

Chapter 5

The Taxonomy of Common Income (Section A)

Post-Communist Russia and China break down the familiar view of the world. Each combines two seemingly conflicting characteristics. Russia integrates universal redistribution of income and limited, indeed symbiotic government. Enterprise Network Socialism in Russia and similar countries is non-governmental total socialism, or, one can say, communism with a lower-case ‘c’. China and similar countries combine a predominantly market economy and a big government. The latter restricts the residual enterprise network from access to the income of new-entrant market firms. Neither of these systems exists on the traditional, one-dimensional map of the world which stretches along a linear dichotomy of market versus government. This one-dimensional map equates market with limited government, defines socialism as restrictive big government, and cannot locate on it economic systems which do not fit these conditions. With no place for post-Communist reality, the canonical, single-dimensional approach misguides policy. It liberalizes and privatizes the predatory enterprise network, which leads to Great Contractions. Wrong map, wrong navigation.

The traditional map came down alongside the Berlin Wall. Its inability to accommodate post-Communist developments calls for a new map of the world. Chapter 5 shows how treating socialism and government as separate dimensions opens a new, two-dimensional perspective on economic systems. It offers a comprehensive taxonomy of economic systems, which incorporates Enterprise Network Socialism.¹ A better map, and, possibly, policy.

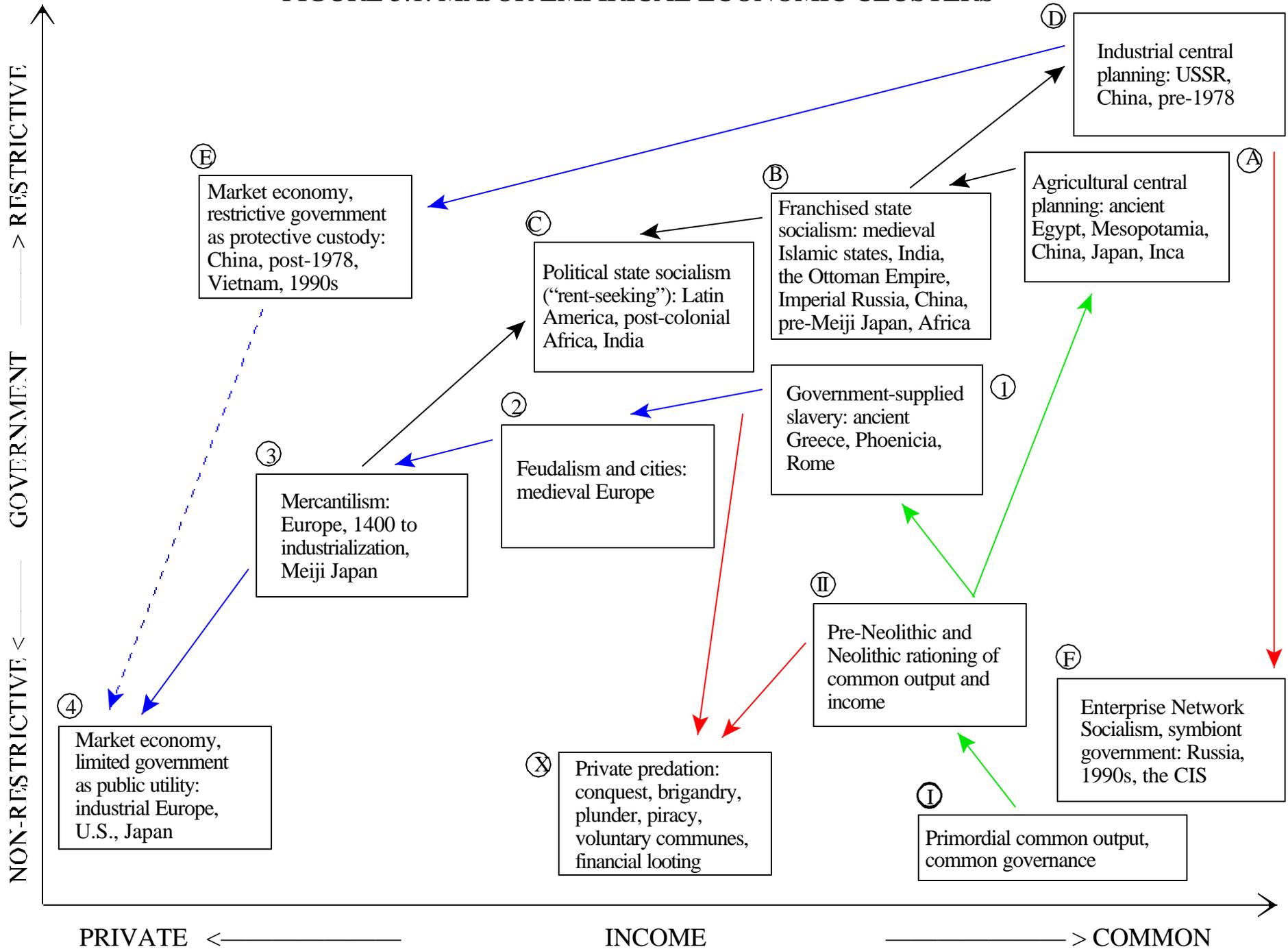
Two Maps of the World

To demonstrate from the outset the capacity of the two-dimensional map, figure 5.1 displays thirteen major empirical economic clusters covering the last 10,000 years. It incorporates the Russian and Chinese economies of the 1990s and fits all of the clusters together on one page. Market and socialism lie on one independent dimension, while government lies on a wholly separate dimension. They form the latitude and the longitude of the new map. The income dimension extends from market to socialism or, synonymously, from private to common income. It measures income redistribution from zero to 100 percent. The government dimension stretches from limited to restrictive government. It measures economic control or restriction from nil to full. Intersections on the two dimensions define economic systems. The chronological inventory below summarizes the major economic clusters mapped in figure 5.1.

¹For seminal work on the taxonomies of economic systems, see John Hicks, *A Theory of Economic History* (Oxford: Clarendon Press, 1969); Frederick C. Lane, *Profits from Power: Readings in Protection Rent and Violence-Controlling Enterprises* (Albany: State University of New York Press, 1979); Manuel Gottlieb, *A Theory of Economic Systems* (New York, London: Academic Press, 1984); and, Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990). A two-variable taxonomy of economic systems appears in a recent cross-national study by Robert E. Hall and Charles J. Jones, “Why Do Some Countries Produce So Much More Output than Others?” *The Quarterly Journal of Economics* 104, no. 1 (February 1999): 83-116.

<p>I. Common output of primordial hunters and gatherers, predatory socialization of output, common governance</p>		
<p>II. The first government: Storing food in fortified settlements (e.g., Jericho, Catal Huyuk). The first insurance, rationing common output surpluses, the first individual shares, and, subsequently, income. This creates incentives for pre-Neolithic tribes to move from hunting and gathering to farming and herding. The Neolithic Revolution. After which the world splits as follows:</p>		
<p>A. Agricultural central planning in ancient Egypt, Mesopotamia, China, Japan, India, the Maya, Aztec, and Inca Empires, the Great Zimbabwe: Centralized irrigation network and forced delivery of agricultural output to the state wholesale monopoly and monopsony</p>	<p>X. Private, non-state predation: Conquest, brigandry, plunder, piracy, voluntary communes, later, financial looting</p>	<p>1. State-supplied slavery for private production in ancient Greece and Rome; state-financed colonization, infrastructure, and major transportation; trade is free and private, land is private, rent and prices are separate from tax</p>
<p>B. Franchised state socialism in medieval Islamic States, India, the Ottoman Empire, Imperial Russia, pre-Meiji Japan, Africa: The government franchises revenue collection (rent and taxes, communally or collectively levied) and the wholesale agricultural monopoly and monopsony to provincial/local bureaucracy</p>	<p>2. Feudalism and cities in medieval Europe: The government is separated from the supply of inputs (no slaves); and from capital and finance when cities rise due to competitive protection and competitive tribute. This breaks up uniform common income into the common incomes of the government, fiefs, and guilds</p>	
<p>C. Political state socialism in Latin America, post-colonial Africa, India: The government confiscates and redistributes income and rations private access to common income through the political process (this system is known as "rent-seeking")</p>	<p>3. Mercantilism in Europe, 1400 to industrialization. The end of rural common income (serfdom), the rise of private rents in agriculture, trade, and craft. Taxes replace tribute. Market is there but with restrictions, confiscations, and privileges (especially guilds)</p>	
<p>D. Industrial central planning: Mono-industry (cotton) forced production in Egypt under Muhammad Ali (1805-1849), multi-industry planning in Germany in 1914-18 (War Socialism) and Nazi Germany, then multi-industry forced production, with forced subsidies and cross-subsidies, in the USSR, Eastern Europe, and pre-1978 China</p>	<p>4. Market economy with limited government, acting as public utility, in industrial Europe, U.S., Japan, the Asian tigers. The breakup of guilds, the rise of private wages and private profit. Finally, private income across-the-board: Non-confiscatory, non-redistributive, separable public income and private finance. Then a step back to the Welfare State</p>	
<p>F. Enterprise Network Socialism in Russia and similar post-Communist countries: Near-total income redistribution by the enterprise network, its self-subsidy (the tax subsidy) under symbiont government</p>	<p>E. Market economy with restrictive government in post-Communist China and neighbors: The government acts as protective custody, restricting the residual enterprise network from new-entrant market firms</p>	

FIGURE 5.1. MAJOR EMPIRICAL ECONOMIC CLUSTERS



These descriptive characteristics of major economic clusters are based on our understanding of facts and the literature.² Details of each case will be discussed throughout this chapter. For the moment, the chronological inventory serves as a reference for figure 5.1. Descriptive characteristics determine locations on the map in figure 5.1. Locations approximate the intersections of income redistribution and government restriction for each specific cluster.

