wrote several years ago in the foreword to Boris Brutzkus's *Economic Planning in Soviet Russia*:

> Even the most careful study of the Russian facts cannot lead very far if it is not guided by a clear conception of what the problem is, i.e., if it is not undertaken by a person who, before he embarks on the investigation of the special problems of Russia, has arrived at a clear idea of the fundamental task that economic planning involves.[30]

4

THE NATURE OF THE SOVIET-TYPE SYSTEM

> The modern world could no more get along without accumulated capital than it could get along without police or paved streets. The greatest change imaginable is simply the change that has occurred in Russia – a transfer of capital from private owners to professional politicians.
>
> H. L. Mencken[1]

INTRODUCTION

If the argument presented in the last chapter that socialism is not only an inefficient form of economic organization, but literally impossible is correct, then we are presented with an immediate conceptual difficulty in analyzing the history of socialist practice. If the Soviet-type economy was not actually an example of socialist central planning – because that social system is an impossibility – then what was it?

This question has rarely been asked by either proponents or opponents of socialism. Among proponents of socialism, as well as traditional comparative systems analysts, the question is not raised because socialist central planning is assumed to be possible (and perhaps desirable). Even though Marxist critics of the Soviet Union have challenged the conceptualization of the Soviet Union as centrally planned, they do so from the perspective that this is evidence of a perversion of socialism by Stalin.[2] The workers' revolution was thwarted by bureaucratic intrigue, and the forces of state capitalism. On the other hand, traditional comparative systems analysis (whether conducted by a proponent or opponent of socialism) argues that the conceptualization of the Soviet Union as centrally planned was essentially correct.[3]

Central planning was portrayed as an alternative to market exchange. Economic activity was viewed as strategically controlled by the center, which directed the development of the economy. Details of the institutional structure of the Soviet system were analyzed, but little attention was paid to the actual processes of decision-making within the system and how the decision-making process related to the conceptualization of the Soviet system as centrally planned.[4]

Some critics of socialism, such as Ludwig von Mises, have argued that comprehensive central planning is impossible, but that Soviet-style socialism was simply an inefficient form of incomplete socialism. Only the full-blown international socialism, which was advocated by the Marxist revolutionaries, is an impossibility. Incomplete socialism would only be seriously impaired economically, not utterly chaotic. Such a system of economic organization would eventually exhaust the social surplus fund (provided by nature's endowment of resources and/or built over generations of economic growth) through waste, but it could stumble along for quite some time. As long as planners could rely on world prices to aid in the allocation of scarce resources, attempts at central planning would merely lead to economic inefficiency and not the breakdown of social order that would follow from the absence of any means of economic calculation.

But this argument did not go far enough in explaining the actual operation of the Soviet-type system. However sound Mises' argument may be, it lacked both a detailed examination of the institutional structure of Soviet-type economies and the incentives within the system that are necessary for an adequate understanding of that system. Much of the *implicit* economic relationships that were vital to the operation of the Soviet system are glossed over in the Misesian analysis. As a result, Mises's discussions of Soviet practice seem somewhat odd.[5] They leave the impression that he was denouncing the Soviet government for doing what he had argued in 1920 was impossible for them to do: centrally plan an advanced industrial economy.

Traditional comparative systems theorists do not fare any better. The *de facto* establishment of property rights and the pervasive operation of illicit markets, as well as the system of special privileges for the Soviet elite, simply did not receive the attention necessary to understand the system as it actually operated.[6] And in the Marxist analysis, where these factors were emphasized, their existence is seriously misunderstood. The Stalinist command economy was not a

perversion of socialism, but the logical, though unintended, consequence of attempting to institute a central planning regime in strict accordance with socialist principles.

Understanding the task of reform and what pressures would bear on the reform movement, requires a clear picture of what it is that is supposed to be reformed. In order to gain such an understanding we must begin by looking at the real, existing system that was in place when Gorbachev initiated perestroika, and not some system that we imagine theoretically to have been in operation. The illusion of central planning must be rejected. Illicit markets existed both inside and outside of the 'plan' and, in fact, were vital to the operation of the system. In reality, the Soviet system remained at heart a commodity production economy that depended on the decentralized decisions of individuals to coordinate economic affairs in an *ex post* fashion.

The Soviet system was best characterized as a market economy dominated by monopoly producers and subject to vast and arbitrary government interference. This chapter seeks to justify this characterization and provide the appropriate backdrop for analyzing the problems associated with reforming the Soviet system and why all historical attempts to do so have failed so miserably.

THE INSTITUTIONS OF SOVIET CENTRAL PLANNING

The Soviet system of economic planning was basically implemented right from the beginning of communist rule.[7] On 15 December 1917, for example, the Bolsheviks established the Supreme Council of the National Economy (VSNKh) that would rationally plan and direct the development of the economy. The establishment of the VSNKh was followed by further economic decrees which nationalized the banks (27 December 1917), foreign trade (22 April 1918), large-scale industry and railway transportation (28 June 1918) and small-scale industry (29 November 1920). Though the New Economic Policy of the 1920s attempted to liberalize the economy and reduce the administrative burden of the bureaucracy (through repeal of some of the decrees, e.g., the 29 November 1920 decree), the major economic centers of the national economy remained under government direction and control. In other words, despite the NEP reforms the basic institutional structure established after the revolution remained intact. The Soviet state as it matured under Stalin, despite some shuffling, renaming and realignment of the institutional

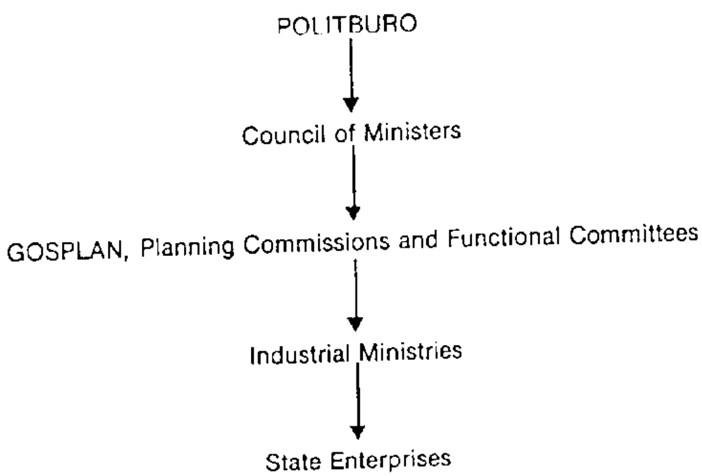

Figure 4.1 The decision-making hierarchy of the Soviet economy

structure, simply reinforced the basic institutions of administrative command that originated with the Bolshevik attempt to construct the new socialist order. The institutional hierarchy of the economic bureaucracy was firmly implanted in the Soviet structure of governance by the 1930s and has remained basically intact ever since.

