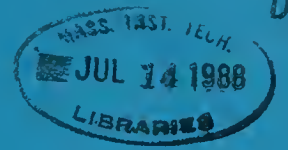


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**THE BLIND MEN AND THE ELEPHANT:  
AN ESSAY ON ISMS**

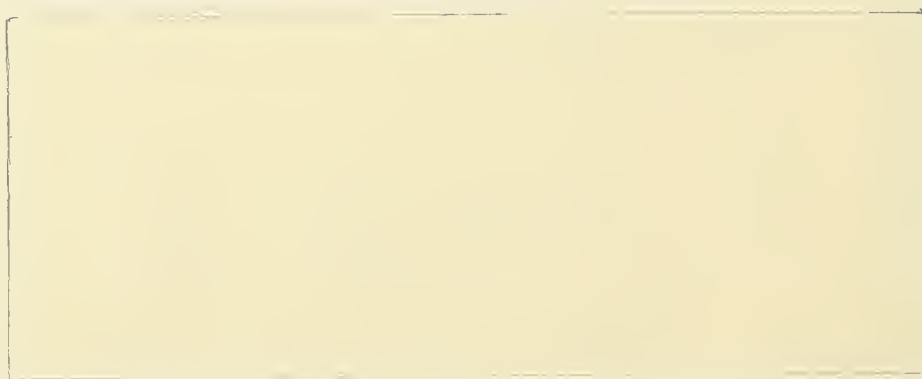
Evsey D. Domar

No. 473

January 1988

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## THE BLIND MEN AND THE ELEPHANT

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AN ESSAY ON ISMS<sup>1</sup>

Evsey D. Domar

Massachusetts Institute of Technology

and

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A certain Prince commanded several blind men to examine an elephant and to describe to him what the elephant was like. Each blind man examined one part of the elephant's body and reported accordingly. And the blind men fell into quarreling among themselves...

An old Indian tale<sup>2</sup>

The comparison between capitalism and socialism presented in this essay was made by one blind man.

\* \* \*

According to an old custom, sanctified by Marx, an essay on Isms should deal with the struggle between two classes: in our time, between the capitalists who own the means of production and the workers who do not. I intend to violate this custom for two reasons: first, I do not regard the question of ownership, by itself, to be so critical. Second, it has been discussed and debated to the point of boredom.<sup>3</sup> Instead, I propose to divide the populace into producers and consumers and inquire how each group fares under capitalism of the American type and under socialism of the Soviet variety. This does not imply that the people suffer from split personalities; only, that each person has a number of different interests.<sup>4</sup> Originally, I had hoped to bypass the question of ownership entirely, but, alas, as the reader will see, it came back because privately owned firms derive all or most of their revenues from sales and therefore must please their customers or go bankrupt, while firms owned by the government, even if they sell their

products and services in the market, are seldom denied access to the government subsidies and credit.<sup>5</sup> But to avoid unnecessary argument, I am willing to recognize the importance of ownership and even to offer it the honorable position of the elephant's head, while retaining that of the tail for my suggestion. In the elephant, this organ is short and insignificant, but it must perform some function. Will the reader not wish to examine it, if only to satisfy his or her curiosity?

Two criteria will be used in our comparisons: economic power and risk. A person or a firm X will be said to have power over Y if X's actions can affect Y's economic welfare.<sup>6</sup> Risk means the possibility of a loss. The meaning of both criteria will become clearer as the argument develops.

## II. POWER AND RISK UNDER CAPITALISM

Tradition demands that we start with the case of perfect competition. This is a purely theoretical exercise because no consumers and very few producers operate in perfectly competitive markets. It is not the number of participants that matters here -- there are certainly plenty of consumers and quite a few producers in most markets -- but the rarity of standardized products.<sup>7</sup> Even a bottle of Gordon Gin bought in one store is not exactly the same as a bottle sold by another: location, appearance and the atmosphere of the store, the manners (and occasionally, the attractiveness) of the sales clerks are not identical, not to mention home delivery, credit and so on. In the labor market, there are many similar but few identical jobs, and among the workers pairs of identical twins are rare. But the virtual absence of perfect competition (except in agriculture and in organized exchanges) does not prevent us from dreaming about it. It is not so much the promise of a Pareto optimum that attracts us but the virtual elimination of power: the availability of perfect substitutes guarantees that no seller and no buyer, and no employer and no worker will be in anyone's power. But for all its virtues, perfect competition is incompatible with the introduction of new products, as Schumpeter observed some forty years ago.<sup>8</sup>

The participants in this market would face three kinds of risk: first, the timing of sales and of purchases amidst frequent (or even continuous) price fluctuations; second, the production and the purchase of the wrong, even if standard, products, including the choice of the wrong occupation; third,

various random factors. The first kind of risk would be shared by both producers and consumers, with the former bearing the lighter burden because they can be expected to be better informed. The second should fall mostly on producers because production, and particularly education and training, take time, while consumers are protected by their knowledge of the standard products and by the diversification of their purchases. The third kind of risk -- from random changes -- would hurt mostly producers, particularly the capitalists, because they own the means of production. But at least they would be relieved of the need to attract and to please their customers.

So much for the case of perfect competition. The typical capitalist firm is (and probably always has been) an oligopolist.<sup>9</sup> It will be assumed to act under the following conditions:

(1) The only, or at least the overwhelming, source of its revenue is derived from the sale of its products and services.

(2) It tries to maximize profits (although the maximization of revenue would do just as well).<sup>10</sup>

(3) The demand curve for its products has the usual negative slope, but its exact position and elasticity are known imperfectly.

(4) The marginal cost curve is positively sloped. This assumption is made because it weakens the argument. A constant or a falling marginal cost would strengthen it.

These are very ordinary and widely accepted assumptions. Subject to them, the behavior of the firm will be depicted by the simple diagram which we all learned in our professional childhood. (I use straight lines because they are easier to draw.)

