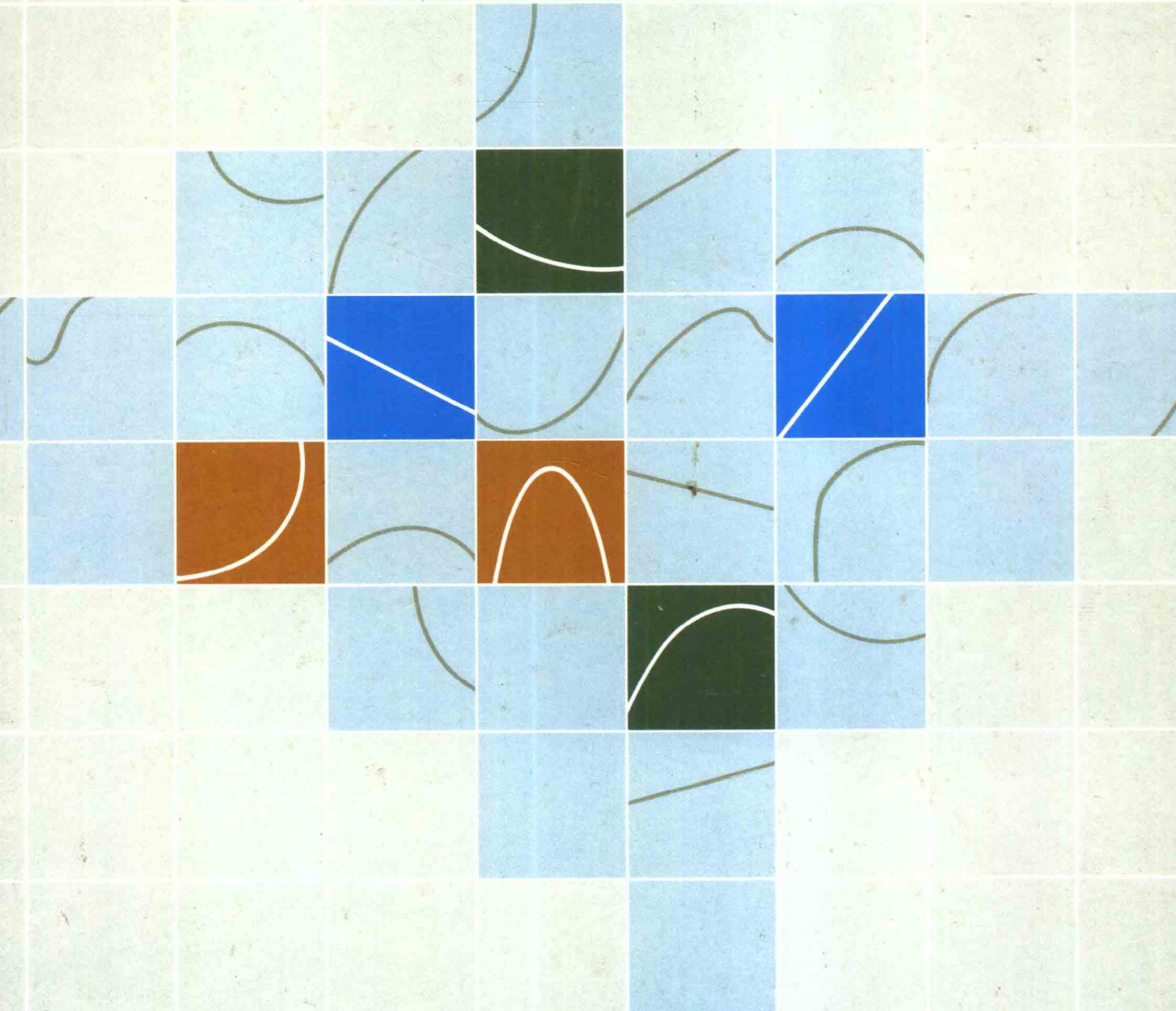
COMPARATIVE ECONOMIC SYSTEMS

John E. Elliott



COMPARATIVE ECONOMIC SYSTEMS

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Preface

This second edition of *Comparative Economic Systems* is, like its predecessor, intended as a core text, primarily for upper division courses in comparative economic systems. Like the first edition, it contains a clear theoretical focus. All students (economics majors as well as nonmajors) need a theoretical framework in order to sift through and interpret contending ideas and information about actual economic experiences. Theories of economic systems are examined mainly in Part II (theories of capitalism from competitive market through Keynesian versions) and Part IV (alternative views of socialism).

