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Edited by Ellen Frankel Paul, Fred D. Miller, Jr., and Jeffrey Paul

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INTRODUCTION

The fall of Communism, and the economic devastation that system bequeathed, leave the people of Eastern Europe and the former Soviet Union facing an uncertain economic future. The collapse of the totalitarian order means that many countries of the region must deal with political instability as well. The breakdown of order has aroused old enmities and has given rein to ethnic conflicts of the sort currently raging in Bosnia and in many of the former Soviet republics.

The antidote widely prescribed for the ills of the region is liberalism, conceived as democratic politics and free-market economics. It is assumed that the East should solve its problems by emulating the West. Yet the West is not monolithic; there are a number of models available to reformers in the East. It may be that no single political-economic system can succeed in bringing stability and prosperity to all the formerly Communist countries. As reformers in each country pursue their own solutions, they must take into account their people's distinctive history and cultural traditions.

To understand the process of transition as it unfolds, we must answer a number of questions. What are the attitudes of Easterners toward capitalism, and how can these be modified? What institutional obstacles exist to reform, and which of the institutional remnants of the old order must be changed or discarded if reform is to proceed? What new institutions must be introduced? More broadly, what model should reformers follow in making the transition to new political and economic systems? Is democratic capitalism the system they should embrace, or does that system have its own flaws and inconsistencies? The essays in this volume address these questions, offering a variety of perspectives on the transition process.

Three economic systems—other than the purely free market—are commonly offered as models for the newly liberated countries of Eastern Europe to adopt: market socialism, the Swedish system, and the German social market economy. In the opening essay of this collection, "The Social Market Economy," Norman Barry examines these models, focusing on the last. Theorists of the social market economy, he notes, endorse the market's primary role in the allocation of resources, but they reject *laissez-faire* capitalism. They argue that, without some central control of the economy, a free market will lead to monopolies and cartels which ultimately destroy the exchange system, and that without some public welfare arrangements the market will lack moral authority. Barry takes a historical look at the social market economy as it was implemented in

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Germany and argues that only some of its features are appropriate for the countries of Eastern Europe. He maintains that these countries would do well to adopt the social market economy's system of property rights, its sound currency policy, and its civil and commercial law. At the same time, he argues that they should forgo the welfare schemes associated with it—schemes which tend to overburden the market and which the fragile economies of the region cannot afford to implement. Barry concludes with an assessment of the prospects for successful liberalization of the post-Communist economies, suggesting that the results are likely to vary. He predicts that those countries with the closest ties to the European liberal tradition—former East Germany, Poland, Czechoslovakia, and Hungary—will probably be able to implement the social market economy, though they will need to be wary of political pressures from special interests that could undermine the market. Other countries, especially those of the former Soviet Union, will need to establish stable political orders before undertaking any experiments in economic design.

John Gray agrees that some of the post-Communist countries may succeed in adopting a version of the social market economy, but argues that many others are unlikely to import Western economic or political institutions. In "From Post-Communism to Civil Society: The Reemergence of History and the Decline of the Western Model," Gray contends that the downfall of Communism heralds a return to traditional ethnic and religious conflicts—a "reemergence" of Europe's history after a totalitarian interlude. The task that faces the people of Eastern Europe and the former Soviet Union is the establishment of the institutions of civil society: a stable legal order and a system of private property and freedom of contract. The renewal of traditional conflicts in the region makes this task especially difficult; it means that stable institutions are not likely to emerge spontaneously, as they did in some Western countries, but may have to be imposed by fiat. The model most relevant to the countries of the former Soviet bloc may be that of the East Asian market economies, where modernization and the shift to free markets took place under authoritarian political regimes—regimes which intervened strategically in economic affairs in order to protect and nurture fledgling industries. In any case, Gray concludes, each country is likely to follow its own path, drawing on its own pre-Communist traditions as it struggles to establish order and pursue economic growth.

Gray examines the issue of ethnic strife as an obstacle facing those countries currently in transition; the next three essays in this volume deal with other obstacles. In "Asymmetrical Reciprocity in Market Exchange: Implications for Economies in Transition," James M. Buchanan explores the extent to which certain negative attitudes toward trade can inhibit change. Buchanan notes that Westerners understand, at least implicitly, that there are gains to be made from trade, and that in a free market both parties to an exchange share in these gains. In the East, however, this

