WHAT DO WE DO NOW?

By Lane Kenworthy

The demise of command socialism in Eastern Europe presents both an obstacle and an opportunity for those interested in constructing a just and effective economic system. The manifest economic failure of *really existing* socialism has convinced many people that laissez-faire capitalism is the only feasible form of economic organization. This is certainly a setback. At the same time, the door is now more fully open than ever before to new ideas about *post-capitalist* economics. No longer does the command model dominate in theory or in practice.

The left ought to take advantage of this opening to the greatest extent possible. Unfortunately, progressives of all stripes, particularly in the United States, tend to be far too cavalier in their thinking about what kind of economic system they favor. We're more likely to focus solely on criticizing existing institutions. We have numerous convincing accounts of the ills of free-market capitalism, but too few cogent suggestions about what to put in its place. If the left is to play a significant role in determining the future economic system in the US and elsewhere, we need a much more explicit and sustained dialogue about where we'd like to go.

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This discussion should be pitched primarily at the level of economic systems, rather than merely at policy options within the present system. While the latter is unquestionably pivotal in orienting the left's near-term political strategy, the former can be neglected only at great peril. Short-run policy demands should be guided by a longer-term vision. The central themes in this system-level discussion ought to be planning and markets, public ownership, worker self-management and equality.

In debating the institutional features of a post-capitalist economic system, progressives should concern themselves more directly and seriously with efficiency issues than they traditionally have. Partly this is to increase the size of the audience; after 100 years it seems clear that moral condemnations of capitalism are insufficient to generate widespread support for alternatives. It is also because the East European experience has demonstrated graphically the importance of "putting bread on the table."

We should also be more attentive to the benefits, rather than just the faults, of existing capitalist economic institutions. Any post-capitalism or socialism -- especially one brought about through reform -- will undoubtedly inherit many features from the economy it replaces. Institutional configurations tend to be *sticky;* they have an inertial quality. Capacities and resources get arrayed in ways that resist alteration. One of the chief lessons of the anti-capitalist revolutions of this century

(Russia, China, Cuba, Nicaragua, etc.) is that economic systems cannot quickly be remade to fit the specifications of radical blueprints, regardless of the will of leaders and citizens.

Since the mid 1800s, centralized planning has been the quintessential post-capitalist goal of the left. Most socialists have viewed planning as a precondition for the achievement of a number of desirable social goods, including efficiency (because it allows, in theory, a rational allocation of resources), economic growth without large fluctuations or cycles, full employment, and realization of the general interest over that of the particular.

During the past decade, however, a growing number of progressives have become convinced that the left should abandon the goal of genuine planning -- at least insofar as that consists of extensive, coordinated, ex ante allocation of the majority of the economy's resources. This sentiment stems from a realization that planning has two inherent defects, both of which were borne out in the experience with centralized planning in the state-socialist countries during the past fifty years.

The first has to do with information. Because of the immense scale and numerous interdependencies involved, full-scale planning cannot be carried out effectively. Modern economies are composed of millions of different goods and services, and decisions about how much to produce and at what price depend upon what Friedrich Hayek has called "knowledge of the particular circumstances of time and place," which is constantly changing. The amount, complexity, interconnectedness and instability of the requisite information is simply too great for a planning commission to aggregate and transform into a set of clear and coordinated directives for each enterprise.

Consequently, planning is bound to allocate resources with less than desirable efficiency. In addition, many directives will be infeasible for the enterprise to which they are given. A breakdown in plan fulfillment of producer goods in one firm leads to shortage at another, which causes another breakdown in quota fulfillment, and so on. As a result of shortages and delays of inputs, firms constantly have parts or workers sitting idle, waiting for supplies. This micro-level shortage phenomenon produces a substantial amount of aggregate waste in the economy. Moreover, in an effort to patch up problems, plans tend to be changed often, which only creates further bottlenecks and inefficiencies.