The planning bureaucracy of the Soviet economy can be represented by the rough organizational chart shown in Figure 4.1. This decision-making hierarchy was supposed to coordinate economic activity in an *ex ante* manner so as to maintain a balance of society's resources.[8] Theoretically, *ex ante* coordination would better serve the interests of society by eliminating the waste and inequities in economic affairs associated with the *ex post* coordination of economic plans by the price system. By bringing economic decisions under conscious regulation, the planning apparatus was supposed to balance the supplies and demands for society's scarce resources in a more effective manner than accomplished by the price system. Supply and demand would be brought into balance by rational and democratic administrative procedures, rather than the chaotic process of price adjustment that occurs in a market economy.

The Politburo and the Central Committee first decide the priorities for the planning period, and set output targets. These output targets are then communicated to Gosplan which in turn establishes control figures and estimates of the required inputs to meet the control figures. Ministries are then informed of the projected material

constraints they will have to face, and they will begin negotiating with Gosplan over the control figures and the availability of resources. After this initial phase of negotiation, the ministries will inform the enterprises of the control figures.

Now a new stage of political bargaining begins as the enterprises negotiate with the ministries over output targets and input requirements. During this stage of the planning process information flows up from the individual enterprises to ministries to Gosplan. At each stage, the requested inputs by subordinates are checked against the input needs as estimated by the superior office. If a discrepancy exists, then the subordinate must defend the deviation from the superior's estimate. Gosplan serves as the final arbitrator of this process by assessing the competing requests. As the bargaining process comes to an end, Gosplan must make sure that planned supplies of each commodity match their planned demand (input requirement and final use). In this manner, Gosplan develops a binding economic plan that assures the *ex ante* coordination of economic activity in society. At least this is how it was supposed to work.

THE ECONOMICS OF ILLUSION

This portrait of political economy decision making at successive stages of the planning hierarchy over output targets and input requirements did not engender the rational allocation of scarce resources in either theory or practice. In fact, the system generated economic irrationalities throughout the entire process. Plan failure among economic agents was a staple part of Soviet economic life for managers of enterprises as well as consumers. Obviously, the Soviet planning system possessed a certain rationality, but it was not economic rationality.

The ideological illusion of a rationally planned economy had to co-exist with the reality of systemic economic failure.[9] Without the ideological illusion, the Party's economic monopoly could not be justified. As a result, the Soviet people had to live a lie. This was not a normal lie, however, in that it was the peculiar Soviet false reality that had to be protected to legitimate the revolution and the Party. Soviet citizens spoke in one language that conformed to the pseudo-reality of Soviet socialism, while they lived within an entirely different reality. There was one lie, but two realities.[10]

The problem with the planning system was not limited to the vast amount of information that was supposed to be processed by the center, and the sheer complexity of that task. Rather, the *quality* of the information available to economic planners in the absence of free market prices would prevent any mind or group of minds from assessing the economic allocation of scarce resources among alternative uses even if the most advanced computational technology was available to them. This fundamental problem with central planning of the economy has often been overlooked because analysts and planners confuse technical and economic efficiency. It is one thing to determine that platinum, steel or cement, could be used to build a bridge, it is quite another to discover which material would be economically employed in that use. The technical problem concerns achieving one end and allocating means to obtain that end given certain physical and engineering constraints. The economic problem, on the other hand, is one where scarce means must be allocated among competing ends, and the knowledge required to accomplish this allocational task economically is dispersed throughout the economy in scattered bits and pieces. In other words, the economic problem of a complex industrial economy is one of mobilizing the private information that is embedded within the various, and often conflicting, plans of economic actors in a way which translates that information into effective knowledge for others so as to promote the coordination of economic plans between actors.

The functional significance of economic calculation in the market economy is that, despite its imperfections, it allows the social system to select out from among the numerous array of technologically feasible projects those which are economic. In economic calculation, the market system possesses a weapon to combat the general knowledge problem that all social systems confront in attempting to mobilize the dispersed and incomplete information that exists throughout the economy and is not available to anyone in its entirety.[11] Through a process of error detection and the corresponding opportunity for economic profit, the market system motivates learning among economic agents so they may discover how better to allocate scarce resources to satisfy consumer demand. The hierarchical planning system does not possess similar weapons.

Not only does the planning hierarchy lack the requisite information rationally to plan the economy, but it also does not possess the disciplinary devices that a market system does to overcome strategic incentive problems.[12] Consider, for example, the principal/agent problem that exists whenever a principal relies on an agent to carry out her goals. In such situations, the agent because of informational

asymmetries may find it in his interest to act in a manner inconsistent with the goals that the principal has set. Unless the principal can effectively monitor the activity of the agent, her goals will not be achieved.

A large corporation potentially faces this problem because of the separation of ownership from control. The owners (shareholders) may desire that management only act in a manner as to increase the profitability of the firm. Management, however, may wish to pursue an alternative course of action that maximizes their perquisites independent of the goal of profit maximization. Without effective monitoring, management can act in a manner that diverges significantly from the goals of the owners. But the market system provides a disciplinary force through the capital market that compels management to act in line with the goals of the shareholders.

A decline in the stock price of a corporation signals to economic actors that the expected future profitability of the firm has declined. If individuals believe they can increase the profitability of the enterprise, then they will buy up shares, take over the enterprise and restructure management. Takeovers and mergers discipline managers to act in accordance with the interests of owners through the market for corporate control. Market competition from new groups of would-be managers in addition to competition within the firm by those who want to climb the corporate ladder present challenges to existing management whenever they behave contrary to the interest of the principal.

Well-established and freely functioning labor and capital markets, however, are a prerequisite for this disciplinary device to exert the corrective monitoring of agent behavior necessary to overcome the problem of strategic incentives. Without these markets, or similar devices, agents will strategically act in a manner that diverges from the interest of the principal.

In a democracy, for example, politicians are supposedly the representatives of the electorate. Elected officials, in other words, are the agents while the citizenry are the principals. The vote mechanism supplies the monitoring device to discipline the behavior of politicians. The problem that exists within democratic procedures, however, is that the phenomena of rational abstention and rational ignorance among voters seriously questions the ability of the voting system to convey accurately information about voter preferences. Moreover, there does not exist in the political process the kind of error detection and learning mechanism that do exist within the market process to motivate a quick adjustment of behavior among political actors so as to conform to the expectations of the electorate.

