

## On the Legitimacy of Mainstream Policy-Making

Enrico Colombatto  
Università di Torino and ICER

December 1999

Previous versions of this paper were presented at ICER (Torino), the Universities of Reims and Aix – en-Provence. On all occasions I received valuable comments, for which I am deeply grateful.

## On the Legitimacy of Mainstream Policy-Making

### **On growth and development**

The post-WWII period has witnessed a number of crucial economic events, and taught important lessons. This paper focuses on one in particular, i.e. the downfall of all systematic attempts to carry out welfare-enhancing policy making. That applies of course to the Communist promise of a Nirvana society where everybody would have been free from need. But also to those theories and experiments that identified economic success in terms of "development" and "social justice". Two expressions which are supposed to refer to higher living standards for all layers of the population, as opposed to average higher income per capita, with relatively little concern for stable income distribution. The obvious examples of such failures are (1) the crisis of the welfare state in Western Europe, (2) the inability to foster growth in the undeveloped world, especially in the poorest countries, (3) the disappointing results obtained in the aftermath of the collapse of central planning in the former Soviet Empire.

These failures were not inevitable. Although largely ignored, the American recipe for productivity growth is not new and its superiority beyond dispute (Maddison, 1995). Yet, the success of the American economy has often been a puzzle for many mainstream scholars and observers, for it does not seem to depend on any of the traditional engines for growth, be they simplified or enriched versions of the so-called catch-up phenomenon, human-capital theories, natural resources or fixed-capital endowments. By contrast, the inability to achieve the declared targets in the rest of world seems startling, in that failure has been the result of repeated, frequently expensive and long-lasting attempts, which surely were not justified neither by the initial, nor by the intermediate results obtained.

As regards growth policies, the mainstream-economics literature has been surely helpful in providing convincing evidence on what happened to the dynamics of productivity, as well as to policy-making. Similarly, a large and expanding amount of work in the field of public choice and institutional economics has offered ample explanation on why productivity can grow faster in some areas of the world than in others; and on why it has been so difficult for the low-income and/or slow-growth countries to imitate the front-runners and improve their performance accordingly (North, 1990; Colombatto and Macey, 1999). However, scholarly contributions have been far less successful from the

normative viewpoint. For the traditional approach keeps suggesting recipes which are clearly good on paper, but unfeasible in practice; whereas the institutional and public-choice visions seem to offer no recipe at all, as if the role of more or less intense government policies were unavoidable, and their long-run evolution outside human control.

This paper aims at suggesting the concepts of "legitimacy" and "functional legitimacy" as possible keys to a better understanding of the role of policy-making. These keys will then be used in order to analyze why the main lessons taught by economic unfolding in three blocs of countries have not always been perceived correctly, and sometimes simply ignored. It will be predicted that although future policies might take different shapes if compared with the past, poor policy-making is not necessarily going to improve in the foreseeable future; and not just because of inertia or resilient interest-group pressure.

### **The orthodox approaches to policy-making**

Post-WWII economics has been dominated by two apparently conflicting orthodoxies, which are commonly identified as the Keynesian and neoclassical schools. An immense literature has contributed to explain the fundamental tenets of both. Although some academic ambiguity still persists as for "who meant what and why", only some key points regarding the foundations of their policy-making prescriptions need to be recalled.

Keynesian analysis focuses mainly on aggregates and macroeconomic issues. Surely, there is nothing harmful in presenting macro-data as the appropriate way to describe general phenomena (*ex post*), be they of a macro nature (e.g. inflation) or of a micro character (e.g. consumption). Information provided by more or less sophisticated statistical tools is also welcome, for it helps to understand the role the various variables have been playing in influencing individual behaviour, on average (Leube, 1999).