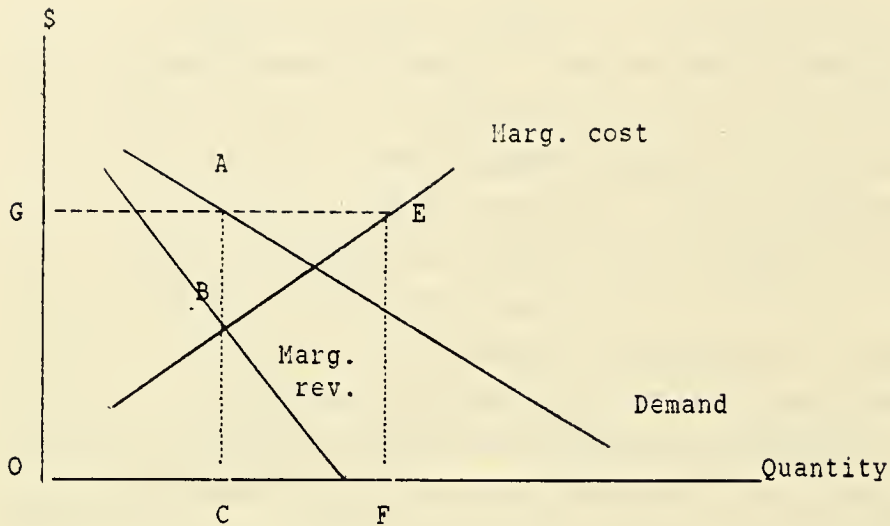


Fig. 1. The Position of the Oligopolist

According to the familiar story, the producer will find the point of intersection of the marginal revenue and marginal cost curves B, draw a vertical line through it and settle down at point A where this line intersects the demand curve. Thus, he will sell OC units and charge the price of OG. What else need be said about this diagram?

A good deal. It conceals the fundamental distinction between perfect competition and oligopoly. Under the former, the producer can sell any quantity he wants, but he cannot set the price. Under the latter, he can set any price he wants but he cannot determine the quantity. Whether he can or cannot sell OC units depends on the willingness of his customers to buy.<sup>11</sup> Actually, he has no particular preference for point C and may not even know its exact location: so long as his price is kept above his marginal cost he will be anxious to expand his output and sales, that is to move along the horizontal line GE until its intersection with the marginal cost at point E. Beyond that point he will not go, but if his position at E (or at any point to the right of A) appears reasonably long-lasting he will realize that he must have underestimated the demand. The new demand curve will be drawn (as it were) above the original one and the story just told will be repeated once more. If the marginal cost is constant or declining, which it often is in the long run, the stopping point E may never be reached; a determined oligopolist will always strive for a larger market and will always deplore its limitation.

That a simultaneous attempt by many firms to expand output may run into a shortage of resources (such as labor) need not affect his micro-image of the world.

Perhaps here lies the source of the belief that a capitalist economy suffers from a chronic shortage of demand, a belief held by Malthus, Marx, Engels, Hobson and many other representatives of the so-called under-consumptionist school, long before the macro-statistics required for supporting this view became available. No statistics were needed for the nineteen-thirties, but when Keynes projected the then existing situation into all of human history and portrayed the latter as a perpetual and usually unsuccessful attempt to escape from an excess propensity to save (recall his discourse on the blessings of Egyptian pyramids), his remarks were little more than amusing.<sup>12</sup> More recently, the existence of this shortage was reaffirmed by Janos Kornai.<sup>13</sup> That this shortage has not been uncommon under capitalism there is no doubt, but its presence cannot be deduced merely from oligopolists' laments. The underutilization of capacity is a perfectly normal and, I would add, desirable characteristic of capitalism which is responsible for its remarkable flexibility.<sup>14</sup>

But to come back to our main theme. The nearly permanent excess of the price charged by the oligopolist over his marginal cost is responsible for some of the most significant features of capitalism, both good and bad. As mentioned above, it drives the capitalist to expand his production and sales, by any means, fair or foul, to search for new markets and to introduce new products, or in a word, to innovate. It generates the remarkable dynamic force of capitalism admired even by Marx.<sup>15</sup> In the present context, it forces the capitalist to exert every effort to please his customers in whose hands his final fate lies. He is in their power.<sup>16</sup> But it also induces him to take advantage of his customers' ignorance and stupidity by adulterating his products, by misleading advertising (so familiar to TV watchers) and by millions of other deceptive tricks well known to all of us. But if this endless pursuit of the consumer's dollar can be most annoying, would the consumer prefer to be met with indifference?<sup>17</sup> Thus a Victorian maiden with a pretty face and an ample dowry might complain that her numerous suitors never left her alone, but would she really prefer to be left alone?

The risk of timing, so important in the perfectly competitive case, now weakens because oligopolistic prices are not as unstable, but the immense variety of non-standard goods brought forward by technological progress creates a great risk of producing and buying the wrong product. The consumer simply lacks the time and the ability to acquaint himself thoroughly with every new product, and often ends up with "lemons." But most of this risk falls on the producer because the invention, testing and production of a novelty takes time and the consumer's reaction to it is uncertain.