This potential problem of agency is compounded within government decision-making when it is recognized that there are also deeper layers of the principal/agent problem throughout the system. Most functional tasks of governance are not carried out by vote-seeking politicians who must face re-election, but by a non-vote-seeking bureaucracy. Beyond the principal/agent problem that exists between voter and politician, there is another principal/agent problem between the politician and the bureaucracy and another between the head of the bureau and her subordinates.[13] Political actors must devise monitoring mechanisms to make sure that the bureaucracy acts in line with their goals. But there are definite limits to the supervisory capacity of officials (or the electorate). And, these limits vary inversely with the degree of coordination required to accomplish the task assigned. In a large organization, the higher the degree of coordination required the lower the limit of supervisory capacity.

Whereas the price system can achieve a high degree of coordination of economic plans in the complex task of advanced industrial production by summarizing the terms of exchange (and, thus, economizing on the amount of information actors must process), politics does not have recourse to any analogous procedure. A free market provides the incentives and information for the mutual adjustment of behavior among participants even though no single mind or group of minds consciously directs the flow of resources for the system as a whole. Bureaucratic organization of the economy, however, would require the superior consciously to coordinate the activities of all subordinates.

Under Soviet rule, even the potential check of the electorate was absent from political economy decision-making.[14] The Party, and the Party alone, was the principal and the planning bureaucracy was the agent. Most Soviet economic practices, in fact, can be explained as attempts by the Party to monitor effectively the behavior of bureaucratic agents. Soviet practices, from the periodic purges within the Party and the elaborate *nomenklatura* system of patronage to the five-year plans and gross output success indicators, can be explained as the rational outcome of attempts to reduce the agency costs associated with centralized economic administration of the economy.[15]

The sole purpose of the Soviet economic administration was to maintain monopoly control over resources.[16] In this way, the Party could treat all economic problems as technological ones. The Party

leadership would decide priorities and dictate that resources flow in a direction that would achieve those priorities. Such a wartime approach to the allocation of scarce resources cannot persist indefinitely since it tends to disregard the economic cost of resource use.[17] Throughout their history, Soviet economic planners possessed neither the information nor the incentive to appraise the alternative use of scarce resources in production. Without any method to assess the opportunity cost of resource use, waste and mis-allocation inevitably result. In other words, the Soviet system was in a state of perpetual economic crisis.[18]

This crisis, however, could not be revealed otherwise the leading role of the Party would be questioned. The underlying ideology of the Soviet system promised a more moral and efficient society. Unfortunately for the peoples of the Soviet Union it produced neither. But, that could not be openly admitted or the system would lose legitimacy.[19] The major function of the economic bureaucracy was transformed into the production and maintenance of the illusion of rational economic planning that achieved tremendous economic growth.

THE DUAL REALITY IN POLITICS AND ECONOMICS

The official version of the economic structure of the Soviet economy was justified on the grounds of its rationalizing effect on the social system of production. Central planning would eliminate the chaos and waste of capitalism, including the business cycle. But, the central planning system was theoretically incoherent. Such an administrative command system of economic organization could not engender the incentives or mobilize the information necessary to coordinate successfully the multitude of economic plans required in an advanced industrial economy.

Alongside the official economy emerged a *de facto* economy that attempted to fill in the gaps created by the failed official system.[20] Markets are like weeds, they spring up all over and are impossible to stamp out completely. Wherever there is a gap, alert economic actors will attempt to grasp the opportunity available for personal gain. In the production process, special middlemen (the *tolkachi*) were relied on to gather resources (inputs) so enterprises could meet plan targets. The *tolkachi* worked on behalf of state enterprises selling surplus commodities on the one hand and purchasing needed products on the other. There emerged an entire secondary supply system around the *tolkachi*.[21] On the consumption side, illicit market transactions attempted to correct for the long queues and poor quality of consumer goods found in the official state stores. Private market activity enhanced consumer well-being by increasing the flow of goods and services available and by offering an additional source of income.

The dual reality that Soviet citizens dwelled within was not limited to economic activity, but also extended to their cultural, intellectual and political life.[22] Jazz music, for example, was for a long time an underground phenomenon. Books and articles suppressed by state censors circulated *samizdat* among scholars and intellectuals. And, the dissident movement arose to challenge the governing authority of the ruling elite on several fronts.[23]

There is, however, a significant difference in the experience of this duality within the economic sphere from that in the cultural and intellectual realm. The underground culture emerged not to 'correct' the failings of the official system, thus propping it up. Rather, the *sub-rosa* culture challenged the official system. Its function was to break the official system down and offer an alternative social order.

The monopolistic grip of the Party over the economy was more difficult to break. The Party's monopoly was its main source of privilege and power. Party officials did not have to wait in queues, they shopped in special stores, lived in nice *dachas* and drove their *zils*.[24] The underground economy existed to correct for the failure of the official system, not to replace it.[25] The ruling elite could co-exist with a system that appeased the population, but they could not co-exist with an economic system that would have threatened the monopoly status of the Party.

Illicit market exchanges propped up the faulty structure of the planned economy. The *tolkachi*, for example, made the appearance of conformity to the planned targets easier; they did not compete with the official industrial supply system. The underground market in consumer goods aided individuals in obtaining desired goods without waiting in queues, but again it did not compete with the official system.

From high officials to bureaucratic functionaries, the failure of the official economy presented opportunities for economic gain. Basically, the official Soviet economy was a non-price rationed economy. If prices are not allowed to tell their story about relative scarcities of goods and ration scarce goods among alternative uses through monetary bids and offers, then some other rationing device will

emerge to allocate scarce resources.[26] Queuing, of course, rationed scarce goods and services in the official economy. But, the existence of queues automatically presented an opportunity for store clerks and others to transform the non-monetary costs to consumers of obtaining goods into economic gains for themselves. Barter or outright bribing could obtain goods that could not be obtained through official channels. Living *na levo* (under the table) was the mainstay of Soviet economic existence. From a taxi cab ride across town to admission to university, from obtaining an apartment to receiving anesthesia for an abortion, securing goods and services required side payments (monetary or otherwise).

In addition, without stable and enforceable property rights, the unofficial economy was forever vulnerable to opportunistic behavior. The discipline of repeated dealings provided an incentive for most individuals to act in a cooperative fashion. But the opportunity for strategic cheating was always there. As a result, illicit enforcement mechanisms emerged to police contracts.

