
1

THE NEED FOR PLANNING

The reasons for state control and direction of the economy can conveniently be considered from the standpoint of two schools of thought and one historical process.

The liberal view

An outstanding early representative of this school was Mandeville. The conclusion of his famous (1724) was that the book had demonstrated:

that neither the friendly qualities and kind affections that are natural to man, nor the real virtues he is capable of acquiring by reason and self-denial, are the foundations of society: but that what we call evil in the world, moral as well as natural, is the grand principle that makes us sociable creatures, the solid basis, the life and support of all trades and employments without exception: that there we must look for the true origin of all arts and sciences, and that the moment evil ceases the society must be spoiled, if not totally dissolved.

He expressed this thought both in prose and also in verse, in his well-known description of the hive, analogous to human society:

There every part was full of vice
Yet the whole mass a paradise.
Such were the blessings of that state
Their crimes conspired to make them great.

This idea played a major role in Adam Smith's great work *The Wealth of Nations*. There is the well-known passage in which Smith argued that 'It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self love, and never talk to them of our own necessities but of their advantage.' At another point he refers to the 'invisible hand' which ensures that individuals pursuing their own selfish ends collectively act in a socially rational way. From Adam Smith's day to the present

a large part of the teaching of elementary economics has been devoted to explaining and expounding this doctrine of the strange virtues of private vices. Traditionally students have come along to lectures on economics concerned about the great problems of poverty, inequality and unemployment. Their teachers have taught them to readjust their vision, and instead of these evils to see in the market system a socially rational process for combining individually rational decisions into socially rational ones.

En passant, one should note that the process by which the acceptance of a new theory replaces what one previously 'saw' by an entirely new set of observations, is not the absurdity that it might seem at first sight. After all, a central part of Marxist economics is concerned with replacing one vision of the labour contract by another. Before studying the Labour theory of Value one may 'observe' a mutually beneficial process whereby a worker obtains a wage in exchange for working a certain number of hours for an employer. After one has learned the Labour Theory of Value one 'sees' a process of exploitation whereby the worker sells his labour power and the employer obtains surplus value. Such a transformation may seem odd to a vulgar positivist, who imagines that there exist so called 'facts' independent of our theories. On the other hand, to someone who accepts the doctrine of Sextus Empiricus and of Popper according to which 'there are no empirical propositions, only theoretical ones' it seems entirely normal.

In some quarters there appears to lurk the view that Ricardo was some kind of 'progressive', a proto Marx. After all, we are told, his theory of the rate of profit is different from, and free from the justificationist bias of, later writers. In addition his theory recognised the class nature of capitalist society and the reality and importance of class conflict. All this is undoubtedly true. It is very important to bear in mind, however, that this same David Ricardo fully accepted Adam Smith's doctrine of the invisible hand. If one looks, for example, at the chapter on wages in *The Principles* one finds the proposition that, 'Like all other contracts, wages should be left to the free and fair competition of the market, and should never be controlled by the interference of the legislature.' This certainly contrasts dramatically with Marx's analysis of the 10 hours Act!

In the late nineteenth century the classical economists, with their concern with growth and distribution, gave way to the neoclassical economists, with their concern with the efficient allocation of resources and the mathematical demonstration both of the invisible

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Excerpt

[More information](#)*The need for planning*

3

hand doctrine and also of the ‘exceptions’ to it.¹ One of the most eminent of the neoclassical economists was Walras, whose views on this matter are clearly set out in the following extract from *The principles of pure economics* (1954 edn p. 255 italics added):

Production in a market ruled by free competition is an operation by which services can be combined and converted into products of such a nature and in such quantities as will give the greatest possible satisfaction of wants within the limits of the double condition, that each service and each product have only one price in the market, namely that price at which the quantity supplied is equal to the quantity demanded, and that the selling price of the products be equal to the cost of the services employed in making them.

Besides their ‘rigorous’, mathematical ‘proof’, of the invisible hand doctrine, the masters of the neoclassical school, such as Marshall and Pigou, were, of course, very much concerned with the ‘exceptions’ to the general rule that leaving things to the market is best, such as monopoly, increasing returns, consumer’s surplus and externalities.