The power exercised by consumers over producers requires no police, no compulsion, and no letters to the editor of The New York Times. It works silently, like gravity. All the consumer has to do is not to come back to the store, not to buy the same product again. Most of the western economists approve of this arrangement. Wasn't it Adam Smith himself who said that "Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer."<sup>18</sup> "Consumer sovereignty" is a sacred concept among us, our usual complaint being that it is not fully implemented because of labor unions, cartels, taxes, etc.<sup>19</sup> Perhaps it is not obvious to us that the same force which we lovingly call "market discipline" appears to the other side, that is to producers, as "market tyranny." In our formal mathematical models supply functions of labor (and of other factors) are given the same place and honor as the consumer demand functions for goods and services, but in reality we follow Adam Smith in expecting the producers to bend their knees to the consumers, rather than the other way around.<sup>20</sup> Bending their knees and subjecting themselves to the discipline or tyranny of the market places a great burden on producers. Schumpeterian "Creative destruction" may sound like a heroic contest, reminiscent of knightly tournaments of old, but how many economists, usually protected by tenure, civil service regulations or custom, would like to take part in it? Even Marx showed a bit of sympathy for the poor capitalists.<sup>21</sup> Still, they can seek protection in the diversification of their holdings, but what protection is available for workers whose skills become obsolete and whose jobs disappear because of the dictates of the market? Few can hold several jobs simultaneously, and a skill not currently exercised quickly deteriorates. And even when employed, the worker has to produce not what pleases him but what

the market commands -- the source of alienation stressed by Marx and his followers.<sup>22</sup>

A simple expression of a person's welfare makes it a function of his income (consumption plus savings) and leisure.<sup>23</sup> This implies that the person is alive only before nine in the morning and after five in the afternoon. What happens to him between nine and five is immaterial, as if our work served no other purpose than providing us with consumables.<sup>24</sup> But there is no shortage of evidence that our work means much more than that.<sup>25</sup>

Actually, we affirm our allegiance to consumer sovereignty only in the classroom. Outside of it we think of ourselves first of all as producers (economists), as does everyone else. If at a cocktail party you ask the host to identify the newly arrived guest, he will state his occupation -- an engineer, a miner, a driver, a garbage collector (depending on the kind of parties you attend) -- rather than describe him as the owner of a huge purple refrigerator. But if our work is of such importance to us why should we not try to transform an exertion for pleasing the consumers into an activity useful and enjoyable to ourselves?<sup>26</sup>

## II. POWER AND RISK UNDER SOCIALISM

According to the report of one blind person, this is exactly what socialism, particularly of the Marxist version, tries to do. It does not forget that, after all, consumption is the aim of economic activity, but it looks at the world from the point of view of the producers (or rather, the workers, since capitalists are supposed to have been expropriated) and seeks to protect them from the tyranny of the market by shifting the risk to consumers, while transferring the power to producers. I will suggest several ways of doing this. For some of them the nationalization of the means of production is necessary; for others -- it may be merely convenient.

The most radical and direct method found in many utopias, including Marx's vision of the future communist state, would be to allow every person to produce what he (or she) wished.<sup>27</sup> It is assumed, of course, that normal, healthy people do wish to engage in some form of productive activity. If some workers enjoyed driving trucks or wagons, or operating pneumatic tubes, like in Bellamy's Looking Backwards, goods might be delivered to consumers'

homes;<sup>28</sup> otherwise, consumers would have to make their own arrangements. There would be no general plan, no prices and no wages.

The great virtue of this scheme lies in the elimination of workers' alienation, as it is defined by the marxists. Unfortunately, the scheme itself is completely impractical. There is no evidence that a positive relationship exists between the social usefulness of a job and the pleasure derived from it by its performer. Even if consumers did not die from exposure and starvation, the existence of input-output relationships in all, except the most primitive, economies would make it impossible for every worker to do what he liked. I am told that in Berkeley, near the university campus, there are (or were) young people selling hand-carved leather belts of their own manufacture -- a pleasant activity, useful to consumers and satisfying the creative urge of the producers. However, leather belts must be made out of leather, and leather is made from cow (or some other animal's) hides. I expect that in most societies a sufficient number of sadists -- known as "hunters" -- willing to shoot the cows (without any danger to themselves) will be found, but who would want to mess with their hides? So this creative activity would have to be given up.

A more practical method would have the producers draw up a self-consistent plan. They might very well take consumers' wishes into account by consulting them or by studying past data, but the main requirement of the plan would be its acceptance by the producers. The so-called "consumerism" would have no place here.<sup>29</sup> Prices and wages would exist, but firms would not be required to make profits, while losses would be made good by government subsidies. (Here the ownership of the means of production becomes relevant.) In a cruder version in this scheme, producers would not be particularly concerned with shortages in some markets and surpluses in others. (Let consumers worry about that.) In a more refined form, they would manipulate prices so cleverly that every market would always be in equilibrium. There would be no shortages and no queues. Consumers would retain complete freedom of choice among goods and services offered to them. Unless they had been abroad, they would never realize that they were enjoying only a part of the consumer sovereignty.<sup>30</sup>



But even this, seemingly moderate, scheme would run into problems. First, such a skillful manipulation of prices, even with the help of computers, would be beyond the ability of any government, at least in the foreseeable future. Second, enough of bourgeois morality would probably remain, at least for some time, to make a manager of a firm suffering chronic losses feel humiliated when begging for a subsidy; for the same reason, the planners would feel uneasy observing the waste resulting from the production of unwanted goods. Even Soviet country stores, the usual dumping ground for unsaleable goods, may object to receiving them. Hence, a better, easier and more practicable scheme has to be found.

In this, the planners continue producing goods and services which, in their opinion, consumers ought to have, but instead of frequent manipulation of prices they keep them more or less constant and generate sufficient purchasing power to create a chronic state of excess demand in most markets. This can be easily done.

Whether the emergence of excess demand in the Soviet Union was intentional or not need not concern us here.<sup>31</sup> Perhaps its original appearance was simply caused by sloppy planning and lax financial discipline, but once it took hold, its advantages were recognized and it has been permitted to thrive. Surely, after all these years of planning, the Soviet regime could have learned how to control demand, if it really wanted to.<sup>32</sup>

In any case, the emergence and existence of excess demand has changed drastically the distribution of power and risk between producers and consumers. Waiting to be served, after a long stand in a queue, the consumer has lost all his power because his, implied or actual, threat to leave and not to come back, or not to buy would be met not with regret but with derision. And if the goods or services were of the wrong quality or assortment, the excess demand would take care of that as well, at least most of the time. In any case, the risk would be borne by consumers.

