problem here is that the personal services have been traditionally primarily provided by the state: health, education, pensions and old age care. And that meant that the state expenditures grew. Now I know that there are some special interests involved here when the public sector's union became more powerful and all the rest of it. To argue that the increase in expenditures on personal services provided by the state was a function of sclerotic unions or the rest of it, I think, is just wrong. It is a natural function of high income elasticities in those areas.

It does, however, lead to a problem because they have been primarily financed not by charges but by taxation, and that leads to the greater tax wedge that you were talking about, which is a function of the shift to a service economy. And that leads to the question we are facing in Europe at the moment, which is how do we deal with the pressures of dealing with an aging population, and dealing with effectively unlimited demand for expensive services (e.g. for health).

Now we haven't handled all those issues exceptionally well, but let me end on what I think is a more encouraging note, which is how do you actually measure personal services. You measure personal services in most cases by the inputs into the personal service; and the measurement of higher education is not in terms of the quality of the lectures, it is in terms of the number of lecture hours and that means almost by definition, productivity is assumed in most services to be zero. If that is true, it means that as you move towards a more service-oriented economy, (and we are going to move towards a more service-oriented economy), your measured rates of growth by definition are going to fall, even if it is actually true that your underlying rates of growth and the provision of

welfare services and utility and what people want, is in actuality growing. It may well be that the sclerosis and slow down that we observe in the higher developed countries is simply nothing more than a statistical artifact of moving from producing primarily goods whose measurement is simple to producing primarily services whose measurement is exceptionally difficult.

M. Olson: Maybe this would be a good time because it is clear that I, I was speaking imprecisely without taking a position on how European Britain should be. I was trying to offer an analysis of the continent. An aspect of the argument I am making now is set out more fully in a article called "The Varieties of Euro-Sclerosis" published in Crafts and Toniolo's book, edited by Crafts and Toniolo and published by Cambridge University Press and you would see there I offer a different analysis of the United Kingdom than of the continental countries. Let me just focus for a moment if I might on France and Germany, Italy and Sweden. Now, of course I agree with Karl Heinz that there have been these measures that you mentioned that have been liberalizing.

But suppose we look at the net distortions in the labor market and measure them in these countries that I have listed by the rate of unemployment. Now it is true that there is search unemployment so that if there is, for example, a huge migration into an economy that can mean more search unemployment. If there is a huge shift in the industrial mix that can mean more search employment. But search employment apart, I think, search unemployment apart, I think unemployment can emerge only if there is a wage that doesn't clear the market. If it is the case that the value of a worker's time is worth less to that worker than it is to some employer, then if they can make a mutually advantageous deal they will. If there remains unemployment, involuntary unemployment on top of that there has got to be some distortion behind it after one has subtracted the search unemployment.

Now let's look at the unemployment in Germany, in France, in Sweden and in Italy. In these countries in the 50s and 60s there were very low rates of unemployment generally and many of them, not least West Germany had tremendous shocks, there were huge numbers of workers coming over from East Germany, there were lots of guest workers, there was rapid growth of employment. France had shocks of the colonials coming back from Algeria. Now

what I am suggesting is that in these countries the unemployment rate has been going up, and up and up. In Germany it can't all be accounted for by the East, this happened even before unification. That what we see is a situation where the net social cost in terms of unemployment is increasing and it's got to be increasing because there is an increase in the distortion there. Now Karl-Heinz Paqué calls it, what was it, passive, a passive rigidity rather than a sclerosis. I think that is terminological that, that it is hard for me to understand the secular increase in unemployment in the set of countries I talked about are without seeing some kind of sclerotic process at work.

A. Clesse: I wonder whether what Charles Goodhart and Karl-Heinz Paqué are arguing and what you are arguing is really necessarily incompatible. Next on the list of speakers Leslie Sklair and then Robert Skidelsky and Russell Hardin.

L. Sklair: I would just like to raise the issue of state centrism here. It is obvious that analyzing questions such as this in terms of comparisons between nation-states is the obvious and 'natural' way in which social scientists generally proceed and I have no argument with that at all. But it seems to me that for certain questions, and I am talking as someone who is working in the realm of the sociology of globalization, whether it wouldn't be useful also when we are making these comparisons between nations, to step aside and to make other sorts of comparisons, for example between men and women, between different ethnic groups, between different immigrant groups, between different occupational groups, between groups with different human resources.

Now if we look at something like the United Nations Development Program, the UNDP does a regular development report and they have started making some very interesting comparisons, for example taking United States white males and seeing how they rank on the human development index. For example do United States white males do better or worse on a variety of indicators than let's say white women in Germany? And you can see the implications of this, that you can make all sorts of interesting comparisons which are not at the level of the nation-state. To say that Britain is doing better or worse than Germany has always seemed to me to be a very difficult statement to be

reconciled with. I know that Holland is doing very badly because their national football team which was very well thought of in the 70s and 80s has done disastrously badly in recent competitions so in that sense I can see that Holland as a nation is doing badly (in terms of football). But to make the comparison between Holland as a nation-state and any other nation-state seems to me to have a lot of problems which are often simply ignored.

Your whole argument is therefore premised, like most social science, on the comparison between distinct nation-states. If you stood aside and made the comparisons between groups within nation-states and indeed groups across nation-states, for example accountants; how are accountants doing let's say in comparison with other people, fashion buyers in department stores, for example? And the example was not an innocent example I admit, but that might also give us some interesting results and it might lead us to re-conceptualize in this "age of globalization." A) what the point of economic growth is for different groups in society and B) also might help us to start to understand this extraordinary feature of modern so-called economic growth that the gap between the rich and the poor in practically every country in the world seems to be widening, which is a totally baffling fact, I would imagine, for those who are following the lines of argument that are being transmitted in the meeting today.

R. Skidelsky: Sorry before coming to Mancur Olson, I would just like to deal briefly with a point raised by Charles Goodhart. It seems to me he is right to say that the growth of a service economy makes it harder to measure GDP and its effects can be disputed. But the growth of the state has been fueled in the last 15 or 20 years by the big expansion of the social security budget, not in the big expansion of superior goods or financial services. Certainly the latter entirely in the private sector, so it seems to me that there is no a priori reason for supposing that a post-industrial economy will have a larger state than a smaller state. That is an important preliminary point and I think that undermines the force of some of what he was saying.

Now to come back to Mancur's point. Mancur postulated a contradiction between the flow of ideas and the flow of regulation. I think that this contradiction is more apparent than real. There has been a decline in regulation, even as there has been a movement in

ideas away from socialism and towards open markets but that still leaves the question of what is the relationship between these two things.

The explanation in terms purely of pressure groups and vested interests leaves aside the role of ideas. I would just remind you once again of that very overquoted remark of Keynes that "in the long run ideas are much more powerful, dangerous for good or evil, than are vested interests." It seems to me you cannot exclude the ideological element from the explanation of what has been happening in the last 20 years. Margaret Thatcher without ideology is a sort of oxymoron, so is Ronald Reagan. What really happened was that in the 1970s belief drained out of these collectivist systems, and new (or very) old beliefs took their place which fueled some of the energy which leaders were able to use when other forces in the external environment were also presaging the end of these systems. The new ideas were put in place by many, by think-tanks, by journalists, and many other proprietary organizations. They were not put in place by the universities, incidentally, and that is why think-tanks filled some of this ideological gap. But the ideas were in place and ready to be implemented.

But a second factor which is equally important is constitutions. It has rightly been said that in Britain a Prime Minister with a majority in the House of Commons can change a system much more radically than any continental Prime Minister is able to do, where you have more of a division and balance of powers. In Britain you pay the price for this, because you can get a Thatcher revolution, you can also get an Attlee revolution as you had in 1945. So you may have more volatile sets of policies. The constitution was an enormous enabling factor in the British case. Once the ideology was in place and you had a Prime Minister in place, with the parliamentary majority, she could do much more to break the log-jam of this sclerosis than was possible in Europe. In Europe, perhaps, you had to rely much more on the erosion of the system by external forces without being able to take very much preemptive action.

The last important factor is the international transmission of ideas. This has always been very important. One can go back to the 19th century and look at the demonstration effect of 1848. One goes back to 1968 and sees how quick the spread of that fire was;

then forward into the 1990s when one goes to Mexico or Peru or other countries, people talk about Thatcherism. Thatcherism was free information and undoubtedly hurried up the speed of change. This strong ideological component seems to me left out of a pure Olsonian analysis.

M. Olson: Just a question Robert. Of course I agree, ideas matter, and indeed there would be no point in the kind of work I do if ideas didn't matter. But suppose we set Britain aside which I was trying to do when I was talking about Europe and meaning the continent in this particular context. You believe, Robert, in the market and you say there has been liberalizing reform, and I infer from the context that you mean on the continent too. Why then have unemployment rates gone up, why has growth of employment been very poor, why is economic performance deteriorating in most of the continent of Europe while the ideas have improved?

R. Skidelsky: Well could I just give two quick answers? One is what Professor Paqué, has said, and I very much agree with this phrase "passive rigidity". The second I would say was hysterics, the two in combination. You had three major shocks in 1973, 1979-1980 and 1990. And when you have very slow response to change then of course you get a rise in unemployment. And you need a lot of deregulation; the more 'passive rigidity' there is, the more institutional change you need. It is not that there has been zero institutional change. There has not been enough to deal with the combined effects of these two factors.

A. King: Could I make a quick point? When I introduced myself this morning I said that I was an economist. If I had been more precise, I would have said that I was a lapsed economist; and one of the things I seem to remember being taught in my economics lectures was the really very important difference in the field of government activity between transfer payments and the government's commandeering of real resources. And this was a point that Charles Goodhart made earlier this afternoon. One of the things that strikes me, in some of the discussions of the role of state expenditure in either increasing or more commonly inhibiting economic growth, is that simple, and it seems to me very important distinction between transfer payments and commandeering of real resources, is not made.

Imagine two countries, each of which are devoting 30% of GDP to "government expenditure." Both of them increase government expenditure by a third; it goes up to 40%. But in one of those countries that increased government expenditure consists entirely of increasing pensions. Money is simply sloshing around from one part of the population to another, whereas the other country is devoting that increase in expenditure to armaments. Now those seem to me to be two activities both of which have economic consequences but which seem to me to be profoundly different in their probable economic consequences. I mention this partly because most of the discussions seem to me to have lost sight of that fact. I was particularly provoked by Robert's reference a few moments ago to the growth of the state, as though an increase in the proportion of the GDP being channeled through the state in its role as an insurance company was somehow on all fours with the growth of the state that might be involved in commandeering real resources. I can imagine a situation in which transfer payments go up but in which the state commandeering real resources actually goes down. In the age of the computer, you can write larger checks with fewer people. But it seems to me in all these discussions the question of the state's impact on the economy simply has to have centrally built into it but what I taught, I think correctly taught, in my first or second-year economics course.

R. Hardin: It appears that the problem is more complex than the simple accounts would fit. So there seems to be Eurosclerosis. But it appears that regulation of many kinds has certainly been reduced by the European Union so that is not the whole story. It is not just regulation by the state and the interesting question then is "what it is?" I don't know. I would be interested in what you think. It can't be regulation.

K.H. Paqué: Back to my passive rigidity. There is common ground for our hypothesis in the sense that we both see the problem on the supply side and we basically say that there has to be more change in a particular direction. But I think in methodological terms, there is quite a difference and that the whole, the core of your story is based on the ideas that societies scleroticize over time. And if you have my model you can have a completely constant institutional structure and nevertheless if you have a particular type of shock

you end up with a persistent problem. Now you say that you had shocks before and you mention the labor supply increases in the 1950s, that was, well that is a very subtle issue but let me briefly say that this was a footloose, highly skilled labor force which came over from the East and I would not even say it is a negative shock, it was almost a positive shock, a shock which we have repeated roughly around 1989, 1990 when again these people came in and were "easily integrated." The long term unemployment in Germany are not the people who came over at that time, that was highly skilled footloose labor and that was a positive shock if we had higher growth at that time.

That leads me to a general issue which is completely overlooked in the general public not only in this room so far but in general. I am fighting to get this point through for years now. Employment growth in Europe was good since 1983 if you look at the numbers, it is the best performance since the 1950s and Germany had the best employment increase record since the early 1980s, in the period 1983 to 1993 let's say since the 1950s. That is completely overlooked. Nevertheless, unemployment persisted so we have a persistence problem. We have not a problem of another stepwise increase after 1983-1985. This is simply not true. The problem is that the OECD numbers which are usually taken up from 1992, I think, 1992 or 93, included suddenly Eastern Germany. So you get a sudden jump in unemployment and that looks like another jump, another increase of the natural rate, this is a statistical artifact. And if you look at other countries, if you look at Holland, if you look at even Belgium, Denmark, a lot of countries in Europe have had sizable employment growth. Holland even had something like an employment miracle in the 1980s, nevertheless unemployment even in Holland never got back to the level where it was in the late 1970s.

So what I want to say is you have clearly a persistence problem and you need a persistence theory and not a theory of further stepwise increases. They happened in 1973-75 and 81-83 but not afterwards.

S. Magee: I would just like to supplement, Mancur, your general micro-theory of sclerosis. Your theory of sclerosis seems to run in the face of rational voter theory in the following sense. We know that through time in the democracies through the last fifty years,

voters have gotten increasingly intelligent and better educated, so, from a voter's viewpoint, it would not make sense that the economy would get increasingly sclerotic. Apart from all the arguments that you have already made, I would like to add the following. We do observe that generalist policies in the United States, like macro-policy, appear to get more efficient. The variance of GDP around potential GDP gets smaller and smaller through time so there is improvement in generalist microeconomic policies. There is also increased efficiency of some microeconomic policies, witness deregulation in many Western countries.

However, some special interest policies appear to get less efficient. I have certainly observed that in the tariff area, the international area where I work. I have called this "Optimal Obfuscation and the Theory of the Second Worst" in my Black Hole Tariffs book. What happens is that through time we see the evolution in the advanced countries from tariffs to quotas and ultimately to voluntary export restraint agreements (VERs). Because the voters are getting more rational, they vote increasingly against politicians who want tariffs and so you move to the quota to avoid that voter loss and then they figure that out and then you move to the VER. The political equilibrium moves to increasingly inefficient policies and these more inefficient policies are more protectionist than the tariffs and stuff they replaced. This can contribute to the sclerosis that you are talking about.

M. Olson: Let me say basically I am enormously indebted for all the benefit that I have received from these superb comments today and I am very thankful and I am struck that the disagreements are much less than they seem at first. Lets take for example the point that Karl-Heinz Paqué, and Robert Skidelsky made about hysterics. Now what gives rise to hysterics? Well, I believe the people who use this term first in this sort of context were Blanchard and Summers and they pointed out that if there is a negative shock in a cartelized labor market that this means that there would then be fewer employed in the market after the negative shock. Now suppose demand returns. Then those smaller number of workers who can without increasing their probabilities of unemployment demand a higher wage than they could have demanded had there not been the negative shock because then with more workers in the labor force, they would have had at the higher wage, they would

have had a higher risk of unemployment but given that some of the workers have been shed the remaining ones can have a still higher wage. I agree to that and I would argue that mainly I think the differences are terminological to, at least, mainly terminological that the analysis that I have heard I think is not very different from my own.

Session V: The special theory of the Soviet-type autocracies

A. Clesse: The second day we will focus very strongly on Soviet-type autocracies and what happened to them. Their decay and collapse and the transition from communism to market and democracy and then there will be the last session on the phenomenon that markets are everywhere present but prosperity is selectively around. So session number five, we call it "The Special Theory of Soviet-type Autocracies". The question and sub-questions are not necessarily new but they may allow to engage a new discussion. So one of them is, given the inefficiency of Soviet-type economies, how could the Soviet Union become a superpower? And whether the Stalin system was basically about exorbitant and implicit taxation and also whether Stalin used bureaucratic competition to reach his ends? We don't have many formal propositions for interventions. There is Alberto Chilosi, who suggested as a theme the surplus maximization and the structure of wages in the Stalinist economy. But I would like to first give the floor to Klaus Segbers, if he is prepared to make a few introductory remarks.

K. Segbers: For me as a political scientist I have to admit the usefulness of applying economic models to some extent under certain conditions. And I would like to define for my field -- that is explaining Soviet-type regimes and post-Soviet-types regimes -- what conditions should be met for any approach for us to explain Soviet and post-Soviet phenomena. And there are basically three points. First, any approach that will cover these events should explain continuity. Secondly, it must explain change. And thirdly it

should be able to identify the relevant units and levels of analysis, which for me is not a trivial question.

So firstly continuity. I think for various reasons it is extremely important to stress that there are indeed many factors of continuity between the Soviet Union, the former Soviet Union, and the situation after the so-called collapse of the former Soviet Union. The Soviet Union never was what it was described in textbooks or most western textbooks. It always was a system with a high degree of diversity, with a high degree of social stratification, with competing apparatuses and competing interests, especially among regional and sectoral actors and players and clientele structures. So basically the Soviet society was a society which was regulated by bargaining, at least after the Second World War, not by direction, not by commands. In that sense the communist party never was in this period a homogenous actor, but it was the very place where the bargaining took place. And ideology was not an operational principle, but it was a sort of a grammar where the official discourses took place and to which the official discourses had to be framed to be pronounced and taken seriously.

So this can very nicely be described, for example, with principal-agent models which Mancur Olson applied explicitly or implicitly in his model. In that sense, it fits quite well. In passing I would like to answer the questions (b) and (c) from this fifth session. Question (b) was: Was Stalin's system basically exorbitant and implicit taxation. My answer would be yes but plus informal mechanisms of what the Russians called "natural forms of exchange," of bartering. Question (c): Did Stalin use bureaucratic competition? Yes he did, but additionally this competitions took place without command of the godfather, of the principal of the principals, it simply took place and it was not only exploited by Stalin. Question (a) then: How did Soviet Union become a superpower? I think that there are two answers. The first answer is it was able to some extent to set priorities, which was the case, especially in the military sector and in some other sectors, and the second answer is that the Soviet Union to some extent never was a superpower. This was partly a Western misperception. It was a superpower basically in so far as it was able to create and to build delivery systems for long-range nukes. And, of course, it had resources, natural resources. In other

respects, economic performance, cultural penetration and other things, it never was a superpower.

My second point then is change. Under Soviet conditions, modernization processes took place almost always. The Soviet Union most of its time was not a stagnant society. Change is especially expressed by mobility, social mobility and spatial mobility and many other indicators. So the question is not if changes took place but when a fundamental qualitative change started under the so-called Soviet system. Following the principal-agent model, the question can be framed as when significant and decisive defection on a mass scale started under Soviet conditions? And here I think you need an explanatory or intervening variable which maybe is not present yet in your model -- but that is a question. This variable in my understanding is that at a certain point the traditional Soviet model of economic regulation failed for objective reasons.

As we know the Soviet economy never grew by increasing productivity. It only grew by introducing over and over again manpower, natural resources, capital and land. Because of certain changes in demographic trends, in the availability of resources and other factors this extensive form of economic growth was finally exhausted in the early 70s. That was not visible at once because the Soviet leadership had the possibility to gain windfall profits by exporting energy, gas and oil, for high world market prices. When this opportunity was over in the late 70s it became visible for anyone in the Soviet leadership that the traditional mode of regulation was gone and that something had to be done. And that some fundamental reaction had to be initiated. And then happened what we called "Perestroika". This and Gorbachev were the first attempts of reacting on this further crisis of the traditional Soviet model. And the reaction was directed firstly, on this economic crisis of the traditional system, secondly on beginning defections of major players, especially regions and sectors, and thirdly on the fact that there were no funds anymore available for the Soviet leadership to distribute and redistribute. It is a very serious point. And fourthly that there was not anymore any possibility to isolate the Soviet Union from the world because, in terms of communication, integration and consumer patterns the opting-out version was no longer available to the Soviet leadership. So the

result was an acceleration of existing modernization patterns plus initiating systemic change or even exchange.

And finally the third point. Any concept which tries to cover the phenomenon of change and exchange transformation in Eastern Europe should reflect that very important traditional organizations of political regulation, especially of the nation-state, are either extremely weak or are almost non-existent, especially in Russia and Ukraine. It is a fiction to talk about effective nation-states over there but that is not to say that you don't have institutions. You do have institutions in the sense of rules and laws but the nation-state as such is almost non-existent or hardly working. So, presumably, the theories you want to cover, and transformation theories should combine some different approaches: especially institutional analysis, institutional perspectives, path dependency, rational choice approaches and even to some extent, yes, deconstructionist approaches which sometimes are very useful to apply for this phenomenon.

A. Chilosi: Whether the Soviet Union was a superpower or not is a matter of definition of what a superpower is, supposed to be. It was certainly a superpower according to CIA, who however had a vested interest in magnifying the Soviet threat. As far as inefficiency is concerned, all systems are inefficient in absolute terms: efficient or inefficient in what? In building an industrial basis very rapidly and constructing an industrial production line on the other side of the Urals, in order to produce tanks when the Nazis invaded the country, it was quite efficient. Of course, it wasn't efficient in the Paretian sense, no real life economy is. The market economy and the planned economy are both inefficient. It depends on the extent of inefficiency to what. It was certainly relatively much more efficient for building up a military power than to produce high-quality consumer goods, this is quite obvious.

As far as the downfall of the Soviet Union is concerned, I was talking with a Polish colleague yesterday and he suggested that this was just the outcome of the contradiction between the evolution of productive forces, in particular technology, and the institutional superstructure. If surplus extraction along Stalinist lines requires a very strict control of society and of the public opinion, it is difficult to maintain it. When there are photocopying machines and computers around, together with more information about what is

happening actually in the world and about the level of, or living standards around the world in advanced countries' economies is, especially when you have for so many years built up unrealistic expectations as to what the construction of socialism would produce for the Soviet consumers or East European consumers. So certainly the previous intervention gives some stimulating thoughts but I think I do not quite agree with all of them.

A. Clesse: By the way I forgot to mention there is one newcomer this morning and it is fortunately Herman van Gunsteren who finally did it, as you know he was Thursday evening on a plane but jumped off the plane which then landed safely and on time in Luxembourg, then next morning he got on it and stayed on it but the plane did not take off, and in the afternoon he then decided for a Dutch solution, took his bicycle and was riding to Luxembourg, it is not very far. No, I am joking, he is a very good cyclist by the way, he could do a few hundred kilometers, I know that he does a lot but we are glad to have him here. So next might be somebody from the former Soviet Union -- Andrei Volodin -- you want to talk but there are many others here who have given a lot of thinking to this question of transition. Alfred Stepan and also Lord Skidelsky and many others and I hope Russell Hardin will intervene in this debate.