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understanding is missing. Decades under Communist rule have shaped people's thinking about trade, and the differences in attitudes and behavior between East and West can, Buchanan suggests, be explained in terms of economic theory. In the West, the buyer is typically at an advantage: he offers money to the seller in exchange for goods or services, and money is more generally desired than other goods. The result is that sellers of goods adopt a deferential attitude toward buyers; they tend to treat potential buyers with courtesy and to advertise in order to attract their business. In the East, this deferential attitude is wholly absent. Under a centrally controlled economy, where goods are rationed, buyers lack any advantage. They still have money to exchange for goods, but money is not enough; in order to complete a transaction, they must also pay some nonmoney price—for example, obtaining bureaucratic approval or waiting in long lines. Chronic shortages of goods, and the absence of any profit motive, mean that sellers have no incentives to cater to the needs of potential buyers—there will always be plenty of others eager to buy. With this kind of background, Buchanan contends, it is no wonder that the countries of Eastern Europe and the former Soviet Union are experiencing a difficult transition. The absence of a tradition of entrepreneurship, moreover, presents a further difficulty, as those who once focused their energies on obtaining bureaucratic favors must now turn their attention to discovering and exploiting opportunities for production.

Like Buchanan, Svetozar Pejovich believes that changes brought about by Communism will make a transition to free markets extremely difficult. In "Institutions, Nationalism, and the Transition Process in Eastern Europe," Pejovich explores three factors which are likely to obstruct institutional change. First, the Communist dictatorships of the region subverted the rule of law to the will of the ruling elite, seriously eroding the people's confidence in their institutions and leaving them with little hope of being treated justly. Second, Communist rule strengthened the old ethos, with its emphasis on national pride and distrust of outsiders—an ethos which served as a refuge from the harsh conditions brought on by years of failed central planning. Finally, the intellectual tradition of the region, which prizes family and community above the individual, lacks an understanding of classical-liberal philosophy or economics. This means that the people of the region will need to come to grips with the theory of the free market, even as they attempt to implement it in practice. At the same time, they must guard against the dangerous and divisive influence of nationalism. Pejovich concludes that the transition from centrally planned economies to markets will depend on the ability of new leaders to create conditions under which capitalist institutions can evolve spontaneously, become incorporated into the old ethos, and be voluntarily accepted (rather than imposed by fiat).

While Buchanan and Pejovich examine background conditions which are likely to inhibit the transition process, William H. Riker and David

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L. Weimer look at problems that may arise out of the process itself. In “The Economic and Political Liberalization of Socialism: The Fundamental Problem of Property Rights,” Riker and Weimer focus on the central task of liberalization: the establishment of secure private property rights as a necessary condition for growth. They sketch the historical and cultural factors that must be overcome: ancient ethnic hostilities and the long experience of collective ownership of land and other resources. These factors, together with political instability, are likely to lead to a climate of uncertainty—a climate that will tend to discourage many forms of needed investment. The resulting poor economic performance during the period of transition may lead to demands for redistribution or for more gradual reforms. This, in turn, may lead to the undermining of property rights, and to further poor economic performance. The net result may be an overall lessening of support for the transition, as various interest groups voice their objections and attempt to manipulate the process. The problem facing the countries pursuing reform, then, is to maintain a liberal political scene—one open to dissent and debate—while at the same time pushing through economic changes which are likely to be painful, at least in the short run. In the end, Riker and Weimer conclude, social science offers little guidance about the course the transition will, or should, follow; the transition does, however, offer social science a unique “natural experiment” for studying the growth and evolution of institutions.

An underlying theme of Riker and Weimer’s essay is the relationship between economic liberalism and political liberalism, and the next four essays in this collection deal with that same relationship, each from a different perspective. In “Democracy, Markets, and the Legal Order: Notes on the Nature of Politics in a Radically Liberal Society,” Don Lavoie argues that the demise of one radical ideology—socialism—makes room for the development of another—radical liberalism. Lavoie notes that liberalism, in its classical sense, stood for two ideals: democracy and markets. Yet these ideals have never meshed well in the experience of Western democratic capitalism. There has always been a perceived tension: if more decisions are made democratically, less will be left to the market; if more decisions are left to the market, there will be less need for political discourse. This apparent tension seems to mean that a radical liberalism would have to sacrifice one of its ideals; they cannot both be taken to their logical extremes. Lavoie contends that those who hold this view are mistaken, because they fail to understand the nature of democracy. He sketches a conception of democracy as openness—the kind of openness that was crushed under Communism and that began to reappear with *glasnost*. He conceives of a democratic society not in terms of the kinds of elections it holds, but in terms of the manner in which the give and take of public discourse is allowed to shape social institutions. On this view, markets and democratic processes are not opposed but related. Both are characterized by a complex web of voluntary interper-

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sonal relationships that can lead to benefits for all who take part in them. The project of advancing a radical liberalism turns out to be potentially viable after all, and Lavoie concludes by looking at debate among some modern libertarians over how far that project can be taken.

