

the prevalence of such firms in the local economies (for the two towns where this can be evaluated). Some historians have imagined that antebellum banks failed to feed the economy's growth sectors, but no such failure is evident in the balance-sheet data.

To assess whether the antebellum banking system moved funds from lower-return to higher-return areas, Bodenhorn turns to the standard question of whether the regional pattern of interest rates shows the convergence implied by arbitrage. A number of historians have found that the postbellum period was marked by a lack of national capital-market integration. Bodenhorn (162) finds, somewhat surprisingly, that "regional interest rate differentials were generally smaller before 1860 than after 1900." The disintegrative effects of the Civil War—or perhaps of the National Banking regulations imposed during the War—were remarkably large and persistent.

Bodenhorn rightly questions the view that Nicholas Biddle personally brought about market integration through the policies he pursued as head of the Second Bank of the United States, a view common among historians who simply take Biddle's word for it. He argues that although the Second Bank was not irrelevant, the integration into a national capital market was largely accomplished by trading relationships among hundreds of banks and commercial paper brokers in different cities: "The antebellum commercial paper market consisted of a complex network of state-chartered banks, exchange brokers, private bankers and speculators."

In all, Howard Bodenhorn has provided economic historians with a useful and persuasive account of the contribution that banks made to America's early development.

Lawrence White

Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships by Mancur Olson. New York: Basic Books, 2000, 233 pages. ISBN 0-465-05195-2.

Mancur Olson, one of the most influential economists of the late twentieth century, died suddenly in 1998, leaving behind an almost completed manuscript of his third major work, subsequently published as *Power and Prosperity* (2000).

Throughout his career, Olson focused his research on the analysis of collective action, a field to which his book *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Mass.: Harvard University Press, 1965) made a seminal contribution. In that work, he argued that individuals have no economic incentive to participate in seeking large-group collective goods unless coerced or presented with other "selective incentives." Therefore, small groups have an advantage in organizing and lobbying for the provision of specific collective goods, gaining that provision at the expense of larger, unorganized groups such as taxpayers or consumers. Successful politicking corresponds with the now-familiar shibboleth of Public Choice theory, "concentrated benefits, dispersed costs."

In his second major work, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (New Haven: Yale University Press, 1982), Olson argued that with the passage of time a stable regime suffers increasingly from "sclerosis" as more and more small groups organize and lobby successfully for government actions that serve their

narrow interests but diminish the efficiency and dynamism of the overall economy. Only a crisis that destroys the political efficacy of the previously entrenched lobbies and clears the political decks can restore the economy's vitality.

In *Power and Prosperity*, Olson concentrates his analysis on the most venerable economic topic, the wealth of nations. He takes an emphatically "political economy" stance, insisting that "theories of markets that leave out government—or conceptions of politics in which the economy is exogenous—are inherently limited and unbalanced. They do not tell us much about the relationships between the form of government and the fortunes of the economy or adequately explain why some societies are rich and others are poor" (pp. xxv–xxvi). As the book's subtitle indicates, Olson seeks especially to shed light on the so-called transition economies of the 1990s, but he claims that his argument, "if correct, has important implications for economic policy in advanced democracies of Europe, North America, and Japan, as well as in the countries that are or have lately been under dictatorships" (p. xxvi).

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To understand the relation between government and the economy, Olson declares, "we need to find out what those in power have an incentive to do and why they obtained power" (p. 2). Thus, Chapter 1 deals with "The Logic of Power." Eschewing the standard Public Choice assumption, he insists that "the logic of power cannot be adequately explained through voluntary transactions," because power "involves compelling authority and the capacity to coerce" (pp. 2–3). Abandonment of the standard exchange-theoretic assumption yields an important explanatory payoff: "When we pass beyond the voluntary trade and its transactions costs and include the gains from the exercise of coercive power in our analyses, there is no longer any bar to explaining the bad as well as the good things that governments do" (p. 61).

