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A Note on Socialist Economics

IN criticism of Dr. Lange's important article on this subject that is appearing in the present and the next number of the REVIEW, I have one major comment to make and a number of minor ones. I shall deal with the latter first.

(1) The distinction between the short period in which the supply of capital is considered as fixed and the long period in which it can be varied by accumulation (p. 65) does not seem to be justified. However short the period one considers there is a certain rate of flow of *free* capital that is being invested or reinvested, and this flow can be varied considerably, rising above the amount necessary to maintain the existing capital (however arbitrarily that may be defined) when there is net investment and falling below that measure when there is net disinvestment. Dr. Lange's analysis for the long period is, however, perfectly satisfactory for the short period too.

(2) There is no reason why technical progress or other dynamic changes should prevent the rate of interest and the marginal net productivity of capital from falling to zero. On the contrary, the expectation of further change, by putting a limit to the period during which one may expect any new capital good to continue to be useful, has the effect of diminishing the scope of interest yielding investment. It is just this consideration which may bring within feasible limits the rate of investment which corresponds to a zero marginal net productivity of capital. After a transition period which may not be so very long it should be possible to maintain investment at this rate and, consequently, the marginal net productivity of capital at zero.

(3) Dr. Lange says: "The loss of his power to determine the rate of accumulation of capital is the price the consumer has to pay for living in a socialist society" (p. 65). This suggests that it is the taste of the consumer rather than the distribution of wealth and the structure of corporations that is the important determinant of the rate of accumulation of capital in a capitalist society, whereas Mr. Keynes has even shown that thrift on the part of the consumer in a capitalist society usually has the effect of *diminishing* rather than increasing the rate of capital accumulation. It is true that in the socialist society limits will have to be imposed on the accumulations of individuals in the interests of the maintenance of the income structure that is considered desirable from a social point of view. But it does not follow that these restrictions need be even as onerous as death duties and income taxes have had to be in capitalist society (although they would have to become operative at much lower levels—the scale of incomes would of course be much less extended). For great wealth is not acquired by thrift alone.

It is possible for the consumer in a socialist society to have much more influence on the rate of accumulation of capital than he has in a capitalist society. Apart from the democratic governmental machinery that might be concerned with such an issue and where the consumer might use his vote, there would be possibilities of using the even more democratic market mechanism to discover the desires of consumers in this matter. Within the socially determined limits (to the *rate* of saving as well as to the amount

accumulated, for a very poor existence is at least as objectionable as great luxury) consumers can be allowed to distribute their consumption through time in the same way as they can distribute it between different consumption goods at the same time. The principle that price should correspond to cost demands that consumers postponing consumption should get interest on their postponement in accordance with the increase (if any) in product that is made possible by the postponement, while consumers who anticipate consumption should suffer a corresponding diminution of consumption or discount. The thriftiness or otherwise of the consumers can then be observed in the degree to which consumption is postponed or anticipated—as shown by the debits and credits of consumers with the state bank—and the authorities could, if they wished, take this index of time preference into account in deciding the rate of accumulation of capital. It might, for instance, be decided to keep the rate of investment at that level which corresponded to a rate of interest at which postponements of consumption, or lendings by consumers, exactly equalled their anticipations or borrowings. Or some other criterion might be preferred. But if there existed the desire to heed consumers' time preferences this could be observed much more scrupulously than is possible in a capitalist society.

(4) Dr. Lange declares that the social dividend must be distributed as a percentage on the wage rate if it is not to interfere with the ideal distribution of labour between different occupations (p. 21). This seems to me to be an error. According to Dr. Lange, " The optimum distribution is that which makes the value of the marginal product of the services of labour in different industries and occupations proportional to the marginal disutility of working in those industries or occupations." If this were so and if, in addition, as Dr. Lange tacitly assumes, the marginal disutility of working in different occupations is proportional to the income obtained by so working, his conclusion would follow. But there is no basis for either of these two propositions.