The second fatal weakness of planning has to do with motivation. There is a strong tendency under central planning for firms to be given what Hungarian economist Janos Kornai calls a "soft budget constraint." That is, enterprises do not face the threat of bankruptcy, of being shut down if they don't perform efficiently; instead they are guaranteed state support. This is probably an inevitable correlate of central planning, because if the state is ultimately responsible for decisions regarding each firm's output, wages, prices, etc., as is the case under centralized planning, then the state must take a good measure of responsibility if a firm fails economically. It will face strong pressure to keep the enterprise afloat.

A soft budget constraint leads to inefficient management practices. Without the threat of bankruptcy, firms have limited incentive to reduce costs. Soft budget constraints also impair efficiency in an indirect fashion, by encouraging firms to exaggerate their input requirements during the plan formulation stage. Any extra supplies the firm is able to get from the center can be hoarded, to be used in the inevitable event of shortages or delays of inputs later on. Since extra costs generally are borne by the government, there is no reason not to exaggerate one's needs. But rather than remedying the shortage problem, for obvious reasons hoarding only exacerbates it.

Soft budget constraints also impede innovation. The absence of effective competition and threat of bankruptcy dissolves the incentive for firms to innovate. Thus, while a centrally-planned economy may be just as effective as a market-based economy in achieving large-scale innovations (such as putting a spacecraft on the moon), it will be less successful at producing the incremental company-level innovations that are at the heart of industrial advance.

Traditionally the left argues that the poor performance of Eastern European planning results from distortions caused by the undemocratic operation of the planning process. The inefficiency could therefore be remedied by a healthy dose of democracy, both at the level of the firm and throughout the planning chain.

Alternatively the left argues that informational difficulties resulting from scale and complexity can be solved by today's powerful computers. Michael Albert and Robin Hahnel have proposed that computers make possible a coherent and effective decentralized planning arrangement, in which firms coordinate production decisions in an ex ante fashion on their own, through a process of iterative bargaining.

The concept of planning is growing less popular, however -- and for good reason. It's clear, based on the experiences of the Eastern European countries, that computers aren't sufficient to remedy planning's deficiencies; there's simply too much information which changes too frequently. Similarly, it seems quite unlikely that democratization and/or decentralization of the process could remove or even significantly alleviate the informational and motivational barriers to effective, efficient planning. A growing portion of the left is coming to believe that an attractive, feasible post-capitalist economy should be coordinated primarily by markets. For all their faults, markets appear to be the most effective available mechanism for allocating economic resources and stimulating innovation.

It's important to realize that market coordination of an economy need not imply that production and consumption are organized exclusively in the form of impersonal, arms-length, competitive transactions. Indeed, most existing market economies -- especially Japan and the continental European countries -- feature an assortment of quasi-market relationships between firms, often referred to as *networks*. Characterized by long-term, informal, personal, reputation-based interactions, networks not only increase the stability of market operations but also enhance efficiency in a variety of ways.

Reliance on markets as a coordinating device by no means implies a laissez-faire orientation by the government. As economists have long known, markets fail in many areas critical to economic performance. Unfettered -- or, more to the point, unassisted -- markets tend to undersupply investment in plant and equipment, research and development, new technology and worker training. In some cases markets simply do not provide adequate incentives for sufficient investment; in other instances market incentives actually discourage investment. Countries such as Japan, France, South Korea, and Taiwan have exhibited considerable success at utilizing direct government steering to prevent or compensate for such market failures.

Many progressives are understandably unwilling to depart from the traditional socialist goal of socializing property ownership. The unrestricted accumulation of private property is the chief source of the widespread inequalities in wealth and power that pervade capitalism. In recent years a number of innovative proposals have been developed for ways to combine markets with public ownership. Three are particularly worth mentioning here: in each, firms make their own production decisions and interact freely with their suppliers and customers, and property is publicly owned. The key differences lie in the way public property ownership is structured and in the mechanism through which finance is allocated to firms.

One *market socialist* proposal, advanced by John Roemer, features completely centralized control of finance. Credit would be allocated entirely by the state in the form of loans. By using differential interest rates, the political party in power could give priority to certain sectors and firms in the economy. According to Roemer it is possible for a government economic bureau to calculate a set of interest rates such that a market interaction between firms and the state credit institutions would yield the desired allocation of resources. This arrangement would enable society to democratically determine its allocation of economic resources while still achieving optimal efficiency.

