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DO COMMUNIST AND FREE ECONOMIES SHOW A CONVERGING PATTERN?

1. WE are witnessing today the coexistence of two radically different economic systems, the 'communist' and the 'free' economies (according to western terminology) or the 'socialist' and 'capitalist' systems (according to the eastern vocabulary). The various names given to them are far from precise. Perhaps the most imprecise thing about them is the suggestion that each of these systems represents something well-defined and hence invariant. Reality shows both to be in permanent change. Analysis of the nature of this change can prove quite fascinating. This essay proposes to show that the changes are in many respects converging movements. As will be seen, our essay is a very brief sketch only, trying to indicate a few main tendencies and not going into any detail, or, for that matter, into differences between the communist countries.

The main forces behind the changes may be brought under two broad headings. On the one hand each system is learning from experience and trying to overcome some of its own weaknesses. On the other hand the systems begin to influence each other more and more. While in the beginning the communist system was not taken seriously by the free system this has changed to a considerable extent. The communist system has been interested in some 'capitalist' achievements from its very start. Now it is not so much imitating some of the western methods as learning economics from its own experience.

2. Some of the major changes which have occurred in the communist system since the Russian revolution will very briefly be summarized in this section:

(i) For a short while it was thought that specialized management was superfluous and that 'the workers' could take care of this activity. It was soon learned that specialization is more efficient with regard to management. In fact, the traditional principle of resistance to specialization in all forms is becoming increasingly less prevalent.

(ii) For a short while an attempt was made to equalize incomes in a drastic way. The well-known consequences of such equalization by decree forced the regime to introduce a wage system which makes

wages largely dependent on productivity. Strangely enough, this was then labelled 'socialist wage policy'.

(iii) For some time planning was done in terms of physical quantities and not in terms of money values. Gradually the use of money as a common denominator penetrated into the planning system and the significance of prices and costs was more and more recognized.

(iv) For a long time interest was considered an unnecessary concept as a consequence of the elimination of private ownership of capital goods. Gradually it was discovered that the elimination of interest as a form of private income does not mean that it should also be disregarded as a cost element.

(v) Rationing was abolished a few years after the Second World War and free consumer choice accepted as a proper institution. Gradually some more emphasis was given to consumption as the purpose of production.

(vi) Mathematical methods of planning, considered as 'capitalist' for a long period, were recently recognized to be objective and helpful and are now widely discussed and applied.

(vii) A profound change is under way in the concepts of international trade, not only between communist countries but also between communist and free economies. The idea that each country should have its own heavy industry is no longer adhered to.

3. The so-called free economies have also undergone thorough changes, which will now be summed up.

(i) The public sector nowadays is considerably larger than it was in the nineteenth century. Especially in western Europe public utilities are publicly owned; railways and tramways, coal mines, steel works, insurance companies and banks are often in the public sector.

(ii) The amount of taxes levied in western economies, often in the neighbourhood of one quarter of national income, means that taxes are among the important regulators of economic activity. In addition a considerable portion of the nation's savings is made in the public sector.

(iii) Free competition has been limited in many ways as a natural consequence of some technical forces (high fixed costs of production). It has also been voluntarily restricted by such movements as the drive for standardization.

(iv) Partly as a consequence of (iii) governments have limited the freedom of entrepreneurs by anti-trust laws.

(v) Access to education has been given gradually to an increasing portion of the population, often by providing education without charge. Moreover, education has been made compulsory up to a certain age.

(vi) Market forces have been eliminated or modified in some particularly unstable markets, especially in agriculture and in some cases even international commodity agreements have been concluded.

(vii) Planning has gradually been given an increasingly important role, both in big private enterprises and in the design of national economic policy.

(viii) Deliberate development policies have been in existence for a long time. In the nineteenth century already, transportation facilities were often created with public help. At present a whole range of measures, from tax facilities to government investments in infrastructure as well as in manufacturing industry proper, are applied to further the development of remote areas or poor regions.

(ix) Some forms of price and wage control as a direct means to prevent inflation have been used recently in a few 'free' economies.

