



A beginner's guide to socialist economics

Marian L. Tupy

November 20, 2016

In recent years, I have given a number of presentations to high-school and college students on the importance of economic freedom and persistent threat of socialism – as witnessed, for example, by the recent economic meltdown in Venezuela. One problem that I have encountered is that young people today do not have a personal memory of the Cold War, let alone an understanding of social and economic arrangements in the Soviet bloc, which, I suspect are either downplayed or ignored in American school curricula. As a result, I have written a basic guide to socialist economics, drawing on my personal experience growing up under communism. I hope that this – somewhat longer piece – will be read by the millennials, who are so often drawn to failed ideas of yore.

As a boy growing up in communist Czechoslovakia, I would, for many years, walk by a building site that was to become a local public health facility or clinic. The construction of this small and ugly square-shaped building was slow and shoddy. Parts of the structure were falling apart even while the rest of it was still being built.

Recently, I returned to Slovakia. One day, while driving through the capital of Bratislava, I noticed a brand new suburb that covered a hill that was barren a mere two years before. The sprawling development of modern and beautiful houses came with excellent roads and a large supermarket. It provided a home, privacy, and safety for hundreds of families.

How was it possible for a private company to plan, build, and sell an entire suburb in less than two years, but impossible for a communist central planner to build one small building in almost a decade?

A large part of the answer lies in “incentives.” The company that built the suburb in Slovakia did not do so out of love for humanity. The company did so, because its owners (i.e., shareholders or capitalists) wanted to make a profit. As Adam Smith, the founding father of economics, wrote in 1776, “It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest.”

In a normally functioning market, it is rare for only one company to provide a certain kind of good or service. The people who bought the houses in the suburb that I saw did not have to do so. They could have bought different houses built by different developers in different parts of town at different prices. Competition, in other words, forces capitalists to come up with better and cheaper products – a process that benefits us all.

Communists opposed both profit and competition. They saw profit-making as useless and immoral. In their view, capitalists did not work in the conventional sense. The real work of

building the bridges and plowing the fields was done by the workers. The capitalists simply pocketed the company's profits once the workers' wages have been paid out. Put differently, communist believed that the capitalist class exploited the working class – and that was incompatible with the communist goal of a classless and egalitarian society.

But capitalists are neither useless nor immoral. For example, capitalists often invest in new technologies. Companies that have revolutionized our lives, like Apple and Microsoft, received their initial funding from private investors. Because their own money is on the line, capitalists tend to be much better at spotting good investment opportunities than government bureaucrats. That is why capitalist economies, not communist ones, are the leaders in technological innovation and progress.

Moreover, by investing in new technologies and by creating new companies, capitalists provide consumers with a mind-boggling variety of goods and services, create employment for billions of people, and contribute trillions of dollars in tax revenue. Of course, all investment involves at least some level of risk. Capitalists reap huge profits only when they invest wisely. When they make bad investments, capitalists often face financial ruin.

Unfortunately, communists did not share the above views and banned private investment, private property, risk-taking and profit-making. All large privately held enterprises, like shoe factories and steel mills, were nationalized. A vast majority of small privately held enterprises, like convenience stores and family farms, were also taken over by the state. The expropriated owners seldom received any compensation. Everyone now became a worker and everyone worked for the state.

In order to prevent new income inequalities and new classes from emerging, everyone was paid more-or-less equally. That proved to be a major problem. Since people did not make more money when they worked harder, few of them worked hard. The communists tried to motivate or incentivize the workforce through propaganda. Posters of strong and determined workers were ubiquitous throughout the former Soviet empire. Movies about hardworking miners and farmers were supposed to instill the population with socialist zeal.

Propaganda alone could not increase the productivity of communist workers to Western levels. To incentivize the workforce, communist regimes resorted to terror. Workers who slacked off on the job were sometimes convicted of sabotage and shot. More often, they were sent to the Gulag – a system of forced labor camps. Sometimes, the authorities arrested and punished completely innocent people on purpose. Arbitrary terror, the communists believed, made the rest of the workforce more productive.

