

4 Causes of Change in Political-Economic Regimes*

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INTRODUCTION

In this chapter, a political-economic regime is defined by the set of relatively stable and long-lasting rules (including the legal system), rights and government organizations within and through which it operates.

In the past, ideal systems described by concepts such as market or planned economy, private or public property, monarchy, aristocracy, democracy, dictatorship, totalitarianism, rule of law and division of power have been applied by economic and political theory to come to grips with the variety of systems that developed in reality. We shall follow this precedence, but bear in mind two reservations. First, the different systems themselves evolved in history. The Stone Age hunters had no knowledge of a market economy, and it is dubious whether we can speak of democracies before the Greek innovations. Second, we can certainly sometimes observe abrupt changes from one political-economic regime to another one. Russia after 1917 and West Germany in 1948 are telling examples. But we should not forget that, in most historical cases, the change of political-economic regime was a nearly continuous evolutionary process, in which subsequent change, and the abolition or introduction of rules and organizations followed each other, to evolve into a transformation of the political-economic system.

2 FORCES RESPONSIBLE FOR CHANGES IN POLITICAL-ECONOMIC REGIMES

The forces I believe to be responsible for the change of political-economic regimes are:

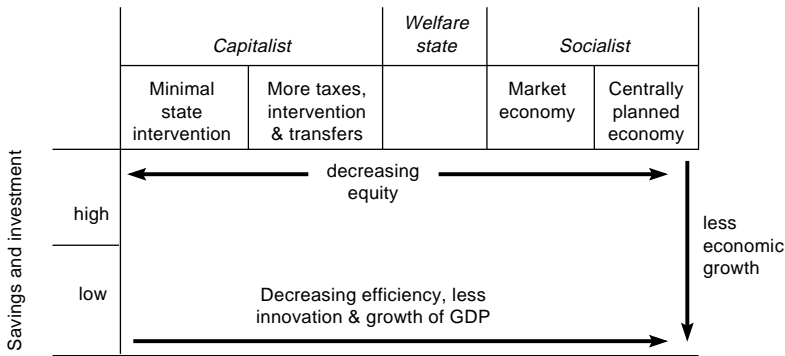


Figure 4.1 Consequences of different economic systems

1. The divergent performance concerning economic efficiency and the innovative capabilities of different economic systems.
2. Political competition for domestic power within states.
3. Competition of states in the international system for dominance and survival.
4. The success during crises of ideological or religious belief systems.

In the following sections we outline how these forces combine to change political-economic regimes, and cite historical evidence in support of our hypotheses.

3 REASONS FOR THE VASTLY DIVERGENT ECONOMIC PERFORMANCE OF DIFFERENT ECONOMIC REGIMES

By now we know that this performance – that is, efficiency, innovativeness and growth of gross national product (GNP) per capita – depends mainly on the economic and political, as well as on the legal, institutions of a country. The main relationships are summed up in Figure 4.1. A so-called planned socialist economy with state property is unable to motivate people to work efficiently or to be innovative. Since people cannot earn higher incomes or profits as a consequence of greater effort, they are not motivated to work industriously and efficiently. For the same reasons, they have no cause to innovate, since they cannot earn the fruits of their ingenuity; they even have to fight a stubborn bureaucracy to get the necessary inputs to innovate, – that is, to invent and to

introduce new and better production processes and goods. Since there is no competition threatening to throw them out of business, they are not driven to be efficient and innovative because they are afraid of losing their present position. The whole problem is made worse by the fact that there are no market prices to give reliable information on the relative scarcity of factors of production and other goods. As a consequence, no manager or worker in state-owned plants knows how best to combine the factors of production to reach the highest productivity, and to produce the goods most wanted by the population, or even by oligarchic leadership (Mises (1920); Hayek (1935); Bernholz (1975) chap. 6; Pejovich (1987)). The central planning agency suffers from a similar defect: because of lack of information, it can never know how best to combine, or where and when to use, the scarce factors of production. All this leads to an inefficient economy and a lack of innovation. Resources are squandered and productivity is low. Central planning restricts freedom, which means that the population's preferences for goods cannot be taken into account. On the other hand, the members of the oligarchy can always reserve sufficient goods, such as dachas, cars, or holidays on the Black Sea for themselves.