Objective and Verifiable Locations

There is no consensus in the literature on the characteristics, the choice, the structure, or even the names of the empirical cases that we assembled in the 13 clusters that appear in figure 5.1. Interpretations vary, swing, and clash. For example, ancient Egypt and Mesopotamia (in cluster A) are alternatively viewed as state-forced irrigation or as precursors of modern Western economies, which combine markets and public works.³ Central planning in the Soviet Union and China (in cluster D) is viewed, in one perspective, as a nationwide forced labor camp or, from a different perspective, as the implementation of a full employment policy by paternalistic Keynesian planners.⁴

What is important for our purposes is that the two-dimensional map can accommodate any

²For vivid recent summaries see Rondo Cameron, *A Concise Economic History of the World: From Paleolithic Times to the Present* (New York, Oxford: Oxford University Press, 1997) and David S. Landes, *The Wealth and Poverty of Nations: Why Some are So Rich and Some So Poor* (New York: W.W. Norton, 1999). For analytical insights, we also draw on Leon de Riedmatten, *L'Economie Dirigée: Les Expériences Depuis les Pharaons d'Égypte Jusqu' à Ce Jour* (Versailles: Editions de l'Observateur, 1948); Evsey D. Domar, "The Causes of Slavery or Serfdom: A Hypothesis," *The Journal of Economic History* 30, no. 1 (March 1970): 18-32; John Hicks, *A Theory of Economic History*; Douglass C. North and Robert P. Thomas, *The Rise of the Western World: A New Economic History* (Cambridge: Cambridge University Press, 1973); Carol A. Smith, "Exchange Systems and the Spatial Distribution of Elites: The Organization of Stratification in Agrarian Societies," in Carol A. Smith, ed., *Regional Analysis*, vol. 2 (New York: Academic Press, 1976), pp. 309-374; Frederic L. Pryor, *The Origins of the Economy: A Comparative Study of Distribution in Primitive and Peasant Economies* (New York: Academic Press, 1977); Frederick C. Lane, *Profits from Power: Readings in Protection Rent and Violence-Controlling Enterprises*; Douglass C. North, *Structure and Change in Economic History* (New York: W.W. Norton, 1981); Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (Hew Haven and London: Yale University Press, 1982); and, Thomas Sowell, *Conquests and Cultures: An International History* (New York: Basic Books, 1998).

³The first view is initiated in Leon Metchnikoff, *La Civilisation et les Grands Fleuves Historiques* (Paris: Hachette et. cie, 1889); Leon de Riedmatten, *L'Economie Dirigée*; and, Karl A. Wittfogel, *Oriental Despotism: A Comparative Study of Total Power* (New Haven: Yale University Press, 1957). The most forceful expositions of the second view are in Morris Silver, *Economic Structures of Antiquity* (Westport, CT, and London: Greenwood Press, 1995) and David A. Warburton, *State and Economy in Ancient Egypt: Fiscal Vocabulary of the New Kingdom* (Fribourg, Switzerland: University Press and Gottingen: Vandenhoeck & Ruprecht, 1997).

⁴The second view is in David Granick, *Job Rights in the Soviet Union: Their Consequences* (Cambridge, New York: Cambridge University Press, 1987). It also underlies the theory of the soft budget constraint in Janos Kornai, "The Soft Budget Constraint," *Kyklos* 39, no. 1 (1986): 3-30. For a detailed presentation and bibliography, see Eric Maskin and Andras Simonovits, eds., *Planning, Shortage, and Transformation: Essays in Honor of Janos Kornai* (Cambridge: MA: The MIT Press, 2000).

interpretation of specific economic clusters and cases (i.e., in which cluster they belong). First, clusters can be easily relocated on the map within the two dimensions. As with geographic maps, knowledge changes latitudes and longitudes of specific sites and improves the map. Second, the map uses direct measurements of income redistribution and government restriction as shares of gross domestic product (GDP). These measurements are free of value judgements which influence interpretations. Whether ancient Egypt and Mesopotamia ran state-forced projects or public works of the Welfare State does not affect their measurement and location. Both interpretations imply a high degree of income redistribution and government management. Whether Soviet and Chinese central planning were forced labor camps or a means to attain full employment, they achieved the same near-total extent of income redistribution and government control. Locations of cases, and the clusters in which they are placed, are objective, even if not precise. They are verifiable by evidence.

In short, the map is free of value judgements and adaptable to learning. A third dimension, property, can be readily added, in the same manner that geographical maps use colors to include additional dimensions. The map is expandable. We will come to this in Section C of this chapter.

All Clusters, Big and Small

The clusters in the chronological inventory are empirically assembled. Each cluster consists of loosely related, time-specific, place-specific examples. Many empirical cases can be added to expand and adjust the interpretation of a particular cluster, or to form one or more new clusters. Clusters can be merged or sub-divided, as illustrated in the following discussion.

- # The Welfare State can be singled out as a cluster of its own, from ancient Rome to modern industrial economies, in Germany, Austria, and Italy beginning in the 1880s, in France and Denmark in the 1890s, and in Belgium, Norway, and U.K. in the 1900s.⁵
- # What we dub as political state socialism in Latin America, India, and Africa can be disaggregated. Political rent-seeking in Latin America, India, Turkey, and similar countries in recent decades⁶ is

⁵Monthly grain allowances to citizens in ancient Rome were established in 58 B.C. and lasted through the end of the Roman Empire. Limited initially to 220,000 plebeian recipients, this entitlement was converted into food stamps by the Third century A.D. and had become inheritable and tradeable. Physically, food stamps represented bronze tablets on which the names of the recipients were engraved. Grain allowances developed into bread allowances when baking services supplemented entitlements and 274 bakeries in Rome disbursed bread to the recipients. Oil and pork rations were added later for five months of the year. For a detailed description, see Arnold H. M. Jones, *The Later Roman Empire, 284-602: A Social, Economic, and Administrative Survey* (Oxford: Basil Blackwell, 1964), vol. 2, pp. 695-705. On the early modern Welfare State in Europe, see extensive data in Peter Flora, Jens Alber, et.al., *State, Economy, and Society in Western Europe, 1815-1975: A Data Handbook*, vol. 1, *The Growth of Mass Democracies and Welfare States* (Frankfurt: Campus Verlag and London: Macmillan, 1983). The chronology of the introduction of the state pension, unemployment insurance, and health insurance programs is on p. 454.

⁶The founding articles on rent seeking are Gordon Tullock, "The Welfare Costs of Tariffs, Monopolies and Theft," *Western Economic Journal* 5, no. 2 (June 1967): 224-232 and Anne O. Krueger, "The Political Economy of the

a separate phenomenon from patronage in Indonesia and from corporatism in South Africa and Argentina under Peron (which can be grouped with the corporate state in Fascist Italy). In Latin America, political state socialism stands apart from violent infighting over economic power in the 18th-19th centuries⁷ and from essentially market economies in the second half of the 19th and early 20th centuries in Ecuador, Argentina, and Chile. The rural-to-urban transfer of income in post-colonial Africa and Arab countries, known as urban bias or the price scissors,⁸ may warrant its own cluster. It retains the government wholesale agricultural monopsony and monopoly, like franchised state socialism that preceded it. Thus the government distributes not only inputs of resources, land, and capital, as under political state socialism, but also agricultural and other output, akin to franchised state socialism.

Political state socialism (“rent-seeking”) in Latin America, post-colonial Africa, and India and mercantilism in pre-industrial Europe are viewed by many researchers as one system.⁹ The structural difference between the two is that rent-seeking uses modern political institutions for sectoral redistributive gains while mercantilism relies on entrenched and long-term privileges. This means that rent-seeking is highly competitive whereas privileged-based mercantilism is less so. This difference has quantitative implications for the extent of income redistribution and government control. Both the role of the government and the extent of income redistribution are greater in rent-seeking. Privileged redistribution is confined to isolated segments of commerce and agriculture whereas rent-seeking spreads over industries and supply chains and constantly involves the government. If empirical evidence does not warrant this differentiation, the rectangles of

Rent-Seeking Society,” *American Economic Review* 64, no. 3 (June 1974): 291-303. A comprehensive compendium is Robert D. Tollison and Roger D. Congleton, eds., *The Economic Analysis of Rent Seeking* (Aldershot, U.K. and Brookfield, VT: Edward Elgar Publishing, 1995).

⁷See Douglass C. North, William Summerhill, and Barry R. Weingast, “Order, Disorder and Economic Change: Latin America vs. North America,” in Bruce Bueno de Mesquita and Hilton Root, eds., *Governing for Prosperity* (New Haven: Yale University Press, 2000), pp. 17-58 and Steve J. Stern, “Feudalism, Capitalism, and the World-System in the Perspective of Latin America and the Caribbean,” in Robert Foster, ed., *European and Non-European Societies, 1450-1800* (Aldershot, U.K.: Ashgate Publishing Ltd., 1997), pp. 19-75.

