

## SURVEY OF THE LITERATURE

### Universality of Institutions Necessary for Long-Term Catching Up Growth

#### A recipe 300 years old: Inviolability of the individual person and protection of property rights

**T**he question concerning ways of accelerated modernization in backward countries has been the subject of discussion among economists for the past century-and-a-half. As far back as the mid-19<sup>th</sup> century, John Stuart Mill, an outstanding economist, put forth the general principles of a policy aimed at overcoming backwardness. These principles have two important special features: first, they remain pertinent to the issue to this day; and second, Russia is mentioned among the European countries which the author's recommendations have an immediate bearing upon.

In the 1840s, Mill wrote that for the industrially underdeveloped regions of Europe (such as Russia, Turkey, Spain, and Ireland), means of economic growth include:

Improvement of forms of management, more perfect protection of property; moderate taxes and the elimination of arbitrary extortion and racketeering practiced under the guise of tax collection;

Raising the level of the intellectual development of the people;

Introduction of crafts borrowed from abroad, which permit increasing the profits derivable from additional capital... attracting foreign capital, something that makes production growth no longer dependent on the thriftiness or the prudence of the inhabitants themselves.<sup>1</sup>

As the principal factors of growth, Mill thus identifies guarantees of property rights and the absence of arbitrary abuse of power by the authorities, development of education among the populace, and attracting foreign capital (as financial resources and technologies or knowhow).

But this is only a general setup for getting one's bearings. Based upon this, a series of specific undertakings must be worked out, which can make it possible to realize the three specified conditions in practice, thus solving the problem of a social-economic breakthrough.

Interestingly, the great educator J. Korczak noted and stressed the significance of this orientation setup on the basis of his observation of children. The property instinct is an outgrowth not of education or socialization, but of one

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<sup>1</sup> See John Stuart Mill, *Principles of Political Economy with Some of Their Applications to Social Philosophy* (England, US, and Canada: Longmans, Green, and Co., Ltd., 1848, first ed.) in 2 vols.

of the principles of the human person, coming to the fore in early childhood. Korczak writes:

*Mine.* What is the source of this thought – this feeling? Has it not coalesced with the notion of the “I”? .... Only later do imitation, the spirit of competition, and the wish to stand out, assert themselves. This is because property meets with respect. It augments one’s importance and grants power. Without a ball, he would have remained in the shadow, unnoticed, while, having one, he can, independently of his own having particular qualities, assume a leading role in the game. If he has a play sabre, he becomes an officer, if a cart, then a coachman; while a soldier or a workhorse is usually he who has nothing. Give, let me, loan me – these are requests which flatter one’s self-exaltation. It’s OK to give, but it’s actually OK also not to give, depending on caprice, because this is – mine.<sup>2</sup>

If, instead of the negatively nuanced “self-exaltation” or “power,” we use their positive-sounding synonyms, “sense of one’s own worth,” “dignity,” or “freedom,” then Korczak’s observations yield the confirmation of a fact: property<sup>3</sup> protects freedom and preserves human dignity. Korczak’s younger contemporary, R. Pipes, reached an identical conclusion. Pipes demonstrated the persistence of the phenomenon of a stable and recurrent link between private property, its development and guarantees, and the level of freedom and dignity of the human person. (Pipes 2000)

Historical experience of modernization (and of catching-up modernization, in particular) enables us to draw certain conclusions concerning the way that new countries embark upon the road leading to long-term economic growth. In brief, these conclusions take on the shape of the following.

First of all, some general objective patterns obtain, which must be taken into account in order to provide the foundation for successful modernization. But these objective patterns are not of a statistical kind. They are based on the study of successful modernization experiences, considering that successful outcomes of modernization are not that many in number.

Second, the specific features of modernization processes depend on the various stages of the development of society and society’s productive capacity.

At the outset, realizing projects of modernization is bound up with the emergence of certain political assumptions essential for modern economic growth. In England, growth began after the moment when, during the Glorious Revolution of 1689, certain political and financial settlements were reached and the Bill of Rights accepted. This last complemented the Habeas Corpus Act of 1679, according to which no citizen could be arrested, or deprived of life or property, without the decision of an open court independent of the Crown. Besides, the King acknowledged the exclusive right of Parliament to levy taxes and money collections, thus giving up arbitrary rule in the organization of state finances. The financial settlement formed the natural extension of the

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<sup>2</sup> Janusz Korczak, *How to Love a Child* (originally published as *Jak kochać dziecko*, Warsaw 1919; 2nd edition, 1920, as *Jak kochać dzieci*). Certain behavior symptoms reminiscent of property can also be observed in animals (Tambovtsev 2005). But this rather bespeaks the difference between the modern institution of property and the natural predilection for possession. An animal aims to protect territory which it uses to provide for its living needs. The factual possibility of possession depends primarily on the ability to protect property from invasion. This resembles the state of affairs in pre-capitalistic societies, where the title alone of possession of land did not provide its holder with so much as the minimal guarantees of protection, especially in case the property attracted the attention of the ruler or a powerful aggressor from the outside. The contemporary institution of property provides guarantees of immunity; this is why, unlike possession in pre-capitalistic times, it leads to considerable investing in delimiting and precise specification of property rights. For even insignificant property becomes a production resource. In pre-capitalistic times, protecting the land lot was incomparably more important than specifying boundaries and rights with any great degree of precision. (Yanovskiy and Javoronkov 2011)

<sup>3</sup> Here we mean property as an institution, rather than property as a stored up supply of belongings.

political one, since by the time it was reached, the fact had been duly appreciated that arbitrary taxation and financial ills (with attendant inevitable inflation) are just as illegal (extra-judicial) a way of taking away property as outright arbitrary confiscation. Providing for the observance of these agreements on the part of the Crown was facilitated by memories of 1649, when King Charles I was executed for abusing power, something that found its expression in his attempts to rule without Parliament, to levy taxes by his own whim, and to subordinate judges to his will.