The major difficulties with Keynesian economics start when its descriptive tools and practices are made us of in order to develop positive and normative theories. More precisely, from the positive standpoint, Keynesian economics rests on the identification of the "representative agent", who is presumed to be a fraction of the aggregate. That is arbitrary and wrong. It is arbitrary, for it describes an agent - the "representative individual" - who does not exist. Hence, it makes little sense to develop theories to explain the behaviour of somebody/something totally fictitious. It may actually be misleading. Furthermore, it is wrong, for by assuming the existence of a representative agent, one rules out the possibility of competition (except in its neoclassical version). As a consequence, economic growth is originated only by the ability to improve the behaviour of the representative agent, given the available,

constant stock of knowledge. Put differently, growth as we understand it today cannot exist. Keynesian microeconomics boils down to identifying market failures, and to enhancing access to pure public goods and merit goods by the representative individual<sup>1</sup>.

In this light, the emphasis on development and stabilization is hardly surprising, for otherwise one would reach the end of economics in general (Ricossa, 1986); and of Keynesian economics in particular. In addition, both development and stabilization are essentially public-good notions, which make them excellent candidates for Keynesian investigation. Yet, although it is supposed to play a crucial role in Keynesian policy-making, the concept of development remains surprisingly vague and ambiguous. Actually, the very concept of the fractional representative individual, which is the cornerstone of the macro approach, turns out to be a nuisance for a normative theory. This is due to the fact that policy-making necessarily assumes that some individuals are more representative than others, i.e. that some agents (the policy-makers) can interfere with the behaviour of ordinary individuals in order to enhance social welfare through appropriate policies.

Macroeconomic stabilization is not immune from ambiguities, either. Necessarily, it rests on the notion of the business cycle, in the absence of which no stabilization would of course be required. In particular the Keynesian business-cycle theory assumes some kind of stickiness in prices, so that nominal adjustment is prevented when negative demand or supply shocks occur. Nevertheless, even textbook macroeconomics today points out the failure of Keynesian economics to provide convincing explanations as for the origin and inevitability of such stickiness. On the contrary, there is widespread agreement on the fact these rigidities are far from spontaneous and inevitable.

---

<sup>1</sup> This is however an issue towards which Keynesian economics shows very little interest, unlike Keynesian economists.

In other words, (1) targeting macro-variables (including the "common good") as the object of policy-making is virtually meaningless, and (2) the presence of the business cycle does not justify policy-making, at least not on Keynesian grounds.

The neoclassical approach differs from the Keynesian vision, in that changes in nominal variables (e.g. money supply) are assumed to have no real effects - the so-called "classical dichotomy". The consequence is twofold. On the one hand, macroeconomics plays no role: the business cycle is ruled out, and so is the role of policy-making in order to smooth it. Of course, the economy can still show deviations from a stationary path. But these are explained as the result of real shocks and in terms of adjustment to such shocks. In addition, aggregates are just the sum of individual behaviour. Hence, they are longer important *per se*, so that the need to define the "common good" also vanishes. The shift in emphasis from macro- to micro-economics is the obvious consequence.

This is where the discrepancies end, and the affinities begin. The most important of which is of course the illusion of the representative individual. In the neoclassical framework it no longer originates from the Keynesian need to identify the micro-foundations of macroeconomics, but rather as a teaching and explanatory device within the realm of static economics. When this simplifying assumption is however made use of outside the limited boundaries of static efficiency, its positive and normative consequences come fairly close to what had already been observed within the Keynesian framework. The idea of competition as a dynamic phenomenon is replaced by its static counterpart dominated by a relatively large number of identical firms run by robot-like managers. Technological progress cannot take place, because the notion of the identical individual makes entrepreneurial discovery impossible and the stock of knowledge constant, as in the classical tradition. This also helps to explain two additional features of neoclassical economics. On the one hand, the concept of the representative individual implies perfect or accessible knowledge, risk as opposed to uncertainty. For otherwise there would be a reward to entrepreneurial efforts, and some individuals would find it attractive to stand out and no longer behave as representative agents. In addition, transaction costs are relevant not because they inhibit dynamic competition, but rather because they bridle static efficiency, provoke a non-optimal allocation of resources, and possibly lead to undesirable market structures (non-contestable markets).