The optimum distribution is reached if it is impossible by moving a labourer from one position to another to increase the product by more than is necessary to give him to compensate him for any net increase in disutility involved by the change. This means that the difference between the incomes obtained in different occupations (which, with freedom of movement, will measure the difference in the disutility of working in the different occupations) must be equal to the difference between the values of the marginal products. In other words, the difference between the total income, including social dividend, that can be obtained by working in different occupations must be exactly equal to the difference in the wage (for the wage is equal to the value of the marginal product). Our conclusion is the exact opposite of Dr. Lange's. There must be *no* connection between the social dividend and the wage (or the occupation, since this would connect the dividend with the wage) otherwise it will interfere with the optimum distribution of resources. If the social dividend is made proportional to the wage, there will be an undue attraction of workers to the occupation with the greater wage on account of the greater social dividend obtainable there in addition to the greater wage.

A numerical example may clarify the matter further. Let productivities and wages in occupations *A* and *B* equal £2 and £3 per week respectively, while the social dividend is 100 per cent of the wage, so that total incomes are £4 and £6 per week respectively. In such an equilibrium, workers in *B* are no better off than those in *A*, the greater disutility of working there being just compensated by, and therefore equal to, the £2 difference in their income. But if a man were shifted to *A* and given £5 a week he would enjoy a net gain of £1. This can be done without social cost, for the shifting of the man from *B* to *A* diminishes the product by only £1. The initial position, chosen by Dr. Lange is therefore not the optimum. If, however, the social dividend is the same in either occupation for any individual (though it may be different for different individuals) the difference in the incomes is only £1 and the difference in the disutilities is just equal to the difference in product so that nothing can be gained by shifting anybody and we have the optimum position. The social dividend may be distributed on any basis whatever, the only restriction is that it must be independent of the wage.

(5) I now come to my main point which is concerned with the two accounting rules given by Dr. Lange for the achievement of economy and consistency in the management of the socialist society.

The first rule is addressed to the managers of individual productive plants and directs them to minimise the average cost of production (a) by adjusting the proportions of the factors used, given the output, and (b) by adjusting the volume of output. The second rule, which directs that the total output of each commodity shall be such that its market price equals this minimised average cost, does not seem to be addressed to anybody in particular, but it can be considered either as defining the function of the Commissar of the Industry or as an invitation to any potential producer to come into the industry if he can make a profit and a warning to any producer who is incurring a loss that he must clear out. As Dr. Lange sees, the successful carrying out of the rules would result in a faithful copy of classical, long period, stationary (or static) competitive equilibrium.

Methodologically my objection is that Dr. Lange takes the state of competitive equilibrium as his *end* while in reality it is only a *means* to the end. He fails to go *behind* perfect competitive equilibrium and to aim at what is really wanted. Even though it be true that if the state of classical static perfectly competitive equilibrium were reached and maintained in its entirety the social optimum which is the *real* end would thereby be attained, it does not follow that it is by aiming at this equilibrium that one can approach most nearly the social optimum that is desired. It would first have to be shown (a) that the technical conditions for the perfectly competitive equilibrium exist, (b) that the rules which, if perfectly carried out would give the perfectly competitive equilibrium (since they are based on the description of that equilibrium) are also the rules that are in fact calculated to give the closest approach to the equilibrium in the course of the continually frustrated attempts to reach it in a dynamic world, and (c) that the degree of approximation to the equilibrium so corresponds to the degree of approximation to the desired social optimum that by maximising one approximation the other is maximised

too. Unfortunately the first two, at least, of these three conditions fail to be satisfied.