4. Several of the changes recorded above are in fact bringing the communist and the free economies closer together. This cannot be said, however, to mean that the differences are already small. There are very large differences still. But the process has not stopped. Both types of economies are facing many problems. They will have to move further. In this section we try to give a picture of the most striking differences still in existence and in the subsequent sections of the most important problems to be solved in both types of economies.

(i) The most striking difference is, of course, the size of the public sector. It should not be forgotten, however, that the power of the private sector in western countries is not commensurate with its formal size. In many indirect ways western societies have reduced this power. For example, taxes take away almost half of the profits. Of the remainder, a large part is invested and only a small part paid out as dividends. Western as well as communist economies are to a large extent dominated by managers. In the west, shareholders are no longer powerful. Social legislation in many respects also restricts the freedom of action of private entrepreneurs. So do a number of regulations with regard to quality control, pollution of water and air, building activity, town and country planning and so on.

(ii) Another important difference is the degree of freedom in production decisions. Factory managers in the west have much more freedom in this respect than managers in communist countries where a still very large number of items is planned centrally.

(iii) Accordingly, there is a considerable difference in the degree of detail in which the future course of the economy is planned in communist countries and in 'free' economies. This refers to production as well as, e.g., to foreign trade.

(iv) Prices are controlled centrally in the communist countries to a much higher degree than in western countries, where, as a rule, only a few agricultural prices are under direct control. Here again, however, western countries use more indirect means of influencing prices. Among these, competition is the main institutional means, but import duties and monetary policies and (in Holland) wage control and price control of some other items are supplementary instruments.

(v) Industrial democracy is very different in the two types of countries. In the west only some beginnings have been made with co-determination of workers or their organizations in some social issues. In the communist world workers are given opportunities to participate in the discussions about the economic plans of the enterprise and about the use of a portion of the enterprise surplus.

(vi) Education constitutes another subject in which there is still considerable difference. In the 'free' countries a certain portion of the potential students of secondary and university training cannot receive the education they need for lack of financial means. The portion is declining, however, as a consequence of several types of financial help, which in some countries enable as much as half of the student body to carry on their studies.

(vii) The differences in the level of savings are recently less striking between such countries as the continental European countries and the communist countries than they were before. Savings of about 20% of national income are now no exception in these western countries; Japan is saving nearly 30%. The United States and the United Kingdom, however, save considerably less.¹

(viii) Regarding the principles of the international division of labour and the priorities of investment projects the differences between east and west are rapidly disappearing.

5. Corresponding to these problems the communist countries may have to face the following issues:

(i) A major problem seems to be the question of whether or not a gain in efficiency will result from making a large number of small enterprises in essence 'private' enterprises by some sort of lease or concession system. If one tries to imagine the volume of administration now usual, say, in shops, it must be a burden on general efficiency.

(ii) A second major problem seems to be whether or not more freedom in production decisions can be given to managers. With rising real incomes citizens of the communist countries will require a finer pattern of qualities and assortment which it is hardly possible to plan centrally. Those closest to the market can probably best judge the needs. There does not seem to be any danger of the central authorities

losing control over general economic development as a consequence of granting this type of freedom for the individual manager.

(iii) One also wonders whether or not the number of items planned centrally should be diminished in order to relieve the central planning agencies of a heavy burden which appears to have relatively unimportant qualifications in terms of increments in national wellbeing produced. The same may well apply to international trade planning.

(iv) The next question communist countries might put to themselves relates to price fixing. What harm is there in permitting prices to move as a consequence of relative shortages or abundances and letting them contribute to restore equilibrium? Is not such a method in fact quicker than a mere adaptation in production programmes or stocks? Prices will have to move anyhow as a consequence of technical progress and changes in crops. It remains an open question whether the changes should be permitted to individual sellers or only to central authorities. In other words, there seems to be a choice here where the answer is not so clear beforehand and where there is an element of discretion.

(v) A very fundamental question, going far beyond economic institutions is of course the one about a possible widening of democracy in our sense. It is not within the scope of this essay to make any speculations on this important subject.

6. Certainly the 'free' economies also have to face questions.

(i) Has the public sector the correct size? In the United States important commentators have made the point that it is too small in that country and that recently some public tasks have been neglected.