In the 1930s there took place, under the impact of the great depression, what in Cambridge England is known as the ‘Keynesian revolution’.² The incorporation of Keynes’ teaching within the accepted corpus of economic theory led to the well-known division of economic theory into two halves, *micro* and *macro*. What did *micro* economics teach? That the price mechanism leads to the efficient allocation of resources, of course. What did *macro* economics teach? That unless the Government pursues just the right sort of stabilisation policy either we will have serious unemployment, or serious inflation, or possibly both together. The curious coexistence of *micro* and *macro* reflected a society in which the overall regulation of the economy was in the hands of the state, whereas concrete production and distribution decisions were in the hands of private firms. *Macro* economics performed the technocratic role of discussing some aspects of the central regulation of the economy. *Micro* economics continued the very important ideological role which invisible hand doctrines have had since Adam Smith incorporated Mandeville’s paradoxical notion into his powerful analysis of original accumulation. It was used to adjust the vision of those who are so benighted that they ‘observed’ poverty, inequality and unemployment.

¹ Generations of economics students have been taught both the ‘proof’ of laissez faire doctrines and the standard list of ‘exceptions’. How many of the teachers have explained how it is possible to ‘prove’ a doctrine which is obviously false?

² This phrase is used to describe the emergence and acceptance of the doctrines of Keynes’ *General Theory*, although adherents of Hobson, Myrdal, Kalecki and Currie might dispute their originality, and Marxists, or indeed anyone living outside the very cloistered world of Cambridge in the 1920s and 1930s, their ‘revolutionary’ character.

What is the relationship between *micro* and *macro*? In the early 1950s it was assumed that they could easily be combined into the 'neoclassical synthesis'. This was the belief that if the state ensured macro-economic equilibrium and growth by macro-economic policy, the market mechanism could be relied on to ensure the efficient allocation of resources. Events in the 1960s and 1970s (the increased rate of inflation in the homelands of capitalism, the declining rate of profit, the decline in productivity growth, increased labour militancy, the crisis of the welfare state, the oil price shocks and associated demands for a new international economic order) undermined this faith. On the policy level this led to the abandonment of *macro* by politicians at the end of the 1970s. On the theoretical level it led to numerous publications seeking to relate *micro* and *macro*, or to replace *macro* by other doctrines (monetarism, new classical macro economics, supply side economics).

Besides developments in the material world, there are also three developments in the intellectual world which have emphasised the special case nature of the invisible hand doctrine. I have in mind developments within welfare economics, game theory and general equilibrium analysis.

Welfare economics as developed by writers such as Pigou was largely concerned with analysing the conditions under which the market would, or would not, lead to maximum welfare. It stressed that, under conditions of technological externality, the market solution would normally be non-optimal. The usual conclusion drawn from this was that the state should intervene in order to improve efficiency, via taxes, subsidies and other regulatory devices. It was assumed that whereas market decisions were often socially irrational (e.g. because of externalities) Government decisions, which took account of all costs and benefits, would be socially rational. As Hahn (1974 p. 37) put it, it was concluded that 'the Government can in principle always do as well and often better than the market'. For writers in this tradition, planning is a substitute for the market which is likely to be more successful in achieving the same aims, the maximisation of consumer satisfaction, because it takes account of all the relevant factors (e.g. externalities).³ Hence the widespread recommendation that decisions on major investment projects should avoid reliance on market prices and purely business rationality and

³ The unsatisfactory conclusion of Pigovian welfare economics from a liberal standpoint gave rise to a liberal critique of it, to the theory of property rights, and to an economic analysis of the political process (new political economy/public choice theory/economics of politics).

instead make use of shadow prices and take account of social costs and benefits. The market, for writers in this tradition, is important and useful, but only for the production of private goods produced under conditions of constant or increasing costs and without significant externalities. Furthermore, welfare economics revealed a painful dilemma for liberals in the claims that could be made about the market economy. If utility was assumed to be a cardinal magnitude (as nineteenth-century utilitarians normally conceived of it) and if the law of diminishing marginal utility was assumed, then welfare economics provided powerful arguments for redistribution in favour of the poor. On the other hand, if utility were assumed to be ordinal, the socialist dangers latent in welfare economics could be reduced but so would be the claims that could be made about the merits of the market economy. Pareto-optimality is a very *weak* claim – a society in which some people are dying of starvation and others living in luxury may be Pareto-optimal but it is not very attractive.