The positive and normative consequences are rather straightforward. The economy is supposed to operate like a machine where knowledge is more or less perfect and individuals rational, or at least rationally ignorant. Unfortunately, transaction costs and natural accidents prevent the system from attaining the textbook solutions. So that the role of the policy-maker consists of making sure that market failures are corrected by means of appropriate regulatory intervention. Of course, not unlike the Keynesian case, the introduction of the neoclassical policy-maker also violates the representative-individual postulate. For the neoclassical school now assumes that the policy-making individual no longer maximizes his own utility, but social welfare<sup>2</sup>.

In a nutshell, the regulatory role of the neoclassical policy-maker rests on highly questionable assumptions about knowledge, uncertainty and transaction costs. Moreover, it implies that the authority has the discretionary power to choose among infinite Pareto-optimum solutions. And it is hardly worth pointing out that since this power is denied in a neoclassical world, neoclassic regulatory intervention is intrinsically inconsistent.

At first sight Keynesian normative economics does not seem to point to the need for redistributive measures, although Keynes did maintain that income distribution (and redistribution) affects the behaviour of the macro-variables, which under some circumstances can be more or less desirable than others. The same seems to hold true for the neoclassical prescriptions, which assign to the regulatory authority the only function of correcting market failures. Transfers are ruled out altogether, unless they are voluntary. Indeed, the neoclassical skepticism towards government intervention and coercion is beyond dispute, especially with regard to fiscal policies, widely understood.

Nevertheless, it would be hard to deny that redistributive policies have played a major role in the economic history in the twentieth century. And it would also be hard to deny that experiments in constructivism have been the rule rather than the exception in most of the developing world in the last fifty years or so. This is somewhat amazing in two respects. First, the disappointing results of redistribution and social engineering should have been manifest enough to discourage further efforts along such lines. Moreover, given the relative weight of transaction costs and of macro-imbalances in different parts of the world, one would have expected neoclassical recipes to be applied in the industrialized world, and Keynesian recipes to be more successful in the less developed parts of the world. In fact, the opposite has generally been true. Sections 3. and 4. try to throw some light on both

---

<sup>2</sup> This term now relates to static allocative efficiency and applies to any point on the utility frontier. The utility frontier is the Pareto-optimum equilibrium locus, where nobody's utility can be improved without lowering somebody else's. Clearly, even a two-people economy displays infinite social-welfare

accounts.

As will be clarified shortly, it is here believed that the traditional distinction between developed and developing countries, though useful for statistical purposes, is almost worthless - possibly misleading - in order to analyze the origin and acceptability of policy making, good or bad as it may be. On the one hand, the developed/undeveloped classification is in relative terms: a country is not regarded as developed/undeveloped *per se*, but with respect to other economies. For instance the UK economy at the end of the 19th century would be developed by the standards of that time, not by today's. Second, and perhaps more important, the concept of acceptability is related to human perceptions and expectations. Although it might seem plausible to assume that individual perceptions and expectations change with development, continuously or in steps, no articulate and reliable theory has been made available so far. In order to bypass these ambiguities the concept of "maturity" will then be employed.

### **Policy-making in "mature" countries**

For the purpose of the present discussion a "mature" country is defined as one where (1) virtually all individuals have adequate means to secure their subsistence, and opportunities to improve their welfare; (2) a substantial amount of the population believe that their living standards are satisfactory, and ask for a significant premium in order to accept an institutional framework which enhances higher expected income with greater short-run volatility.

Two other notions will also be referred to in the remaining sections - legitimacy and functional legitimacy. The former is a negative concept. A set of rules are considered legitimate if they do not run against any values and objectives shared by the virtual totality of the population, especially if voting with one's own feet is not a realistic opting-out solution offered to dissenters. This also applies to policies consistent with such values and objectives. As an example, coercive redistribution would not be fair or respectful of individual freedom. But according to the present definition, it would still be perceived as legitimate, if it violates the property rights of a very small number of individuals.

