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Paul R. Gregory

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## I

## The Jockey or the Horse?

The Soviet administrative-command economy was the most important social and economic experiment of the twentieth century. Its failure continues to reverberate throughout those countries in Europe, Asia, and Latin America that adopted it, either forcibly or voluntarily. Its symbolic end dates to December 25, 1991, when the flag of the once-powerful Soviet Union was lowered over the Kremlin and replaced by that of the Russian Federation. The abandonment of the administrative-command economy began in the late 1980s in Central and Southern Europe, spread throughout the fifteen Soviet republics with the collapse of the USSR, and expanded into Asia.<sup>1</sup> The former administrative-command economies have had to confront their pasts as they make their transitions to market economies. Empirical studies show that the heavier the imprint of the administrative-command system, the more difficult has been the transition.<sup>2</sup>

The administrative-command economy was formed without a theoretical blueprint in the 1930s by a small coterie of revolutionaries with little or no economic or administrative experience. Their first experiment,

<sup>1</sup> China, of course, had begun a major reform of its former administrative-command economy in 1979.

<sup>2</sup> Robert Stuart and Christina Panayotopoulou, "Decline and Recovery in Transition Economies: The Impact of Initial Conditions," *Post-Soviet Geography and Economics* 40, no. 4 (1999): 267–80; James Millar, "The Importance of Initial Conditions in Economic Transitions: An Evaluation of Economic Reform Progress in Russia," *Journal of Socio-Economics* 26, no. 4 (1997): 359–81; Gary Krueger and Marek Ciolko, "A Note on Initial Conditions and Liberalization During Transition," *Journal of Comparative Economics* 1, no. 4 (December 1998): 718–34.

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called War Communism, was motivated by ideology but later blamed on wartime emergency; it caused a severe economic collapse, and a retreat was sounded to the mixed economy of the New Economic Policy (NEP). After resolution of a brutal power struggle over the succession to Lenin's mantle, the victorious Stalin and his allies embarked in 1929 on a course of rapid industrialization and forced collectivization, which required the creation of a new command system. This "Team Stalin" had fashioned, by the mid-1930s, an economy of full state ownership run by administrative resource allocation. As Stalin consolidated power, the team carried less weight than did Stalin the dictator, but they remained important cogs in the economic administration. Planning was carried out primarily by the State Planning Commission (Gosplan), but production was the responsibility of industrial ministries, which managed state enterprises and collective farms. The Soviet state was a close amalgam of the Politburo of the Communist Party and the Council of People's Commissars, the highest state body. This "administrative-command system," to use the pejorative term later coined by Mikhail Gorbachev, remained remarkably unchanged until its final collapse.

### Blame the Jockey or the Horse?

Some contend that the Soviet system was doomed from the start. Ludwig von Mises and F. A. Hayek, in their classic critique of planned socialism written in the 1920s and 1940s, outlined the system's many Achilles' heels.<sup>3</sup> They contended that socialism would fail in the end. Lacking markets, there could be no rational economic calculation, and no economy can function if it does not know what is abundant and what is scarce. With state ownership, there would be little incentive to use resources rationally, and even dedicated state managers would be left without operating rules. A central planning board, charged with managing an entire economy, would find itself overwhelmed by the complexity of planning. In a word, Hayek and Mises insisted on the inevitable unfeasibility of planned socialism – the first prognosticators of its collapse. At best, the system would operate at low levels of efficiency and would clearly be inferior to market economies. The contemporary literature on the inefficiency of

<sup>3</sup> Ludwig Mises, *Socialism: An Economic and Sociological Analysis*, trans. J. Kahane (London: Jonathyn Cape Ltd., 1936); F. A. Hayek, "The Use of Knowledge in Society," *American Economic Review* 35 (1945): 510–50; F. A. Hayek, "Socialist Calculation: The Competitive Solution," *Economica*, n.s., 7 (May 1940): 125–49.