Government, in Olson's view, is best understood if we begin by likening it to a protection racket, or a "stationary bandit." Such a predator has a direct interest in the well-being of those on whom he preys: "other things being equal, the better the community is as an environment for business and for living, the more the protection racket will bring in" (p. 5). Hence, up to a point, the stationary bandit will protect his prey from outside aggression, invest in public goods that enhance their productivity, and restrict his takings to a fairly predictable, tolerable tax. If governing power is not concentrated in a single bandit but dispersed among persons or groups, then those with the more encompassing interest in the economy's well-being will have a greater incentive to refrain from the kind of predation carried out by the "roving bandit," who snatches and runs without a thought for the morrow.

Expectations about future predation play a critical part in Olson's analysis because they determine whether people will choose to accumulate capital and thereby bring about economic growth. Obviously, if a government's promise to protect capital and its returns is not credible, then no one will forgo current consumption in order to invest. Notably, "the promises of an autocrat are never completely credible" (p. 27), as demonstrated by countless confiscations, repudiated loans, debased currencies, and other autocratic outrages over the centuries, but even if a particular autocrat were trusted to keep his promises, his successors might not be so reliable. In autocratic regimes, crises attend the succession of power, and "capital often flees from countries with continuing or episodic dictatorships" (p. 42). Thus,

Olson argues, autocracy and economic progress tend to be incompatible. Historically, sustained economic growth had to await the emergence of a system of government he calls “democracy” (an unfortunate choice of words: better to have called it limited, representative government).

That emergence required the simultaneous satisfaction of three conditions: a dispersion and balance of power among various leaders, groups, or families; a geographical mingling of those power-holders, so that the formation of segregated “miniautocracies” was infeasible; and an absence of conquest by outsiders while democracy was developing within a given society. Under these conditions, the various domestic power-holders, each incapable of overcoming the others, had an incentive to develop formal power-sharing institutions for the maintenance of peace and the provision of public goods, including a legal system to define and protect property rights, enforce contracts, and resolve disputes impartially. A society that currently lacks such conditions, however, cannot look to Olson for a recipe to create them, because in his view the previous realizations of the requisite conditions were simply fortunate “accidents of history” (p. 31).

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The middle part of *Power and Prosperity* contains a discussion of transaction costs, bargaining, and anarchy (to which I shall return) and a reprise of subjects treated at greater length in Olson’s previous books and now familiar to all who have dipped their toes into the literature on collective action. Here, as elsewhere in his writings, Olson adopts a model of purely instrumental action to explain the choice between participation (cost-bearing) in collective action and free riding. Relying on this model, he concludes that “Voluntary Collective Action *Must* Fail in Large Groups.... Since many groups are large and have no opportunity to obtain selective incentives, they can *never* act in their collective interests” (pp. 77, 88, emphasis added).

This deduction stands only so long as one clings to the representation of the action in question as purely instrumental; it collapses once one admits that individuals may act in pursuit of expressive interests, such as the identity-related goals inherent in ideologically impelled action (see Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* [New York: Oxford University Press, 1987], pp. 35–56). Aside from such theoretical problems, one might also note that Olson serenely disregards the many instances of large-group collective action that have occurred even in the absence of Olsonian selective incentives, for example, the mass demonstrations against the Communist regimes of Eastern Europe in 1989. (Olson’s understanding of ideology was always blunt-edged [see, for example, pp. 112, 130]. For the most part, he simply ignored the issue).

Olson also includes a short chapter on law enforcement and corruption, in which he reaches the stock conclusion that “legislation or regulation that is *market contrary* must leave all or almost all parties with the incentive to evade the law, and it is likely to promote criminality and corruption in government” (p. 107). He appears to believe that in peaceful, orderly, rights-respecting societies, it is the government that creates those auspicious conditions (p. 106)—a largely erroneous belief, in my judgment.