On the other hand, the notion of "functional legitimacy" applies to policies which involve a trade-off between conflicting values and objectives, ultimately leading to a legitimate outcome. In particular, functional legitimacy refers to a situation where the policy action has no legitimacy *per se*, but could nevertheless be accepted for it allows to attain legitimate goals. Consider for instance an exogenous shock on the relative-price structure, leading to a different distribution in income. If the common values and objectives include non-decreasing income for all members of the population, a redistributive policy

---

solutions of this kind.

which affected large numbers of people negatively will be considered illegitimate and raise opposition. But if this redistributive policy were understood as the result of some kind of collective insurance mechanism against unpredictable shocks, then such a redistributive policy could be tolerated - sometime even welcomed. Of course, the greater the perceived inter-temporal benefits of the policy with respects to its costs, and the wider the time-horizon the idea of non-decreasing income applies to, the stronger the functional legitimacy of - and the weaker the opposition to - coercive redistribution.

Let us now assess how these concepts apply to the nature of policy-making in a mature economy. Here the idea of development dominates prevail on that of growth. Given the definition of maturity proposed earlier on, a mature economy obviously appreciates growth. Nevertheless, growth-enhancing purposes *per se* would not be enough to acquire legitimacy. For legitimate growth in this context requires that exogenous shocks do not provoke losers; neither in the short-, nor in the long run. That would be unlikely, especially if rent-seeking is serious and widespread inefficiencies abound. Thus, opposition would nullify efforts to enhance competition and growth, especially if the rent-seeking positions to removed are sizable. As a result, although consensus for the existing situation may not be overwhelming, a mature economy would exhibit little interest in changing it. And growth with volatile income distribution would be rejected, since it would not satisfy the evaluation criteria of a mature economy. It would lack legitimacy.

Along the same line of thought, crisis measured by the standard tools (high unemployment and foregone opportunities to increase GDP and purchasing power) may not be considered as such in mature economies. The usual remedies suggested from a neoclassical or Austrian standpoint would therefore be off the mark. For instance, unemployment in a mature economy is not generally perceived as a tell-tale sign of failure in the labour market, for labour-market liberalization would necessarily imply volatility in the wage rate. This would be induced by the institutional change in the short run, and by exogenous changes in prices and perhaps even in productivity in the long run. On the contrary, a mature economy would perceive unemployment as the failure of politicians to meet expectations and fulfill the legitimate request for non-decreasing income to virtually all members of the population. In fact, an increase in the rate of unemployment presents more serious political difficulties than the failure to reduce high unemployment.

In this framework, it is apparent that neoclassical receipts are far from satisfactory, in terms of both legitimacy and functional legitimacy. Appropriate regulatory policies to compensate for market failures are beside the point, for allocative efficiency *per se* does not legitimize policy-making in mature economies. Anti-trust legislation is a telling example in this respect, for in the real world it turns out to have little to do with neoclassical prescriptions. Rather, it seems to have a much closer affiliation with sheer political demagoguery [De Jouvenel 1952; Schoeck, 1966]. In fact, antitrust action seldom serves the purpose of breaking up normative monopolies, and usually concentrates on fighting allegedly unjustified profits in the private sector. This appears to be consistent with the above definition of legitimacy, for the overwhelming majority of the population does not object if the freedom of one individual (or one company) is violated.

On the other hand, Keynesian policies are often successfully proposed and accepted. The reason is that they usually meet functional legitimacy. Sticky markets in mature countries are legitimate in that they are perceived as appropriate guarantees against negative income changes. Counter-cyclical policies plus redistribution are thus welcome, since they are supposed to offset the negative consequences of real shocks. As pointed out earlier on, functional legitimacy is a question of degree. This explains why the deeper the shock, the more acceptable counter-cyclical policies tend to appear. Easy monetary policy is of course a prime candidate, for it tends to make nominal losers disappear and perhaps also reduces the number of the real losers. Furthermore, if the shock is accompanied by greater uncertainty - which is often the case in times of soft monetary policy, i.e. relatively high inflation - redistribution policies tend to be interpreted as some kind of insurance mechanism, rather than an outright transfer of income. Should this be the case, the border between functional legitimacy and legitimacy would become very thin indeed. The same would hold true should the transfer be enacted by issuing public debt, which implies an inter-generational transfer. In this case the policy-maker would be fully within the boundary of legitimacy. Opposition to debt-financed public expenditure would rise only when the incumbent generation senses it is being asked to finance policies approved by past generations, so that marginal inter-generational transfers would be increasingly expensive, or altogether unfeasible.

