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The Devolution of Power
In Post-Communist Societies

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IRIS Reprint No. 84
February 1999

This publication was made possible through support provided by the U.S. Agency for International Development, under Cooperative Agreement No. DHR-0015-A-00-0031-00 to the Center on Institutional Reform and the Informal Sector (IRIS) and administered by the Office of Economic and Institutional Reform, Center for Economic Growth, Bureau for Global Programs, Field Support and Research.
The views and analyses in the paper do not necessarily reflect the official position of the IRIS Center or the U.S.A.I.D.

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Reprinted from *Russia's Stormy Path to Reform*, The Social Market Foundation:
pp.9-42, 1995

Chapter One. The Devolution of Power in Post-Communist Societies: Therapies for Corruption, Fragmentation and Economic Retardation

by Mancur Olson

Compare what happened after the defeat of fascism in World War II to the societies that had been under fascist dictatorships, with what has happened after the defeat of communism in the societies that had been under communist dictatorships. West Germany and Japan enjoyed economic miracles after World War II, but in many of the formerly communist societies economic performance is even worse than it was under communism. West Germany and Japan have also enjoyed a tranquil social order and their citizens have not been especially victimised by crime and official corruption,¹ but many citizens and firms in some formerly communist countries complain bitterly about mafias and corrupt officials. Post-war West Germany and Japan have shown no tendencies whatever to suffer geographical fragmentation or devolution, and Germany has even, after the collapse of the German Democratic Republic in 1989, seen a reunification. But several of the formerly communist countries — Yugoslavia, Czechoslovakia, and the Soviet Union — have broken into parts, and Russia has experienced not only some secessionism by Chechens, Tatars, and others, but also a devolution of power from Moscow to republics and other regional and local units of government. These extraordinary differences are all the more remarkable in view of the desires of the victorious countries in World War II. At the end of the war and for some time afterwards, the victorious countries were fearful that Germany and Japan would again emerge as aggressive dictatorships, so they did not want them to have either strong industrial economies or to become substantial and unified countries.

The dramatic contrast between the outcomes in the formerly fascist and the formerly communist societies has not previously been explained, I believe, because an idea or theory that is indispensable for a full understanding of the matter has not been available. We must have a deeper understanding of the ways in which post-communist societies function — better insight, as it were, into their social physiology — to obtain a correct diagnosis of the disease that sometimes keeps them from having economic miracles, from eliminating official corruption, and from conflict over political fragmentation. When we have the right diagnosis, the therapies that will cure the disease and allow the peoples of the post-communist countries to achieve their aspirations will be immediately evident.

Everyone already knows that he does not, but it is important to see why. The typical individual thief in the society of, say, a million people, might bear something like one-millionth of the loss to society that occurs because his crime makes society's output less than it would otherwise be, but he alone is likely to bear the whole loss of whatever opportunities for theft he passes up. Thus the gain to criminals from a wealthy society and the fact that crime reduces society's wealth does not keep crime from paying — it is society's punishment of criminals and the efforts of individuals and firms to protect themselves that, sometimes, keeps crime from paying. Though each criminal does have a stake in the prosperity of society, that stake is so minuscule that the criminal ignores it.

As we shall see, it makes a great deal of difference whether individuals with coercive capacities have a tiny or 'narrow' stake in the society, on the one hand, or an 'encompassing' interest, on the other.

Now let us shift from the individual criminal to the head of a Mafia 'family', or other criminal gang that can monopolise crime in some neighbourhood. Suppose that in some well-defined turf, a criminal gang can not only steal more or less as it pleases, but also prevent anyone else from committing crime there. Obviously, the Mafia family has an incentive to keep other thieves out of its domain. Will it gain from stealing whatever it finds on its own ground?

Definitely not. If business in this domain is made unprofitable by theft, or migration away from the neighbourhood is prompted by crime, then the neighbourhood will not generate as much income and there will not be as much to steal. Indeed, the Mafia family with a true and continuing monopoly on crime in a neighbourhood *will not commit any robberies at all*. If it monopolises crime in the neighbourhood, it will gain from promoting business profitability and safe residential life there. Thus the secure Mafia family will maximise its take by selling 'protection' — both against the crime it would (if not paid) commit itself as well as that which would (if it did not keep other criminals out) be committed by others. 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. Accordingly, if one family has total power to commit and monopolise crime, there is (apart from the protection racket) little or no crime. The considerable literature on monopolised crime makes it clear that secure monopolisation of crime does lead to protection rackets rather than ordinary crime, and that outbreaks of theft and violence in such environments are normally a sign that the controlling gang is losing its monopoly.²

stationary bandit. Since all of the settled bandit's victims are for him a source of tax payments, he also has an incentive to protect them.