Of course, excess demand, like any medicine, should be served in proper doses; too heavy a dose will disrupt the economy and reduce the desire of the populace to work and the willingness to obey. Since it is impossible to spread excess demand evenly over all markets, a moderate general application will bypass some markets and even leave an excess supply in others. Some firms will sustain losses either because the prices for their outputs were set

too low, or due to mismanagement, or for other reasons. Losses are embarrassing, but so long as the firms have unlimited access to the state credit or the state budget (as they usually do, being owned by the state), they will continue to function and their workers will keep their jobs.

The market for consumer goods, however, is only one of many. Its conditions are bound to affect the labor market and the markets for intermediate products and capital goods. With an excess demand for labor, independent labor unions could exercise tremendous power over their employers and demand and achieve ever higher wages. An endless inflation would result, disrupting the economy beyond control and making rational allocation of resources impossible. Hence, wages must be set by the government and not by collective bargaining. But unions may be permitted to engage in other activities related to the workers' welfare, fairness of treatment and the like. Indeed, this is the actual situation in the Soviet Union and other socialist countries today.

The knowledge that his employer needs him more than he needs his employer and that his job is virtually guaranteed places the socialist worker in a superior position, unknown under capitalism (except in wartime). He is not under pressure to perform; pleasing the consumers (or any buyers, with the exception of the defense and space establishments) is not among his duties, and the realization that by his efforts consumers are supplied with scarce commodities may give him a feeling of accomplishment, which capitalist workers, concerned with the preservation of their jobs, may not have. For workers, acting as workers, socialism has important advantages to offer.

But for the managers, the prevalence of excess demand creates a difficult and complex problem. Lords to their customers, they are slaves to their suppliers; helpless before the latter, they cry for help to the party and government functionaries (the "bureaucrats") with whom the ultimate power rests. This particular power is not derived from organs of compulsion, such as the KGB, the police, or the army. It arises because these functionaries perform the allocative functions of the market. They decide who shall and who shall not receive the scarce goods and services. If a chairman of a collective farm needs roofing iron for a new barn he will seldom get it without the support of the local party secretary. And this support is given in exchange for obedience to the secretary's orders.<sup>33</sup>

The absence of open compulsion makes this exercise of power particularly effective and pleasant because compulsion, a poor method of governance, is frowned upon. No class or group willingly parts with power, and socialist bureaucrats would be no exception. When Western economists insist that the Soviet Union (and other socialist countries) should let the market allocate their resources (with a minimum of planning), they may not realize what a tremendous change they are advocating: the market cannot function properly without the elimination of excess demand; in its absence, the bureaucrats would lose an important source of their power.<sup>34</sup> Some of them may even become unemployed. And (reports one blind man), all this can happen without any changes in the ownership of the means of production.

To persuade the reader that it is the existence of excess demand that is the key to the problem, let me invite him (or her) to join me in two experiments: the first is imaginary (the so-called "thought experiment"), the second is real. Imagine that by some unspecified method (magic, perhaps) excess demand in the Soviet Union is suddenly eliminated. Examine now the changes in the behavior of a manager of some ordinary Moscow store. Usually, when he arrived in the morning to open his store he was greeted by a sizable queue. Now there is no queue. Customers drop in at a leisurely pace, look (or sniff) at the merchandise; some buy, others do not. By the end of the day, and later, by the end of the week, month and quarter he realizes that he has failed to fulfill his sales and profit plans. For the first time in his life he has been short of customers! What will he do to attract them? He may redecorate his store, rearrange his merchandise to make it more accessible, display the best of it in the window, demand the authority to order merchandise instead of passively accepting what is sent to him. He may even advertise (if he is permitted), and, finally, he will call his sales personnel and, paraphrasing a late World War II New Yorker cartoon, he will tell them that "under the new circumstances they are to proceed on the assumption that the customer may be sometimes right."

The second experiment consists in visiting one of the Soviet Berezka stores which cater mostly to foreigners and accept hard currency only.<sup>35</sup> The visit will be a pleasure. The store is attractive, the goods are plentiful, of good quality, and tastefully displayed, the sales ladies are educated, well groomed, polite and helpful.<sup>36</sup> Do these stores belong to some foreign

capitalist? Not at all. They are state owned, just like other Soviet stores. But they do not suffer from (or shall I say "enjoy") excess demand.

Actually, it is not necessary to travel to Moscow to observe the creation of power by excess demand. My contemporaries can still recall how sales clerks treated their customers during World War II. The younger generation may still remember the adventures of finding gasoline in 1973 and 1979. The service stations had not changed their owners, but their employees suddenly became socialist functionaries. Those, however, were only short episodes. We have in our midst two permanent socialist, or at least socialist-like, sets of organizations: the government, in all its numerous units, and the more prestigious universities.

That government functionaries of all countries have much in common (soon they will proclaim "bureaucrats of all countries, unite!") is too well known to need elaboration. The explanation of their peculiar behavior is simple: they are not confronted with paying customers who can go elsewhere but with humble petitioners who do not pay (at least directly) for services received and therefore wield no power. The universities present a more interesting case.

The tuition in our leading universities is set sufficiently low to create an excess demand for the available seats. Its presence serves as evidence of high standards and is a source of pride; it also places the consumers, that is the students, in the power of the producers, or the faculty, who derive additional power from assigning grades and writing recommendations. Students are helpless because they do not pay the market (shadow) price for instruction and consultation. Oftentimes, they pay nothing or are paid instead. Besides, the universities do not try to maximize profits or revenues. Should a student decide to leave, no regrets would be expressed because his place would be quickly occupied by others. Fortunately, university teaching usually attracts nice (if I may say so), nonaggressive people who, on the whole, believe in noblesse oblige, like to be popular and take pride in the performance of their students. But if the reader wants to understand the role of power in the university, let him compare the present arrangements with the following imaginary ones: professors would not be paid for teaching; those who desired to teach would sell (indirectly, to preserve their dignity) tickets to their lectures at rates established by themselves; consultations would be paid for

in a similar manner.<sup>37</sup> Tests, grades and degrees, if given at all, would be handled by some outside body.<sup>38</sup> Space forces me to stop here, but I am sure that the reader's imagination will be adequate for visualizing the resulting changes in human relations in the universities and in the quality of teaching.<sup>39</sup>

