Liberalism, Stability, and Profit: The Political Economy of Autocratic Legislation

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Introduction

There exists a substantive body of literature addressing the political economy of democracies, in which it has generally been concluded that democracies produce highly illiberal laws, due to rational ignorance (Caplan 2008) and rent-seeking special interest groups (vis-à-vis the public choice school). Regardless, it has remained the consensus that, to (perhaps apocryphally) quote Churchill, "Democracy is the worst form of government, except for all the others." Autocracies are decidedly bad. Economics has, as a discipline, embraced Acton's warning against absolute power.

This paper sets out to address the economics of autocracy, and provide a theoretical model for understanding autocratic rule creation. I begin by analyzing the work of Leeson and Coyne (2012), which predicts the "wisdom" of various rulesets arising from different institutional frameworks. They argue that private rules overcome a wisdom/alterability tradeoff inherent to legislation and norms. While I fundamentally agree with their analysis, I offer criticism of their use of the term "wisdom," which they employ to mean, "preference satisfaction." I reevaluate legislation with respect to *liberalism*, as opposed to preference satisfaction, concluding that democratic legislation and private clubs should both produce relatively illiberal rules. The surprising conclusion: autocracies, when stable, should yield more liberal rules than either democracies or markets. I argue that instability produces authoritarian law, and thus, the instability of many autocracies around the world causes them to perform worse than democracies with respect to liberalism. Lastly, I formalize this in a simple model: stable autocracies are more liberal than either democracies or private clubs, which are more liberal than unstable autocracies.

Legislation, norms, and private rules

Leeson and Coyne (2012) measure social rules on two axes: wisdom and alterability. "Wisdom refers to the extent to which social rules reflect society members' rule demands… Alterability refers to the ease with which society members can change social rules when their rule demands change in response to changed conditions" (*2*). From there, they taxonomize three different kinds of rules, and evaluate their relative performance on these criteria.

Three questions provide the basis for analysis:

> (1) What incentives do social-rule producers under a particular social-rule source have to produce rules whose substance reflects society members' rule demands? (2) What information do social-rule producers under a particular social-rule source have about the substance of rules society members demand? (3) What incentives and information do social-rule producers under a particular social-rule source have to modify the substance of existing rules to reflect changes in society members' changing rule demands? (Leeson and Coyne 2012, *3*).

It quickly becomes apparent that two of the rule types – legislation and norms – confront a wisdom/alterability tradeoff. Legislation is highly alterable. It can be effectively changed in minutes at any meeting of the parliamentary body in any Western democracy. However, policymakers have neither the necessary incentives nor information to formulate rules that correspond with the demands of their constituents broadly. First, and perhaps most insurmountably, legislation confronts the "knowledge problem" (Hayek 1945, 1973). The specific knowledge requisite for the efficient coordination of society is not concentrated in any individual database, but is instead fragmented – each person possesses a small fragment of information, relevant to his circumstances, but of unknown importance to the aggregate, and "frequently contradictory" to the information held by others in different circumstances.

Additionally, Leeson and Coyne argue that legislation suffers from a principal-agent problem. Legislators (the agent) face a strong incentive to exploit their constituents (the principal) when monitoring is insufficient. Revolution checks an autocrat, but, due to collective action problems (Tullock 1971), it will only occur under anomalous circumstances. The problems are possibly worse for democratic regimes. Since individual votes count for so little in national elections, voters have little incentive to monitor office holders. This causes many democracies to be "characterized by vote-seeking politicians, rationally ignorant voters, and special interest groups" (Leeson and Coyne 2012, *8*). Nor are ballots an effective means of tabulating voter preferences, and thus overcoming the information problem. Since each ballot only expresses a preference, without regard to the *intensity* of that preference, they cannot be relied upon to accurately represent the voters' policy wishes.

Norms – rules that emerge spontaneously, and are observed and enforced, without having been handed down from a central government – are highly wise. They arise to address the particular needs of the people in a particular time and place. They are venerated by experience. As a result, they correspond strongly to their subjects' preferences. However, they are largely unalterable. Since the norm was not established by a legislative body, there is no legislative body that can convene to do away with it. Another unfortunate consequence of norms' unalterability comes in the fact that they can take a great length of time to effectively develop. While norms may be relied upon for their wisdom *once they exist*, during their formative stages, the problems that the norms will eventually address must remain unsolved.