'Socialism with a human face' – that is, some kind of market economy – does not seem to provide a much better solution, as economists such as Ward (1967), Bernholz (1979) and Pejovich (1987) have shown. While informational problems will be solved with the help of markets, the problems of inefficiency, inflation and unemployment remain. Another problem is the distorted investment policies that arise from labour-controlled firms where workers possess weak and unsaleable property rights. The former Yugoslavia, with its high unemployment, inefficiency and rampant inflation provided a depressing example. Free-market economies only work if certain conditions are met. These include a legal framework, assured property rights and a stable monetary system, which, as suggested by Dorn and Schwartz (1987), must allow for extensive credit and capital markets. The absence of excessive government intervention and regulation, over-high taxation and unsustainable budget deficits are further pre-conditions. Where some or all of these conditions are not met, economic efficiency and development will be thwarted, as seen in the Latin-American economies and other underdeveloped countries. A regime with relatively free international trade in goods and services and free international capital movements is crucial to the efficient allocation of resources and innovation. Foreign competition not only encourages firms to compete with firms from abroad through

innovation, but also has the merit of limiting domestic cartels and monopolies.¹ Welfare too is increased by the international division of labour and the allocation of international capital according to highest productivity.

Recent literature on economic development, by Donges (1976), Krueger (1978), or Little, Scitovsky and Scott (1970), for example, has demonstrated the dismal failure of economies that have tried to further development through import substitution and the erection of import barriers or foreign exchange control. Cartels and monopolies sheltered from foreign competition produce inefficiently and have no need to innovate. Resources and productive capacity are misdirected because of distorted relative prices. Firms compete for import or foreign exchange quotas and dissipate resources to obtain rents. This promotes corruption, both political and bureaucratic.

It is not surprising, therefore, that several newly-developing countries, including Taiwan, South Korea, Singapore, Hong Kong, Thailand and Malaysia all pursued an export-oriented policy, eventually relaxing import and foreign-exchange restrictions. Unfortunately, political forces, especially in democracies, tend to favour the restriction of foreign exchange and trade. The superior performance of private-property-owning 'pure' market economies does not mean that these systems can solve all problems. Particularly important are the so-called negative externalities, such as environmental pollution; scarce, non-reproducible, 'positional' goods; and the distribution of wealth. Although environmental pollution appears to be even worse in planned economies, government measures may well be needed to internalize these negative externalities and reduce pollution to sustainable levels. Economists have shown that, as far as possible, taxes or charges on offending firms, households and communities are preferable to regulation. Clearly, wherever feasible, quasi-market mechanisms are preferable to control. As Faber and Manstetten (1989) observe, this motivates the polluters not only to reduce the level of pollution, but also to search for new technologies.

4 THE INFLUENCE OF THE DOMESTIC POLITICAL REGIME

The second factor that influences change in political-economic regimes is political competition within states. A developed system of free markets and private property requires the existence of a strong (but limited)

state to protect the safety of property rights and to adjudicate and enforce binding contracts as necessary. Nevertheless, government must be limited in order to prevent excessive tax burdens and frequent, unforeseen changes in the law. Government has an obligation to provide public goods, such as internal order and safety, as well as defence against foreign aggression. It also has a role, as already discussed, in preventing and removing environmental pollution and ensuring some income or wealth redistribution.

The important point is that it is not democracy, but some form of limited government and the rule of law that are essential to the success of a free-market economy with private property. The rapid economic development of countries such as Hong Kong, Taiwan and South Korea provides empirical evidence of this proposition. On the other hand, a decentralized market economy seems to be a pre-condition of a long-lasting democratic regime.

What do we understand by democracy? Democracy is a political regime in which most issues within the jurisdiction of government are decided by referendums or by simple majority voting in legislative bodies (parliaments) by members of parliament elected by the population at regular intervals. A democracy, in this sense, is not identical with a regime dominated by the rule of law. First, the rule of law may be present in monarchies, aristocracies and pluralistic regimes not dominated by any specific group. Second, in a democracy, where problems are addressed by government and/or parliament, the rule of law may be threatened. This is likely to happen where the democratic regime's domain is not restricted by constitutional or other safeguards, and a small shifting majority in parliament – that is, a small minority of the population – inadequately controlled by rationally uninformed voters can impose their will on the rest of the population. If a shifting majority can legislate at will, individuals do not have secure rights, as these could be abrogated at any time by the legislature. For example, ethnic and other minorities could be disadvantaged or suppressed by the majority. This could engender international tension, particularly where a minority in one state forms the majority in another. Unrestricted, or even moderately limited, democracy may tend not only to weaken individual rights but to restrict their freedom, and erode the efficiency and innovative capability of market economies with dominating private property.