Put differently, neoclassical recipes in mature economies are not ruled out altogether, but it would be more correct to say that neoclassical views are employed for purposes which have little to do with neoclassical economics. Whereas Keynesian economics is welcome when it confines itself to monetary policy. Other than that, it is not tolerated because of its theoretical soundness or proved success, but rather because its policy-making consequences are sometimes deemed as functionally legitimate. In this light, redistribution is instrumental in strengthening the features of functional legitimacy,

as well as making it politically attractive.

It is of course a matter of empirical investigation to establish which countries are mature and which are not. Perhaps similar distinctions are also worth making within single countries. As a working hypothesis, one can however assume that much of the continental EU area is composed of mature economies; whereas the US and possibly the UK are not. In turn, this raises much more fundamental questions, as for where the origins of maturity can be traced. A task to which economics has no ready answer to provide. Perhaps more suitable explanations could be offered by other social sciences, and through the exploration of the origins of Power in modern societies - say, the subjectivistic principles underlying the Declaration of Independence and the Romantic ones embodied in (and exported by) the French Revolution. Though fascinating and of dramatic importance, this issues will however not be addressed here.

### **The legitimacy of neoclassical economics in undeveloped and transition countries**

Undeveloped and transition countries have in common (1) high and often justified - expectations about their future living standards and (2) a record for low transparency and high transaction costs (leading to huge rent-seeking) in policy making. Differences are far from negligible, of course. But their substance concerns more the features and beneficiaries of the rent-seeking process, than individual ability to choose or tolerate an institutional system or policy. It should be apparent that in these countries the scope for orthodox Keynesian policies is indeed limited. Given the lack of monetary and financial markets and the severe inadequacies of a fiscal system, the possibility of running counter-cyclical policies in order to enhance developments is out of the question, whatever their actual effectiveness and the prevailing political regime.

On the other hand, neoclassical recipes have often been considered legitimate, for they would promise the benefits of the perfect, textbook economy. Transaction costs are described as a temporary inconvenience, and adjustment costs are negligible and possibly softened by foreign aid. Growth would be guaranteed by a catch-up process, the speed of which would be accelerated by massive foreign direct investment.

As is now obvious to most observers, the results turned out to be quite different from what was expected. One can surely design perfect societies and Nirvana economies. But even if correct on paper, such ideal social programs can only be feasible if they match the informal institutional framework they are supposed to interact with (Pejovich 1997 and 1999). When this is not the case, the gap between the formal and institutional rules brings about political instability and economic deadlock, if not disarray

(Colombatto, 1999).

Yet, the question is why the very recipes which have been systematically rejected in the mature economies have been in principle accepted - although *de facto* light-heartedly disregarded - in most undeveloped economies; and often uncritically embraced in many transition countries. Attempts to introduce neoclassical economics have never been taken seriously in most developing countries for a variety of reasons<sup>3</sup>. As argued elsewhere (Colombatto and Macey, 1999), the ruling *élite* in these economies has very limited interest in pursuing growth, development. As a matter of fact, short-run, rent-seeking behaviors are the optimal strategy in order to stay in power. With respect to legitimacy, it is therefore clear that no theory or prescription for growth is legitimate (or functionally legitimate), given the fact that the only legitimacy which counts is the one of the *élites*. Neoclassical policy-making recipes have been listened to mainly because that was the price to pay in order to have access to international aid and recognition, easy credit. In turn, the donors - including international agencies - have been particularly fond of these recipes, because by recommending orthodox neoclassical economics the bureaucrat in charge can hardly be held responsible for disappointing results, and yet fulfil his budgetary objectives. Indeed, there can be nothing bad with Nirvana economics, almost by definition. Surely, when politicians have a role in these program the emphasis on neoclassical textbook is milder, since these actors are more sensitive to failure. But since such programs are managed by bureaucrats or consultants, the weight of Nirvana orthodoxies turns out to be prevailing.

