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# **THE ECONOMIC SYSTEM AS AN END OR AS A MEANS AND THE FUTURE OF SOCIALISM: AN EVOLUTIONARY VIEWPOINT**

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## **ABSTRACT**

After the demise of “real” socialism and the decline of “western” socialism, socialism can be salvaged as a social preference system oriented towards equality and social justice, to be implemented without systemic constraints in the organizational and institutional sense. At the same time there is a case for maintaining an institutional framework allowing different forms of economic organization, capitalist and non-capitalist, to compete on equal footing, in an evolutionary perspective, thus allowing the second to develop if proven efficient. Another way for a spontaneous extension of the domain of socialism could derive from the socialization of consumption, if the consumption of public goods continues to make up a growing component of real consumption.

JEL Classification number: P50

### ***1. The Economic System as an End or as a Means.***

A criterion for the choice between different (economic, political or social) systems may be the capability of a system to pursue the ends that correspond to one's interests and values (i.e. to a system of preferences over alternative social states). The adoption of specific varieties of the institutions that make up a system can be calibrated to the pursuit of those aims, given the initial historical and institutional set-up. Thus, the system and the institutions that make it up and qualify its specific variety can be seen as a means, an empirically adaptable instrument rather than an end in itself. An alternative viewpoint attributes an intrinsic value to the choice of a system as such. The choice of the system becomes a choice of intrinsic, epochal or ethical, value, a choice of civilization, independently of the effective results that in the immediate or in the middle run (historically speaking) such a choice may bring about. This remark applies both to economic and political systems. For instance, the second viewpoint is often applied to democracy, seen as a value in itself rather than, à la Churchill, as the least obnoxious political system that has been invented up to now, as it renders relatively more probable social states that are higher valued relatively to widely (albeit not unanimously) shared social values.

### ***2. The Fetishism of Systems***

The fetishism of socialism or capitalism leads to the persuasion that the choice of a system has an intrinsic salvific or thaumaturgic value, for two possible reasons. The first is the millenarian viewpoint, of the realization of the ultimate bliss in an indefinite future, which sometimes is perceived as imminent. The second is the ethical viewpoint. Historically the first viewpoint applied in particular to socialism. The millenarian force of "real" socialism rested in the official doctrine that the system was a transition towards a qualitatively superior stage, where the intrinsic imperfections of the intermediate stage would be overcome. In the Marxist tradition this was supposed to apply in particular to the limitation of resources in relation to needs, nullifying the relevance of the distributional issue.<sup>1</sup> It is more difficult, even if not impossible, to attribute millenarian properties to an existing and well experienced system, whose

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<sup>1</sup> Remember the *Gotha Programme* (Marx, 1875).

characteristics are well known and there to be seen, that has already fulfilled its potentialities and manifested its intrinsic flaws and imperfections. In the case of transition economies the starting point was characterized by much lower average living standards in comparison to the advanced market economies, and the attainment of the living standards of the advanced liberal democracies was seen as some kind of relative bliss, which could be brought about by the institutional transformation towards a capitalist market economy. In this context systemic transformation becomes a pre-eminent objective to be pursued by all means, as fast as possible, without adequately considering the specificities of the historical and institutional context and the extent of the transition costs associated to its speed and modalities. In another context the relative well-being achieved in the framework of the capitalist system can be defended through an idealization of the latter, considered to be, à la Pangloss, the best of all possible systems, being the most natural one, not being artificially constructed, along a pre-determined model, such as is socialism, the latter being, unlike capitalism and market, as an unnatural constructivist deviation. At the same time the ideology may assume an ethical connotation, and the market may be seen as intrinsically just, because through the market everybody gets according to his merits, etc. etc.

As far as socialism is concerned, the fetishism may be based, even independently of any millenarian view, on the moral foundation of the ethical illegitimacy of profit. This view may be based on ad-hoc theories (such as the Marxian theory of labour value and exploitation), on simplistic viewpoints (such as the idea that the wealth of somebody must per force originate from the poverty of somebody else), and on erroneous perceptions of the functioning of the real world. Or, more simply, it can derive from the consideration that private capital and entrepreneurial incomes lead to wide income differentials that can be perceived as ethically unjustified.