⁸On income transfer from rural to urban sectors through controlled prices in developing countries see Michael P. Todaro, *Economic Development* (Reading, MA: Addison-Wesley, 1997) and the definitive article by Raaj Kumar Sah and Joseph E. Stiglitz, “The Economics of the Price Scissors,” *American Economic Review* 74, no. 1 (March 1984): 125-138. See also Michael Lipton, *Why Poor People Stay Poor: Urban Bias in World Development* (Cambridge, MA: Harvard University Press, 1976); Charles M. Becker, Andrew M. Hamer, and Andrew R. Morrison, *Beyond Urban Bias in Africa: Urbanization in an Era of Structural Adjustment* (Portsmouth, N.H.: Heinemann and London: J. Currey, 1994); and, Michael P. Todaro, *Reflections on Economic Development: The Selected Essays of Michael P. Todaro* (Aldershot, U.K. and Brookfield, VT: Edward Elgar Publishing, 1995).

⁹On the overlap of mercantilism and rent-seeking, see Robert B. Ekelund, Jr., and Robert D. Tollison, *Sacred Trust: The Medieval Church as an Economic Firm* (New York: Oxford University Press, 1996) and Robert B. Ekelund, Jr., and Robert D. Tollison, *Politicized Economies: Monarchy, Monopoly, and Mercantilism* (College Station, Texas: Texas A&M University Press, 1997).

mercantilism and political state socialism (rent-seeking) in figure 5.1 can be easily merged. The two-dimensional map does not take sides in these debates. Rather, it is a learning tool.

Franchised state socialism across medieval and pre-modern Asian, African, and Eastern European economies may be too much to lump into one cluster. Two basic elements hold it together.

(1) The government distributes agricultural output. The state wholesale agricultural monopsony and monopoly, inherited or reproduced from agricultural central planning, defines transactions between independent peasant communities and the state, as well as rural-urban relations. It amalgamates tax and rent because producer surpluses above state-set purchase prices accrue to state revenues. Land tax, another principal revenue source, also fuses tax and rent.

(2) This revenue collection, together with the enforcement of the monopsony/monopoly and other taxation, is franchised to provincial and local officials. For this purpose, they are allocated land (or, rather, territory and communities) to separately collect their own keep, initially in kind, and, later, in money income.¹⁰ This system of separate localized revenues is uniformly and independently dubbed in various countries and languages as “feeding,” and its franchised collectors, as “eaters.”¹¹

¹⁰The literature documenting and analyzing these two points is voluminous. It starts with the brilliant insights of Francois Bernier and the path-breaking work of Henry Sumner Maine. See Francois Bernier, *The History of the Late Revolution of the Empire of the Great Mogol: Together with the Most Considerable Passages for 5 Years Following in That Empire. To Which is Added a Letter to the Lord Colbert, Touching the Extent of Indostan; the Circulation of the Gold and Silver of the World to Discharge Itself There, as Also the Riches, Forces, and Justice of the Same, and the Principal Cause of the Decay of the States of Asia*, vols. 1-4 (London: Moses Pitt, Simon Miller, and John Starkey, 1671-1676) and Henry Sumner Maine, *Village-Communities in the East and West* (London: John Murray, 1872). To skim the cream of the modern literature, see William H. Moreland, *From Akbar to Aurangzeb: A Study in Indian Economic History* (London: Macmillan, 1923), pp. 145-233; William H. Moreland, *The Agrarian System of Moslem India* (Cambridge: W. Heffer & Sons, 1929); Winifred S. Blackman, *The Fellahin of Upper Egypt: Their Religious, Social, and Industrial Life Today with Special Reference to Survivals from Ancient Times* (London: George G. Harrap & Company Ltd, 1927); Charles P. Issawi, ed., *The Economic History of the Middle East, 1800-1914: A Book of Readings* (Chicago: University of Chicago Press, 1966); Charles P. Issawi, ed., *The Economic History of Turkey, 1800-1914* (Chicago: The University of Chicago Press, 1980); Baber Johansen, *The Islamic Law on Land Tax and Rent: The Peasants' Loss of Property Rights as Interpreted in the Hanafite Legal Literature of the Mamluk and Ottoman Periods* (London and New York: Croom Helm, 1988); Hossein Modarressi, *Kharaaj in Islamic Law* (Toptree, Essex: Anchor Press, 1983); Angus Maddison, *Class Structure and Economic Growth: India and Pakistan Since the Moghuls* (London: George Allen & Unwin, 1971), especially pp. 17-34; Irfan Habib, *The Agrarian System of Mughal India, 1556-1707* (New Dehli: Oxford University Press, 1999); Harold Bolitho, *Treasures Among Men: The Fudai Daimyo in Tokugawa Japan* (New Haven: Yale University Press, 1974); Peter J. Arnese, *The Medieval Japanese Daimyo: The Ouchi Family's Rule of Suo and Nagato* (New Haven: Yale University Press, 1979); Vasili O. Kliuchevskii, *A History of Russia*, vol. 2 (London: J.M. Dent & Sons, Ltd. and New York: E.P. Dutton & Co., 1912); and, Solomon D. Goitein, *A Mediterranean Society: An Abridgement in One Volume* (Berkeley: University of California Press, 1999). For a succinct statement see the section “Taxation and Distribution of Revenue Resources” in the article “India,” the articles “Iqta” and “Timar” and the sections “The Bakuhan system” and “Daimyo” in the article “Japan” in *Encyclopedia Britannica*.

¹¹*Iqta* in the Arab Califate, *khubz* in Mamluk Egypt, *timar* in the Ottoman Empire, *jigardar* in India (the term of Persian origin), *daimyo* and *han* in Japan, and *kormlenie* in Russia are similar terms. They mean the official's feeding and the land (locale) assigned for feeding. In China, the hierarchical terms circle around “the bowl” (“the rice bowl,” “the

Why this isomorphic “feeding” system from the Arab states to the Ottoman Empire to India to Burma to Russia to China to Japan to Mali, Benin, and Madagascar? In the absence of forced delivery of output to state storage facilities, the central government cannot monitor the fiscal performance of its revenue franchisees and enforce full collection and remittance. To solve the enforcement problem, the government assigns *fixed* revenue targets *and* makes the franchisees the *residual* revenue claimants.¹² They get their own revenues from the same locale after they deliver specified sums to the government. Any uncollected balance owed to the government comes from their own revenues or accrues to their debt.¹³ In short, eat as you remit.

If the cluster of franchised state socialism is too inclusive in the judgement of experts, it can be subdivided into two phenomena: (a) franchised taxation and indirect collective (communal) taxation in medieval Islamic states, India, medieval and Manchu China, medieval and Tokugawa Japan, and the Ottoman Empire, which accompanied government wholesale monopoly, and (b) franchised serfdom and direct communal taxation in Imperial Russia.¹⁴

Communal taxation may also be part of central planning. Examples include collective farms in the USSR, communes in China before 1978, and villages in pre-Columbian America on the periphery

porcelain bowl,” “the iron bowl,” “the rice and meat and wine bowl,” etc.) for the official-scholar, the local “tax captain,” and the *li-chia* community chief. See, e.g., Francois Bernier, *Travels in the Mogul Empire A.D. 1656-1668* (Westminster: Archibald Constable & Co, 1891), p. 224; Eric L. Jones, *The European Miracle: Environments, Economies, and Geopolitics in the History of Europe and Asia* (Cambridge, New York: Cambridge University Press, 1987), pp. 198-201; Angus Maddison, *Class Structure and Economic Growth: India and Pakistan Since the Moghuls*, pp. 22-24, 33; Harold Bolitho, *Treasures Among Men: The Fudai Daimyo in Tokugawa Japan*; and, Vasilii O. Kliuchevskii, *A History of Russia*, vol. 2, pp. 242-287.

¹²Francois Bernier, *Travels in the Mogul Empire A.D. 1656-1668*, p. 224: “the King, as proprietor of the land, makes over a certain quantity (...) [as] *jah-ghir* signifying the spot from which to draw (...) to governors, in lieu of their salary, and also for the support of their troops, on condition that they pay a *certain* sum annually to the King out of any surplus that the land may yield.”

¹³The franchisees were interested to maximize current consumption, maximize debt, and leave it to the state upon death or dismissal. See, e.g., Angus Maddison, *Class Structure and Economic Growth: India and Pakistan Since the Moghuls*, p. 23. In a series of reforms in the 16th-18th centuries, governments from Russia to the Ottoman Empire to India to Japan closed this loophole by making their tax collecting position and land holding claims hereditary. “The placed one” replaced “the fed one”: *zamindar* in India, *malikanel* in the Ottoman Empire, and *pomeshchik* in Russia replaced *jigardar*, *timar*, and *kormlenshchik*, respectively. Similarly, in Japan, under the *bakuhan* system, *shugo daimyo*, the appointed provincial revenue collectors, were supplanted by the hereditary *sengoku daimyo*. This last period of franchised state socialism may warrant a separate cluster.