A major change in this revision is the expansion, both absolutely and relatively, of consideration of economic systems in practice. The material on contemporary managed capitalism (Part III) has been completely rewritten and supplemented with two new chapters on Western industrialized economies. The discussion of contemporary Communism (Part V) has also been thoroughly reorganized and rewritten. Examination of the Soviet economy, economic reforms in East Europe, and the theory and practice of a worker-managed system in Yugoslavia has been considerably expanded and updated. A new chapter has been added on Communist China. A concluding chapter that compares the performance of economic systems in several pairs of countries—USA and USSR; West and East Germany; China and India; Cuba and Costa Rica—has been added.

Greater and more focused attention is given in this edition to what may be called the *political economy* of economic systems. This is illustrated in several ways. Chapter 1 now includes an extended discussion of criteria for evaluating systems performance. Chapter 2 provides a review of major developments in economic systems in the twentieth century. The social philosophies accompanying the theory of competitive market capitalism (notably, classical liberalism) are examined in Chapter 4. Marxian theories of history, social classes, and alienation are incorporated in Chapter 5 (which has been substantially revised) and connected with the Marxian economic theory of capitalism. Contending views concerning the transformation and future of capitalism (Marxian, Schumpeterian, Veblenian, and institutionalist) are compared in Chapter 6. A new chapter on post-Keynesian perspectives on managed capitalism has been added for this edition (Chapter 8). Marxian and democratic socialist perspectives on socialism have been expanded and rewritten (Chapters 12–13), and examination of issues pertaining to socialism, freedom, and democracy have been incorporated directly into Chapter 14. Discussion of the Soviet economic system under Lenin and Stalin includes analysis of contending perspectives on the character of the Soviet political economy (Chapter 17). Chapter 19 on Yugoslavia incorporates a new section comparing competing evaluations of worker management.

In this edition, discussion of contemporary managed capitalism in practice (Part III) immediately succeeds that of major classic theories of capitalism (Part II). Similarly, examination of theories of socialism (Part IV) is followed by consideration of contemporary Communism in practice (Part V). Teachers who prefer the alternative arrangement found in the first edition, however, may wish to have students read contending theories of both capitalism and socialism first, before turning to contemporary practice. The appropriate order would then be: Parts I, II, IV, III, V, VI.

The author is grateful to many people for the preparation of this book. Although Professor Robert W. Campbell was unable to play an active role in this edition, the chapters on contemporary Communism in

the first edition, primarily written by him, have been drawn on and inform this work. Dr. Phillip Lesser, Sunkist Growers, Inc., wrote the first drafts of Chapter 21 and the section in Chapter 19 on performance of the Yugoslav economic system. Similarly, Professor Philip Klein, Pennsylvania State University, had primary responsibility for the chapters on managed capitalism in practice (Chapters 10–11), and Jan Prybyla, Pennsylvania State University, had primary responsibility for Chapter 20 on Communist China. The author is deeply indebted to these three co-contributors and extends his apologies for adaptations required by the revision.

The author would like to thank several people who reviewed the manuscript and made constructive suggestions for its improvement: Joseph Ascheim, George Washington University; Gordon S. Bergsten, Michigan State University; Thomas Bonsor, Eastern Washington University; W. Robert Brazelton, University of Missouri, Kansas City; Martin Bronfenbrenner, Duke University; Andrzej Brzeski, University of California at Davis; David Conn, Wayne State University; Barry L. Duman, West Texas State University; Daniel R. Fusfeld, University of Michigan; Peter M. Lichtenstein, Boise State University; Hans C. Palmer, Pomona College; George Rosen, University of Illinois at Chicago Circle; and J. Ron Stanfield, Colorado State University.