Leeson and Coyne present private rules as an alternative that overcomes this wisdom/alterability tradeoff:

> The possibility of different clubs offering different social rules, including the possibility of forming a new club or refraining from joining a club altogether, contributes to the existence of a diversity of opinions and independence in opinion formation. Under a system of private rules people are able to form diverse opinions and to self-select into clubs that reflect those opinions. Further, as their opinions change over time, they're able to reselect into a new club that better satisfies their preferences… The possibility of

> different clubs offering different social-rule alternatives means that the production of private rules is decentralized. There's no centralized, monopoly body that imposes rules on everyone per legislation. Finally, private rules provide the information aggregation and feedback mechanisms required for wise crowds. As Mises (1920 [1935]) and Hayek (1945) pointed out, prices and profits and loss in markets provide precisely such mechanisms. This is as true for producers of "ordinary" goods and services as it is for producers of private rules" (Leeson and Coyne 2012, *20*).

One objection to this analysis might be to the word "wisdom." The word might imply that the "wise" rule is normatively desirable. It is entirely plausible, however, that the demanders of rules will, out of ignorance or bad temper, demand rules that are invasive and destructive. In other words, it is not necessarily good that a given ruleset be structured according to the wishes of its subjects, if we ascribe to an ethic other than preference satisfaction. This objection has been comprehensively raised by Taylor and Crampton (2009). The following analysis is not normative in its nature; i.e., neither I nor Taylor and Crampton make claims about the desirability non-invasive rules. Rather, it should be understood as a conditional: *if* we desire a society in which the lives of some are not violently intruded upon as others, *then* we should be cautious to label preference-satisfaction as "wise."

The wisdom of private rules?

Taylor and Crampton grant that a society governed by competing private rulesets "will be robust to the existence of self-interested knaves: a well-functioning private defence industry will be capable of preventing aggression against property… however, [it] will be less robust to certain distributions of meddlesome preferences. In an anarchic society, not only the protection of rights, but also the definition of the rights themselves is determined by market forces: if consumers demand illiberal law, that is what they will get" (2009, *3*).

Taylor and Crampton compare private rules to legislation by appealing to a factor noted by Leeson and Coyne: preference intensity. They begin by dividing the constituents of a hypothetical society into three broad classes: busybodies, libertines, and indifferents. Busybodies have “meddlesome preferences,” that is, they desire rules to prohibit behavior that doesn’t inflict any physical cost on them. Busybodies might want their beliefs regarding substance use, sexuality, or firearm ownership, among other issues, reflected in law. Libertines are the target of the busybodies’ tender ministrations. They use psychoactive substances, pursue alternative sexual lifestyles, hunt recreationally, etc. Indifferents don’t engage in activities that the busybodies want to control, but neither do they care if others engage in these activities.

In a democratic country, if there are a great many busybodies, they will have their way. However, if there are a small number of busybodies, no matter how intensely they harbor their meddlesome preferences, their preferences will not be reflected in law. In a civilization governed by private rules, preference intensity becomes vastly more significant. “Anarchy… produces no budgetary boundary between political and non-political resources: law and private consumption are purchased with a common currency. A person with strong preferences over law can have a disproportionate influence in all issues by forgoing private consumption” (*8*).

This generates the conclusion that, given sufficient intensity of busybody preference, market law will tend to be less liberal than the product of democratic legislation. The capacity for the busybody to influence policy outcomes by foregoing personal consumption is very slight, given the extremely low impact of individual votes he might purchase, and the extremely high transaction costs associated with bribing elected officials (as well as the fact that he must compete with public opinion for the politician’s favor). The capacity for the busybody to purchase invasive rules is significantly increased by giving preference intensity a voice through the market.