¹⁴A pioneering Western study is August F. von Haxthausen, *The Russian Empire, Its People, Institutions, and Resources* (London: Chapman and Hall, 1856), vols. 1-2. Before that, Ivan N. Boltin, *Primechaniia na Istoriu Drevniia i Nyneshniia Rossii g. Leklerka*, vols. 1-2 (St. Petersburg: T. Gornago Uchilishcha, 1788), in response to good insight in Nicolas G. Le Clerc, *Histoire Physique, Morale, Civile et Politique de la Russie Moderne*, vol. 1 (Paris: Chez Froulle, 1783). The most influential account to-date is Vasilii O. Kliuchevskii, *A History of Russia*, vols. 2-5 (London: J.M. Dent & Sons, Ltd. and New York: E.P. Dutton & Co., 1912-1931).

- of the centralized irrigation and infrastructure networks (peripheral franchised central planning and forced delivery of output). Also, communal taxation was carried over from peripheral central planning to political state socialism in Latin America.¹⁵ One can also view the price scissors in Africa and elsewhere as an indirect method of communal taxation, inherited from franchised state socialism.
- # Another separate cluster can be set for franchised central planning in India under the Mughal Empire, in medieval and Manchu China, in medieval and Tokugawa Japan, and in pre-colonial Madagascar. But one can also view this element of forced production as a necessary part of franchised taxation.¹⁶
- # Labor management in Communist Yugoslavia in the 1950s-1980s is, in the view of many scholars, a separate phenomenon from, rather than a special case of, central planning.¹⁷
- # In the post-Communist world, Poland and other Eastern European economies can be located along the diagonal between Enterprise Network Socialism in Russia and market economy with restrictive government in China (Poland, closer to China; the Czech Republic, closer to Russia).¹⁸ They can qualify as a separate cluster.

These examples and many other separate cases, which we did not map and will enumerate later,

¹⁵See Oscar Lewis, *Life in a Mexican Village: Tepoztlan Restudied* (Urbana, IL: University of Illinois Press, 1951); Ernest Feder, *The Rape of the Peasantry: Latin America's Landholding System* (Garden City, N.Y.: Anchor Books, 1971); and, Andre G. Frank, *Mexican Agriculture, 1521-1630: Transformation of the Mode of Production* (Cambridge, New York: Cambridge University Press, 1979).

¹⁶Francois Bernier, who practiced medicine at the Indian court during 1656-1668 and greatly influenced his friend, another physician, John Locke, in 1675-79, grasped it all: "As the ground is seldom tilled otherwise than by compulsion, and as no person is found willing and able to repair the ditches and canals for the conveyance of water, it happens that the whole country is badly cultivated, and a great part rendered unproductive from the want of irrigation. The houses, too, are left in a dilapidated condition, there being few people who will either build new ones, or repair those which are tumbling down. The peasant cannot avoid asking himself the question: 'Why should I toil for a tyrant who may come tomorrow and lay his rapacious hands upon all I possess and value, without leaving me, if such should be his humour, the means to drag on my miserable existence?' The *Timariots*, Governors, and Revenue contractors, on their part reason in this manner: 'Why should the neglected state of this land create uneasiness in our minds? and why should we expend our own money and time to render it fruitful? We may be deprived of it in a single moment, and our exertions would benefit neither ourselves nor our children. Let us draw from the soil all the money we can, though the peasant should starve or abscond, and we should leave it, when commanded to quit, a dreary wilderness. The facts I mentioned are sufficient to account for the rapid decline of the Asiatic states.'" Francois Bernier, *Travels in the Mogul Empire, A.D. 1656-1668*, pp. 226-227.

¹⁷See the excellent treatment in John H. Moore, *Growth with Self-Management: Yugoslav Industrialization, 1952-1975* (Stanford, CA: Hoover Institution Press, 1980) and Svetozar Pejovich, *Economic Analysis of Institutions and Systems* (Boston: Kluwer Publishers, 1998).

¹⁸Figure 5.2 plots this diagonal based on the national data. We will return to its findings shortly.

are not exceptions or outliers. They are all self-contained cases or possible clusters in their own right. They can be readily located on the map. They do not require special treatment. From the two-dimensional perspective, any specific intersection of income redistribution and government restriction qualifies as an empirical case. As many empirical clusters and cases can be placed on the map as one deems fit, depending on how one interprets the evidence for specific cases and how to combine them to constitute clusters. Which cluster is big and which is small is in the eye of the beholder. It is merely up to a researcher's judgement to select empirical cases and bunch them into specific clusters or just scatter them over the map. This judgement or misjudgement on selection does not affect the map itself.

The two-dimensional map can accommodate all and any specific clusters at any level of aggregation and disaggregation, because all clusters (and all cases within each cluster) contain some extent of income redistribution and government restriction. Their intersections readily place clusters on the two-dimensional map. One can apply to the two-dimensional map the same simple and merciless test which we used for the unidimensional approach. If a single case can be found outside of the map, or if the map cannot find room for it, then the map fails to grasp comprehensively the relations between market, socialism, and government. If all empirical clusters and cases in any combination can be placed on these two dimensions, and not on just one dimension and not on some other dimension, then we can say with confidence that the two-dimensional map (like figure 5.1) is both necessary and sufficient for capturing the relations between market, socialism, and government.

The objective of figure 5.1 is not to provide the exact selections, aggregations, and locations of empirical clusters but to demonstrate the analytical capability of the two-dimensional map—the *existence* of specific, identifiable location for every extinct and extant case. Later in this chapter (Section B) we will approximate the specific locations of 86 major and minor empirical cases in a form akin to the Periodic Table of Elements.

Patterns and Paths

Once major empirical clusters are assembled, figure 5.1 reveals their patterns and paths. If the descriptive characteristics in the chronological inventory are in the ballpark, the empirical clusters in figure 5.1 line up in four disparate groups:

- # Prehistoric societies, from primordial predatory redistribution of common output to the Neolithic Revolution. We mark them with Roman numerals.
- # Western societies, from ancient slavery to feudalism and cities to mercantilism to fully-fledged market economies. They originate in Europe, extend to the British outstretches, and, later, incorporate Japan and the Asian Tigers. We denote them with Arabic numerals.
- # Non-Western societies, from agricultural central planning to franchised state socialism to political state socialism and industrial central planning, and, recently, to post-Communist economies. We

identify them with Roman capital letters from A to F.¹⁹

- # A diverse, world-wide grouping of private predation. It ranges from the timeless conquests, brigandry, and plunder to historical piracy and voluntary communes to modern financial looting.²⁰ We designate it with an X.

The paths tell us more than the four groups themselves. If the locations in figure 5.1 are not too far off mark, they yield three distinct paths:

- # *The government path:* The government path is the development of government and income, depicted by green arrows. Communities invented government to insure their survival by smoothing consumption. This first insurance entailed storing and rationing of very short-term surpluses of common output (daily, weekly, monthly).²¹ The first government controlled access to common output in order to check predatory socialization of output by individuals or small groups. The government broke up primordial common output. This started a 10,000-year march of separation of production from predation, as we discussed in Chapter 3. Breaking up common output formed the basis for the development of unique human society. It is characterized by the capacity to produce beyond subsistence, which releases the variable productivity of resources.²² Thus the rise of government, seen in the one-dimensional map as the thesis of socialism and the antithesis of markets, in fact reduced the extent of socialism, as shown in figure 5.1. An important insight of the two-dimensional map is that the emergence of government initially reduced the degree of redistribution. Put another way, the first relationship between government and redistribution was

¹⁹The terms “Western” and “Non-Western” are not strictly geographical or cultural, if only because Germany and other countries occasionally bounced between the two groups of economic clusters. We use these terms, for the lack of better ones, to sketch a long-term milieu. It is a geographical coincidence that on the two-dimensional map in figure 5.1 the direction towards market is westward, and towards socialism, eastward.

²⁰E.g., the S&L episode in the U.S. and the financial-industrial groups in Chile in the 1970s-early 1980s. See George A. Akerlof and Paul M. Romer, “Looting: The Economic Underworld of Bankruptcy for Profit,” *Brookings Papers on Economic Activity*, no. 2 (1993): 1-73.

²¹See Allen W. Johnson and Timothy K. Earle, *The Evolution of Human Societies: From Foraging Group to Agrarian State* (Stanford: Stanford University Press, 2000) and Terry Y. LeVine, “The Study of Storage Systems,” in Terry Y. LeVine, ed., *Inca Storage Systems* (Norman, OK: University of Oklahoma Press, 1992), pp. 3-30. See also Robert M. Townsend, *The Medieval Village Economy: A Study of the Pareto Mapping in General Equilibrium Models* (Princeton: Princeton University Press, 1993) and Orazio Attanasio, “Consumption Smoothing in Village Economies: Some Evidence and Some Normative Theory,” Paper presented at the Econometrics Seminar, Department of Economics, Stanford University, March 2001.

²²On the variable productivity of resources as the defining human characteristic and its material and economic accounting, see Michael S. Bernstam, *The Wealth of Nations and the Environment* (London: The Institute of Economic Affairs, 1991), pp. 29-37, 61-62.

negative.²³ Government rationing allocated individual shares of common output. This was equivalent to the invention of income and money and led to the birth of exchange. They, in turn, put in place incentives for the shift to agriculture because they enabled individuals (or families) to internalize part of their output beyond a very short-term horizon. After the invention of government and income, the world subdivided into various types of government and income in the West and non-West and also private predation.

The socialist path: The socialist path is consolidation and realignment of common income, denoted by black arrows.