The distribution of power in our better universities allows their tenured professors to lead double lives, as it were, enjoying the benefits of both socialism and capitalism, without suffering from the defects of either: as producers, during working hours, say from nine to five, they live under socialism; after five and during vacations (and vicariously through their spouses) they become capitalist consumers. This remarkable arrangement is perhaps responsible for the greater tolerance which professors usually display to both systems than is commonly shown by the society at large. If the society gains from this tolerance, as it probably does, perhaps it also loses because those who play such important roles in the formation of public opinion lead such atypical, privileged lives.<sup>40</sup>

### III. INTERNATIONAL COMPARISONS

The urge to compare life in the United States and in the Soviet Union (or among other countries) is irresistible and most students of Comparative Economic Systems succumb to it. It involves a number of methodological questions on which a vast literature exists. But on one aspect of the comparisons there is a nearly complete agreement: whether they involve gross national product, national income, consumer expenditures, etc., they are made from the consumer point of view.<sup>41</sup> Comparisons made by international tourists follow the same path. Indeed, how could it be otherwise, since a tourist, by definition, is a hundred-percent consumer. He (or she) does not take a job in a foreign country; if he does, he stops being a tourist.

Even before leaving the airport, an American tourist in Moscow begins picking up consumer horror stories, and by the time he leaves for home he is likely to carry a whole suitcase of them, for the entertainment of his friends (and students). Most of these stories are true; for the consumer, life in the Soviet Union is very hard indeed. No doubt, the American consumer is immensely better off. A Soviet tourist visiting the United States comes to

the same conclusion. He must be so overwhelmed by the fantastic quantity and variety of goods (including food) in our stores as to be never the same person again.

What about American and Soviet producers, or rather workers, since no capitalists are supposed to exist in the Soviet Union? Curiously enough, their welfare is usually excluded from these comparisons. Tourists do not get the information, and economists, even if they do, are at a loss what to do with it. Now, I do not claim that a Soviet worker, as a worker, is definitely better off than his American counterpart, but I do insist that the following inequality holds:

$$\frac{\text{Welfare of an American consumer}}{\text{Welfare of an American worker}} > \frac{\text{Welfare of a Soviet consumer}}{\text{Welfare of a Soviet worker}} .$$

Surely, a comparison based only on the numerators of these fractions biases the result in our favor. Unfortunately, I do not know how to quantify this bias any better than my colleagues do. What is the value of job security or of absence of tension on the job?

If this bias works in our favor, there are a few others acting in the opposite direction. The low quality of Soviet merchandise and the lack of variety are well known, as is the excessive amount of time spent on shopping.<sup>42</sup> What is less well known is the frequency with which Soviet shoppers have to accept a less satisfactory substitute because the desired object is not available.<sup>43</sup> How many percentage points could we add to our measures of aggregate output if we followed the Soviet example? Probably quite a few, by drastically reducing the quality and variety of goods and services. To some extent this happens automatically when we approach the state of full employment; hence, the statistical gain achieved at that time exaggerates the true improvement in consumer welfare. Full employment is supposed to be welcome by all; actually, it is a friend to producers and an enemy to consumers.

\* \* \*

If and when socialism arrives, the classical struggle between workers and capitalists, so dear to Marx, will cease because there will be no capitalists left to struggle against.<sup>44</sup> But the conflict between producers and consumers

will continue. In the end, the elephant's little tail may outlive his big head.<sup>45</sup>

## NOTES

<sup>1</sup>Since some thirty-seven years passed from the inception of this paper to its completion, a brief history of it may be called for. The basic idea was suggested by a silly old movie Born Yesterday around 1950. One of its principal characters is a successful junk dealer whose business operations have become so vast as to require the services of a public-relations expert. He hires an ex-senator (who must have failed his last re-election) at the then fantastic salary (in 1950) of one hundred thousand dollars. Both the junk dealer and the ex-senator know that in no other employment could the latter command such a salary. As a result, the senator finds himself in the power of his employer who treats him worse than the proverbial dog. The movie taught me that money (or income) and power can be exchanged for each other.

Scholarly integrity requires that due credit be given to as many of the author's predecessors as possible, and particularly to those whose works he consulted when writing his own. My attempt to honor this good custom resulted in a huge pile of notes and references (the literature on socialism and related subjects being so vast) which could not possibly be included in this paper. A separate paper, or even a book, would be required. I have decided, therefore, to express to their respective authors my sincerest gratitude and apology and to mention here only those who have influenced my thinking directly.

I start with Oscar Lange's classical essay (On the Economic Theory of Socialism, Minneapolis, 1938), proceed to Janos Kornai's first book (Anti-Equilibrium: On the Economic Systems Theory and the Tasks of Research, Amsterdam, 1971) (though I disagree with his explanation of the demand deficiency under capitalism -- see below), then to some unidentified essay by Burton Weisbrod (which neither he nor I has been able to find again), and to ideas propagated by the American radical movement expressed in, among other places, The Capitalist System: A Radical Analysis of American Society, Englewood Cliffs, N.J., 1972, edited by Richard C. Edwards, Michael Reich and Thomas B. Weisskopf. The two very important sources which I should have read at the time, but did not until recently, long after the second draft of the paper was completed, are Albert O. Hirschman's Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States, Cambridge, MA, 1970, and an unpublished manuscript of my colleague Robert L. Bishop, Microeconomic Theory, 1956, Book III, Chapters 1 and 2, which contains the clearest explanation of the existence of excess supply under oligopoly (see below.)