A second proposal, developed by Leland Stauber, features a more decentralized mechanism for allocating finance. Firms would continue to sell equity shares as they do presently under capitalism, and this would constitute their principal source of finance. But the share purchasers -- and thus owners of firms -- would be public investment banks controlled by local governments. Ownership would remain decentralized in that each investment bank could purchase no more than 10 percent of the shares in any particular firm. The objective of Stauber's model is to approximate as closely as possible the allocative efficiency of a decentralized capital market, while removing ownership from private hands.

Public ownership of property is a central component of most conceptions of socialism. Traditionally, much of the left has assumed that *public* meant the state, and that the transfer of property from private to public hands would occur largely in one fell swoop of nationalization. During the past several decades, however, social democratic strategists have drawn up proposals for gradually transferring capital ownership not to the state but to the workforce. The best-known of these plans, the Swedish wage-earner funds proposal of Rudolf Meidner, would require firms to place a small percentage of profits into a union-controlled fund. Over the course of fifty or so years the bulk of the nation's capital would come under labor force control via its union organizations. Other proposals in this genre rely on alternative mechanisms -- such as pension funds and employee ownership schemes -- for socializing capital ownership.

Worker management of firms, like planning and public ownership, has long held a privileged place in progressive visions of a post-capitalist economy. Ethical concerns such as reducing alienation through participation, eliminating power asymmetry in the workplace, and, most importantly, extending democracy to the realm of work motivate the attraction to self-management. Proponents of self-management rightly insist that if democracy is justified in the political realm, it must be justified in governing economic enterprises. This relies on the age-old principle that *what touches all should be decided by all.*

Most enthusiasts of self-management also contend that, by increasing worker satisfaction and morale and reducing monitoring costs, workplace democracy enhances productivity and efficiency. Recent empirical studies on employee participation in decision making within traditional capitalist firms have found participation indeed associated with higher productivity.

Still, there is a profound difference between participation and control, one which has a direct bearing on economic performance. Economists have demonstrated that, theoretically, an employee-managed economy -- in which workers have full, rather than just partial, decision-making rights -- will tend toward underinvestment, inflation and underemployment. Workers in self-managed firms face an incentive to pay out a high portion of profits to themselves in the form of wages, which reduces the quantity of funds available for reinvestment and results in price increases and inflation. Worker-managers may also be reluctant to reinvest profits because, if firms are collectively owned by the workforce, an individual worker cannot recover her share of such investments upon leaving the firm; hence, it is preferable to have that share paid out in the form of wages. Cooperatives can also be expected to keep their level of employment as low as possible, so that profit per worker is maximized.

Centralized wage setting among representatives of worker-managed firms -- along the lines of that in corporatist economies such as Sweden and Austria -- would help minimize wage exaggeration. Coordination promotes wage restraint by encouraging labor leaders to take into account the long-term interests of wage-earners as a group.

Economist Saul Estrin has suggested that the tendency toward underinvestment of profits can be remedied by placing self-managed firms under the control of competing public holding companies. These companies, a prominent feature of Austria's economy, would provide external finance in the form of loans to the cooperatives, thereby surmounting the problem of insufficient reinvestment of internally generated funds. The public investment banks in Leland Stauber's market socialist proposal or the state credit institutions in John Roemer's model could serve the same function. An alternative mechanism for overcoming the underinvestment problem would be to give each worker an equity stake in her firm, which could only be redeemed upon leaving the firm or retirement.

Finally, the employment-creation deficiencies of self-managed firms could be alleviated by having holding companies or some other government bodies encourage start-up cooperatives in profitable areas and/or offer incentives for existing firms to hire additional workers.

If self-management is attractive and feasible, why are there so few cooperatives in existing capitalist economies? Skeptics contend this indicates that worker management isn't really so desirable or workable after all. Yet there are a number of plausible alternative reasons for the scarcity of cooperatives, ranging from biases in capital markets to risk aversion among workers under capitalist constraints. Because of the uncertainty inherent in evaluating its efficiency properties, the case for worker self-management must rest fundamentally on considerations of justice. Still, since self-management -- unlike central planning -- seems both practicable and potentially efficient, its ethical force should compel us at least to experiment widely with the institution.