Russell Hardin's essay, "Liberalism: Political and Economic," continues the exploration, begun by Lavoie, of the compatibility of the two strands of liberalism. Hardin takes as his starting point the development of the two strands, contrasting a consciously designed political liberalism with a spontaneously evolved economic liberalism. Political liberalism, he notes, had its origins in the efforts of eighteenth-century political theorists to find ways of easing religious conflict and promoting tolerance. Economic liberalism, on the other hand, developed slowly through the workings of custom and the common law, culminating in a system of property rights and rules of contract. Hardin accounts for these differences in origin in terms of the kinds of problems the two liberalisms serve to address: issues of tolerance addressed by political liberalism are collective in nature, while the interactions regulated by economic liberalism typically involve pairs of trading partners or small groups engaged in joint ventures. The joining of the two strands of liberalism in Western democratic-capitalist states results in a complex whole that may not, in the end, be consistent and coherent. Yet the two strands do seem to be united in their justification, as conditions necessary for the promotion of well-being. Some early theorists, such as Hobbes and Locke, separated the two liberalisms conceptually, according to the kind of well-being they promoted: economic liberalism was thought strictly to promote material well-being, while political liberalism was thought to promote nonmaterial or spiritual well-being. But Hardin argues that the dividing line between material and nonmaterial well-being is difficult to draw, especially in modern societies, where individuals often turn to the marketplace for the satisfaction of at least some of their important spiritual needs. It may be that liberalism—political and economic—is a conceptually coherent theory after all.

Both Lavoie and Hardin propose that free markets are the proper economic complement to democratic politics, but some theorists have argued that socialism is more consistent with democracy. In "Socialism as the Extension of Democracy," Richard J. Arneson evaluates the view that, in modern societies, the strict application of democratic principles entails a commitment to a socialist reconstruction of society. Arneson opposes this view, on normative and interpretive grounds: he argues that democratic procedures are not a suitable moral basis for fundamental social criticism, and that forcing socialist critiques and proposals into the mold of democratic theory distorts their character. The key value underlying socialism, Arneson suggests, is not democracy but a principled opposition to exploitation; and a central aim of his project is to clarify exploitation's nature. To oppose exploitation, he says, is to view as undesirable the fact that

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some people take advantage of undeserved assets in ways that improve their position relative to others. On this interpretation, socialism is a means for achieving a radical egalitarian brand of distributive justice – and not, as on the democratic view, a means for promoting collective self-determination. Arneson concludes by noting that the Communist regimes of the former Soviet bloc did not embody either view of socialism, and that the collapse of those regimes should not be taken as discrediting socialist theory.

Daniel M. Hausman agrees that the downfall of Communism does not necessarily herald the failure of socialism, and he suggests that reformers in the countries of Eastern Europe and the former Soviet Union should be cautious about embracing free-market economic systems. His contribution to this collection, “Liberalism, Welfare Economics, and Freedom,” is an attempt to illuminate some problems facing reformers by exploring the foundations of political liberalism and its relation to economic theory. The case for free markets and limited government rests largely on contemporary economic theory, which assumes that people are rational and self-interested, and that they act to increase their own welfare. But Hausman argues that concerns with equality and autonomy are more central to liberalism than are concerns with welfare, and consequently that contemporary welfare economics is not particularly liberal. Nevertheless, liberals can support market reforms for a number of reasons, not all of which have to do with welfare. Hausman sketches three sorts of arguments that could support such reforms: the liberal can support markets because they make people better off, because they enhance individual independence and freedom, and because they shore up political liberty by limiting the power of government. Hausman maintains, however, that the central concerns of liberalism provide justification for government regulation and intervention in markets. Reformers should recognize the role of government in mitigating the inequalities in wealth and power that markets tend to cause – inequalities which can undermine individual autonomy.

Hausman’s essay touches on a central question facing citizens of the countries currently undergoing liberalization, the question of the proper role of the state. The final four essays in this collection deal with various aspects of this question, theorizing about what sorts of policies and institutions best promote freedom and justice. Peter C. Ordeshook looks specifically at the constitutional arrangements appropriate to a democratic state. In “Some Rules of Constitutional Design,” Ordeshook notes that political scientists have been able to give little practical guidance in the construction of stable democratic institutions. The reason for this shortcoming, he suggests, is that they have failed to understand how constitutions can become self-enforcing documents. Political scientists have generally assumed that constitutions function as social contracts, in which people agree to surrender certain powers to their government, in return

for guarantees of security. But this view gives no account of how social contracts are enforced. Ordeshook suggests an alternative view of constitutions as coordinating devices that allow societies to achieve stable outcomes when making collective decisions about controversial issues. He sets out a number of guidelines for the drafting of constitutions, showing how a state can achieve stability by, for example, instituting a separation of powers; avoiding lists of utopian policy goals (universal employment, guaranteed health care, and so on); and establishing fundamental rights (to free expression and freedom of religion, among others) which serve to remove certain issues from the arena of political debate. He emphasizes the importance of limiting the functions of the state so as to reduce the potential for the abuse of state power – a prospect which is especially ominous in Eastern Europe and the former Soviet republics, where ethnic majorities are likely to attempt to use such power to exercise control over minorities.