An example may clarify this point. During prohibition of alcohol in the US, drinking did not cease.[27] Rather, an illicit market for alcohol quickly arose to meet consumer demand. But several things were undesirable about the characteristics of this particular market. First, the quality of the product sold changed radically, increasing in potency and, thus, risk to consumers. The high cost of transporting the product (which now had to include the cost of evading the police) dictated that per unit potency must increase in order to maintain profit margins. Beer and wine almost disappeared from the market as pure grain alcohol was transported and mixed at points of distribution. Second, the private mechanisms for enforcing contracts increased the criminal element in the production and distribution of alcohol. In other words, prohibition did not eliminate alcohol consumption, but it did create 'bathtub gin' and Al Capone.[28]

Without clear property rights and contract law, product quality cannot be guaranteed and the market environment may deteriorate due to the criminal element. The underground economy of the former Soviet Union cannot be relied on completely to transform the economy into a functioning free market system. The unofficial economy existed solely because of the failures of the official economy brought on by the prohibition of free market exchange and production, and, thus, lived in a symbiotic relationship with the official economy.[29] Transformation required the abolition of prohibitions against market activity and the establishment of well-defined and strictly enforced property rights. In other words, transformation required the preponderance of the *sub rosa* economy to cease to exist. Not because of a government 'crack-down' on corruption and theft of state property, but because individuals would be allowed freely to produce and exchange goods as they saw fit. Competition from an above-ground and legitimate free market sector would overtake the state sector in the production and distribution of goods.

Socialist theorists traditionally did not predict that this would be the outcome of a competition between the private and state sectors. Fabian socialists, for example, argued that the laws of economics were on the side of socialism. Basically, their argument was that since state enterprises could sell their products at cost and not for a profit, they would undersell and thus out-compete capitalist firms. The Fabian strategy for social change, as opposed to the Marxist strategy, was one of gradual encroachment by the state sector. Public production of goods and services would eventually crowd out capitalist production as public enterprises proved to be the superior producer of the good.

After the collapse of the Russian economy as a result of 'War Communism' in the Spring of 1921, the Bolsheviks introduced partial market reforms with the New Economic Policy. While retaining their Marxists credentials, the Bolsheviks were implicitly engaging in a controlled experiment with the Fabian idea of a socialist encirclement of capitalism as opposed to an immediate revolutionary abolition of capitalism. During the NEP in the 1920s, the old Bolsheviks introduced the concept of 'socialist competition.'[30] The socialist sector of state-owned enterprises would compete with the small-scale private enterprise that was allowed to exist legally. The state sector would eventually defeat the private sector because of the efficiency of large-scale industrial planning, and then socialist economic planning could be fully implemented throughout the entire economy. This competition was cut short by arbitrary intervention into the economy by the Soviet government throughout the 1920s which destroyed the incentive to engage in above-ground, private capital accumulation and investment, and finally, by Stalin's revolution from above beginning in 1928 in which all private market transactions sought refuge in the underground economy from then on. The state socialist sector 'won,' not by outperforming the private market in economic competition – this, contrary to socialist expectations, it could not do – but by destroying the legal private market altogether.

That was the basic economic system Gorbachev supposedly sought to reform. The Soviet social system of production was characterized

by the pseudo-reality of a rational, hierarchical planned economy, co-existing with the reality of plan failure and illicit corrective measures on both the producer and consumer side of the market. The Soviet system not only relied on the decentralized decisions of thousands of economic actors to coordinate plans that were supposed to be pre-reconciled by the organs of central administration, but it also remained at heart a commodity production economy.[31] Production was not for direct use, but rather was divided into two categories: production for production's sake (to maintain the illusion) and production for exchange (to sustain the population). Bargaining and haggling were a way of life for those who had to subsist by living *na levo*.

In other words, the Soviet economy was not a centrally planned economy radically different from any other economic system witnessed in history. It was over-regulated, abused and distorted, but it was, nevertheless, a market economy.[32]

THE SOVIET ECONOMIC SYNDICATE

The Party elite watched over this market economy as if it was their own private domain – which it was. They were the *de facto* owners of Soviet society's scarce resources. As Milovan Djilas pointed out a long time ago, they were the 'New Class' of propertied owners under socialism.[33] Each layer of the Party elite, from Politburo bosses to local Party officials to enterprise managers, was a feudal lord. They benefited directly from both the successes and failures of the official economic structure.

The central planning bureaucracy simply represented the central office of an elaborate system of interlocked industrial cartels in the Soviet economy.[34] The ministerial organizational structure established barriers against competition from other producers. The market was segmented and the central office monitored the cartel.[35] The persistence of excess demand for products caused by artificially low official prices produced a sellers' market. The shortage economy in combination with the monopoly status of producers simply reinforced the power of the managers of the state economy. The seller in such an environment can insist on whatever terms of trade he desires.

As a method of monitoring the cartel arrangement the Communist Party exercised tight control over managerial appointments.[36] Approval of the Party district committee was necessary to change jobs. Party organizations were responsible for creating a 'managerial reserve' list of qualified individuals for management positions. Party organs maintained the right to veto any appointment made to posts listed in the *nomenklatura*.[37] Loyalty to the Party and political reliability were the critical factors in the criteria for selection to managerial posts.

The mature Soviet economy was simply a syndicate or 'ultramonopoly' created and enforced by the organs of centralized state power. 'The *nomenklatura* class,' Michael Voslensky writes, 'exercises unlimited sway over the huge syndicate of which the Soviet economy consists. That is the principal feature of the country's economic organization. Nevertheless, the outside world goes on believing that its chief characteristic is economic planning.'[38]

CONCLUSION

The revolution of 1917 did not usher in a new era of social justice and economic rationality. Rather, the economic system born in the Russian revolution was the twentieth-century version of the 'old regime.' Political and economic privilege was granted to those in positions of power, and the organs of state power were employed to defend those positions. The countryside was brutalized into a new form of serfdom and forced to finance the ruling elite's preoccupation with building industrial cities. Moreover, citizens throughout the Soviet Union were compelled to shoulder the burden of a military empire that was ridiculously expensive.

The Party's influence was felt in every area of life. Those beholden to the system existed throughout every layer of society from Party boss to local school teacher. The conceptual difficulty of reforming such a social system was not that this was an entirely new adventure in economic restructuring. All that needed to be done was to eliminate the leading role of the Party and its monopolistic grip over the economy. The conceptual difficulty lay in mobilizing a people that had been culturally conditioned to submit to authority to challenge the main beneficiaries of the system.

The challenge of reforming the Soviet system was not one of pure economic theory as is suggested in the usual conceptualization of the problem as a move from a centrally planned non-market economy to a private market economy. A private market economy, in a fundamental sense, does not need to be created. A market economy evolves spontaneously wherever opportunities for economic gain present themselves as is evident in the continued existence of the *sub-*

rosa economy of the former Soviet Union even at the heights of 'war communism' (1918-21) and Stalin's assault on private economic activity in the 1930s. Well-functioning markets, however, do require the establishment of rules which protect private property and ensure the freedom of entry. Without these institutional constraints, individual economic activity cannot be guaranteed to move in directions that will be viewed as socially desirable. Within the proper institutional constraints, however, the profit-seeking activity of individuals will tend to generate an overall economic order that allocates scarce resources in a manner which will enhance the economic welfare of citizens.[39] Policy choices should be limited to the choice of the institutional constraints, i.e., the general rules, within which economic activity will transpire.