With the monopolisation of theft, the victims of the theft can also expect to retain whatever capital they accumulate out of after-tax income and therefore they also have an incentive to save and to invest, thereby increasing their own future income and tax receipts for the stationary bandit.

In a world of roving banditry there is little or no incentive for anyone to produce or accumulate anything that may be stolen and thus little for bandits to steal. Bandit rationality accordingly induces the bandit leader to seize a given domain, to make himself the ruler of that domain, and to provide a peaceful order and other public goods for its inhabitants, thereby obtaining more in tax-theft than he could have obtained from migratory plunder.

Thus we have 'the first blessing of the invisible hand' — the rational, self-interested leader of a band of roving bandits is led, as though by an invisible hand, to settle down, to wear a crown, and to replace anarchy with government. The gigantic increase in output that normally arises from the provision of a peaceful order and other government goods gives the stationary bandit a far larger take than he could obtain if he did not provide government.

Since the stationary bandit takes a part of total production in the form of tax-theft, it will also pay him to provide other goods, besides a peaceful order, that the market will not provide. It is now widely understood that the market will not provide large populations with goods — such as flood control, quarantine against contagious disease or defence — whose benefits inevitably go to a broad population: the individual who strives to obtain such goods for himself will find that he reaps only a minute part of the benefits. Thus individuals and firms in the market will not have an incentive to obtain or provide a peaceful order or any other 'collective' or 'public' goods.⁵

But the rational stationary bandit will have such an incentive. He would reap a significant gain through increased tax receipts from any public goods that increased the productivity of the economy or the size of the population he controls.

Let us now consider a democracy under the control of a unified majority, and impartially assume that this majority has the same self-interest as the autocrat and redistributes income from the minority to itself. Since the members of the majority not only have the same control of the tax and transfer system as the autocrat, but also earn income in the market, they necessarily have a more encompassing interest than the autocrat. It follows that they will treat the minority better than the autocrat treats his subjects. This, in combination with some inherent reasons why there are superior individual rights to property and contract-enforcement in the long-run in lasting democracies, greatly strengthens the traditional case for democracy. But since these advantages of democracy are not necessary to the present argument and have been explained elsewhere,⁷ no more will be said of them here.

The anti-social or special-interest groups

Consider now situations where the firms or workers in an industry or the individuals employed in some occupation or some profession are organised to act collectively, as a lobby or a cartel. The firms or workers in any single industry or occupation are unlikely to be a majority of the electorate and unlikely to earn any substantial percentage of the national income of a country. Because they are not a majority they cannot obtain complete control of the taxation and spending power of a government. They must instead take advantage of the 'rational ignorance' of the electorate about the details of public policy and about their particular industry or occupation. They will then often through lobbying secure special-interest measures, such as protection against imports, regulations that limit entry and competition, tax loopholes or subsidies. They may also be able to cartelise or collude to obtain monopoly prices or wages in their market.

To what extent will the organisations for collective action that represent particular industries or occupations have an incentive to refrain from any redistribution to themselves that will do great damage to economic efficiency?

The profits and even the value-added in a typical industry and the wages in a typical craft or occupation are a small fraction of GDP. Suppose, for ease of calculation, that a given organised interest obtains exactly one per cent of the GDP. Then it will pay this organised interest to press for both governmental and cartelistic redistributions to itself up to the point where the social losses are 100 times as great as the amount it obtains: only then will its marginal share of these social losses be as great as its gain at the margin from further redistribution. Thus the typical special-interest group

The hidden sources of honest government and law-abiding behaviour

We do not yet have an explanation of why there has been an epidemic of complaints about official corruption and mafia crime after the defeat of communism, whereas there was no such epidemic after the defeat of fascism. Though they occasionally have suffered from notorious scandals, the citizens of West Germany and Japan — and of most of the other Western market democracies — have not complained nearly as much about official corruption and mafia gangs as many people in some formerly communist countries have. As has long been known, one source of law-abiding behaviour is a strong government that efficiently punishes illegal acts. West Germany and Japan, and most of the other major market democracies, appear to have had stronger government than Italy has had, and this helps explain why Italy, in its southern regions, has had major problems with mafia families when most of the other major market democracies have not. (Ethnic and racial division and the degree of elaboration of the legal right of defendants may also make a difference and help to account for the extraordinary levels of street crime in the large cities of the United States.)

