Understanding Capitalism

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George L. Priest's research included a deep insight into the legal basis of capitalism. From his perspective, capitalism emerges from the rule of law and constitutional democracy, as property rights and competition require a limited government. The United States Constitution enabled the success of the United States' economy by concentrating on limiting power. Priest's work suggests that Latin American countries undertake institutional reforms oriented to a similar objective for getting their economies to take off.

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Introduction

This Article aims to elucidate George L. Priest's understanding of capitalism. This understanding encompasses two dimensions—one internal and one external. On the one hand, Priest offers insights into the structure of capitalism, particularly regarding the tensions and the complementarity between property rights and competition. Nevertheless, in my opinion, his most significant contribution lies in clarifying the role of capitalism in other orders of human life. This endeavor is crucial, as it not only overcomes the accusations of economic reductionism towards law and economics but also preserves the value and meaning of economic considerations.

Priest's understanding of capitalism is contained in his writings, speeches, and participation in public debates. However, his papers on political economy stand out in particular. These include "The Ambiguous Moral Foundations of the Underground Economy," "Poverty, Inequality, and Economic Growth—Simple Principles," and "Reducing Global Poverty: Theory, Practice, and Reform." These are compiled in *Reconstruyendo la libertad: una selección de artículos de George L. Priest*.[1] Nevertheless, perhaps his lecture "The Capitalist Foundations of America" presents the most compelling explanation of how he places capitalism within the broader spectrum of human life.[2]

Priest defines capitalism as "the promotion and achievement of economic advance and personal economic improvement." From his perspective, capitalism is defined not so much by the elements that compose it as by its purpose or objective. Priest clarifies that capitalism is not—and does not purport to be—a substitute for religion. As he sees it, capitalism is merely a practical tool, grounded in the assumption that human life is good and should be extended as far as possible by reducing poverty. Its means to that end consist of establishing property rights over scarce resources and allowing them to be allocated by competition.

Property rights serve as the fundamental source of incentives for economic activities. They alone foster the perseverance and diligence needed to steward scarce resources responsibly. Meanwhile, competition ensures that actors continually strive to allocate these resources to their most valuable uses. Priest—like F.A. Hayek[3] before him—views competition as a discovery process of such uses through the price system. If property rights affect the acting person, competition benefits society. By its very nature, competition acts in the interest of consumers, not

1. MARINA LAZARTE, RECONSTRUYENDO LA LIBERTAD: UNA SELECCIÓN DE ARTÍCULOS DE GEORGE L. PRIEST (2011).

2. George L. Priest, May Bradley Lecture: The Capitalist Foundations of America (May 14, 2007), https://www.aei.org/events/the-capitalist-foundations-of-america [https://perma.cc/6XL6-YQCY].

3. F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945).

producers, giving them access to increasingly better goods and services at decreasing prices.

The alternative to capitalism is socialism. Under socialism, the allocation of goods and services is decided not by the impersonal competition mechanism but by the reason and will of the politicians and bureaucrats in charge of the government. Although they may occasionally get it right, competition is more likely to yield better outcomes because the price system aggregates widely dispersed information. Socialism fails not because of any inherent lack of intelligence or will on the part of politicians and bureaucrats but because they lack the necessary information to make effective economic decisions.

I. Law and Economics

Since property rights are institutions, capitalism requires governments that recognize and defend them. Mancur Olson once said, "There is no private property without government!"[4] Similarly, Priest emphasizes that "Markets must be defined by law and the rules of the market enforced."[5] In Priest's perspective, capitalism's institutional framework is extensive, encompassing both informal and formal institutions. These include systems for registering property rights and periodically updated antitrust laws. Ultimately, however, capitalism rests upon the rule of law and constitutional democracy.

Priest emphasizes that economic considerations played a central role in the American Revolution and the writing of the U.S. Constitution. The American Revolutionaries' motto, "No taxation without representation!" expresses such motivation. They did not get rid of British rule to contest issues like traditional definition of marriage; rather, they wanted to avoid abusive taxes. Establishing a representative government was meant not to redefine core social institutions but only to achieve a reasonable level of taxation. American Revolutionaries wanted a limited government and were conservatives on social issues.

The U.S. Constitution was written with the same economic goal in mind. At its core is the principle of separation of powers.[6] Its authors followed Montesquieu's observation:

> [E]very man invested with power is apt to abuse it, and to carry his authority as far as it will go. Is it not strange, though true, to say, that virtue itself has

4. Mancur Olson, *Dictatorship, Democracy, and Development*, 87 AM. POL. SCI. REV., 567, 572 (1993).

5. Priest, *supra* note 2.

6. The horizontal dismantling of government through the separation of powers established in the original articles of the U.S. Constitution was complemented by its vertical dismantling established by the Ninth Amendment. Kent H. Barnett, *Standing For (and Up to) Separation of Powers*, 91 IND. L.J. 665 (2016).