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INTRODUCTION

I

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The Study of Economic Systems

1

The study of economic systems is both fundamental and topical. It is fundamental because the problems of "making a living" are as old as mankind itself. From one perspective, economic necessity refers to the basic fact that resources are scarce relative to the uses to which they can be put, and thus procedures for "economizing" must be established. From another, "making a living" refers to the necessity of organizing and employing labor and other resources to provide material products for human sustenance, and the associated creation, distribution, and disposition of an economic surplus above basic sustenance. From either perspective, economic life is fundamental to any society, and the institutional framework for resolving economic problems differs among different systems of economy.

The topicality of economic systems is highlighted by institutional change and diversity. Since World War II, systems of economy based on social ownership and centralized political direction have been established in such diverse settings as Eastern Europe, China, and Cuba. Since the 1960s, the diversity among the economic structures of these countries has increased, and, at least in some, the pace of institutional change has heightened. Evolution of the western, industrialized countries also has been characterized by institutional change and diversity. Compare, for example, the relatively centralized "indicative planning" of France or the highly developed "welfare state" of Sweden with the weaker commitment to both social welfare expenditures and national planning in the United States. Finally, movements toward national independence, concerted development programs by former colonial and less developed countries, and the dramatically altered economic status of some of these countries during the 1970s through control over oil resources are further prominent examples of change and diversity in the world's economies.

ECONOMIC SYSTEMS

What Is an Economic System?

An economic system, in essence, is a set of relations among decision-makers and between decision-makers and economic variables. It consists of the sum of ideas, goals, methods, and institutions used in society to resolve these economic issues in some more or less organized or "systematic" way.

A major feature of an economic system is the planning and making of economic decisions. The resolution of economic problems in society requires difficult choices and decisions. The wisdom and success of these decisions depend in part upon systematic planning. Planning requires organization, which has a number of prominent aspects.

First, every economic system must have methods to establish social *goals* or priorities, in terms of which decisions can be made and resources allocated. Goals often are multiple and not consistent with one another. Thus, choices must be made and priorities established.

The organization of economic activity also requires procedures for *analysis*, that is, processes for comparing the gains and costs of alternative goals and programs.

Economic decisions are made through social *institutions:* governments, labor unions, business firms, agricultural associations, families, banks, and cooperatives. These institutions are of central importance because they largely determine the location and degree of concentration of economic power, or the capacity to make and enforce economic decisions.

To execute plans and programs, and thus to translate into practical action the decisions of persons and organizations exercising economic power, methods must be available to enforce decisions and *control* economic actions, that is, to encourage desired actions and to discourage undesired actions.

Three Approaches to the Study of Economic Systems

The study of comparative economic systems may be approached in three related, yet different, ways: (1) theoretical economic systems, (2) actual economic systems, and (3) economic systems as movements for social change or reform.

A theoretical economic system is a body of ideas about the organization of economic activity, such as capitalism, socialism, and communism. Some theoretical economic systems are descriptive; that is, they are alleged to correspond to some degree to an actual set of economic arrangements. Many, however, are not descriptive; that is, they refer to how an economy would be organized *if* it were characterized by the institutional features of the theoretical model. Theoretical economic systems also may be classified as explanatory or normative. An *explanatory* theory offers an analytical apparatus to explain how an economy operates. A *normative* theory attempts to evaluate how an economy *should* be organized. Explanatory theories of economic systems require close attention to logic and fact. Normative theories also require judgments of value, that is, judgments about what is socially desirable or undesirable. Needless to say, the same body of ideas (for example, the classic theory of competitive market capitalism) may serve all theoretical purposes.