But the strength of the government is by no means a sufficient explanation of the extent of crime and corruption, in part because we also need an independent explanation of official corruption. If government officials are corrupt, law breakers can buy immunity from prosecution and there cannot be a strong government combatting crime.

There is another source of law-abiding behaviour and honest government in most societies that seems to have escaped notice. This source of law-abiding behaviour and official integrity was missing under communism. To understand it, we must consider countries with market economies and good economic policies and institutions.

The self-interest of the individuals and firms in a market economy with good economic policies and clearly delineated property rights is a major force for crime prevention, lawful behaviour and law enforcement. Consider the prevention of theft or the maintenance of property rights (theft is of course taking something from someone who has a property right to it). The self-interest of the owners of goods leads them to guard against theft. In a society with private property, the self-interest of individuals and firms leads them to install locks, hide valuables, hire guards, and keep watch.

The self-interest of individuals and firms in the private sector also often helps the police, the courts, and the government generally in apprehending

at issue, the more substantial and wealthier interests will normally be on the side of upholding the law. If the average burglar is not as prosperous, as well placed, or as politically influential as his victim, that means that the net force of the private sector is on the side of the law. If lenders are on average more influential than borrowers, this makes loan-contract enforcement work better. This not only works in favour of contract enforcement, but it also helps those who can gain from borrowing money by creating an environment where money can be borrowed on reasonable terms. The net private force in support of many laws is, I think, a matter of extraordinary importance.

Now let us look at countries that do not have good economic policies and institutions. Suppose that the government fixes prices and sets a price lower than the market-clearing price. If there is a price that is lower than the market-clearing price, the quantity demanded will be higher than the quantity that the suppliers, at that lower-than-market-clearing price, want to supply. So it will then be the case that there can be a *mutually advantageous trade* — one with two parties, a buyer and a seller, gaining — at a price that is higher than the controlled price and lower than the market-clearing price. Here is a situation in which *both parties* gain by violating the law — essentially all of the parts of the private sector act to undermine the law. The same thing holds true if the government sets a price above market clearing levels.

Suppose now that the government determines how much of some good will be produced, and that the quantity chosen by the planners is lower than the quantity that the market would have generated. There will then be some buyers who do not get as much as they would like and also some potential sellers who would profit from supplying these buyers at a price they are willing to pay. Both parties can gain from evading the law and, if necessary, corrupting the officials who are supposed to enforce it.

Now assume that it is ordained by the government that some good must be produced in excess of the amount that the market would dictate, or that some good must be produced which the market would not produce at all. There are then enormous costs that producers can escape if they do not produce this good or do not produce the prescribed amount of it, and (since the production is by stipulation uneconomic) the good is not worth nearly so much to buyers so they do not put up much of a fight for it.

The general point is that any legislation or regulation that is 'market contrary' must leave all or almost all parties with the incentive to evade the law and is likely to promote criminality and corruption in government.

activity and official corruption than could be accounted for by the foregoing argument.

It turns out that this additional corruption-inducing feature of the Soviet-type systems was, paradoxically, a side-effect of the very same thing that made the Soviet countries as powerful and imposing they were for a time. The same thing that made the Soviet Union a super-power also in the long-run corrupted it and accounted for its decline and ultimate collapse.

To understand what enabled Stalin to make his domain a super-power — and also led to its corruption, decline and collapse — we must return to the criminal metaphor with which we began, and especially to the theory of the autocrat as stationary bandit.

The theory of power extended to cover Stalinist regimes

The theory of autocracy earlier in the paper puts the spotlight on two reasons why the Soviet empire for a time offered both an economic and military challenge to the United States and its allies. Stalin's Soviet Union was an autocracy and therefore:

1. It was governed by an encompassing interest — the more productive the Soviet domain was, other things being equal, the more resources were available to achieve the autocrat's objectives, so Stalin had a powerful incentive to make his empire more productive, and
2. Stalin, as an autocrat, extracted the largest possible surplus from the society to increase his political power, military might and international influence.