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Whereas Olson's mid-volume discussions merely lack freshness, his chapters on "The Theory of Soviet-Type Autocracies" and "The Evolution of Communism and Its Legacy" are astonishingly ill-informed. Though dealing with a topic to which all the fundamental contributions have been made by members of the Austrian School, Olson never mentions Ludwig von Mises, F. A. Hayek, or any other Austrian economist. He treats almost as a news flash the fact that the Soviet government commanded resources not so much by explicit taxation of individual incomes as by setting the prices of inputs and outputs so that state-owned firms would generate "profits." He views with similar wonder the well-known devices by which the Soviets made the marginal efforts of workers more remunerative than the inframarginal efforts—bonuses, selective access to housing, better consumer goods, and so forth—and the similar setup in agriculture, where cooperatives had to deliver fixed quotas to the state but farmers could devote their marginal efforts to tiny individually controlled plots.

Olson treats the Soviet-type economies as if they succeeded in the short term and hence the puzzle is to explain why they "gradually deteriorated and ultimately collapsed" (p. 134). His explanation runs along the same lines laid out in his book *The Rise and Decline of Nations*. As time passes, "the difficulties of covert collective action are bound to be overcome in more and more enterprises, industries, localities, and ethnic or linguistic groups" (p. 153). "More and more small groups explicitly or tacitly agree that they will do less work, allocate more of the resources under their control to their own purposes, and share more of the state property among themselves" (p. 151). Hence, the "modicum of rationality" (p. 148) previously characteristic of the planning and administrative system breaks down, the rulers at the center lose their control over resource allocation, and eventually the state itself goes broke and is reduced to inflationary finance of its projects.

Olson's account of the deterioration of the centrally planned economy is not so much wrong as Procrustean. It adds a perspective, though hardly a new one, to one's understanding of the breakdown, but it wholly neglects more fundamental matters. In truth, the centrally planned economies were never economically successful, notwithstanding the fevered fears and hopes of various external commentators and propagandists. For a few decades, by forgoing almost everything else, the USSR managed to maintain a formidable military apparatus. Credit for that accomplishment belongs at least partly to the patriotic efforts and sacrifices of the Russian people during the era of World War II. Information about the prices prevailing on world markets also gave the planners some guidance, allowing them to avoid setting their own prices completely at random. Nonetheless, as Olson fails to appreciate, the centrally planned economies were doomed from the start, *even if the bureaucratic and interest-group sclerosis he emphasizes had never occurred*. Olson does not understand that not even a perfect administration could maintain the production of genuine consumer-validated wealth, much less generate genuine economic growth, in a system lacking private property rights and free markets. Centrally planned economies, because of their arbitrarily set prices, necessarily give rise to nothing more than what Mises called "planned chaos."

Olson claims that "economists, operations researchers, and systems analysts have long understood theoretically what would be needed for a fully efficient planned economy" (p. 136). This statement betrays a complete ignorance of the many pertinent issues Austrian economists have written about during the past eighty years. As Mises remarked, "The paradox of 'planning' is that it cannot plan, because of the absence of economic calculation.

What is called a planned economy is no economy at all. It is just a system of groping about in the dark. There is no question of a rational choice of means for the best possible attainment of the ultimate ends sought" (*Human Action*, 3rd rev. ed. [Chicago: Henry Regnery, 1966], pp. 700–701).

Olson admits that "a bureaucracy cannot obtain or process all of the information needed to calculate an optimal allocation or put it into practice," but he has no appreciation that a planned economy cannot possibly *generate* the requisite information in the first place. The problem is not a practical one, it is a logical one. It is not, as Olson supposes, a matter of administrative processing of information and mutual monitoring by the bureaucrats. A centrally planned economy, by its very nature, suppresses the only means—free transactions in private property rights—by which a movement toward an "optimal" allocation of resources might be set in motion. Olson recognizes that "firms with losses were about as likely to obtain resources as firms with profits" (p. 147), but he fails to appreciate that those so-called profits were themselves necessarily meaningless, given their derivation from arbitrarily set prices of inputs and outputs. His reference to "a rational planned economy" (p. 164) speaks volumes about his ignorance of the fundamental aspects of this subject.