Actual economic systems are those that exist or have existed in practice, such as the Swedish, English, ancient Athenian or sixteenth-century Spanish economies. Actual economic systems rarely correspond precisely to theoretical models. Most are "impure" or "mixed," that is, they contain elements found in more than one theory. For example, most economic systems *blend* the institutional characteristics associated with both capitalism and socialism; they are "socio-capitalist." Of course, there are degrees of capitalism and socialism, and a particular economy may lie closer to one than the other. Still, the student of economic systems should be cautious of identifying theory and practice too readily and loosely.

Movements for economic change or social reform consist of parties, platforms, and programs of social groups prior to their acquisition of power or the full-scale establishment in practice of their programs. Examples are the socialist movement in England during the nineteenth century or the pronouncements and activities of American communists. Soviet communism, in one sense, falls into this third category. Soviet communists have acquired political and economic power, but they have not established, nor do they claim to have established, classic communism. Thus, in one sense, it is misleading to classify the Soviet economy as "communist." Yet Soviet leaders claim to be working toward the eventual establishment of this goal in the Soviet Union and throughout the world. Thus, it is relevant to speak of a communist political and economic movement.

A proper, balanced knowledge of comparative economic systems requires an understanding of explanatory theoretical models, philosophies or value judgments about how economic systems should be organized, descriptive information about the operations of particular economies in practice, and movements for economic reform. Many unproductive and emotional debates could be avoided in discussion of economic systems if we learned to recognize the natures of, and the differences among, theories, facts, ideals, and movements.

Major Differences Among Economic Systems

Economic systems differ in two basic ways: (1) the economic problems faced and the degrees of emphasis placed on specific economic issues; and (2) the methods and institutions used to meet problems. To illustrate the first difference, compare the heavy emphasis placed on rapid industrialization in Soviet Russia during roughly the last half-century (and the accompanying deemphasis upon income distribution and equality) with the comprehensive social security system and progressive income tax rates in Great Britain's postwar "welfare state." Clearly, economic growth has been of compelling and foremost importance to Soviet political leaders and planners, whereas the promotion of lesser inequality and insecurity in income distribu-

tion has engaged the attention of the British in recent years.

Even if social goals were the same in all economic systems, differences would exist as to the most effective means and institutions to attain them. Industrialization and economic growth, for example, are prominent objectives in both Soviet Russia and India. But wide differences of opinion exist as to *how* to foster these goals. The Soviet industrialization program has been committed to rapid development of heavy industry and centralized governmental economic planning, whereas Indian economic development is proceeding under a less intense program, involving a mixture of heavy and light industry, capital investment and current consumption, government plans, and private business decisions.

Disagreements about goals and programs exist within, as well as among, economic systems. Some prominent American economists are convinced that recession and unemployment are the most compelling aspects of economic instability. Others are equally concerned with the dangers of inflation. Among those who believe that recession is the greater problem, disagreements exist over the extent to which public policies should be directed toward attaining full employment. Even if people do agree on a goal in this area (for example "full employment"), there is disagreement over how best to attain it (for example, through monetary measures, tax and expenditure changes, or foreign trade policies).

Moreover, we should not think of institutions solely in an instrumental sense, that is, from the standpoint of their effectiveness in attaining goals or solving problems. Ways of organizing and directing economic activity acquire an independent significance in different economic systems, quite apart from the problems toward which ostensibly they are directed. One example is private versus public ownership. In both the United Kingdom and the United States, transportation, gas, water, electricity, communications, and banking are considered industries "affected with a public interest," and which, accordingly, cannot be left alone to pursue private profit on an individualistic basis. However, Americans are more disposed to the idea of private ownership than Englishmen. In England, all of the aforementioned industries, with the exception of inland truck transportation, are government owned. In the United States, ownership is private but is supplemented by public regulation through semi-independent regulatory commissions, such as the Federal Power Commission and the Interstate Commerce Commission.

COMPARATIVE ECONOMIC SYSTEMS AND THE DISCIPLINE OF ECONOMICS

Comparative economic systems is an approach to, rather than a part of, the discipline of economics. The unifying theme of the study of comparative economic systems is the use of the comparative methodology. Because this methodology may be applied to the study of topics pertinent to *any* subfield within economics (for example, a comparative analysis of systems of taxation or labor unions in different countries), or to economies as a whole (for example, a comparative analysis of the theories of socialism or the overall performances of selected national economies), comparative economic systems cannot be isolated from the general principles of the discipline or from any of its branches. When the study of economic systems takes the form of comparisons of general theories concerning the overall functioning of the economic system, it is more appropriately described as an approach to, rather than a separable subdivision of, the discipline.