We should note that there was no question of introducing principles of modern democracy in any of these settlements. Political rights were enjoyed by an insignificant minority of the population, freedom of speech was conditional, political censorship was maintained, religious tolerance was extremely limited. But none of this stood in the way of an unprecedented flowering of entrepreneurship and acceleration in economic growth the likes of which had never before been seen.

But the history of the last one hundred years has known cases of rapid economic growth even without these presuppositions. The USSR constitutes the most vivid case in point. However, in these instances, growth always turned out to be historically limited in time, accompanied by colossal loss of resources, and, what is most important, always leading to a severe crisis in the systems running the country.

A society which has embarked on the road to long-term flourishing can see the moral foundations of its condition depicted in the near exhaustive description provided by Adam Smith. The state in such society occupies a worthy but modest position. It collects moderate taxes (not, as experience has shown, necessarily regularly), provides peace and security,<sup>4</sup> and does not abuse its lawmaking capacity. Finally, it provides legal order and just trial and judgment, which “guarantee for each the opportunity to enjoy the fruits of his labors, thus stimulating all kinds of productive activities.”<sup>5</sup>

The substantial question arises concerning the mutual relationship among different political institutions, and their relative significance vis-à-vis each other.

Unlike the textbooks, a real-life political process involves legal democratic institutions which cannot all emerge at the same time. A considerable amount of time must elapse before they become established and their functioning entrenched in everyday practice. We can single out those institutions (rules of the game, norms, laws, as well as the mechanisms of their implementation), which are essential for providing stable economic growth and by comparison with which others take on a secondary role.

Thus, the primary institutions essential for growth include guarantees of the inviolability of the human person, of human life and freedom. This presupposes the existence of a court system independent of the other branches of power, as well as a certain degree of independence for the mass media and their ability to enable public control of events. Protection of life and property from being arbitrarily disposed of is an absolute must and a sine qua non as a foundation for modern economic growth. This is perfectly natural: prior to amassing wealth and making investments, prior to organizing and producing, and even prior to preserving property and spending money, a person must be assured that his or her life and liberty do not depend on anybody's arbitrary actions.

We have conducted a statistical study measuring the impact of different political institutions on economic growth in more than 50 countries which have undergone a profound transformation in the second half of the 20<sup>th</sup> century.<sup>6</sup> The analysis demonstrates that, as compared with the

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<sup>4</sup> As this was required of the royal authority by the Pentateuch and commentaries to the Biblical text, “he should not have a multitude of horses... but only according to the number of chariots of war... and let him not have great hoards of gold and silver... but only according to the quantity (pay for) the troops...” (Deuteronomy 17:16-17; see also the Babylonian Talmud, tr. Sanhedrin 21b).

<sup>5</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: Strahan & Cadell, 1776, first ed.).

<sup>6</sup> Mau, Yanovskiy, Javoronkov et al. 2003.

factors we have enumerated, a much lesser role is played by the constitutional system (presidential or parliamentary republic), territorial arrangement (federation or unitary state), tax regime or schedule, administrative barriers, and many other elements. The experience of England – the first country to have embarked on the road of contemporary economic growth – fully corroborates this finding.

To sum up: the nature of the political regime alone (whether it is authoritarian or democratic) is not of critical importance for economic growth; it does not scare off investors, especially foreign ones. What is more important for them, are the safeguards for the immunity of the individual person and property, as well as the comprehensibility and predictability of the rules of the game accepted in the country in question.<sup>7</sup>

In their book *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History* (2009), North, Wallis, and Weingast attempt to trace historically the genesis of judicial market democracies which safeguard property rights. However, parallel to this, the authors do not provide any explicit description of the mechanism for preventing arbitrary confiscation of property by the new social orders and competition (except for a reference to new strategies of the elites and new interests accompanying the transition to general, non-individual-specific rights rather than privileges).

There is also a palpable lack of a detailed account of the mechanism or stimuli prompting the elite to convert their exclusive privileges into universal rights.

We assume that far from all the members of the elite voice a demand for such a conversion; only particular groups do. These are the groups who feel vulnerable in the face of steps which can be arbitrarily taken by the ruler. Consider, for instance, the noblemen who led their troops out onto the fields of Runnymede and compelled King John of England (John Lackland) to sign the Magna Carta, or the Grand Charter of Freedoms. The universalization or simply the expansion of the privileged groups becomes an understandable means of defense and stabilization of the new order. Provided that the expansion takes place at the expense of those who, should the ruler or some other elite group violate the agreement, are ready to take up arms to defend their rights. But if society numbers many groups capable of such a step, but they are hard to identify so as to include a list of them in an agreement, the interest the initiators demonstrate in universalizing privileges becomes understandable.

It is hard not to agree with D. North and his co-authors that democracy and economic growth share a third determining factor in common.<sup>8</sup> Moreover, the notion of “social orders” is overly general. Like the box with holes made for the Little Prince in St. Exupery, it can accommodate any interpretation within certain reasonable limits. And this doubtless includes our interpretation, as well. That is: both democracy and economic growth require the same precondition: safeguards against physical annihilation and deprivation of freedom.

If a voter or a candidate can disappear easily, democratic procedure turns into a farce, worsening the situation of the individual person in zones of conflict (Yanovskiy, Javoronkov,

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<sup>7</sup> It is easier to provide property rights guarantees when acute political and media competition is in evidence. Such guarantees turn out to be more stable than those provided by a single leader (even by one ruling in a dynastic authoritarian regime, which has long-term economic interests. For further detail, see Appendix I). But neither elections as such, nor particular political freedoms provide a quality business climate. A democratic political regime may potentially better protect the immunity of property owners, and thus of property. But, let us stress again, this is true only potentially.

<sup>8</sup> North, Wallis, Weingast 2009, p. 13.