Von Neumann and Morgenstern in their (1944) opened up a new field of theoretical investigation in economics, game theory.⁴ Subsequent research in this field uncovered a far-reaching proposition which, from an invisible hand point of view, appeared a paradox. Under certain circumstances the interaction of isolated individuals, each making individually rational decisions, may result in a situation which is not only socially irrational but also worse for each individual than an alternative which was open to him but which he consciously declined! This proposition is known, for reasons which will appear shortly, as ‘The prisoners’ dilemma’. The simplest method of explaining it is by way of example.

Consider the following situation. Two suspects have been arrested. The police have enough evidence to ensure that each one would receive on trial a light sentence, e.g. one year. They would very much like, however, to strengthen their case by obtaining confessions. Accordingly they decide to interrogate each prisoner separately and offer him the following deal. If he confesses, they tell him, and the other prisoner does not, then the prisoner who does confess will receive only three months. If he does not confess, and the other prisoner does, then the prisoner who did not confess will get ten years. If he confesses and so does the other, he gets five years. The situation is set out in figure 1.1.

Take prisoner 1 (the situation is symmetrical for both prisoners). If

⁴ Whereas the ‘marginalist revolution’ had been concerned with applying seveneenth-century mathematics to economics, the ‘von Neumann revolution’ applied twentieth-century mathematics to economics.

Figure 1.1 *The prisoners' dilemma*

		Prisoner 2	
		Not confess	Confess
Prisoner 1	Not confess	1 year each	10 years for 1 and 3 months for 2
	Confess	3 months for 1 and 10 years for 2	5 years each

he does not confess, the worst possible outcome for himself would be that he would receive a ten year sentence (in the event that 2 caves in). If he does confess, the worst possible outcome for himself is that he receives a five year sentence (if 2 also confesses). Accordingly, if prisoner 1 is a cautious person who, when making choices, chooses the least bad of the worst possible outcomes, he will confess. The same argument applies to prisoner 2. Accordingly, the outcome will be that each prisoner will receive a five year sentence. In the event, however, that neither prisoner had confessed, each would have received only a one year sentence (because of the lack of evidence). Each decision maker has made an individually rational decision, but as a result both are worse off than if they had both made an alternative decision which each one considered and rejected.

Each individual prisoner would be better off if some force other than his own immediate self-interest (such as Republican loyalty, working-class solidarity, the state, or belief in the golden rule) compelled him not to confess. This 'paradoxical' situation has resulted from a combination of the decision rule adopted (striving to avoid the worst possible outcomes, i.e. the maximin criterion), the fact that the decisions are made in isolation (i.e. that it is a non-cooperative game), and that the total sentence received depends very much on the decisions made (i.e. that it is a non-constant-sum game).

This startling (from an invisible hand point of view) result has been interpreted by Runciman and Sen (1965) as an elucidation of Rousseau's concept of the 'general will' and his idea of the advantages to the members of society of their being 'forced to be free'. Many writers have found Rousseau's concepts absurd or meaningless, but the prisoners' dilemma is a situation in which the general will is clearly distinct from and superior to the outcome that would result from atomistic decision making. Pursuing this line of argument, one

The need for planning

7

can say that, if Mandeville's doctrine is the 'liberal paradox', the prisoners' dilemma is the 'totalitarian paradox'. From this point of view one can say that the difference between 'liberal democracy' and 'totalitarian democracy' (Carr 1945 pp. 5–19, Talmon 1952, 1957 and 1960) is that, while both make the value judgement that social choices ought to be based on individual preferences, liberal democracy assumes that individual preferences are both unconcerned with, and independent of, the choices of other individuals whereas totalitarian democracy assumes that the decision-making process normally corresponds to the 'prisoners' dilemma' situation.⁵