Important as these two factors are, they do not explain why autocracies in the Stalinist pattern — i.e., what has come to be called the communist or Soviet pattern — were organised the way they were. Before Stalin consolidated his control over the Soviet political system at the end of the 1920s, no autocrat (not even Lenin) had organised his domain the way Stalin organised the Soviet Union. Why did Stalin impose on the Soviet Union (and later on the satellite countries) an economic system with almost universal state-ownership and the vast proportion of the prices and wages set by the regime?

The conventional assumption — that the choice for a centrally planned economy was because of Marxist-Leninist ideology — is inadequate. Saying the actions of autocrats are explained by their ideologies adds only a word

obtain still more? It *appears* that expropriation of capital goods, because it reduces future investment and income, cannot increase the tax receipts of an autocrat over the long run. But there is one way that it can, and Stalin was the first one to discover this way.

Confiscations that increase savings and investment

Stalin confiscated all of the farmland and natural resources of the Soviet Union, and all of the commercial and industrial property that had been privately held in the period of the New Economic Policy, and *the rate of savings and investment increased substantially*. In general, the Soviet Union after Stalin's innovations, and the other societies on which the Stalinist system was imposed, had far higher rates of savings and investment than most other societies. Stalin's innovation was to take almost the total natural and tangible capital stock of the country through a 100 per cent wealth tax, i.e., an expropriation, and then to use these resources to produce a mix of output that was much more intensive in capital goods, and other goods Stalin wanted, than would otherwise have been produced. By determining himself how much of the nation's resources would be used to produce consumer goods and keeping this proportion much smaller than it was in most other societies, Stalin gave the Soviet Union an extraordinarily high rate of capital accumulation at the same time that he augmented his annual tax receipts by an amount approximately equal to all non-labour income. In the long history of stationary banditry, no other autocrat seems to have managed this while at the same time greatly increasing savings, investment and the level of output."

How taxes can increase the incentive to work

Stalin and his advisers also discovered a second innovative idea about how to increase the amount of resources he could obtain for his own purposes. Though most of Stalin's resources were obtained by taking all of the profits of state-owned enterprises rather than from explicit taxes on individuals, we must recognise that this was an *implicit* if inconspicuous form of taxation, and thus analyse it as a form of taxation.

We must also understand that, when an autocrat has *different tax schedules* for individuals of different productivities, he can collect much more tax revenue. In the typical modern democracy, high-income people confront higher tax rates or brackets than do low-income people, but everyone faces the same tax law or schedule. When everyone faces the same tax schedule, it is impossible to tax people more on their *first* hours of work than on their last or *marginal* hours of work and also to have very high tax rates.

Second, he established a system of bonuses and of special rewards for people who were Stakhanovites or model workers. He also used *progressive* piece rates — that is, piece rates that increased the *per-unit* payment with the amount that the person produced. Stalin's combination of bonuses, progressive piece rates, prizes for Stakhanovites, and special perquisites for other especially productive workers was a system that provided people with a large proportion of the marginal output that they produced, but at the same time implicitly taxed them very highly indeed on their infra-marginal work.

In effect, Stalin's system of wage and salary setting had the effect of implicitly confronting individuals in different jobs or with different ability levels with a different tax schedule. This made it possible to impose higher average tax rates on the more able individuals who could produce a larger surplus over subsistence, while at the same time taxing the first hours of work severely and the last hours only lightly. To paraphrase an old saying, it was 'from each according to his ability, to the man in charge'.

The Stalinist regime obviously knew that it took more ability to be a factory manager than an unskilled factory worker, and it must have known roughly what ability and education level was appropriate for each major type of job. To motivate the more able people to take on the jobs needing more ability, Stalin made the total pay — including bonuses and other forms of marginal pay — for the jobs demanding higher ability higher than the total pay for the less demanding jobs.

Note that the familiar Western progressive income tax would not have served Stalin's purposes at all. Thus it is no coincidence that the Soviet Union, even as it attacked the market democracies for their inequalities of income, did not in any serious way use the progressive income tax. For a long time, the maximum rate of income tax in the Soviet Union, for example, was only 13 per cent.