Changing the general rules in the former Soviet Union, however, amounted to recontracting the basic social compact that had existed from at least the 1930s.[40] Some would certainly gain with the new regime, but many would lose. And, those who had the most to lose were those in positions of power. That was the conceptual problem associated with reforming the former Soviet Union.

The problem was one of *political economy* and could not be addressed otherwise. But in order to begin to address the problem, it was necessary first to understand what was supposed to be reformed. Unfortunately, standard Sovietology did not pay enough attention to the unofficial system that sustained the official Soviet system. The reasons for this failure to examine in detail the real operation of the Soviet system can be attributed to: (1) a disregard among economists for evidence other than measurable statistics; (2) the elegance of the formal structure of central planning and the balancing of inputs and outputs; and (3) the preoccupation with aggregate measures of economic growth as opposed to detailed microeconomic analysis of the industrial structure. Any one of these intellectual prejudices, let alone all three in combination, would possess a deleterious effect on the attempt to understand the Soviet system.

The Soviet economy simply was not a centrally planned economy where the leading stratum sought to employ society's resources in an efficient manner, but just failed to do so for lack of ability or effort. Rather, the system that evolved out of the attempt to realize the Marxist dream of a more rational and just society was a caste society of political power and economic special privilege. The Soviet reality, as opposed to the pseudo-reality often portrayed in Soviet propaganda and Western textbooks, was represented in the interconnection between the official and unofficial economies and the economic self-interest of those who benefited from that structure. Understanding the real Soviet reality is a necessary prerequisite for satisfactorily examining the difficult problem of transforming the former Soviet economic system into a thriving and prosperous market economy.

5

THE LOGIC OF POLITICS AND THE LOGIC OF REFORM

> A nation so unused to acting for itself was bound to begin a wholesale destruction when it launched into a program of wholesale reform . . . An absolute monarch would have been a far less dangerous innovator. Personally, indeed, when I reflect on the way the French Revolution, in destroying so many institutions, ideas, and customs inimical to freedom, abolished so many others which were indispensable to freedom, I cannot help feeling that had this revolution, instead of being carried out by the masses on behalf of the sovereignty of the people, been the work of an enlightened autocrat, it might well have left us better fitted to develop in due course into a free nation.
>
> Alexis de Tocqueville[1]

INTRODUCTION

In accomplishing any difficult task, recognition of the problem to be solved is one thing, providing a workable solution is quite another. A clear conception of the problem, however, is a necessary prerequisite. In fact, one of the major stumbling blocks to the transformation to a more liberal and civil society in the former socialist countries has been the failure to appreciate the depth and nature of the problem at hand. Moreover, the cultural legacy of the previous system of economic organization – the administrative command economy – has been misunderstood.

Not only were scholars, intellectuals and political actors confused over the nature of the Soviet-type system, people in both the East and West were generally confused over what the economic organization of a liberal and civil society would look like.[2] This confused state is a result of a

4 THE NATURE OF THE SOVIET-TYPE SYSTEM

1 H. L. Mencken, 'Capitalism' (1935), in *A Mencken Chrestomathy* (New York: Vintage Books, 1982), pp. 296–7.

2 See, for example, H. H. Ticktin, 'Towards a political economy of the USSR,' *Critique*, 1 (Spring 1973): 20–41, and 'The class structure of the USSR and the elite,' *Critique*, 9 (Spring/Summer 1978): 37–61.

3 See Paul Gregory and Robert Stuart, *Soviet Economic Structure and Performance*, 3rd edn (New York: Harper and Row, 1986), pp. 155–214. In the leading textbook on the Soviet economic system discussion of the second economy is limited to less than two pages (pp. 203–4). And, in the discussion of price setting, reliance on world market prices is limited to one line (p. 195).

4 For a discussion of the debate concerning the conceptualization of the Soviet system as centrally planned see Igor Birman, 'From the achieved level,' *Soviet Studies*, 30 (2) (April 1978): 153–72, J. Wilhelm, 'Does the Soviet Union have a planned economy? A comment on "From the achieved level",' *Soviet Studies*, 31 (2) (April 1979): 268–74, Alec Nove, 'Does the Soviet Union have a planned economy? A comment,' *Soviet Studies*, 32 (1) (January 1980): 135–7 and John Wilhelm, 'The Soviet Union has an administered, not a planned economy,' *Soviet Studies*, 37 (1) (January 1985): 118–30.

5 See Ludwig von Mises, *Planned Chaos* (1947), reprinted as epilogue in *Socialism: An Economic and Sociological Analysis* (Indianapolis: Liberty Classics, 1981(1922)), pp. 479–540; *Omnipotent Government: The Rise of the Total State and Total War* (Spring Mills, PA: Libertarian Press, 1985(1944)), pp. 55–8; *Human Action*, 3rd rev. edn (Chicago: Henry Regnery, 1966), pp. 717–19.

6 The most important notable exception to this was Ed Hewett, *Reforming the Soviet Economy* (Washington, DC: Brookings Institution, 1988), pp. 94–220, where he contrasts how the system was designed to operate with how it actually operated in practice. As Hewett states: 'An analysis of the potential effect of reforms on the system must rest on an understanding of how those reforms will interact with the system as it actually functions, rather than as it is supposed to function' (p. 153).

7 For a detailed discussion of the institutions of Soviet planning implemented in the first years following the revolution see Silvana Malle, *The Economic Organization of War Communism, 1918–1921* (New York: Cambridge University Press, 1985) and Thomas Remington, *Building Socialism in Bolshevik Russia: Ideology and Industrial Organization, 1917–1921* (Pittsburgh: University of Pittsburgh Press, 1984). For an interpretative examination of the formation of the Soviet political economy see Peter Boettke, *The Political Economy of Soviet Socialism: The Formative Years, 1918–1928* (Boston: Kluwer, 1990).

8 See J. M. Montias, 'Planning with material balances in Soviet-type economies,' *American Economic Review*, 49 (4) (1959): 963–85. Montias argued that while some, such as the German economist Walter Eucken, had challenged the efficacy of centralized economic planning, analysts should not forget that static efficiency is not the be-all and end-all of planning. 'The Soviet system with all its compulsion and waste is a vehicle for high rates of growth. To some extent, a higher rate of growth than might otherwise be feasible makes up for short-run inefficiencies' (p. 982). As was argued in Chapter 2, however, the higher rate of growth was only an illusion.