In other words, neoclassical economics has not provoked major damages in undeveloped economies for it never had a substantial impact. Its only pernicious direct effect was to justify donors - both government and international agencies - in their alleged efforts to subsidize and ease hypothetical reform programs. In fact, most of the resources ended up by being controlled by the incumbent ruling UDC *élites*, which used them to enhance their discretionary prerogatives, their rent-seeking activities, and thus their hold on Power. Had one had Keynesian policy-making, the story would not have been much different, as the experience of the 1960s and 1970s witnesses.

As pointed out above, transition countries exhibit relatively low living standards and have undergone a drastic political change. Hence, policy-makers are faced with several problems, among which promoting growth, acquiring prestige and enhancing consensus are the most important. Keynesian policy-making is out of the question for the reasons mentioned in the previous paragraph, although they can become appealing once basic institutional requirements are met, such as an active role for money

---

<sup>3</sup> The only exceptions to this general claim occur when attempts to improve policy-making follow a drastic change in the political system. This is indeed the "transition-country" situation, discussed in the

and an effective system of taxation.

Unlike mature economies, in TCs the emphasis of neoclassical economics on static efficiency and Smithian growth did provide (and to some extent still provides) considerable functional legitimacy to its proposed policy prescriptions<sup>4</sup>. In addition, its Nirvana features met the utopian expectations of public opinion. Thus it is not surprising that the neoclassical tenets were so successful in the TC area. They promised what public opinion desired, they came with international recognition, to the benefit of the local new (or renewed) *élites*, and - last but not least - they often came with significant financial resources attached, including aid and foreign investment.

It is now acknowledged that the overall design failed on two accounts. Both contributed to undermine the functional legitimacy of the neoclassical policy-making effort, with momentous consequences. First, it was fairly quickly realized that neoclassical recipes had nothing to say about the reallocation of property rights. Yet, this was and is a major problem in a TC, which has been answered through a mix of social-democratic solutions under the cover of an allegedly newly-devised gradualist neoclassical strategy. Put differently, neoclassical recipes cannot be thought of in a property-right vacuum, and offer no suggestions as regards the way such vacuum can be filled. As a consequence, the disappointing results generated by gradualist policies ended up by widening the functional-legitimacy gap (with respect to legitimacy) and ultimately by de-legitimizing neoclassical economics altogether. This is indeed where we stand today.

The second set of breakdowns originates from one of the very shortcomings of neoclassical economic theory. For even if one ignores the discrepancies between the formal institutional rules suggested by orthodox textbook microeconomics and the pre-existing informal customs, the neoclassical rules of the game necessarily apply to equilibrium conditions. Disequilibrium is not even considered, both because its mere conception would imply that the appropriate neoclassical prescriptions have been at least in part violated; and because the neoclassical framework lacks a mechanism to react to disequilibrium (the obvious candidate for a this reaction mechanism would of course be entrepreneurship, which is however an Austrian concept). Now, a TC is typically a disequilibrium economy and operates successfully if individual agents are in a position to react quickly to disequilibrium, or to discover the institutional rules which enable quick reaction. But of course, neoclassical economics is not conceptually equipped to solve this kind of issues.

---

next paragraph.