Over the years, I have presented this paper orally in my classes and since 1972 -- in numerous seminars and lectures. The ideas spread. They were reflected in Martin L. Weitzman's well-known book The Share Economy: Conquering Stagflation, Cambridge, MA, 1984, and in a paper by Tibor Scitovsky, "Price takers' Plenty: A Neglected Benefit of Capitalism," Kyklos, Vol. 38, 1985, pp. 517-36, who attributed them to Weitzman. Of course, both Weitzman and Scitovsky might have been inspired by other sources as well.



<sup>2</sup>The person who identified this little tale as Indian was Patma Desai. The more I think of it, the more I am struck by its depth. Consider how many religious disputes, persecutions and wars might have been avoided if its spirit had prevailed. It seems to have prevailed among the thirteenth century Mongols who practiced remarkable religious tolerance in the belief that every religion had something to contribute. See René Grousset, The Empire of the Steppes: A History of Central Asia, New Brunswick, N.J., 1970.

<sup>3</sup>Public (or social) ownership of the means of production is regarded by almost all socialists as a necessary condition of socialism. (This is how socialism is usually defined.) But few regard it as sufficient. Among their additional demands we find democracy, non-bureaucratization, workers' self-management, abolition of workers' alienation and of commodity production, the end to markets and to the profit motive, and so on. Richard Crosland forms an exception: he did not attach much importance to the question of ownership. A whole section of his book The Future of Socialism, New York, 1963, pp. 35-42, is entitled "The Growing Irrelevance of the Ownership of the Means of Production." By now he must have company.

Perhaps the importance of class struggle, which to Marx embodied the essence of human history, should also be re-evaluated. In our times, the sight of business and unions lobbying hand-in-hand for protective tariffs and government regulation for their industry does not point to an intensive class enmity. In the seventies and early eighties, business generously granted union wage demands greatly exceeding the growth in labor productivity and then recompensed itself by passing the higher costs to the public. Arthur M. Okun found a close relation between wage and price increases, but not between their reductions. See his Conflicting National Goals, Brookings Institution, General Series Reprint 320, Washington, D.C., 1977, p. 80.

<sup>4</sup>This is not a particularly original suggestion. Already in 1921, G.D.H. Cole wrote that "It is no longer necessary to deal with the argument that, because producers and consumers are the same persons, there is no need for distinct organizations to represent the respective points of view." (Guild Socialism, New York, p. 82). However, he also stated that "... because consumers and producers are practically the same people... there can be no real divergence of interest between them." (Ibid., p. 29.) Perhaps he could not make up his mind.

Other divisions have been suggested:

... To Saint Simon the antagonism between the third estate and the privileged classes took the form of an antagonism between 'workers' and 'idlers.' The idlers were not merely the old privileged classes, but also all who, without taking any part in production or distribution, lived on their incomes. And the workers were not only the wage workers, but also the manufacturers, the merchants, the bankers.

From Friedrich Engels, "Socialism: Utopian and Scientific," in Robert C. Tucker, The Marx-Engels Reader, New York, 1972, p. 610.

A Danish Professor Joergen Dich "has propounded... a theory that the members of the new ruling class in the welfare state are public servants, and that the Marxist conflict between labor and owners of capital has been succeeded by a conflict between those who work in the private sectors and those who work in the public sector." (The New York Times, February 12, 1976, p. 16.)

This quotation suggests that my division of the populace into consumers and producers who (under capitalism) work for firms deriving all, or most, of their funds from sales may be too simple. Government employees are also producers, but they do not have to please the users of their services, at least not directly. The same holds true for employees of non-profit organizations.

<sup>5</sup>The distinction is not as clear as the text implies. Private firms have been known to receive credit and subsidies from the government, as the Lockheed and Chrysler examples demonstrate. So have American farmers and many others. On the other side, Mrs. Thatcher has been closing down unprofitable government-owned mines and Mr. Gorbachev has insisted that public enterprises should pay their way. See Pravda, June 27 and July 1, 1987.

<sup>6</sup>The source of this power is the absence of perfect substitutes. Perhaps it will amuse the reader to reflect that true romantic love, so glorified by the poets, can be a perfect instrument of enslavement because, by its very nature, it allows no substitutes. Reciprocity (if it can be induced) is the only known antidote.

<sup>7</sup>The rarity of standardized products has not prevented their use in most economic models. Sometimes, no harm is done, but they are certainly out of place in studies of technological change, consumer economics and comparative economic systems, to mention just a few. In general, this assumption deprives economists of a rich source of ideas and of insights into the working of the economy.

<sup>8</sup>"As a matter of fact, perfect competition is and always has been temporarily suspended whenever anything new is being introduced -- automatically or by measures devised for the purpose -- even in otherwise perfectly competitive conditions." (Capitalism, Socialism and Democracy, New York, 1942), p. 105.

<sup>9</sup>In discussions of oligopoly the emphasis is usually placed on the interaction among several producers of similar products. This question is irrelevant here. All that we borrow from oligopoly is a negatively sloping demand curve. Morris Bornstein suggested that "imperfect competition" would be a better term. I have not used it because there is nothing imperfect about the situation described here. It is a perfectly normal state of most capitalist markets.

<sup>10</sup>As Peter Wiles said about a capitalist firm, "It may not wish, as in western economic textbooks, to maximize profit, but it will certainly be keen to avoid loss. For the basis of the market economy is that loss-makers cease to exist." (The Political Economy of Communism, Oxford, 1962, p. 20).

<sup>11</sup>This point was also made by Tibor Scitovsky in Welfare and Competition: The Economics of a Fully Employed Economy, Chicago, 1951, p. 247.

<sup>12</sup>I wonder if Keynes ever realized that the principal assumption of classical economics that he rejected was that of perfect competition. It is its absence that forces most of the adjustments to demand to fall (at least in the short run) not on prices and wages but on output and employment.