Further, a system of private rulesets is likely to manifest groups that have intense, meddlesome preferences. Taylor and Crampton draw upon the work of Mulholland (2008) and Berman and Laitin (2008), among others, to show that hate groups and extremist organizations are more likely to form where there is not a source of security from the state. The simple reason is that these groups are capable of providing the public good of security, and so their existence is more demanded in areas where security is lacking. While these clubs do not necessarily have to be meddlesome, "requiring members to conform to costly behavioural norms weeds out the uncommitted and reduces free-riding" (Taylor and Crampton 2009, *12*).

It thus seems tendentious to label consumer satisfaction "wise," if we desire that some kind of liberalism be reflected in our legal order. Taylor and Crampton demonstrate that democracy yields more liberal rules only under certain preference dispersions; if busybodies have low-intensity preferences, then private clubs will yield more liberal rules. For the purposes of this paper, it is not necessary to estimate the array of conditions under which democracy performs more liberally than clubs, and vice versa. The point is simply that, while democracies tend to produce illiberal law for a variety of reasons, private clubs can do so just as easily.

Residual claimancy and the creation of rules

Olsen begins his analysis of autocracy by sharing with the reader a statement from an Italian villager: "Monarchy is the best kind of government because the king is then the owner of the country. Like the owner of a house, when the wiring is wrong, he fixes it" (Olsen 1993, *567*). To one raised in a democratic society, this statement might seem shocking. We should not find it so surprising, however, given our intuitions regarding institutional incentives. The commons is subject to tragedy – communal ownership of a good results in a race for consumption that destroys its capital value. Conversely, if the good is durable, and its value has a residual claimant, we should expect that, ceteris paribus, its value will be maintained for a longer length of time.

Olsen raises this point to discuss a hypothetical anarchy before states exist. His theory of state formation is essentially that, if there were a time at which society was primarily composed of victimized villages and roving bandits, eventually, some of the bandits would become "stationary." Realizing the benefits of leaving a village around to plunder again – say, annually – a bandit gang would set up its jurisdiction over the village and levy taxes. To prevent a tragedy of the commons in village-plunder from foiling its rapacious endeavors, the bandit gang would likely provide some measure of defense against other bandits. Thus, states arise. The radical welfare implication that Olsen derives is that subjection to a stationary bandit constitutes an improvement for the village – the plunderer's barbaric interests align with the villagers' desire for protection. Plunder is minimized dynamically.

Hoppe (2002) expounds upon the matter by applying the logic of collective ownership to rule creation. A profit maximizing owner of a resource wants to balance the loss of capital value due to consumption with the profits accrued as a result of the resource's use. If the resource is owned collectively, then any of the individual claimants can have no guarantee of the resource maintaining its capital value. If one abstains from use in order to preserve the resource, others might not. This possibility creates an *incentive* to consume. The value yielded by using the resource accrues instantly to the user; the value of abstaining from consumption is uncertain at best. When all members of the collective realize this, they will attempt to consume as much of it in the present as possible, so that they can be assured of realizing some of its value for themselves, as opposed to seeing it all disbursed into their neighbors' hands. Thus, the capital value of the resource is destroyed. Following such logic, elected representatives can be seen as owners of the current use value, but not capital value, of a country. As a result, they face an incentive to "consume" the country – extract as many resources as possible for personal gain before they can no longer hold office. Hereditary monarchs can conversely be conceived of as owners of the capital value of the country. For the king, capital consumption in the present reduces future profit.

Hoppe and Olsen are in agreement that the critical component is the time horizon of the autocrat. Political elites who face longer time horizons have a lower incentive for consumption. The bandit who is most stationary has the longest time horizon. Given the welfare superiority of governance by stationary bandit over the marauding one, the question arises: if a society is governed by a low time-preference autocrat, can we expect its rules to be "wise"?

Not on the Leeson and Coyne account:

> The sovereign's residual claimancy on citizens' productivity might provide an alternative channel through which his interests could be aligned with citizens'. But this fails too. The sovereign isn't a residual claimant on the revenues he generates from producing social rules citizens desire. He's a residual claimant on the revenues generated through his citizen's productivity. This gives the sovereign an incentive to maximize his citizens' productivity. But the social rules that maximize citizens' productivity needn't be the ones that maximize citizens' welfare. And these are the social rules citizens desire. The social rules the sovereign will produce legislatively only dovetail with the ones citizens demand in the event that citizens care only about maximizing their incomes. That would, for example, require citizens to value leisure only instrumentally—as a means of making them more productive laborers. This is unlikely (Leeson and Coyne 2012, *7*).