Zatkovetzky 2007). Election results provide detailed signals for the bandit about the loyalty or the disloyalty of the tribute-paying population. The population can then never simply bribe all the dangerous bandits in order to sleep soundly.

If a property owner can disappear easily, private property as an institution disappears for all intents and purposes. And any hopes of long-term stable economic growth disappear with it. Yet the authors prefer directing attention to a set of factors optimal for economies of “open-access social orders.”

Some of these are impossible to disagree with<sup>9</sup>:

- Absence of restrictions on engaging in economic, political, religious, or educational activities;
- Impersonality and universality of legal norms, with equal and impartial consideration of the issue, and thus, possibility of impersonal exchange.

Besides these, the following are listed as also being key:

- “Universally open support for organizational forms of all kinds of endeavor” and so, accordingly, the opportunity to create corporations and engage in impersonal exchange (a view hard to argue with, but the significance of this requirement is far from obvious);
- Stability (unlimited time) of the existence of the state supporting the norms.<sup>10</sup>

There are also two conditions which invite serious doubt:

- “Consolidated political control over violence,<sup>11</sup>” as well as
- “Generally widespread set of firmly held beliefs concerning inclusion and equality of all citizens.”<sup>12</sup>

Insofar as we are concerned with equality other than the indisputable equality before the law already brought up above, this requirement throws a bridge across the chasm to Tilly and Dal, who for all intents and purposes identify democracy with universal suffrage. We will consider the issue of the relationship between democracy and universal suffrage in further detail in Chapter 13 below.<sup>13</sup>

## A Recipe 90 Years of Age

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<sup>9</sup> For features of “open access” referred to here and further, see *ibid.*, p. 114.

<sup>10</sup> This is obviously useful, but, as the authors themselves agree, it does not constitute a distinctive feature of judicial market democracies by comparison with the “traditional” (“natural,” as the book terms this) states.

<sup>11</sup> Obviously, this contradicts the right of citizens to bear arms; but the denial of this right is the grounds of a consensus only among leftist politicians. As in the previous case, a problem in its own right consists in the self-evident fact that a host of ferocious dictatorships well known in history provided no less “consolidated” a form of control over the suppression apparatus, but were at the same time also infinitely distant both from the abstract notion of “open-access social orders” and from genuine judicial democracies, especially during the “pre-Socialist” era.

<sup>12</sup> The function of generally widespread firmly held beliefs will be our focus and the subject of more detailed discussion in Chapter 9.

<sup>13</sup> We should note, however, that the authors do not put any emphasis on the universal suffrage requirement as a precondition for a successful transition to “open-access orders.” Moreover, according to their estimates, the first three states to have made the transition to such orders – the US, Great Britain, and France – completed the transition by the 1880s, that is, prior to the introduction of universal suffrage in the first two of these countries, and at a time when universal suffrage applied only to men in France.

The deleterious effect of state government by means of economics, redistribution of wealth, and “perfect” planning stands in no need of being demonstrated by us. As far back as the first half of the 20<sup>th</sup> century, L. Mises and F. Hayek demonstrated the inadequacy of models of plan economics and socialistic redistribution.<sup>14</sup> The same models have since confirmed their inefficacy in practice.

Suffice it to note that the successful implementation of a state-controlled economics based on the advantages of centralized information requires that this information be reliable, at the very least. This last is impossible to achieve as long as wholesale coordinated sabotage obtains, carried off by clerks and other executives interested in decreasing the load and the planned work level, and, correspondingly, interested in concealing part of the resources. At the same time, the stimuli responsible for effective planning and plan implementation can be created only when the fiercest of dictatorships is in evidence.<sup>15</sup> M. Olson has noted several of the effects of fierce repression. The first consists in the opportunity enjoyed by the state to amass resources in its own hands. The second involves the downtrodden condition of special interest groups. Practically the entire state begins to function as the dictator’s private enterprise. True, instances of success to date are limited to a single branch of the economy (arms production) and a short period of time.

To sum up: a must, which lowers the likelihood of conspiracy by the dictator’s employees, consists of regular (or unceasing) repressions which leave no time for the team building of interest groups and which paralyze society by means of fear. At the same time, on-the-spot retribution for real infractions is not treated as an objective. The dictator consciously “cuts down” his subordinates “layer by layer.” This is done regardless of the dictator’s underlings’ level of efficacy or loyalty at the moment, simply for the purpose of sustaining fear as a foundation for the loyalty of new subordinates.

According to Scully’s way of seeing things (Scully 1997), repressions are a dictator’s way of signaling to his competitors about the high cost of opposing him. True enough, as a precondition of the repressions’ effectiveness, a dictator introduces “cheapness of life” (where a low level of human capital is a fact for most agents). Soviet experience (“sharazhki”) shows that by means of repression and real threats, the bearer of significant human capital can be forced to work for a lowered price, a fact which augments short-term returns from mass coercion. This, too, is a reason for our supposing that the reverse causal connection is more often operative. Given a great likelihood of one’s being repressed, the stimuli for long-term investment in one’s (one’s children’s, or one’s spouse’s) human capital are undermined.

Experience has shown that the repression mechanism cannot feature longevity. Sooner or later, after the dictator’s death, his successors fail to maintain an interest in keeping up the same policies. This comes despite their perfect ideational fit with the former regime and their understanding of its effectiveness. Paying for effectiveness by risk to their own lives is something they take no interest in.

Under dictatorship, giving up repression of activities aimed against the state apparatus quickly leads to the growth of interest groups, and to the conscious distortion or even blocking of information sluicing in upwards.

The absence of opportunity for effective centralized management together with weak personal stimuli and bureaucrats’ growing influence gradually leads the economy to stagnation. Ultimately, fear of punishment for failure to obey orders grows weaker. And this threatens to explode the country; which is precisely what happened in the USSR in 1989-91.