9 See Peter Rutland, *The Myth of the Plan: Lessons of the Soviet Planning Experience* (LaSalle, IL: Open Court, 1985), pp. 101–67.

10 See Alain Besancon, *The Soviet Syndrome* (New York: Harcourt Brace Jovanovich, 1978), pp. 87–103.

11 See Israel Kirzner, *The Meaning of Market Process* (London: Routledge, 1992), pp. 139–62. Kirzner argues that one cannot solve the problem of dispersed information by postulating equilibrium prices. The ability of the price system to coordinate the plans of participants, in fact, does not lie in the hypothetical system of equilibrium, nor in the accuracy of the information conveyed by equilibrium prices. Rather, the price system coordinates economic plans through the ability of disequilibrium prices to offer opportunities for pure profit to economic actors. When market participants experience plan failure this is expressed in an array of prices that alerts economic actors to the possibilities of pure profit. The price system, through a process of error detection and the lure of pure profit, motivates economic actors to learn how better to coordinate their plans with those of other market participants.

12 For a discussion of the problems that 'shirking' presents to economic organizations see Armen Alchian and Harold Demsetz, 'Production, information costs and economic organization' (1972), in Armen Alchian, *Economic Forces at Work* (Indianapolis: Liberty Press, 1977), pp. 73–110.

13 On the problems that superiors face in coordinating the activities of subordinates within and between bureaus within the bureaucratic hierarchy see Gordon Tullock, *The Politics of Bureaucracy* (Lanham, MD: University Press of America, 1987(1965)), pp. 120-220.

14 See Paul Gregory, *Restructuring the Soviet Economic Bureaucracy* (New York: Cambridge University Press, 1990), pp. 13–24, for a discussion of the principal/agent problem applied to the Soviet situation. My analysis differs from Gregory because despite his employment of the principal/agent literature he maintains a 'public interest' view of the Soviet leadership by claiming that the leadership was concerned with the obtainment of economic goals at the least cost of society's resources, whereas I want to jettison the public interest view of the Soviet leadership. Ed Hewett also implicitly maintains a public interest view when he states that he 'assumes that Soviet leaders are most interested in the growth rate of national income, of labor productivity (which is closely related), and of living standards.' However, this assumption prevents him from satisfying one of the main goals in his study – to develop a successful explanation of the reform process which is built on 'a good theory of the politics of economic reform.' See Hewett, *Reforming the Soviet Economy*, pp. 10 and 238 (see Note 6).

15 See John H. More, 'Agency costs, technological change and Soviet central planning,' *Journal of Law and Economics*, 24 (2) (October 1981): 189–214. Also see Arye Hillman and Adi Schnytzer, 'Illegal economic activities and purges in a Soviet-type economy: a rent-seeking perspective,' *Interna-*

tional Review of Law and Economics, 6 (1986): 87–99, Jan Winiecki, 'Large industrial enterprises in Soviet-type economies: the ruling stratum's main rent seeking area,' *Communist Economies*, 1 (4) (1989): 363–83, Gary Anderson and Peter Boettke, 'Perestroika and public choice: autocratic succession in a rent-seeking society,' *Public Choice* (1992), forthcoming and Gary Anderson and Peter Boettke, 'Socialist venality: a rent-seeking model of the Soviet-style economy,' mimeo (1992).

16 On the importance of the economic monopoly to Soviet power see Olimpiad Ioffe, *Gorbachev's Economic Dilemma* (St Paul: Merril/Magnus Publishing, 1989), p. 4. 'The Soviet system,' Ioffe argues, 'consists of two essential ingredients: unlimited political power of the ruling elite and economic monopoly by the same elite as the source of its unlimited power. If either of these elements is eliminated, the Soviet system will have been replaced by another system.'

17 Though universally accepted, the idea that centralization during wartime or emergency is unequivocally desirable is also questionable. Take the example of labor mobilization in wartime. Undoubtedly the military draft allocates labor quickly, but it does so in a very costly manner. Certainly the draft hides the cost of fighting the war to the taxpayer, but the opportunity cost associated with the draft is quite high. In other words, the military draft does not reduce the cost of mobilizing labor for the war. The draft simply transfers the cost burden of maintaining the military from taxpayers to draftees. For a discussion of the argument for centralization in emergency situations see Patrick Bolton and Joseph Farrell, 'Decentralization, duplication and delay,' *Journal of Political Economy*, 98 (4) (1990). Bolton and Farrell, however, do not address the question from an opportunity cost perspective. For an examination of the implications for economic reasoning of consistently pursuing the opportunity cost logic see Philip Wicksteed, 'The scope and method of political economy in light of the "marginal" theory of value and distribution' (1914), in *The Common Sense of Political Economy*, vol. 2 (London: Routledge, 1938), pp. 772–96; James Buchanan, *Cost and Choice: An Inquiry in Economic Theory* (Chicago: University of Chicago Press, 1978(1969)); and James Buchanan and G. F. Thirlby (eds) *LSE Essays on Cost* (New York: New York University Press, 1981(1973)).

18 The Soviet system represented an institutional innovation which provided the ruling elite with a high degree of security against the competition of political entrants at the cost of reduced economic efficiency. The system proved to be one of the great political successes (in terms of protecting the rulers from competition) at the same time that it was perhaps the greatest economic failure of the twentieth century.

19 Soviet economic history is in some sense the history of economic reform attempts. While the leaders claimed great achievements, they constantly sought to reform the system in a manner which corrected the failure, but maintained the illusion. 'War communism' (1918–21) sought to establish the Marxist utopia overnight, but led instead to the utter collapse of the Russian economy. The Bolsheviks were forced to retreat from their original ideological position concerning the transition to socialism and introduce market liberalizations in order to maintain political power. The

New Economic Policy of the 1920s, however, gave way to the collectivization and industrialization of the 1930s. The Second World War was followed by a post-war reconstruction. The late 1950s and early 1960s were characterized by Khrushchev's attempts at political liberalization and economic reform. The much discussed Liberman reforms of the mid-1960s attempted to introduce profit incentives in state enterprises. In the 1970s, Brezhnev introduced industrial reforms to no avail. Finally, with the Gorbachev reforms the myth of Soviet industrial strength was challenged by the leadership. But, even with Gorbachev's reforms the idea was never to reject the 'socialist choice' of October 1917. The original Gorbachev reforms were conceived as improvements in the administrative procedures of economic planning – to enforce strict labor discipline and accelerate industrial development. Superministries and superagencies were created to improve the techniques and efficiency of state economic planning and an anti-alcohol campaign was pursued to eliminate drunkenness and sloth among workers. Leonid Abalkin, *The Strategy of Economic Development in the USSR* (Moscow: Progress Publishers, 1987) and Abel Aganbegyan, *The Economic Challenge of Perestroika* (Bloomington, IN: Indiana University Press, 1988) give a pretty clear account of the original economic philosophy behind the Gorbachev reforms.

