

Mises and Gorbachev: Why Socialism Still Doesn't Work

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Last summer, the following headline appeared over a page-one story by Dusko Doder in the *Washington Post*:

*Gorbachev's Vigor Raises Expectations
New Soviet Leader Focuses on Economy*

Mr. Doder proceeded to inform us that the new Soviet "leader" (what an odd word to use, by the way) had been showing an "almost breathtaking determination to make changes in the Soviet economy."

Two weeks later Serge Schmemmann of the *New York Times* wrote of "the depth of excitement and hope that Mr. Gorbachev seems to have tapped across the land in his first 100 days in office."

Since Gorbachev's accession, there have been many similar stories, conveying a ventriloquized media enthusiasm for the new "leader." There can be no doubt that, in the opinion of many U.S. journalists, the socialist economic system of state-controlled resources and central command has not worked well lately in the Soviet Union because the men in charge have been elderly and incompetent. In other words, there is nothing wrong with the system itself—provided it is managed by a skillful, vigorous elite.

Robert Kaiser of the *Washington Post* put it this way in an article headlined "Now Russia Will Change." Gorbachev, he said, is a "new kind of Soviet man." He is "young, well-educated, vital, relaxed and by all outward appearances self-confident." True, Kaiser conceded, there were problems in the economy—"corruption," for example, and "inefficiency."

Also an “entrenched bureaucracy.” But all this would no doubt soon change with the vigorous Mr. G. at the helm.

Well, Mr. Kaiser (who was the *Post’s* correspondent in Moscow in the early 1970s) is in for a big disappointment. And so are the poor, long-suffering Russian people. Nothing is likely to change, although it is possible that Gorbachev will make things worse.

The great difficulty for Mr. Gorbachev is this: socialist economies all have a serious defect which cannot be resolved by vigor or good intentions. This defect was spelled out by Ludwig von Mises as long ago as 1920—before the evidence of socialist failure was available. His analysis amounted to a prediction that has been verified.

The problem is this: It is one thing for central planners to draw up a plan of production. It is quite another thing to carry it out. Here we encounter the famous “problem of economic calculation” formulated by Mises. How can you (the planners) know what should be produced, before you know what people want? And people cannot know what they want unless they first know the price of things. But prices themselves can only be established when people are permitted to own things and to exchange them among themselves. But people do not have these rights in centrally planned economies.

The planners can, of course, decide beforehand what goods are to be manufactured, whether or not the people really want them. But as Trygve Hoff points out in his book *Economic Calculation in the Socialist Society*, only the most primitive planning can proceed in this way. In real life the planners and their subordinate factory managers bump up against the central fact of economic life—scarcity. There is not enough of everything to go around. One is tempted to say that there is not enough of anything to go around—if it is both desirable and free. (Air seems to be the only exception.)

It is worth noting that when, in the 1920s and 1930s economists tried to rebut Mises, some of them went so far as to

challenge the assumption of scarcity, suggesting that it was a chimera stage-managed by nefarious monopolists. But if we assume that scarcity is a reality, as we must, then we are forced to conclude that goods must be priced. And yet the central planners do not know how to price them in the absence of markets.

Prices depend for their formation on the real possibility of personal profit or loss. Try to imagine a serious game of poker played with Monopoly money. All psychological incentive is removed by the knowledge that at the end of the evening, no one playing is really going to lose or gain anything.

In *The Foundations of Morality*, Henry Hazlitt made one of the clearest statements of the problem of socialist pricing:

“If I am a government commissar selling something I don’t really own, and you are another government commissar buying it with money that isn’t really yours, then neither of us really cares what the price is. When, as in a socialist or communist country, the heads of mines and factories, or stores and collective farms, are mere salaried government bureaucrats, and sell their finished products to still other bureaucrats, the so-called prices at which they buy and sell are mere book-keeping fictions. Such bureaucrats are merely playing an artificial game called ‘free market.’ They cannot make a socialist system work like a free-market system merely by imitating prices while ignoring private property.”

The Polish economist Oskar Lange tried to save the day for the socialist by claiming that prices could be established by trial and error: set prices at a given level and then move it up or down depending on whether it yields a shortage or a surplus. But here the socialist run into their second great difficulty—the transmission of information to the central planning authority. How do the central planners know where things are in shortage and where they are in surplus? (This problem was first elucidated by F. A. Hayek.) The point is that it is difficult and expensive to move information to a central point.

Alternatively, one could say that only a comparatively small amount of information can be crammed into a central point. Here we may think of another analogy. How do you get a message onto President Reagan's desk? Obviously you can't just call him up, and if you write, your message will compete with the thousands of letters that arrive each day. A lot of money is spent in Washington trying to solve this problem. The same problem exists for Soviet commissars trying to get the attention of the people in Moscow who have decision-making authority.

In response to these various difficulties there are, I believe, three options open to the planning authority (over which Mr. Gorbachev presides). It can turn a blind eye on the various underling officials and managers as they make transactions and exchanges among themselves without getting permission from Moscow. This option—*de facto* decentralization—is labeled "corruption," however, and it is very unpopular with those who think that socialism should be made to work according to the prescriptions of Lenin. Leonid Brezhnev evidently used the "blind-eye" method. But with Yuri Andropov there was a crackdown. Various officials were shot to discourage the others.

"Crackdown" is in fact the second option, and the one preferred by reformers everywhere, including, of course, American liberals. Gorbachev is Andropov's protégé and he may well try to go this route. Apparently he already tried it in agriculture, over which he earlier presided. Grain production declined from 237 million tons in 1978 to 170 million tons in 1984. (Such declines are normally attributed to "bad weather.") Nonetheless Gorbachev was promoted, and he may well now attempt a more general crackdown. If he does, he would provoke a more general decline in Soviet production.

The third option is for Gorbachev to attempt to decentralize the system—i.e. to legalize many of the actions previously labeled corrupt. This in effect is a movement away from

socialism. It would be the best thing Gorbachev could attempt, but here he will run up against the “entrenched bureaucracy” that Robert Kaiser alluded to. Decentralizing the Soviet economy depends on issuing orders that are the functional equivalent of telling captains that they no longer need to obey majors, and corporals that they are on a par with sergeants.

The point is that it is very difficult to get such unpopular orders to pass down the chain of command. Colonels will always find ways of obstructing commands that have the effects of denying their own authority. (In the reverse direction, the Soviet economy suffers from an equally serious problem: just as unpopular orders won’t travel downhill, so unpopular information won’t travel uphill. Reports of unfulfilled plans and quotas tend to be ameliorated as they move closer to the center.)

Of the various problems associated with the Soviet economy (and all socialist economies) the “entrenched bureaucracy” is the one that U.S. journalists are beginning to appreciate and describe. For example in late May David Ignatius wrote in the *Wall Street Journal*:

It may prove impossible to both increase the independence of individual Soviet enterprises and retain full central control of the economy. Says Arnold Horelick, the director of the Rand-UCLA Center for the Study of Soviet International Behaviour: “I would describe Gorbachev’s reforms as trying to have his cake and eat it, too.”

Maybe China will prove me wrong. I hope so. But at present the evident suggests that communism cannot be reformed from within. My guess is that of the three options listed here, the “Brezhnev-blind-eye” is the only one that is remotely workable—not that it produces brilliant results—and Mr. Gorbachev will almost certainly resort to it if he stays in his office for any length of time.