In his discussion of the transition from central planning, Olson makes cogent, if not very newsworthy, points. Many enterprises and resources in the transition economies remain state-owned. Those that have been privatized often continue to receive subsidies to keep them afloat, and influential kleptocrats preside over—and not infrequently loot—huge operations snatched during more-or-less fraudulent privatizations. In Olson's words, "the problem is the depressingly large percentage of organizations for collective action in the recently communist countries that have inherently inconsistent interests with economic efficiency" (p. 165). Yes, that is a problem, but it is far from the only one. Olson avers that China has performed better in making the transition because during the Cultural Revolution it got rid of entrenched opponents of change. I have considerable doubts about the adequacy, and even the accuracy, of that explanation.

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In beginning, and again in concluding the book, Olson makes much of the ubiquity of markets. Even the USSR and other centrally planned economies had markets in abundance—black, gray, off-white, and so on. But certain kinds of markets, especially those in which hard-to-hide or long-lived property is at stake, require more protective property-rights institutions for their operation.

Without such institutions, a society will not be able to reap the full benefits of a market in insurance, to produce complex goods efficiently that require the cooperation of many people over an extended period of time, or to achieve the gains from other multiparty or multiperiod arrangements. Without the right institutional environment, a country will be restricted to trades that are self-enforcing (p. 185).

And therefore the country will be poor. As Olson concludes, "Incomes are low in most of the countries of the world ... because the people in those countries do not have secure individual rights" (p. 194).

Thus, after some two hundred pages, Olson finds his way to the conclusion reached by Adam Smith 225 years ago in *The Wealth of Nations*, (Book V, Chap. III):

Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government.

Or, in Olson's statement, "If a society has clear and secure individual rights, there are strong incentives to produce, invest, and engage in mutually advantageous trade, and therefore at least some economic advance" (p. 196).

Even a casual inquiry into the course of events in the transition economies of Eastern Europe reveals its correspondence with this ancient wisdom. In Russia, according to Roland Nash, chief economist for the Renaissance Capital investment house, "businessmen have found that there is a very large gray area of interpretation in Russian law, and that has caused a lot of problems" (Jon Boyle, "Pope case highlights business risk in Russia," *Seattle Times*, December 7, 2000, p. A17). In Romania, the worst-performing transition state, bribery of government officials has become the rule, and money-losing state-owned firms continue to compose the bulk of the economy. Declining to seek reelection in 2000, President Emil Constantinescu said, "If we continue to break laws and if theft, crime and lies continue to proliferate, then any investments or support through international programs are in vain" (Donald G. McNeil, Jr., "Long-Suffering Romanians To Vote for a Leader Today," *New York Times*, November 26, 2000, p. 14; Matthew Katnitschnig, "Romanian Vote Signals Return to the Past," *Wall Street Journal*, November 28, 2000, p. A23). Where private property rights have been more clearly established and better protected, as in Poland and the Czech Republic, the transition has proceeded more successfully.

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Mancur Olson was in many respects an admirable scholar. He concentrated his efforts on the analysis of important issues. He usually avoided the sort of exhibitionist pyrotechnics prized by the mainstream economics establishment. He ventured into adjacent intellectual domains and profited from what he discovered there. He wrote clear, straightforward prose, and he lectured in an instructive and delightful style. Yet, notwithstanding his scholarly virtues and contributions, there is something sad about his having arrived, after a long period of scholarship, at a set of conclusions so banal and, in certain respects, so ill-informed.

I have hinted at such deficiencies in my prior comments about Olson's views on centrally planned economies, views formulated in apparent ignorance of the most fundamental analyses of such systems. Another instance of such inadequacy appears in his comments on anarchy, which are scattered throughout the book but concentrated in Chapter 3, "Coaseian Bargains, Transactions Costs, and Anarchy." This subject deserves more careful attention than it receives from Olson.

For Olson, any form of government—in his scheme, it is either “autocracy” or “democracy”—is vastly preferable to anarchy, because to him anarchy is synonymous with chaos and rampant violence, a situation in which life is nasty, brutish, and otherwise “horrible” (p. 66). Anarchy, he maintains, is an “obviously inefficient outcome” (p. 60) because “anarchy not only involves loss of life but also increases the incentives to steal and to defend against theft, and thereby reduces the incentive to produce” (p. 64). In contrast, a society under the rule of a government is characterized by Olson as “a peaceful order.” Of course, “governments are inherently compulsory” (p. 61), levying taxes, prescribing behavior, and waging wars, among other things. Nonetheless, “if a population acts to serve its common interest, it will never choose anarchy” (p. 65). “The gains from eliminating anarchy are so great that everyone can become better off” (pp. 89–90).