Democracy is not only *not* a pre-condition for a capitalist market economy, it could even endanger it and, in the long run, threaten its very existence. With political parties competing for votes, and needing to finance their organization and electoral campaigns, it necessarily

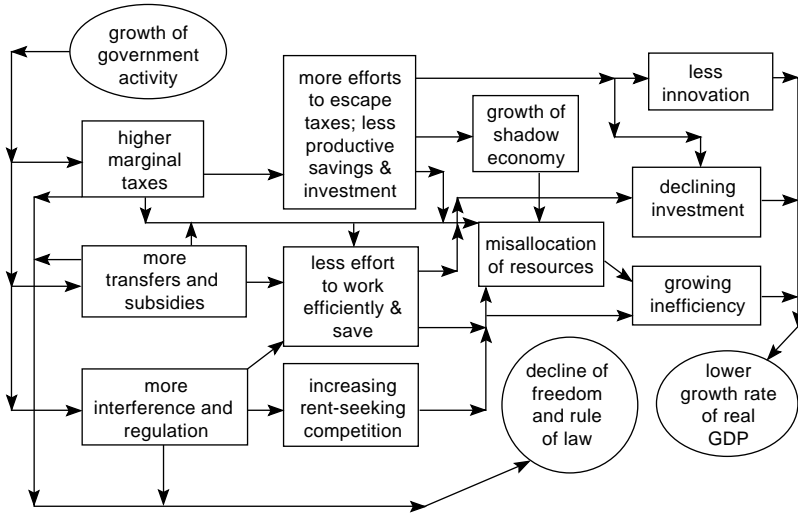


Figure 4.2 Consequences of growing government activity in democratic market economies

follows that whenever the majority of voters is rationally uninformed about the issues, there will be growing public expenditure, excessive regulation by government, tax loopholes and subsidies to special minority interests and strong pressure groups. This is illustrated in Figure 4.2. If decisions impinge only marginally on citizens they will have little reason to inform themselves. Consequently, we find certain industries protected against foreign competition, agricultural prices fixed above market-clearing levels, or subsidies to the coal industry, even though it is clear that the majority of voters will be hurt by higher prices and taxes. It is only when developments such as rent increases are perceived by the majority, that government action will favour the majority; for example, by rent control (Downs, 1957; Bernholz, 1966). The influence of minorities thus depends crucially on the rational ignorance of the majority, which in no way contradicts the decisiveness of shifting majorities, which operates where the majority is well-informed on issues.

It follows that unlimited democracy will encourage subsidies, transfers and regulations that appeal to the different minorities, interest groups and even shifting majorities (see Figure 4.3). However, it is not easy and it takes time to set up an interest group. As Olson (1965) and

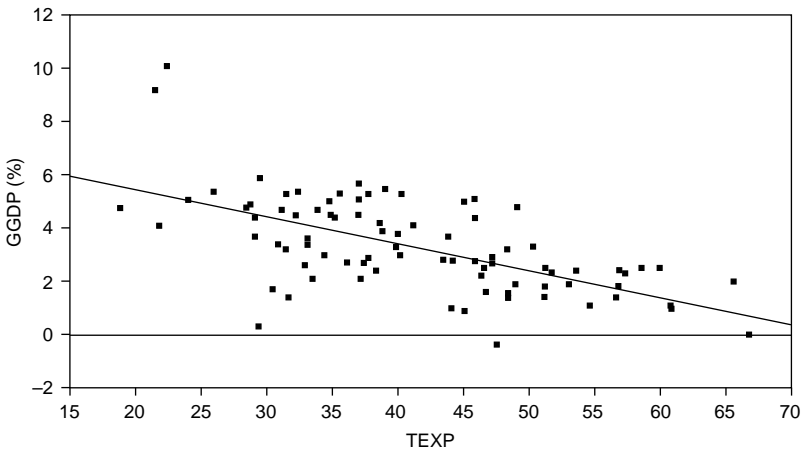


Figure 4.4 Growth of real GDP 1960–93 in 17 OECD countries.