A. Volodin: I just try to draw the attention of Professor Olson and other enlightened colleagues to the historical aspects of the development of the Russian Empire and the former Soviet Union. The problem of the so-called "overstretch." From my point of view, Russia proved its vitality as a nation with the expansion of the territory to the east and this territory, I quite agree with Klaus Segbers, should somehow be integrated intellectually, culturally, economically and so on and so forth. And to my mind if we take this historical aspect of Russia's expansion to a territorial unity we should also include in the analysis another aspect, the aspect of the existence of the West, the existence first and foremost of Western Europe.

From the beginning of the 18th century, the existence of Western Europe became an independent and very important and very influential and instrumental factor in the internal development of the Russian Empire and then the Soviet Union. Western Europe

from the beginning of the 18th century was a kind of demonstration, model I just use the theorem applied yesterday by Robert Skidelsky, and practically all the developments in the Russian Empire and Russia in the Soviet Union was somehow compared with what was and is going on in the West. Military power, economic power, then per capita consumption and so forth.

The Russian leaders, the Russian elite always felt a sense of insecurity and inferiority vis-à-vis the West. That is why we had the expansion, that is why the enforced type of modernization, the enforced type of industrialization after 1917 and that is why the so-called "dictatorship of development."

And the first important question which comes to one's mind is: given the inefficiency of Soviet-type economies how could the Soviet Union become a superpower? I just put aside the problem of superpower. For me the "superpower" is a 19th century concept and this concept persisted in the public opinion due to the two world wars that raged in Europe in the 20th century; it is better to talk about the "vital power". I think that this demonstration effect of the West was very instrumental. Professor Olson is right in saying that the concentration and modernization of resources was one of the characteristic features of the Russian Empire and even more so in the Soviet Union. These resources were concentrated in the sectors which were somehow connected with the international activity of Russia, the military aspect of foreign policy and the development of the so called military-industrial sector. That is why the competition between Russia and the West from the 18th century onward was very productive for Russia in the historical and the strategic sense. Due to the existence of the West, a highly professional potential was created in the former Soviet Union, especially in Russia, Belarus and the Ukraine which are competitive in many respects with their Western counterparts. That is why the problem is how to convert this potential into a productive type of economic relations. According to many estimations, not only in Russia but in the West, the managers of the military industries or former military industrial enterprises are quite efficient, are quite competent, especially the new generation of people between 45 and 50 years, and the fate of reform depends to a large extent on their ability to integrate their enterprises in a larger competitive type of economy or framework. I think the

disintegration of the Soviet Union created problems as well as possibilities for this integration.

I quite agree with Klaus Segbers that after 1945 the Soviet Union became a more diversified power. The Soviet Union was always culturally diversified, various nationalities, various cultures. Despite the special role of the Russian language, there was the problem of Russification. Then the second source of pluralism were the different regions and their interests, which were not discussed openly but they were discussed at the preliminary sessions of the Central Committee of the Presidium of the Supreme Soviet and so on and so forth. We were not informed about this, but this dispute took place and Stalin was quite effective in manipulating these different interests. But, after Stalin the manipulation of these interests became more and more difficult. This heterogeneity, ethnical and regional -- was, in the final analysis, one of the reasons of the disintegration of the Soviet Union. But, I think -- I'm coming to a close -- that these sources of vitalities that existed before 1917 and after 1995 are very present and the problem is just how to exploit this potential. What is necessary, from my point of view, are competent economic, political, and intellectual elites, and a high degree of inter-penetration between these three elite groups.

I. Ståhl: Well, my picture of the Soviet economy before 1991 is more of a system or, what I would call, parallel economic hierarchies -- a kind of corporate structure and, every corporation or economic hierarchy acting as a special interest group. That could be the textile industry, or it could be the steel industry, or it could be the railway system. And, you made all the careers inside your corporate group, your special interest group. And, in a way, the role of the Communist Party, then, was partly controlling and commanding, allocating a little bit of resources between the interest groups. And, that's part of the bargaining part of the economy that Professor Segbers described.

I just take a very simple example, which, I guess, most of us have got in contact with. That's the Academy of Sciences, which actually worked as a corporation -- a very integrated hierarchy, with their own hotels, booking services, restaurants, housing, lodging, everything was inside the Academy. So, you started your career the old way. And, what did the Academy sell? They sold the bomb to the military outfit -- the big bomb. And that was sold

even to the Party to confirm their powerful position in the international field. And, then you got some privileges for your cooperation -- the Academy Nauk. Of course, you had produced, you were delivering all the time. And, I think, Mancur's a little bit wrong when talking about prices and wages because nobody knew about prices and wages in this system. I would argue that there was no single Soviet company that could produce a balance sheet. They didn't know about those things. Ordinary, double-entry book-keeping was unknown. And, why should it be known? My suggestion is, go to the US Navy and go to the US Air Force and see if they use double entry book-keeping or if they produce a profit and loss account or a balance sheet.

They used a system of military hierarchies, the whole way through. It was a kind of war socialism. Remember that Lenin was extremely impressed by the operations of Ford and General Motors and thought he could run the companies as a limited set of General Motors corporations. And, I think, what was typical for the Soviet society was that prices, wages never mirrored opportunity costs. Everything was done in quantities.

No, no my point is that they never aggregated it. They run into a quantitative number of data that was so enormous that they couldn't manage it. Take an example, a textile factory in Narva. They got the cotton from Kazakhstan and Uzbekistan. They never bought it. These were deliveries, bargained a little bit through the different ministries. Or why do you think Aeroflot was a big success? Because everybody had to go for all these bargainings all over the Union. And, nobody really calculated the opportunity cost of selling, sending cotton from Uzbekistan, Kazakhstan all through Russia or the Soviet Union up to the Baltic. When they realized, back in '89 when it was liberalized, they immediately saw that it was much cheaper to buy the cotton on the world market and disrupted the lines between Kazakhstan and Abouldin.

So, I think, the typical part of the systems was a lack of knowledge of how it was really operated internally. Then, you just went into some very simplifying assumptions like decreasing the number of qualities, decreasing the variety in goods and so on. And, I think we will get wrong if we use economic terms like prices and wages. They were accounting figures -- only used for accounting purposes. And, they never mirrored anything like

opportunity costs in the Soviet society. Nobody really knew what the opportunity costs were of all these quantitative deliveries between industries all over the country. You just sent your order and you had to bargain a little bit to get these quantities.

A. Chilosi: Yes, it is true that there was not much knowledge of opportunity costs. But, still you had prices as an aggregation device for measuring the value of gross production, at least. You also had prices as a device for measuring and allocating consumer purchasing power. So, you had prices, indeed. You had "khozraschet" -- the separate accounting, of individual enterprises.

As far as pressure groups are concerned -- in an Olsonian perspective -- one might see the start of the end of the Soviet Union beginning when purges were ended. In fact, purges can be conceived as a device to break up pressure groups before they could get strong enough to condition Soviet power effectively. When you had finished with purges, then the time bomb or the growth of pressure groups started. Eventually the center grew too weak -- also because all the different leaders were supported by different pressure groups inside the society, even if it was not a democratic society, obviously. In the end, the power of pressure groups led to what is everywhere one of its usual pathological manifestations, the financial crisis which brought down the Soviet state. That could be an Olsonian interpretation of the collapse of the Soviet Union.

R. Skidelsky: I'd like to take up a central point, it seems to me, both in Professor Segbers' presentation and in Mancur Olson's view. And, that is about the role of ideology in the working of the Soviet system. Professor Segbers has this phrase that ideology was simply the grammar in which discussion took place, which, of course, also does tend to rob it of its status as a belief system, because we don't really believe in languages. We use them, and some important quality of ideology is being obscured by talking about it as grammar. Professor Olson simply denies the role of ideology in the construction of the Stalinist system. I refer you to Olson's text where he says that "Stalin was not a sincere ideologue. Ideology played a role in explaining some of his support, but Stalin was not a Marxist in any way, and had he been he wouldn't have done many of the things he did." Now, of course, I don't know whether he was

a sincere Marxist or not. The examples given to suggest that he wasn't are not really persuasive, especially the argument that he wouldn't have killed people had he been a sincere Marxist. Sincere ideologues do tend to kill people.

But, the more important point is that it wasn't Marxism that's at issue. It's the issue of central planning, about how you organize an economy. That belief does seem to me absolutely crucial in explaining the motive force behind the construction of the Soviet system and also many of the reasons for its decay. That was a central principle used throughout. And, I think, it's important to understand this. They believed in certain things. They wanted to achieve a certain kind of society; that's why they did the things they did. And, it made sense to them, even at the end. When Gorbachev, in 1990, said, "I am still a communist," he wasn't just using automatically a figure of speech. You must take beliefs seriously. May I give an analogy?

When I was in the British Labour Party, I was one of the people who argued strongly that they should get rid of a famous clause in their constitution. Clause 4, which committed them to the ownership of the means of production. The argument that I always got was, "But, this means nothing. It's just a grammar. It's just a kind of ritual. Underneath this ritual, everything goes on as though it didn't exist." And, I always doubted this. And, finally, Tony Blair agreed with my view and said, "In order to signify that we have changed, and that another set of beliefs and possibilities for action are open, we have to get rid of this commitment." And, they did get rid of it. So, I would emphasize this point about language. It's more than grammar. There is something there omitted, it seems to me, in Mancur Olson's account of the logic of the system.

The second point is the implied contrast, between a bargained economy and a mobilized economy or a commanded economy. Now, of course, you cannot conceive of a society in which bargaining isn't an absolutely essential feature of all processes. Perhaps, in the Stalinist period, you got as far as you could without that, and where you could talk of a commanded society, commanded on a military model, which it has rightly been said Lenin picked up from the way the German war economy was organized. One of the political science weaknesses is that when you start using terms like bargained, corporatist, pluralist, you start

thinking that the Soviet Union wasn't really that different from German social democracy or the social market economy -- a corporatist society, lots of bargaining, pluralism under the surface -- but, as Professor Volodin said, they were never aware of it. And that is the crucial point: it wasn't like other societies. And, some of the uses of these terms are quite misleading. There were priorities. They were set by the Central Committee. Within those priorities, a certain amount of bargaining was possible. But, the structure of the economy was not like that of other economies in which market principles were important. For one thing, there was a very small service sector, and for another thing, the priority on military spending was much, much greater than you would have got in any other kind of economy. So, please, don't let's slip into the trap of thinking that by using certain words that can be applied to both systems -- that those systems were structurally identical. Because they weren't.

Now, the very last point, I want to make -- because it also refers to something that was said earlier in this meeting -- central planning was not just an ideology specific to the Soviet Union. It had an enormous influence throughout the whole world in the era from the 1920s to the 1960s. Probably because of the common roots. You only have to think of India, which was an explicit copy of the Soviet planning system. Various types of Latin American and African development were influenced jointly, perhaps, by Soviet planning and fascist ideas about autarky. So, in this whole era, central planning was a very important element in our thinking and the market system, as a way of organizing economies and allocating resources, was in decline. It was partly revived, in the 1930s as a result of the debates between the Austrians and the central planners about the possibility of central planning. From that point, I think, when Hayek and von Mises attacked Lange and Learner, you really get the birth of the market system as an ideology, as an ideology counter to that of central planning. So, this is an aspect of historical experience and an explanation of choices people made in this period.

A. Stepan: I think my comments do build logically on that. First of all, in the larger discussion of the relationship between ideology and growth and regime erosion, we should be absolutely clear that high growth will never erode a democratic regime. It may create a

bit more tension, but it doesn't erode it. High growth, normally and often, erodes a non-democratic regime. For example, Korea, Taiwan, Chile, Brazil all grew for the decade before the transitions around eight to ten percent. They were some of the fastest growing countries in the world. Now, a non-democratic regime, unless it has a very special ideology, normally claims to rule under exceptional conditions. Success erodes this claim of exceptionalism and secondly, just sociologically, systems change. So, we shouldn't be too fixated that regimes change and erode only because of economic strength.

Now, the Soviet Union, then, fits in a very different way. I mean, I do pay great attention to the question of belief in their right to coerce people and their capacity of coercion. They were more willing to coerce than other people were to stop it. And, in this sense, they were clearly a regional hegemon. And, no one would challenge them. Now, if we're looking at the entire bloc and not just the USSR, an analysis of the erosion of the economy in the 1970s is obviously of no use whatsoever for explaining some major changes that already had occurred at the level of, at least, the individual countries. Hungary in 1956 was a successful revolution against a totalitarian regime. It was only reversed by the physical use of Soviet tanks. Why did the Soviets use those tanks because, not only because of the geographical proximity -- had Hungary been situated in Spain, it would never have happened -- but they were also confident enough to use repression because they really still believed in their mission. The case of Czechoslovakia in 1968 was different in so far as the aims of the regime were rather diffuse. Nevertheless, it was clear that they would have left the Warsaw Pact had they not been invaded.

So, coercion is the key variable. Certainly, in Poland in 1981 when you had 8 million people joining an opposition trade union movement, in Gramscian terms there was no hegemony for the regime at all. It was totally relying only on coercion. And, it was the belief that the Soviets might use their power. So, it was a combination of their belief and their willingness to use coercion -- their confidence to use it -- and the costs they were going to pay.

When I talked to Yakovlev. He might not have known what happened later, but in 1988, he was already saying, "Every time we take a look at the Russian economy, the military component of it

appears to us to be larger and larger. And, it's not only the percentage of GNP. It's their privileged access to any part of the economy that they want if they need it for national security, which totally disrupts the entire economy." And, he says, "And every time we look at the size of the economy, it's smaller than we thought it was." So, he said, "We can't continue with this military dimension." And, that was part of the reason for Glasnost and reaching out.

Now, the only collective good that the Empire paid for was security. If you traveled in the region, you always noticed that the closer you got -- one of the peculiar things about this Empire -- the closer you got to the center of the Empire the poorer the place was. I mean, Hungary really had a much higher standard of living in the 80s. It's almost like it's a different world. And, Czechoslovakia, even though it was gray, was still a different world. So, they extracted a huge surplus from themselves for reasons of coercion. The economy eroded, but also the belief eroded at the same time. And this is highly interactive. Max Weber, in a very simple assessment said, "No regime lasts unless the coercive elite believes in the right to shoot at people." I insist that in Tianamen Square, the Chinese still believed in their right to shoot people. And, almost no one believed in the right to shoot people in the name of this ideology in East Germany or Czechoslovakia. So, in theoretical terms, these regimes collapsed. They just melted away. We actually have some marvelous sociological analysis of precisely the group that Weber would call the inner coercive core. They were asked, "Do you believe that when you joined this in the 1950s you had the right to repress protests and to shoot people?" And 90 percent of the people -- and this was asked after the regime collapsed -- said that they believe that they had that right in the 1950s. But only around 20 percent believed they had the right by the time of the 1980s. That's extraordinary.

I also believe that even if you have a 10 percent growth rate for the next ten years in China, people will look through the fraudulent use of ideology by then. There is such incredible coercion that if they have to put down 100,000 people in the year 2005, there won't be enough people who will shoot them because they say, "We can't shoot our people in the name of this ideology any more because this ideology, by then, will be considered absolutely false."

M. Olson: I'd like to think a little bit about ideology. Now, of course, we have to take it as one of the things that influences the course of history. I'm sure, one couldn't have imagined the Bolshevik Revolution without lots of Russia's intelligentsia believing in Marx and being influenced by Lenin writing and so on. So, no question that ideas affect things.

But, now, the question comes, how precise are these ideas. Are they ideas that are like a recipe that enable one to tell exactly what will be done in what order. I think not. Ideology didn't say that there should be a shift to the New Economic Policy, to a market economy. Something Stalin himself argued for and helped put into practice under Lenin. Ideology didn't explain why after Stalin had been in power a few years at the end of the 20s he, then, collectivized all agriculture, seized all the natural resources for himself and imposed the system that his propaganda services and people since have called communism.

Now, the ideology also didn't help us understand why it was that the main, the most intense enemies in many ways of the Soviet Union were the Chinese. The Chinese-Soviet quarrel doesn't make sense in ideological terms. If you want to further the ideology of central planning, why not have unity among all those who believe in it? Look at the intensity of the animosity between Yugoslavia and the Soviet Union in Stalin's time and after. How can one explain that as being due to ideology?

And, then, of course, you have the further problem that the Soviet Union became a major actor in world affairs. Now, I agree, maybe, that its power was greatly exaggerated. Maybe, we shouldn't think of it as a superpower. But, even to create the false impression that you're a superpower is an achievement of a type. And, how can we explain that in terms of ideology? Well, if the ideology is right, if it captures the essential ideas that make an economy efficient and, thus, produce a lot, then ideology could explain the power of the Soviet Union. But, as an economist, it's beyond my imagination that we could attribute the power of the Soviet Union to the validity of its economic theory. Marxism was discredited in economics in the nineteenth century. And, there hasn't been anything interesting from Marxism for the economist in the present century. So, therefore, it seems to me, we need to go beyond ideology. We need to add to ideology something else.

That ideology has been used to analyze the Soviet Union since 1917, and we need to add something more. I think, we need to add the idea that one of the things that Stalin did, that he didn't have to do because of his ideology, but that he did because it added to the resources available to him, and thus to his power, one of the things he did was what no autocrat before had done: he seized all the capital goods and instead of, then, observing or suffering what other autocrats had suffered when they seized capital goods, namely a fall off in investment, and thus a fall off in future income, and thus a fall off of future tax receipts. What Stalin did was to get an increase in investment, after he had confiscated all the capital goods. And, he did it by controlling society's choice between consumption and investment.

Now, he also set prices and wages very low, so we got the income effect of taxation making people work more. He taxed marginal income very slightly. The output of peasant plots was not taxed at all, progressive piece rates, things like that. So, we had a system of implicit taxation, which led the labor force participation in the Soviet Union to increase gigantically at the same time that Stalin exacted an unprecedently high proportion of output out of the Soviet Union. So, here you have someone who did something that you can't find Marx saying, you ought to have done. Something different from the New Economic Policy that Lenin had blessed, and he himself had argued for. And, you find that what he is doing is, in fact, succeeding in getting more resources for his purposes, for making him strong in the international society. I provide data in the book about how very much more Soviet munitions output exceeded Czarist munitions output in World War I than did German, British, or American World War II output exceed the World War output of these countries. It's just a fact that he mobilized very much more resources as a percentage of what the society could do than any of the other combatants did. It's just a fact that he had a tremendously inefficient economy and, nonetheless, became a very major power. The Soviet Union gave a much better account of itself in World War II against the Germans than the Czars did in World War I, even though the Czars had the advantage of a second front from the first day. So, it seems to me, ideology doesn't explain lots of the things that Stalin did; it doesn't explain how he came with such an inefficient society to come to

have such extraordinary power. And so, therefore, we have to add to the ideological ideas that have been used for 70 years to explain this system -- a different set of ideas, an additional set ideas. That, at least, would be my thought.

A. Adonis: I thought to my mind, that Mancur gave the game away when he said that Marxism had nothing to say to economists since the nineteenth century. If economists ruled the world, then that might be a relevant factor. Alas, Marxism had a huge amount to say to the great mass of people who determined what was going to happen in Russia in 1917; a very huge amount to say to the mass of people who determine what happened in China between 1945 and 1949; and an enormous amount to say to what happened even in Eastern Europe, picking up on Alfred's point, even in Eastern Europe in the mid-1940s. If you look at what actually happened in Czechoslovakia in the first democratic election after '45, you know, the largest party in a free election were the Communists. They didn't succeed in getting remotely close to 50 percent, but they were able to sweep a huge amount of public opinion behind them. And, they were able to do so for perfectly obvious reasons: a record of appalling oppression, a belief that elites had betrayed any sense of national cohesion, an enormous sense of bitterness. All forces which made for an ideology of leveling, an ideology of redistribution, and one -- picking up Robert Skidelsky's point -- of state planning. And, it doesn't seem to me that you can even begin to make sense of what happened in the Soviet Union and large parts of Western Europe over this century without seeing the central role of ideas in it.

The question, then, is how you fit your autocrats into an ideological framework. No one doubts that autocrats -- you know, going on to our bandits of yesterday -- have interests of their own once they achieve power, which are then very different. You can't begin to explain the purges without understanding what was a megalomaniac at work within an ideological framework. But, it would seem to me, as somebody who isn't close to these debates, but trained as a historian, you need to put that into the ideological framework, and not attempt to claim that there is a kind of wholly separate trajectory of ways that dictators behave which can divorce from the ideas which either bring them to power or which motivate the elites which support them.

If I can just end with an anecdote. I remember, when I was a student, I had great difficulty trying to make sense of the Reformation. Why -- I mean, to people in this century, it just seemed appallingly difficult -- why were Catholics burning Protestants, Protestants burning Catholics, and large parts of the elite deeply motivated, who looks at English history in the sixteenth century, deeply motivated to carry out the most appalling atrocities on each other. And, when regimes change different sets of people were then bumped off and so on. And, you can't really begin to address this without accepting that perhaps, they believed it. Perhaps, Protestants really did believe that the supremacy of the Pope and a whole series of propositions that went with that were not only deeply false, but were going to lead to eternal damnation and the other way round. Unless you can accept that as a starting point, then you have to assume that the whole world is so deeply irrational that those things which we try to study around the table are quite pointless, because we can't begin to understand how human beings behave.

K. Segbers: I would like to make three comments. Professor Ståhl talked about information problems and problems of knowledge, and I think that, indeed, was very important under Soviet conditions. What I would like to say is that maybe the most important problems with adequate information were at the top. And, I'm pretty sure that the civil leadership never had a really clear understanding of production results. They definitely had not clear understanding of the cost of the military effort, for example. So, to some extent, secrecy was not the desperate attempt to hide something, but the expression of information deficit. I think, that is to some underlining the relevance of principle-agent approaches.

My second comment on ideology. I didn't say ideas don't matter. Ideas do matter. For example, under Soviet conditions, Soviet patriotism was an idea which definitely mattered. But, ideology in the sense of Marxism-Leninism, well, you could explain the Revolution in October-November 1917, was communism, socialism in one country, internationalism, New Economic Policy, five-year planning, co-existence, deterrence, and what you have, in these terms. So, what is that good for? If an ideology is so flexible, beyond delivering a framework for a discourse, and when different, even antagonistic interests can be framed and presented

to each other. If you can explain behavior otherwise than resorting to ideology, I prefer to explain phenomena otherwise, for example, by describing interests. And, only if that doesn't work, I would, then, look for other explanations.

And, finally, I didn't get quite what Professor Stepan said on economic problems and what they were explaining or not explaining in connection with the events in 1950. I mean, I think it is relevant for me to know why the traditional Soviet system stopped to function and when. Why and when. And, I think, it is possible to explain that -- that happened exactly in the 70s. There was no correlation whatsoever which happened in the 50s. And, to explain what happened in the 50s, in '56 say, or in the late 70s -- '79, Afghanistan -- that was not a mission viewed from the actors who took this decision. We know the protocols of the sessions where they deliberated to go in or out for days and weeks. You didn't get the feeling, if you read these protocols, if you talk to the people who were the relevant actors, that there was a mission. There were very difficult decision processes for those involved at those times. And, I'm not saying the decision was right or not. That's another matter. But, I didn't have the feeling that they have a mission there.