<sup>4</sup> In order to have full legitimacy, the policies should have guaranteed almost negligible adjustment costs - that is, higher income for everybody and limited recession during the transition period - both in terms of time and of GDP. Within this framework, the Western aid programs were supposed to

A third bloc of problems regards the direct consequences of the downfall of gradualism and brings back the very notion of legitimacy in TCs. When neoclassical economics started to be perceived as illegitimate, rather than functionally legitimate, its incomplete and partially working institutions were not eliminated, for there was no obvious alternative to replace them with. In fact, by identifying the neoclassical doctrine as the quintessence of free-market economics, the fiasco of the former delegitimized the latter. The fact that this was an aberration may be obvious from the theoretical viewpoint, but practically irrelevant. The outcome has thus been political instability and economic confusion. The former gave way to a new political season, whereby incumbent governments have found it increasingly difficult to be confirmed in office, and the former communist parties have enjoyed unexpectedly high support, as a consequence of widespread discontentment and of the general desire for stability. While economic confusion generated a significant slowdown in growth rates, fear for change, emerging appetites for some version of the welfare state. More generally, it is not difficult to discern an alarming fast slide towards the mature-economy pattern, though attained at much lower income levels than in Western Europe.

The outlook for the future is not catastrophic, but great opportunities are being missed, while new symbols are emerging as powerful candidates to provide functional legitimacy to new policies. The role played by the EU myth as a future problem solver could hardly be over-emphasized. Indeed, it is not hard to predict that legitimacy will soon be transferred from the free-market paradigm to a Federal-European ideal. And functional legitimacy from neoclassical policy-making to a vague notion of "third way" managed by a European super-state.

### **Concluding remarks**

This paper claims that the debate between growth and development, so fashionable since WWII, has led to conclusions whereby the best way to enhance welfare for everybody is to create an environment which stimulates entrepreneurial activities and institutions apt to reduce transaction costs. Nevertheless, the lesson has been ignored much too often. In spite of their manifest failures and questionable theoretical foundations, Keynesian and neoclassical policies keep coming to the surface in mature Western economies, in undeveloped countries, in the transition world.

It has also been argued that such theories have met success because they have been satisfying legitimacy or functional-legitimacy criteria. And as the economies "mature" Keynesian prescriptions tend to be more successful than rival theories. Thus, viewed from the policy-makers standpoint, the challenge

---

improve the terms of the functional-legitimacy trade-off mentioned at the beginning of section 3.

for the future seems to be to understand how the content of legitimacy evolves in the various countries, and provide new matching recipes accordingly. It should then be apparent that instability will not come from the standard reasoning about the lack of knowledge about what will happen in one, two, ten years from now. In fact, following the Austrian literature, such very lack of knowledge would be a major support for growth. Instead, precariousness will be generated by two other sources. The first refers to the attempts to propose new functionally-legitimate policy-making strategies, and to the efforts to close the gap between functional legitimacy and full legitimacy, whatever the cost may be in terms of growth foregone. The second refers to the political bewilderment generated by the gradual loss of legitimacy of the incumbent economic policies. Whereas that can be tolerable in mature economies, it may lead to severe instability in other parts of the world.

## References

- E. Colombatto, "Is there an Austrian approach to transition?", ICER Working Paper, 16/99, Turin, September 1999.
- E. Colombatto, J. Macey, "Information and transaction costs as the determinants of politically tolerable growth levels", Journal of Institutional and Theoretical Economics (JITE), 155, 1999.
- B. de Jouvenel, The Ethics of Redistribution, Cambridge University Press, Cambridge, 1952 [reprinted by the Liberty Fund, Indianapolis, 1990].
- K. Leube, "On the foundation of the Austrian institute for business cycle research and some methodological problems of economic forecasting", Journal des Économistes et des Études Humaines, 2/3, juin/septembre, 1999, pp. 321-340.
- A. Maddison, Monitoring the World Economy 1820-1992, OECD Development Centre, Paris 1995.
- D. North, Institutions, Institutional Change and Economic Performance, Cambridge University Press, 1990.
- S. Pejovich, "Law, tradition and the transition in Eastern Europe", The Independent Review, 2, 1997, pp. 243-254.
- S. Pejovich, "The effects of the interaction of formal and informal institutions on social stability and economic development", Journal of Markets and Morality, 2, 2, 1999, pp.164-181.
- S. Ricossa, La Fine dell'Economia, Sugarco Edizioni, Milano 1986.
- H. Schoeck, Envy: a Theory of Social Behaviour, Irvington Pub., 1966.