Notes:

1. Average of 4 seven-year and 1 six-year periods.
2. Regression equation estimated:

$$\text{GGDP} = 8.31 - 0.107\text{TEXP} + 0.041\text{FINV} - 0.030\text{ADEM}$$

(7.21) (-8.610) (1.222) (-6.082)

 values: $n = 85$; $R^2 = 0.60$;
 t-statistics in brackets.
3. GGDP: percentage growth of real GDP;
 TEXP: total government expenditure as percentage of GDP;
 FINV: fixed investment share of GDP;
 ADEM: years of undisturbed democracy.

vation within the capitalist market system, which not only destroys the economic basis of the welfare state, but increasingly curtails citizens' freedom through discretionary intervention, regulation, high taxation and obligatory social security dues. This erosion of freedom may be a gradual development, as the underlying process feeds on the rational ignorance of voters. Thus, a major crisis may be needed to cause a political turnaround which could even lead to the overthrow of democracy and the establishment of a dictatorship or oligarchic regime. Argentina and Uruguay, among the wealthiest democracies around 1930, provide interesting examples of his phenomenon.

This means that, to preserve freedom, innovation and productivity, democracy with capitalist markets and a parliamentary majority decision-

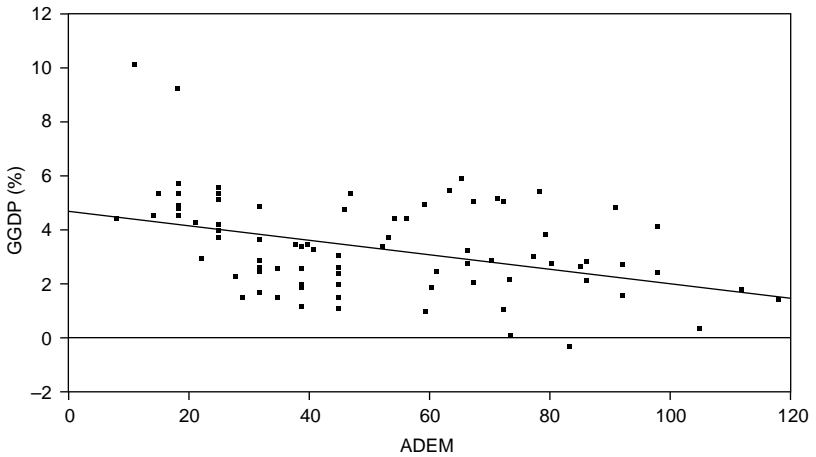


Figure 4.5 Growth of real GDP 1950–93 in 17 OECD countries.

Notes:

1. Average of 4 seven-year and 1 six-year periods.
2. Regression equation estimated:

$$\text{GGDP} = 8.31 - 0.107\text{TEXP} + 0.041\text{FNV} - 0.030\text{ADEM}$$

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3. GGDP: percentage growth of real GDP;
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 ADEM: years of undisturbed democracy.

making system must be limited by constitution or some other legal means. How this should be done is still an open question (Buchanan (1987), Gwartney and Wagner (1988)). We know that an independent judiciary, federalism and the division of power, an independent central bank, guaranteed property rights and constitutional limitation on government all help to achieve this goal, but history shows that even in this case – witness Germany, Switzerland and the USA – these provisions will gradually be eroded. In an authoritarian regime such safeguards will be weak, because the rulers themselves determine the domain of their power unless counterbalanced by quasi-religious or social conventions, the rulers' goodwill or a delicate balance of power between oligarchs. Authors such as Arendt (1968) and Bernholz (1991a and 1991b) analyse how freedom, the rule of law and capitalism can be

threatened by totalitarian movements, which completely reshape the social fabric – organizations and institutions – subordinating them to supreme values, as under Nazism, Communism or Islamic Fundamentalism. The old system will no longer be tolerated and may even be abolished; market institutions and individual freedom will be subjugated to fit in with the new supreme value system.

5 COMPETITION BETWEEN STATES AS A REASON FOR A FREE AND PROSPEROUS SOCIETY

Given an oligarchic, totalitarian and/or despotic regime, why should the ruling elite agree to strong and safe universal property rights, minimal state intervention and regulation, limited powers of taxation, and thus of its powers to command and to take away goods and resources? This is an important question because, throughout history, democracy, freedom, and the rule of law have been the exception rather than the norm. An answer is now provided by contemporary writers such as North and Thomas (1973) North (1981) and Jones (1981) on ‘the rise of the West’.

As Erich Weede (1987, p. 2) wrote: Europe *disunity* has been our good luck’. After the breakdown of the Roman Empire and the emergence of feudalism, many power centres emerged and a rift between religious and temporal power – pope, emperors and kings – developed (Berman, 1983). Strong rivalry for greater power between emerging states and rulers forced European rulers to take an interest in the well-being and loyalty of their subjects. In particular, because they needed to secure a greater tax base to pay for their armies, they were forced to take an interest in economic development. But, economic development, as we have seen, depended on free markets and adequate property rights. Thus competition between states limited the domestic power of rulers and prevented theocracy. Limited government and a pluralist society therefore existed before democracy. This was not planned, but emerged: first capitalism, and later democracy were their progeny.