A. Stepan: My only point about 1956 was that we can't take the explanation: the decay of the system of the Soviet Union is based on an explanation of the decay the economy. And, most people say the big decay starts in the 60s and 70s. All I'm saying is there are some major things happening. There was a massive rejection in Hungary of this system in 1956. That's before the decay. There was a massive rejection, at least from the people in Czechoslovakia there was a feeling of an authenticity about it. So, I'm just introducing this, where nonetheless at that point, the Soviet Union was still confident in their right to impose coercion. I completely agree with you. Regarding Afghanistan, that's a much more difficult decision to make than was in 1956, or, indeed, than it was in 1968. And, at this point, from the 1970s on, you get a sense that you're exploiting yourself, and do you have a right, and it's costing so much, and it gets much more complicated. But, people didn't believe in the simplest Weberian sense, at a certain moment people didn't even believe in their right to coerce.

A. Volodin: A few observations, reacting to our discussion. First and foremost, I just want to continue the thoughts of Robert Skidelsky and Klaus Segbers concerning pluralism and these interest groups struggling against each other. If we look at the Soviet history, the history of decision-making, then the promotion of Marshall Ustinev to the post of defense minister was a tragedy for the military establishment because Marshall Ustinev was known -- that is a concrete fact -- as the man responsible for the military-industrial complex. This promotion meant that the military establishment was subjugated to the military-industrial complex. That is one thing.

And secondly, this promotion adversely affected the competitiveness of the Russia on defense industries because there was a very interesting system of bargaining between the military and the defense industries. There were special military representatives that went to the plants, to the factories inspecting the quality and the capacities of different weaponry. The unification process in the military industry came to a standstill after this decision. This balance that shifted in favor of the military-industrial complex somehow adversely affected the balance of interests within the vested interest groups in the Soviet establishment.

Then, the second point which is very relevant for our discussion. Klaus Segbers was right by saying that a sense of pluralism existed in the Russian society. I would suggest to make a distinction between: firstly *pluralistic society*, that are Western societies, having a competitive type of economy, a multi-party system, division of powers; and secondly the *plural society*, where there are a multiplicity of interests, but those interests are not aggregated, are not articulated, and from this point of view, maybe, the Soviet Union can be regarded as a plural society.

Then, two very short observations concerning the presentation of Professor Ingemar Ståhl and the role of the military-industrial complex. There was a very heated debate, but a debate that was not made public. The issue was whether to include the production of the military-industrial complex into the GDP or not. That is very instructive when you relate this to what you were saying.

And, the last comment on the statistics. There are two explanations for the bad shape of Russian statistics. The first

explanation is that Russian statisticians were physically destroyed by Stalin and Lenin, and some were forced to emigrate. And, that is why there is no continuity in the statistical service in the Soviet Union. The second explanation is that statistics were used to confirm the ideology, just to exaggerate the rates of economic growth that came to a standstill in the year of 1970. And, now, we have the reverse trend. Yesterday, Professor Stepan told me that official figures were published that the decline in the Russian Federation amounted to 5 percent. I have a feeling that the decline is very much there in the Russian Federation but lower, 20 percent, for the simple reason that the directors of the plants just decrease the real amount of their production for the purpose of tax exemption or tax evasion.

H. Szlajfer: First, as far as ideology is concerned, I would only say that probably we are not going to convince Mancur Olson to include the ideology in his equation. And, I would say there are compelling reasons why not. Can we explain all shifts in the Soviet policies using the ideology framework? The answer is no, we cannot. Secondly, which was presented during the discussion, can we explain the Soviet Union without ideology? The answer is no. So now we are moving on this type of shifting target. Probably a separate discussion is needed to clarify where to put the ideology. So, I am not going to speak about ideology.

I would like to emphasize concerns and doubts about the validity of the reasoning which was presented in the manuscript about the communism of Stalin or Stalinism as a tax collecting machinery, and the arguments which were used when explaining some specific cases. When explaining the tax collection activity of Stalin, you used the example of the agriculture, and you tried to explain why Stalin used the framework of kolkhoz and not sovkhoz, that means collective farms and not state farms to minimize the labour costs. If this was the major logic of Stalin when choosing between a kolkhoz and sovkhoz, and if the logic was also to increase the tax collection capacities and the amount of taxes, then it is legitimate to ask why at all Stalin decided to collectivize? If the reason was neither institutional nor ideological and had no other goal but the amount of taxes at the disposal of a stationary bandit, then why to collectivize? This is not a theoretical question because I knew one case of a communist economy in which the collectivization hasn't

taken place and the amount of taxes are no lower than in Soviet Union. I mean, Poland. Even at the height of Stalinism, the communist regime in Poland collectivized only at the maximum 9% of the arable land. What operated, in a quite efficient way, was a tax and fiscal squeeze as far as the private peasants were concerned. It worked quite efficiently. So then, going back to your example, why kolkhoz and sovkhoz at all? If the main reason was the capacity and the amount of taxes collected? So, I would say the burden is on your shoulder to explain why not to simply tax private peasants and why this solution was not chosen by Stalin.

The second point I would like to raise, which concerns this enormous, fantastic saving capacities and the rate of saving in connection with the Stalinist regime. I would say that the examples which are quoted in your manuscript, showing this fantastic potential, which concern mainly the military production, must be probably explained to some extent with the war economy, especially during the actual war time, and therefore are not very indicative. What is interesting are probably the long term trends. My feeling is that if we deduct from the official accumulation of savings, collected and then transformed into the accumulation, if we deducted the waste, which is a very important factor, then probably the real accumulation in an economic sense was not very high. But even when we look at the nominal accumulation, without the deduction of waste, if we compare it with the present saving's rate of some former Eastern bloc countries which is in the range of 35 - 40%, then probably the achievement of the Soviet Union under Stalin and later was not so impressive. But, this is not the major problem.

The question which is not touched upon here and which is connected with the problem of economic decline is the question, that I called some time ago, the problem of a "mimetic" industrialization. "Mimetic" means that, contrary to other systems, the accumulation cannot be equated with the innovation in the Soviet system or a communist system. It means accumulation is a separate issue. Usually, it should be linked with the innovation, at least partly. This divorce of accumulation and innovation was clear in a Soviet or communist type of economy. So, when we look at the sources of innovation, technological progress, and so on, we must look simply at the history and that there are clear stages when

we look at the technological progress. Some elements of explanation were mentioned in your manuscript and generalized. But they played a very restricted role. I refer here to, what you call, "the competition among the bureaucracies". In some specific sectors of the economy, especially of the Russian economy where this is more visible than in other countries, this clearly artificial competition was apparent, especially in the military sector. The system of creating competitive groups of researchers dealing with specific problems was one of the most interesting innovations of a rigid communist system. This is why you have Mikoyans, Vuvochkins, Tupolevs, and Adars. This was a real competition, a system of competitions organized in the framework of a non-competitive system. This is something which has to do with your competing bureaucracies but without this explanation it cannot be generalized.

M. Olson: The question Mr. Szlajfer asked, one of them was, why didn't Stalin simply tax private agriculture? Well, this was a system that was tried by the Czars and in the period of New Economic Policy. One of the ways that they would do this is by lowering the price of farm products so that the farmers wouldn't get such a high price and this, of course, meant that this was an implicit tax on the farmers. Now, one of the problems that emerged then was that farmers would produce less; that they naturally found it advantageous to produce a smaller amount when the price was less.

So, then, you would find, both under the Czars and sometimes in the period before Stalin launched the full-fledged collectivization that what they would do is try to have some compulsory collections: there is supposed to be some more provided by farmers than they wanted to provide at the given prices. But, then, of course, you also had black markets. Farmers would try to sell in a separate market where there would be a higher price. These things happened, I believe, sometimes in Poland as well under communism. Now, these things worked so badly under the Czars in World War I that the liberal riots began as bread riots because the Czars were sufficiently unsuccessful at taxing agriculture, which was, of course, the bulk of the Russian and early Soviet economy. They were so unsuccessful that at times there was a shortage of bread in the cities, worse shortage than apparently ever happened in World War II in the Soviet Union.

So, a different system of taxation, one where you could monitor the people very well by having them in a collective where you could inspect them, where you could have people from machine tractor stations come in and do part of the work and monitor from the outside, a complex system of devices, which, in effect, made people poorer so that that gave them incentive to work more but also left their marginal output of the peasant plots untaxed so that that too would make them work more. These devices would collect more than any straightforward system of taxation and price fixing. And, it did collect more! Despite all of the things that happened in World War II, and despite the heroic inefficiency of the system, the Soviet Union didn't starve to death in World War II. And, there were never any bread riots or anything like that. So, the idea of the collective farm as a system of collection seems to me one that fits what we actually observed.

Interesting, there's also another parallel to it. Suppose you had asked the question back in an earlier period. Suppose the Czars in a much earlier period had said, "We are going to tax the farm laborers and the farmers and get our receipts that way." Well, if it was true, as it was in that time, that labor was the scarce resource and Russia had a lot of land, it couldn't get the money out of a land tax. You'd always have the problem of the people who were heavily -- if you taxed labor very heavily that the labor would try to run away. Solution: serfdom, slavery.

Now, in the times of the Czars there wasn't the administrative capacity to have a system of slavery over the whole of Czarist Russia with one management from the center. That was administratively impossible at that time. So, you set up a series of mini-autocracies or collection systems under serfdom with each, as it were, land-owner, each aristocrat being the slave-owner, tax collector. And, this seemed to increase the power of Russia as compared to without this system. So, I think of the collective farms then as serfdom or slavery done in a more centralized way, consistent with the administrative potentialities of the twentieth century and working to create a superpower that served Stalin's purposes very well.

H. Szlajfer: Three points. First, the system was from the point of view of tax collecting ineffective. It brought disaster in agriculture, contrary to what you wrote in the footnote.

In terms of agriculture production, disaster continued until late 50s practically in terms of absolute levels of production. Third, even Stalin realized that his concept failed after a short accumulation drive at the beginning of the 30s. It was Stalin, first, in the 30s who introduced private plots for peasants. This was his admittance that the system doesn't work from the point of view of the efficiency of collecting the accumulation from the villages. In other words, still it seems to me the burden is on your shoulders to explain why this system and not another one of tax collecting.

C. Offe: Given the time pressure, let me just raise a series of questions or considerations in a telegraphic way. The preface of the telegram is an epistemological one. I would like to defend the principle that any decent and self-respecting theory -- has a theory about itself, namely a theory answering the question: why do my opponents (if any) oppose my theory? Unless I don't understand why other people do not agree with me, my theory is incomplete. Why is my understanding not shared by you? Applying this idea to explanations of historical processes, we would have the following: if I name a cause for some breakdown of some regime, why were the actors of that regime denying that cause so that they were unable to prevent it? Why is it that they were unable to learn? And only after I pinpoint learning deficiencies by specific arguments, rather than simply saying, "Well, we are smarter than they are.", it is a valid theory. I think it is easy to agree on this. If we check alternative explanations of the breakdown of a regime, we have to answer that question: why were they unable or insufficiently equipped to do something about the problem that we consider causal?

Let me start with economic causes. We have the very interesting debate here on economic causes. Why is it that the regime's protagonists were unable to do something about perceived economic deficiencies? One argument is that they did not perceive deficiencies because they could not calculate, and they had a learning impediment built into their own system because the system was so opaque: there was no bookkeeping, there was no accounting, there was no way of adequate self-observation. Hence, learning was not possible. Another possibility has to do with the Second World War. The structures of the Soviet Union that were built up in the 30s and that proved so uniquely successful in leading

the great patriotic war to a fortunate outcome were frozen as a consequence. They served as the model of success for the entire post-War era. Learning from the Soviet Union means to learn to win: everything has to be imitated, emulated, and copied. Thus the whole system became a civilian victim of its military success. That is another interpretation of learning deficiencies.

Then you get a family of *political* explanations having to do with mass faith, mass legitimacy, and, as Alfred Stepan pointed out, also elite lack of legitimacy, elite lack of faith. It is not clear what led to this -- why they couldn't renovate their ideology so as to make it more acceptable, make it a more plausible set of ideologies. Ideologies can learn and renovate themselves. That is another question that remains. Third, you get a theory that is a clear non-starter in my view. It claims that the breakdown was due to a revolution. And we can dismiss this.

A fourth possibility is the over-extension argument that is very popular now among contemporary historians of breakdown. The argument suggests that the possibility to control the periphery, in particular, Afghanistan, was so limited due to the deficiencies of what Max Weber would have called the "administrative staff" and the loyalty of the administrative staff and the local rulers remaining loyal to the center. So, this was not just distance, but social distance, and religious distance, one might add, which over-extended the capacity of the system for control.

But, then, after all these very limited, partial economic, political, military theories must be dismissed as not very plausible according to the epistemological principle stated at the beginning. One theory remains, namely that the breakdown was accidental. No one *could* have learned about this. No one could have known it in advance. Not only the West didn't know what would happen, also the East had no idea. It was an accident. Something went wrong. Someone picked the wrong elite personnel, and the elite personnel, then, made mistaken decisions that they could not know were mistaken. In fact, they did these decisions in the best of intentions, namely to reform, modernize, and put a learning pressure on the system. But, the worst thing you could do at that point, with a system like that, is to reform it because that was extremely dangerous. So, it was not possible to know that reform would have these consequences and, therefore, this ignorance led to the breakdown. But, this is all a far

cry from your kind of interpretation, Mancur; which, as I understand it, that the process that led to the breakdown was *predictably* leading to the breakdown and simply people did not see it and were preoccupied with their maximizing interest without being capable to learn.

R. Skidelsky: All I want to say is that the discussion about the role of ideology has been left in a very unsatisfactory state, and particularly by Mancur's last interventions. First of all, in what he says, he puts ideas into Stalin's mind that were certainly very implausible for him to hold while ignoring ideas which we all know were there. So, I think you get a wrong picture of the process if you apply the logic of power to it independent of belief.

Secondly, it seems to me, and this is a strict methodological point, that Mancur imposes impossibly stringent conditions for saying that a policy is influenced by ideology. His main condition is that one sees a blueprint, this is followed with fidelity all the way through. But, no one denies that politics come into things as well. What ideology does is to give you a sense of direction. And, when you come to forks in the road, it suggests that you choose one fork rather than another. It says that you exclude certain possibilities. A very good example of that is precisely the crises that struck the New Economic Policy in the late 1920s -- things like the scissors crisis. The NEP was a halfway house: you could either go forward to a more full-blooded system or you could try to restore capitalism. And, there was a debate within the Party as to which you should do. But, the debate was won by those who believed you should go forward. And, in a way, it always was going to be won that way because that was what the revolution was about. It wasn't about restoring capitalism. So, having said all that, we can go further than Mancur has gone. And, I think to leave it in that condition is to expose yourself to damning and unnecessary criticism for being totally naive about the political process, the way ideology and policy interact. It doesn't damage your central argument. It's an unnecessary concession to the critics: you give them ammunition which you don't need to.

N. von Kunitzki: I would like to contribute two points to the discussion which we had, whether the Soviet Union was a superpower; there were some answers that she was not a

superpower, because she lacked certain ingredients which seem necessary to that status. Personally, I think these arguments are not valid, as they amount to saying that Queen Elisabeth is not a queen, because she is only 1,50 m or that Mr. Kohl is not a real statesman, as he is too fat and cannot speak English. Quite evidently, these are no arguments. For half a century, from the mid-thirties to 1989, the Soviet Union behaved like a superpower and played the role of a superpower in the world -- and thus she was a superpower.

The real question is not, to my mind, whether the Soviet Union *was* a superpower, in spite of her evident shortcomings, but rather how she managed to be a superpower with all these shortcomings. This is the real question which, I would say, can be answered in a very easy way: The Soviet Union was a superpower because she wanted to be a superpower and used all her potentialities to be one. Just take womanizers; here too, we can ask how they possibly can have the success they have with the beau sex? Normally, they should be more handsome than ordinary men -- but they are usually on the less attractive side; if their beauty doesn't do the trick, are they more witty than others? Usually, they are less than average -- at least to male onlookers. If you go into the problem, you will soon discover that the most important factor of their success is just the wish to have it: They are womanizers, because they want to be womanizers and they are ready to go a long way to conquer women and put all the scarce resources at their disposal to that goal.

If you see the sacrifices that the countries of the former Soviet Union had to go to, we can say that that is what the Soviets did. But here, of course, we have to answer a second question: Why did they do so? I think there are three answers: One historical, one ideological and one political. Historically, the Russians had felt threatened by the West since the days of the socialist revolution, when they were told the western powers gave heavy support to the White Army (even if, in fact, they didn't). After the Stalin-Hitler non-aggression agreement of 1939, they were told that Hitler's bragging about annihilating the Soviet system was only official theory -- until the invasion of 1941 by Hitler's hordes showed that this grammar was bloody reality, which cost them 20 million lives. This explains, why they later took America's grammar very seriously; whereas the Western Allies of the United States took President Reagan's threats against "the empire of evil" for pure

rhetoric, the Russian population felt genuinely threatened by America's military power and considering SDI, not as a purely defensive device, but as an absolute protection that was granting the United States impunity when attacking other countries.

While some authors consider that America's war efforts -- which culminated in Star Wars -- pushed the Soviet Union into a competition which, finally, caused its demise, one can also consider that a world order which centered on two superpowers gave the Soviet leaders the possibility to ask any sacrifice from their populations, in order to maintain the status of a superpower, essential to the survival of the Soviet Union.

The second factor which made the Soviet Union maintain its status of superpower at whichever price is ideology: We must not forget that, from the beginning, Bolshevism started on the basis of an international mission of what the Soviets called socialism and what was considered as "communism" in the rest of the world. We must not forget that Hitler called his totalitarian system "national" socialism, a testimony to the general opinion that Lenin's socialism was in essence "international".

If the Soviet Union had not maintained its status of superpower, it would have been a traitor to its very calling which was to be the pillar of an international ideology, destined to conquer the world.

Even if this mission did certainly not find a strong echo in the broad population after the death of Stalin, it accounted for the straight line of the Soviet regime to act as a counterweight to international capitalism, as represented by the United States. The Soviet Union could only exist as a superpower.

The fact that the centralized system inherent in Lenin's communism did not fulfill the population's needs was not in contradiction at all with official theory. Let us remember that Lenin's theory affirmed the temporary necessity of a very strong state apparatus but which, afterwards, would "wither away" by itself. Translated into the economic field, this principle might be interested as a "supply theory" *avant la lettre*: Lenin apparently believed that once the country had sufficiently boosted its production infrastructure (supply side), consumption would come about by itself. There is no doubt, though, that the belief of the Russian population in this mechanism lost impetus as their consumption possibilities visibly fell behind those of the West --

and even those of their allies in East Europe that adopted more liberal methods, like Yugoslavia first, Hungary and Czechoslovakia afterwards.

The third reason for the Soviet Union to insist upon the status of superpower can probably be found in internal politics: As the switch towards a consumption society remained an empty promise and a vain hope, the Soviet populations could find some consolation in the fact that they were condemned to remain number two became more and more general. The maintenance of the superpower status was probably a factor of survival of the Soviet regime confronted with growing dissatisfaction of citizens.

The military disaster in Afghanistan greatly shook the confidence of the normal Soviet citizen in the superpower status of his State and, thus, greatly contributed to its breakdown. I think that these three explanations convincingly prove that Russia has to be considered to have been a superpower under the form of the Soviet Union -- even if it was too fat and did not speak English.

Session VI: The long decay and ultimate collapse of communism

A. Clesse: Session VI: "The Long Decay and Ultimate Collapse of Communism" -- the reasons, the causes of the decay and the breakdown.

L. Sklair: I really wanted to intervene some time ago on the issue of ideology because though I agree with Skidelski's statement, I didn't quite agree with his rationale for it. We are using the idea of ideology in a rather curious fashion. In fact, I think that there is a bit of a non-argument going on here. It's not the case, as I read Mancur Olson, that he ignores the role of ideology. And, indeed, it's not the case, as his opponents argue, that they only focus on ideology. It just seems to me commonsensical -- I know that's never a good argument when you're talking, particularly to economists -- that ideology is always important and material interests are obviously important. And, obviously, political expertise, planning, and structure are always very important. So,

what we should be looking at is how material interests and politics and ideology connect. And, I think, that's a much more fruitful way to proceed in the sense that proponents of ideology and proponents of self-interest are clearly not entirely neglecting their opponents' point of view.

The other point, I would like to make, is that what follows from what I just said -- and I may have misunderstood entirely the argument -- but I get the feeling that part of the argument is based on a misconception, I would call it a sociological misconception, that somehow some societies can be explained in terms of ideology, whereas other societies can be explained without the need for ideology. I was particularly struck when Andrew Adonis brought up the question of the Reformation and how baffled as a student he was about why Protestants and Catholics were killing each other. Well, of course, it is not only Protestants and Catholics who are still killing each other in various parts of the world. And, it just occurs to me that during the Reformation and throughout history maybe the Catholics and Protestants who were killing each other understood perfectly well why they were doing what they were doing. But, if they looked at us in the twentieth century, they would find lots of things completely baffling. One of the things that I think, they would be really unable to understand, which I'd like to connect with arguments about the decline of the Soviet Union, is what I would call the culture ideology of consumerism which, I think, drives global capitalism.

Now, this is a very, very long argument, which I won't go into here. But, perhaps at a later stage if it comes up, I might do so. But, the way in which it connects with the decline of the Soviet Union -- and again, this is to make the point that we can't really understand these issues unless we look at the integration of economic, political, and cultural-ideological factors -- if we look at the way in which an "ideology and material culture of producerism" dominates the Soviet Union up to about the 1950s and 1960s, we see that for a whole variety of material and ideological and cultural reasons, this started to change. It started to change very much because of the phenomenal growth in the 60s and 70s of the mass media of communication and the way in which the Soviet Union, Eastern Europe, China -- no country, no part of the world, was able to isolate itself entirely from this rising

ideology of consumerism. Now, I'm not saying that this is a historically unique feature. People have always been interested in some way or other in consumption and increasing their level of consumption. But, by culture-ideology of consumerism, I mean something rather different. That is, that it becomes the motif -- perhaps, even in some ways, to borrow Segbers' phrase, the sort of grammar in which everything else takes place, with which everything else takes place. And, that is, of course, the commodification and commercialization of everything.

