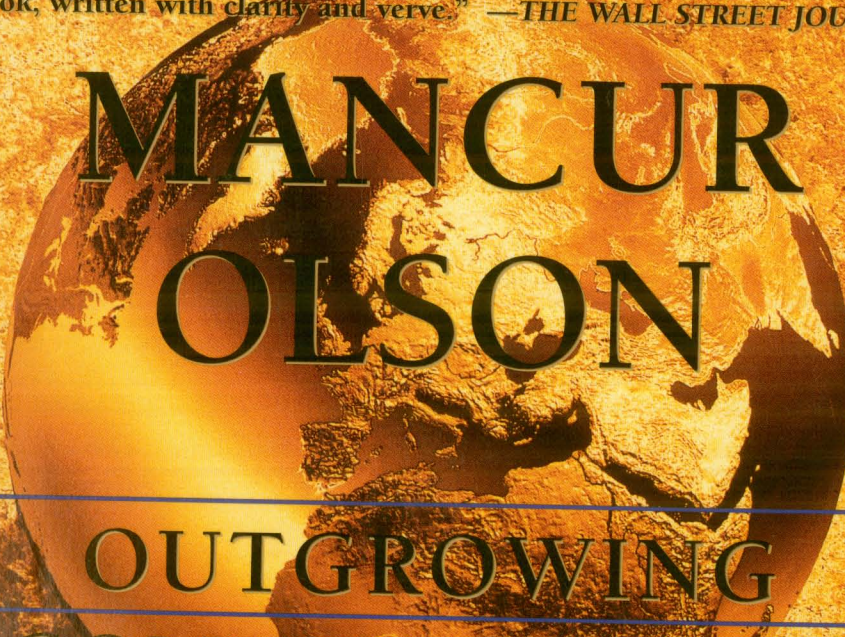


POWER AND PROSPERITY

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MANCUR
OLSON

OUTGROWING
COMMUNIST AND
CAPITALIST
DICTATORSHIPS

POWER AND PROSPERITY

*Outgrowing Communist
and Capitalist Dictatorships*



Mancur Olson



PUSTAKA PERDANA



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PREFACE

THE TELEPHONE RANG on the evening of August 19, 1991, the first day of the Soviet hard-liners' putsch against Mikhail Gorbachev. I was sadly watching the television reports, which were saying that the putsch seemed to be successful. The telephone call was from a favorite columnist who asked some shocking questions. Wasn't the only hope for the stalled Soviet economy, he asked, a no-nonsense dictatorship that would impose a free-market regime on the Soviet Union? Hadn't the economic performance of Chile under the pro-market dictatorship of Ugarte Pinochet, of South Korea under Chung Hee Park and Doo-Hwan Chun, of Taiwan under Chiang Kai-shek and his son, of Singapore under Lee, and of mainland China under Xiaoping Deng brought rapid economic growth? Hadn't I shown, in *The Rise and Decline of Nations* (1982), that the lobbies and cartels that accumulate in democratic societies eventually rob them of their dynamism? Hadn't Soviet economic performance, as leaders of the Soviet putsch claimed, plummeted as Gorbachev introduced his somewhat democratic reforms and let the Soviet satellites go their own ways?

Though the conversation went on until my wife had called me for dinner twice, I did not provide the shocking answers that the columnist was hoping to obtain. The problem was not so much that I was hesitant about supplying an instant analysis of such momentous and complex issues—I had, as it happened, been thinking about these issues for some time. The problem was that I did not know the answers.

The questions would not leave me, in part because they related to my daily work. Just months before the columnist's call, I had become involved in an effort to research and provide advice on economic policy and institutional reforms to formerly communist and third-world countries. At the University of Maryland, I established a Center on Institutional Reform and the Informal Sector (IRIS), which was at first funded exclusively by the U.S. Agency for International Development. IRIS has since had offices or programs in forty-five formerly communist or third world countries, and in many of these countries there were sometimes questions disturbingly similar to those the columnist had posed. Some Indians, for example, told people from IRIS that they wondered whether India's economy had not fallen behind those of China, Singapore, Taiwan, and South Korea because India was a democracy. An erudite Russian, then in the Russian government, told me in Moscow that he feared that Russia's democratic revolution would soon reach the "Thermidor" phase in which it devoured its own. When I naively pointed out that it was shortly after Thermidor that Napoléon set up his dictatorship and engaged in aggression throughout Europe, he replied, as though to a child who knew nothing of the harsh ways of the world, "Of course!" When the analogies were not to the French Revolution, they were to Weimar Germany. I was left thinking about what would happen if a Napoléon or a Hitler came to control Russia's nuclear stockpiles.

This sort of experience concentrates the mind and as a result—thanks in large part to a flow of information from many countries and to fresh research from colleagues—the columnist's questions could be answered. The biggest problem had been the lack of an appropriate intellectual framework. Nowhere in the literature was there a systematic understanding or satisfactory theory that encompassed both dictatorship

and democracy, much less the market as well. Luckily the insights that were needed to achieve a systematic understanding gradually emerged. With them, it was no trick to work out the intellectual framework or theory that was needed to deal with the columnist's questions.