Why did this happen? The pre-conditions for economic decentralization and free markets were safe property rights and the rule of law. For most groups and individuals this meant considerable freedom from political interference, enabling them to form their own judgements and decisions, shoulder the risks and enjoy the benefits. This self-reliance fostered the need for rational decision-making and participation in the political domain. As Andreski (1965, p. 357) states: ‘Up till now

representative government has flourished only where there was in existence a large class of economically independent persons, not necessarily independent in the sense of enjoying unearned incomes but in the sense of having no boss', and again, 'Thus apart from primitive systems with self-supporting peasants, only market economies with private property, where production is not concentrated in a few giant corporations, seem to be fertile breeding grounds for democracy.'

Clearly, a multi-polar system such as existed in feudal Europe was conducive to the chain of events outlined.² Outbursts of innovative activity in many fields of life, together with strong economic performance, characterized not only the Renaissance, with its Italian city-states, but also early and classical Greece, with Ionia and Milet at its centre in the former, and Athens the leader in the latter. Both were characterized by military and political competition between city-states. It is possible that the flowering of Phoenicia and remarkable success of Sumeria may also be attributed to competition between city-states. Note that Greece, in its early and classic periods was threatened by Lydia and Persia; and Phoenicia by Assyria and Persia.

In early Greece – 700–500 BC – not only were there numerous warring city-states, but the country was split geographically into many small regions. Military competition led to the formation of hoplite armies, the phalanx and mercenaries. Murray (1980) emphasizes that the trading of mass commodities such as grain, bronze, pottery and slaves implied an international division of labour, and the discouragement of piracy and confiscatory taxes, for only states with safe property rights, which traded with low duties, succeeded in strengthening the economic base of their military power and so flourished economically. This international competition, Murray suggests, had the following consequences:

1. The introduction of the hoplite army broadened the number of people sharing in political power, because all capable male citizens who could afford weapons were enlisted.
2. A legal order developed. The codification of the law in the seventh century BC was, especially in trading cities, enforced by the lower strata of citizens.
3. The development of trade led to the founding of new colonies. This both presupposed and encouraged economic development. Trading posts, such as Al Mina in Syria. Pithekussai (Ischia), Naukratis in Egypt, and Graviscae and Spina and Etruria were all founded by Greek cities. All were neighbouring, highly civilized regions or re-

- gions rich in material resources. Strong trade competition developed between them – as, for example, between Corinth and Aigina.
4. Coins were invented, which furthered trade and economic development.
 5. General economic prosperity and relative individual freedom encouraged profitable innovation and scientific and artistic inventions. Insofar as this was related to geography, including cartography, the development of prose and political thinking and writing about countries and their peoples also promoted trade and economic growth.
 6. Economic growth led to the restructuring of the economy and society. Conflict arose between the nobility and the new wealthy class, as described by Alkaios and Theognis. Rich traders emerged, such as Sostratos in Aegina, who regularly traded with Graviscae in Etruria.
 7. This economic restructuring led to a redistribution of income and wealth, with implied political tension. Reforms, as introduced by Solon of Athens, became necessary. These reforms entailed a change of political system.

The hypotheses seem to be corroborated by these observations. They are also supported by examples of stagnation under different conditions. First, international political competition did not mean that all states were reformed. Many states preferred to keep to their inefficient rules and regulations, which hindered restructuring. Others were subjugated by greater powers, which stifled their innovation. Historical evidence confirms that:

- (i) The relative economic importance of Sparta decreased. This deterioration was caused by the number of state regulations imposed on the citizens. In *Lykourgos*, Plutarch refers to the need to pay merchants, poets and artists. But Sparta had banned the new Greek currency.
- (ii) The great oriental empires with their system of discretionary government intervention stagnated. Even in Ionia and Phoenicia, after they were swallowed by the Persian empire their development was arrested, whereas it continued on the Greek mainland, especially in Athens and Carthage – Phoenicia's daughter one could say.