The technical conditions for competitive equilibrium are that in the production of *every* commodity in the economy there shall be needed a large number of plants working at their optimum in order to produce the appropriate output. For if only a few plants are necessary it will be only by a fortunate accident that the optimum output of any whole number of plants is such as reduces the price to the minimum cost. There is a clash between Dr. Lange's two rules. The difficulty of maintaining competition under capitalism is the increase in the size of the optimum plant or firm, and this will interfere with Dr. Lange's copy of competitive equilibrium nearly as much as it does with actual competitive equilibrium. *Nearly* as much because the increase in the size of the productive unit will tend to upset the equilibrium *before* the technical difficulty arises, insofar as it facilitates combinations of relatively few producers for the purpose of obtaining monopoly gains. This aggravation is prevented in Dr. Lange's scheme by the principle of treating prices as parameters, but the primary difficulty remains. It is fundamentally the same as that in the way of restoring competitive conditions under capitalism by state intervention —the interference with progress in productive methods—and is to be found in the tendency of the technical prerequisites for a competitive regime to give way to those of another social order. To insist on the framework fitted to the old conditions is in the strict sense of the word reactionary.

More important than this is a further implication of Dr. Lange's solution. Even if the ultimate technical conditions for perfect competition do obtain, are his rules such as to give the closest approach to the optimum desired in the course of the continuously frustrated attempts—in a dynamic world—to reach the equilibrium ?

In competitive equilibrium prices are equal and therefore also proportional to both average and marginal cost. But it is the proportionality of price to marginal cost that is significant for the optimum distribution of resources, for that condition alone is necessary and sufficient to ensure that no resources that could be used to satisfy a greater need (or marginal utility as measured by demand) are used to satisfy a lesser need. In all cases where the complete system of perfectly competitive equilibrium cannot be attained—and that means always—it is important that the proportionality of marginal cost to price shall be sought after and not some other condition whose only merit is that it is to be found together with the desired condition in the competitive equilibrium. Thus, if for any reason there is an excess of equipment for the production of any product so that the production of the output which makes price equal to marginal cost makes price less than the average cost, it would be a social waste to restrict output to that which makes price equal to average cost. This would be equivalent to the attempts in monopolistic capitalism to maintain capital values which Dr. Lange so forcibly and rightly condemns. Yet that is his rule. Based on too close a pre-occupation with the achieved competitive equilibrium it becomes too static.

In describing Dr. Lange's scheme as reactionary and static I would not like it to be thought that I do not consider his work to be anything but the

most up to date of what has been written so far on the subject, and, indeed, I use those words in a rather specialised sense. But I have always been puzzled by the degree to which nearly every writer on this subject has been so dazzled by the picture of competitive equilibrium that he has not been able to pick out the elements in it that are significant for this purpose from those that are not. The peculiarity seems to be bound up with the more general attractiveness of averages. I have no doubt that Dr. Lange, like others who start with the simple average notions will make reservations and complications about the counting of rents and quasi-rents and about the way in which average costs are to be calculated which will do much to correct any errors that result from too simple an application of the rules, but all these commentaries and complications are unnecessary if one gets the essentials clear in the beginning.

The two rules which are necessary for the economic running of a socialist society in accordance with the tastes of the spenders of income in the society are :

(1) Every producer must produce whatever he is producing at the least total cost.

(2) A producer shall produce any output or any increment of output that can be sold for an amount equal to or greater than the marginal cost of that output or increment of output (or some multiple of the marginal cost fixed for everybody by the Minister of Production, since *proportionality* is all that is necessary). (Prices must always be taken as parameters so that this rule insists that producers shall increase their output as long as price is above marginal cost even if this has the effect of making the total receipt of the firm less than its outlay—price will always be equal to marginal cost.)

These are the *general* rules for economic accounting. The first rule ensures economy in the narrower sense. The second ensures what Dr. Lange calls consistency—the direction of resources in accordance with the urgency with which they are demanded. If there happen to exist the conditions for competitive equilibrium, and if adjustment is able to catch up with dynamic change, the other conditions of competitive equilibrium will arise automatically. Each plant will be working at the point of least cost, and the marginal cost will be equal to the average cost as well as to the price. But whether these conditions are there or not the more closely these rules are observed the greater will be the economy and consistency of the society.

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