> need of limits? / To prevent this abuse, it is necessary, from the very nature of things, power should be a check to power.[7]

However, they took the search for checks and balances even further, applying them to the hinge between society and the State, that is, the political parties. As *The Federalist Papers* explain, their foremost aim was to prevent the rise of factions.[8]

So, the U.S. Constitution established electoral rules that encourage people with similar ideas and interests to form broad political associations. These include the election of representatives in single-member districts and the election of the President through the Electoral College. With such rules, it enabled an orderly alternation of two parties in power, increasing the likelihood that the rule of law would take hold. The opposition, knowing it would likely win the next election and lose the following, maintained a check on those in office. As later affirmed by game theory, "repetition enables cooperation."[9]

The electoral calendar is also a critical feature of the U.S. Constitution. To balance continuity with opportunities for change, it calls for presidential elections every four years, House elections every two years, and Senate terms of six years—renewing a third of the seats every two years. It also establishes the lifetime tenure of federal judges, making the Judiciary the *first among equals*. These rules sought to facilitate the "adaptive efficiency" that New Institutional Economics would later speak of.[10] So, as Priest stressed, economic considerations were constantly on their minds, though not necessarily using contemporary terms. "I am not claiming that, since the days of the Pilgrims, America has been committed to the Washington consensus," Priest mischievously points out.

II. Comparative Politics

Comparing the political institutions and economic outcomes of the United States with those of Latin American countries suggests that the authors of the first largely got it right. By contrast, many Latin American constitutions pay more attention to enumerating fundamental rights than to establishing strong political structures. Article 10 of the 1979 Peruvian Constitution established, "It is the right of the family to have a decent home."[11] Article 20 of the 2007 Bolivian Constitution guarantees, "Every

7. BARON DE MONTESQUIEU, SPIRIT OF THE LAWS, Book XI, ch. 4 (1748).

8. THE FEDERALIST NO. 9 (Alexander Hamilton).

9. Robert J. Aumann, Professor, Hebrew Univ., Jer. Isr., Nobel Prize Lecture (Dec. 8, 2005) (transcript available at https://www.nobelprize.org/uploads/2018/06/aumann-lecture.pdf).

10. DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (James Alt & Douglass North, eds., 1990).

11. CONSTITUCIÓN PARA LA REPÚBLICA DEL PERÚ [CONSTITUTION] July 12, 1979, art. 10 (Peru).

person has the right to . . . domestic gas."[12] Article 52 of the 1991 Colombian Constitution "recognizes the right of all people to recreation."[13] Article 13 of the 2008 Ecuadorian Constitution says, "Individuals and communities have the right to safe and permanent access to healthy, sufficient and nutritious food."[14]

The 1999 Venezuelan and the 2019 Cuban constitutions represent the extreme end of this trend. Article 86 of the first says,

> Every person has the right to social security as a non-profit public service that guarantees health and ensures protection in contingencies of maternity, paternity, illness, disability, catastrophic illnesses, disabilities, special needs, labor risks, loss of employment, unemployment, old age, widowhood, orphanhood, housing, burdens derived from family life and any other social security circumstance.[15]

Meanwhile, Article 73 of the second "guarantees free, affordable and quality education services for comprehensive training, from early childhood to graduate school."[16]

At the same time, the organizational dimension of the Latin American constitutions is neglected. They neither carefully distribute powers among the three branches nor establish clear rules for the election, appointment, renovation, or removal of public officials. In addition to the classical three-branch framework, these constitutions incorporate numerous independent agencies, thus constructing a baroque constitutional model. The 2022 proposal for a new Chilean Constitution illustrated this tendency to an extreme. It even regulated the firefighters![17] Fortunately, a large majority of Chileans rejected such a project.

However, the most severe deficiency of the Latin American constitutions lies in the systems of proportional representation that they establish. The election of members of Congress on large party lists has produced an atrocious legislative fragmentation. The average number of political parties in Latin American Congresses approaches twenty.[18]

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12. CONSTITUCIÓN POLÍTICA DEL ESTADO [CONSTITUTION] Dec. 14, 2007, art. 20 (Bol.).

13. CONSTITUCIÓN POLÍTICA DE COLOMBIA DE 1991 [CONSTITUTION] July 7, 1991, art. 52 (Colom.).

14. CONSTITUCIÓN DE LA REPÚBLICA DEL ECUADOR [CONSTITUTION] Oct. 20, 2008, art. 13 (Ecuador).

15. CONSTITUCIÓN DE LA REPÚBLICA BOLIVARIANA DE VENEZUELA [CONSTITUTION] Dec. 20, 1999, art. 86 (Venez.).

16. CONSTITUCIÓN DE LA REPÚBLICA DE CUBA [CONSTITUTION] Apr. 10, 2019, art. 73 (Cuba). Although now that I have a son attending graduate school at Yale, I am finding out this Cuban constitutional provision is not that crazy.

17. CHILE PROPUESTA DE CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA [PROPOSED CONSTITUTION] July 4, 2022, art. 56 (Chile).

18. Michael Coppedge, *The Dynamic Diversity of Latin American Party Systems*, 4 PARTY POL. 547 (1998) (arguing that Latin American legislative fragmentation characterizes all 20th Century Latin America).