Examples of rulers who were motivated to limit their domestic power and strengthen the economy as a power base in the international system can still be found today – for example, China's effort since 1979 to decentralize and move towards a market economy, and the attempt

by the USSR and Eastern European countries to do the same probably owe more to the ambition of China and Russia to build up and maintain their status as a great power than with any wish to supply their peoples with more and better goods, or even to grant them greater freedom. This would explain Mikhail Gorbachev's attempts to persuade the USSR to undertake far-reaching institutional and economic reforms. The *Neue Zürcher Zeitung* of 13 December 1984 reported that Gorbachev, 'the youngest member of the Politburo was the main speaker at a (Communist Party) conference on ideology' and he stated that 'it was inescapable to transform the Soviet economy and to raise its technical and organizational performance to a qualitatively higher level . . . Only a modernized economy could meet the needs of the population, allow a strengthening of the position of the USSR on the international stage and enable her to enter the new millenium as a powerful and flourishing state. The newspaper commented that 'One could not learn from the presentation in what way the Soviet economy should be modernized and which reform ideas Gorbachev would like to apply.'

The reasons for reform seem obvious. Reform by rulers, however, is only possible under a dictatorship and/or a totalitarian regime, for, as Gordon Tullock (1974) argues, free economic and democratic regimes are public goods, and the risks to life and family implied in a *coup d'état* far outweigh the gain for any person not in control of some military or police power. Moreover, the wish of rulers to grant freedom in order to realize a more successful economic regime does not mean that the reforms will be adequate or successful.

Japan during the second half of the nineteenth century provides an example of successful reform – constitutional, legal and economic. The Meiji Restoration in the 1860s was a revolution led from above by sections of the nobility who challenged the weakened shogun. It depended on skilfully restoring power to the Tenno. This move was caused by the realization of the superior power of Western states after the forced opening of Japan's harbours to Western trade. To quote *Encyclopaedia Britannica*: 'The new slogan was "*fukokukyohei*" (rich country, strong arms). Reform in Japan meant the wholesale adoption of Western constitutional, legal, educational, economic, technical, administrative and military systems, which in the long run proved successful, although, in a sense, these reforms were only fully completed after the Second World War.

In the case of Taiwan and South Korea, it appears that it was the foreign policy situation *vis-à-vis* North Korea and Communist China which prompted their espousal of capitalism, encouraged the rulers to

limit their own powers, and indirectly motivated these peoples to seek greater political rights, and even, democracy. Communist China, since 1970 pretty successful with its stepwise policy of economic reform towards a market economy, probably wanted to strengthen its position as a world power.

What other reasons might motivate rulers to limit their power? My impression is that only some kind of crisis would trigger this. UK economic performance, for example, had for years lagged behind Germany and France, and this fact may have been more responsible for the turnaround under Margaret Thatcher than, as Seldon (1990, p. 19) put it: 'by 1979, the British had experienced the practical consequences of all the ideas propounded by the politicians in all the parties'. The crises faced by Hong Kong and Singapore were finding ways to support the inflow of refugees, and their separation from the hinterlands in China and Malaysia.

6 THE ROLE OF CRISIS AND IDEOLOGY IN CHANGING REGIMES

Ideology and crisis, largely neglected by 'public choice theory', play a major part as a cause and as a beneficiary of eruptions which lead to changes in political and economic regimes. The tendency in democratic market regimes towards ever-increasing intervention and/or a welfare state leads, in time, to less and less efficiency, freedom, innovation and productive investment, a misallocation of resources and decreasing GNP growth. Eventually, widespread voter dissatisfaction will bring about a political-economic crisis. Crises can also arise for other reasons – war, ethnic and religious strife, hyperinflation, depressions. Obvious examples are the consequences of the First World War peace treaties of Versailles, St Germain, Trianon and Neuilly; the 1929 Great Depression; and the hyperinflations in Europe in the 1920s, in China in the 1940s and, more recently, in Latin America. Not only are crises clearly a fertile ground for reform and the introduction of new political-economic regimes, but also for new ideas or ideologies designed to solve the perceived problems. For example, Peacock and Willgerodt (1989) show how during the Nazi regime, German neo-liberals such as Eucken, Böhm-Bawerk, Röpke and Müller-Armack had prepared their theoretical vision of a free market regime, and that these ideas were fully formulated and ready for implementation by Ludwig Erhard and others by the time of the 1948 currency reform.