As I mentioned above, and as Ronald McKinnon's important work on this subject explained earlier,¹¹ the main source of tax revenue for the Soviet-type societies was the profits of industrial enterprises (and turnover taxes that were, in effect, mainly taxes on the profits of these enterprises). Stalin not only claimed for the regime all of the profits of state enterprises, but also had his planners set infra-marginal wage rates and prices at level that would make industrial profits — and thus implicit taxes — very high.

The proportion of income in the Soviet Union in Stalin's time that was devoted to personal consumption of the population was lower than in any non-communist country, and that is exactly what the theory here predicts.

A test: the ratio of power to income

If the theory offered here is true, the military or geo-political power and the expenditures on projects that add to the status and prestige of the political leader should have been greater, in relation to the standard of living of the population, than in other societies — even other autocratic societies. A casual glance at the historical record is enough to show that this was the case.

Tsarist Russia, though much the largest country on earth, was not able to give a good account of itself in the Crimean War. Nor was it able to defeat even the then-backward island society of Japan in 1904-5. Similarly, Chiang Kai-Shek's China, though it had the world's largest population, was militarily impotent.

Compare also Tsarist Russia in World War I with Stalin's USSR. In World War I the gigantic Empire of the Tsars was defeated essentially only by Germany,¹³ even though the German army had its hands full fighting on a second front against the French and British from the beginning of the war and normally used only a small fraction of its forces against Russia. By contrast, in World War II Stalin's Soviet Union was victorious against Nazi Germany, even though the Germans committed the great bulk of their fighting troops to the Soviet front: there was no 'second front' until the Normandy invasion in June of 1944. Though German ground and air munitions production was 2.6 times as large in World War II as in World War I, Soviet munitions production was 24.5 times as high in World War II as the Russian Empire's munitions production in World War I.¹⁴

Whatever interpretation may be offered for the fortunes of the different Russian autocracies in World Wars I and II, there can be no doubt that after World War II the Soviet Union was universally accorded a superpower status that the Tsarist autocracy never achieved and that the Tsars never managed a prestige coup comparable to the Soviet initiation of flight in space. When the Stalinist system was applied in China, Vietnam, and North Korea, it again made the communist autocracies incomparably more powerful militarily and politically than other third world regimes.

The inefficiency and decline of the Stalinist system

Having given the Stalinist devil its due, we must not forget the well-known point that the Soviet system, even at its best, was inefficient. The Soviet system mobilised a fantastic amount of resources, but it also wasted a lot. Stalin's confiscations eliminated many of the markets needed for an efficient economy. To obtain all of what would, in a market economy, have

Stalin himself had to worry about. To paraphrase Keynes: In the long run, Stalin was dead.

But it is an overwhelming problem for the societies in transition from communism. As we shall see, the drop in income levels that most of these societies have endured and their continuing difficulties are mainly due to the sclerotic structures that continue to plague the societies in transition. So the 'red sclerosis' must be understood if the societies in transition are to find the therapy that will cure the disease from which they suffer.

How can there be sclerosis without freedom of organisation?

Obviously, the communist countries did not have freedom of organisation. It would be absurd to suppose that lobbying organisations of the kind that buy advertisements in the American media or labour unions such as those that have played such a large role in the United Kingdom could be responsible for their sclerosis. The red sclerosis was very different from that in societies with freedom of organisation, and not only because it reached the point of being fatal. It was also incomparably more discreet and subtle.

The key to the gradual decay of Stalin's system under his successors was its dependence on the decisions of subordinates in the bureaucracy. Though the role of markets in Soviet-type societies was much larger than is often supposed,¹⁷ the Stalinist system of implicit tax collection obviously had to limit markets more than any other societies have done. To maintain and increase investment after confiscating the capital stock, the Soviet-type regimes had to control consumption and saving decisions. After seizing all the tangible capital and natural resources in the society, there could be no private firms. If infra-marginal wages are to be set far below the free market levels, they cannot simply be left to the market. Thus a system of the type Stalin founded obviously must handle an awesome number of matters through its command and control system, and for this it had to rely on a vast army of nomenklatura and lesser administrators.