Now, the Soviet Union, as many specialists have shown, I think, to everybody's satisfaction, was unable to satisfy consumer demands and that was certainly one reason why the collapse took place. I don't know how important that is. My guess, without being a specialist in this area, is that it was tremendously important in terms of the way in which the political elite felt that there would be growing pressures for something that they couldn't deliver. In particular, in comparison with the apparent ability of the capitalist powers to deliver higher and higher levels of consumption within this culture ideology of consumerism, not just in the heartland of capitalism -- the US and parts of Western Europe -- but also in rather unlikely places. So, in the 70s, 80s, 90s, you have a rapidly accelerating growth of what you could call the middle class consumer, all over the world. So, you have figures that I'm sure would baffle people in the Reformation -- that 20 million Brazilians, i.e., larger than the whole of the Scandinavian market, are middle class consumers. Figures like 200 million Indians are now middle class consumers. Figures like 250 million Chinese are now middle class consumers. And, you can define this in any way you like. The capacity to buy a color television set, for example, is one good way. I'd be very interested in an answer to the question, how is this possible?

I don't know if Mancur Olson has an answer to the question of how this is possible in terms of economic growth and the way in which this connects with a point that I made yesterday of the increasing gap between the rich and the poor. So this interesting notion that there are more and more rich people around all over the world, particularly in the Third World or what we used to call the Third World and perhaps parts of the new Second World (Eastern Europe), and there are also more and more poor people around the

world and the gap between the two is getting greater. And, it seems to me that this pattern is being reproduced in Russia and the former Soviet Union today.

So, really, I'm trying to feed in three points here: one is that the argument about ideology versus material interests is really a non-argument and that it would be more profitable to look at the way in which these connect. That's the first point. The second point is that it's not just the Soviet Union that can be usefully analyzed in terms of ideology because the burden of my argument is that we can't understand what's happening in the West and the newly industrializing countries, or the peripheral countries of the Third World, unless we see the issues in ideological terms, in terms of this culture ideology of consumerism and the way it connects with material interests and how people perceive and construct their own material interests and how that drives their own life projects, which I see very much in terms of a global capitalist project of consumerism which keeps the system eternally going. And, then, thirdly, to see whether this has any power to explain the decline of the Soviet Union, the Soviet Empire, and to see the ways in which the remnants of the old Soviet Empire, what I would call the new Second World -- I know First, Second, Third World is now very unfashionable, but I find it quite useful as a first approximation -- develop. The Second World didn't just disappear in 1989. I think the new Second World is quite a useful idea in terms of looking at the continuities, the historical residues which might, and in fact, in some cases are making a difference in the way in which the whole of Eastern Europe is developing in the latter part of the twentieth century.

A. Chilosi: It's still on ideology and the decline of the Soviet Union, so it's very relevant to the issue. Even if you have a very coercive system, you have still to motivate the coercers and to motivate the people to be, in some way, disposed to be coerced. And, this may be the role of ideology.

As far as the Soviet Union is concerned, somebody said before that Marxism-Leninism didn't really play an important role in ideological terms. It was official religion, of course; moreover, there is a very special piece of Marxism-Leninism which was of the greatest importance: 'that socialism was on the wake of history'. Those running the show in the Soviet Union were clever because

they understood history. History was on their side, and the people as well thought that history was on their side. Eventually, the system would win and expand in the world, and there would be some kind of bliss. You can be very poor in material consumption at a certain moment of time; if the discounted value of your expected revenues in the future is high enough, you may be subjectively rich, as far as your expectations are concerned. You have the bliss of full communism or the over-taking of capitalism -- it depends on the versions -- or the expansion of the socialism, and the power of the state, all over the world, and this was probably an important factor propping up the system. But, there was a moment in which the story of being in the wake of history started to crumble, even the leaders no longer believed it, not to speak of the people. And, perhaps the real moment was Afghanistan, when it was proved that the Soviet Union, that socialism was not able to expand, not even in an undeveloped, limited country that was close at hand.

A final point. I don't agree with what Skidelsky said before, namely that when there was a bifurcation ideology prompted to go for the more advanced direction, in the sense of the implementation of socialism. In 1921, you had a bifurcation: you had a retreat, not an advance -- a step backward in the word of Lenin himself. At the end of the 20s, you had another bifurcation -- the conflict between Bukharin and Trotsky. But it was Bukharin who had the upper hand, together with Stalin, and only at the end after having got rid of Trotsky, was the road to collectivization embraced by Stalin, who got rid of Bukharin. So, I think it's more complicated than that.

K.H. Paqué: Well, first of all, I would like a very brief footnote on the discussion in the last session, which is a bit outdated now. It refers to the superpower status. I was wondering whether we're not in the process of mystifying the concept if we say it was not a superpower or it was a superpower, the Soviet Union. In my view, the superpower status is a term from international politics and it very much refers to the nuclear destructive power. You know, if you have a large country, and it may be as inefficient as you like in its internal matters. That does not really matter. But, if it is able -- and that was the case in the Soviet Union -- to put up a military power, a military might, backed by nuclear weapons, then, of

course, you have superpower status. Apparently, the country was a major player in international politics, whatever the mess at home. So, I think that one really shouldn't over-interpret the term. This superpower status was really not lost until the end of the system because the nuclear power remained. And, of course, setting up the nuclear power that was, of course, a field where the command economy was not particularly bad at compared to other things and that leads me to my main point.

The main point is referring to the question of the decline, the causes of the decline of communism. And, that really leads back to Mancur Olson's hypothesis with which he sees the decline very much in the framework of his theory of an increasing amount of collusion. I have doubts whether this is the main point. It is a very nice and plausible intellectual construction to rationalize what happens, but to me it looks much more like a very fundamental development, which you could observe on a world-wide scale and which had consequences in the West and in the East in a sense. And, you see specific characteristics of that in the West. We were talking about unemployment yesterday and in the East. Let me briefly explain what I have in mind.

Well, if you have a command economy, a command economy is relatively good at pursuing very specific aims in a very short period of time. This is why all wars are usually fought by command economies, at least they are turned into command economies for a while because you cannot simply wait until market signals give you the right allocation of resources. You need to fight your enemy right now. Even Britain was a kind of command economy in the Second World War. Even America was to some extent. So, you have a comparative advantage in this respect.

What is the comparative disadvantage of a command economy? Well, if you really pin it down to the main point, and that ties back to what Ingemar Ståhl said, it is the information processing capacity, which is dismally low. You simply do not get the information from the bases to the top and back to the bases. That simply doesn't happen. And, I think, everybody at the bottom notices how inefficient the system is. By the way, you could very nicely observe that in Germany. As long as the Iron Curtain was there, everybody who could migrate from East to West did because you observe that his economic prospects were much better in the

West. So, apparently, people noticed what was happening, so it was not per se a lack of information at the bottom. But, it was a lack of information processing capacity. And that was exactly Hayek's argument in the 1930s in his fascinating discussion with Oscar Lange because he said, well, socialism, a command economy, is simply not able -- you can fiddle around with it and its organizational structures -- but, you never get this information capacity.

Now, Hayek's arguments were excellent, but nobody listened for a long time. Nobody listened in the East, but not very many people listened in the West either. And, we had, if you look at the time from roughly 1950 to the mid-1970s, the Hayekian ideas were completely heretic, left at the sidewalk of mainstream economics. And, mainstream economics was mainly concerned, if you look at growth theory, with a kind of mechanical devices to look for proximate causes of growth as Madison called it. So, it was not intellectually popular in the West and it was, of course, not in the East.

Now, what happened at this time -- fortunately for communism, in my view, things did for a while go in the direction of not putting the main emphasis on this information processing capacity but on economic growth. For quite a while, even in the West, you had a tendency of firms to grow, to reap economies of scale, and to set up vertical integration, to build up conglomerates. All these kinds of discussion, which were around in the 60s up to the early 1970s. This was basically in the same direction as what happened in communist countries. And, while growth was, I sometimes say, like driving on a highway which goes just straight on. You had to build steelworks, you had to build up a certain industrial capacity. That was it. You didn't have to worry too much about your information capacity. Well, you were much more inefficient than the West, but it did not systematically worsen.

But, then, sometime in the 1970s, this seems to have changed. And, this is due, first of all, to the advent of new technologies, which completely revolutionized production. If you take the personal computer and the general move to telecommunications, to an information intensive society that was completely easy and created no further pressure in the direction of decentralization of information. But in a command economy this was particularly bad

and simply disastrous for Eastern countries. Also the move to the service sector was simply not on the agenda in the East. Now you are -- we were discussing that yesterday -- at the end of this process, of this de-industrialization in the traditional sense, which happened in the West. You had crises in the West, and at the end of the day, you had wage differentiation in the United States, and you have high long-term unemployment in Europe. So, there has been a cost in this respect in Western societies, as well. And, if you look at the 70s and 80s discussions in Western countries -- I know it from my country -- that was not a very optimistic discussion about the wonderful growth prospects in the future. There was a persistent feeling that there was a crisis going on. First, due to the external shocks: oil prices. And, second, due to the persistent pressure of structural change.

But, at the end of the day, these societies were at least capable of transforming, of digesting these signals. And, of course, Eastern European societies were simply not able to do that. So, now, if you look at the concrete political events, which finally led to the demise of communism, then, of course, that was not predictable in any way. But, this systematic worsening, I think, that could be observed. And, it also was reflected, I think, in the political and economic thinking of people in the East. If you compare the ideas of Dubcek, in 1968, with the ideas of Vaclav Klaus, who later took over after the democracy was introduced, there is a vast difference between the two. Dubcek certainly wanted something like a social democratic system with strong elements of -- not quite a command economy, but still socialist elements in a way. And Klaus went straight on to free market ideas, which even surpassed those implemented in institutions in the West. So, I think, you can find indicators scattered around in a lot of places. I would not interpret the demise of communism as something where you need a particularly sophisticated theory of the problems within the organization getting worse and worse. But, you can, once again, assume passive rigidity in the system and say that simply the challenges changed; that the world changed completely. And, that this system was particularly inept to tackle the emerging challenges.

I. Ståhl: I agree fully with what you have said now. But, as an economist, I could also formulate it in a little bit other terms. And

that's the change, the deterioration of terms of trade for the Soviet Union in this period. Start with the oil crisis, which was a very good thing for the Soviet Union, in '73 and further on in '79-80 because it increased the price of the main export commodity. And, I think, it's no coincidence that glasnost and Perestroika came around 1985, after the prices went down. Norway had a big crisis in '85, and why shouldn't then Russia, being the third or fourth largest producer of oil, have a similar crisis? So, terms of trade were a little bit improved up 'til 1985, from 1973-85. And, that, perhaps, delayed the collapse a little bit. But, if you look in other fields, you have the deterioration of terms of trade going continuously.

Automobiles -- take that as an example, which is a main commodity in the western society. A Volga and a Volvo: tractors turn into personal cars. Roughly, much the same in 1960. You couldn't see much of a difference between Volga and Volvo. But, in 1980, the difference was, of course, enormous: the Volvo looked more like a Mercedes Benz and the Volga looked like it had always looked like. Perhaps, using a little bit more steel than before because of tiring out of the equipment.

Steel had a very bad price development in this time, except for structural steel -- structural steel of high qualities which were not produced in the Soviet Union. That was also the main bulk of Soviet production. And, you can only explain some of the steel production in the Soviet Union if you accept the hypothesis that a lot of this steel was just going back as scrap steel in the process, moving around all the time without really moving out very far from the steel mills. Otherwise, you can't explain the production figures. Or, they might be just lies.

Has anybody here tried Soviet pharmaceuticals? Or electronics? The PCs I mention as example. The heavy frame computers were of extremely bad shape in the Soviet Union. So, I mean, if you look at this, all the modern technology and what is happening in raw materials industry created an enormous deterioration of the Soviet terms of trade. I mean it's like Argentina in the 1930s, in a way, or more Uruguay: a combination of political problems and deterioration of terms of trade.

S. Magee: I think Paqué's point is very important in the following sense: everybody in the United States is preoccupied with the

Information Revolution that this needs to be a part of the book, or, at least, a part of the discussion. I think Mancur does have something in an earlier chapter in this book about how in the West and in democracies, the private incentives are for individuals to publicize corruption and illegal activity because that facilitates self-interest. In contrast, in more corrupt systems, particularly toward the end of the Soviet system, there was every incentive for everyone to suppress information to keep corruption from being exposed because self-interest rules against processing information. This provides a partial incorporation of information into Mancur's theory.

M. Ambrosi: We have now two explanations: one is *information*, the other is *terms of trade*. Of both, I am not very convinced that they are really strategic for the downfall of the Soviet system. Before information technology came up to its present-day level, it was often said that if we had more information and more information transformation capacity, then central planning could really work. So now with the advent of tremendous new capacities in information gathering and information processing it would have been the time, when central planning could really work. The astonishing thing is that it did not.

As far as *terms of trade* is concerned, it should be remembered that most of the foreign trade of the communist countries was conducted in the framework of their COMECON system of trade, devised to force together under the guidance and control of the Soviet Union all the centrally planned economies. Thus, the Soviet Union was not really dependent on world trade. They had their own resources; they could have had everything themselves and the Communist states were in control of a third of the world. The astonishing thing in this context is that within the sphere, which they could very well control -- i.e. within the socialist sphere -- there was not an alternative system of exchange which made their economies independent of the capitalist system. I think, *that* must be explained; not how the terms of trade for the Western economies developed relative to the members of the communist system.

I also wanted to say something concerning the discussion about ideology. I would agree, as Mr. Szlajfer said, that maybe one should have a separate discussion on that. But, what astonishes me is that we have a long-going discussion right now without really

defining that term. If you define ideology in the Marxist tradition, it means "wrong consciousness." When Mancur Olson says, "ideology is a smoke-screen" I would like to ask: "smoke-screen for whom?" It seems to me that it was exactly because of such a smoke-screen why that system was incapable of dealing with facts. According to the definition just given, I would say, a learning ideology is a contradiction in itself. If an ideology is a mental system of perceiving reality wrongly, and if that mental system adapts to its deficiency, it becomes even more wrong and not right by definition of the term of "ideology". That would be my comment concerning ideology.

Another comment: granted that there could be rational individuals and irrational societies, but why have our political scientists come up with a concept of *raison d'Etat*? Should we not employ, in this context, a different definition of rationality, one which had a long tradition in philosophical and political thought since the eighteenth century? If we did, I think, one could address the situation of the Soviet Union by asking expressly: what was the *raison d'Etat* of the Soviet Union? Two *raisons d'Etat* have been mentioned: it was Socialism and it was World Revolution. These were tasks, which were quite independent of what Stalin wanted to do or what Lenin wanted to do. These persons were actors of the *raison d'Etat* of a system which had these two points on its agenda.

Of course, that it should be the Soviet Union which defined its existence with regard to this agenda was part of the ideology of that body in the sense of a wrong perception of reality. The consciousness of this political body taking up these political tasks was wrong because it was, more or less, a feudal peasant state. It put itself into the position of a state which, according to the Marxist conception where socialism should develop, should have been one where accumulation had come to its end. But you installed this agenda in a system where the capitalist accumulation in the sense of "Das Kapital" had not really started. Because of this ideology you needed special mechanisms which had nothing to do with the Bible which they took to have given the blueprint for their system and for its world historical task. Nevertheless, they had this agenda as their much propagated political idea.

Let me briefly also address the question: what is the reason for the downfall of the Soviet Union? I would say, it is totalitarianism.

As you have the “tragedy of the Commons”, you have the “tragedy of totalitarianism”. Its tragedy is that it is too efficient in controlling its own society. In any non-totalitarian system you could always have elements which did not belong to the system, thus reserving some parts of our society where reform could come from. I would have liked to go into some aspects of this when we talked about the “roaming bandit” and about the feudal systems. The medieval German emperors sometimes had great need for internal political reforms. Although they were exponents of the feudal system where peasants were not at all recognized, the emperors occasionally used the peasants in order to fight against their “own” noble underlings which had become too independent for an efficient working of the feudal system. This strife for independence of the powerful underlings seems to be universal. Let us note that in the contributions of today, we had a number of examples how differentiated the Soviet system became; how important aspects of its manifested independence; how the underlings in this totalitarian state managed to become exponents of their independent spheres of influence but presenting themselves as functionaries of the centralist system itself. The problem of a supposedly totalitarian system is now where to find the lever of working against that type of phenomenon.

As long as you define yourself within this ideology, in this wrong perception of reality, you had no critical leverage against it. It was only Mao who had some sort of answer with his concept of “permanent revolution” -- and you described the beneficial effect. Mao was able to break out of the model of totalitarianism. That was his genius -- maybe, his internal revolution was detrimental for the daily working of the system at the moment, but it was a genial inspiration as far as the development of that type of states is concerned.

A. Clesse: Robert Skidelsky doesn't agree totally with what you were saying about Mao at least.

R. Skidelsky: I think it's been very helpful. I'll be very brief. When Professor Ambrosi calls ideology a mental system for perceiving facts wrongly, I think, that's an important contribution. Perhaps, we can think of ideology as parametric and then we have a system of choices within that framework. If the parametric system

is also false consciousness, then we have a recipe for disaster because the choices are distorted.

M. Olson: This is extraordinarily helpful to me, and I wonder if it would be helpful to others to think of the expositional problem that I have, and which I obviously haven't solved adequately in the present draft. And, it comes up in what has just been said.

Now, we obviously know that communism collapsed, and for economists, the idea that this was a very inefficient system is such an old and familiar idea that one doesn't need to dwell much on it. To the extent we have ideology with false consciousness, which we surely do have in the Soviet Union and the other communist countries, we clearly then have something that is going to work against the prosperity of these societies. So, we don't have a big intellectual problem in explaining why communism didn't prevail in the Cold War -- that, at least to an economist, that's not a big problem. The interesting intellectual question, the difficult question is why didn't it collapse earlier. How could it sustain a superpower? So, we need an explanation, it seems to me, of why the system became so formidable; why it was feared all over the world; why it ran down gradually over time; why it finally went broke and collapsed. And, only if we have a single theory that can bring all these things together should we have the beginnings even of a satisfactory explanation.

Now, clearly, the familiar ideologies don't do this. Marxian false consciousness, obviously, doesn't do the trick of explaining reality. But, explaining the short-comings of communism isn't sufficient either because that can't explain why it was powerful for a while. So, that's why I try to put forth this argument about the capacity of the system when it was first set up to mobilize an exceptional amount of resources for the state; how initially, when there wasn't collusion among subordinates, how this system could get some information about what was happening in the productive enterprises, so this information could be used to get some faint semblance of a coherent allocation of resources; how as there was more collusion over time, this system ran down and became less and less efficient as time went on, ultimately ran out of money and collapsed. So, my expositional problem is to jar people into asking, what seems to me surely a necessary question, how can we have an explanation of all of these things at once? If we don't have an

explanation of all of these things at one, we really haven't got an explanation of any of them. So, I tried to -- unwisely, I now see -- to slap ideology aside, saying, "Obviously that's not sufficient." But, here, I think that that was a mistake. It sets up an unnecessary dispute. What I do need to do is put the reader in a frame of mind where he is asking a question that I'm trying to answer, and it seems to me a question that is not only legitimate but essential.

Now, Karl-Heinz Paqué's point is a possible explanation. I would say, he is offering the beginnings of an answer to both questions, but I don't think satisfactory. That is to say, it's argued by some people that the system was able to work in the beginning when things were simpler, but as time went on technology became more complex and then it couldn't live with that. So then, there is an alternative explanation to my explanation that can account for both why it worked when it worked and why it ran down over time and collapsed and that's this complexity explanation: in the age of computers, it wouldn't work; in the age of mass production, it could work. While I find this explanation admissible because it fits the time profile, I think, it's wrong.

Suppose we look at the size of countries and the size of firms over history. Now, as time has gone on, production has become more complicated, more advanced; products are being created and so on. Production has become more complicated. But, is it the case that firms and nations are getting ever smaller? Quite the opposition. We go back to the Middle Ages, we have the manorial economy because there isn't the technological basis for governing a big nation-state when you didn't have telephones and radios and so on. When you had to supervise a kingdom on horseback, essentially the only effective system of government was a kind of manorial system with small baronies. As time went on, and the railway was developed, you had continental powers. In this period, you get the beginnings with the railway companies of big corporations. For the first time there are big corporations that can be run efficiently.

Then, you read work like Chandler's about the twentieth century, superior technologies, again in the twentieth century, telephone and radio and highways and so on, and you get more and more big corporations. And, big countries become relatively more important. The idea that a big territory like the Soviet Union or the United

States can be governed under a single government, this is something that can become a reality.

Now, carrying on with this, I would argue that the development of the computer and the other technological advances since World War II increased net administrative capacity. That these technologies helped the center and, therefore, it collapsed, I would hypothesize, for the kinds of reasons I offered rather than because the world was changing in a way unfavorable to communism. The higher price of oil, the higher price of some minerals was only helping the Soviet Union. It was something internal to it that led it to collapse, not a change in technology, such, at least, I would hypothesize

A. Clesse: I think one factor that we listed as a possible contribution to the decline and ultimate collapse hasn't been mentioned yet, namely, corruption and crime. But, above all corruption.

H. Szlajfer: After hearing your last intervention, would you argue that the collusion you describe in your manuscript was *the* reason, which in the age of new technologies, blocked the technological progress in the Soviet Union?

M. Olson: That and did other damage too. It did that but other types of damage as well. Among the kinds of damage that occurred was that the lack of information at the center also allowed more stealing, so the corruption increased.

A. Tyrie: You've correctly said that the planned economy was very inefficient; you've also correctly said that the Soviet Union, an extreme form of planned economy, was extremely successful in fighting the War. And, it is a fact that a very large number of countries, including most Western countries, abandoned market signals to a large degree in order to fight the war because they thought it would make them more efficient in pursuing it. I think that we need to address that issue a little: why you become more efficient by abandoning the market signals to fight a war. It seems to me that the reason that you do it is because in a war everything becomes a public good: the cup of coffee that will keep the soldier awake on the front-line becomes far more valuable to everybody than the cup of coffee that the man wants to drink on the railway

station on the home front. And, therefore, you make sure, at whatever price, that he has the food and vitals or whatever to keep awake on the central front.

It seems to me that you've cited the basic conditions in your book required to be prosperous and when these conditions were absent in the Soviet Union. This was a partial explanation for why they collapsed. One of those was the need for individual rights. It seems to me that individual rights are only needed when you want to satisfy individual wants. You don't want to satisfy individual wants during a war. You have a collective want, which is to survive the war. Therefore, the victory, I think, of the market economy over communism has a lot to do with the victory of the consumer society. It has a lot to do with the fact that people demanded a set of things which they would have to forego in a time of great national crisis, which is why the Russians spent so much time trying to bring a spillover of the wartime exigencies into peace-time with talk and ideological reference to the Great Patriotic War. So, it seems to me, that the first ingredient you need is a revival of consumerism, which I think took place in the Soviet Union in the 1980s.