If the second internal intellectual discovery which undermined invisible hand doctrines was in the field of game theory, the third was in the field of general equilibrium analysis, the branch of economics which was widely assumed to have demonstrated in a 'rigorous', 'scientific' way the validity of the assertion by Walras quoted above. During the 1950s and 1960s there was a great deal of research into general equilibrium analysis. According to two leading workers in this field (Arrow and Hahn 1971 p. vii) the purpose of this research was to ascertain the conditions under which Adam Smith's assertion about the invisible hand is valid. The main result of this immense body of research has been to emphasise how very stringent these conditions are. The general equilibrium model focuses attention on trade rather than production; ignores the central role of labour; treats prices as guides to efficient allocation rather than as a reflection of the mode of production, the distribution of the national income and the methods of production; treats competition as a socially rational process for ensuring efficient allocation rather than as a mechanism for fostering technical progress or as a cost-increasing factor; emphasises the equilibrating role of markets and neglects the disequilibrating role of markets; ignores information other than price information; approaches all decision making from the standpoint of maximisation; focuses attention on the combination of individually rational choices into socially rational choices while neglecting the possibility of individually rational choices combining into socially irrational choices; neglects the role of increasing returns in manufacturing; concentrates on auction markets; treats the quantity of resources and

⁵ The invisible hand doctrine is not entirely inapplicable in a Prisoners' Dilemma situation. If the game is played an indefinite number of times, if the future weighs heavily with the players, and if each player begins by cooperating and then reciprocates what the other player did (the tit for tat strategy) then the invisible hand will ensure a stable state of cooperation to attain the socially rational outcome. The invisible hand doctrine is inapplicable if the game is played a finite number of times, the future does not weigh heavily or a turn the other cheek strategy is adopted.

the effectiveness with which they are used, rather than the level of effective demand, as the determinants of the level of output; considers an economy without a past and with a certain future; plays down the difference between a barter and a monetary economy ... Indeed, according to Hahn (1974 p. 36), an eminent general equilibrium theorist often referred to as a supporter of 'orthodox' or 'neoclassical' economics, general equilibrium analysis, by emphasising the stringency of the conditions necessary for Mandeville's doctrine to hold, has demonstrated that the Mandeville-Smith world 'cannot serve as a description of an actual economy in which prices are never fully known and economic agents are ceaselessly adjusting to new circumstances'. The same author has also argued in his (1973 p. 330) that 'the vulgarizations of General Equilibrium theory [i.e. the view that General Equilibrium theory is a descriptive theory of the world in which we live and hence that Mandeville's doctrine is valid in our world] which are the substance of most textbooks of economics are both scientifically and politically harmful'. The knock out blow to the idea that general equilibrium analysis was a descriptive theory of an (ideal) economy was given by Weintraub (1985), the author of which was a keen defender of the general equilibrium approach. He argued that the general equilibrium approach was not a descriptive theory but the hard core of a particular research programme. Theories inspired by it might be relevant to particular economic problems, but the idea that a particular economy ought to be assessed by or transformed into the one modelled by what had traditionally been described as general equilibrium theory was shown to be senseless. The result of a century's work in the Walrasian tradition has been that the Mandeville-Smith assertion about market economies has been replaced by a scientific research programme. Scientifically this was an advance but for liberals it was an important ideological retreat.