20 The classic paper on the *de facto* Soviet economy is Gregory Grossman, 'The "second economy" of the USSR' (1977), in Morris Bornstein (ed.) *The Soviet Economy: Continuity and Change* (Boulder, CO: Westview Press, 1981), pp. 71–93. Also see the discussion of the different 'colored markets' that were in operation in the former Soviet Union in Aron Katsenelinboigen and Herbert Levine, 'Market and plan, plan and market: the Soviet case,' in Moris Bornstein (ed.) *The Soviet Economy*, pp. 61–70.

21 See Hewett, *Reforming the Soviet Economy*, p. 155 (see Note 6). Also see Joseph Berliner, *Factory and Manager in the USSR* (Cambridge: Harvard University Press, 1957), pp. 207–30.

22 See Hedrick Smith, *The Russians* (New York: Quadrangle, 1976). One of the most important features of Smith's book was his insistence on exploring the *sub-rosa* existence of Soviet counter-society. Soviet citizens, Smith points out, were masters at lying low. The scientific ban on genetics under Stalin and Khrushchev did not stamp out research in genetics, rather scientists secretly keep their science alive. Cybernetics had a similar history. Rock and jazz music, while publicly condemned, nevertheless flourished in underground clubs and music studios. Many of the most interesting cultural and intellectual developments were going on in a private and secret world hidden from officials and foreigners.

23 See Ludmilla Alexeyeva, *Soviet Dissent: Contemporary Movements for National, Religious, and Human Rights* (Middletown, CT: Wesleyan University Press, 1985).

24 See Boris Yeltsin, *Against the Grain* (New York: Summit Books, 1990), pp. 157–68, for a discussion of some of the privileges accorded to those on the top of the political pyramid. Also see David Willis, *Klass: How Russians Really Live* (New York: Avon Books, 1985).

25 Ferenc Feher, Agnes Heller and Gyorgy Markus, *Dictatorship over Needs: An Analysis of Soviet Societies* (New York: Basil Blackwell, 1983),

pp. 98–105, argue that there were 'three economies' in operation. The first economy was the official planned economy. The second economy was the unofficial economy on the consumption side, and the third economy was the unofficial economy on the production side. The second and third economies, however, existed only to fill in the gaps of the first economy. Moreover, these economies were interconnected with the second linking up to the first through the third.

26 Perhaps the most prevalent alternative method of rationing goods and service in the former Soviet Union was *blat*. The word implies the use of personal influence to obtain goods and service that one is not formally entitled. The prevalence of *blat* in Soviet economic life was expressed in common sayings. In the 1950s, for example, a common expression was: 'Blat is higher than Stalin.' (Refer Berliner, *Factory and Management in the USSR*, pp. 182–206, see Note 21.)

27 See Mark Thorton, *The Economics of Prohibition* (Salt Lake City: University of Utah Press, 1992). The Gorbachev anti-alcohol campaign produced the same undesirable effects as did other periods of prohibition. No sooner had state controls on the production and sale of alcohol been imposed, than a *samogon* (moonshine) industry arose to meet consumer demand. For a discussion of some of the unintended consequences of the anti-alcohol campaign see Anders Aslund, *Gorbachev's Struggle for Economic Reform* (Ithaca, NY: Cornell University Press, 1989), pp. 75–6, and Marshall Goldman, *What Went Wrong With Perestroika* (New York: Norton, 1991), pp. 137–8.

28 Milton and Rose Friedman, *Tyranny of the Status Quo* (New York: Harcourt Brace Jovanovich, [illegible] extend the argument to argue against current drug laws in the US.

29 The lack of a well-established alternative supply network for scarce resources meant that 'theft' from the state sector was the major supply system for the unofficial economy. Diverting resources from the state sector into the market system also continued with the development of cooperatives under Gorbachev. In fact, the lack of a viable alternative supply network made the cooperatives simultaneously dependent on the official supply system and vulnerable to the criminal element in order to protect those supplies accrued through 'illegal' diversion of goods from the state sector.

30 See, for example, Lenin, *Political Report of the Central Committee of the R.C.P.(B.)* (27 March 1922), *Collected Works*, vol. 33 (Moscow: Progress Publishers, 1980), pp. 263–309. Lenin's basic argument was that communists in the socialist sector had yet to learn how to manage the economy correctly. They had everything at their disposal in terms of power and resources, but they lacked ability. Responsible communists must learn the ABCs of business and management. If they fail to learn how to manage the economy properly, then they will fail in their test against private capital. The 'last and decisive battle' must be won in the competition between the socialist sector and private capital. Nikolai Bukharin argued that 'if the tendencies of capitalist growth gain the upper hand over the tendencies to improve large industry, then we are doomed.' See Bukharin, 'The New Economic Policy of Soviet Russia,' in Lenin, Bukharin and

Rutgers, *The New Policies of Soviet Russia* (Chicago: Charles H. Kerr, 1921), p. 60. Trotsky represented the Bolshevik attitude on this question most clearly. He may have accepted the NEP as a necessary policy shift for the time, but he accepted market principles only tentatively. His firm conviction was that the superiority of industrial planning would eventually eliminate the anarchy of capitalist production within socialist competition. The success of the planning principle would spread to the entire market, swallowing and eliminating it. The success of large-scale planning under the NEP would lead to the liquidation of the NEP as an economic policy and its replacement with a full socialist policy. See Trotsky, 'Thesis on industry' (6 March 1923), in Robert V. Daniels (ed.) *A Documentary History of Communism*, vol. 1 (New York: Vintage, 1962), pp. 234–7. Also see Richard Day, *Leon Trotsky and the Economics of Isolation* (New York: Cambridge University Press, 1973), p. 82.

31 As Michael Polanyi argued, the Soviet central 'plan' was simply the meaningless aggregate of all the individual plans of enterprises. In other words, the Soviet plan was analogous to a chess captain announcing the aggregate moves of his players. But outside of the particular context of the game each individual player was engaged in such an aggregate statement of moves is meaningless and does not constitute a 'move in chess.' Similarly, stating the sum of output of two plants is no more meaningful than announcing the move of two castles in two separate games of chess. See Polanyi, 'The span of central direction,' in *The Logic of Liberty* (Chicago: University of Chicago Press, 1980(1951)), pp. 134–5.