And, you need awareness of what consumerism can bring. And, that is what the information technology revolutions brought. Whereas, in the 50s and 60s, parts of Eastern Europe and most of the Soviet Union were largely ignorant of exactly what was going on in the West, by various means in the 70s and 80s, which are technologically related, people started to discover what was going on, and that spurred consumer demands. And, I think that that is absolutely crucial to the collapse of communism. And, therefore, individual rights, sitting alone in your framework, do not fully answer the question: why did communism collapse?

C. Goodhart: I want to go on to section six, which I think we're supposed to be dealing with, though it does relate quite a lot to what Mancur said. And, I want to try some marginal criticisms of Mancur's positions.

If you take the first question you pose: "Did the covert collusion of subordinates ultimately eat away most of the power of the communist's centers?", the implication is that the collapse of central power was in part what did it for Russia. But, there is an inconsistency here because if you look at what happened to China,

Mancur actually says that it's the collapse of central power under the Maoist Cultural Revolution that actually helped China. Now, I think, the way that you resolve that particular inconsistency is that the problem with the Russian system was that it effectively had no competition, and it was centrally controlled, and those very huge and massive, great factories (that you seemed actually to think were a good thing) were actually a disaster because it meant that you had far more power in the hands of the Nomenclatura, and you had far less competition. One of the reasons why they built up these huge, bloody great factories -- I mean, three factories producing tractors in the whole Soviet Union -- was partly for control purposes. They couldn't control the system unless they had very few producing units.

Now, what happened in China was that there was much more competition, tournament competition between the regional governments which increased their power. It was in no sense a move towards capitalism. And, one of the things, for example, that you need to re-consider is the following. You indicate that the shift to agriculture, to an individual responsibility market system was introduced from the top by Deng. It finally worked that way, but what happened was that a number of provinces were experimenting with different mechanisms. The province that first started to experiment with the individual market responsibility system was initially under enormous criticism from the rest of the Chinese. And, then, it worked very well. And, when it appeared to work very well, as a result of competition, it was then introduced throughout the rest of China. So, the Chinese have got a kind of ersatz competitive process through the competition between the provinces, between the regions, which Russia, because of its enormous use of these huge, single factories or very, very few factories completely lost. My feeling is that the emphasis on property rights as an element in the growth of countries is slightly exaggerated -- only slightly -- as compared with the importance of competition. If you think of a number of long-standing countries, which have fairly well-established property rights but not competition, they tended to stagnate. It was interesting that the one comment about where Russia did well was when it had ersatz competition between different groups of scientists. It was the failure of the competitive process leading to inefficiencies.

Now, the second question: crime and corruption. You have to distinguish between the two. You know, like sex and violence. They are always put together, but really they are very distinct. I reckon that I would have been safer from having my wallet pinched walking around a pre-1990 Russia than I would be walking round most of the major cities in the United States. I do not think that crime, speaking of violence, mugging, auto theft and all that was anywhere near as prevalent in pre-adjustment communist countries as it was in the West.

Now, corruption, of course, there was a lot of corruption. You get a lot of corruption because the incentives for corruption, because of the distortion of the prices, is enormous. But, note also that there were some restraints in the centralized control system. And, note that the corruption has got a lot worse after the Russian reforms in the former Russia than it was. Certainly it is bad if not worse. And, this leads on to the sort of questions we are going to deal with in section VII, which is: can you actually introduce capitalism in any sense until you have your rule of law? I mean, is giving private property to people who are not constrained by the rule of law going to lead to anything other than Mafia capitalism, anything other than a total disaster?

Now, finally, there is a distinction between your approach and, I think, Paqué's approach. You suggest that communism collapsed at the end because it somehow went bankrupt, rather than because it was inefficient, in large part because of these huge, monolithic factories, which you seem to like, whereas I think that they were a part of the story of why it all went wrong and disaster occurred because there were no competitive pressures. I don't think that communism did go bankrupt in any technical financial sense. And, usually, a good indicator of when something is going to go bankrupt is when they have to turn to the printing press to finance themselves. And, I know that there was some suppressed inflation, but the degree of suppressed inflation -- the degree to which they were actually financially going bankrupt, I think can be wildly exaggerated. I agree with Professor Paqué: the collapse was one of efficiency and perceived inefficiency and a feeling that you had to do something to change the system. And when you felt you had to do something to change the system, reforms under those circumstances led to its unravelling. I don't think, it was financial.

They were able to obtain the taxes. They were able to run themselves without a financial crisis until after the end. And, it didn't collapse because they were bust. I don't see any evidence that it was a financial bankruptcy.

R. Skidelsky: I just think, Charles under-estimates the extent of state bankruptcy by the end of the Gorbachev period. I think the suppressed prices problem was much greater than emerges from what you just said. I think, in fact, Russia was on the verge of hyper-inflation before the Gaidar system took over.

The second point is, I think, if you look at the revenue collections, you find the expenditures are being maintained, but the revenue is going down. And, it falls dramatically in the period 1990-91. Until roughly the late 1980s, the budget is balanced, more or less. By December 1991, the deficit is 16 to 20 percent of GDP. So, there was a financial crisis. And, I think, that was the trigger of the end of the system. The state ran out of money to support these gigantic factories.

C. Goodhart: Can I go back to that? I don't deny your numbers. What I deny, in some part, is the interpretation. What was happening was that, at the end of this period, the end of the 80s and the beginning of the 90s, the initial process of trying to reform the system was such that they were trying to get towards western-type market prices. In other words, it was the reform of the system, and the shift of the pricing mechanism, that revealed or led to the inability of the state-owned enterprises to generate the surpluses that had been generated before. So the financial crisis or the financial collapse of the centralized budget, which did occur, I agree, at the beginning of the 1990s before the final end, was partly in itself a sort of botched attempt to reform the initial system. And, the reform finally broke the thing in half. As I think Professor Volodin was saying, if you have a really fairly rigid system, as they had, and you then try to reform it, the reforms can be very, very dangerous. And, they didn't manage to introduce the reforms in a way that was sustainable.

K. Segbers: I have to admit that I got at last nervous, and my impression is that it has to do with the terminology we are trying to apply to some extent.

I'm going to start with corruption. What does this concept give us analytically? I mean the whole thing which fueled the Soviet Union were informal relations. Informal relations were not a deviation from something. That always was the real thing. Now, we can define that as corruption, but analytically, I don't think, that it is extremely fruitful. The same thing, by the way, goes for a legal-illegal divide nowadays in Russia. There simply is no clear boundary between what is legal and what is illegal. If any individual or social group wants to act, to do something, this person or this group has to violate 57 laws every week; otherwise, you have to sit at home and do nothing. So, the whole concept of legal-illegal does not lead really to any meaningful point during periods of accelerated changes.

To some extent, the same is true for "shock therapy." By the way, in my understanding it never happened in Russia. It is exactly the point that prices were free before Gaidar came into his position, and nobody was really able to control them in the first place. And, the one meaningful thing which Gaidar did was to talk publicly about this fact: that he was not any more able to control them, sorry. Is that freeing prices and shock therapy?

And, the last point, and maybe the most important, is again about how we understand and how we frame and perceive the former Soviet Union. I mean, there was again a lot of talk about communism and retreat and advance and so forth as if there were a group of people who masterminded a transition from capitalism to socialism at any given point in the real history of the Soviet Union. I pretty much doubt that -- that this is a useful concept for understanding the Soviet Union. That is sort of rational choice combined with totalitarianism and unitary actor approaches and things like that. I personally don't think that that is very fruitful for anything. We ignore, then, a huge pack of literature which is at hand, which was written since the 50s by the way, about networks, about how Soviet enterprises do function. We ignore the whole bag of literature on the Soviet Interview Project, the first and the second, and all other analytical things we have. I don't think that we are well advised to do that. We should take that into consideration. I mean, most Soviet actors acted in networks, under conditions of incomplete information, under conditions of uncertainty, and mostly rather ad hoc to such an extent that some

people tried to apply concepts like ad-hocism for how the Soviet system really worked. And, what they did is accessible and explainable.

So, I even got the impression, Mancur, in the last couple of minutes that you retreated a bit. I mean, many of your last questions actually for me were answered in your manuscript. And, now you start again with the same question: why the Soviet system worked and why it broke down. I mean, their answers are basically at hand for me. Basically. So, you shouldn't give that away, would be my recommendation.

U. Preuß: Well, I think you impose a very heavy burden on me because now everyone thinks that is the final word to the problem which you are discussing and that is, of course, not. I am not an expert in that field, and even worse, I am not an economist. I think that the explanations which we heard so far, mostly purely economic, are very impressive, but I think, they are unsatisfactory.

I rather would suggest to raise the question of the interrelation between economic processes and statehood because I have the impression that the Soviet Union was no state and that the basic failure of the Soviet Union may be the fact that the lack of statehood prevented the system and the economy from providing the basic solutions of the society which were necessary for surviving. Professor Ambrosi mentioned the question of *raison d'Etat*, presupposing that there was a state. But, I think, the Soviet Union was not a state. Of course, it was a state in the international sense of the word because it participated in the community of sovereign states and it played a role within the United Nations and within the international community. But, in the essential sense of what a state has to provide for society, I think, it did not really meet the requirements of statehood.

These are the three basic requirements: that there is a clear-cut territory, a clear-cut people who live on the territory and who are -- this is the third element -- subject to a homogeneous unitary political power. There may be a clear-cut territory and, as a consequence, there was also a population which lived within the physical boundaries of the territory and which were subjects to the powerholders. But, the power itself was not organized in the sense in which modern power is organized in the framework of statehood. There was no formal organization of the competencies;

there was no mechanism of accountability and responsibility; and in a certain sense, I think, there was also no clear-cut sense of legitimizing authority. I do not mean to say that this has to be a democratic legitimization, but any kind of legitimization which would meet requirements of rational legitimacy in the sense of Max Weber, who was already mentioned here.

I think, the Soviet Union was more an empire in the sense of unorganized, uncoordinated, and irresponsible and unaccountable powers, indeed a plurality of powers which were not able to coordinate themselves according to a kind of rational device. If we look at the development of Western states we see there is a development which starts with statehood, that is, a sovereign state power which imposes its control over the individuals and over society. But, in order to become an efficient economy or to develop an efficient economy, they need, in the first step, the rule of law or the idea of the rule of law, of what we call in Germany the *Rechtsstaat* -- a basic element of rationalization of political power according to rules. Government of man is not a government of man but of rules. I think, this is essential for the development of an economy. The next developmental step is, of course, some kind of legitimization by the ruled. That would be the democratic step in this development.

These two developmental steps were absent in the Soviet Union, with which I do not want to deny that there was some kind of pluralism as Klaus Segbers mentioned; some kind of bargaining; some kind of social articulation of interests and of needs. But, it was not that kind of rational organization of power and resources in the sense of the Weberian concept of state, which I think is still paradigmatic of modernity and paradigmatic of the relation between the economy and the political sphere.

If this is the case, then, I think, everything what has been said can be explained. It can be explained that the political authority's right to coerce people -- what Alfred Stepan mentioned -- including the authority to dispose of the life of its subjects simply faded away. State authority does not easily fade away. The state is, in itself, something which provides authority, and as long as the state exists there is a minimum degree of authority in a well-ordered society. Since authority in the communist system was not allocated to statehood but to a vanguard party which legitimized its rule with

some kind of international or internationalist ideology, it was very much susceptible to a decrease of authority in a situation in which the credibility of the party and the internationalist ideology faded away on grounds which we are not going to discuss here.

Corruption, or what Klaus Segbers just mentioned, the distinction between legality and illegality became absolutely unimportant and irrelevant under such a stateless system. This was simply so because there was no state which established the criterion between legality and illegality. That is another indication for the absence of statehood of the Soviet Union. I don't mean to say that this is an explanation of why the Soviet Union collapsed. But I suggest that we extend our framework of analysis and our explanation to that dimension of the society.

The question is, of course, why did the Soviet Union fail to become a state. Two answers are possible. I don't know which one is correct. Maybe, none of them. Or, maybe only the combination of the two. The first is history. The predecessor of the Soviet Union was the Russian Empire. The Empire was no state either, not in the sense in which Western European states became states in the seventeenth century. There is a historical continuity, and according to this historicistic interpretation the Soviet Union was just an ideological super-structure which was imposed on Russia without disrupting the continuity of the historical existence of Russia as an empire, that is, as a non-state. The second hypothesis is that they didn't want to become a state because the ideology told them that the Soviet Union is the home of the world proletariat. It is not meant to be the home of the people who live on that territory. That means, it's not meant to be a state. Rather, it meant that it was to be the vanguard of a world society. That would be another explanation. I don't know if this is satisfactory, I suppose there are still others. However this may be, it is a fact that the Soviet Union was not a state. This is one of the main elements why they finally did not cope with the challenges they had to face at least in the 70s. At that time -- as Paqué rightly said -- the necessary reactions required to react, required far more complex methods than the Soviet system provided; they lacked the devices for learning, for adjusting to new circumstances and everything that is included in the idea of statehood.

H. van Gunsteren: There is something that doesn't work in the things ideology and belief and so, and maybe, Mancur, you don't need it too much in your argument. I find the whole argument about autocracy very good. The question is where to stop because it's not a question, of course, of Stalin only and his ideology. It's that, when we said Stalin did this and that to the peasants, there are many people who did it, and your explanation for that is rather run of the mill. You say, "Well, he could play one group against the other and so." But, in many cases that doesn't work. So, that leaves the question open why it works: did those people believe or live in an ideology, or did they have certain beliefs? I think, even those terms don't catch it. You know, when Stalin died many people who hated his guts and thought he was bad for the country, they cried their eyes out. Why would that be?

It resembles the case of people in the First World War who hated the war, and nevertheless went back to the trenches even when, with shell shock and so, they could have stayed in England. Or, it is like the coal miners in 93: when you have young people and you ask them, "Well, what do you want to do?" For the same money, they would rather tend the garden then go into the mines. But, once they have worked half a year underground, they want to stay there. They demonstrated here in Belgium in the streets, and they were even prepared to die. That's why the government had so much trouble closing the mines which were losing lots of money. So, there is something in people that they can go on and keep a system going without belief, just because they are there. I think this requires a different kind of explanation than in terms of ideology.

The second point is on corruption. Whether that is useful or not, it's difficult to say. We all see that in systems that strictly speaking cannot work but that are kept going by 'forbidden' activities. Not only central planning, but also in hospitals and so. If you do what is required, the patients will die, so people out of good-will, or out of other motives, develop informal ways of doing that violate the rules and that give certain results. You have that in war also. The Soviet Union, of course, needed that. And, then, when you want to change those ways of helping the invalid system to keep going, suddenly these ways are qualified as corruption and they are an obstacle to change because when you change the official rules, still the unofficial behavior is in place. I had a student doing a Ph.D. on

the work brigades in the USSR building industry. These brigades worked hard and so the authorities tried to semi-legalize them. But that is very hard, because then the whole point of having those brigades is gone. And, what's interesting, I think, in the Soviet Union is not whether there is more corruption or not, but what I as a political scientist find very interesting that accusations of corruption have become one of the main ways of making political careers and displacing people in power. When corruption cannot be defined in terms of the law, that is a very disturbing aspect because then you get democracy not tempered by law, which according to the ancients was a recipe for having one tyrant after another.

N. von Kunitzki: I have two subjects. The first is to try to give an answer the question why the Soviet Union system lasted for so long and then disintegrated so quickly; this can be answered probably with a short explanation.

If we speak about the Soviet system, we speak about central planning; now it has already been said that in war time, any community adopts central planning. One must not forget that in the Soviet Union, war economy did not end on May 8, 1945; it lasted on for years and years, long after Stalin's death in 1953. It should not be forgotten that even in Great Britain, rationing was only abolished in July 1954. In the case of the Soviet Union, we must take into account that the country was still in the build-up of its infrastructure: Until 1917, one could scarcely speak of a modern industrial infrastructure in Russia; then came the civil war between the Red and the White Army, followed by Stalin's build-up of a war industry and the German invasion that thoroughly destroyed any infrastructure in the western Soviet Union. The priority of building an infrastructure for industry as a war machine in the western Soviet Union. The priority of building an infrastructure for industry as a war machine lasted certainly into the sixties, reaching a climax with the successful launching of Sputnik, Lunik and major Yuri Gagarin in the late fifties and the beginning of the sixties. We can consider that this need for infrastructure and therefore the usefulness of economic centralization lasted until the end of the sixties.

It is only when consumerism reached the Soviet Empire that it began to fall behind quicker and quicker, as new sorts of goods

with a greater variation and a much shorter life-cycle were demanded from the Soviet production machine, a process that had begun in the West in the beginning of this century, in the golden twenties and, with more vigor, after 1950. The western industry thus had a long time to adapt its productive apparatus to the needs of a consumer society; but in the Soviet Union, Magnitogorsk and Cheliabinsk are still copies of the great seed mills that Krupp ran in Essen and Schneider in Le Creusot before the First World War. We should, thus, not be astonished at the lack of adaptation of Soviet industry to the needs of modern times. Even given considerably more time for adapting, great companies in the United States and Europe have been blown away by the wind of technological progress and changing consumer needs, like TWA and PanAm in the United States, British Leyland or AEG in Europe.

With the more and more rapid evolution of innovation in the productive field and of tastes in the market, the most important factor of success is the possibility to capture -- and respond to -- the market signals. Companies whose internal communication is complicated and which are thus not capable of reacting to them rapidly have no chance to survive -- even in the West. A system of central planning which is totally based, not upon signals from below, but upon orders from above has, of course, no chance at all to live up to the challenge. The future belongs to small or decentralized enterprises.

One might, of course, point to the fact that the present trend of take-overs, mergers and acquisitions, gives rise to bigger and bigger units: This is true for the company, not for the enterprise; we have here a very important distinction. Greater markets and more and more capital-intensive processes need enormous financial means and therefore privilege the giant company; but in its administrative, commercial and technological alliances, in order to be able to follow market demand on one side, technological progress on the other. The economy of the end of the 20th century is lethal to big enterprise, based on centralization and vertical integration. This is a general truth, valid under capitalism as well as under socialism. As Russia's industry lagged behind the West for at least half a century, it died quickly. Big companies in the West could survive adopting models that allow their agents to react like a

small enterprise in a bigger frame. But that was forbidden in the Soviet Union because of the system; decentralization was anathema. The possibility to combine the advantages of a small enterprise with the advantages of a big organization, which is the company, was not open to them for ideological reasons. This is the first point I want to make.

The second point relates to Mr. Goodhart's question about corruption or crime. I fully agree with Mr. Goodhart that it was corruption. But the more important question is why generalized corruption developed. I think that if you eliminate price signals as a way to steer the economy, you have to develop other criteria in order to decide about the use of production factors. To which product, to which enterprise should the production factors available be directed? Production factors being limited in quantity and quality, you have to attribute them to the production of bread or guns, of tanks or tractors, books or blue jeans. Of course, there was a lot of competition between those in need of production factors and hard negotiations with those that were in charge of distribution of production goods. It was the duty for any agent responsible for his company, for his enterprise to convince the central distribution authorities to supply him, rather than others. Contrary to the West, price was no argument in these negotiations, so what was normal than to try to convince one's vis-à-vis with arguments "ad hominem" or rather "ad pecuniam"? As a matter of fact, as soon as you eliminate the price mechanism, personal preferences, nepotism and corruption come in irresistibly. If I were cynical, I would say that, if the system worked to a certain degree, it was because those that were economically more deserving could afford to pay the higher corruption prices. But this, of course, is a joke.

Session VII: The transition from communism to markets and democracy

A. Volodin: I just have a very few observations that may be of relevance to Professor Olson, and they pertain to the destruction and disintegration of the Soviet Union. I just enumerate them in telegraphic style:

Causes of structural importance. That is, first of all, the growing cultural and civilizational heterogeneity of Soviet society plus a fast changing demographic structure. I will decipher this point in two words because by the end of the 80s, the greater part of Russian population, felt themselves encircled by foreigners or some other civilizational *encerclement*--that is, Central Asia and Transcaucasia. And, it is not accidental that in 1990, the famous and frequently quoted article by Solzhenitzyn "How to Restructure Russia" was published and discussed within the former Supreme Soviet of the Soviet Union.

Second that is important because it is a very controversial phenomenon: it is the reaching of parity with the West. After 1972, when SALT I was signed, it became very difficult to explain to the rank and file that you recognized the existence of some external menace. That is when the ideology based on War memories, of War reminiscences, began to lose ground.

And, the third point, that is very important, that is the point just raised by Claus Offe and Herman van Gunsteren -- the role of the Second World War or the Great Patriotic War as referred to in Russia. This victory in the Second World War had a very controversial effect on the society on the whole and on mass consciousness in particular. If such a strong economic and military machine like Germany was destroyed, the society that destroyed this machine must be quite sophisticated and needs no internal reformation. So we should not only blame the highest authority, but also the people because no impulses for internal reforms did come from below.

Another point, concerns the corruption. I think that you, Professor Olson, should be more historical in dealing with this problem. I will just distinguish three stages in dealing with corruption, in corruption emerging as a phenomenon of political importance. In Russia, before 1861, before the Alexander II reform, there was no corruption, and there was no reflection of this corruption in the form of bribery in the law system of the Russian Federation. Since the reform started and Count Vita used to say that it is very easy through the means of the state and the Czarist apparatus in the government to control the gentry and to control the society. This was the first stage from the 1860s - 1917. In 1917, new actors emerged, new institutions emerged and corruption was

introduced in the form of bribery as a certain element into the law system of the Russian Federation. The second stage, corruption, in the form of bribery -- that was the category, bribery -- was introduced into the Russian law system: bribery was punished. At this stage, 1917 up to the middle of the 1960s corruption did not exist as a social phenomenon. There were certain privileges; certain distribution agencies. But, as a mass phenomenon corruption did not happen in the Soviet Union. From my point of view, these trends started from the end of the 60s and were legalized by two laws adopted by the former Supreme Soviet of the Soviet Union: the first one is the law on individual economic activity and the second is the law of the liberalization of foreign trade. New actors come to the fore and Herman van Gunsteren was completely right saying that there is no proper definition what is legal and what is illegal. And, that is why we have such problems.

And my last point. There are four forms how the corruption influenced the political life of the Russian Federation. First of all lobbying of the power bodies, in particular on the middle level, that is, regional level or city level. Second point is direct participation of bureaucracy in the privatization of the former so-called public property, that is, more or less known. Third form is the slowing down of the process of decision-making in areas potentially profitable to the officials. And, the fourth, which is very new to the Russian Federation, is the creation of new structures with long-term consequences: the para-legal participation in the distribution of property.

I will terminate by saying that now the situation is so grave that those people who are in power understand fully that corruption is a danger not only to their position but also to the state itself. That is why, here I anticipate, there will be a very serious process against corruptionists, maybe in some instances they will be reminiscent of this process of the 30s -- but not with the death sentence -- but they will be made public.