### ***3. The Intrinsic Imperfection of Economic Systems and their Comparison***

In reality, the institutions of both “real” capitalism and “real” socialism are largely imperfect, and are characterized by an unavoidable set of shortcomings and

inefficiencies, on which there is no need to dwell because they are well known.<sup>2</sup> The actual contest between “real” capitalism and “real” socialism during last century has eventually seen the former to prevail. The experiment has been of enormous value in deepening our understanding of social facts and possibilities. The costs have been sustained on their very flesh by the countries of the former socialist bloc, the same that have later served as guinea pig for another original experiment, of lesser, but still great, social significance, that of the post-communist transition, aiming (according to the late Branko Horvat’s preferred terminology) to the restoration of capitalism, or, rather, to the construction, or reconstruction, of modern capitalist institutions.

Does all this mean that socialism is doomed not only for the present, but also for the indefinite future? Will it worthwhile to try again? In the name of what? Certainly it is not enough for justifying a new experiment of organizational socialism, however partial, the simple consideration that the capitalist system, in all its variations, leads to questionable results, both with respect to ethics as well as to efficiency, in comparison with some abstract benchmark. The view that the proved imperfection of a system is a sufficient reason for the establishment of a new, after the removal (be it forcible or peaceful) of the first, is a fallacy which has led to tragic consequences, but that continues to find new supporters (such as by late the so-called no-globals and other radical groups).

Owing to the inevitable shortcomings of really existing systems, and the experience of the last century, the only reasonable perspective may consist in an instrumental and pragmatic approach towards systems and institutions, whereby the latter are not considered to have intrinsic value, and their merit lies exclusively in the societal objectives they allow to be reached in a limited time horizon, rather than in what they are alleged to bring about in an indefinite future. Moreover, one must be aware that the consequences of introducing new institutions depend on the specific historical circumstances, as is shown by the different impact of the introduction of analogous institutions in different countries. In particular, the introduction, or restoration, of market institutions has in general produced better results in the countries where a functioning market economy was present in a not too distant past.

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<sup>2</sup> For a extensive non-technical consideration see Berliner (1999). As Stiglitz (1994, p. 243) puts it, “we live in an imperfect world, in which often we face nothing but the choice of the lesser of two evils!”

#### ***4. Socialism of the Means and Socialism of the Aims***

In this perspective we can make a distinction between socialism of the means and socialism of the aims. The means consist, on the negative side, in the prohibition of private entrepreneurial activity, and of private ownership of productive assets. The positive part is the substitution of public, or “social”, ownership and entrepreneurship for private (“capitalist”) ownership and entrepreneurship. But socialism can also be seen as a set of aims, such as equality, or social security, the same that would be usually advocated for justifying the adoption of a variety of socialism of the means, apart from the Marxist discredited justification of socialism as being an historically inevitable, much more productive, economic system. Theoretically speaking these aims translate in preferences over social states. More precisely, one may characterize as “socialist” a subset of the possible preference sets, the set of those preference sets that are relatively better shaped by socialist values. Thus, one may conceive a socialism of aims, independent in principle from the choice of a particular social system through which socialist aims can be pursued. In this case the socialism of aims, not being constrained to a particular choice of means, acquires in theory an additional degree of freedom, and its pursuit may bring about outcomes superior (in the weak sense of not being inferior) to those that can be achieved through the constrained pursuit of socialism, given a “socialist” preference system. In this perspective what is left of socialism is the specificity of the aims that are pursued, even in a context where capitalist institutions prevail, if the latter are seen as more suitable to achieve preferred social outcomes on the basis of the given “socialist” preference system, whereby socialist aims, such as equality or social security, cannot be exclusive, but must be traded off with alternative relevant ones, such as material affluence or the span of choice. Summing up, in this perspective socialism is characterized by the nature and the weighting of the objectives, independently of the institutional means that are used for their pursuit. The qualification of President Obama as a “socialist” by the “tea party” republicans could be seen not as absurd from the viewpoint of socialism of the aims as it is from that of the socialism of means.