In the end, tens of millions of people in the Soviet Union, China, Cambodia, and other communist countries were sent to labor camps. The living and working conditions in the camps were inhuman and millions of people perished. My great uncle, who was accused and convicted of being a supporter of the underground democratic opposition in communist Czechoslovakia, was sent to mine uranium for the Soviet nuclear arms program. Working without any protection from radiation, he died of cancer.

By the late 1980s, communist regimes lost much of their revolutionary zeal. Terror and fear subsided, and productivity declined further. Thus, in the late 1980s, an average industrial worker

in Western Europe was almost eight times as productive as his Polish counterpart. Put differently, in the same time and with the same resources that a Polish worker needed to produce \$1 worth of goods, a Western European worker could produce \$8 worth of goods.

Just as they replaced the profit motive with propaganda and terror, so the communists replaced competition with monopolistic production. Under capitalism, companies compete for customers by slashing prices and improving quality. Thus, a teenager today can choose between jeans made by Diesel, Guess, Calvin Klein, Levi's and many others.

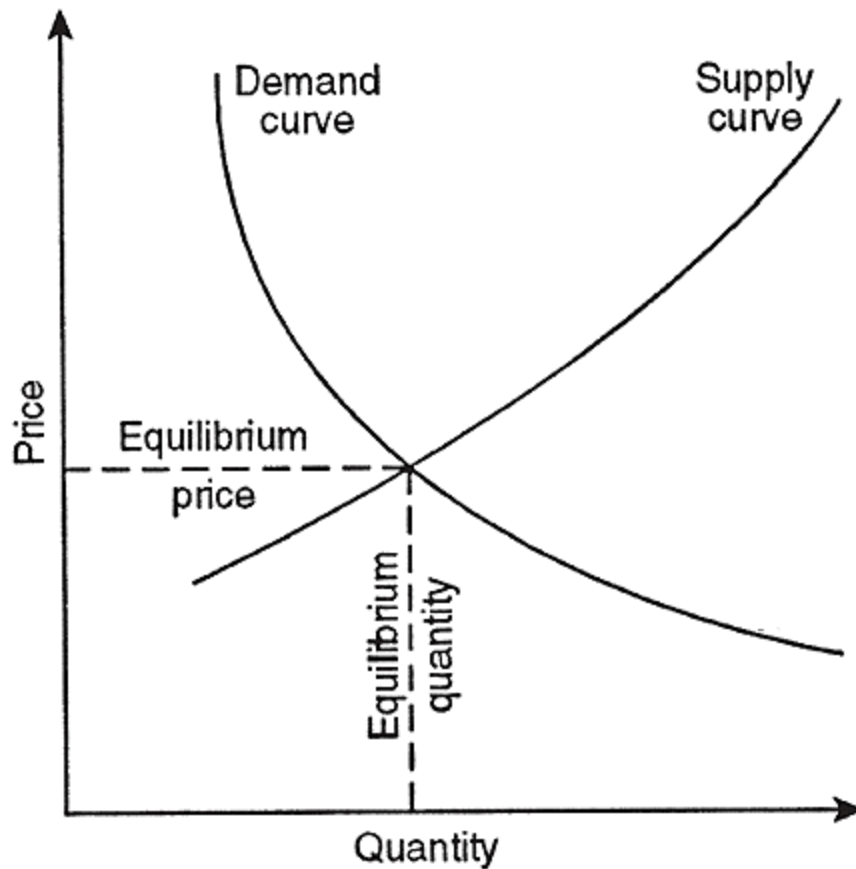
Communists thought that such competition was both wasteful and irrational. Instead, communist countries tended to have one monopolistic producer of cars, shoes, washing machines, etc. But, problems soon arose. Since producers in communist countries did not have to compete against anyone, they did not have any incentive to improve their products. Compare, for example, the BMW 850 that went into production in West Germany in 1989 and the Trabant that was made in East Germany at the same time.

Communist producers were protected from domestic competition by having a monopoly. They were also protected from foreign competition by prohibitively high import tariffs or an outright ban on imports. Put differently, they had a "captive" consumer base. The Trabant car manufacturer did not have to worry about losing consumers, since the latter had nowhere else to go.