H. Szlajfer: Four short points. Firstly, I would like to say a word still about the collusion which is indicated in the manuscript as one of the main reasons, and practically the exclusive reason or the most serious reason, for the disintegration and then the collapse of the communist system. I have some doubts if this was the case. Similarly, I have doubts concerning the interpretation of the Mao

experience with the Cultural Revolution. I doubt whether one can see, to some extent, in the atrocities of the Cultural Revolution a sweeping wind, so to say, which, in the long term, brought beneficial results to the system. Probably some hard empirical data are necessary to see exactly who was touched in which part of the state apparatus, how, for example, the Shanghai leadership survived and so on. So, it seems to me that this argument is vulnerable as long as there are no exact data to confirm this.

The second point, which is connected with the collusion, is the topic already discussed here, namely, the transition to what was said to be “extensive growth”. I ask you if you can see a direct relation between collusion and, for example, technology transfer or technology assimilation in the Russian economy. So, was then collusion responsible for the low innovation rate in the Soviet economy? If this was a main reason, it means, probably, the collusion was responsible for it. I see this in a more complex way. I see a relationship between technology or specific types of technology, collusion indicated also ideology and the requirements for the system's stability. A small example: Why, if we admit this was the case, was there no problem with the dissemination of cinema films, radio programs or TV programs in the Soviet Union? On the other hand, why was there a problem with the introduction of the personal computers? Was it by accident, or were there simply some choices made? Especially, when we know that at the end of 1950s the computer technology in Soviet Union, in Poland, other countries only lagged some five - six years behind the United States. And then, suddenly, there was a blockade in this field of telecommunication, information service and so on. So, the question is, can collusion explain this serious problem which grew bigger over time? My guess is that not.

And another point, I would like to mention: the collapse of communism is only treated here with the example of Soviet Union. Therefore, this chapter should have a sub-title or something like a footnote indicating that it only deals with the experience of the Soviet Union because the diversity in the process of collapses among the Communist countries was enormous. Already the initial conditions were, of course, different: from borrowing stability in Czechoslovakia, to the delayed or blocked reform in Poland, to the

exhausted reform potential, probably, in Hungary, and so on and so on. And, the paths were probably also different too.

And the last point: I would suggest to look at the discussion about the reasons for the collapse not only in economic terms but rather to look at this as a political response to some economic problems. I am not saying there were no economic problems but they were increased during the political process and began, through the feedback mechanism, to play an even more important role than had they initially had.

R. Hardin: Ulrich Preuß said this morning, "I'm not an expert; even worse, I'm not an economist." It sounded like he meant that expert and economist were separate categories. I'm neither either, so that's okay. I think, these two chapters or these two sessions, six and seven, are strongly connected. And, I am going to make four quick points.

First, Charles Goodhart talked about the difficulties of the large firms. In fact, historically, Stalin's gigantism was just a kind of projection or extension of a trend that was underway earlier in the West but that was basically ending at the time he did it. So, he created bigger factories than have ever existed anywhere else in the world just when big factories were beginning to go into decline except for the War effort, which kept them alive for a little while. One of the long-term implications of that is the long term implication of the same kinds of industries as Norbert said this morning. They are dead in the West as much as they should be dead in the former Soviet Union or in Russia today. It would be wrong to say that the capital of those firms had no value, but it would have remarkable little value in an economy that was much more ahead of the economy that now exists in the East. Such firms have almost no capital value in the United States, for example, or in West Germany or now Germany.

The second point is about the discussions of high tech innovation. The issue isn't, as I think you were taking it to be Mancur, whether this kind of innovation would enable central control; it's rather whether the Soviet Union or the Russian economy could even do it, whether they could do the high tech kind of innovation. The first comment on that is, of course, it doesn't take a lot of capital. Steve Jobs did it in a garage in California. And, Bill Gates did it in his bedroom in Washington.

So, the kinds of high tech innovation that we have seen in lots of areas -- some of it does take a lot of capital, the chemical innovations and the drug innovations -- but a lot of it comes from the Steve Jobs, Bill Gates, and so forth, of the world. There haven't been many of those in the context of a centrally controlled economy. And, so one of the things that couldn't happen is the kind of innovation that goes in the computer industry or in the software industry with changes every couple of years. And, that would mean that this economy was going to be left far behind as of about the time it collapsed.

The third point, the collapse itself was a tipping phenomenon, which makes it seem, as somebody said earlier, "It was an accident"; it wasn't an accident in the kind of thing it was, just the timing maybe was an accident. That it was a tipping phenomenon that meant that, in essence, when something went wrong, that made even more things go wrong. So it got worse and worse and then collapsed. The creation of a market is not a tipping phenomenon. That is going to take a long haul of creativity: lots of different acts of creativity. And, it will not happen anything like as fast as the tipping phenomenon that put an end to the old system.

And, then, the fourth point -- This isn't actually against anything that has been said here, but is more nearly an introduction into the seventh session on the list. A lot of the discussion in the West of shock therapy has made it sound like it was an economic policy. I think it's not an economic policy; it's a political policy. The whole point of shock therapy is not to instigate the market immediately but rather it's to get rid of the government organizations that control the economy during the period when you are going to do piecemeal innovations and move to the market. You really want to get rid of them immediately. And, getting rid of them immediately means shock therapy and throwing the economy into instant effort to create markets and to create firms that can work well within a market, which is, of course, going to mean massive harm to lots of people in the initial instance, people who are involved in activities that will not survive after the change of the system. But, again, the whole point is to get rid of the kinds of government organization that could handle a managed shift to the market. If they can handle that, five years later under another regime, they can handle maintaining the old kind of system, and that's exactly what you

want not to have. So you want shock therapy to get rid of those guys.

S. Magee: Mancur has an extensive discussion in the middle and late parts of this book of the large-firm problem. I wish to supplement his explanation with one from Garret Hardin.

In Hardin's common problem, you have basically an institutionalized absence of property rights, and that's the link to the middle of the book. In the West, you have a smaller commons because you have large numbers of private firms, and it's only certain things within the government purview such as pollution, the environment and the provision of public goods which qualify as commons. So, you have much less free riding over commons' issues in the West. In a Soviet-type system, however, very much of the economy is common: there is little private. In such a system, the reduced role of private greed must be replaced by other motivating forces, such as ideology to Goodhart's question about the very large factories: if you have a commons, then you have a problem of collective action. When you have some very large firms and some very small firms, and the very large ones are politically powerful but inefficient and the small firms are efficient but not powerful then collapse is inevitable. This makes Mancur's overall thesis more compelling.

Second, on the ideology thing, a strong case can be made both for and against the importance of ideology. It has so many different meanings that it reminds me of the story of the blind men feeling of an elephant -- they each had very different definitions of what it was. For present purposes, I think that ideology can serve as a motivating force. For me, it is important in Mancur's current work in the following sense: ideology becomes more important in Communist-type societies in collapse than it is in Western societies. Particularly, at the end when you start running out of food, the only thing that leaders can offer is hope. And, ideology is a form of hope. It's something like what the coach tells the soccer team, at half-time when they are behind 4-0. I see ideology as important motivationally. It is a way of writing rational individuals but irrational societies. One way of motivating a society that isn't working very well or that has an enormous commons problem is to try to focus on other things, and one of them is hope and big ideas via ideology.

L. Sklair: I just want to re-iterate what I said this morning that I think this assumption that ideology is more important in the explanation of some societies than in other societies is (a) unargued and (b) that there is a tremendous amount of evidence to suggest that this is not the case. To be crude about it, what the other guy thinks is ideology is what we think is the truth. And, this, of course, feeds into the discussion about how do we define ideology. Now, the one definition that was offered this morning was that ideology is just false consciousness -- it's a belief system that is demonstrably false about the world. Well, this is a fascinating idea, but extraordinary difficult to build on. It makes much more sense to look at ideology as a belief system, a set of beliefs and it's very difficult to assess how much of it is true, how much of it is false. We have an epistemological question here. We need to look at the ways in which different sorts of ideologies operate in different sorts of societies. The point that Steven Magee just made about hope raises the issue: how do you cope with the South Bronx? How do you cope with the Indian village? How do you cope with the 100 million people who are still starving in China? The idea that Western societies are non-ideological because a lot of people there seem to spend all their time watching television, and they don't riot on the streets, and they don't put pressure on their governments to change things dramatically just seems crass to me. So, I'd like to register a small protest -- I know, this might be seen as lacking in politeness in such a meeting -- of this assumption that they've got ideology and we haven't.

I. McLean: I feel a bit guilty because, perhaps, what I have to say is about transition to transition in which case it comes properly now. Perhaps, it's about transitions; in which case, I should have waited my turn a long time behind. But, a theme which has recurred is that in some cases good institutions don't come straight away. And, it's clear that most of us round the table have been using "institution" in an inclusive way to include not just laws and contract and so on but attitudes as well. One of the cases that have popped up from time to time in the last two days is north Italy, south Italy. Since talking yesterday, I have looked at Mancur's other book in press -- the collections of essays, which has one from Bradford DeLong who, I see, says exactly the same as I was saying yesterday from North and Weingast about the strong state being

weak and the weak state being strong. And, either that or another chapter, I can't remember which, also draws a contrast between north Italy and south Italy and the luck of north Italy in not being conquered by Frederick Hohenstaufen and the bad luck of South Italy in being conquered by somebody else. And yet, this is put forward quite seriously, and indeed I think plausibly as a ground for the differential success of north and south Italy now. That surely implies that since Italian law has been uniform for a century there is something other than law at work. And most of us are happy, and I'm happy to include this something else within the scope of institutions. But, does that then lead to a pessimistic projection that whereas, in examples that have been suggested, Hungary and the Czech Republic might get good institutions whatever those are -- and we will come to that -- quickly; it might take Russia, Ukraine, Belarus as long as it has taken -- namely 1000 years and it's not yet complete -- for the south Italians to catch up with the north Italians?

A. Tyrie: I'm not sure northern Italy is the paradigm, but I very much take your point that countries -- even regions within countries -- with very similar legal systems can deliver quite different results as a consequence of other influences -- including institutional factors.

I wanted to ask just three questions really, or to try and give a few thoughts on three quick questions. One is how far is Eastern Europe and the former Soviet Union traveling down the road outlined by Mancur Olson in his book? That is, trying to get rid of predation and trying to develop individual rights. And, I'll only answer part of it, that part that we've looked at the Bank -- I work for the European Bank for Reconstruction and Development. I am talking in a personal capacity here today. The second question I'll just briefly look at is to put a few qualifications to the points that Mancur makes about why Eastern Europe has done less well after '89 than Western Europe did after '45: why the growth bounce back hasn't been as spectacular as people hoped. And, then, finally, I'll end with a question about whether we Westerners are not really in a transition as well, and how far we're also diverging from Mancur's paradigm.

Quickly, on the first question, I think that the most striking feature of all about transition in Eastern Europe is that despite the

enormous diversity of starting points between, say, Central Asia, the Baltic, the Balkans, or the Czech Republic, there has been a remarkable uniformity of agendas that everyone has set themselves for reform. And that agenda is largely in conformity with what Mancur Olson is setting out. The principles that countries are striving to put in place are very similar. And they are also in conformity with Article I of the statutes of my bank, which in a different language also sets those two key goals, individual rights and the development of market economy in a way that will limit predation. Of course, countries are moving at different speeds, and what they have all found is that some forms of reform are much easier to implement than others. Because these countries have come from central control, those reforms that can be delivered through central control have been done quickly. So, we have seen the removal of price controls, the introduction of a single exchange rate, trade liberalization. What they have had much more difficulty with is reform that requires a wider culture of general consent and knowledge and understanding of the way markets work. So, for example, competition policy is much more difficult to construct; financial sector reform is much more difficult to achieve; the restructuring of enterprises, where it requires a lot of cooperation from local managers, has been very difficult to achieve. But, the overall picture is, I think, quite remarkable; I think, unprecedented in history that I know of: everybody marching in the same direction. Quite extraordinary.

Now, why, if everyone is marching in the same correct direction in Eastern Europe, has there not been a bigger bounce back? Mancur's argument is, that the vested interest groups are still very powerful in these countries. I think, there is a lot of evidence to support that. I'd also like to add a few more thoughts, which qualify that view. One is, I think, that a history of market reform in your country, even if it was 50 years ago or even more ago, is already very valuable for conducting these reforms and making a success of them. Those countries that have never been democracies and never had market-based capitalist systems are having much more trouble implementing them, at least among the 26 countries of operation of my bank, than those that do.

Another factor that I think needs to be taken into account, in drawing this very apparently stark conclusion that the bounce back

after 1945 was much more vigorous than the bounce back after '89 in Eastern Europe, is to remember that for the vast majority of Eastern Europe and particularly for the former Soviet Union, they have also experienced massive demilitarization -- that is -- the closure of a very large sector of the economy. And, that is why the GDP figures show such a sharp fall. It may interest you to know that in the two to three years after 1945, the official GDP statistics for the United States show a fall in American GDP of 20 percent. The US economy underwent enormous post-war restructuring. And, it's worth bearing in mind when looking at the GDP statistics for Eastern Europe and particularly for the Soviet Union today, that some similar restructuring is taking place which will distort the figures.

The second very important point is I don't believe the GDP figures at all. We have an expert in our bank who has spent years putting these together, and he has written a small appendix to last year's transition report, in there, in the appendix to last year's report, you'll find a very interesting section which, I think, completely dismembers the view that we should take too much notice of GDP figures. It shows how they are constructed. Basically, even despite enormous efforts by the IMF and other advisors to help put better figures together, they are still based largely on old collection methods in most countries. And, that means that most of the growth of the new private sector, even if it is legally based, is probably not being captured in the statistics. And, that may be a partial explanation for why there hasn't been such a terrific political backlash against these falls in GDP because the falls haven't taken place. Of course, there has been massive redistribution within countries as a result of these reforms, particularly from the old to the young. The old have lost out because of the loss of their pension rights they were hoping to obtain. The young have benefited because they are able to be active and take advantage of the new economic environment. And that's also, I think, partly explaining why the polling evidence and even many election results suggest wide-spread support for these reforms even though they are generating such pain according to official figures. In other words, the official figures are wrong.

And, now it's time to say something really controversial and certainly nothing to do with my bank. I think that Western Europe

is in a similar position and not that far ahead of Eastern Europe in the very long run in terms of putting in place the right kind of economic environment. The speed of transition in Eastern Europe will depend very much on what we do here in Western Europe. I think that the European Union, in particular, is very much a ramp for interest groups -- vested interest groups of the type that Mancur Olson has described in his book. And, it's reflecting many of the ossifying tendencies, which you identify. And, I think, the European Union, therefore, needs fundamental reform if it's to be of much relevance in the 21 century and to assist, not only in the transition of Eastern Europe, but of Western Europe as well.

I will conclude by identifying what I think the Community was set up to do and then say what I think it should be doing now. It seems to me, it was set up -- very, very briefly -- to demonstrate that the French and Germans could live together happily without recourse to war, to provide a framework of economic management, which included planning in order to avoid the beggar-my-neighbor policies of the 1930s -- that's why it was based on a customs union, a partial and cautious move to trade liberalization -- and it was devised as an economic counterpart, and thought of as an economic counterpart, to NATO. I think that that agenda is now largely obsolete, and I think that the agenda confronting the countries of Western Europe now is very, very different. The first part of that agenda is to make sure that stability in Eastern Europe remains and that they are integrated as fast as possible into the family of Western nations and that they do not come off the rails of this relatively uniform transition process that I have described. And the most important thing that we should do there is to do what we say *they* should do, that is, to open our frontiers fully in those crucial areas where they can compete and where we are at present denying them access. There is much happening in Western Europe about free trade.

The second big issue -- I'm not giving these any order of importance - that I think faces the European Union in the 21 century is the accommodation of the enormous instability that is likely to remain and to come from the former Soviet Union and in particular Russia. I don't think the European Union has a policy for this: a little bit of funding and sending in some advisors and the odd billion from the IMF is hardly a policy. I think that it is

absolutely vital that we find ways again of opening and integrating our markets in a way that can assist their greater stability. And, I don't think that we are achieving that at the moment. On the contrary, we are for example obstructing de-militarization in some sectors in the former Soviet Union by trying to prevent them from turning into civilian use some of the things they're constructing because it would compete with western markets. Ship-building is an example.

And the third big issue that I think will face us in the 21 century is the one I raised briefly yesterday which is international competitiveness in the face of the rise of far more efficient new Mancur Olson-inspired countries on the rim of China and elsewhere in the world too. All these points -- and I'll stop now, but I should have stirred it up enough, particularly for those for whom the European Union, perhaps, looks rather more attractive than I'm implying -- all this points in my view to a radical reform of our thinking about where we want to take our relations between one another in the EU and the application of Mancur Olson's lessons for us. I think it's almost as important that we apply those lessons in Western Europe as in Eastern Europe.

E. Mühlen: It's not on behalf of EBRD that I make my address. I represent a shareholder, the Grand-Duchy of Luxembourg, and I would like to take a certain hindsight on the connected problems. In this respect, I refer more closely to what Professor Olson has said. He made, in connection with transition, very interesting statements. There are even a lot of other aspects that could be discussed. I try to limit myself therefore to two points. The first point that Professor Olson has raised, concerns the speed of the process of privatization: rapid process of privatization -- the so-called shock therapy -- or on the other side a gradual approach. The second question I would like to comment are the so-called poor results of the transition process. A question that has been already discussed in Washington.

The first question is related to the rapidity of the process of the transition. I apologize for overshooting in saying it's a wrong question. It's a theoretical discussion that does not comply with the practical situation. What happens? You have to transform a system of a central planned economy to a market economy. This is a long-lasting, time consuming process. I only want to draw your attention

to a lot of conditions to be fulfilled to make the new system work. You must first have a change of mentality, a change of behavior. Normally this change of behavior takes time. You must complete the privatization process and even if you are choosing the fastest way, the voucher system, and distribute these vouchers to the population, a fund or to the workers, then all has not been accomplished. Even in this assumption, the process of the restructuring of the industry has not been fulfilled. On the other side, you have the method of selling out the industrial companies like the German did. This is a process that takes longer time theoretically, but at least, you are able to solve previously the structural problem so far as you have to close at the beginning the units previously that are not competitive.

All these examples confirm that privatization is a long lasting process. Furthermore, you have to create the legal infrastructure, precondition to make the market economy work. You need ownership laws; you need competition regulations; you need a bankruptcy law; you need a new legal system to be able to privatize. Another question that has already been raised before, is the question of organizing the new fiscal environment. I would like to point furthermore to the focus at the liberalization of prices, it's a process that takes time, especially the liberalization of energy prices. All these problems can not be solved in a hurry, especially not for several reasons. You need, from the early beginning, the help and the intervention of the country concerned, and you need also simultaneously the help and the support from outside. What is important: You must have at the early beginning a real commitment, not only a real commitment for market economy, but also a commitment to democratic rules. Simultaneously you have to restore the human rights. All these conditions have to be fulfilled before the different international institutions and also the national governments are prepared to intervene in favor of the transition. These commitments are a very important precondition.

There is a second question.

A. Clesse: Mr. Mühlen, excuse me. Could you put the second comment in a somewhat more concise form because we are under terrible time constraints. I have, at least, seven or eight participants still on this session number seven, and I want to get a variety of opinions.

E. Mühlen: Yes, I will be short so far as the second question is concerned: the question of the poor results that had already been discussed in Washington. The poor results are mainly due to the fact that the system of central planning was abolished before having been able to create the mechanisms of market economy.

Secondly, you are judging the results and the performance of the transition process, you should make distinctions between the different countries, between countries that reached an advanced level of transition, Poland, Czech Republic, Slovakia, Hungary, Slovenia, and the other countries. The results are quite different. This could be an interesting point to be discussed further on. In this respect you may ask yourself if there is not a correlation with the level of development reached in the transition countries.

A. Stepan: I agree very much with what Andrew Tyrie said about all the countries going in the same direction in the area of economics. I don't agree that they are going in the same direction in politics. But, concerning economics, I think it's very useful to insist that they all go in the same direction but some countries are far ahead while others are far behind. There are already in the 27 countries of post-communist Europe vastly greater variations in the subset than there are in the 20 countries of Latin America. With all the doubts about growth, just in rough orders of magnitude, the Warsaw Pact countries -- even if Bulgaria and Romania are included -- are pretty close to 100 percent of GNP whereas the CIS countries that were a part Soviet Union for 75 years are about 55 percent. That's one change.

An even more important distinction is visible in the bond rating. Right now, nearly all former Warsaw Pact countries are ranked higher on the bond rating index of Standard and Poor's than the Latin American countries with the exception of Chili. The Czech Republic, Poland and Slovenia are higher, and Hungary and Slovakia are one notch below Chili. So, all of those countries are above Argentina, above Brazil, above Mexico. Now, we really wouldn't have thought this five or six years ago. We just have to recognize that. No country in the CIS has any bond rating whatsoever. They are just invisible.

Secondly, regarding politics, in the Freedom House Annual Survey of Public Rights and Civil Liberties the best score you can get is a 1 on political rights and a 1 for civil rights; the worst score

you can get is 7 on both. Countries like the Czech Republic, Poland, Slovenia, Hungary and Lithuania are all in the 1-2 bracket. They all have received this rating for the last three years. But among the 12 CIS countries the highest rating goes to Russia and Ukraine, where we know the most about, namely 4-5 and 4-5. There are four of the 12 CIS countries that score a flat 7-7, the lowest score you can get. That's new. Some three to four years ago they were still making 5-5.

By the way, I wonder why they scored them all the same. Just to give you an example, in February 1994, there was a plebiscite in Turkmenistan. The president had closed the congress. He had re-written the constitution, and he wanted to have a plebiscite to promote him and have a new constitution. It was approved in better than Soviet-style figures, 99.99 %. There were only 212 Turkmen who voted against it, and I don't even think that they got home. In Tajikistan, the president only got 99.96 % in a similar plebiscite.

Thirdly, public opinion polling. If you ask people, "Are you better off now in a system of elections than you were before?" In the Central European countries, according to Richard Rose's data about 62 to 66 % of the people said "yes" whereas in Russia in 1994 only 34%, in the Ukraine only 14 % responded with "yes":

Why this difference? The CIS countries were part of the USSR for 75 years and none of them had his own state. All of them are new states, whereas all the Central European countries had states already. They were dependent but, at least, they had states. Countries like Poland got a huge boost from regaining their autonomy, whereas Russia got negatively affected by the disintegration of the USSR. When asked in 1994 about the disintegration of the USSR only 12 % of the Russian people said that it was the right decision. Also according to Richard Rose's poll when asked whether "the present system better than old" 74% said yes in Poland, whereas only 36% said so in Russia. But the Russians did not want to go back to the old system either. People are complicated and sometimes difficult to understand. I won't go into it.