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<sup>14</sup> Mises 1922, 1944, 1947, 1957, 1949; Hayek 1944, 1989. The dates indicated are the first publication years for the texts in question. Corresponding titles in Russian are listed in the Bibliography.

<sup>15</sup> Olson 1994.

## **Wealth of Natural Resources – A Source of Institutional Risks**

The point of view has lately become common that economic growth in Russia in 2000-2008 was determined by the high cost of petroleum. It is impossible to know whether economic growth would have been just as high, had petroleum prices been lower. The claim is occasionally made that growth could have even shifted to recession, had petroleum prices gone down. In actual point of fact, the role played by natural resources in ensuring high growth rates is not as unambiguous as *prima facie* may appear to be the case.

There is no doubting the fact that the Russian economy is greatly dependent on the raw material (especially the fuel-and-energy) sector, just as was the case for the economy of the USSR in 1970-1980s. But this, in turn, implies vulnerability not only for the economic, but also for the political system: the fall of the USSR had to do with a sharp lowering of petroleum prices at the level to which the Soviet economy had adapted in the course of the 1970s. But no direct comparisons can be appropriate here.

High revenues from natural resources (such as high petroleum prices), while stimulating economic growth in some sectors, create obstacles on the way to long-term growth of the economy as a whole.

We can list a series of factors which impact the economic situation when natural resources are abundant.

First, there is the “Dutch disease.” While it eggs on the climbing international currency exchange rates, it also lowers the competitive capacity of a significant part of the economy. Measures resorted to by the authorities in order to contain the ruble’s real exchange rate lead to the growth of inflation.

Second, a significant gap between a profitable raw material branch and all other branches of the economy leads to the de-stimulation of investment in other sectors. This means that structural transformation is held back, and motivation for diversifying is undermined. Structural reforms are also decelerated.

Third, a conflict emerges between budgetary interests and the interests of economic growth. “Cheap money” lightens the load on the budget and makes room for budgetary maneuvering. At the same time, a significant number of economic agents are not at all interested in a situation of the kind where the competitive capacity of branches of the economy working with the internal market’s demand goes down.

Fourth, state authorities are exposed to the temptation of economic populism and corruption. The availability of considerable financial resources provokes the intensification of lobbying, which involves not only entrepreneurs, but also representatives of the regime who are responsible for the resolution of branch-specific economic issues. The government finds it ever harder to withstand this pressure. With time, budgetary expenses can begin to grow uncontrollably, intensifying the danger of macroeconomic destabilization in the future.

Thus, on the one hand, being blessed with natural resources provides the opportunity for economic growth, but on the other, it prevents the growth of institutions facilitating long-term economic growth.

## **Institutions of the Family and Morality: The Crisis in Systems of Education**

There are practically no contemporary research works investigating the problem of the loss of a very important component of human capital – the habit of civil life. “Habits of

city life”<sup>16</sup> is a term N. M. Karamzin used to refer to everything “which had the look of liberty and ancient civil rights.” In Russia, these habits were largely lost when the urban population of medieval Rus’ was destroyed, first by the Mongols,<sup>17</sup> and then by Ivan the Terrible. Political scientists and sociologists use “social capital”<sup>18</sup> as a term corresponding to this concept. In order to avoid confusion, the present book will not avail itself of “social capital” as a term. Habits of civil life are an important component of the set of institutions facilitating long-term economic growth.

When speaking of this component of human capital, we do not mean the human propensity to take part in elections. Participation in elections for certain categories of budget-dependent voters is rather testimony to the degradation of certain principles among the citizens, and, accordingly, of the degradation of this component of their human capital. And we definitely do not mean society’s “racial-religious-cultural diversity” (which is often achieved by artificial means; see Chapter 7). The notion of “social capital” is also fundamentally distinct from the component of human capital as per way of formation. “Social capital” as a totality of helpful objectives is the product of large hierarchical systems.<sup>19</sup> The human capital component which we have in mind takes shape primarily in the family and in society directly constructed upon family-related bonds and ties of friendship (for more detail, see Chapter 11). Skills and norms which lower the costs of “depersonalized” (that is, formal and judicial) interactions, are supported by the **monotheistic faiths** (cf. the definition above and, in greater detail, in Chapters 9 and 12) and the corresponding type of societies.

A discussion has been unfolding between D. Acemoglu<sup>20</sup> and A. Shleifer<sup>21</sup> about the role played in economic development by European-imported institutions in different countries (USA, Canada, South America, and others). Acemoglu sees the institutions established by the European colonists as the principal factor accounting for the success of countries such as the US and Canada. By contrast, Shleifer maintains that the basic factor impacting the success of these countries were not institutions, but human capital in the familiar sense of the term: the amassed technical knowhow, skills, and abilities.

Let us note that at the time of colonization by the Europeans in North and South America, the colonists’ advantages vis-à-vis the natives in education, technical skills, and mastery of technologies were not self-evident. The settled Indian tribes often had superior knowledge and skills (especially in agriculture) as compared to the European arrivals even as late as the 16<sup>th</sup>-17<sup>th</sup> centuries. At the same time, some of the Europeans’ capacity for self-organization, active coordination, and setting up efficient institutions based on solid moral principles formed an undoubted advantage. The line between the institutional component and the human capital factor turns out to be rather hazy. The import of civil skills has, accordingly, been corroborated indirectly for the time being, but as based on historical statistics.

Thus, in order for an institution (a norm) to exist under conditions of judicial democracy, the presence of market agents is required, who support the institute in question (that is, agents, who, first of all, respect the rights of property) and who provide for the support of the institution’s implementation, including sanctions both formal and informal for violations.

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<sup>16</sup> N. Karamzin referred to what he termed “habits of city life,” while we use “habits of civil life” as a contemporary synonym of the term.