If by wisdom we mean preference satisfaction, then clearly a low time-preference autocrat will create unwise rules. However, we have already seen that preference satisfaction does not necessarily coincide with liberal laws. If we consider the wise rule to be the liberal rule, then the autocrat's wisdom is still up for debate.

Autocratic liberalism

Leeson and Coyne maintain that there is no necessary link between productivity maximization and welfare. The link, however, while perhaps not necessary, is certainly stronger than they believe. If the autocrat generates his revenue by taxing income, production, or exchange, he has a vested interest in facilitating the highest number of voluntary exchanges possible. In addition to allowing large amounts of taxable wealth creation, maximizing his subjects' voluntary exchanges expands the division of labor, which, of course, allows for further wealth creation. The division of labor can exist only when it is coordinated by an infrastructure which provides both *knowledge* of what to create and *incentive* to create. The price system, as demonstrated by Mises (1920 [1935]) and Hayek (1945), whose arguments were referenced by Leeson and Coyne, supplies this coordination.

Mises and Hayek furthermore demonstrate that the price system can only exist in a market, i.e., to the extent that production is controlled by the state, prices will be artificial. They will provide neither the necessary information nor incentives. Thus, in any sufficiently large economy, productivity depends upon economic freedom. This allows us to make several predictions about an autocrat's behavior. (1) If the ruler has a vested interest in taxing productivity for personal gain, then he should make the laws such that his society is subject to few economic regulations and controls. (2) He also faces a strong incentive to protect his subjects' property rights, not only against external invasion, but also from domestic crime, as this, too, will threaten the number of voluntary exchanges. (3) Black markets will generate untaxable income, so the revenue maximizing autocrat should also do as much as possible to stamp them out, by legalizing all exchanges. (Legalization is obviously less costly than enforcement.) By facilitating productivity, in other words, the autocrat passes highly liberal laws: light economic regulation, strong property protection, and few, if any, illicit goods.

Leeson and Coyne are correct in their argument that residual claimancy – that is, ownership of rules – is essential to wise and alterable rule creation. But freedom can be significantly curtailed in the society structured according to private rule clubs. As we have seen, democratic policies are often illiberal as well. A stationary bandit who expects to pillage his land routinely, however, faces incentives that maximize individual liberty. If liberalism is our guiding legal light, then a stationary bandit creates wiser rules than a private club.

It should be noted that this refutes Leeson and Coyne's contention that "citizens must value leisure only instrumentally" for their interests to coincide with the autocrat's. On the contrary, by cultivating a market, and thus creating such a liberal ruleset, the autocrat must necessarily leave his citizens the opportunity to pursue leisure. The only case in which the autocrat will "crack down" on leisure arises when the costs of monitoring unproductive citizens is exceeded by the cost of their un-productivity. This will only occur when monitoring is almost costless (implausible), or the citizenry is *extremely* unproductive. Since there will not, however, be any sort of social safety net in the pure case, citizens will face a fairly steep opportunity cost of excessive leisure (that is, unemployment), and thus we should not expect this latter occurence.

Lastly, a brief note on tax rates: we should expect autocrats to tax less than their democratic counterparts, but perhaps more than a private club would charge. Democratically elected representatives face strong incentives to earn future votes through wealth transfers. These transfers are necessarily the product of taxation or inflation (which functions as a tax via

Cantillon effects). Private clubs must compete with each other to lower rates, so we can expect membership prices far lower than the tax burden in a democracy. An autocrat has no competition, so he need not lower his tax rate significantly on that account. However, low tax rates allow for more future wealth creation – hence, more future tax revenue. The longer he abstains from plundering, the more wealth will be created. Thus, the longer the autocrat's time horizon, the lower he will set the tax rate.

