

## INSULATING ECONOMICS FROM POLITICS: TOWARD A CONSTITUTION OF LIBERTY

*James A. Dorn*

You cannot change the form of property without changing the form of power. . . . [I]n Communist countries the economy, in the final analysis, is the means of politics. The economy is ruled and controlled by politics. You must change the political system first, because it is a tyrannical regime without respect for laws.

—Milovan Djilas<sup>1</sup>

### Some Basic Questions

Can economic life be insulated from political life? And, if so, why has this separation not occurred in the Soviet Union, or even fully in the United States? To address these questions, one must first define “economic life” and then consider how it can be insulated from political life.

For our purposes, economic life can be thought of as the process of making choices in a world of scarcity where some form of competition takes place to determine “who gets what.” The problem of economic life, in essence, is a problem of pricing and property (Alchian 1967, p. 6). Consequently, the answer to the question of whether economic life can be insulated from political life hinges on the question of whether pricing and property can be insulated from politics, or more specifically, whether constitutional constraints can be implemented and maintained to limit the range of political action as it affects economic liberties. These questions were fundamental to the 18th-century American Revolution and are at the heart of the liberal revolution that is sweeping Eastern and Central Europe as well as the Soviet Union.

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The author is Vice President for Academic Affairs at the Cato Institute and Professor of Economics at Towson State University.

<sup>1</sup>Cited in Hornik (1990, p. 18).

## Competing Visions

The choice of the property rights regime and the choice of the political/constitutional regime depend on ideology, that is, on how one views the role of the market and government in organizing economic life. Two competing visions can be discerned: (1) the liberal vision that traces back to Adam Smith and other classical liberals, and (2) the socialist vision that is associated with Karl Marx and Vladimir Lenin.<sup>2</sup> Let us briefly examine each of these visions and consider their implications for insulating economic from political life.

### *The Liberal Vision*

The key feature of the liberal vision is that economic and social order will emerge spontaneously when individuals are free to choose and when property rights are protected by law. Such a vision takes individual self-interest as a given. The institutions of private property and government by law are then added to ensure that self-interest is compatible with the rights of persons and property.

Experience has shown that the wealth of a nation is best advanced when markets are free and when government is instituted primarily to protect persons and property. That government should be so limited was taken for granted by the framers of the U.S. Constitution. James Madison ([1829] 1865, p. 51), the "chief architect" of the Constitution, wrote:

It is sufficiently obvious, that persons and property are the two great subjects on which Governments are to act; and that the rights of persons, and the rights of property, are the objects for the protection of which Government was instituted.

When individuals know the bounds of government and are free to trade, they will be able to use their knowledge and skills to gain material advantage in a *mutually* beneficial way.

In the liberal vision, economic life is effectively insulated from the state by a "constitution of liberty," to use F. A. Hayek's expression (Hayek 1960). Such a constitution limits the range of democratic/majoritarian rule, protects property rights, and lays the basis for a spontaneous market order. In this "system of natural liberty," as Adam Smith ([1776] 1937, p. 651) called it, the private market system generates rational prices and coordinates individual plans. Since individuals are held accountable for their use of scarce resources, there will be an incentive for resources to move to their highest

<sup>2</sup>For a more detailed discussion of these competing visions, see Brunner (1983) and Sowell (1987).

valued uses. Enterprises that ignore consumers' preferences will not survive; consumers, not planners, are sovereign.

Classical liberals see a just government as one that provides equal protection under the law so that private rights to "life, liberty, and property" are secure. It is in this sense that Thomas Jefferson ([1801] 1989, pp. 15–16), one of America's greatest liberals, wrote:

A wise and frugal government, which shall restrain men from injuring one another, which shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government.

When the state steps away from its primary function of protecting property and begins to take property for redistribution at will, the character of the state drastically changes—from that of protector to that of predator. The further this process is carried, the greater will be the politicization of economic life. In the United States, the economic clauses of the Constitution—protecting property rights, contractual freedom, and interstate trade—have been seriously eroded (Niskanen 1988). Since the late 1930s, the Supreme Court has not afforded economic liberties the same protection under the law as other liberties, such as freedom of speech and freedom of religion (Pilon 1987). Activist legislatures have taken the signal and opened the door for all sorts of direct and indirect transfers.<sup>3</sup> In the process, government has grown to a point that would shock the Founding Fathers.<sup>4</sup>

The heavy tax, regulatory, and debt burdens that accompany the modern welfare state have hampered the market's wealth-creating potential and stifled economic life. Even so, the U.S. Constitution and Bill of Rights, though eroded, have constrained government and allowed the market system to survive. No such constraints, however, are present in the Soviet system, where the Communist party has held a monopoly over both political and economic life.

Thus, unlike the United States, the Soviet Union is characterized by virtually total politicization of economic life. Larissa Piyasheva (1991, pp. 281–82) has brought this point out well:

The causes of the present-day inefficiency of our economy are rooted not in the poor diligence of our people, not in their sloth or indolence, drunkenness or truancy. . . . The causes reside else-

<sup>3</sup>Government transfer payments have risen from less than 1 percent of GNP in 1929 to about 12 percent in 1991. Federal transfer payments accounted for 40 percent of federal outlays in fiscal 1991. For a discussion of the rise of the so-called transfer society, see Dorn (1986).

<sup>4</sup>In fiscal 1991, total government spending in the United States amounted to about 42 percent of national income.

where—in the fabric of our economic life subordinated to political goals. . . . The trouble is that our economy does not serve its main purpose and designation—to feed people and make their life comfortable. It is pegged to politics, to political power.