Equality has always been a central concern of progressives, and must undoubtedly be a key component of any just economic system. Does equality reduce efficiency? While attempting to achieve perfect distributive equality would likely detract substantially from economic performance, there's little reason to think that equality greater than that now existing in most developed nations would have this effect. Income equality enhances and stabilizes demand, helping to perpetuate a virtuous circle of high wages, high growth and high employment. And because of its fairness properties, distributive equity may improve worker motivation and cooperation, thereby enhancing productivity. Empirically, too, the evidence weighs against the conventional wisdom. The record of the sixteen most developed capitalist economies over the past thirty years offers no support for the notion of a tradeoff between income equality and economic performance.

Does equality impede freedom? Libertarians such as Milton Friedman have forcefully articulated the position that freedom and equality are antithetical. This contention, however, relies on a rather limited conception of liberty, as merely the absence of coercion. True individual freedom must consist of positive capacities, not just the absence of barriers. Greater equality of income, education and power would enhance the capability of large numbers of people to generate and fulfill informed preferences, and thereby augment their freedom. In this sense, equality and liberty are not only compatible; they are interdependent.

During the past twenty years philosophers have debated the relative merits of the principles of equality of opportunity and equality of outcome. On purely philosophical grounds it is difficult to favor equal opportunity, since innate talents are surely a morally arbitrary basis upon which to justify differential outcomes. Nevertheless, no one has yet elaborated an even remotely feasible design for implementing a policy of strict equality of outcome (whether *outcome* refers to resources or to welfare). Furthermore, a limited degree of distributive inequality is not necessarily unjust. For these reasons, the goal of egalitarians should be to reduce end-state inequality to a reasonable, acceptable level, while attempting to achieve to the greatest degree possible a situation of equal opportunity.

In existing capitalist economies the principal government measures used to reduce outcome inequality are social policy and progressive taxation. Although these measures helped equalize incomes in the United States during most of the postwar period, there are limits to the effectiveness of such policies. As noted earlier, accumulation of property is the chief source of capitalism's extreme resource inequalities. Although plainly there will have to be space for some private property ownership -- for a sector of small-scale petty capitalists -- in a desirable and feasible post-capitalist economy, the portion of property held in private individual hands must be restricted. As a rough estimate, perhaps 75 percent of employment should be accounted for by the public or socialized sector. (It is worth noting again here that *public* need not refer to the state.) We must develop a mechanism to reduce the inequality-producing effects of inheritance. One possibility is British economist James Meade's proposal for transforming the traditional inheritance tax system, giving people incentives to bequeath substantial portions of their wealth to those less well off.

Achieving equal opportunity requires, first, that access to skills and jobs be equalized. This would of course entail a restructuring of our existing educational system so that funding is more equally distributed. Also crucial is a serious government commitment to vocational training, retraining and job placement programs. Sweden's active labor market policy is a model upon which post-capitalist policy makers could usefully draw. Equalizing access to jobs would also require the removal of the various impediments -- present in all existing economies -- to labor market equality for women and minorities. These include hiring discrimination, job segregation, and unequal pay for similar work.

A second precondition for true equality of opportunity is a guarantee of a basic degree of material security for all individuals. The most straightforward means of achieving this would be to distribute to every citizen a *basic income grant,* sufficient to ensure a minimum standard of living, not contingent upon performing any work. Such a grant would have the additional salutary effect of forcing up the wages for, and/or increasing the mechanization of, society's most undesirable jobs.

Not everyone on the left will agree with these proposals. Nevertheless, an attractive, feasible economic system would arguably combine state-guided markets, substantial public ownership, worker self-management and equality. What we need is a little bit of Japan, a little Austria, a little Yugoslavia and a little Sweden nicely meshed together. Others, no doubt, hold different views. Further disagreement surely exists regarding strategy for how to get there from here. What perhaps we can all agree on, however, is that progressives need desperately to think, and talk, about what exactly we want in an economic system. The opportunity, and the necessity, for such discussion have never been greater.

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