If these statements had issued from a lay person, they would be unremarkable, but coming as they do from a distinguished political economist, they strike me as facile and ill-considered. Consider, for example, that the world’s several hundred nation-states are usually at peace with one another. Moreover, the citizens of one nation routinely cooperate with the citizens of other nations, engaging in massive and complex transactions for the exchange of goods and services and for the sending and receiving of loans and investment funds. Yet the nations and their citizens who engage in these vast undertakings do so completely without the aid of what Olson declares to be the *sine qua non* of such transactions, “a third party with coercive power” (p. 62). If anarchy is bound to produce the horrors alleged by Hobbes, why does *international* anarchy work so successfully most of the time? Nor is this question the only one that springs to mind.

For most of the 1990s, Somalia, a country of some seven million inhabitants, had no national government. According to a United Nations report of August 1999 (Anthony Goodman, “Black hole’ of anarchy swallows Somalia; National government simply doesn’t exist,” *Seattle Times*, August 19, 1999, p. A14), “the functions that states perform, such as providing social services, regulating the movement of goods and people, controlling the environment, air space and coasts, and representing the Somali people in international bodies, are all absent.” Although some violence has occurred, “where it is not simple banditry, [it] is mainly defensive in nature.” Notably, “approximately half of Somali territory is peaceful.... While struggles continue over control of some key southern towns, much of the day-to-day violence in Somalia is now criminal rather than political in origin”—a statement that applies equally to, say, Mexico, a country blessed with plenty of government. Whatever else one might conclude about the Somali example, no one can dispute that Somalia compares favorably with many other African countries in which governments continue to exercise their power.

According to the careful estimates compiled by R. J. Rummel in *Death by Government* (1994), some 169 million persons perished between 1900 and 1987 *at the hands of their own governments*, not counting the tens of millions who died in the wars their governments conducted against other states. Can this ghastly experience be what Olson has in mind by a “peaceful order”? I submit that the Turkish Armenians in the mid-1910s, the peasants of the Ukraine in the early 1930s or of China in the late 1950s or of Cambodia in the late 1970s or, needless to say, the German Jews in the early 1940s would have greeted anarchy as a godsend. The claim that the elimination of anarchy promises gains for everyone seems,

if nothing else, empirically dubious. Olson never squarely faces the colossal demonstrated capacity of national governments for murder and mayhem.

Nor, Olson's assumption notwithstanding, does the operation of government relieve citizens of the need to protect their own persons and property. Even in the United States, the private provision of security ranks as a major economic activity, employing millions of persons and costing, in all its forms, countless billions of dollars annually. Why all this private effort? Because the governments with which the country is all too lavishly endowed are not accomplishing what Olson presumes to be their very *raison d'être*. What then are they doing? Dare I suggest that they are busy plundering and menacing the very population whose rights they pretend to protect? The governments of the United States undoubtedly seize more wealth in a day than all the sneak thieves, pickpockets, con men, and muggers in all the world have taken since the dawn of recorded time. If government is a blessing, as Olson insists, it is a manifestly mixed one.

Yet, as Adam Smith remarked, "the uniform, constant, and uninterrupted effort of every man to better his condition, the principle from which public and national, as well as private opulence is originally derived, is frequently powerful enough to maintain the natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration" (*The Wealth of Nations*, Book II, Chapter III). What rich countries can tolerate from their governments, however, poorer countries cannot, and therefore Olson is correct to observe that "whatever the optimal role of government may be in developed nations, it is smaller in developing countries" (p. xvii). I would simply add that whatever the role of government is currently in any developed nation, its optimal role there is a much smaller one.

Robert Higgs

Senior Fellow in Political Economy,
The Independent Institute,
714 Laurel Street,
Edmonds, WA 98020;
rhiggs@independent.org.