Likewise, Alexei Yemelyanov (1991, p. 270) argues,

Under the authoritarian regime that prevailed in the USSR, politics always took precedence over economics. Political democratization defines the limits of the democratization of economic life.

### *The Marxist-Leninist Vision*

For more than 70 years, the Soviet Union has been dominated by one world view, that of Marx and Lenin. According to the Marxist-Leninist vision, the state, not the individual, is sovereign. Property and resources are concentrated in the state, and individual rights lose their meaning. Consequently, under socialism, all economic decisions become political decisions. Those in power, for example, can set below-market prices and then ration goods via nonprice competition. “Who gets what” will be determined not solely by the prices individuals are willing to pay but also by proximity to those controlling the political-economic hierarchy (Alchian 1967, pp. 13–14; Cheung 1990, pp. 27–28).

In the Marxist-Leninist vision, the first step toward communism is to abolish private property. Thereafter, the Communist party’s task is to keep tight control over political, economic, and social life. During the transition to communism, the state is to wither away until, in the end, everyone is to be free from the state and free from want. In reality, without private property, the Soviet state has grown and material progress has languished.

Under socialism, which is the first stage of communism, the state becomes more, not less, powerful. Without effective private property rights and a rule of law, there is nothing to limit government discretion, nor is there any automatic feedback mechanism to make individuals responsive to changes in economic conditions. Without the ability to capture rewards from efficient management of resources or to bear responsibility for inefficient use, socialist managers will trade off the wealth of their firms for personal gain whenever possible. As such, corruption will be a constant problem under state ownership.

The absence of a profit-loss test and the lack of bankruptcy as a tool of discipline mean that socialist managers will not feel the competitive pressure to respond to consumers’ preferences. As Nikolay Shmelyov (1987) stated, “The basic vice of our current economic system is the total irresponsibility of the upper levels of the pyramid, the absence of any ‘feedback’ from below.”

Under state ownership, risk is socialized and individuals have little incentive to maintain either their human or nonhuman capital. Without a real set of markets and prices, adjustments to changing economic conditions must occur through the bureaucracy. The rigid nature of central planning and control means that the adjustment process under socialism will be sluggish at best. Errors will accumulate and cracks in the economic landscape will widen until the time of total collapse. The only way to release the pressure and remove the distortions is to make a clear and radical shift toward a private market system—something planners have little incentive to do.

Given the lack of private property rights and the attenuation of individual freedom under socialism, it is no surprise that the Marxist-Leninist vision has led to a growing role for the state and an ossified, rather than spontaneous, economic order. “During 70 years of socialist experimentation in Russia,” writes Alexander Tsypko (1991, p. 290), “not one major problem that the country was facing in 1917 has been solved.”

The reality of the failed socialist experiment contrasts sharply with the vision of Lenin ([1917] 1963, p. 418), who proclaimed: “We have a right to say, with the fullest confidence, that the exploitation of the capitalists will inevitably result in a gigantic development of the productive forces of human society.”

The problem with the Marxist-Leninist vision is that it clashes with the reality of scarcity and ends up destroying the very institutions—property and contract—that are the basis of civil society and material progress. It is wishful thinking to believe that the economic problem of society can be solved in a satisfactory manner when freedom of choice and equal protection under the law are absent.

### A Constitution of Liberty

The politicization of economic life under socialism means that economic reform requires political reform or, more correctly, constitutional reform. To insulate economic life from political life requires a constitution of liberty—a constitution that protects private property and provides for equal freedom (not equal outcomes) under a rule of law.

In the transition from socialism to market liberalism, therefore, one can benefit from the advice of Adam Smith ([1759] 1976, pp. 380–81), who warned against the “man of system” and the politicization of economic life:

The man of system . . . seems to imagine that he can arrange the different members of a great society with as much ease as the hand

arranges the different pieces upon a chessboard; he does not consider that the pieces upon the chessboard have no other principle of motion besides that which the hand impresses upon them; but that, in the great chessboard of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature [or central planning agency] might choose to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously, and is very likely to be happy and successful. If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder.

The post-Soviet challenge is to accept the idea of spontaneous order and to adopt a constitution of liberty that will set the framework for a free-market system. The transition from plan to market, therefore, requires discarding the ideological baggage that has hampered clear thinking about the role of private property rights in insulating economic life from political life.

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## REVITALIZATION OF SOCIALISM OR RESTORATION OF CAPITALISM?

*Alexander Tsypko*

### The Myth of Convergence

The ideology of reconciliation and the combination of communist and traditional, so-called capitalist, forms of production and society have proved virtually bankrupt. It is obvious without any experiment that convergence (merging what we called “socialism” and what was the stuff of our lives with the characteristic features of the developed Western countries) is impossible in principle. The idea of converging the two systems was a reflection less of the needs of the development of human civilization than of the despair of common sense, as the peoples of Russia and Eastern Europe lost all hope that they would be able to end totalitarianism by themselves. Hence, we arrive at the pessimistic prognosis about the long-term historical interaction of Western democracies and left-wing totalitarian régimes. We also find the concessions of Western theoretical thinking, the tendency to mythologize our achievements in planning and centralizing industry, and the forgetting of the basic truth that only efficient production can be efficiently regulated. We forget that Soviet centralism, based on fear, was essentially impossible to reproduce in different political and cultural circumstances. Fire and ice cannot be put together. The fire will melt the ice, and the water from the melting ice will put out the fire. And there will be neither fire nor ice.

Even before perestroika, before our attempts during the past five years to revive Soviet industrial and social structures with the help of borrowed economic mechanisms that we spied on the other side of the fence, we could have predicted the groundlessness of these hopes to reconcile the irreconcilable.

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The author is Professor of Philosophy at Moscow State University.