How could the leadership of a Soviet-type economy, given that it had to make through a bureaucracy millions of decisions that in other societies are governed mainly by markets, obtain an even faintly rational allocation of resources? That such a system would be insensitive to consumer demands and would also have major inefficiencies is so well-known that it should no longer need to be discussed. But how could it work well enough to create and sustain a superpower? I have explained how the encompassing interest of the Soviet dictator gave him a strong incentive to make his domain as productive as he could in the interest of increasing his total tax collections. We still need to explain how the autocrat was able to obtain the

Competition among bureaucrats

Competition among bureaucrats is such a countervailing factor. The strong incentive for production facing the leader of a Soviet-type society can at times be translated into tolerable performance because of the constraints on bureaucratic misrepresentation and negligence that arise because each bureaucrat or manager can be constrained and monitored by others. Suppose that a manager understates the output that can be produced with the inputs that are being allocated to him or that he produces much less than he could produce. Those managers who are given similar inputs and responsibilities then have an opportunity to make a good impression by promising or producing better outcomes.

The boss can also check with his subordinates' subordinates, and if there is unqualified competition among all the bureaucrats, the lower-level managers have an incentive to correct any erroneous information their superiors have given the boss in the hope of promotion and other rewards. Thus when there is bureaucratic competition among all administrators, each official must accordingly be cautious in under-reporting the potential productivity of the resources being allocated to him or in under-producing with the resources he is actually given. An astute superior can accordingly use competition among subordinates to exploit their more detailed knowledge and to draw out better estimates of potential production and better productivity than would otherwise be obtained. When there is full competition among subordinates, a leader can even allocate resources among his subordinates to those who make the best credible offers about how much output they will produce, so that, in effect, the resources are auctioned off to the subordinate managers who offer the highest 'bids' or output-to-input ratios.

Bureaucratic collusion

The foregoing argument assumed that collusion of subordinates does not limit bureaucratic competition or reduce the information or power available to the centre. For the early period of the Soviet-type economy (or a period after a purge, or a cultural revolution like the one Mao instigated, or other total shake-up of society), this is a fairly realistic assumption. But, as earlier parts of the paper argued, in stable environments, collusion and other types of collective action increase over time. This eliminates the competition among subordinates that is the dictator's only source of information about what is actually happening in the factories, farms, and other enterprises. It also means that he cannot, as it were, auction the productive inputs off to the managers who promise to produce the most

and ethnic loyalties facilitate collective action can become conspiracies at the expense of the centre.

The foregoing accumulation of covert collective action would not be so damaging to the productivity of a Soviet-type society if each of the separate collusions, enterprises, and industry associations had a significant incentive to make the society work. But whereas the dictator or politburo at the centre has an encompassing interest in the productivity of the society, the separate collusions and special-interest organisations do not. Their incentives are quite as perverse as those of narrow organised special-interests in the market democracies, and nearly as perverse as those of the individual criminal.

Banding together against the bandit

We earlier discussed the way in which market-contrary policies undermine law-abiding behaviour and promote official corruption, because they create situations in which all of the parties involved have a common interest in evading the rules, keeping the evasion secret from the authorities, and corrupting the relevant officials. We know that the uniquely high rates of implicit tax collections in the systems of the Soviet type implied great interference with markets and that this encouraged corruption under communism. But this market-contrary character of the Soviet-type systems does not adequately convey communism's corruption-inducing tendencies. This can best be understood by going back to our stationary bandit metaphor.

It should not be astonishing if the subjects of a stationary bandit feel morally entitled to withhold income that a stationary bandit wants to tax, or to take back some of the income he has taken from them. Thus exploitative autocracies may not benefit much from the common feeling in successful democracies that individuals should not cheat on their tax returns, much less steal public property. Probably the Soviet-type regimes suffered some losses because many of their subjects recognised that they were exploited, but we must be careful not to exaggerate this factor. The populations of these societies were from childhood exposed to education and propaganda designed to make them believe in the regime and to uphold the norms it required. Obviously the media in these societies contained nothing analogous to the complaints about high taxation and waste in government that are commonplace in democracies.

The most remarkable corruption-inducing feature of the Soviet-type systems becomes evident when one compares this system of implicit tax collection with the traditional types of autocratic tax-theft. The autocrat

There are, however, limits to what any small group can take without being observed by someone outside the group. If the managers take too much, their subordinates may notice. If those in Department A take too much, those in Department B may be able to tell what is going on. So, if there is time for the manager and his subordinates, or Department A and Department B, to reach the point that they can trust each other with secrets, they can agree that more of the goods they produce and the assets they control will be kept for themselves. What happens in group after group and department after department becomes commonplace, and what becomes commonplace seems only natural and right. Eventually the enterprise, the industry, the locality, and even the ethnic or linguistic group come to agree, tacitly if not explicitly, that they can and should keep more for themselves. So as time goes on more and more of the central bandit's theft is taken back.