Even if in European countries the question does not seem to be a controversial issue, the related question of how further to restrict the privileges of some forms of private income or capital still is one under discussion. There is an interesting argument about the possibility of restricting consumption financed out of capital gains, introduced by Nicholas Kaldor's book on 'An Expenditure Tax'. Possible restrictions on the income paid to directors are discussed and the case for higher inheritance taxes has not been decided upon. The impression of a certain stagnation in the reforms in this field is due not so much to general satisfaction about the present state of affairs as it is to the fact that progressive political parties are re-thinking their programmes.

(ii) There is not much debate in western countries about restricting the freedom of decisions of managers about their production programmes. Rather there is an increasing interest on the side of management for general economic forecasts and market analysis to help them in their decisions.

(iii) Accordingly the case for some more planning is a living issue in the west. One government after the other feels it has to do something in this field. The most recent example is Belgium, with a possibility for Germany to follow. In Asian countries planning is generally accepted; only the methods differ. The borderline European and Asian country, Turkey, has just established a planning agency. Latin American countries are one after the other engaging in some planning. There is a wide variation in the degree of detail planned and the time has come to discuss in a more precise way which degree of detail is the most appropriate. The outcome of such a discussion may also have its value for the communist countries.

(iv) Price formation is an issue of discussion in the west mainly when the general price level is at stake: should not governments have more instruments to counteract inflationary price rises, especially of the cost-push type? The existing situation is unsatisfactory. The use of only monetary and financial means contains the danger of creating unemployment before the price level goes down. Wage control as an indirect means of controlling prices is not accepted. International integration in order to strengthen competition may give some help in small countries, but does not solve the problem for larger countries. It may therefore be that after all some new form of price setting is necessary.

(v) There is a continued pressure in western countries to facilitate the access to education for larger groups of the population. Some of the proposals are going into the direction of the communist solution, namely to pay a wage to the student. Other proposals are more traditional.

(vi) Industrial democracy is an unsolved question too. The attempts so far made in Western Europe differ from country to country. None is very satisfactory.

7. The picture given shows that communist as well as 'free' countries have to solve some problems and that there may be further tendencies to a converging movement. This is true particularly for the main question about the degree of decentralization in production decisions and planning. It is to some extent also true for the process of price formation. It is less clear with regard to the formal side of property, but a distinction between formal property and the real situation must be made. As already observed, both the income from property and the freedom of decision with regard to its use have been strongly reduced in the west and the process may continue.

It is interesting to add a more theoretical analysis to the factual description already attempted. What does economic science have to tell us about the probability of a further convergency of the organization patterns? It is evident that economic science can only tell us

something about the subject in so far as economic forces will determine the movements. Clearly in the past other than economic forces have been at work. Nevertheless, would it be denied that economic considerations are important both to communists and, let us say, to Americans?

The chapter of economic science we may first consult is welfare economics. In principle, it tells us about the conditions which the optimum pattern of organization of society has to fulfil. Its contents have long been considered a defence of the free enterprise system, but wrongly so. It is true that welfare economics show that uniform prices (i.e. absence of price discrimination) are among the conditions for maximum welfare. But these can be established just as well by a system of government-controlled pricing as by competitive markets.

Another proposition of welfare economics is that prices should be equal to marginal costs. This statement implies that for the activities characterized by high fixed costs and technical surplus capacity private enterprise cannot be the system leading to maximum welfare, unless two-part pricing be applied for these activities.² Even in the case where all enterprises in these branches of activity would apply two-part pricing the question might arise whether or not a more efficient administration of this system could be obtained if these enterprises were combined. This combination, in turn, in order not to degenerate into a super-monopoly should be in public hands. Socialization may be the best solution therefore for all the activities concerned.

Similar remarks are valid with regard to activities showing external effects. It can be shown, at the basis of welfare economics, that activities of this kind should be carried out by integrated units; integrated, that is, with the producers or consumers whose wellbeing is affected by the external effects. Socialization may again be a solution.

In concrete terms, the most important activities falling under these two categories are about the same as those already socialized in Western European countries, namely public utilities, rail and air transportation, highway construction and education. Possibly also steel and coal should be added and perhaps other types of transportation.