### ***5. Is There Socialism in the Future of Capitalism?***

The fact that in the past century the socialism of means (or organizational socialism) has failed in the contest with capitalism does not mean that in the future a different set-up it could not reveal itself superior. In a very long-run perspective the failing could turn out to be only temporary; in Schumpeter's words a simple "surface" in relation to "the tendency toward another civilization that slowly works deep down below".<sup>3</sup> Moreover some institutions that are usually considered as socialist could be usefully imported into capitalism (or rather, into the mixed economy), as has been the case in the past, such as with the social security systems. The opposite grafting could also be successful. One can refer for instance to the insertion of capitalist institutions into Soviet socialism during the NEP, or the transformation of the Chinese economy since 1978, amounting to a gradual evolution into a capitalist mixed market economy, where the capitalist element gradually increases its relative weight in time, and the power of private (or at any rate decentralized) entrepreneurship is harnessed to achieve exceptional rates of growth in a context of still strong state ownership and control.

As far as the public<sup>4</sup> ownership and management of economic activities goes, they have been shown in the past to be on the whole less efficient: In the case of the former socialist countries, in dynamic terms, with respect to the generation and absorption of technical progress in production to consumer advantage, and, more in general, in terms of factor dynamic efficiency (growth in the value of production deriving from total factor growth) and also, more trivially, in terms of X-efficiency.<sup>5</sup> At the same time, the relative organizational slack that in general characterizes public activities, which theoretically speaking could be not incompatible with Pareto-efficiency, may well be inefficient from the point of view of the principle of compensation, and thus from the unconstrained Paretian viewpoint as well (in other terms the advantage for

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<sup>3</sup> "From the standpoint of immediate practice as well as for the purposes of short-run forecasting—and in these things, a century is a 'short run'—all this surface may be more important than the tendency toward another civilization that slowly works deep down below" (Schumpeter, 1976 [1942], p. 163).

<sup>4</sup> Here and below by "public" ownership or entrepreneurship we broadly intend "non private".

public employees could be less than its cost for taxpayers). In practice up to now whenever state and private enterprises have coexisted the former have proved to be on the whole less efficient.<sup>6</sup> But the actual consequences of state ownership and control can be different in the different social and political contexts, and not always so disastrous such as, for instance, in the Italian case, where the cumulated past losses of state enterprises account for about half of the present huge public debt.<sup>7</sup> As a matter of principle there is no fundamental reason why the performance of state owned enterprises should be worse than that of private owned enterprises. For efficiency what matters more than ownership are probably the extent of competition and the enforcement of hard budget constraints (here lies the problem with state owned enterprises: often they are established in non-competitive environments and instead of the objective of profitability they are assigned by politicians a variety of different other commitments<sup>8</sup>). But in the future things can change, for the reasons considered in what follows, and public ownership and management may become relatively more efficient than private ownership and management.

### ***6. Public goods, Collective goods, and the Socialization of Consumption***

But let us consider first of all the process of change in the nature of consumer goods leading to a progressive increase in the relative importance of public goods, as a consequence of changes in technology and tastes. Among the possible characteristics of a socialist system there is the tendency towards socialization of consumption, this means an allocation of consumer goods independent of individual budget constraints. In Marx's *Critique of the Gotha Programme*: the part of social product "which is intended for the common satisfaction of needs ... from the outset ... grows considerably in comparison with present-day society and it grows in proportion as the

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<sup>5</sup> For the comparative efficiency of real socialism and capitalism, see in particular Bergson, 1987, and 1992; Gomulka and Rostowski, 1988.

<sup>6</sup> For the relative worse performance of state owned in relation to private owned enterprises in mixed economies, see the empirical analyses reviewed in Meggison and Netter, 2001, sect. 3, pp. 328–338.