(1) The socialist path is primarily state socialism, bouncing back and forth between clusters. The familiar example is Latin America. Much of it experienced consecutive clusters of state socialism for centuries, despite at least four major market reforms since independence from Spain in the 1820s²⁴ and a period of successful market development in Ecuador, Argentina, and Chile in the second half of the 19th century. A fascinating example is Egypt. It moved from centralized irrigation, with forced delivery of agricultural output to the government, at the age of the pyramids to franchised state socialism under Arab, Mamluk, and Ottoman Empires to the first industrial central planning under Muhammad Ali in 1805-49²⁵ to political rent-seeking after World War I to the rural-to-urban transfers (“the price scissors”) and the wholesale monopsony/monopoly after the Revolution of 1952, and, at one point in the early 1960s, approached multi-industry central planning as in Soviet Central Asia—a full circle of state socialism from Djoser to Nasser.²⁶

²³The canonical view holds this relationship invariably positive, because government and redistribution are postulated as one and the same.

²⁴Hernando De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000), p. 3 and *passim*.

²⁵Afaf Lufti Sayyid-Marsot, *Egypt in the Reign of Muhammad Ali* (Cambridge, New York: Cambridge University Press, 1984), pp. 142-185 and Fred H. Lawson, *The Social Origins of Egyptian Expansionism during the Muhammad Ali Period* (New York: Columbia University Press, 1992), pp. 90-143. For an excellent summary, see David S. Landes, *The Wealth and Poverty of Nations*, pp. 404-407 and the entry “Muhammad Ali” in *Encyclopedia Britannica*, which emphasizes the country-wide forced plantation. This case ended in 1849 and was in decline after 1837. Ironically, when Karl Marx and Frederick Engels proposed an “industrial army, especially in agriculture” in *The Communist Manifesto* in 1848, the first test had been already completed nearby, but they did not notice it.

²⁶Recently, Egypt has shed many elements of state socialism and moved significantly towards a market economy. See a sweeping treatment by Charles P. Issawi, *The Middle East Economy: Decline and Recovery. Selected Essays* (Princeton: Markus Wiener Publishers, 1995); and a broad overview in Hugh N. Kennedy, ed., *The Historiography of Islamic Egypt, 950-1800* (Leiden, Boston: Brill, 2001). Egypt, post-Communist China, and southern countries of Latin America in the second half of the 19th century testify that geography (factor endowments) and history (path dependence) are not destiny. In the past, they usually were. In modern times, the world market expanded country policy choices. Chapter 7 will explore these themes. On path dependence in history, see recent summaries by the pioneer of this idea, Paul A. David, “Why are Institutions the Carriers of History? Path Dependence and the Evolution of Conventions, Organizations and Institutions,” *Economic Dynamics and Structural Change* 5, no. 2 (1994): 205-220; “The

The empirical bouncing back and forth on the socialist path can be explained in terms of the government's decision on how to maximize its fiscal take of the share of national income. One approach is to reduce redistribution and predation in order to increase productive incentives and expand the economy—smaller squeeze, greater pie, greater tax revenue.²⁷ Reducing the tax burden to increase the tax base, which results in greater revenue over time, works at relatively moderate or low levels of redistribution and restriction. At high levels of redistribution, an alternative approach is to impose forced production under central planning—greater squeeze, greater pie, greater tax revenue. This second approach works only if additional enforcement costs are low and forced production is truly feasible. If both conditions hold, forced production may offer a larger payoff to the government than the first alternative. As we discussed in Chapter 3, forced production substitutes for voluntary productive incentives, the economy expands, and tax revenue and other gains for the government increase. One can say that the government applies cost-benefit analysis to determine which approach, market incentives or forced production, yields the highest return.

(2) The bouncing of common income between clusters does not necessarily result in state socialism. The red arrow on the map pointing southward from industrial central planning shows a different outcome, from state socialism to Enterprise Network Socialism. The result is the liberalization of common income after the abolition of central planning, but with total income redistribution intact. This is socialist devolution, in which government restriction breaks up but common income does not.

The market path: The market path is the path from state socialism to market, from governmental common income to private income. The blue arrows designate the market path. This is the path of serial breakups of common income.

(1) First, there was state-supplied slavery and state-financed colonization. They constituted government production of inputs (slaves, land, infrastructure, transportation) for private production of output. Output itself was un-rationed. This was the shift from the Neolithic rationing of output to free exchange of output in trade, while the government supplied the inputs. Figure 5.1 thus locates the extent of common income and government restriction in ancient Europe at significantly lower levels than the rest of the world for centuries to come.

(2) Second, feudalism and private serfdom removed the government from supplying inputs for agricultural production. Decentralized government, the feudal manors and the feudal network, regulated the inputs of land and labor (private serfdom) but did not produce them. This

Economics of Path Dependence in Industrial Organization,” *International Journal of Industrial Organization* 6, no. 6 (October 1997): 643-852, Special issue, Christiano Antonelli and Paul A. David, eds.

²⁷Martin C. McGuire and Mancur Olson, Jr., “The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force,” *Journal of Economic Literature* 34, no. 1 (March 1996), pp. 72-97.

differentiates feudalism from slavery. The advent of feudalism resulted in less redistribution, less government, their new interaction and different function, namely, regulation versus production of inputs.

(3) Third, the emergence of cities separated government from handicraft production, transportation, finance, and investment. The government regulated but did not produce capital inputs. This differentiates medieval European cities from ancient cities (the government supplies inputs) and Oriental cities (the government distributes output). Medieval European cities are economic entities on their own, not secondary to the government economic function.

(4) Fourth, the age of Mercantilism spelled the breakup of labor rationing (serfdom), the end of rural common income, which redistributed income from peasants to landlords, and the substitution of centralized taxation for sweeping feudal tribute. The government specialized in protection and levied taxes as payment for public service.²⁸ Protectionism, privileges, and other subsidies of mercantilism meant government regulation of output with generally free, unregulated inputs of labor, land, and capital. This development resulted in another reduction of redistribution and government restriction.

(5) Fifth, came the breakup of guilds, both by market forces of spawning rural industries and by the deliberate action of local and central governments.²⁹ This breakup created private wages and private profit.

(6) Sixth, private profit incentives fostered the movement for separable, non-confiscatory, non-redistributive public income. It ended confiscations, subsidies of colonial plantations, debt repudiations, and excessive, arbitrary taxation. Public income became the private income of the government, separate from the private income of firms and households. The government started to serve the people as a public utility—a market government, as it were. The breakup of government predation led to the Financial Revolution and private finance fueled the Industrial Revolution.³⁰

²⁸Edward Ames and Richard T. Rapp, “The Birth and Death of Taxes: A Hypothesis,” *The Journal of Economic History* 37, no. 1 (March 1977): 159-170.

²⁹On the critical role of the breakup of private guilds and the rise of rural industries as the cradle of industrialization, see Mancur Olson, *The Rise and Decline of Nations*, pp. 121-129, 147-150; Eric L. Jones, *The European Miracle: Environments, Economies, and Geopolitics in the History of Europe and Asia*, pp. 98-102; and, David S. Landes, *The Wealth and Poverty of Nations*, pp. 242-245, 546-547. This pattern of rural industrial development at the local level, on the backdrop of the decline of traditional cities, reemerges in the Township and Village Enterprises (TVEs) in post-Communist China.

³⁰We discussed this process in Chapter 4. But there was also backward bouncing from mercantilism to more state socialism. Germany and parts of Eastern Europe saw the restoration of serfdom in the 16th and 17th centuries, often in the form of state-franchised serfdom. The most conspicuous example of backward bending is the introduction of central planning of private corporations in Germany during War Socialism in 1914-18 and under the Nazi regime. The

The serial breakups of common income build the market path. Japan, the Asian Tigers, Chile, other non-European societies, and, finally, post-Communist China and Vietnam wound their way to market through their own breakups of inherited state socialism. The physical destruction of the network of the centrally planned private corporations in Germany at the end of World War II preceded Germany's return to the market path. The administrative breakup of central-plan private monopolies, *zaibatsu*, in Japan after World War II had a similar effect. The breakup point in Chile was government eradication of the network of predatory financial-industrial groups (known as *Grupos*) in 1981-82.³¹ South Korea, Thailand, and Indonesia went through a similar process after the crisis of 1997. China and Vietnam, as we discussed in previous chapters, consistently broke up the redistributive network of inherited state enterprises. In the latter instances, the government acted in a protective custodial manner by restricting the residual enterprise network from access to the income of the new-entrant market economy. China and similar countries created market economies with non-market government. This is an impossibility if seen on the one-dimensional map of market versus government, but is a normal outcome if seen on the two-dimensional map. The broken blue arrow in figure 5.1 indicates a possible path of convergence to classical market economies once the eradication of the inherited enterprise network is complete.

The government, market, and socialist paths describe economic evolution on the two-dimensional map. Apart from evolution, the red arrows indicate socialist devolutions, which are government breakdowns from various types of state socialism to predation without breakups of redistribution. The most familiar example is the collapse of the Roman Empire and subsequent brigandry across Europe. Others are incessant conquests after the Neolithic Revolution, the Thirty-Year War in Germany during 1618-1648, and protracted conflicts in Latin America and post-colonial Africa. The latest socialist devolution is Enterprise Network Socialism.