Moreover, the workers at the Trabant car plant received the same salary irrespective of the number of cars they produced. As a result, they produced fewer cars than were needed. People in East Germany had to wait for many years, sometimes decades, before they were able to buy one. Indeed, shortages of most consumer goods, from important items such as cars to mundane items such as sugar, were ubiquitous. Endless queuing became a part of everyday life.

Under capitalism, shortages are generally avoided through the movement of prices. Some prices, like those of national currencies traded globally, change virtually every second. Other prices change more slowly. If there is a shortage of strawberries, for example, their price will rise. As a result, fewer people will be able to buy strawberries. On the upside, the people who value strawberries the most and are willing to pay the higher price will always find them.

The movement of prices provides important information for the capitalists. Capitalists take their money and invest it in more profitable business ventures. If the price of something is rising, not enough of it is being produced. Investors rush in with new capital, hoping to make a profit. Production increases. The economy as a whole thus tends toward an "equilibrium" or a point at which capital is distributed roughly where it is needed.



Prices are an important source of information, but where do they come from? In a capitalist economy, nobody sets prices. They emerge “spontaneously” in the market place. Every time I buy a cup of coffee on the way to work, for example, I incrementally increase the price of the coffee bean. Every time I fail to buy my usual morning cup of coffee because I am late for work, I decrease its price by a tiny amount. If everyone stopped buying coffee, its price would collapse.

Communists banned profit, capitalists, competition, free trade and much (if not all) private property – all of which are necessary for accurate prices to emerge. Instead, tens of millions of prices for items ranging from tractors to a loaf of bread were set annually (or every few years) by government bureaucrats. Since they could neither accurately predict how much bread would be produced (i.e., supplied) nor how much bread would be consumed (i.e., demanded), the bureaucrats almost always got the prices wrong.

Price-setting made shortages associated with low productivity worse. If the price of flour was set too high, bakeries would bake too little bread and bread would disappear from shops altogether. If the price of flour was set too low, too much bread would be baked and much of it would end up rotten. Put differently, communist economies were very inefficient.

To complicate matters, communists sometimes mispriced items intentionally. The price of meat, for example, was kept too low year after year out of political considerations. Low prices created an impression of affordability. On their trips abroad, communist officials would often boast that

the workers in the Soviet empire could buy more meat and other produce than their Western counterparts. In reality, shops were often empty. As a consequence, money was of limited use. To get around shortages, many people in communist countries resorted to bartering goods and favors (or services).

Under communism, the state owned all production facilities, such as factories, shops and farms. In order to have something to trade with one another, people first had to “steal” from the state. A butcher, for example, stole meat and exchanged it for vegetables that the greengrocer stole. The process was inefficient, but it was also morally corrupting. Lying and stealing became widely used and trust between people declined. Far from fostering brotherhood between people, communism made everyone suspicious and resentful.

Of course, not everyone was equally affected by shortages. Government officials and their families could generally avoid the daily hardships of life under communism by having access to special shops, schools, and hospitals. Communism started as a movement for greater equality. In reality, it was a return to feudalism. Like feudal societies, communist societies had an aristocracy composed of the communist party members. Like feudal societies, communist societies had a population of serfs with limited or no rights and little possibility of social mobility. Like feudal societies, communist societies were held together by brute force.

Postscript:

I am sometimes asked why, if communism was so inefficient, it had survived as long as it did. Part of the reason rests in the brute force with which the communists kept themselves in power. Part of it rests in the emergence of smugglers, who made the economy run more smoothly. When, for example, a communist shoe factory ran out of glue, the factory manager called his contact in the “shadow” or “underground” economy. The latter would then obtain the glue by smuggling it out of the glue factory or from abroad. Smuggling was illegal, of course, but it was preferable to dealing with the government bureaucracy – which could take years. So, in a sense, communism’s longevity can be ascribed to the emergence of a quasi-market in goods and favors (or services).

Marian L. Tupy is the editor of www.humanprogress.org