32 See Don Lavoie, 'Political and economic illusions of socialism,' *Critical Review*, 1 (1) (1986–7): 1–35. Lavoie argues that a strict distinction must be drawn between power and control in political economy. The Soviet government possessed tremendous political power, but it did not control the Soviet economy. What really went on in the Soviet economy was a vast amount of government intervention into a polycentric order that economic officials did not (and could not) understand in the concrete detail necessary to plan the system. The economic system remained, fundamentally, out of their control despite the existence of almost unlimited political power. In some sense, then, the Soviet economy was not categorically different from the economies in the West. The difference was one of degree, not kind. The Western politician's claim to be steering the economy with fiscal, regulatory and monetary policy is no less of a façade covering up blind interventionism and justifying political power, than the Soviet façade of planning. The main difference between the West and the Soviet Union was the pervasiveness of Soviet interventionism.

33 Milovan Djilas, *The New Class: An Analysis of the Communist System* (New York: Praeger, 1957) and *The Unperfect Society: Beyond the New Class* (New York: Harcourt, Brace & World, 1969).

34 Ideology played a dominant role in the founding of the Soviet industrial structure, but after the purge of the old Bolsheviks by Stalin in the 1930s, the ideological influence waned considerably. The ideology led to the establishment of centralized institutions of economic planning, but the ideology was utopian, and, as such, could not be realized. The institutions of central planning were captured by the guardians of the new order who

directly benefited from their possession of instruments of political power over the economy.

35 For a historical treatment of the leading role of the Party in industrial planning see William Conyngham, *Industrial Management in the Soviet Union: The Role of the CPSU in Industrial Decision-Making, 1917–1970* (Stanford: Hoover Institution Press, 1973).

36 See, for example, the discussion in Vladimir Andrle, *Managerial Power in the Soviet Union* (Lexington, Mass.: Lexington Books, 1976), pp. 39–66.

37 See Michael Voslensky, *Nomenklatura: The Soviet Ruling Class, An Insider's Report* (New York: Doubleday, 1984), pp. 68–111.

38 Voslensky, *Nomenklatura*, pp. 127–8 (see Note 37).

39 I do not have space to establish the argument here, but I would assert that the entire equity/efficiency trade-off is mistaken. Income distribution over time tends to spread as individuals from different generations move within different income groups, provided they are not legally prevented from doing so by a rigid caste system. Socialist societies were both inequitable and inefficient. Competition in the free market tends to compel suppliers to increase the quality of their product and offer it at a lower price. Economic competition makes available to average citizens products that only the most wealthy individuals in the previous generation could afford. There simply is no inherent 'economic law' in the operation of competitive capitalism that leads to greater discrepancies in income. Efficiency gains bring with them the cheaper production of goods and services that otherwise would be more costly to produce.

40 For an examination of some of the related issues to recontracting see Paul Hauslohner, 'Gorbachev's social contract,' *Soviet Economy*, 3 (1) (1987): 54–89.

5 THE LOGIC OF POLITICS AND THE LOGIC OF REFORM

1 Alexis de Tocqueville, *The Old Regime and the French Revolution* (New York: Doubleday, 1955(1856)), p. 167.

2 For example, Adam Michnik has argued that:

> If, after the dogmatic faith in the benefits of the planned economy, there comes an equally dogmatic faith in the benefits of the market, then we are in trouble . . . [T]he market is not a self-activated mechanism that can replace the economic policy of the state . . . We know the difference between the market as it is seen by Milton Friedman and the market with a human face.

See Michnik, 'The two faces of Eastern Europe,' *The New Republic* (12 November 1990): 24.

3 As Ed Hewett points out, the problem that confronted GOSPLAN within the bureaucratic planning system of the Soviet Union was analogous to the bureaucratic problems within US Bureau of Budget. Both bureaucracies attempted to arrive at a consensus by mediating among the

competing claims of various interest groups. See Hewett, *Reforming the Soviet Economy* (Washington, DC: Brookings Institution, 1988), p. 121.

4 See James Buchanan and Richard Wagner, *Democracy in Deficit* (New York: Academic Press, 1977) for an analysis of the legacy of the Keynesian system of activist policy. Also see Charles Murray, *Losing Ground* (New York: Basic Books, 1984) for a discussion of the failure of social policy, James Bennett and Thomas DiLorenzo, *Underground Government: The Off-Budget Public Sector* (Washington, DC: Cato Institute, 1983) and *Destroying Democracy: How Government Funds Partisan Politics* (Washington, DC: Cato Institute, 1985) for an examination of fiscal policy and tax-funded politics. Also see Jeffrey Friedman, 'The new consensus: I. The Fukuyama thesis,' *Critical Review*, 3 (3–4) (Summer/Fall 1989): 373–410, and 'The new consensus: II. The democratic welfare state,' *Critical Review*, 4 (4) (Fall 1990): 633–708, for a discussion of the implications for political philosophy of continuities between 'first world' and 'second world' interventionism.

5 John Kenneth Galbraith, 'The rush to capitalism,' *The New York Review of Books* (25 October 1990): 51–2. Also see John Kenneth Galbraith, *The Culture of Contentment* (New York: Houghton Mifflin, 1992), where he argues that despite the myth of a *laissez-faire* revolution with Reagan, non-intervention has been highly selective. While government spending and activism has decreased in some areas, it has increased in others. Galbraith is quite accurate in his assessment of the situation with regard to the leading role of government in the US economy. The US economy is far from *laissez-faire* capitalism. In fact, the impact of government intervention is felt throughout the entire economic system.

6 For a theoretical explanation of the growth of government see Sam Peltzman, 'The growth of government,' *Journal of Law and Economics*, 23 (October 1980): 209–87. Peltzman explains the growth of government as the outcome of the incentive to use the political process to redistribute wealth. Counter-intuitively, he concludes, with empirical evidence across nations to support his claim, that with the greater equality of private income, the demand for political redistribution increases. In other words, the growth of the 'middle class' in the twentieth century, has been a major factor in the growth of government as this group became more capable of perceiving and articulating their interest in political redistribution. Also see George Stigler, 'Director's law of public income redistribution,' *Journal of Law and Economics*, 13 (April 1970): 1–10, for a discussion of the 'middle class' thesis. In addition, see Robert Higgs, *Crisis and Leviathan* (New York: Oxford University Press, 1987) for a discussion of the erosion of constitutional constraints in the twentieth century and the corresponding loss in economic freedom, and Richard Wagner, *To Promote the General Welfare* (San Francisco: Pacific Research Institute, 1989). Also see F. A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960) and *Law, Legislation and Liberty*, 3 vols (Chicago: University of Chicago Press, 1973–9) for a philosophical, legal and economic analysis of the failed attempt at constitutional democracy and suggestive proposals to correct the situation.

7 The classic work in the economic analysis of politics is James Buchanan