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bureaucratic governance of state enterprises validates Hayek and Mises's conclusions, especially given that, in the Soviet case, the public sector encompassed the entire economy.<sup>4</sup>

Contemporary defenders of the administrative-command economy, however, argue that the Soviet system, which transformed Russia from backwardness to industrial power, failed because of *inept policies* and *incompetent administrators*, not because of its fundamental flaws. They cite that, up to its end, the Soviet economic system was not unpopular among the citizenry and that most Soviet officials and Western experts felt that the status quo could have been continued, albeit at relatively low rates of growth.<sup>5</sup> Advocates also argue that if only someone other than Stalin had won the power struggle or if policy mistakes had been avoided, the system's soundness would have been demonstrated.

The worldwide appeal of Marxism, communism, or the Radical Left remains remarkably unaffected by the collapse of communism.<sup>6</sup> Some avoid the implications of the collapse entirely by arguing that the Soviet Union and Eastern Europe were simply "posing as 'socialist' or 'command' economies"<sup>7</sup> and were "tragic or misunderstood embodiments of good intentions."<sup>8</sup> Leading leftist intellectuals argue that "the tragic abortive attempt [in the former Soviet Union] proves nothing about the impossibility . . . of building socialism." And "Marxist thought becomes even more relevant after the collapse of communism in the Soviet Union and Eastern Europe than it was before."<sup>9</sup> Although contemporary socialists focus on the coming crisis of capitalism, they do little to explain how a "new" communist system would work differently. Some advance a pragmatic market socialism, which will avoid dictatorship and use

<sup>4</sup> W. A. Niskanen, *Bureaucracy and Public Economics* (Aldershot, England: Edward Elgar, 1994); W. A. Niskanen, *Public Analysis and Public Choice* (Cheltenham, England: Edward Elgar, 1998).

<sup>5</sup> This is the conclusion reached based on interviews with former Soviet officials and advisors in Michael Ellman and Vladimir Kontorovich, *The Destruction of the Soviet Economic System* (Armonk, New York: Sharpe, 1998), 3–29.

<sup>6</sup> Currently, there are more than five hundred leftist parties of different persuasions in Europe alone, with the numbers of leftist parties in France and Italy exceeding one hundred each. Argentina and Brazil have nearly fifty leftist parties each, and the number of parties of the left appears to grow each month according to [www.broadleft.com](http://www.broadleft.com).

<sup>7</sup> Platform of the International Bureau of the Revolutionary Party, available from <http://www.geocities.com/leftcom.html>.

<sup>8</sup> Paul Hollander, "Which God Has Failed," *The New Criterion* on Line, April 15, 2002, p. 2; available from [www.newcriterion.com](http://www.newcriterion.com).

<sup>9</sup> Statements of Daniel Singer, Cornel West, and John Cassidy cited in Hollander, "Which God Has Failed."

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market forces, but preserve state ownership.<sup>10</sup> The continued appeal of the communist system is easy to understand. It promises fairness and the elimination of the anarchy of the market – business cycles, poverty, unemployment, inflation, and currency crises. To those living in poor countries, this is a powerful message. The Bolshevik leadership promised to create such a fair, prosperous, and orderly system in 1917. They had some sixty years to deliver on this promise. How and why they went wrong cannot be ignored; it is one of the most significant questions of history.

The late Joseph Berliner used an analogy to characterize the debate.<sup>11</sup> Did the administrative-command economy fail because of a bad jockey or a bad horse? If it had been directed by smarter leaders, would it have been a success, or were Mises and Hayek correct that the system's collapse was inevitable? This book seeks to answer Berliner's jockey or horse question.

This book describes the first two and a half decades of the world's first administrative-command economy, under the tutelage of an increasingly brutal dictatorship. The Soviet command system remains the most complex organization ever constructed by mankind. How it really operated was kept from public view by pervasive secrecy. Official Soviet writings emphasized the fable of "scientific planning," a mythical economy run according to harmonious mathematical balances prepared by omniscient planners and executed by selfless producers. Throughout the Soviet period, we lacked open records, candid memoirs of officials, and a free press to inform us how and how well the system operated. We had to rely on a controlled press and a muzzled statistical office, émigré interviews, and rare serendipitous behind-the-scenes glimpses of the system's workings.<sup>12</sup> The published Soviet literature permitted only tantalizing hints of massive "political-economy-type" negotiations, strategic behavior, and

<sup>10</sup> James Junker, *Socialism Revised and Modernized: The Case for Pragmatic Market Socialism* (New York: Praeger, 1992).

