

Did socialism have to fail?

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Lecture no. 5



The QUESTION:

What is the nature of economic transformation from socialism to capitalism?

So far we know:

- What socialism means in theory...
- What intellectual tradition is behind...
- What were the consequences of socialism in practice

We will learn now:

- Whether central planning is a viable alternative to markets

2

Why should socialism be superior?

- Capitalism cannot produce enough wealth for all because it lacks rational coordination mechanism;
- Competition means anarchy;
- Competition is a wasteful method of allocating resources

In socialism, everything will be precisely calculated

„Given these economic preconditions, it is quite possible, after the overthrow of the capitalists and the bureaucrats to proceed immediately, overnight, to replace them in the control over production and distribution, in the work of keeping account of labour and products, by the armed workers, by the whole of the armed proletariat ... Accounting and control – that is mainly what is needed for 'smooth working', for the proper functioning, of the first phase of communist society.“

V. I. Lenin *Collected works* 3

Economic calculation

How to produce efficiently? With minimum costs...

Example

Produce heat $\xrightarrow{\hspace{2cm}}$ burn diamonds
 $\xrightarrow{\hspace{2cm}}$ burn wood

What is more efficient?

- Technically? Diamonds burn with no ash left
- Economically? Depends on opportunities...

1) Imagine I dislike diamonds (consider them devil's gift) \rightarrow opportunity cost close to zero...

Does it make sense for me to burn them?

2) You may like diamonds very much \rightarrow exchange opportunity \rightarrow now, my opportunity cost of burning diamonds is the price you are willing to pay

\rightarrow Now, cost is not determined only by my opportunities but also by yours

4

How to take OC of other people into account?

Through exchange ratios...

How to meaningfully compare the exchange ratios of all goods?

We need a common denominator that is present in all exchanges

MONEY = universal medium of exchange

5

Monetary prices make it possible to **compare** opportunity **costs of all people** entering the division of labor \rightarrow allocate resources to the best uses.

How does it work?

- In their consumer roles, all people make monetary bids for the existing stocks of final goods according to their subjective valuations, leading to the emergence of objective monetary exchange ratios which relate the values of all consumer goods to one another

market for consumer goods \rightarrow prices of consumer goods

6

- Entrepreneurs (having the existing knowledge of the technical conditions of production) seeking to maximize monetary profit bid against one another to acquire the services of the productive factors currently available and owned by these same consumers (including those in entrepreneurial roles). In this competitive process, each and every type of productive service is objectively appraised in monetary terms according to its ultimate contribution to the production of consumer goods.

market for producer goods → price of FoP

CALCULATION (comparison of costs and benefits in terms of money) is a *sine qua non* of efficiency

Calculation in socialism

Calculation is possible only on the markets

→ Without markets there is no calculation; there can be no complex economy. It is impossible for the central planner to determine opportunity costs of his decisions.

“To the entrepreneur of capitalist society a factor of production through its price sends a warning: Don’t touch me, I am earmarked for another, more urgent need. But under socialism these factors of production are mute.”

Mises, Bureaucracy

The distinction between socialism and capitalism is not planned order versus anarchy...

Calculation in socialism

1) What to produce?

Difficult to ascertain but not impossible (market research...)

2) How to produce?

It requires aggregation of the judgments of all individuals about opportunities they face and solutions they perceive

- Not about gathering existing pieces of information

Hayek: „the knowledge of the particular circumstances of time and place“

“Every human action means planning. What those calling themselves planners advocate is not the substitution of planned action for letting things go. It is the substitution of the planner’s own plan for the plans of his fellow men.”

Mises, Planned Chaos

In capitalism – there is an “intellectual division of labor”

By abolishing PP in the FoP socialism abolishes the mechanism which makes societal economizing behavior possible.

Calculation summary

Ex ante calculation:

Entrepreneurs forecast the spread between present prices of FoP and future prices of consumer goods

Ex post calculation:

Entrepreneurs compare incurred costs with receipts and calculate profit or loss – thereby realizing whether it was rational to allocate resources this way.

The only way to discern whether there is a CAPITAL CONSUMPTION or ACCUMULATION.

- Without private property in the means of production, there will be no market for the means of production.
- Without a market for a means of production, there will be no monetary prices established for the means of production.
- Without monetary prices, reflecting the relative scarcity of capital goods, economic decision-makers will be unable to rationally calculate the alternative use of capital goods.

Why did socialism fail?

- Calculation is not decisive in a static economy (historical technical coefficients)
- Incentive is not a problem when people share the common goal

However, both problems become important in the LR...

- **Both problems played an important role**
- **SR failures of socialist economies were mostly due to incompetent revolutionary economic policy, not due to application of central planning...**