By an ideology, I understand a world view, a *Weltanschauung* – an interpretation of major aspects of the world and their interrelationships. Ideology fulfils a latent human demand for spiritual goods – a creed to solve problems and provide security in an otherwise incomprehensible world. Communism and national-socialism are examples of ideologies, as well as the major religions. It is obvious, that in times of crisis, ideology offers an attractive solution to a disoriented and suffering people. Frey and Weck (1981) point out that both Communism and Nazism gained electoral support in Germany during the crisis of the Great Depression; in Russia it was no accident that V. I. Lenin gained power after the defeats and suffering of the First World War. In China, would Mao Tse Tung and his followers have defeated the Kuomintang so easily in 1949 if the country had not been in a dismal economic plight, ravaged by hyperinflation and corruption?

It appears, then, that an ideological movement's best chance of grasping power is during a crisis, if it offers an attractive belief system and a solution to the masses' problems. After obtaining power, the new ideology may mean turning the nation into a totalitarian state, if, as Bernholz (1991a)³ discusses, the supreme values of the creed appear to demand it.

Supreme values usually include rules pertaining to the desirable economic regime. Islam, for example, banned interest; Christianity forbade usury; Communism and Nazism implied a more-or-less centrally-planned economy, with (under Communism) socialist or state-owned property. Ideologies require fixed constitutional rules binding on everybody, including the leadership. In Bernholz (1991b), I have described this as a 'constitution of totalitarianism', in the sense that, as far as a written, or unwritten, constitution embodies comprehensive rules on the organization of the economy, the political success of any ideology will inevitably lead to economic as well as political change. This is exactly what happened in the USSR, Nazi Germany, Eastern Europe, Communist China, Cuba, Vietnam and Cambodia. Communist countries all introduced collectivized or state-owned property and more-or-less central planning instead of free markets. In time, such a system must lead to economic inferiority, because of an inability to solve the informational and motivational problems within the system (Pejovich, 1987). The weakening of the relative economic base of military and political power inevitably leads to increasing tension, which will end in a major eruption, as witnessed in Eastern Europe.

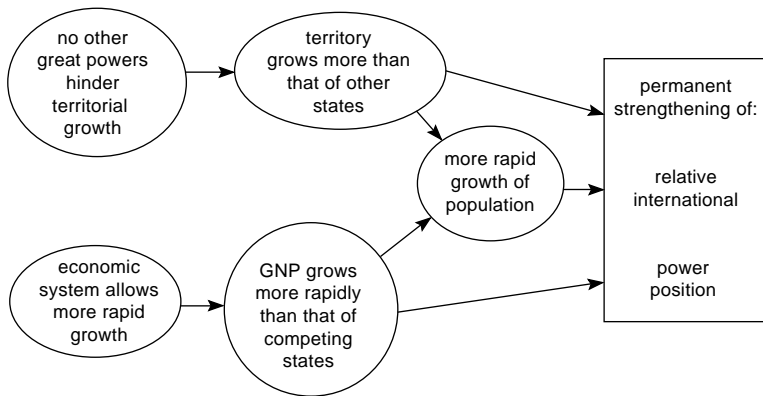


Figure 4.6 Basis for long-term predictions of change in relative international power

7 BACK TO ARISTOTLE OR CYCLICAL POLITICO-ECONOMIC REGIMES?

Our analysis suggests the existence of long-term cyclical movements from one economic, and perhaps political, regime to another. Over time, free markets in an unrestricted democracy degenerate into excessive welfare and/or interventionist states. The ensuing crisis allows an ideological movement to grasp power, transforming the economic regime through central planning, possibly with collective property ownership. Central planning implies a central political authority, possibly a dictatorship. In time, such an economic system must lead to a deterioration in the relative power position in the international system of competing states, as shown in Figure 4.6. This will be followed by reform from above to encourage a free market economy with privately owned property. Economic liberalization requires political decentralization, which allows a rule of law and democracy to emerge, and the cycle repeats itself. Given these stylized relationships, could we be witnessing some kind of political cycle as discussed by Plato (1965, book 8) and criticized by Aristotle (1965, book 5)?