<sup>17</sup> See N. M. Karamzin, *Istoriya gosudarstva rossiyskogo (History of the Russian State)*, Moscow: Nauka, 1989-1993), vol. 5, chap. 4.

<sup>18</sup> Putnam 1995 and 2002.

<sup>19</sup> That is, primarily of states, budgetary organizations, quasi-societal groups, such as ACORN and others, as well as, partly, of large corporations.

<sup>20</sup> Acemoglu et al. 2001.

<sup>21</sup> Shleifer et al. 2004.



An important attempt was undertaken by L. Mises to analyze the institution of agreement as a part of marriage. However, this did not meet with economists' support. In his work,<sup>22</sup> Mises defends the moral and humanitarian advantages of the capitalistic judicial state as compared to all other economic and judicial systems. Mises claimed that the new institution of equal and voluntary union based on agreement could optimize family relationships. Work by G. Becker<sup>23</sup> was not a direct continuation of this approach, albeit the two had points of mutual kinship and contact.<sup>24</sup>

In analyzing institutional limitations impinging upon modern economic growth, it is essential to take into account problems bound up with crisis in the family (increase in the number of divorces, fall in the birth rate) and moral values. These issues are primarily connected with two elements:

Contraction or disintegration of societies, in which, largely thanks to a high level of morality, trust had been maintained (trust within the community and trust toward members of the community from the without);

Usual undersupply of qualified, educated, and conscientious workers to the labor market, growth of the population unfit for work as a constituent of the population total, and, correspondingly, intensification in the tax burden of the working population.

Along with the weakening of the institution of the family, secularization (separation of church from state) has undermined the authority of what had appeared to be eternal and universal norms. "Moral pluralism" has been the outcome, along with a capitulation of sorts by the older generations, who find it continually harder to provide grounds for valuing the knowledge and experience package being passed on to the young.<sup>25</sup>

## Political Economy of Reforms

The 1990s experience of reform in the post-Soviet countries has made it clear which economic and political institutions are in fact significant. The most important ones in the package of borrowed political, organizational, and judicial solutions turned out to be the ones facilitating the formation of adequate economic reforms of the judicial environment. For instance, these are solutions facilitating the appearance of such political preferences among the voters, which make it possible for the problem of constructing a judicial state to be successfully resolved. That is, the demand for the introduction and launching of judicial state institutions is stably high.

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<sup>22</sup> L. Mises, *Socialism: An Economic and Sociological Analysis* (Yale University Press, 1951).

<sup>23</sup> G. S. Becker, "Crime and Punishment: An Economic Approach," in *Journal of Political Economy* 76 (1968): 169-217.

<sup>24</sup> The only exception was Robert Aumann, a mathematician who described in the form of a game institutions based on a meticulously balanced asymmetrical family contract with minimal interference by the courts. See R. J. Aumann, "Risk Aversion in the Talmud," in *The Journal of Economic Theory*, vol. 21 (2; 2003): 233-239.

<sup>25</sup> The current situation is reminiscent of Karl Jaspers' description of a similar process in 1931 in Germany, when the mechanism of intellectual and moral heredity was projected onto the school:

Where education, based on a spirit of the whole, is substantial, the young as such are unripe. They venerate, obey, trust, and have no significance of their own insofar as they are the young, for this is a preparation and potential state of being summoned for the future. But under conditions of disintegration, the young as such acquire a value of their own. They are expected to produce that, which has already been lost in the world. They may feel themselves the origin. Children are already allowed to take part in discussing school rules. As if the young are being required on their own to produce what their teachers no longer possess. Similar to the way that future generations are burdened with the duties of the state, they are also burdened with the consequences of the squandering of the spiritual wealth, which they are left on their own to win anew. The young acquire a false weight and are compelled to become groundless, for the becoming of a human being is possible only if he grows in the course of decades, strictly formed by means of consistent steps. (Jaspers 1994)

The fiasco of numerous attempts at modernization can be interpreted as excess cost of introducing institutions which provide economic growth over reformers' resources. Reformers' resources grow in proportion to the initial "store of political capital" (or society's interest in institutional change). Costs are high in proportion to the share of people who, for whatever reasons, are willing to "invest" in opposing reform.

A. Drazen was one of the first researchers to look at the process of reform as a series of stages dictated by the must and the varying ability of the reformer government to provide political support for the transformations being carried off.<sup>26</sup> Among Russian research scholars, S. Afontzev, among others, devotes attention to political-economic reform.<sup>27</sup>

The political science study by G. V. Golosov<sup>28</sup> introduces a number of approaches useful in estimating the impact of relative costs on the successful formation of a strong coalition. The author also notes the importance of the correlation of forces which takes shape in the course of the first free elections. Taking into account the low level of voter readiness to shoulder the costs of obtaining information about politics and politicians, we can say that the power correlation as initially crystallized among party groups (or "niches," to resort to the term used by K. Truyevtzev<sup>29</sup>) continues to reiterate itself by force of inertia later on, as well. An important part in the relative stability of the support level for the principal political coalitions is determined by the fact that most voters do not fundamentally change their preferences without having some substantial reasons for doing so. Inertia of this type is typical even of young democracies, whose gestation period is saturated with events of a kind that give people grounds for revising their stances. Thus, in works by V. Mau and O. Kochetkova,<sup>30</sup> the authors note that one of the most significant factors impacting the results of voting is the outcome of the voting during the previous elections in the region in question.

## The Road to Slavery

### First Bells

In his attack on the system of the "caring state" and the very notion of the responsibility of society for the able-bodied poor, G. Spenser relied on an analysis of the laws and the law enforcing practices in England. The galore of instances he cited included, inter alia, the history of laws passed concerning the poor and the most recent contemporary factory production laws tying in with a centuries-old tradition of paternalism. Spenser criticized the "caring state" attempts to dictate to the individual what the "best" behavior models are in the diurnal round, business, private life – that is, the attempts to keep individual citizens from debauchery, idleness, or, on the contrary, from predator exploitation, as well as attempts to regulate prices, work conditions, and to keep track of private producers' goods quality level.