<sup>11</sup> Joseph Berliner, "Soviet Initial Conditions: How They Have Affected Russian Transition," paper presented at the International Conference sponsored by Moscow University, Harvard Davis Center, and University of Houston International Economics Program, entitled "Soviet Economy in the 1930s–1970s," Zvenigorod, Russia, June 22–24, 2001.

<sup>12</sup> Joseph Berliner, "The Contribution of the Soviet Archives," in Paul Gregory (ed.), *Behind the Facade of Stalin's Command Economy* (Stanford, Calif.: Hoover Institution Press, 2001), 1–10. The most notable émigré research projects were the famous Harvard Interview Project of the 1950s and the Soviet Interview Project and Israel Soviet Interview Projects of the 1980s. Representative publications are Alex Inkeles and Raymond Bauer, *The Soviet Citizen* (Cambridge, Mass.: Harvard University Press, 1959) and James Millar (ed.), *Politics, Work and Daily Life in the USSR: A Survey of Former Citizens* (Cambridge: Cambridge University Press, 1987).

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opportunism taking place out of sight of Western observers.<sup>13</sup> Thwarted by this veil, we came to rely on convenient textbook stereotypes,<sup>14</sup> despite a number of scholarly efforts to probe for the real workings of the system.<sup>15</sup> As the postwar Soviet leadership, disappointed by economic performance, opened the door for discussion of economic reform, we learned more about the weaknesses of the system.<sup>16</sup> The system's inability to reward risk takers meant limited technological progress.<sup>17</sup> Unable to calculate rates of return, planners could not make rational investment choices.<sup>18</sup> One reform initiative after another was aborted, placing the system on a "treadmill of reform."<sup>19</sup>

We cannot answer Berliner's jockey-versus-horse question without a clear understanding of how the system really worked, both formally and informally. We must obviously move beyond the convenient textbook generalities into the real world of the Soviet system. What we know for certain is that the administrative-command system survived longer than Mises and Hayek would have expected and, at its peak in the 1960s and 1970s, it constituted a credible military threat as a world superpower. These facts alone suggest that the real workings of the administrative-command economy were complex and subtle. Mises and Hayek's critiques of a "pure" planned economy are undoubtedly valid: The center cannot plan and price millions of goods and services; the coordination and incentive problems of such a complex organization would have been overwhelming; extracting reliable information from reluctant subordinates must have been a nightmare. Yet this system survived for more than sixty years!

<sup>13</sup> D. V. Averianov, *Funktsii i Organizatsionnaia Struktura Organov Gosudarsatvennogo Upravleniia* (Kiev: Nauka, 1979).

<sup>14</sup> Paul Gregory and Robert Stuart, *Russian and Soviet Economic Structure and Performance*, 6th ed. (Reading, Mass.: Addison Wesley, 1998). Alec Nove, *The Soviet Economic System* (London: Allen & Unwin, 1977).

<sup>15</sup> Peter Rutland, *The Myth of the Plan* (LaSalle, Ill.: Open Court, 1985). E. A. Hewett, *Reforming the Soviet Economy: Equality Versus Efficiency* (Washington, D.C.: Brookings Institution, 1988).

<sup>16</sup> Alec Nove, "The Problem of Success Indicators in Soviet Industry," *Economica* 25 (1985): 97; Paul Gregory, *Restructuring the Soviet Economic Bureaucracy* (Cambridge, England: Cambridge University Press, 1990).

<sup>17</sup> Joseph Berliner, *The Innovation Decision in Soviet Industry*, (Cambridge, Mass.: The MIT Press, 1976).

<sup>18</sup> Gregory Grossman, "Scarce Capital and Soviet Doctrine," *Quarterly Journal of Economics* 67, no. 3 (August 1953): 311–43.

<sup>19</sup> Gertrude Schroeder, "The Soviet Economy on a Treadmill of Reforms," U.S. Congress Joint Economic Committee, *Soviet Economy in a Time of Change* (Washington, D.C., 1979).