While certain forces may work towards a long-term cyclical movement, others may be pushing the process in different directions, as shown in Figure 4.7. An excessively interventionist or welfare state could be reformed by reducing government regulation, taxes and redistribution, if an opposition party with an alternative programme stands

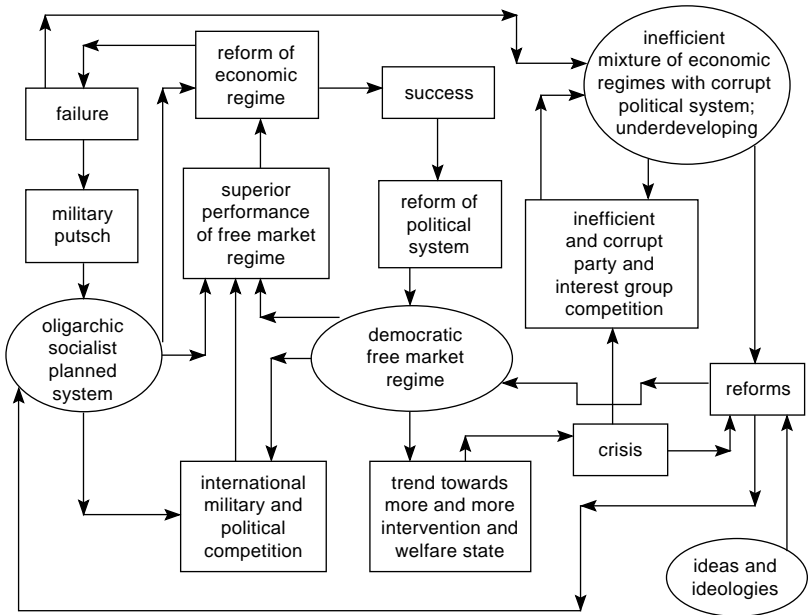


Figure 4.7 Long-term politico-economic developments

for election in a time of crisis. Where there is no such alternative, the political-economic system may eventually cause deterioration into an under-developing country, as happened to Argentina in the 1930s. The same could occur where reforms – in the former planned socialist economies, say – are unsuccessful. When the reform process fails, a return to dictatorship and central planning may even occur. Events in the former USSR show how likely the first option is. It is a fact that it is much harder and politically dangerous to attempt to move from a less complex to a more complex system than vice versa.

Political-economic systems may not substitute for each other in a fixed cyclical order, for short cuts or moves back to a former regime are possible. The economy may move away in an unstable process from a stable economic regime to a system with weak inadequate political and economic institutions for long periods. Obviously, much work still needs to be done, both in economics generally, and in public-choice theory specifically, to understand the pre-conditions and dynamics of these processes.

I close my chapter by raising another problem. What should be the

role of economists, in advising politicians on the best strategy and economic policy to adopt in order to promote and maintain the institutions of a free market economy? I think that there is at least one answer: namely, that the right ideas at the right time in a crisis may prove successful, if they can triumph over other ideas and ideologies. How can this be ensured? One could cite the better empirical record of the free market economies with strong private property rights. This, however, may not suffice to convince a power-hungry oligarchy or badly-informed population, influenced by ideological fanatics and mass-media intellectuals hostile to a free-market economy (Schumpeter, 1943). Do we need a religion or ideology that embodies the tenets of a free-market economy among its supreme values? Max Weber's (1965) discussion on 'Capitalism and the Protestant Ethic' would seem to point in this direction.

Notes

* An earlier version of this chapter was published in Gerken, L. (ed.) (1995) *Competition among Institutions* (London: Macmillan) pp. 65–88, and in different form under the title 'Efficiency, Political-Economic Organization, and International Competition among States' (1992) in the *International Journal of the Unity of the Sciences*, vol. 5, no. 4 (Winter), pp. 443–83.

1. We have argued that the state has to play an important role concerning the provision of safe property rights, a reliable legal system and stable money. The same is true for defence, environmental problems and some infrastructure. From this it follows that a positive effect on the growth rate of GDP should be expected from an increase in the share of government expenditure up to a certain level. Such an influence did not, however, show up empirically in the range of observations covered by the studies and calculations carried out for Figure 4.4, for example.
2. Multipolar systems are, however, a rather unstable international system (Bernholz (1985), pp. 23–33). Their beneficial consequences for the development of efficient and innovative capitalist market regimes are bought, moreover, at the cost of increasingly efficient warfare with all its concomitant sacrifices and human suffering. A way out may be the invention of the federal state. It allows internal non-military competition among the member states because of the open borders between them. This presupposes, however, that the central government is somehow hindered from undergoing the developments sketched in Section 4. This problem has not yet been adequately solved.
3. As already mentioned, sound reform ideas may also have a chance of being accepted if proposed during a crisis. This chance should be greater the more examples other nations there are of that have successfully adopted

such reforms. In this sense the success stories of the South-East Asian countries, and especially of Chile, may be important for the economic reforms undertaken in other Latin-American countries, and these reforms, in turn, may further the process of democratization.

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