Comparative economic systems is not solely a matter of economics. In part, this stems from the fact that the study of economic systems includes criteria for evaluation of the effectiveness of the economic system and judgments about the goodness of economic performance. These criteria and judgments, found implicitly in most theories of economic systems and in most strategies for economic change and reform, involve moral, political, and social dimensions.

Comparative economic systems also goes beyond economics as traditionally conceived, by virtue of its central substantive concern. Economics, as customarily conceived and taught in western societies, focuses on analysis of magnitudes (or changes therein) of selected economic variables, such as investment, saving, national income, prices, quantities, and employment, within a "given" institutional, motivational, and technological framework—"given" in that it is regarded as being determined by forces beyond the scope of economic analysis. In contrast, comparative economic systems is concerned with the specification of alternative institutional-motivational-technological frameworks, and with the explanation and evaluation of their impact upon economic processes and performance. Comparative economic systems regards as variables (or at least as topics to be carefully identified and compared) social, political, psychological, and technological fac-

tors given within economics in general. Thus, comparative economic systems incorporates an approach to the subject of economics that is broader than the traditional one.

Finally, comparative economic systems transcends the traditional boundaries of the discipline of economics by virtue of its comparative methodology and concern for alternative systems. As a systematic social scientific discipline, economics emerged and developed coterminously with the emergence and development of competitive market capitalism as an economic system in the western world. In the minds of many economists, economics became essentially a study of one major type of economic system: market capitalism. But comparative economic systems, by its very nature, is concerned with various systems of economic organization, including, but not limited to, coordination through markets, and thus is broader in scope than the traditional analysis of market forces.

STRUCTURE, BEHAVIOR, AND PERFORMANCE OF ECONOMIC SYSTEMS

Throughout this book, we shall use a threefold framework for comparing economic systems in theory and practice. First, the *structure* of economic systems will be identified. *Structure* refers to salient features that characterize an economic system and distinguish it from others. Structural features include resource-technological, institutional, and motivational aspects of the economic system. Institutional aspects, in turn, include such dimensions as ownership and control of the means of production, locus and organization of economic power, and social processes for economic coordination. Second, various aspects of economizing *behavior* will be examined, notably those pertaining to resource allocation, income distribution, economic stability, and economic growth. Third, the *performance* of economic systems will be studied. Performance indicators will include such criteria as allocational efficiency, distributive equity, full employment and price level stability, and optimum economic growth. Discussion of systems performance will also include consideration of such broader criteria of political economy as consumer and worker sovereignty, freedom and democracy, and alienation. Systems structure will be described more fully in the next chapter. Some introductory comments on behavior and performance will be made here.

ECONOMIZING AND SYSTEMS BEHAVIOR

Resource Allocation

Because resources (human, natural, and capital or man-made) are limited, whereas the uses to which they can be put are generally many or even unlimited, economic systems must establish methods to select which uses are most urgent, and to obtain and administer resources so as to satisfy wants most closely. The first problem is one of choice; the second, of allocation.

Economic choice is a function of scarcity. Were resources not scarce in relation to human desires, all wants could be met, and economic choices would not be necessary. Man would, in these conditions, be living in a pre- or posteconomic paradise. The existence of scarcity, however, raises such choices as guns versus butter, necessities versus luxuries, work versus leisure, consumption versus saving, and present versus future. Incidentally, the reduction of scarcity through the increase in the quantity and quality of resources does not necessarily simplify the problem of choice, since the increase in resources may be more than matched by an increase in the volume and variety of human wants.