Then it seemed that serendipity knew no bounds. As an economist, I could easily combine the new framework with standard economic theory to present solutions for how to make a country's economy thrive. Take, for example, the question of how a society obtains the kind of market economy that generates high and continually increasing incomes. Even in the poorer third world countries, markets are everywhere. Within hours of leaving the airport, the visitor to a third world country encounters any number of peddlers and merchants. There are bazaars filled with astute traders and the typical village has its shops, markets, or market days. Yet the economies work badly and the people are poor. After the collapse of communism, markets become ubiquitous. In Moscow, just after the freeing of prices at the beginning of 1992, people were trading at virtually every Metro stop and kiosks appeared on almost every sidewalk. Even two generations of communism had not eliminated the entrepreneurial spirit, so countless markets emerged spontaneously. Yet at the same time the people were poor and production was falling not only in Russia but in many other formerly communist countries as well.

What is it that makes some market economies rich whereas others are poor? What policies and institutions does a country need to change from a market economy of peddlers and bazaars to a market economy that generates a cornucopia of riches? In developing the theory that answers the columnist's questions, this book also provides a large part of the answer to the seemingly very different question of why there are innumerable markets in almost every society, yet riches in only a few.

With these answers, we can quickly understand why there were dramatically different outcomes after the defeat of fascism and after the collapse of communism. At the end of World War II, most observers expected that West Germany, Japan, and Italy would remain in poverty for quite some time. The United States was concerned that it might for many years need to provide much of the food needed to keep the populations of these societies alive. In fact, all three of the defeated Axis nations enjoyed rapid economic growth as soon as the constraints of the war and occupation had been removed. These three episodes of growth were so far beyond explanation with the prevailing theories that they were called "economic miracles." By contrast, when communism collapsed, the people who had endured the economic absurdities of Soviet-type economic systems, like most Western observers, expected that economic performance would improve dramatically. In fact, in many of the formerly communist societies economic performance so far has been even worse than it was under communism. Every formerly communist country suffered from a drop in output, if not a collapse, and many are taking a very long time to recover. Though I believe that the official statistics in the ex-communist countries exaggerate the drop in real incomes and I am personally optimistic about the future of some of these economies, there can be no doubt that economic performance has been below expectations.

The extraordinary and unexpected difference between economic performance after the defeat of the Axis powers and after the collapse of communism is all the more remarkable in view of the desires of the victorious countries in World War II. For some time after World War II, the victorious countries were fearful that Germany and Japan would again emerge as aggressive dictatorships, so they did not want them to develop strong industrial economies or even to become unified countries. By con-

trast, the countries that were the winners in the cold war from the outset wanted to help the once-communist countries develop successful societies in the image of the West. Thus, one question this book asks is: Why was economic performance so much better, especially in relation to expectations, after the defeat of fascism than after the collapse of communism?

The lifting of the iron curtain revealed something else that the developed nations of the West, whether they had been winners or losers in World War II, did not expect to see: an extraordinary amount of official corruption and Mafia-style crime. In Russia, for example, some polls indicate that crime and corruption are considered the most significant problem of the society. Though there are, of course, corrupt officials and Mafia organizations in most Western countries (and in major American cities there is probably more street crime than in the formerly communist countries), the extent of official corruption and organized crime in the ex-communist countries (and especially in the former Soviet Union) is outside the range of Western experience. Therefore, another question this book asks is: Why do the formerly communist countries suffer so much from official corruption and organized crime?

The reason that this book is able to answer the foregoing questions is that, after the intellectual framework that was needed to deal with the columnist's questions was available and was combined with standard economics, we have an intellectual structure that simultaneously encompasses both markets and governments. Whether societies are rich or poor, they obviously have both economies and politics. The economies move the politics and the politics govern the economies. Therefore, theories of markets that leave out government—or conceptions of politics in which the economy is exogenous—are inherently limited and unbalanced.

They do not tell us much about the relationships between the form of government and the fortunes of the economy or adequately explain why some societies are rich and others are poor.

Though Adam Smith, John Stuart Mill, and some other great economists in prior centuries included government and politics as well as firms and markets in their analyses, economists in the twentieth century have not, until rather recently, recovered this grand ambition. The first great twentieth-century economist to do this was Joseph Schumpeter, with his inspiring and brilliant (but not prescient) book on *Capitalism, Socialism and Democracy*. In an acknowledgment of this contribution, I titled early versions of this book *Capitalism, Socialism and Dictatorship*. However, the current title, *Power and Prosperity*, was chosen to communicate the main idea more clearly. Robert Klitgaard thought of the subtitle *Outgrowing Communist and Capitalist Dictatorships*. For this I am most grateful not only because of the dual meaning of the word *outgrow* but because it reminds us that even the most secure and developed democracies want more impressive economic growth than the world's dictatorships (after adjusting for their higher starting points and lesser catch-up potential). The argument in this book, if correct, has important implications for economic policy in advanced democracies of Europe, North America, and Japan, as well as in the countries that are or have lately been under dictatorships.

I have made strong claims in this Preface. It is not for me, but for reviewers, readers, and the authors of subsequent studies, to judge whether these claims are true. If my claims are not true, I deserve severe criticism. Though I have built upon the work of others and have had an extraordinary amount of invaluable information, help, and criticism from colleagues,

and especially those at IRIS and the Department of Economics at the University of Maryland, I am solely responsible for all of the shortcomings in this book as well as for any unwarranted claims. If the reader studies all of the pages that follow, I shall be grateful, however severe the standard by which they may be judged.

Mancur Olson