The two-dimensional map points out two key developments of human progress. The first

classic account of the origins of War Socialism is Carl Ballod, *Der Zukunftsstaat: Produktion und Konsum in Sozialstaat* (Stuttgart: Dietz, 1920). Another example was the privately-run, state-subsidized central plan colony in Java under the Dutch, which we described in Chapter 4. The Portugese Jesuits organized forced plantation communes with central planning among American Indians, amply called *reducciones*. The best known were the Guaranis in what is now Paraguay and several others in the Sao Paulo region in Brazil. See Philip Caraman, *The Lost Paradise: The Jesuit Republic in South America* (New York: Seabury Press, 1975); and, Selim Abou, *The Jesuit Republic of the Guaranis (1609-1768) and its Heritage* (New York: Crossroad Pub. Co., and Paris: UNESCO, 1997). The example which proved to make the most long-lasting influence, survived by today, was the adaptation of Spanish mercantilism, with its privilege politics, in the Latin American colonies. We depict it by the backward-bending black arrow from cluster (3) to cluster (C) in figure 5.1. In the words of Douglass C. North, "the Spanish *encomienda* system in Mexico substituted the overlordship of Spanish *encomenderos* for Aztec rulers. In return for 'protection and justice', the new rulers received tribute and forced labor." Douglass C. North, *Structure and Change in Economic History*, p. 145. For a detailed analysis see, Ernest Feder, *The Rape of the Peasantry: Latin America's Landholding System* and Andre G. Frank, *Mexican Agriculture, 1521-1630: Transformation of the Mode of Production*.

³¹James Tybout, "A Firm Level Chronicle of Financial Crises in the Southern Cone," *Journal of Development Economics* 24, no. 6 (December 1986): 371-400 and George A. Akerlof and Paul M. Romer, "Looting: The Economic Underworld of Bankruptcy for Profit," pp. 18-23, 59.

development is the invention of government (and, subsequently, income), which marked the breakup of common output. The second development is the series of breakups of common income.

Together, they form a counter-clock-wise movement from primordial predation to modern prosperity (first, the two westward-northward arrows on the map, then the blue arrows). An alternative movement comes full circle from primordial predation to agricultural central planning to franchised state socialism to industrial central planning to modern predation of Enterprise Network Socialism (first, the green arrows northeastward, then the black arrows back and forth, and, finally, the southward red arrow).

One of the key observations of Friedrich A. Hayek, now broadly recognized, is that the twentieth century saw a counter-movement. It went from market and limited government to state socialism, in the extreme, to central planning.³² Post-Communist experience in Russia and similar countries adds an extra step backwards, the devolution from central planning towards the historical archetype of non-governmental communism.

The Diagonal From State Socialism to Market as a Special Case

Examine the two-dimensional map of economic systems in figure 5.1. One can readily draw a diagonal running from central planning through various clusters of state socialism to the market economy with limited government. This diagonal represents a special case. It is unwarranted to generalize it and to infer from it that government is the only redistributive force. It is also not valid to generalize that state socialism is the only socialism, that the extent of income redistribution and government restriction are the same in every cluster, that market and government are opposites, and that liberalization always leads to market, and never to predation.

The dichotomy of market versus government and the equivalence of government with socialism grew out of this one generalization—movement from state socialism to markets with limited government. This doctrine was articulated in Marxism, which viewed nationalization and government control as the starting point of socialism. Then, in a bizarre twist in the evolution of ideas, this approach was developed by the Austrian thinkers, until it became, in recent decades, part and parcel of the canonical, one-dimensional consensus.³³ This construct gave rise to the unidimensional map:

³²Friedrich A. Hayek, *The Road to Serfdom* (Chicago: The University of Chicago Press, 1945). Chapter 4 discusses a partial comeback.

³³The World Bank, *From Plan to Market. World Development Report 1996* (New York: Oxford University Press for the World Bank, 1996). The latest restatement of this approach is in Rudiger Dornbusch, *Keys to Prosperity* (Cambridge, MA: The MIT Press, 2000). This paradigm is dominant but not universal. Mancur Olson advanced a powerful analysis which combines an opposition of market and both predatory government and private predation, and complementarity of market and what he calls “market-augmenting government.” See Mancur Olson, *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships* (New York: Basic Books, 2000). It is only a next logical step to make these premises two-dimensional.

Market economy	Government and socialism (state socialism)
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Or, empirically, and using our earlier terms for major and additional clusters:³⁴

Market economy	State socialism: Mercantilism, political state socialism, the Welfare State, feudalism, slavery, franchised state socialism, central planning
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On the one-dimensional map, state socialism means that state is socialism and socialism is state—the concepts are identical and interchangeable. On the two-dimensional map, state socialism means something different, that the government monopolizes redistribution and access to common income—a special, even though prominent and frequent, combination.

The frequency of the group that constitutes state socialism is natural. Predators benefit from scale. Predation, like violence, exhibits decreasing costs, displaces competition, and leads to a natural monopoly.³⁵ Predators either become government³⁶ or are supplanted by government, which takes over predation.³⁷ This has been the rule until the post-Communist case of the enterprise network, which subordinates the government to it. The frequency of state socialism makes it a tendency, but one that is not universal. Restrictive government is neither necessary for socialism (as exemplified by private predation and by today's Russia) nor sufficient (as exemplified by post-1978 China). State socialism stands as a special case or group of clusters.

Empirically, the one-dimensional map locates 8 out of 13 major clusters in figure 5.1. The 8 include 7 clusters of state socialism and one of market. The one-dimensional map misses prehistoric societies with their development of government and the Neolithic Revolution. Prehistoric economies do not fit the one-

³⁴This is a composite representation of economic systems and their empirical examples found across the literature under these and different names. For summaries, see John Hicks, *A Theory of Economic History*, pp. 9-34; Frederick C. Lane, *Profits from Power: Readings in Protection Rent and Violence-Controlling Enterprises*, pp. 5-7, 50-65; Manuel Gottlieb, *A Theory of Economic Systems*, pp. 31-184; Manuel Gottlieb, *Comparative Economic Systems: Preindustrial and Modern Cluster Studies* (Ames, IO: Iowa State University Press, 1988); Robert E. Hall and Charles I. Jones, "The Productivity of Nations," National Bureau of Economic Research, *Working Paper 5812* (November 1996), pp. 18-21, 28-29; Immanuel Maurice Wallerstein, *The Modern World-System*, vols. 1-3 (New York: Academic Press, 1974-1989); and, Graeme Donald Snooks, *The Ephemeral Civilization: Exploding the Myth of Social Evolution* (London and New York: Routledge, 1997), pp. 56-59.

³⁵See Douglass C. North and Robert P. Thomas, *The Rise of the Western World*, pp. 6-8, 94. For a most elaborate analysis, see Frederick C. Lane, *Profits from Power: Readings in Protection Rent and Violence-Controlling Enterprises*.

³⁶Mancur Olson emphasizes this outcome in his *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships*.

³⁷Frederick C. Lane emphasizes this outcome in his *Profits from Power: Readings in Protection Rent and Violence-Controlling Enterprises*.

dimensional diagonal because primordial redistribution was greater than the scope of government rationing. The unidimensional map further misses non-governmental, private predation. Yet, until modern times and even recently in some parts of the world, private predation constituted the bulk of human economic enterprise. For millenniums, civilizations were like islands in the ocean of conquests, brigandry, and plunder. A high degree of redistribution coupled with the absence of any effective government generally resulted in non-state socialism. Clusters are not equal in scope over time and space. By missing private predation, the unidimensional map misses more than half of human experience counted in man-years.

Most importantly for our study, the unidimensional map rules out the entire realm of post-central plan economies. It cannot include a market economy under the aegis of a restrictive government such as China and similar countries where government serves the function of protective custody. The one-dimensional map automatically excludes Enterprise Network Socialism in Russia and similar countries with universal redistribution of income and symbiont government. Nor can Eastern European and other post-Communist countries, which combine features of Russia and China, fit the one-dimensional map.