Choice-making raises such questions as: Who is to have the authority for making basic economic choices, and what "weights" should be attached to each person's wants? Is decision-making power to be shared equally among all members of society, or do (or should) some persons or groups have greater influence than others? How should the proportion of total output to go into consumption goods to satisfy current desires versus investment goods to raise the capacity to satisfy future wants be determined? How are choices to be communicated to other members of society? Through the ballot box? Through consumer demand ("dollar ballots")? Or by some alternative technique?

Choice is only part of the problem. If choices are to be made effective, resources must be allocated. Land, labor, capital, and entrepreneurship must be obtained, organized, and directed toward production. On many occasions, the proportions of these resources or factors of production are variable rather than fixed; that is, a given level of output may be produced with varying combinations of inputs. The construction of a highway, for example, may be labor-intensive, using a large amount of human labor power, or capital-intensive, relying heavily on labor-saving machinery. A desk-top

may be made from wood, plastic, glass, or aluminum. Thus, the decision to construct a highway or to produce 100 desk-tops per day requires another set of decisions about what resources should be used, and in what quantities and combinations, to produce specific quantities of particular products and services. The question of *what* is to be produced necessarily is followed by the question of *how*. Because resources are scarce, every economic system requires some means to economize in their use, that is, some way to "get the most" out of a given body of resources and to apply them in those specific directions that correspond most closely to the satisfaction of human wants.

Income Distribution

The employment of resources results in the production of output, that is, a flow of products and services over a period of time. It simultaneously creates income, since *real income* consists, by definition, of this same flow of goods. A person's *money income* (for example, wages, rents, interest payments, profits) represents in essence a "claim" against national output, and the totality of these claims during any past period of time (abstracting from foreign trade) must be equal by definition to total output.

Total output, or income, must be distributed somehow among the members of society. Every economy must determine for whom products and services are to be produced. Should income be distributed according to "contribution to production"? Or, should people be rewarded according to "need"? How can productive contribution or need be measured? Should income be distributed more equally? Or less equally? Should the share of national income going to wages be greater or smaller?

Few topics in the history of economic systems have aroused hotter debate than those centering around income distribution. Perhaps this is because income is so close to our personal well-being, both directly, in terms of its capacity to satisfy our wants, and indirectly, through its impact upon power, prestige, and status in society. Perhaps it stems from the realization that if a larger percent of a given national economic pie accrues to one person or group in society, some other person or persons necessarily must receive less. At any rate, the distribution of income is an issue facing every economic system. Conversely, one of the prominent differences among competing economic systems lies in the particular methods of distributing or redistributing income, as well as the actual patterns of equality and inequality.

Economic Stability

No contemporary economy seems able to escape the fluctuations in the overall level of activity we call "economic instability." The nature, causes, severity, and regularity of these fluctuations differ considerably in different countries, and, indeed, in the same country at different times. Unemployment, for example, comes in a much different form in a poor economy than in a highly developed one. Unemployment is typically "open" in the latter; that is, the unemployed are out of work and seeking jobs. Unemployment in the former is sometimes "disguised"; for example, agricultural workers are used so ineffectively that, were they moved to industry, agricultural output would not fall greatly. Their net contribution to agricultural production is low, perhaps zero. Similarly, inflation (defined as "a period of generally rising prices") suppressed by governmental price controls has different characteristics and raises different problems from "open" price inflation, where prices are permitted to rise. Still, no contemporary economic system remains perfectly stable. The level of aggregate economic activity at any time and its fluctuations over the passage of time are matters of concern for any social economy. Every economic system has supplies of resources potentially or actually employed in the productive processes. Every system also has demands for resources to meet various wants or to attain alternative planning targets. If aggregate demand falls short of potential aggregate supply, the result is a failure to utilize society's resources fully, which means that actual output will fall short of its potential. If aggregate demand for resources exceeds aggregate supply, at full employment utilization of resources, some demands cannot be met, resulting in various pressures in the economic system, for example, rising prices. Overly ambitious central planners, as well as overly exuberant consumers and investors, may all encounter this problem.