The functions of the state, and its responsibilities toward ethnic minorities, are also the focus of “The Morality of Inclusion,” Allen Buchanan’s contribution to this volume. Buchanan considers whether there are principles reformers must follow when they deliberate about redrawing political boundaries on the basis of nationality or economic advantage. He asks whether there are any general moral obligations to include others in political arrangements, obligations which would place limits on groups wishing to form a new state or secede from an old one. To answer the question, he sketches two opposing conceptions of the function of the state and of the scope and nature of justice. The first conception views the state as a mechanism for enforcing rules of interaction among those who choose, on the grounds of self-interest, to take part in a cooperative scheme. The second conception views the state as a device for enforcing basic rights or principles of justice which apply to all individuals, independently of their capacity to be net contributors in this or that cooperative scheme. According to the first conception, there are no obligations of inclusion; according to the second, there are at least some such obligations. Buchanan goes on to make a case for the second conception, arguing that those who advocate reform must take into account their obligations toward those at risk of being excluded from political arrangements – arrangements which, in the context of the current upheaval in much of the former Soviet bloc, could be essential to securing the future of the people of the region.

Two other important issues facing reformers are the institution of tax policies and the formulation of regulatory measures designed to protect the interests of workers and the public. In “A New Contractarian View of Tax and Regulatory Policy in the Emerging Market Economies,” Robert H. Frank proposes a way of thinking about these issues that departs from standard Western assumptions and practices. He begins by noting that scholars in the contractarian tradition have attempted to explain laws and

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a variety of other institutions by asking what constraints rational, self-interested actors might deliberately impose upon themselves. While this approach explains many of our laws and institutions, it cannot, Frank argues, explain them all. A more general version of contractarianism is needed, based on a characterization of preferences that differs from the self-interest model and that is theoretically and empirically more plausible. The key feature of Frank's version of contractarianism is that it takes into account positional preferences—the desire of individuals for a better relative position in the distribution of wealth and other advantages throughout society. In an unregulated market, such preferences can lead to undesirable effects; for example, they can cause workers to choose jobs that pay high wages but entail higher than average safety risks. Workers may choose such jobs in hopes of improving their economic position relative to others, but as more and more workers make similar choices, their overall positions relative to one another do not change. In terms of position, they are no better off than they were before; yet in terms of safety risks, they are much worse off. To deal with such problems, Western governments have resorted to cumbersome workplace safety regulations, but Frank suggests that a tax on positional consumption—consumption designed to improve one's position relative to others—would be simpler and more effective. He concludes with further discussion of how tax policy can replace direct regulation as a means of achieving desired outcomes, illustrating his position with a description of a scheme for taxing pollution.

The final essay in this volume deals again with the regulatory functions of the state, and with institutional arrangements for carrying out those functions. In "Associations and Democracy," Joshua Cohen and Joel Rogers look at the role that associations can play in helping to devise and implement regulations and to achieve compliance with them. The associations discussed in the essay—trade unions, employer associations, citizen lobbies, and other private groups—are generally thought to be capable of either retarding or advancing progress toward egalitarian political reform. Cohen and Rogers argue that the activities of such groups can be directed in positive ways, and they recommend specific changes in government policy which would affect the status and powers of associations, allowing them to take over certain regulatory functions. Associations could provide the state with information, aiding in the definition of problems to be addressed by governmental action. They could assist in enforcement of regulations and, in so doing, could help remove a constraint on political debate by countering the common reservation that certain policies, while desirable, are unenforceable. On the other hand, there are serious objections that can be raised against the idea of giving associations governmental power. Associations might represent the special interests of their leaders, rather than the interests of their members. They might abuse their powers to enhance their own status and entrench their position. Moreover, in the absence of clear guidelines, the powers dele-

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gated to associations are bound to be vague, and their exercise dangerously open to discretion. Cohen and Rogers address each of these concerns, maintaining that a well-designed system of institutions could harness the energies of associations while avoiding the pitfalls that often accompany the delegation of governmental authority.

The countries of Eastern Europe and the former Soviet Union face a double challenge: to establish political order and to institute free markets. By exploring the nature of liberalism and the various strategies for liberal reform, the thirteen essays in this volume offer insights into how these challenges can be met.

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