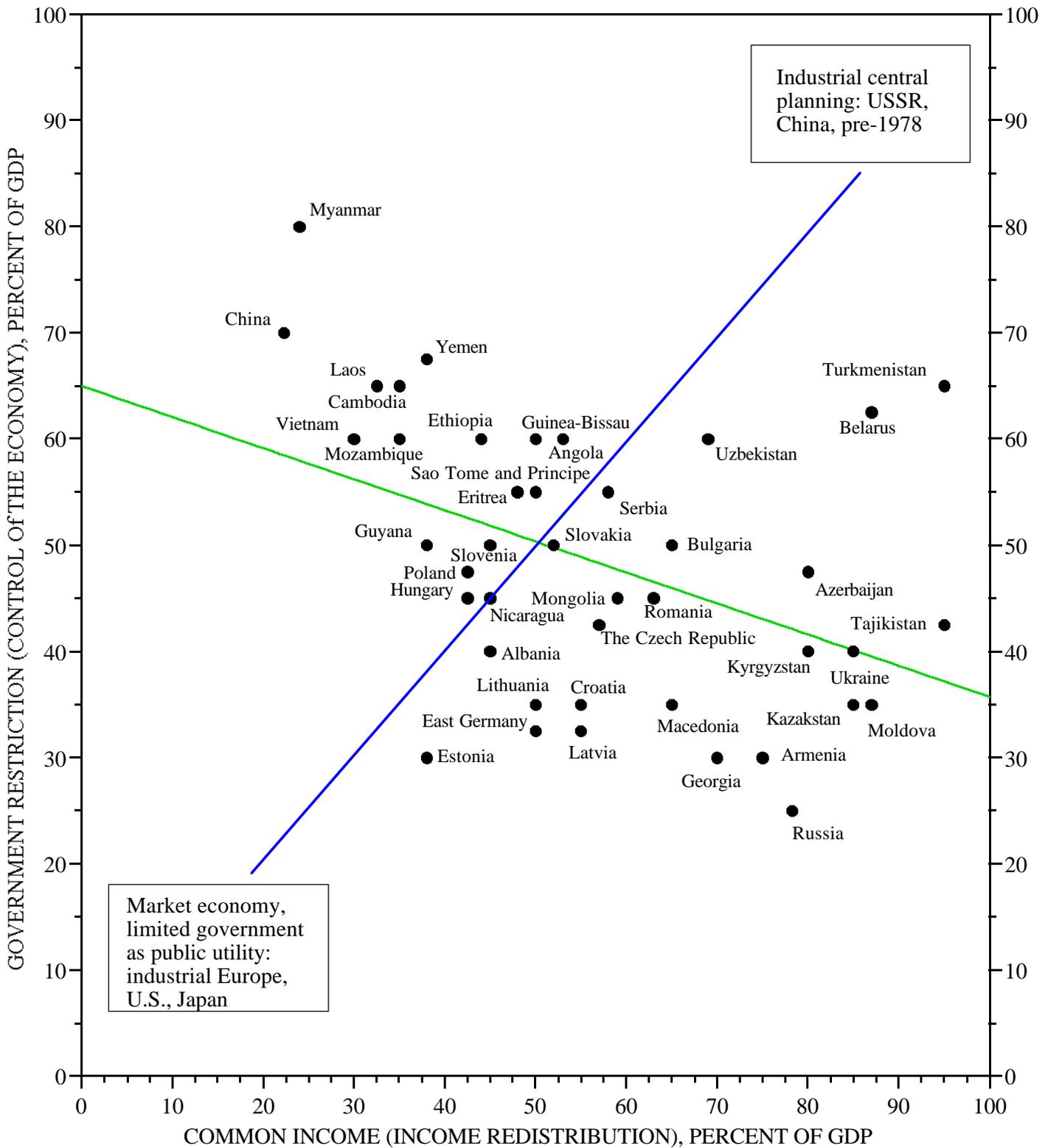
Figure 5.2 plots data on 42 post-Communist economies in the mid-1990s. It displays that the entire post-Communist development occurs on the green-colored diagonal, which is opposite in direction from the blue-colored diagonal of state socialism. For reference and comparison with figure 5.1, we copied the two extreme clusters. Industrial central planning is placed in the northeastern corner and classical market economies in the southwestern corner of the map.

The horizontal axis in figure 5.2 measures the share of income redistribution in GDP. It retrieves the data on private income in figure 2.1, but recalculates the figures to express shares in terms of common income (thus, 77.8 percent private income in China's GDP becomes 22.2 percent common income and 21.8 percent private income in Russia's GDP becomes 78.2 percent common income). Following the method applied in Chapter 2, income redistribution is approximated by the output of the inherited enterprise network, which is calculated as the difference between total output and the output of the new entrant and other independent enterprises outside the network. The vertical axis provides rough estimates of government restriction as a share of GDP.

In contrast with generating reasonably confident percentages on income redistribution, we did not develop a reliable method of quantifying government restriction on the basis of published statistics. Instead, we resort to crude approximations using statistics on the government share of income redistribution and various qualitative, descriptive accounts of government control over the rest of the economy. Our estimates of government restriction may be inaccurate by as much as 10-15 percentage points for many countries. The greatest weakness is an overestimate of government restriction in resource-rich Central Asian countries and Azerbaijan. The government ostensibly controls energy and other resource production and exports, but, in reality, the enterprise network is in charge and the government is a symbiont, as in Russia. We chose to err on the side of the government, not on the side of the redistributive enterprise network, which weakens the negative correlation between them, and flattens the slope of the green-colored diagonal. Various alternative tests with possible adjustments of our estimates affect only the slope of the negative

FIGURE 5.2

INTERACTION OF INCOME REDISTRIBUTION AND GOVERNMENT RESTRICTION IN POST-COMMUNIST ECONOMIES, 42 COUNTRIES, MID-1990s



Sources:
 Common income: Calculated by the authors from national official statistics, The Economist Intelligence Unit, and national sources.
 The data on East Germany refers to 1994 when major industrial enterprises, which produced at least half of GDP, were subsidized by the Ministry of Privatization.
 Government restriction (control over the economy): Estimated by the authors from national official statistics, other national sources, annual and semi-annual reports of the IMF and the World Bank, IMF country reports, international non-governmental publications, especially Transparency International's *The TI Source Book* and Economist Intelligence Unit's *Country Profiles*, and descriptive literature, especially Ian Jeffries, *Socialist Economies and the Transition to the Market: A Guide* (New York: Routledge, 1993)

relationship between income redistribution and government restriction. They do not change the negative sign of the correlation or reverse the direction of the green-colored post-Communist diagonal.

To explain this empirical finding, recall the discussion in the policy section of Chapter 4. We surveyed evidence that the development of private income after central planning depends on the breakup of common income, which requires government restriction of the residual enterprise network. This implies a positive relationship between private income and government restriction, or a negative correlation between income redistribution and government restriction. To put it plainly, the more government restricts the enterprise network, the less income redistribution. In this regard, more government results in less socialism. Figure 5.2 shows this correlation. The correlation is weak (R^2 is about 0.2) but it is there.

The negative correlation between government restriction and common income creates the northwestern-southeastern diagonal on the two-dimensional map. Along this diagonal lie most post-Communist economies. One can observe a diagonal cross on the two-dimensional map in figure 5.2. The green post-Communist diagonal of the trade-off between redistribution and restriction, the diagonal running from China to Russia, crosses the blue diagonal of the positive relationship between redistribution and restriction, diagramed in the northeastern-southwestern direction from state socialism to the market economy with limited government.

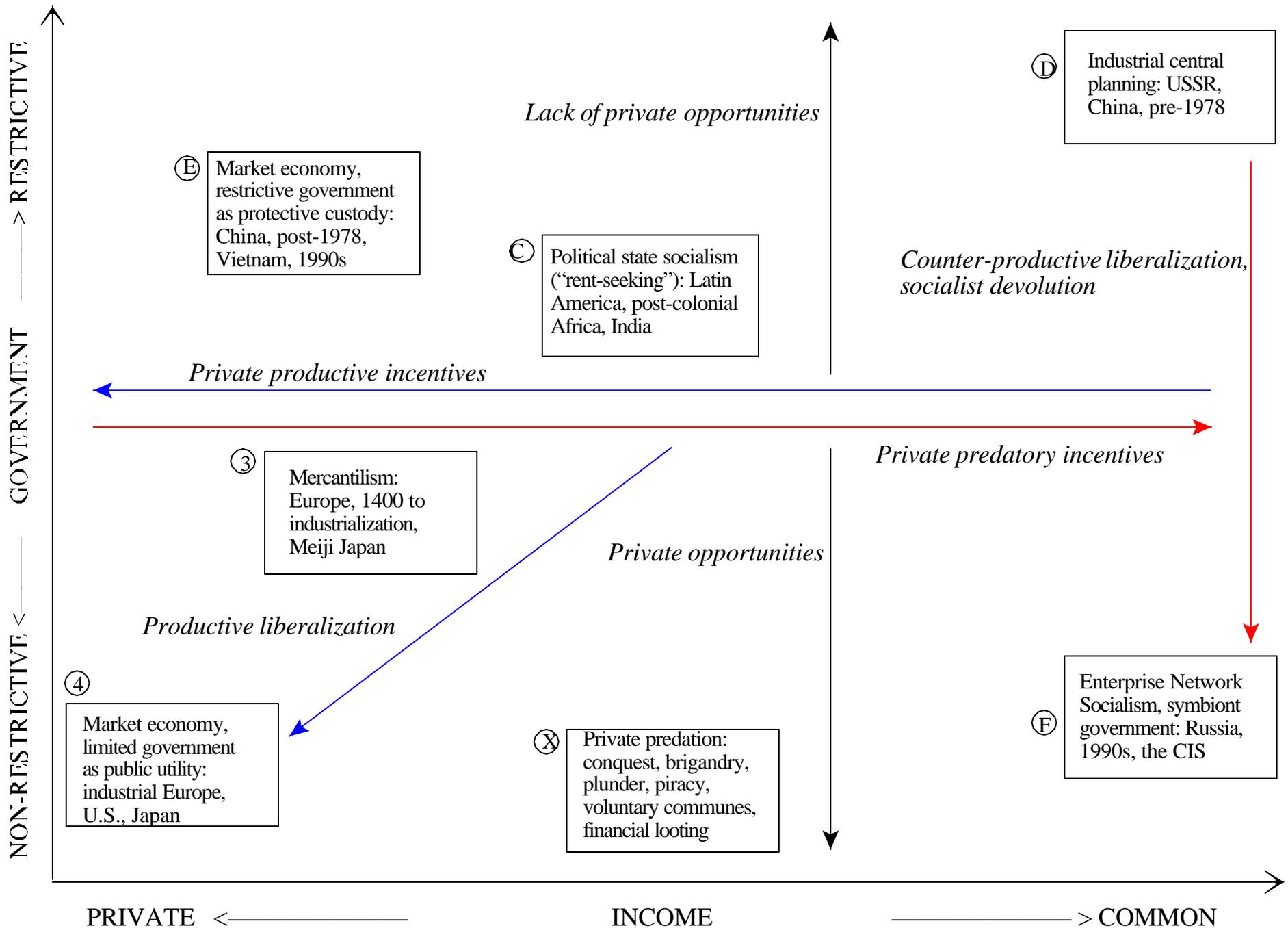
Even on its own turf, the diagonal of the special path from state socialism to market obscures more than it reveals. Specific empirical clusters of state socialism are packed together, each with about the same scope of socialism and government. In addition, there is considerable overlap among clusters lying along or adjacent to the diagonal. Ancient European slavery overlaps medieval and pre-modern non-Western franchised state socialism. Medieval European feudalism overlaps political state socialism in modern non-Western countries. Ancient European slavery and modern non-Western state socialism overlay as equidistant clusters. Collapsing all clusters into one dimension loses all global and historical distinctions. The patterns and paths of major empirical developments are lost. The breakups of common income are lost. The bouncing back and forth of state socialism is lost. The origin of the market economy is lost. The evolution of economic systems is lost.