A further subject relevant to welfare economics is taxes. Two principles are important: first, that there must be some form of income redistribution and second, that income tax is not the optimal way of doing so. The redistribution taxes should approach as much as possible the lump-sum type, i.e. the type not taxing marginal income. Wealth taxes are perhaps the nearest example we know today.

All this points to the desirability of some sort of a mixed system, as far as property is concerned, and to a tax system which may hit personal wealth more than it now does in the west. It also points in the

direction of admitting more decentralization with regard to the activities showing constant or increasing costs, i.e. generally for industries where small units are justified as the communist countries may discover in the future.

8. Reference to another chapter (or chapters) of economics may be needed, in order to answer the following questions. What element of truth is there in the contention sometimes made that there is no optimum in the middle, but rather a tendency for optima to be at the extremes?

This opinion is sometimes illustrated by the argument that 'once you start to deviate from market price formation you have to regulate more and more until the whole economy is regulated'. Is this illustration relevant to our subject and would it, in a general way, disprove the assumption of an optimum somewhere halfway? The alleged tendency to divergency rather than convergency can no doubt be observed in some cases of war economy regulations. If you start rationing and price control in some markets you will soon find it necessary to regulate other markets too. The argument does not necessarily apply to other types of intervention, however. An interesting example to the contrary can be found in business cycle policy. Here it is generally accepted that if you regulate the total flow of demand by appropriate instruments—e.g. financial and monetary policy—you may then leave most markets to themselves. You can, in addition, select a few markets showing characteristics of instability, which may be controlled without the necessity for controlling other markets. Those to be controlled are the ones showing long production lags or a long life of the products.

In the same manner the ownership of the means of production is not characterized as such by a tendency to spread. In Western Europe there exists a public sector of a certain size which has maintained itself for years without making it necessary to expand it rapidly in order to preserve some equilibrium. If in the USSR private business has virtually vanished it is because it was discriminated against on ideological grounds and, in the initial period, for reasons of political power.

In the case of planning a similar position can be maintained. Planning the main elements of the economy does not necessarily imply the need for detailed planning.

It cannot be argued therefore that there is an inherent tendency for economic regimes to move to the extremes. Our theoretical reconnaissance therefore, seems to support rather than to undermine the views derived from observation. No doubt the optimum organization of the economy will differ from country to country and from period to

period. It is also hardly conceivable that we will soon be able to indicate precisely where the optimum lies, or even to say whether 'east and west' will actually 'meet' in their attempts to find the 'welfare summit'.

9. This essay may be concluded with a few remarks about the 'non-committed' countries, that is non-committed to one of the two economic systems at the extremes. Being underdeveloped countries at the same time, they still have a significant number of feudal elements. They are less subject to preconceived ideas about the economic system. If the state sector plays an important role in some of them it is because the necessary initiative was first taken in this rather than in the private sector (Turkey, India).

This group of countries is now facing some very urgent economic needs, partly as a consequence of increasing contacts with the outside world, partly because they have only recently become independent states. The most pressing need is the one for a higher level of production. Another need is to live under a system of stabler prices. Several secondary aims of policy can be derived from these primary ones, such as the full use of resources, an increase in investment levels and a diversification of their production pattern.

Because of the presence, in today's world, of the two major systems the underdeveloped countries are looking to both in order to learn from them. They are above all interested in rapid growth and less in such issues as parliamentary democracy, since they have hardly ever had it. The communist example impresses them greatly. Planning is in high esteem. State initiative does take up part of the tasks neglected by private initiative. The willingness to interfere with price formation is understandable since they are often depending on typically unstable markets. Conditions seem favourable in these countries to try to combine the best elements from communism and free enterprise. These countries therefore may become the experimental ground for economic regimes.

They may, as they sometimes do in technical matters, skip one phase in their development and at once aim at the best solution. They should try to. And we may follow with particular interest the pattern of society that is emerging.

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¹ One may comment that probably the US and the UK are the most mature economies among the western countries. Interestingly enough, however, continental Europe used to have the same low savings rate as the UK and the US for a long time, but after 1950 showed a remarkable increase.

² J. Tinbergen, 'The Theory of the Optimum Regime', *Selected Papers* (Amsterdam, 1959) p. 264.