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The first studies of Soviet managers suggested an answer to the apparent puzzle of the system's durability.<sup>20</sup> At the microeconomic level, managers, chief engineers, and accountants had an unexpectedly wide range of discretion outside of the planning system. Vast expanses of unplanned actions existed in the planned economy. Enterprises supplied themselves, concealed information from superiors, and formed opportunistic alliances with their immediate superiors. Studies from the postwar period, in turn, disclosed a massive "second economy" existing alongside the official economy, which provided businesses and consumers the goods and services that planners could not.<sup>21</sup>

Managerial discretion and the second economy relate to actions taken at relatively low levels. They do not explain how resources were allocated in the real world of high-level decision making. My earlier study of the "mature" Soviet economy concluded, based on interviews with former officials, that we still knew relatively little about how *central* institutions actually worked.<sup>22</sup> We did not know how central authorities dealt with each other, how they coaxed information from subordinates, how they managed the complex problem of planning, how they shared responsibility, what incentives were used, what areas were planned and what areas remained unplanned, and what the true goals of the leaders were. These are only a few of the questions that remained unresolved as of the late 1980s.

Raymond Powell, in an overlooked article written in 1977, attempted to explain the puzzling durability of the Soviet system. He proposed that the system could indeed generate enough information to be "workable,"<sup>23</sup> by utilizing unorthodox sources of economic information that are of secondary importance in market economies. State and party officials could tune in on the thousands of petitions, complaints, emergency telephone calls, and other appeals from subordinates to determine what must be done and what could be put aside. Powell's theoretical hunch was that the Soviet system survived so long because its officials learned how to use

<sup>20</sup> Joseph Berliner, *Factory and Manager in the USSR* (Cambridge, Mass.: Harvard University Press, 1957); David Granick, *Management of Industrial Firms in the USSR* (New York: Columbia University Press, 1954).

<sup>21</sup> Gregory Grossman, "The Second Economy of the USSR," *Problems of Communism* 26 (September–October, 1977): 25–40; Vlad Treml, "Production and Consumption of Alcoholic Beverages in the USSR: A Statistical Study," *Journal of Studies on Alcohol* 36 (March 1975): 285–320.

<sup>22</sup> Paul Gregory, *Restructuring the Soviet Economic Bureaucracy*, 146–67.

<sup>23</sup> Raymond Powell, "Plan Execution and the Workability of Soviet Planning," *Journal of Comparative Economics* 1, no. 1 (March 1977): 69–73.

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unconventional information for decision making. He did not argue that such “nonprice signals” made the system work well, only that they made the system work.

**The Soviet State and Party Archives**

Ironically, it was the collapse of the administrative-command system that made this study possible. With the lifting of the veil of secrecy, two new research approaches were opened. First, persons who had worked at high levels within this system could either be interviewed or their increasingly candid memoirs could be read. Starting with the *Glasnost* initiated by Gorbachev in the mid-1980s, former high-level actors could serve as “expert informants.”<sup>24</sup> Officials and managers who occupied responsible positions in the 1970s and early 1980s should still have vivid memories of how things were done. One drawback is that living participants could provide information only about the mature system, not about its origins. The administrative-command economy was founded in the early 1930s; even young administrators at the time would have been in their late eighties or early nineties when they were allowed to speak freely. The demographic odds of such high-level administrators being alive in the 1990s would have been relatively slim, given the hard times of the 1930s and the war years of the 1940s. Moreover, few of the founding fathers survived the Great Purges of 1937–8. Fortunately, three of the highest-level surviving founders did leave behind fragments of memoirs in the early 1990s.<sup>25</sup>

The search for the origins of the administrative-command economy leads us to the Soviet State and Party Archives, which were opened to scholars in the 1990s. This book deliberately focuses on the first two and a half decades of the administrative-command economy because we are

<sup>24</sup> Yuly Olsevich and Paul Gregory, *Planovoia Sistema v Retrospektive: Analiz i Interviu s Rukovoditeliami Planirovaniia SSSR* (Moscow: Teis, 2000).