The English legal history traced by Spenser shows that attempts of this kind have throughout the centuries always led to parasitism. Unselective help to the poor at the expense

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<sup>26</sup> Drazen 2000. The same problems were touched upon by Ann Kruger, Vice-Director of IMF (International Monetary Fund), in a series of speeches made in Moscow in December 2001.

<sup>27</sup> See S. A. Afontzev, "Mobilizatsiya politicheskoy podderzhki reform: Motivatzii, strategii, rezul'taty," in *Ekonomicheskiy rost: Posle kommunizma (materialy mezhdunarodnoy konferentsii): Nauchnye trudy* ("Mobilizing Political Support for Reform: Motivations, Strategies, Results," in *Economic Growth: After Communism (International Conference Proceedings): Research Papers*) №40P (Moscow: IET (Institute for Economy in Transition), 2002).

<sup>28</sup> Golosov et al. 2000.

<sup>29</sup> In his *Partitura dlya parlamenta i partiya presidenta (Zakonomernosti razvitiya mnogopartiynosti i izbiratel'nogo protzessa v Rossii)* (*Score for Parliament and President's Party (Law of Development of Multi-Party Systems and the Voting Process in Russia)*), Moscow: State University – Higher School of Economics, 2001).

<sup>30</sup> Mau, Kochetkova, Yanovskiy, et al. 2001; Kochetkova 1999.

of the rest of society always forced the strata of the population “bordering” upon poverty to abandon work activities, anticipating state aid or community support.<sup>31</sup>

E. Gaydar is concerned with an entire series of scenarios having to do with growing economic problems which impinge upon modern democracies with universal suffrage.<sup>32</sup> Inter alia, the author notes the crisis in social security systems, the destructive capacity of redistributive coalitions, stimuli for increasing the tax burden to the breaking limit, crisis in the institution of the family, fall in the birth rate, and many other considerations. However, Gaydar sees no real danger in all this, supposing that the old democracies have a great deal of stability in store.

In a research piece assessing the impact of initial conditions, culture, and politics on long-term economic results, D. Lal<sup>33</sup> studies the history of the emergence and – what is of the greatest interest in connection with our focus – of the decline of the ideas of freedom, individualism, and the universal moral principles and religious legitimation bound up with these. He demonstrates the way in which the evolution of technologies, way of life, and religion gave rise to situations where leaders’ personal decisions led to far-reaching “unintended consequences,” just as in the case of a Hayek-type setup, competitive interaction and struggle among leaders, groups, and norms led to the emergence of unique institutions which opened the way for private initiative and led to an unprecedented leap of the economy. In a similar vein, attempts “even further to improve” this mechanism lead to a new type of “unintended consequences,” which consist in the degradation of market institutions.

### **Bake the Pie or Divide It? An Open Road to Decline**

Researcher economists have begun to devote more and more attention to issues of armed redistribution of wealth, a process accompanied by mass annihilation of material valuables, destruction of institutions which support social order, and human loss. Thus, in their report on world development titled “How to Make an Investment Climate Beneficial for Everyone,”<sup>34</sup> the authors first indicate the way leading to the creation of an investment climate which is unbeneficial for everyone. This is the way of civil war. This point is considered in greater detail in the work of a different group of World Bank experts analyzing the factors which raise the likelihood of the eruption of civil war.<sup>35</sup> Among factors of this kind, poverty is singled out first of all, but then so are a series of geographic features which make it attractive to target the secession of a single province particularly rich in resources. However, the authors do not provide any detailed consideration of the question of the fundamental reasons for poverty itself, and see no direct connection between violence and the likelihood of civil war; this despite the fact that, in poor countries, violence is the principal means of legitimating authority. Perhaps, the authors do not see this direct link because no judicial states are included in their set of countries under observation. Yet the history of modern judicial states prior to the establishment in them of the rule of law, rather than the rule of human beings, is quite rich in civil wars. Thereafter, once the rule of law is established, instances of civil war are almost completely exhausted by the war of the North against the South in the US.

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<sup>31</sup> Spenser 2006. It should be noted that in the course of all of its history, England never encountered such a thing as a large-scale influx of significant rental revenues into the central government’s budget, which would have made it possible temporarily to soothe problematic issues in the least rational way. What are, in Spenser’s view, bad laws concerning the poor in England, were implemented on the level of parishes. That is, by contrast with Russian national projects, they were put into effect locally, in situ, in the very places where, at least, the current needs of the poor were known best, independently of the reasons for a person’s having fallen into poverty. The same went for a multitude of regulative norms affecting small business.

<sup>32</sup> Gaydar 2005.

<sup>33</sup> Lal 2007.

<sup>34</sup> World Bank 2005.

<sup>35</sup> World Bank 2003.

Any individuals or groups, whose success seems to imply a challenge to an authoritarian leader legitimating his rule by means of violence, can become such a leader's victims. Now, if the leader begins to think that certain persons or groups flourishing abroad are inadequately defended, then the option of the "roving bandit" can become from his point of view preferable to the "stationary bandit" choice. That is, such a leader can unleash a war for territory presently not subject to his control.<sup>36</sup>

Calls by terrorism pose nothing principally new for modern developed and transition countries. During the period of antiquity and the Middle Ages, when economic backwardness did not imply fatal military-technical retardation, so that seizing prey (levying tribute) was a possibility on the basis of an "honest victory," forays and wars were common against neighbors who were rich but unready to go to war. China, Egypt, ancient Rome, Byzantium, Eastern Europe, and other lands became the object of such attacks.

In more recent centuries, when economic backwardness almost invariably took on the meaning of military backwardness, as well, an "earnings" strategy of this kind has lost its efficacy.