<sup>13</sup>See his Anti-Equilibrium, *op. cit.*, and his other writings. A particularly strong statement appears in his paper published in Judith Thornton, Ed., Economic Analysis of the Soviet-Type System, Cambridge, MA, 1976, p. 207:

... Total purchasing power intended by the population for consumption is incapable of consuming the mass of commodities offered for consumption at any single moment... In the final analysis, effective purchasing intentions lag behind commodity supplies as well as behind sales intentions based on potential production.

<sup>14</sup>To Edward Chamberlin this disparity between prices and marginal costs merely represented waste. See his The Theory of Monopolistic Competition, Cambridge, MA, 1939, p. 109. I can see now why Schumpeter had so little use for this type of argument.

<sup>15</sup>There is no shortage of compliments in The Communist Manifesto. The best known of them reads: "The bourgeoisie, during its rule of scarcely one hundred years, has created more massive and more colossal productive forces than have all preceding generations together."

<sup>16</sup>The plight of some of our largest corporations in the last ten-fifteen years demonstrates the overpowering strength of the market. It also shows how wrong Galbraith has been in denying that. See his The New Industrial State Boston, 1967, and his other writings.

<sup>17</sup>A few hours spent in Moscow should persuade the reader of the validity of this argument.

<sup>18</sup>The Wealth of Nations, The Modern Library Edition, New York, 1937, p. 625. But the same Smith expressed deep concern for the mental development of workers engaged in repetitive operations. He thought that, in this respect, members of "barbarous societies" pursuing varied occupations, were better off. *Ibid.*, pp. 734-37.

Alfred Marshall listed "The growth of mankind in numbers, in health and strength, in knowledge, ability, and in richness of character" (my italics) as "the end of all our studies." (Principles of Economics, Eighth Edition, London, 1936, p. 139.) He wondered

... Whether the present industrial organization might not with advantage be so modified as to increase the opportunities, which the lower grades of industry have for using latent mental faculties, for deriving pleasure from their use and for strengthening them by use...

Ibid., p. 248. Many similar quotations from other non-socialist writers can be given, but to all of them the satisfaction of consumer desires was the paramount objective of economic activity.

<sup>19</sup>Of course, a strict interpretation of this concept would require the equality of all prices with their respective marginal costs and thus exclude the oligopolies which bestow so much power on the consumers. Under perfect competition (with standardized products) the producers should simply move to the point of equality of price with marginal cost and stay there. They would be interested only in cost-reducing technological change.

<sup>20</sup>The expression "Worker sovereignty" is not seen very often, but is not unknown. See, for instance, Abram Bergson, Essays in Normative Economics, Cambridge, MA, 1966, p. 202, and Peter Wiles, op. cit., p. 97.

<sup>21</sup>See his The Economic and Philosophic Manuscripts of 1844, New York, 1964, pp. 88-89, as reproduced in Paul Craig Roberts and Matthew A. Stephenson, Marx's Theory of Exchange, Alienation, and Crisis, New York, 1983, p. 49.

<sup>22</sup>See Marx's "Alienated Labor" in his Economic and Philosophical Manuscripts as reproduced in David McLellan, Karl Marx: Selected Writings, Oxford, 1977, pp. 77 - 86 and his other writings; there exists a large literature on the subject. It has become very popular with American radicals.

<sup>23</sup>Such a utility function was suggested by James J. Heckman in his "Estimates of a Human Capital Production Function Embedded in a Life-Cycle Model of Labor Supply," Household Product and Consumption, Studies in Income and Wealth, No. 40 NBER, New York, 1975, p. 229. A more sophisticated version would include the time pattern of consumption and saving, risk, etc.

<sup>24</sup>The opposite point of view was strikingly expressed by Heinz-Otto Vetter, the head of the West German Union Federation: "I am not half helot, half man... The idea that I become a man when I go out of the factory is intolerable. I'm indivisible. I want to be a man in my whole life, at work and at leisure." As quoted in The New York Times, March 25, 1976, p. 14.

<sup>25</sup>As a long-time (26 years) graduate placement officer in the Economics Department at M.I.T., I can testify that our new Ph.D.'s were much more interested in the quality of the academic environment, research facilities, courses to be taught, etc., rather than in their salaries. None of them ever asked their prospective employers whether the university was close to good shopping facilities. Essentially, they were interested in their careers, not in consumption.

But they were hardly a good sample of the American population. However, in a study reported in Work in America (U.S. Department of Health, Education and Welfare, Washington, D.C., December 1972, p. 11) on the attitudes of American workers, "Interesting work" commanded the first place, while "Good pay" took the fifth. In a similar study made in Poland, "The atmosphere of the place" was in the first place. Even though the respondents might have been embarrassed to stress their concern for money, it seems safe to conclude that non-monetary aspects of their work were important to them.

My surprise witness on this issue is former president Nixon who declared that "... The most important part of the quality of life is the quality of work, and the new need for job satisfaction is the key to the quality of work." Work in America, op. cit. p. i.

The non-monetary rewards (positive or negative) from work are called "Psychic income" and most economists recognize its importance. But they don't quite know what to do with it. Those who assume that this income is already embodied in the wage rate, whatever that happens to be, may decide that it calls for no special recognition.

<sup>26</sup>A number of suggestions for relieving the monotony, boredom and fatigue, and in general for making work more attractive have been made and some have been carried out, particularly in Sweden. To the extent that their adoption does not raise the cost, no problem arises. But if it does who will bear it?

It is very strange that our labor unions have shown so little interest in this problem. Does it really exist or has it been merely invented by intellectuals? Are our workers satisfied? A number of opinion polls have not given definitive results. Could it be that unions don't want their members to be satisfied with their work because dissatisfied workers make better union members?

<sup>27</sup>Here is Marx's famous statement on this freedom: "... To hunt in the morning, fish in the afternoon, rear cattle in the evening, criticize after dinner." The German Ideology, p. 22, as quoted in Roberts and Stephenson, op.cit., p. 31.

<sup>28</sup>Edward Bellamy, Looking Backward 2000 - 1887, New York, 1960. (Originally published in 1888.)