Furthermore, their relative participation in the seating distribution is relatively even. Because of this, both government and opposition require the formation of large parliamentary last-minute coalitions. Consequently, Latin American political processes are all but predictable. Peru's record of six presidents in the five years between 2018 and 2022 is just an example of this.[19]

Latin American countries, lacking party systems, do not offer the long-term horizons required for large business projects and capital accumulation. Consequently, as the region's country risk premium reveals, economic agents, in general, and investors, in particular, demand immediate high returns. However, they are not the only ones that highly discount the value of future cash flows. Navigating the agitated waters of Latin American political storms, consumers tend not to postpone consuming. So, capital accumulation weakens.[20] Angry moralistic critics of Latin American economic agents forget that time preference depends on the predictability of the economic processes, and thus on the rule of law and the political structures upon which it rests.

III. Institutional Reform

Latin American constitutions have prioritized ends over means. As a result, unlike Eastern Europe and Asia, the region is increasingly falling behind the developed countries of their hemisphere. It does not use what Erich Weede called "the advantages of backwardness."[21] A recent report of the G30 notes that Latin America falsifies the convergence hypothesis:[22] while Estonia, Lithuania, and Latvia have already matched Italy's development levels, and Singapore and South Korea are catching up with Japan, Latin American countries drift further from the United States and Canada. The average Latin American GDP per capita is 12% of the one of the United States, compared to 17% in 1960. Over the intervening 64 years, Latin America has effectively become 30% poorer than the United States.[23]

Priest does not venture to explain the roots of Latin American constitutional romanticism. However, he emphasizes the need to consider the economic consequences of political institutions and to adopt a humble yet practical approach. In a similar vein, Peruvian economist Felipe Ortiz

19. The five presidents are Pedro Pablo Kuczynski, Martín Vizcarra, Manuel Merino, Francisco Sagasti, Pedro Castillo, and Dina Boluarte.

20. ROGER GARRISON, TIME AND MONEY. THE MACROECONOMICS OF CAPITAL STRUCTURE (M.J. Rizzo & L.H. White, eds., 2001).

21. Erich Weede, *The Impact of Democracy on Economic Growth: Some Evidence from Cross-National Analysis*, 36 KYKLOS 21 (1983).

22. GROUP OF THIRTY, WHY DOES LATIN AMERICA UNDERPERFORM? (2003).

23. Ismael Benavides, *La Increíble Capacidad Destructiva de la Izquierda Latinoamericana*, EXPRESO (July 21, 2024), https://www.lampadia.com/opiniones/ismael-benavides/la-increible-capacidad-destructiva-de-la-izquierda-latinoamericana [].

de Zevallos M. has argued, "A Constitution should not propose the maximum to which a society aspires but the minimum on which it can agree to govern itself."[24] Rather than debating about great principles, Latin Americans must negotiate political and electoral rules that enable productive interaction among people with different opinions and interests. As Priest insists, what can lift Latin American countries out of poverty is not foreign aid but institutional reform.

Priest has stressed that poverty reduction has always resulted from economic growth, not from the redistribution of resources. Economic growth occurs when the value of goods and services increases, arising from their allocation to their most valuable uses as defined by their free exchange in the market. The economic value of goods and services lies not in the goods and services themselves but in their relative scarcity—that is, in their scarcity relative to people's preferences. Most importantly, the economic value of goods and services can shift when individuals discover new uses for them through innovation. Nevertheless, Priest points out that free markets require:

> a system of law—contract, tort, property, antitrust—that creates and defines productive market activities; a stable macroeconomic environment—controlling inflation to maintain a stable currency to give confidence that investments will return profits; plus limitations on the extent to which government activities impinge on private investment through excessive taxes, duties or other governmental obligations or by the government forcing out private economic activity through government ownership or regulation.[25]

Latin American countries need institutional reform that provides such a system of law.

However, to do so well, they should remember the constitutional foundations of market institutions. In the United States, the market process is sustained by a political structure that protects property rights and secures competition. This includes the separation of powers, the vertical disintegration of government through federalism, and an ordered alternation of two political parties in government. Focused on controlling the abuse of power, the U.S. Constitution unleashes a dynamic economic landscape in which entrepreneurial innovation thrives and provides all kinds of things, from electricity and automobiles to the Internet and artificial intelligence. These goodies do not answer life's meaning but expand its possibilities. Latin American countries may try such an approach.

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24. Felipe Ortiz de Zevallos M., *Opiniones de un lego (I)*, PERÚ ECONÓMICO (Mar. 1993), at 20.

25. George L. Priest, *Reducing Global Poverty: Theory, Practice, and Reform*, 26 SELA 4, 14-15 (2005).

Conclusion

George L. Priest's understanding of capitalism underscores the critical role of legal institutions in fostering economic development. However, pointing out its consequences also invites a reasonable and open debate on their character and meaning. Through all his writings, lectures, and public engagement, Priest has championed reasoned dialogue serenely and gracefully. Indeed, humor has not been absent in his intellectual work. In celebrating such an understanding, we also celebrate our higher, more humane capacities.