Economic Growth

Economic growth, defined as a sustained upward movement in the aggregate level of output (or output per person), is of vital concern for contemporary economic systems. Soviet leaders, for example, are concerned with the prospects of "catching up with the West" in overall output. The industrially advanced western de-

mocracies are interested in economic growth both to maintain their industrial edge in the Cold War, to continue to expand their domestic living standards, and to meet the pressing public needs of an urban society. The economically underdeveloped nations of Africa, South and Central America, and the Near and Far East similarly are concerned with this issue.

In part, the issues of economic growth overlap those of resource allocation. Growth and development for a national economy require decisions regarding: (1) the rate of capital formation or overall division of output into consumption versus investment goods; (2) the apportionment of investable funds among alternative firms, industries, or projects; (3) the geographic location of industry. All of these decisions, crucial to economic growth, involve the allocation of society's scarce resources.

Yet, economic growth goes beyond the notion of resource allocation because (1) the essence of economic growth lies in the augmentation of the quantity and quality of society's resources (and in the accompanying increase and alteration in the uses toward which resources are allocated), not in the administration of a *given* body of resources among *unchanging* ends; (2) some of the most important aspects of growth are qualitative, notably alterations in institutional and ideological structure, not simply economic decisions made within a given setting.

Not all economic systems experience or have experienced economic growth. Moreover, economic growth, as a goal of economic policy, is not shared by all societies and cultures. Indeed, sustained expansion in income per capita and the idea that such an expansion is both possible and desirable for large masses of society is historically unique to a very small geographic and temporal segment of human civilization, specifically, to a small number of countries in Western Europe and the western hemisphere, and Australasia, in modern times.

Still, though economic systems may experience different growth rates, may have different degrees of interest in economic growth, and may attempt to encourage or discourage long-run expansion in a variety of ways, all economies must draw upon some combination of the following in order to grow: (1) human, natural, and capital resources; (2) technology, or the application of human knowledge to production; (3) institutions, or ways of organizing human activity, and (4) motivations, or ways of thinking about economic organization and development. The quantity and quality of these factors are the major sources of economic growth and the basic determinants of long-run economic change in any economy.

A Graphical Illustration

A simple graphical illustration of these basic economic problems is seen in Figure 1-1. The problem of *resource allocation* can be illustrated as follows: The employment of a given quantity and quality of scarce resources, under given technological conditions, might yield a potential maximum output of, say, 2 million hats or 4 million shirts, or some combination of the two. Suppose that all resources were employed in the production of hats only. Hat production would be OH_2 and shirt production would be zero. Now suppose that consumers (or central planners) desire some shirts as well as hats. To accomplish this, under the assumed conditions, it would be necessary to decrease production of hats, to, say 1 million, thereby releasing resources that might be reallocated to the production of 2 million shirts. Hat production would fall to OH_1 and shirt production would rise from zero to OS_2. In Figure 1-1 this would be illustrated by a movement from point H to point F along line HS. The same idea would hold in reverse. Commencing at point S, where shirt production is 4 million and hat production is zero, a decrease in the production of shirts to OS_2 would release resources that could be reallocated to the production of OH_1 hats. This would be illustrated in Figure 1-1 by a movement from point S to F. Line HS thus illustrates a *production possibility frontier:* It shows all the potential combinations of hats and shirts that might be produced from the employment of a given quantity and quality of resources under given technological conditions.*

This diagram also may be used to illustrate other major economic problems. If wages and profits were

*HS is depicted as a straight line in Figure 1-1 for purposes of simplicity and brevity. As a straight line, it shows a *constant* ratio in the transformation of H to S (or S to H). This implies that the ratio of the costs of producing hats to the costs of producing shirts remains constant regardless of the shift of resources from one to the other, that is, that resources are equally adaptable to producing hats or shirts. A more realistic illustration is provided by a concave-shaped production possibility curve. Resources used in the production of hats may not be equally adaptable in the production of shirts and vice versa. Thus, the shift of resources from hat to shirt production plausibly will be accompanied by increases in costs. Equal decrements in the production of hats are accompanied by *decreasing* increments of shirts. The same is true in reverse as we move up the curve.

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