<sup>25</sup> Of Stalin's original team, which numbered more than twenty, only four survived the Great Purges: Lazar Kaganovich, Vyacheslav Molotov, Anastas Mikoian, and K. E. Voroshilov. The first three lived to advanced ages, as did the former minister of oil and Gosplan chairman, N. K. Baibakov. Molotov and Kaganovich were interviewed by Chuev in F. I. Chuev, *Sto Sorok Besed s Molotovym* (Moscow: Terra, 1991), and F. I. Chuev, *Tak Govoril Kaganovich* (Moscow: Otechestvo, 1992). Baibakov was interviewed in Olsevich and Gregory, *Planovoia Sistema*. Another founder's (Anastas Mikoian) memoirs were published as A. I. Mikoian, *Tak Bylo. Razmyshleniia o Minuvshem* (Moscow: Vagrius, 1999). Voroshilov died in 1960.

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keenly interested in how its institutions were created. Russian archivists have placed virtually no restrictions on the use of documents for this early period. The Soviet State and Party Archives constitute a treasure of records of the founders. The administrative-command system was run by written decrees, instructions, reports, and studies, although many key decisions were made in Stalin's private study and not recorded. Most actions, however, were recorded on paper, and these records were meticulously maintained by generations of archivists. Officials and archivists were loathe to discard documents; hence, the archives reveal both the light and dark sides of the system. Unlike the Nazi regime, which carefully avoided written records of its crimes, the Soviet archives speak frankly about persecutions, purges, terror, executions, and the infamous gulag system. Stalin's correspondence is interspersed with terse orders to send opponents of collectivization to concentration camps, to execute those stealing property, and to shoot political opponents:<sup>26</sup> "Kondratieff, Groman [two prominent nonparty economists, especially reviled by Stalin], and a few other scoundrels must definitely be shot."<sup>27</sup> Stalin's signature appears on documents authorizing mass executions.<sup>28</sup> Stalin could casually order the resettlement of thirty thousand peasant families to desolate regions where they stood little chance of survival.<sup>29</sup> The archives also do not whitewash the misdeeds of party officials, all supposedly dedicated to building a better world of socialism. Thousands of party investigations of criminal wrongdoing by party members are carefully filed in the archives awaiting investigation by scholars. These documents show party officials stealing millions of rubles, constructing massive bribery networks, and selling party memberships to the highest bidder.<sup>30</sup>

This book uses materials from the formerly secret Soviet State and Party Archives, in particular from the Russian State Archive of the Economy (RGAE) and the State Archive of the Russian Federation (GARF).<sup>31</sup> These

<sup>26</sup> Oleg Khlevnyuk et al., *Stalin i Kaganovich. Perepiski. 1931–1936 gg.* (Moscow: Rosspen, 2001), 235.

<sup>27</sup> Lars Lih, Oleg Naumov, and Oleg Khlevniuk, *Stalin's Letters to Molotov, 1925–1936* (New Haven, Conn.: Yale University Press, 1995), 165–7, 200–1.

<sup>28</sup> J. Arch Getty and Oleg Naumov, *The Road to Terror: Stalin and the Destruction of the Bolsheviks, 1932–1939* (New Haven, Conn.: Yale University Press, 1999), 25.

<sup>29</sup> Khlevnyuk et al., *Stalin i Kaganovich. Perepiski*, 316.

<sup>30</sup> For an analysis of economic crimes committed by party members, see Eugenia Belova, "Economic Crime and Punishment," in Paul Gregory (ed.), *Behind the Facade of Stalin's Command Economy* (Stanford, Calif.: Hoover Institution Press, 2001), 131–58.

<sup>31</sup> Readers interested in learning more about these archives should start with the thorough guides to the Soviet State and Party Archives, such as *Kratkiy Putevoditel': Fondy i*



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archival materials were studied both in Moscow and at the Hoover Institution. The original archival material is drawn from the various archival “funds” (*fondy* in Russian) described in Appendix A. We also draw heavily from annotated collections of archival materials<sup>32</sup> and from the various monographs based on archival research cited throughout this book.