Stability and time horizon

It has been clearly shown that the time horizon is a critical component in the reduction of plunder. Democracies fail to produce liberal rules on account of the numerous incentive problems they confront. Private clubs fail to produce liberal rules because they will manifest illiberal preferences. Ironically, autocratic governments should theoretically produce the *most* liberal rules. Why, then, do autocratic regimes have such abysmal track records when it comes to freedom? If the preceding analysis is correct, then the problem lies not in the nature of autocracy, but in the autocrats' rates of time-preference. Autocrats with insufficient time horizons face the incentives of democracies and roving bandits – they must extract as much value as possible from their resource before time runs out.

Most autocracies are unstable. This is not endemic to autocracy, but instead to government – states. Almost 70% of countries globally are classified at the "warning" stage by the Fragile States Index (Messner, et al. 2018). The capacity for an autocrat's continued resource consumption is uncertain. Dictators never know when there is to be a coup, a peasant insurrection, or an international intervention. This shortens their time horizons and makes them more eager to consume. Further, given their instability, they form coalitions with local factions and members of the international community. In exchange for these parties' support, autocrats must often provide legislation friendly to these foreign aims. The result is that a great many meddlesome preferences are manifested in in law. Moreover, the regional instability accelerates the time horizons for these local factions as well as the dictator, so they make more consumptive demands in exchange for their loyalty. This theory predicts a couple of outcomes that should be empirically tested by future research: (1) law should be more oppressive and tax rates should be higher in less stable autocratic regions; (2) in a given autocratic region, tax rates should increase and laws should become more oppressive in times of greater instability.

Formalizing the model

Taken together, the arguments above provide a theoretical model for a benchmark liberal government. Where L represents the extent to which law is liberal, D signifies democracy, P signifies private clubs, As signifies stable autocracy, and Au signifies unstable autocracy, we can expect:

$$\text{Assuming profit-maximization: } L_{As} > L_D = L_P > L_{Au}$$

This satisfies our intuitions regarding the authoritarianism of autocracy, as it predicts a range of cases in which autocratic regimes produce highly illiberal law. The model also provides a theoretical case for a kind of government that satisfies our economic intuitions, but is empirically unlikely to occur: liberal autocracy. Lastly, it recognizes that democracies and private clubs function as a check on authoritarian government, but contain their own illiberal strains of rules.

By providing a benchmark institutional grounding for rule predictions, the model can help explain deviations. For instance, if a stable autocracy bans psychoactive substances, we can reasonably conclude that its autocrat is not a perfect profit maximizer. The ideal case allows us to understand to what extent, and on what issues, autocrats are “true believers” – that is, the extent to which they are willing to forsake monetary profit for psychic gain (likely a result of ideology). Alternatively, the model functions as the basis of a predictor of a region’s stability. If we hold constant the assumption that the autocrat is reasonably motivated by profit, then the extent to which his ruleset is liberal informs us of the stability of his domain. We should expect that in a draconian autocracy, there are a number of concessions to factions/international powers that the governor must make, from which result the invasive policies.

Conclusion

In summary, the model relates three different variables: the degree to which laws are liberal, the stability in a region, and the extent to which an autocrat is motivated by pecuniary reward. By holding two constant, we can form a reasonable expectation about the third. It also raises a counterintuitive conclusion: autocracies, under the right conditions, will generate more liberal rules than any other system of social organization.

The model can benefit from empirical testing. The questions outlined above regarding the nature of stability are viable avenues of future research. Additionally, since examining the wisdom/alterability tradeoff outlined by Leeson and Coyne, I have left the subject of norms. A model for the propensity of liberal or illiberal norms to arise would help to expound upon this model. Most importantly, the question must be resolved: is there a stable, liberal autocracy to which we can point?

Regardless, the model presents an important theoretical baseline from which we ought to begin our inquiries into the political economy of autocracy. Rather than expecting brutal dictatorship – though that can so often arise – we should hold autocracies up to a benchmark of liberalism. Their failing to be liberal should not be interpreted as something endemic to autocracy or inherent in the nature of power, but rather the result of exogenous circumstances. Liberalism and autocracy are not incompatible. They coalesce, when the autocrat is profit-motivated and holds a secure position of power.

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