Concerning the case of Russia, I already thought in September 1991, and I still think, and Jeff Sachs finally agrees with me, that it was probably a mistake not to try to rapidly re-constitute the state and give it an appropriate structure for the envisaged economic

reforms. Instead, they left the old Brezhnev constitution and the old Congress in place that has been elected under the communist system, and this in a situation where the state had imploded. This led to the horrible power struggle later on. There were costs for that, economically and politically. In Mancur Olson's term, the CIS countries don't have a left hand. It's blunt in Central Europe, but both parts of the scissors are working.

C. Goodhart: Only one question: if decline in Russia is all a figment of the statisticians' imagination why has the mortality rate among men become so much worse? And women, too, but not so bad?

A. Tyrie: Well, that's very easy to answer. Read the transition report, is the short answer, Professor Goodhart. And, you'll see that we also measure social indicators, and, of course, there has been a collapse in the social services in these countries and, therefore, as a result morbidity and mortality rates have got much worse. Interestingly, although they have also collapsed in Eastern Europe, the morbidity and mortality rates have improved since 1989. They've got worse in the CIS; they've got better in Central and Eastern Europe. That has very little to do with the growth rate. I mean, the growth rate can rocket, and you can still get deterioration in morbidity and mortality and vice versa.

A. Steinherr: I didn't find that answer totally satisfactory because the question by Charles Goodhart was why did male mortality decrease, so you have to explain why the decline of the health services affected only the males and not the females. I find it much more productive to discuss transition now than it was a few years ago because we have already seven years of experience and can compare. Just a little comment. Mr. Mühlens talked about shock therapy. I think, just to clean that up, shock therapy never meant to achieve results quickly but rather to tackle things immediately and to destroy the old system of vested interest groups. But, I think, it is always quite clear that building a new legal system and stuff like that takes time. The question is whether you tackle it immediately or whether you wait for better times or something like that.

In this respect I find the social indicators published by the EBRD particularly useful. If you make a regression, as I have done, on taking just the major indicators and do a cross section where you

classify reforms in each country by whether they have been done more or less according to a shock therapy or whether it's sort of a laggards attitude, you can see that shock therapy on average worked. I mean, those countries that tried to do things immediately did on average perform much better.

What has been achieved so far? I think what is truly remarkable is the extremely rapid re-orientation of external trade. Most successful in this respect were, of course, the Central European countries (CE). If you take a theoretical benchmark -- of course, we may quibble about what that is, but I took a gravity model, relying on the factors of geography and GDP. The amazing thing is that for the CE countries they export more after the opening-up to Western Europe than basic economic factors would predict.

This is truly remarkable and demonstrates the key role of the European Union for all these countries. Some people criticize the fact that the EU has a current account surplus with Central Europe. I just would like to make a little reminder: if you want to make capital transfers to these countries, you have to run a current account surplus. That's the only way to do that. So, there is nothing wrong with the fact that the Union or the western world as a whole is running a current account surplus because these countries have to run a capital account deficit in order to import capital.

Now, that brings me to the second point. At the beginning of this discussion in the early 90s, some reports have stressed the need for massive transfers to these economies in order to allow them to grow very quickly. Such massive transfers have not taken place, and if one compares with the post-World War experience of Western Europe, the Marshall Plan at that time was certainly more important than what we have been able to transfer to Eastern Europe. Although, the form is also different: we witness -- not during the first years, but right now -- impressive amounts of foreign direct investments, not just loans. Whether more is needed is debatable but, at least, the practitioners, the people who are in the field, are claiming that most of the projects that make economic sense are not being stopped or held back for lack of financing. So, there doesn't seem to be a capital shortage. When you have a good project in Central Europe -- at least in Central Europe, Russia may be different -- you also get the finance. What is, however, disappointing is that the internal financial capacity as expressed by

the savings ratio is lower than what one would hope for a country that would like to grow rapidly. Savings rates are typically between 15 and 20 percent. When compared to those of the East Asian Tigers of 25 to 40 percent then, indeed, there is something that is not really preparing the ground for very rapid growth.

And, one of the problems is, of course, and here I point for the first time to something where we haven't been very successful and where probably a lot of work needs to be done, and that is the reform of the financial sector. Overall, these countries were quite successful with macro-stabilization, with enterprise reform, but enterprise reform is, in a way, something formal. It doesn't mean something really concrete if you don't have proper systems of corporate governance, if you don't have some mechanisms that assure that the allocation of resources is done more or less properly. And, one of the reasons why that hasn't been done is that to build the institutions for financial sector is much more difficult than many of the other tasks that had to be confronted. Of course, here the legacy of history was extremely heavy: the inheritance of a lot of debt that could not be recuperated; the technical knowledge is not there; and after all, the financial sector is supposed to play that central role which in very few countries has been improving. There is some encouragement. For instance, one, which is often quoted, is the experience of Estonia where they showed an extraordinary courage by creating a currency board, and in a way, put tremendous pressure on their domestic banking system in order to cope with that and were able to remain tough and force the banking sector to get streamlined.

Last point: The other major reform that has not been very successfully tackled and which shows up as a problem in many areas is, of course, a reasonable social safety net.

R. Skidelsky: I want to make two points. First of all that phrases about sequencing and shock therapy come out of the language of controlled reform. They are useful in understanding transformation in countries where the system did not collapse entirely. But, they are useless -- they have no explanatory value whatever -- for systems which collapsed. It is true, but banal, to say that things could have got better had policy been better. But, there was no way of making these policies better when the system collapsed. The state broke down; the system imploded, as Professor Stepan said.

What they could do was to liberalize prices, as in Russia, because they had no longer any control of them. I would say privatization was forced because the central state had lost control over the enterprises. The only bit of the state that went on working was the printing press; that explains the inflation.

The second point, I wish to make is that in hyper-inflation -- money was very loose in 1992-1994 -- you had a restructuring mechanism which was completely unanticipated. As you got into hyper-inflation and workers were kept on in the enterprises because they weren't chucked out, their real wages fell so low that they were forced out into the private sector where wages however low were still higher than they were in the old loss-making enterprises. Restructuring wasn't done by the state, it happened as the unexpected consequence of high rates of inflation. And, that is why, despite dysfunctional policy, you have had a considerable restructuring of the Russian system, so that you had a large growth in the private sector. The law of unintended consequences certainly was in operation.

A. Chilosi: Yes, the big bang. I am better acquainted with the Polish case; in Poland the big bang consisted essentially in price liberalization and the pursuit of financial balance. It didn't involve privatization. The only way to privatize through a big bang, one that wasn't followed anywhere in former socialist countries, would have been just immediate general worker privatization. You change the nature of enterprises; you make them joint stock companies, and then you give every employee, let's say, one share. That could have been immediate and very quick. Big bang privatization wasn't tantamount to voucher privatization. In Poland, it took five years and more to be started. In the Czech Republic, it was much quicker. But, any method of privatization would have been quick, perhaps, with the Czech bureaucracy.

As far as the *Treuhand* destruction is concerned, it was really constructivistic. You have a state agency which restructures the enterprise, through different procedures, you don't sell it in the market to the highest bidder, but you impose a lot of constraints and consider a number of different criteria. People bid for the different constraints in different ways. And, then you choose to whom you give the enterprise, with heavy subsidy, in one way or other.

C. Offe: I want to make a suggestion. Given this group of experts on the question what determines outcomes of transition and how do we explain the diversity in outcomes we should really try to make a complete list as to what are the promising variables which explain the variation in outcomes.

Several speakers have argued that the *past* is the major determinant namely, whether or not a country has had a democratic and industrial market economy past in the inter-war period or not. The second is the *present* level of development, which has to do with the first. If the level of development is high, then the transition is smooth and successful. Third, an independent variable that has not been discussed here, namely religion. It is obvious that these countries that you have just enumerated are very different in their religious composition. Following a Weberian hypothesis, there is some *prima facie* evidence that this variable (Protestant, Catholic, Orthodox, and Islam) is not neutral as to its impact. Fourth, geographic location. It seems obvious that the closer to the West, the better the prospects for consolidation which may be explained in a number of ways: being under the influence of trans-national interests of banks, governments, or trans-national organizations helps and being distant from West European interests of that sort, in particular EU and NATO does not help. Fifth, the type of reform strategy that has been adopted, including the legal strategy. And, finally, political culture having to do with the duration of the old regime. It is interesting to note that all the CIS states that have been mentioned have a period of 70 or more years of non-democratic tradition; whereas, all the others have a shorter period. So, a non-democratic political culture may sink in three generations much more easily, than in countries with a shorter experience. This is probably an incomplete list. I just wish to suggest that this list be completed in the further course of our discussion.

H. Szlajfer: So, first, directly to the point which is mentioned in the manuscript in the part dealing with the transition and concerning the obstacles or the problems or the factor which can de-rail the transition or slow down substantially, namely, the vested interests. They are identified in the manuscript as practically exclusively as the big enterprises or big elephants from the previous economic and political system. My feeling is that now in some countries -- and I mean here Poland, Czech Republic, and Hungary -- probably the

vested interests are now changing their character. So, it's not so much or exclusively the big enterprises, but rather more general issues. Let's call it aggregates rather which will replace the big enterprises. In Poland, the problem which is now emerging as one of the most important is the aggregate which is called peasantry, and the Peasant Party representing the peasantry. This is the best organized vested interest in Poland -- much better organized than any single or individual enterprise and, of course, trade unions. So, this is the first thing.

Second obstacle which cannot be identified with any specific enterprise or similar establishment are the obstacles in reform of the health care systems, social security systems, and financial systems. So, these are partially old and partially new phenomena which appeared also as a result or were shown as a result of the very transition process. So, the big enterprises, as those white elephants, preventing the success of the transition, they are moving now somehow backside, on a second plane. This is the case in Poland, and I think, once more in the Czech Republic and in Hungary. So this means that what you describe correctly is connected probably with the first stage of the transition rather than with the present stage and the present day obstacles.

Second, is the problem of the shock therapy versus a gradual evolutionary path. I think that the recent history, already five years, settled the problem, which was hotly disputed especially in Poland and Hungary. Shock therapy is or was better. The evolutionary path was based on some compromises for which you must pay now, and the Hungarians are paying.

Third, it was impossible to present or draft a program for a shock therapy, which wouldn't be in all possible details a failure. Shock therapy in all details was a failure. We made mistakes in all possible detailed evaluations: exchange rate, deficit, budget deficit: we planned that there would be a budget deficit; we had the surpluses. We planned the shortage of foreign exchange; we got the surpluses of foreign exchange. And so on and so on. So, simply it shows that there was not an economist in the world, including Jeff Sachs, who would have been able to present a proper, in a technical sense, program. But, the main intuition was correct, and it is a success in those countries, which took the path.

Session VIII: Markets are ubiquitous in all countries but prosperity is rare

R. Hardin: Why did so many relatively well-developed Third World nations fail to take off at all during the period 1960 to 1990 while the Asian Tigers did and various other places did? There was -- recently, some of you may have read -- a long account in the Wall Street Journal and then in the New York Times of the differences between South Korea and Egypt during exactly that period. If you had tried to predict in the early 60s which of those was going to be the more prosperous country thirty years later, a generation later, almost everyone would have said Egypt. Of course, it's not that way at all.

In many of the cases, a compelling pair of reasons may actually play a major role in explaining what went on. The first of those is that they had ideological resistance against the developed world, probably particularly against the United States and Western Europe, that harmed investment and development because it made them close off as India did, for example, and as many other nations did against investment from the West. And, they also had quasi-socialist central control of the economy. So they had problems like those of the Soviet Union during the same period. And, of course, those two are probably related considerations. But, for nations like India and Egypt, which had going for them a lot of the educational benefits and other things that should have suggested they would have developed relatively well during that period, their failure is probably one of the great disasters of our life time: that they have not done better than they did. And, I trust that, in fact, Mancur's kinds of argument for why some nations take off and others don't -- some of those arguments will give a clear explanation of why a particular nation takes off once we see that it has taken off, but they may not give us a good clue to say why it takes off in this decade rather than the next or the one after that. Taking off in those ways is probably itself a tipping phenomenon, and once it starts, it really rolls. But getting it started is probably dependent on a lot of quasi-accidental factors, and having good leadership or whatever at relevant moments. So that if we try to look at a collection of nations, we might expect a great deal of diversity in the timing of

their taking off even though they look like they are quite similar so that once they do, they might actually do relatively similar things.

A. Adonis: Can I first of all start by winding back the discussion to our bandits from yesterday because I have just been reading the *Financial Times*. And, I think, Mancur should have drawn to his attention a classic case of a roving bandit who has become stationary because they have a long account today of the wanderings of the Sheik of Qatar in today's FT. The Sheik of Qatar was deposed by his son while he was out of the country two years ago, and his whereabouts were unknown so roving has he been over the last two years. Having taken the equivalent of \$12 billion out of the country, which presumably he extorted through the means that Mancur has expressed so vividly. But, because his son wants to remain, he has established himself as a stationary bandit, and is quite keen to remain put. He is opening up the domestic political system, and he has promised the country a new and permanent constitution. He seems to be following the Olson practices really quite closely, and he has promised to consult with his people -- he doesn't quite use the term broadening the encompassing interests, but he has promised that he will consult with them more formally than he has done before.

But, there have been two particular reforms, which our Chairman might like to notice. The first is that he has appointed the first woman ever to his cabinet, and second is that despite that, his family still controls two-thirds of the seats in the Qatar cabinet. So, the concessions haven't been too great. But, the figure is quite staggering when you consider the size of Qatar -- quite how much it is possible to take out of a country if you are a roving bandit. \$12 billion on the back of Qatar's gas revenues is quite extraordinary, and that's simply the money that they know about, not the money that they don't.

So far as the broad theme is concerned, actually, I want simply to put a question to Mancur which I hope he might address if -- I assume he is going to reply to this discussion, so I hope he might address it -- which is to take up here McLean's remarks and Mancur's lecture which I have now read about weak states being strong and strong states being weak which is a very attractive idea if you come from a developed nation like those around the table: that states with governments that do have absolutist powers, even

on a constitutionalist basis, that are subject to checks and balances, that are, therefore, weak are likely to have much stronger intermediary market institutions; and states that are strong like the British one with a government backed by the sovereignty of parliament -- there are very few checks and balances -- are likely to be weak. It's easy to see the meaning of that for developed countries. The problem, it seems to me, is for states in transition. For a state in transition, which wants to end up with a weak state but has very few of those intermediary institutions and market institutions which are going to promote prosperity, what use does it put government to in the process of creating the institutions which are going to be necessary for prosperity?

In the last page of Mancur's lecture in the *Journal of Economic Perspectives*, he says, "Poorer countries that adopt relatively good economic policies and institutions enjoy relatively rapid catch up growth," which is a statement none of us would disagree with. The great question in the minds of irritating people like me, who have to write about these things in newspapers and try to popularize them is: who should be responsible for seeing that relatively good economic policies are adopted?

And what role does he attribute to governments in the process? If he attributes a very high role to government in the process, a very high role -- then how do you then dismantle -- almost in a Marxist sense -- how do you dismantle that government to allow a much freer range to the operation of the market once you've done so? This is a debate very familiar to British political scientists because of the long-running debate about Thatcherism. Thatcherism was intended to dismantle a large part of the operation of the state in the industrial sphere, but it required a big increase in the powers of the state to do it, and a famous book was written called *Thatcherism and the Strong State*. And, it's a subject that intrigues me in the context of states in transition: how big a state do you need to build up in the first place to establish those institutions which Mancur sees as being absolutely vital for economic prosperity? And, then, how do you dismantle that state afterwards if that's the road you're going to go down, so it doesn't become a threat in a bandit-like fashion to those very forces which you wanted to cultivate?

M. Olson: I think that that's a very good question, and I would like to underline a point that I mentioned obliquely yesterday, I think.

And, that is that it seems to me that what is best for development is a state that's so strong that the property rights and contract enforcement rights it provides are completely secure. People think that state and its courts and its powers will last indefinitely, so people make trusts for grandchildren with perfect confidence, 99 year leases, things like that. But, the same state that is strong should be inhibited about intervention in governments and not respecting the rights of the citizens and firms of the society and, indeed, foreign firms and foreign investors in the society. So, one reason there are so few rich countries in the world, it seems to me, is that this is a very hard combination; that, in general, the strong states, say because they've got a strong dictator, will very often be states which engage in various forms of predation and unconstructive intervention that do an awful lot of harm. If you've got weak states, there are no property rights that people can count on; foreign investors don't know whether they'll be able to be protected or not, whether they can take their money out and convert it into their own currency or not. So, it seems to me that we're in a planet with lots of weak states, and that's bad for development and with most of the strong states using their strength, in large part, for doing mischief.

I hate to raise the question of ideology again because I obviously didn't do it very well in the manuscript. But, it seems to me here that the ideologies of the West are, perhaps, a little bit misleading. Our ideologies have arisen since the late nineteenth century in some sense, and they've been mainly debates about the welfare state and Keynesian interventionism, and things like that since the late nineteenth century -- with the conservatives wanting to retain something like the late nineteenth century British state and the Left wanting a somewhat more venturesome state. So, the ideological debate has been about the market versus the states, and there has been a kind of mannequin element in this debate, with lot of people saying the market is all good, the state all bad or vice versa; whereas, if those who agree with me that what you need is a strong state that is inhibited, that leads to a somewhat different view. Indeed, I would argue that what we really need to emphasize, and one thing that I am thinking of underlining in the revisions of this book, is the idea that the single best way to summarize what we need is a market-augmenting government. And, you can't have a

government that augments markets most unless you have a government that is both strong and inhibited.

A. Adonis: Of course, a government with the power to augment markets in the way you're talking about is almost certainly going to be one with the power to destroy them too.

M. Olson: Now, but suppose that you look at Switzerland or Britain or the United States, and, of course the armies are strong enough to destroy markets, not questioning that, but in some sense the strength of the strongest of market economies rests, in large part, on a consensus that the prevailing constitutions should be retained, the prevailing arrangements should be retained, and these arrangements involve not violating individuals' and companies' rights to property and contract enforcement and, by and large, even enforcing the rights of foreigners within your own boundaries so that in some sense, I would like to think that we could say, say of Switzerland -- this might be a clear-cut case -- that we could say Switzerland is a strong state, but in some sense, it's not within the power of the Swiss government to drastically curtail the property and contract enforcement rights of the Swiss.

R. Skidelsky: We need to, I think, make a number of distinctions when we talk of states. One obvious distinction is between a strong state and a big state. A big state is defined by the scope of its activities. One indicator of that is the amount of taxes it raises -- where it comes on the Laffer Curve. Some states tax more heavily than others, why they do so is an interesting discussion of its own. A big state is not necessarily a strong state. Anthony King pointed out in the 1970s that the problem with British government was that its reach had come to exceed its grasp. It was an overloaded state -- one that had become too big for the conditions of consent.

A second distinction is between an enterprise state -- a state that tries to run bits of the economy -- and a transfer state. We've been moving in the direction of the second: the idea of the enterprise state is virtually finished. The state has been divesting itself of the industries it owns. The associated idea of the developmental state or the developmental dictatorship has largely disappeared under the influence of experience: countries which adopted economic policies consistent with the idea of a developmental dictatorship didn't do terribly well. What we're left with is big states which

aren't very strong as well as extraordinarily weak states which aren't even strong enough to enforce the basic property rights which Mancur was talking about.

The problem for Western types of societies now -- is that our states are too big. They take too much of our money, and they spend too much of it in ways that are not conducive to economic prosperity.

Everyone understands that, there's not even any dispute about it. The only argument you get is that politically it's too difficult to do anything about it. Let it happen gradually. Let the welfare state be reformed slowly. I've never found a contrary argument in Europe, at the moment, to the effect that the welfare state does the right kind of things in the right kind of way. It's a question of political conditions for changing things. This is probably the biggest problem in our own societies.

C. Goodhart: First of all, I would like to say how enormously much I like and appreciate Mancur Olson's overall message. In particular, that markets are not an abstract, self-organizing entity. That a market or most markets -- particularly the markets that occur intertemporally which we need in order to grow -- need a great deal of infrastructure. An infrastructure needs a degree of coercion under the rule of law without which they won't occur, and that coercion has to be undertaken by some governmental body. I think that his view that we economists have generally lacked the third leg to the tripod is enormously valuable in retrieving some degree of awareness of the importance of political institutions into economics, and particularly into growth economics, is enormously valuable. So I do think that the book does represent a great step forward, and I congratulate you on it.

One comment is that, I note, in this discussion we have been talking about the state and the role of government. And one of the areas which we are reaching towards in Europe, and maybe in other parts of the world, is whether the development of the world in the future is going to throw the question of what is the state into a certain amount of doubt. For example, in my field which is finance, the firms are global in scope, whereas financial reputation and the laws that support such regulation are national.

All these different national laws make a hell of a mess. A global financial system regulated by national regulators is causing great

difficulties. And, again, within the field of Europe, for reasons that we are all aware of, there is a desire to move to a different range of states with some states doing some things and other levels of government having other sovereign powers. And the question is: which should be where? And if you no longer think of a single state, but think of states or levels of sovereign power and sharing sovereign power at different levels, where does that leave one? I think that my own particular fury with Thatcherism, which makes me almost apoplectic, is that she jumped all over the (perfectly reasonable) concept of subsidiarity and said that means that we must keep everything out of Brussels, and keep it back in Westminster and Paris and Bonn at the national centers. But, when there was any suggestion of devolving powers down to lower levels, down to the regions, to Scotland, to the counties, to the local authorities, to the individual hospitals and individual schools -- Oh, no, no, no. We must centralize. There was a total absolute, essential inconsistency at the heart of Thatcherism. Hypocritical English women were clearly, I think, at the forefront. That was a particular instance. But, I do think that one is going to have to think increasingly over the course of the next century whether the governmental structure is going to be in terms of the state, or whether a mixture of levels with differing degrees of powers, and which powers should go where. A very difficult subject. Maybe, maybe, the idea that everything should be measured, concentrated, and identified in terms of the nation-state may be on the way out. Let's hope it is, but we have yet to see.

I. Ståhl: After listening to Professor Goodhart, I just wanted to make a short plea for law without the state by quoting three very simple and well-known examples: Iceland 1000 to 1250 where there was no king, no constitution; nothing like that, and it was still a system of law and order and spontaneously arranged courts. You'd find that in most primitive societies. So law and order has nothing to do basically with the state.

My second example is what's called the pie powder courts, the courts of the dusty feet. Pie powder being an Anglo-Saxon version of pied powder, used then as French was the legal language in England during the Middle Ages. This was the start of lex mercatoria, and there were private arbitration courts which seemed to be working efficiently, and they created a legal system -- lex

mercatoria -- which was much more sophisticated in many cases than the Canonical law or the Roman law adapted to the demands of the modern commercial society.