**Models of Dictatorship**

The Soviet system is one of many in a long line of brutal dictatorships, dating from the Egyptian pharaohs to the latest African or Middle Eastern despot. Stalin has earned the dubious record as Hitler’s rival as measured by the sacrifice of innocent lives. Scarcely a Russian, Ukrainian, or Central Asian family was spared his cruelty either in the form of executions and deportations of peasants or in purges of officials, managers, and military personnel. This book has more to say about an *economic* dictatorship than of a *political* one, although the two are closely intertwined. It describes an economic system where the dictator strives to gain full control of the economy through an extreme concentration of power. Other dictators have had different goals: in Pinochet’s Chile, the dictator used political power to establish market allocation and private ownership.<sup>33</sup> Hitler’s dictatorship was based on nationalism, state control, ethnic hatred, and the push for territorial expansion, but it preserved the property rights of ethnic Germans. Iraq’s Saddam Hussein used the control of economic resources to suppress opposition, eradicate ethnic groups, and reward loyalty. Clearly, the Soviet dictatorship was unique in a number of respects; nevertheless, we must consider whether general principles can be gleaned that apply to other dictatorships, motivated by other principles and pertaining to different circumstances.

All economic dictators presumably face common problems: they cannot decide and control everything themselves. They must, therefore, use an administrative structure in which subordinates are delegated authority.

*Kollektsii Sobrannye Tsentral’nym Partinym Arkhivom* (Gosudarstvennaia Arkhivnaia Sluzhba Rossiiskoi Federatsii) (Moscow: Blagovest, 1993); William Chase and Jeffrey Burds (eds.), *State Archival Service of the Russian Federation, A Research Guide: I. Guide to Collections* (Moscow: Blagovest, 1994).

<sup>32</sup> Three annotated document collections cited frequently in this book are Lih et al., *Stalin’s Letters to Molotov*; and O. V. Khlevnyuk, A. V. Kvashonkin, L. P. Kosheleva, and L. A. Rogovaia (eds.), *Stalinskoe Politburo v 30-e gody* (Moscow: AIRO-XX, 1995); and Khlevnyuk et al., *Stalin i Kaganovich. Perepiski*.

<sup>33</sup> Carmelo Mesa-Lago, *Market Socialist and Mixed Economies: Comparative Policy and Performance, Chile, Cuba, and Costa Rica* (Baltimore: The Johns Hopkins Press, 2000).

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The dictator must control these subordinates by incentives and threats – carrots and sticks, if you will. Some subordinates will be closer to and more trusted by the dictator. Others will possess skills necessary to the dictator, such as the ability to manage production facilities or to plan, but may be remote from or even inimical to the dictator. The performance of all subordinates, both from the dictator's immediate circle and from outside, must be monitored and evaluated. Subordinates, seeking to avoid the dictator's wrath, will be inclined to report only positive information, concealing unfavorable information from the dictator's view.

How a socialist economic dictator would organize and control this inevitable administrative hierarchy was an issue into which Mises and Hayek did not delve deeply. They wrote vaguely of a Central Planning Board or euphemistically of “the center,” but a command economic dictatorship requires a massive administrative apparatus, whose workings must be understood. Organization theory, information economics, and the new institutional economics provide templates for studying complex organizations, such as corporations, industrial ministries, or even entire administrative-command economies.<sup>34</sup> These literatures share common features: they stress that the dealings of the superior (such as the dictator), or *principal*, with subordinates, or *agents*, can be explained by transaction and information costs. When it is too costly to use the agent to carry out an action, the dictator will execute the action himself. Agents will not faithfully interpret and execute the directives of principals because their goals typically diverge. Agents possess more information about their local circumstances; therefore, they engage in opportunistic behavior, taking advantage of the dictator's information disadvantage. The dictator must establish checks and balances to limit such opportunism and must devise appropriate incentives and punishments. The new institutional economics particularly focuses on the dictator's problems with organized groups of agents – industrial, regional, or other lobbies formed to elicit actions favorable to the narrow group but against encompassing interests.<sup>35</sup>

<sup>34</sup> See, for example, Ronald Coase, “The New Institutional Economics,” *American Economic Review* 88, no. 2 (May 1998), 72–4; D. C. North, “Institutions and Economic Performance,” in *Rationality, Institutions, and “Economic Methodology”* (London: Routledge, 1993), 242–63; O. E. Williamson and S. G. Winter (eds.), *The Nature of the Firm* (Oxford: Oxford University Press, 1993); and Oliver Williamson, “The Institutions of Governance,” *American Economic Review* 88, no. 2 (May 1998), 75–9.

<sup>35</sup> The two most relevant works are Ronald Wintrobe, *The Political Economy of Dictatorship* (Cambridge: Cambridge University Press, 1998), and Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Mass.: Harvard University Press, 1971).