Possibly, the closing chapter in the history of this "business" was written by US Navy Captain S. Decatur, who in 1815 destroyed the pirate naval forces making up the real substance of the power of the pirate states of North Africa: Tunis, Libya, Algiers, and the rest. Also taking part in this was the French expedition corps, which occupied the pirates' principal port cities. The English historian P. Johnson refers to this milestone in providing a grounding for his famous claim that "colonialism can be the answer to terrorism of such dimensions."<sup>37</sup> Johnson stresses that the brilliant American military successes cannot compare with the occupation and colonization of North Africa by the French in terms of durability of the results. True enough, the author does not presume to explain why, despite their success, they turned out to be temporary, albeit long-lasting. Something had changed both in French society and in the world, and the process of gradual instruction of barbarians in the ways of culture became the bloody process of decolonization.

Hirshleifer<sup>38</sup> stresses the availability of an alternative means for obtaining wealth, as contrasted to the one described by Adam Smith and John Stuart Mill (reasonable laws, moderate taxes). You can just rob someone. That means that the efforts and the monetary possessions of both individuals and entire nations can be directed not only at the creation of wealth, but also at its forcible redistribution. The author also reminds us that the notion of "robbing someone" has a long history. The author cites a reference to V. Pareto, who reiterates the maxim enunciated in Macchiavelli: "He who has power is he who has gold." He also quotes Adam Smith: "The productive and rich nations have the greatest chances of becoming the object of attack." The productive and rich nations are, in turn, interested in defending their wealth, rather than in plundering the wealth of others. Hirshleifer supposes that the level of wealth achieved has an impact on the strategy of choice made by society when it comes to further enrichment.

Poor nations, by contrast, are more likely to wage war obdurately, to evince greater stubbornness, or, in other words, to invest the greater part of their resources in warfare. All this is because they count on a greater gain – greater in terms of its significance for them.

However, let us note that instances were not uncommon when a relatively wealthy country would attack one which was relatively poor, as well as extremely weak militarily. Such are the cases of Italian aggression against Ethiopia (1935), and of Germany against Poland (1939) and Yugoslavia (1941).

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<sup>36</sup> Olson 2000.

<sup>37</sup> Johnson 2001.

<sup>38</sup> Hirshleifer 2001.

The demand for ideas providing grounds for ransom strategies from “roving bandits” became rife in the second half of the 20<sup>th</sup> century. By that time, technical and military backwardness had made obvious the powerlessness of “roving bandits” faced with civilized countries’ armies. But interest in direct colonial control over them had also disappeared among voters in the developed countries.

This was precisely the time span when developed countries began to encounter the modern incarnation of armed forays: terrorism. Add to this the fact that technical accoutrement and capability of inflicting damage by terroristic means made this threat particularly significant in the last few decades. The economic facet of terrorism and an assessment of the impressive losses it occasions are the subject of the article by Nicole and Mark Crain.<sup>39</sup>

Throughout the second half of the 20<sup>th</sup> century (up until September 11, 2001), whenever issues in the developing countries came up for discussion, violence tended to be viewed not as a cause, but as a consequence of retardation. And so the authors of the various solutions which would be put forth presumed that in order to overcome retardation and the evils which it spawns – the exasperation, the penchant for violence, the terrorism – the “poor should be given hope.” More specifically, they should be fed and outfitted with some initial investitures for starting out, thus enabling the poor countries to embark upon the road to accelerated catching-up development. The Keynesian theory of the “Big Push” began to be interpreted in a similar vein, opening a gateway of opportunity for leading a backward economy onto the road of accelerated growth by means of a one-time jump in investitures.<sup>40</sup>

Political demand for such economic ideas came especially vividly to the fore in the famous reports by B. Brandt (1980, 1983) on the need for regular massive aid to be given to backward countries by the developed states. Unfortunately, ideas supporting poorly controllable “aid” to “black holes” are very stable. This can only be explained by the motivation of reoriented behavior. Something else to be included in the same series is the universal fad of annulling the debts of countries which, most likely, take advantage of their improved financial situation to buy new weapons. The 2002 publication in *Public Choice* of an article by Garoupa and Gata provides a typical instance of this kind of approach. The article, titled “Theory of International Conflicts: Management and Sanctions,”<sup>41</sup> had been accepted for publication as far back as the summer of 2000. The authors propose a mathematical model for evaluating the stimuli emerging when international sanctions are introduced against a regime with aggressive tendencies. They ground the must of using the “carrot of aid” rather than the “stick of sanctions” by claiming that this way of proceeding is more likely to result in the triumph of the “pigeons” over the “hawks” in the aggressor country. A similar discussion has been unfolding for the past few years on the pages of the periodical *Conflict Resolution*.<sup>42</sup>

Relatively conservative authors, such as Lindsey,<sup>43</sup> resort to the same approach, replacing, however, the idea of aid with that of expanding the practice of agreements concluded concerning free trade for the purpose of stimulating industry and the professions as an alternative to terrorist activity.

Margaret Thatcher sharply criticized Brandt’s ideas (2003), arguing that sympathy brewed upon a false sense of guilt only harms those countries whose problems consist

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<sup>39</sup> N. Crain and M. Crain 2006.

<sup>40</sup> A variety of changes in this theory have been under discussion since 1943 for backward European countries, and, up until the early 1970s, for so called developing ones. See the survey by R. Nureev 2001.

<sup>41</sup> Garoupa and Gata, 2002.

<sup>42</sup> Maoz, Katz, and Ross, August 2002, or Sprecher and DeRouen, April 2002.

<sup>43</sup> Lindsey 2003.

primarily in bad and corrupt management. She cited a passage from a speech made by Julius Kambarage Nyerere, Tanzania's first President, who said,

I claim that it is unfair to put the overwhelming majority of the world's population in the position of paupers without dignity. In a unified world, just as in a unified state, if I am rich because you are poor, or I poor because you are rich, the redistribution of wealth in favor of the poor must be done by right, not as an act of charity.