And, the third example, I would just quote, which everybody can visit, is the enormous market outside Vilnius, where people trade from China, Turkey, Belarus, Russia, Lithuania, Latvia, and there's no court; there are no official regulations regarding this market, and it functions quite well. And, it really solves the basic problem of the market, the very sophisticated problem of the market: how to trade with strangers.

And, I think, we should learn much more about these examples: how you can have market relations without really state interference. But, I think, Mancur is right, and I think, in a certain sense, this distinction is very important: the distinction between a primitive market economy, bazaar economy -- and that's in your paper -- and a modern capitalistic economy with all the modern sophisticated institutions.

I thought about this when I was in Johannesburg a year ago. If you are in Johannesburg, it would take you 5000 miles flying north to get something similar to the institutional structure, say, regarding the exchange, the Anglo-American Corporation, and banks in Johannesburg. There is nothing of that type between Johannesburg and probably Milan. So, there is a void area, 5000 miles void of capitalistic institutions.

A. Chilosi: However you call them, you need the territorial institutions for exerting force in order to allow the implementation of contracts which are not of the simple self-enforcing type which Mancur Olson quotes in his work.

As far as nation-states are concerned, they are just regulating financial markets. They are agents of the international financial markets working under condition of competition; this brings liberalization because a restricted state pays some prices in terms of the controls of financial flows and financial transactions. On the higher level, there are international treaties which the state could be the enforcing agent on the territory as in every other area of international intercourse. This could be a way in which states free a little bit themselves of the straightjacket of the international competition in order to limit competition on the international level which leads to unwanted, perhaps, distribution effects or instability,

perhaps, in financial flows. You may just get international treaties if you can limit the degree of competition, but otherwise that's the situation.

M. Olson: Well, on politics, it seems to me that though in a well-functioning society the vast majority of deals are settled out of court. And, then, of those that involve disputes, many of those will be resolved by private arbitrators, and there's all sorts of the market forces that are important to making private arbitrators get reputations -- try to get reputations -- for honesty and giving good value, and adjudication, and so on. But, nonetheless, if there isn't, in the final analysis, the force of the sheriff, that people know would be there, then you've got a problem. So, if you've got the force of the sheriff or the police or the army there, then you've got something that will also involve politics. That is to say, what is the mechanism, which controls this force? Well, we can't leave it open to a private firm because that private firm if it's a profit-maximizing firm will take over the country and be the stationary bandit. And, so, therefore, we need politics. I would say that one of the ways we get the combination of strong but inhibited government that we need is to have a rich structure of governments.

This relates also to what Charles Goodhart was saying. That is to say, one of the reasons that I think the Swiss government, though I believe it is strong and that people can make long term contracts in Switzerland with some hope that they will be enforced, nonetheless, one of the reasons it's unlikely that the Swiss government is going to grossly violate a lot of property rights or contract enforcement rights is there are all sorts of Swiss governments, and if the people in Bern are up to mischief or those in Basel are up to mischief, there may be people in other cantons or at another level of government or at the communal level or something that will do something different; similarly in the United States. If the federal government was up to really great mischief, and a significant possibility, there will be resistance in the states and other governments. So, there's politics, but I think that politics will work best not only with constitutions and rule of law that limit what governments do but also a rich texture of governments. Now, I think, one sees this in places like Switzerland. I think, one sees it in places like the United States, Canada, and so on. And, in some sense, my optimistic hope for the European Union is that the

European Union is one part of such an evolution in Europe. That is to say that in Europe individual rights will -- that there will be strong government and strong rights among other reasons because there will be a complex mosaic of governments in Europe which will hold back anyone that goes too far in infringing on rights. So, this is the optimistic side of Europe as I see it. Now, I've maybe gone on too long, so maybe I shouldn't get to the second question -- What was the second question? I've also forgot the second question.

H. van Gunsteren: It was about individual private property.

M. Olson: I would respect corporate property for joint stock profit-seeking corporations, the property of non-profit organizations. I think it's important to let a wide range of institutions compete equally, and so, therefore, I would like to see laws that don't restrict a society to just one or two types of organization or enterprise.

I. McLean: This discussion on the optimal strong state and, notably, Mancur's last contribution shows rather clearly, I think, that what Mancur has just said is a résumé of *Federalists* numbers 10, 45 to 51, and 78. It is producing the same justifications of a particular sort of limited government as did Madison and Hamilton. And, I think, there are good reasons for re-inventing Madisonian political theory. The arguments which Madison and Hamilton used in that context were good ones. I think, they were in essentially the same context. The states that have been given as examples of strong states in this normative sense over the last two days include Switzerland, a federal state; the United States, a federal state; Germany, a federal state; and Canada, a federal state.

The one that has been pilloried as being too strong for its own good although democratic is Great Britain, by Charles Goodhart, recently, by Andrew Adonis, by me -- indeed, by many of the Brits at this conference. Too strong by virtue of not allowing a protected sphere in which sub-national government have their sphere of influence. Too strong, above all, I would say, in the doctrine of parliamentary sovereignty: a parliament can do anything except bind its successor. Well, that is to say in so many words that a parliament cannot pre-commit to not violating the sorts of rights that Mancur says are so important.

The UK parliament may not pass expropriatory legislation very often, but it does sometimes.

It did in a notorious case about 20 years ago when the courts had ruled that it must compensate the Burma Oil Company for wartime facilities that had been destroyed by the British troops retreating from Singapore. Parliament, then, retrospectively annulled the judgment of the courts. So, it does happen. However, this does then give us a classical problem in political theory. Because the ideal constitution of Madison and Hamilton, which I may say in our generation is also the ideal constitution of, at any rate the mid-period Robert Dahl and the late-period Bill Riker -- a federal constitution with checks, balances, and judicial independence -- is subject to a very well known political objection which is that as it embodies super-majority rule, it has virtues of stability but it has the defects of its virtues, and among the defects of its virtues are that, as it requires a super-majority to get things done, something less than the majority can stop things from being done. And, we were immediately back with the problems that Mancur's second blockbuster, *Rise and Decline of Nations*, warned us all about in 1980: the problems of sclerosis. And, I remain, as I said yesterday, a bit skeptical that there even exists a state which is optimally strong to meet the purposes of the current discussion while not being too strong to prevent the sclerosis that Mancur talked about in *Rise and Decline of Nations*.

S. Magee: The only way this relates is, I guess, to Iain's last point which is the transition and some of Mancur's earlier work. I'm not an expert on Eastern Europe or the former Soviet Republics. But, I do see, as an outsider, a lot of pessimism about the transition for the former Soviet Republics and what will follow. Mancur's 1982 book had a really up-beat message which was the following: after terrible calamities, like wars, the vanquished, if they let go of their former special interest structures, are going to eventually out-perform everybody else. Your 1982 book discussed Germany and Japan after World War II and how their economies were devastated for five or ten years. But after the transition, there was great optimism and extraordinarily economic performance. And, so, in both Eastern Europe and the former Soviet Republic, they can eventually expect to grow more rapidly than the rest of Western

Europe, maybe for a long period of time. And, so, I think, there's a real up-beat message here in this book.

K.H. Paqué: I have only a remark on the very last pages of your manuscript where you go back to the preface, and you set out the two conditions which have to be satisfied: first secure and well defined individual rights and second the absence of predation of any kind. Now, these are, in your way, how you present it, the fundamental, almost sufficient conditions if I understand you.

And, I think, that goes a little bit far at this point. It's a nice message to present because it gives hope, and it gives a clear-cut handle on how to get rich. But, well, as an economist, we probably -- if you look at the empirical evidence, digest all the empirical evidence we have -- we probably have to be a little bit more modest in this respect. There are good arguments in favor of your strong case, and it is certainly in the right direction. There is no doubt about it, but two questions remain open to me: first, we do not really know how strong the capacity of a country of different people in the world is to adapt technological knowledge even under perfect institutional conditions. Now, I give you an example of what I mean by that. The example is within the United States, an intra-national example. This is the destiny of the different ethnic groups which immigrated into the United States, which basically all arrived in New York City and under basically the same conditions. The closest you can get in history to a laboratory experiment in a geographical area which basically provides the same opportunities to all. But, if you took all these different groups and calculated average growth rates over the one, two generations which came, then you get completely different results. Why?

Well, of course, this a big question to which we do not have easy answers. But, I think it is certainly a reasonable starting point to argue that the past which these people carried on their back -- because they had a completely different life in Europe in their different positions -- matters. The Irish in Ireland in a persistent political fight against the British for centuries. The Jewish people having no confidence in whatever sort of capital except what they had in their minds, human capital; so with a very strong urge to get educated. The Germans with a certain industrial tradition and certain agricultural expertise. The same with Scandinavians, the Dutch people. So, you get a vast array of variables which are very

hard to control and which are at the end of the day really not irrelevant for the end result, which comes out. You may have, if you measure the average income of the different groups, after one or two generations, then you see them converging to an income slot in American society which may be for one group double the average income of the other one. So, you do not find the same result which you see in the European Community, for example, or if you look at these countries you find, for instance in the Western part of Central Europe, you see that you have a very low coefficient of variation between the per capita incomes. That's simply not what you see in America between these different groups. And, this is an indication that -- after all, the world is very different in its different places -- that the East Asian experience which we have now watched for a couple of years, over 20, 30 years, which is not all that much and may not be representative after all. I think, it conveys very important messages. I completely agree with that. But, we should be a little bit more cautious on that. That's the first point: an argument for cautiousness.

The second is more looking into the future: any of the countries which grow in your scenario will somehow fit into a slot -- will fit themselves into a specialization pattern, a worldwide specialization pattern. And that, again, depends on many factors, which are hard to control. We simply don't know why, for instance, the Swiss have become good producers of watches. There is a very different specialization pattern, which cannot simply be taken for granted or predicted in a reasonable way if you look at factor endowments at the beginning. Factor endowments, at least, in the upper echelon of income, do not tell you much of the story. So, again, you have something, which may make for a very differentiated per capita income at the end of the day. So, you have two uncontrollable forces, which I think remain fascinating puzzles. But, as economists, we should not simply brush over them, and we should clearly say that there is still a large area of per capita incomes -- the term rich is simply in itself very rich in this respect. So, we should be careful about making too strong statements..

L. Sklair: We can look at this crucial relationship between long term economic growth and the state in quite another way from the way that we've been looking at it the last couple of days. In order to do that, I think, we have to pose a fundamental question and that is:

what is the point of economic growth? There is an obvious answer to this question, and, then, there is a rather non-obvious answer to this question. This really depends on, who the growth is for.

For people who are hungry, poor, and have no decent standard of living -- we can argue exactly what we mean by decent standard of living, but I think we can all more or less agree on most of it -- the answer is obvious. So, obviously the point of long-term economic growth is to feed, clothe, heal, educate, and nurture everybody who lives on the planet. And, I think few people would disagree. That's what we're talking about.

Now, the not so obvious answer to the question is where that proportion of the world's population whose food, clothing, healing, educational, and nurturing needs are more or less satisfied fits in. And it's these people that cause the problem here, I think. Because, we haven't been talking the last couple of days about the very poorest people, strictly speaking. A lot of our conversation has been about the decline in Europe and in Eastern Europe and in some other parts of the world that are not literally starving. And this is why I previously introduced this idea of the culture, ideology of consumerism, which is a tricky idea, I confess, but it directs our attention, I think, to where basic needs are satisfied. And, again, I'm quite conscious of the fact that it's difficult to define these things.

But, we can come to some sort of consensus. The economist's notion that our needs are never satisfied is wheeled in to explain the consumerist ideology, which, most people agree, drives the economic system over most of the world. Whether you think it's a good thing or a bad thing is neither here nor there. So, the point of economic growth for the poor and the Third World and parts of the new Second World and even pockets in the First World is pretty clear. And, I don't want to argue about that. But, it raises two sorts of problems: first of all, who is driving this economic growth? I've been very interested to hear several people pronouncing the death of the large corporation. Maybe, this is economic orthodoxy nowadays: that the large corporation is so inefficient that it's unimportant and it's dying out. But, clearly, as people have said, the large corporation has enormous political power, and so it's not liable to die out in the short term. And, it seems clear to me that the trans-national corporations -- the *Fortune* Global 500 or the

Financial Times 500 or whatever, and all those who do business with them, the small corner shop on whose shelf their products are -- these are the people who are driving this economic growth.

So we have to ask, is this growth sustainable? This is the first meeting I've been to in a long time where the issue of sustainable development has not been raised. Now, I don't know whether you feel that this is completely irrelevant. Or, that it's such an ideological concept as not worth wasting our time over. But, it seems that it does need to be raised here. I won't labor the point in terms of the resources of the planet and the sink effects of this productive system that we have. But, surely, this must be relevant for the question of long term economic growth and the role of the state in it. And, it's very interesting to observe the slow encroachment of some global ideas about the way in which the nation-state is losing certain sorts of powers and capacities to other forces, I'll call them "global forces." And, it would be interesting to follow this up -- perhaps, on another occasion -- as to what exactly these global forces are. It would be quite valid to say that, if this analysis has any plausibility at all, what are the alternatives to this market-driven, privatized economic growth, which is based on what I would call the ideology of consumerism? But, fortunately, time is running out, and I don't have time to elaborate on any of the alternatives. So, I'll leave it at that.

A. Clesse: Perhaps, you can cite them without elaborating.

L. Sklair: I feel, they wouldn't be taken terribly seriously, or maybe, I'm misjudging my colleagues here. This very largely revolves around the idea of more modest styles of life in the first world which, of course, under our present flawed democratic systems in the First World are quite politically unrealistic. And, it also revolves around the very, very tricky question of what appropriate styles of life are for those who haven't got to our level of consumption. So, I'm not suggesting that there are any easy answers to this. The questions are extraordinarily difficult.

But, for a start -- and I'm heartened to hear one or two people who have already raised this issue -- it does to some extent connect with genuine participatory democratic politics in the sense of giving larger constituencies of people more genuine connection to the political processes so that their "real interests" might be more

manifest in the political choices that we have. It is terribly difficult to elaborate these arguments without sounding hopelessly naive and utopian, but it always troubles me that there isn't a person here who would really spend more than one minute arguing for the delights of our democratic system. I think most of us would agree with -- was it Churchill -- who said that it's a lousy system but all of the others are worse. So, we don't have much faith in the real nature of our democratic polity. But, because we have all these horrendous counter-examples of Stalinism and Fascism, we think, it's better to have the devil we know, however, awful it is, than those other alternatives which are even more awful. Now, this is a terrible dilemma to be in, and it's a terrible dilemma to have to explain to one's children, to be sentimental about it for the moment. But, it's something that we have to confront. And, to imagine that somehow in the lack of good government, what Mancur Olson is suggesting, will improve the situation seems to me to be quite fantastic. So, if I can just end by saying that the question of "real democracy" really does have to be addressed. And, of course, the reason we tend not to address it is because it seems so intractable given the systems that we live in.

R. Hardin: I just wanted to make a minor point about the earlier comment. I don't think any one has said that large corporations are disappearing but rather large firms, single factories. This is the problem that the Soviet Union had to deal with and that, indeed, many of the older industries in the West have dealt with by simply closing them down.

A. Volodin: Yes, a very short comment on what Professor Paqué was saying concerning the historically acquired qualities of the people. You know, there are two very known historical facts -- known from the economic history -- why Japan has such a sophisticated electronic industry and the housing conditions in Japan are worse than in America and Europe. That is a substitution for the absence of pre-requisite. And, concerning the Swiss watch manufacturing and precision industry in the territory that is now Switzerland and like in Holland: traditionally, there was a very highly sophisticated level of education. That was the response to the man-nature relationship and very limited territory that somehow limited the choice. The precision industry because the Swiss were

known not only for watches but precision industries plus French and Italian sense of proportion and a sense of perfection; not only Swiss watch but BMW and Mercedes Benz cars are designed by Italians.

A. Chilosi: Before saying that the big corporations are the engines of growth, you should provide us with quantitative data. You cannot just say that by going to the grocery shop... it's a little bit casual.

As far as participation is concerned, the more people participate, the more they express their wish for higher consumption levels. How could higher participation lead to the decision to have lower consumption levels? I don't understand.

A. Clesse: In a chapter in his book on civil society, the late Ernest Gellner has a chapter where he is venturing into economics and he is saying that the market alone is not enough: you cannot leave the economy to the market alone, but one needs also a strong role for government and state. In fact, there is literature on the limits of capitalism also by some, who previously seemed less critical. This seems eventually to reflect a new awareness on the future of capitalism. And, there are a number of other recent studies and books and essays. But, I would like to give the floor for the last intervention of this meeting to Mancur Olson.

M. Olson: Thank you Armand. I think, the discussion these last two days is incomparably too rich to summarize. There are just so many extremely valuable things that have been said and so many points that it's absolutely beyond summarization. But, I know one thing, and that is that I have been helped a very, very great deal. Within a week, I will be setting to work revising the manuscript, and I'm going to revise it very, very substantially in response to these criticisms and others that I've received, and I am profoundly thankful to you for your criticisms. And, of course, I'm especially thankful to Armand Clesse and his superb staff. By the way, it's an extremely efficient staff, and I hope every one has noticed that for organizing this meeting which has benefited me so. And, I wonder if maybe I could presume to speak for the rest of saying that probably also that you people are thankful to the Luxembourg Institute for European and International Studies, to Armand, and his staff, and to the good people of Luxembourg and the

government of Luxembourg for providing this marvelous public good for us all. Thank you.

A. Clesse: I thank all of you for having come to this meeting. I think we had very interesting and, most of the time, intellectually stimulating discussions.

Conference participants
(professional positions at the time of the conference)

- Andrew Adonis**, Political Editor, The Observer, London
- Gerhard M. Ambrosi**, Professor, European Economic Policy,
University of Trier
- Silvio Borner**, Professor, Institute for International Economics,
University of Basle
- Alberto Chilosi**, Professor, Department of Political Science,
University of Pisa
- Armand Clesse**, Director, Luxembourg Institute for European and
International Studies
- Martin Forst**, Administrator, Local Economic and Employment
Development Programme, OECD, Paris
- Charles A. E. Goodhart**, Professor, Financial Markets Group,
London School of Economics
- Herman van Gunsteren**, Professor, Department of Political
Science, University of Leiden
- Russell Hardin**, Professor, Center for Advanced Study in the
Behavior Sciences, Stanford
- Mario Hirsch**, Social Scientist, Luxembourg
- Anthony King**, Professor, Department of Government, University
of Essex
- Norbert von Kunitzki**, Professor of Economics; Chairman of the
Board of Directors, SIDMAR S.A, Gent
- Stephen Magee**, Professor of Finance and Economics, University
of Texas, Austin
- Iain McLean**, Professor of Politics, Nuffield College, Oxford
University
- Ernest Mühlen**, Alternate Director, European Bank for
Reconstruction and Development, London
- Claus Offe**, Professor, Department of Political Science, Humboldt
University, Berlin
- Mancur Olson**, Professor, Department of Economics, University
of Maryland at College Park
- Karl-Heinz Paqué**, Professor, Wirtschaftswissenschaftliche
Fakultät, University of Magdeburg

362 *Conference participants*

- Ulrich K. Preuß**, Professor, Institut für Innenpolitik und Systemvergleich, Freie Universität Berlin
- Gaston Reinesch**, Professor of Economics, Centre Universitaire de Luxembourg
- Klaus Segbers**, Professor, Osteuropa-Institut, Freie Universität Berlin
- Robert Skidelsky**, Professor of Political Economy, Warwick University
- Leslie Sklair**, Reader, Department of Sociology, London School of Economics
- Ingemar Ståhl**, Professor, Department of Economics, University of Lund
- Alfred Steinherr**, Professor; Director, Directorate for Economic and Financial Studies, European Investment Bank, Luxembourg
- Alfred Stepan**, Professor, All Souls College, Oxford University
- Henryk Szlajfer**, Director, Department of Studies and Planning, Ministry of Foreign Affairs, Warsaw
- Andrew Tyrie**, Senior Economist, European Bank for Reconstruction and Development, London
- Andrei Volodin**, Professor; Member, Russian Science Foundation, Moscow

Index of the contributions to the discussions

- Adonis, Andrew*, 196-197, 216-217, 282-283, 344-345, 347
Ambrosi, Gerhard M., 179-280, 219-220, 249-250, 304-306
Borner, Silvio, 199-200, 208, 231, 237
Chilosi, Alberto, 179, 183-184, 187, 197, 223-224, 229, 237-238,
247, 270-271, 275, 299-301, 340, 350-351, 359
Clesse, Armand, 177, 184-185, 203, 209, 217, 222, 227, 237,
245-246, 247, 251, 260, 267, 271, 295, 306, 309, 334, 357,
359, 360
Forst, Martin, 190-191, 231,
Goodhart, Charles A. E., 218-219, 228, 229, 235-236, 257-258,
310-313, 337, 348-349, 350-352
Van Gunsteren, Herman, 318-319, 352
Hardin, Russell, 204-207, 208-210, 264, 325-327, 343-344, 358
King, Anthony, 199, 211-312, 238, 263-264
Von Kunitzki, Norbert, 181, 189-190, 213-215, 254-256, 292-296,
319-321,
Magee, Stephen, 195-196, 201-203, 207, 224, 265-266, 303-304,
327, 353-354
McLean, Iain, 181-182, 221-223, 229-230, 247-248, 328-329,
352-353
Mühlen, Ernest, 333-334, 335
Offe, Claus, 180-181, 242-244, 290-292, 341
Olson, Mancur, 177-179, 182-183, 193-194, 194, 195, 200-201,
112-113, 215-216, 227-228, 228-229, 229-230, 230-231, 235,
246-247, 258, 259-260, 263, 266-267, 280-282, 288-289, 307-
309, 345-347, 351-352, 359-360
Paqué, Karl-Heinz, 188-189, 191, 220-221, 230, 231-232, 239-
241, 244-245, 248-249, 251, 264-265, 299-302, 354-355
Preuß, Ulrich K., 181, 237, 315-317
Reinesch, Gaston, , 223, 237
Segbers, Klaus, 267-270, 283-284, 313-315
Skidelsky, Robert, 181, 192-193, 194, 211, 213, 233-234, 241-
242, 261-263, 275-277, 292, 306-307, 313, 339-340, 347-348
Sklair, Leslie, 183, 184, 194-195, 217-218, 234-235, 260-261,
295-298, 328, 355-358
Ståhl, Ingemar, 210-211, 218, 232-233, 236-237, 253-254, 273-
275, 302-303, 349-350

- Steinherr, Alfred*, 185, 207-208, 215, 337-339
Stepan, Alfred, 185-187, 224-225, 277-279, 284, 335-337
Szlajfer, Henryk, 197-198, 256-257, 286-288, 89-290, 309, 323-325, 341-342
Tyrie, Andrew, 251-253, 309-310, 329-333, 337
Volodin, Andrei, 191-192, 200, 271-273, 285-286, 321-323, 358-359