The Marxist view

The Marxist analysis of capitalism rejects the liberal view that capitalism is a socially rational system. It argues that only a planned socialist economy can be socially rational. It stresses two advantages which a planned socialist economy has over an unplanned capitalist economy. First, the absence of the anarchy of production, and secondly the absence of class conflict. On the first point a classical Marxist text, Bukharin and Preobrazhensky (1969 edn pp. 88–9), argued that

The need for planning

9

under capitalism the production and distribution of goods is quite unorganized; 'anarchy of production' prevails. What does this mean? It means that all the capitalist entrepreneurs (or capitalist companies) produce commodities independently of one another. Instead of society undertaking to reckon up what it needs and how much of each article, the factory owners simply produce upon the calculations of what will bring them most profit and will best enable them to defeat their rivals in the market. The consequence often is that commodities are produced in excessive quantities . . . There is no sale for them. The workers cannot buy them, for they have not enough money. Thereupon a crisis ensues. The factories are shut down, and the workers are turned out into the street. Furthermore, the anarchy of production entails a struggle for the market; each producer wants to entice away the other's customers, to corner the market. This struggle assumes various forms: it begins with the competition between two factory owners; it ends in the world war, wherein the capitalist states wrestle with one another for the world market. This signifies, not merely that the parts of capitalist society interfere with one another's working, but that there is a direct conflict between the constituent parts.

The first reason, therefore, for the disharmony of capitalist society is the anarchy of production, which leads to crises, internecine competition, and wars.

A major achievement of capitalism was that it introduced the idea of economic rationality or efficiency, the use of given resources to produce the maximum output, or the achievement of given goals with minimum effort. In the Marxist view, under capitalism this rationality is confined to individual firms and does not extend to society as a whole. What is rational for a firm may be irrational for society as a whole. Individual firms may dismiss workers to raise efficiency and save costs, regardless of the fact that whether or not they work and produce an output the workers have a claim on the output of society (e.g. via unemployment benefits) and that the unemployment may itself generate social costs (e.g. ill health or riots).

On the second point the same text (pp. 89 and 119–20) explains that a major

Reason for the disharmony of capitalist society is to be found in the class structure of that society. Considered in its essence, capitalist society is not one society but two societies; it consists of capitalists, on the one hand, and of workers and poor peasants, on the other. Between these two classes there is continuous and irreconcilable enmity; this is what we speak of as the class war . . . [Under socialism, on the other hand] there will have ensued the liberation of the vast quantity of human energy which is now absorbed in the class struggle. Just think how great is the waste of nervous energy, strength, and labour – upon the political struggle, upon strikes, revolts and their suppression, trials in the law-courts, police activities, the State authority, upon the daily effort of the two hostile classes. The class war now swallows up vast quantities of energy and material means. In the new system this energy will be liberated; people

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will no longer struggle one with another. The liberated energy will be devoted to the work of production.

It is for these two reasons, to overcome the anarchy of production and class struggle characteristic of capitalism, that socialists have traditionally argued for a socialist planned economy. It is hoped in this way to establish a rational society, a society in which social objectives (e.g. full employment, or an equitable distribution of opportunities and income) are achieved in an efficient way.

Experience of socialist planning has shown that the Marxist classics had an oversimplified conception of the functioning of a socialist planned economy. Hence, while retaining the traditional idea that social rationality requires conscious social regulation and control, Marxist-Leninist doctrines about a socialist planned economy have evolved considerably in recent years. This evolution has resulted from developments in both the socialist and capitalist countries, theoretical reflection on those developments and political struggle. This evolution affects such matters as the most efficient organisational forms for agriculture, the merits of the non-state sector, the relationship between state ownership of the means of production and social ownership of the means of production, the importance of feedback mechanisms in economic and political life, the role of prices and markets in a socialist economy, the significance of conflicting social groups in determining economic policy and economic results under socialism, the role of economic planning in a socialist economy and the kind of economic planning appropriate for a socialist economy. At appropriate places later in this book, attention will be drawn to some of these developments in Marxism-Leninism.

The global industrialisation process

The division between advanced and backward countries has been a major feature of the world economy since West European military technology overtook and surpassed that of all other parts of the world in the sixteenth century (Cipolla 1965). This division widened still more after the industrial revolution. The advanced countries were in Western Europe and subsequently in certain overseas territories which they colonised. The backward countries comprised the rest of the globe. Historically speaking, this division is very recent. When Marco Polo visited China, he was most impressed by Chinese civilisation, which manifestly compared extremely favourably with that of mediaeval Western Europe. Within a historically very short period the Europeans used their military superiority to overrun what