<sup>29</sup>It is best to define "Consumerism" by a direct quotation from the book of radical readings edited by Edwards, Reich and Weisskopf, op. cit., p. 369: "Consumerism derives from a fundamental tenet of capitalist ideology: the assertion that the primary requirement for individual self-fulfillment and happiness is the possession and consumption of material goods."

The importance attached to consumers and consumption differs greatly among socialist writers. A survey of their views cannot be undertaken here.

<sup>30</sup>In Lange's classical essay prices are also manipulated to equilibrate all markets (except for the highly competitive ones), but consumers do enjoy complete sovereignty. Among socialist writers, Lange is one of the few who look at the world from the consumer point of view. He accepts the market allocation of resources and is not concerned with the protection of workers from the market. (But they would not suffer from unemployment.) For a related view on Lange see Paul Craig Roberts, "Oscar Lange's Theory of Socialist Planning," Journal of Political Economy, Vol. 79 (May/June 1971), pp. 562-77.

It is not clear to me why Lange favors the free distribution of as many goods as possible. Since under socialism, income distribution is expected to be quite equitable, there is really little reason for not using the price mechanism. As soon as a good (or service) becomes free, its consumers lose all control over its quality, appearance, assortment, etc. On Peter Wiles' troubles with free army socks see his "A Comment but not a Rejoinder," Soviet Studies, Vol. XXII (July 1970), p. 41.

<sup>31</sup>In 1930 Stalin declared: "... In the USSR, the growth of consumption (purchasing ability) of the masses all the time overtakes the growth of production, pushing it forward, while with them, the capitalists, the growth of consumption of the masses (purchasing power) never catches up with the growth of production and all the time falls behind it, time and again causing production crises." Sochineniia (Collected Works), Vol. 12, Moscow, 1949, pp. 322-23.

In 1956 Mikoyan repeated this: "... In a socialist society demand must be ahead of the supply of goods." United Nations, Economic Survey of Europe in 1958, p. 28, note 72.

Whether the two gentlemen were merely boasting or describing their actual policy I do not know.

<sup>32</sup>"Had the Soviet leaders wished to eliminate the disequilibria between supply and demand, they could have done so long ago. That they had not done so was a decision of economic policy." Joseph Berliner, The Innovation Decision in Soviet Industry, Cambridge, MA, 1976, p. 89. The advantages of excess demand were also noted by Franklyn D. Holzman in "Some Notes on Over-Full Employment Planning, Short-Run Balance, and the Soviet Economic Reforms," Soviet Studies, Vol. XXII (October 1970), pp. 255-61. A number of references are given in his paper.

<sup>33</sup> Excess demand creates power in all sorts of places. For instance, the prices of tickets to our popular athletic events, like the Rose Bowl, are set way below their market values. The power so created falls in the hands of the organizers who decide who shall and who shall not get them. Do they use this power to obtain favors from the lucky recipients of the tickets? (I owe this observation to Steven Chung.)

It is interesting to note that the existence of excess supply can also generate power for those who are given the right to allocate the scarce resource--this time, the customers. See Berliner, op. cit., pp. 209-24.

<sup>34</sup> They would still retain, however, other sources of power.

<sup>35</sup> There are also bars operating on the same principle. I wonder if Soviet administrators are aware of the irony that West German customers are welcome to these exclusive places but East Germans are not.

<sup>36</sup> This was my own experience.

<sup>37</sup> A close friend of mine (now deceased) who taught at one of our leading universities set his office hours at eight in the morning in the hope that no students would ever come.

<sup>38</sup> As a long-time beneficiary of the present arrangements, I am not advocating these changes.

<sup>39</sup> These ideas were developed at greater length in my unpublished utopia The Fall and Rise of the American Academic Establishment: The Revolution of 1960-2020, written around 1970.

<sup>40</sup> On the other hand, they are, or at least regard themselves to be, underpaid. Hence, their true, or alleged, sympathy for the underdog.

<sup>41</sup> This problem was recognized by Abram Bergson: "... A comparison of the total market value of the consumers' goods produced in the rival systems... already implies the acceptance of the principle of consumers' sovereignty." Bergson, op. cit., p. 236.

<sup>42</sup> See Frederic L. Pryor, "Some Costs and Benefits of Markets: An Empirical Study," The Quarterly Journal of Economics, Vol. XCI (February 1977), pp. 81-102.

<sup>43</sup> In an old Krokodil (The Soviet satirical magazine) story (or cartoon), a young couple wishes to buy a pram for their baby. "There are no prams," says the salesman, "why don't you take a suitcase instead?" Suppose they did. In no statistics known to me would the true character of this transaction be recorded. Kornai has remarked that "Rising living standards in suction [excess demand] economy give less satisfaction to the consumer since there is continuous tension due to unfulfilled aspirations." From Thornton, op. cit., p. 109.

Irwin L. Collier, Jr. has estimated that the East Germans lose the equivalent of 13 percent of their consumer expenditures because they cannot find the items they wish to buy. See his "Effective Purchasing Power in the Quantity Constrained Economy: An Estimate for the German Democratic Republic," The Review of Economics And Statistics, Vol. 68 (February 1986), pp. 24-32.

<sup>44</sup>But chances are that future Stalins and Maos will find some enemies to struggle against. If necessary, they will invent them.

<sup>45</sup>If the reader is interested in some quick and simple differences between the American and Soviet economic systems, here are a few examples: American folklore abounds in anecdotes about salesmen, but neglects purchasing agents (at least, I have never heard one), while in the Soviet folklore it is the purchasing agent (the famous tolkach or pusher) who plays a major (and often a nefarious) role. A famous American play is called "The Death of a Salesman," not "The Death of a Purchasing Agent." Our business schools offer a variety of courses on marketing, but I have not seen any on purchasing. I doubt if courses on marketing are offered in the Soviet Union. Do they teach purchasing?









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