And, in fact, the investment climate of the "Rule of Force" type of society is such as to preclude long-term growth of the per capita GDP. It is the lot of this indicator in such countries to oscillate in the vicinity of stable and distressingly low values.<sup>44</sup> This is why such perceptions of the state of affairs as "You are rich because I am poor" and vice versa are natural for such countries, just as the severest of economic consequences of socialist experimenting are natural in a country none too rich to begin with. Sooner or later, such countries' leaders begin to interpret economic aid as a tribute paid by the world to a great leader as a sign of acquiescence in his greatness.<sup>45</sup>

Even the experience of countries with a transition economy, whose institutional structure differs substantially from Third World backward countries with bandit regimes,<sup>46</sup> shows that foreign aid is effective in those cases, where it can really be done without.<sup>47</sup> In cases where institutions provide the stimuli for investment and protect the individual person and individual rights, offering opportunities for long-term transactions and making the state accountable and transparent for society, every additional dollar is spent more or less effectively regardless of its source. This means that aid to the poor can be extended with maximum effect in the US and in Switzerland, but not in Rwanda or Tanzania.

Let us conclude this glance at the poverty-as-a-cause-of-hatred-and-terrorism scenario with a mention of a 2001 article by M. Sherman. The piece features a rare instance of "politological imperialism," or interference in economic analysis and forecasting by a political scientist using the appropriate academic tools and common sense. Commenting upon a statement made by Shimon Peres to the effect that "Peace in the Near East will prevail only when the GNP levels of the region's countries will balance," the author notes that "Since there is no chance that the per capita GNP in Egypt (\$750) will become comparable to the one in Israel (\$17,500), peace will prevail only after Israel's GNP is brought down to \$750 per capita annually."

Let us note in this connection that targeting "equalization" is a misguided notion altogether. Attempts at artificial equalization of income and consumption levels by means of redistribution unaccompanied by profound institutional reform in poor countries or regions are likely to lead to equalization along the lines indicated by the lowest set of figures. Besides, this is a truism which holds in general, not only in the Near East.

## **A New Apology for Roads Leading to Slavery**

**Amartya Sen's "Ethical Hunger".**<sup>48</sup> Amartya Sen, Nobel Prize winner in Economics, often writes on issues reaching far beyond the bounds of his area of specialization and the sphere of his initial interests in economics, which had to do with public choice.

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<sup>44</sup> See, for instance, the historical statistics in Melyantzev 1996.

<sup>45</sup> Consider, for example, Kim Il-sung and Kim Jong-il.

<sup>46</sup> Not all poor countries are governed at present by "roving" or "stationary" bandits. Not all countries governed by bandits are poor (consider, for instance, the oil monarchies). However, the connection between absence of security guarantees and inability to embark upon a road leading to long-term economic growth seems clear beyond the shadow of a doubt.

<sup>47</sup> Mau and Yanovskiy 2003.

<sup>48</sup> Amartya Sen, *On Ethics and Economics* (Oxford: Basil Blackwell, 1987).

In his work *On Ethics and Economics*, he puts forth the notions of “ethics” and the “ethical” as ones bound up primarily with equal distribution of goods and their redistribution by force in favor of the “poor” (the “hungry”) specified by the authorities (journalists, or public opinion leaders).

Sen begins his discussion by taking the modern science of economics, and especially by taking economists of the classical liberal type, to task. He charges them with having departed from the ethical normative elements of theory, with having abandoned ethical norms, and with relying on models which are incapable of reflecting anything at all, except primitive egotism involved in exchange for the purpose of gain.<sup>49</sup>

For instance, he charges them with fostering a one-sided understanding of Adam Smith, who, in his opinion, was a supporter of mutually profitable cooperation only as part of the limited frameworks of particular transactions. On the whole, Adam Smith was supposedly a convinced proponent of regulating prices, high taxes, and large-scale interference by the state in “favor of the poor.”

Sen elaborates upon this approach, which he himself calls ethical, by citing the problem of hunger as an example. The author is ready to draw upon any abstract theoretical considerations whatsoever (including Adam Smith), except for economic history, for the explanation of the origins and causes of hunger. But history testifies quite unambiguously: hunger as a threat to the survival of hundreds of thousands of people accompanies:

either pre-capitalistic economic systems (which are definitely paternalistic, rather than based on seeking one’s own benefit; i.e., they are almost “ethical” as per A. Sen’s approach);

or socialistic experiments.

Countries which, in Sen’s opinion, are governed by principles of a “profit-seeking” organization of the economy, often rush to the aid of the hungry. However, these countries **are never in need of such aid themselves**. Hunger as a mass phenomenon, as a threat to life, is not to be observed in them.

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<sup>49</sup> Here it is appropriate to remind ourselves of the “extended family” model (Barro, 1974) and the model of family relations based on love with each of the spouses investing in the other independently of the reciprocal stream of investments (G. Becker). The accessibility and the renown enjoyed by these publications make reproaches against the science of economics rather strained. As for disregard of the final destination point of the route taken by governments whose consultants are Sen’s and Keynes’ ethically concerned colleagues, this concern is widely discussed in works by L. Mises, F. Hayek, and other representatives of the Austrian school. M. Friedman has himself marked out the “Shining Path” for his less keen colleagues, as well as the final destination point to be reached by “ethical economics” as a “road leading to slavery.” One may disagree with such an assessment (albeit this is hard to do after the crash of so many redistribution experiments in the interests of the poor both in the East and in the West). In any case, there is no claiming that the modern science of economics is not concerned about anything except primitive exchanges or aims only at what Sen has dubbed the “ethically oriented look,” contrasting this with the one-sidedness of what is, in his view, a limited “engineering approach” (one that asks no questions along the lines of “What leads to the human summum bonum?” or “How should one live?”).