Productive Liberalization as a Special Path

In the unidimensional framework, liberalization invariably leads to market. On the two-dimensional map, the breakups of common income build up the market path. Liberalization leads to market only if it is preceded or accompanied by the comprehensive breakup of common income. This is a special path of productive liberalization. It enhances private productive incentives with increased private opportunities. This was the historical case in England in the 18th century and, later, in other market economies. Figure 5.3, building on figure 5.1, depicts productive liberalization with a diagonal blue arrow.

If common income is entrenched, liberalization creates socialist devolution. The combination leaves income redistribution intact, reduces government restriction, diverts private opportunities to predatory

FIGURE 5.3. PRODUCTIVE LIBERALIZATION AND SOCIALIST DEVOLUTION



activities, and releases counter-productive incentives of predatory networks. Chapters 1 and 2 discussed in detail how public income and all incomes in Russia and similar countries became free goods open to common access. Liberalization without separation of incomes turns economic liberty into open access to common income, a free-for-all. Figure 5.3 depicts this counter-productive liberalization after central planning with a red arrow. Similar devolutions can occur after liberalization of other systems of state socialism. Liberal socialism can be as predatory as state socialism before it, and as much distant from a market economy.

Drawing on our previous discussion in Chapters 1 through 4, figure 5.3 puts productive liberalization and socialist devolution in the two-dimensional structure. Private income is the core of private productive incentives. The blue arrow of productive incentives goes from common to private income on the income dimension. Conversely, the red arrow of private predatory, redistributive incentives runs from private to common income. On the government dimension, government restriction reduces private opportunities, while less restriction increases private opportunities. Vertical black arrows depict these directions. It is the two-dimensional combination that matters. Private opportunities can realize only the prevailing incentives, which may be productive or predatory. Figure 5.3 shows the two-dimensional intersection, the cross of private incentives and private opportunities, and the resulting variety of liberalizations.

- # The diagonal of productive liberalization combines the maximum of private productive incentives and private opportunities.
- # Private productive incentives develop in China with limited liberalization and with restricted private opportunities, after the major breakup of common income and control of the residual enterprise network.
- # The drop-down line of socialist devolution, of counter-productive liberalization in Russia without the breakup of common income, descends from central planning to Enterprise Network Socialism.

China's policy freed the economy from income redistribution. Russia's policy freed the economy from government restriction. The classical market economies in the 18th century and thereafter were freed from both. The latter, special path of productive liberalization combines both freedoms on both dimensions. But the unidimensional idea of liberalization either takes freedom from redistribution for granted (if the government is the only redistributive force, liberalization automatically ends redistribution), or assumes it away. It generalizes the special case.

This unwarranted generalization of a special path leads to counter-productive policies. The triad of stabilization, liberalization, and privatization (SLiP), which has become the staple policy of recent decades, can succeed only as a special case. In fact, it is a special case of a special case, namely, the application of broadly defined liberalization to the era of fiat money. The SLiP triad worked most successfully in Great Britain in the late 1970s and 1980s at the time of Prime Minister Margaret Thatcher.

Although Great Britain was a highly expansive Welfare State, with numerous producer and consumer subsidies, the core of its economy was based on private income. Liberalization and privatization in the Welfare State cut subsidies and curtailed segments of common income on the redistributive periphery. These segments of income redistribution are the essence of the Welfare State. When SLiP was applied in the 1980s and 1990s to developing countries, which can be characterized as political state socialism (“rent-seeking”), it proved to be much harder to achieve sustained stabilization and sustained economic growth. Liberalization and privatization in much of Latin America and similar regions have been less productive than expected, and financial stabilization, unsustainable. Regarding this experience, Hernando de Soto chose a damning book subtitle: “Why capitalism triumphs in the West and fails everywhere else.”³⁸

Under SLiP, deep-rooted redistributive networks evolved to replace old subsidies with new ones, sometimes on a larger scale. Examples include financial looting in Chile in the late 1970s-early 1980s until the government broke up the financial-industrial groups, the patronage system in Indonesia which exploded in 1997, sectoral subsidies in Brazil in the late 1990s, regional subsidies in Argentina, which resumed its economic crisis in 2000, and in many similar cases around the world.

Even worse outcomes evolved after the abolition of central planning. We discussed in detail in Chapters 2 and 4 how SLiP invariably failed in post-Communist countries and how success was dependent on the policies of breaking up the inherited enterprise network. Some of these policies liberalized markets for new-entrant firms. Other policies were illiberal, reinforcing government control over preexisting enterprises and restricting the links between the old and new sectors in the two-track economy. Illiberal policies may have limited private economic opportunities, but they had the beneficial effect of preventing predatory devolution. Post-Communist experience demonstrates the two-dimensional trade-offs between freedom from redistribution and freedom from restriction.

Two-Dimensional Liberty and Its Trade-Offs

Russia and China illustrate the idea which could have transpired from historical experience, namely, that economic liberty is two dimensional. One dimension is freedom from redistribution and the other is freedom from government restriction.³⁹ Liberalization, in contrast, is one-dimensional. It is only freedom from

³⁸Hernando De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*.

³⁹More precisely, liberty is at least two-dimensional. To go beyond the two dimensions, confiscation of property, such as capital and financial assets, limits one more liberty, and there are others. David Friedman sums it up: “Freedom is multi-dimensional because there are many different things with regard to which you can be free, and there is no natural way of comparing them, of adding them up to give one number. So you have what mathematicians call a partial ordering of societies by how free they are. If country A has a certain amount of freedom in each dimension and country B has as much freedom in some dimensions and more in others, then we can say that B is freer than A. But if country B has more of some freedoms and less of others, then B and A are incomparable, and that will often be the case.” In Walter E. Block, ed., *Economic Freedom: Toward a Theory of Measurement. Proceedings of an International*

government restriction. If both freedoms develop in tandem, liberalization is productive. If not, liberalization releases redistribution from government monopoly and opens the redistribution of resources and income to common access. Once government control vanishes, predatory, redistributive networks of enterprises and other economic participants are free to confiscate output and income from all members of the community.

The practical problem is that the two freedoms cannot work in tandem to achieve productive liberalization unless the breakup of common income has already been attained to a significant degree. This precondition existed in England in the 18th century. It did not, indeed cannot, exist at the time of the dissolution of central planning. This means that trade-offs exist between the two freedoms, resulting in trade-offs between private productive incentives and private opportunities. Consider the Chinese and Russian examples.

The Chinese case (cluster E) entails more breakup of common income, more de-socialization, more freedom from redistribution, but less liberalization. Private productive incentives increase, but there are reduced private opportunities and temporary preservation of strong government controls.

The Russian case (cluster F) entails more liberalization, less freedom from redistribution, more non-governmental predation, resulting in socialist devolution. Private opportunities increase, but counter-productive incentives divert them to predation and cause contraction.

The trade-offs mean that we ask the two-dimensional, not the one-dimensional, questions. The two-dimensional questions are, first, does government interference reduce or increase redistribution and by how much, and secondly, does liberalization reduce or increase redistribution. In contrast, the one-dimensional question is only if government interferes and how much.

As a general rule, the greater the extent of common income, the greater the initial distance from the market, and the more that redistributive forces are entrenched in the economy, the less that liberalization is initially warranted. Two simple conclusions follow, especially applicable to China and Russia.

1. In successful historical and contemporary economies, the more extensive the degree of common income, the more its breakup preceded or accompanied liberalization.
2. If redistribution did not decline before or together with government restriction, new private opportunities turned into access to preexisting common income. Open access to inherited common income led to private and network predation within the pre-existing scope of redistribution.

Symposium (Vancouver, B.C.: The Fraser Institute, 1991), p. 46. One correction: countries B and A are comparable multi-dimensionally if their position on each dimension is measured separately and a comparison includes two or more measurements independently.

(Chapter 5, Section B follows)