The centre has those who watch the watchers: the higher officials, party cadre, police, secret police and other watchdogs whose job is to ensure that none of the autocrat's property is stolen and that every enterprise, industry, locality, and ethno-linguistic group produces huge implicit tax collections for the centre. *But if no one except the centre owns property, and if no one except the centre has the legal right to claim the implicit tax receipts, then everyone except the centre has an incentive to induce these officials to become a part of the countless conspiracies to take back some of what the stationary bandit has stolen from them.* If the watchdog officials can persuade the centre they are doing a great job guarding the property and increasing the implicit tax collections of the centre, then they are likely to be rewarded. Even a small share of the gains from a diversion of production or the theft of assets is, however, likely to be worth more than the extra salary that comes from a promotion. The best outcome of all for the official is to be promoted and then take a share of the implicit tax collections and state property over a wider part of the economy. Of course, the centre has an interest in preventing this, but it has virtually no source of information on what is happening other than subordinate officials, all of whom have an interest in being part of a conspiracy to take back some of what the stationary bandit has stolen.

Ironically, it was Marx who coined the best phrase for describing a situation such as this. There is an 'internal contradiction' in any system of the kind Stalin created. In such a system, the autocrat takes most of the economy's output for his own purposes and owns almost everything. But this means that almost everyone else has an incentive to be part of collusions to take back some of what the stationary bandit has stolen. If all of the autocrat's subordinates simply compete with one another to receive the autocrat's

See, for example, Diego Gambetta, *The Sicilian Mafia* (Cambridge, MA: Harvard U. Press, 1993)

For the concepts of encompassing or narrow interests, see my *Rise and Decline of Nation* (New Haven, CT: Yale University Press, 1982.)

James E. Sheridan, *Chinese Warlord: The Career of Feng Yu-hsiang* (Stanford, CA: Stanford University Press, 1966)

Since this reasoning is set out fully in my *Logic of Collective Action*, (Cambridge: Harvard University Press, 1965), I will say no more about it here.

If there is both a Mafia family and a maximising autocrat extracting resources, the combined protection-racket tax plus autocrat's tax will be higher than if only one of them had been taxing. When the Mafia leader, for example, is deciding on the protection-racket charge and is aware that activity in the neighbourhood is curtailed by the protection charge, he notes that some of the loss takes the form of lower governmental tax collections, and the Mafia family has no incentive to take this loss into account in deciding on the rate of protection payment it demands. If a Mafia family were, like our bandit gang that settles down, strong enough so that its protection-racket charge was the only tax, then the aggregate tax rate imposed on citizens would be lower and the income of the neighbourhood would be higher. In other words, *competition* among autocratic rulers for power over the same domain is bad for the subjects and *monopoly* by a single ruler is better for them. By contrast, competition in a democracy between two parties to obtain a majority that gives the winning party a term during which it has a monopoly of government means a significantly lower tax rate than under a single autocrat, and a much lower tax rate than results from a stationary bandit plus a Mafia family.

In my 'Dictatorship, Democracy and Development', *American Political Science Review* (September 1994) and formal proofs and additional results are provided in Martin McGuire and Mancur Olson, 'The Economics of Autocracy and Majority Rule: The Hidden Hand and the Use of Force' (IRIS, Working Paper # 127, August 1994)

The argument in this and the immediately preceding paragraphs are developed in my *Rise and Decline of Nations* and my *Logic of Collective Action*.

In the very short run, just after the collectivisation of agriculture and other productive assets, there was apparently a period of 'indigestion' and confusion when output may have significantly declined. But for most of the rest of Stalin's reign, the output that Stalin cared about was far higher than it had been before he imposed Stalinisation on the USSR.

I am grateful to James Buchanan for pointing out to me, at a very early stage of my work on the hypothesis that Stalinism was fundamentally a tax-collection system, that a communist tax-maximising system would not only try to raise the ratio of infra-marginal to marginal taxes, but also try to take more taxation from those who were more productive.

See McKinnon's 'Taxation, Money and Credit in a Liberalising Socialist Economy', in Christopher Clague and G. Rausser, eds. *The Emergence of Market*