<sup>7</sup> For the role of state owned enterprises in emerging economies see the recent special report by The Economist, 2012.

<sup>8</sup> Cf. Stiglitz, 1994, pp. 80-81.



new society develops”.<sup>9</sup> There are three types of consumption that can be of relevance here: 1) collective consumption proper, which may be made up by private, public or semi-public goods in an economic sense, whose production and distribution is decided collectively through the political process and is not rationed through private budget constraints (such as public provision of health, education, social services, defence, law and order, national broadcasting, even private consumer goods under the future hypothetical abundance of Full Communism and saturation of needs). 2) Pure public goods (at least in the sense of non rivalry), which are privately or publicly produced (such as radio and TV broadcasting or the Internet<sup>10</sup>) and are freely available, financed by the state (such as in the case of national broadcasting services), by private volunteers and benefactors (such as in the case of Wikipedia<sup>11</sup>) or advertising. In the latter case production of public goods is strictly derivative of the existence of a large market for private goods, where the returns to advertising can be reaped.<sup>12</sup> As the production of public goods is the main reason for the existence of the state, there are some obvious theoretical reasons in favour of pushing forward through public financing or direct public production the limits of private provision. 3) Non-rival but excludable goods for the consumption of which a royalty is charged. There is a clear market failure here that may (but need not) constitute a reason for public provision. If the barriers to entry are low (such as in the case of the setting up of Internet sites), and no conditions of natural monopoly apply, or monopolistic positions are anyway contestable by newcomers, competition tends to bring the fees down towards the point where they just cover costs, where the fees may be quite disproportionately low in relation with the consumer surplus that is created. Moreover, in order to have the

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<sup>9</sup> This statement was inspiring the 1961 Programme of the Communist Party of the USSR, according to which “as the country advances towards communism, personal needs will be increasingly met by public consumption funds, whose rate of growth will exceed the rate of growth of payments for labour”: cf. Chilosi, 1978.

<sup>10</sup> Here obviously we refer not to the access to the Internet as such, but to Internet contents.

<sup>11</sup> On the exceptionally interesting case of Wikipedia see below.

<sup>12</sup> Thus free private provision of public goods financed through advertising may be effected only as long as there is still a substantial part of consumer goods that are private in an economic sense. In the limiting case of a world in which all goods were public and publicly provided by the state for free there would no way of financing their production but through direct taxation of free time or through the administrative direction of labour.

provider of the good (say, the Internet site or the broadcasting site) and the good itself (say, a computer programme) known to the public, some initial losses would be occurred and the good made available, as may often be the case, for nothing or very little fee. Since this is an ongoing process (as the dynamics of Internet sites may show) those whose opportunity cost of time is lower may look for the newcomers rather than pay the incumbent sites for their services. This opportunity can benefit the worse off, who by spending some of their time could avoid paying for the same kind of goods what the others are enjoying for a fee. Thus their substantial nature of public goods, as far as non-rivalry is concerned, may still be dominant in the way consumption is allocated. In other words, in case dominant positions are realized through sunk costs and network economies of scale, because of significant dynamic contestability and the degree of the economies of scale, the fees would often tend to be very low in relation to the substantial nature of the goods, and to the consumer surplus that may be created, and consumers with low opportunity cost of time could avoid paying altogether.

Of the above three categories of goods, only the first makes up collective consumption in the sense that is collectively decided through political representation, and allocated irrespective of budget constraints. Moreover, public non-profit production, such as in the areas mentioned by Marx (1975), health and education, may be preferable whenever the nature of the product cannot be sufficiently appreciated by the public, and there is need of strict quality control.<sup>13</sup> This may mitigate the potential impact of the growing importance of some types of medical services that are increasingly costly and are intrinsically mostly private goods, as there could be some good reasons, owing to their specific nature, for a public provision, and an allocation through assignment rather than through the market.

All in all we may have entered a period when the nature of consumption is quite different from those times when, even in relatively more prosperous countries, the great bulk of consumption was made up by predominantly private goods (food, first of all, but also clothing, shelter, transportation and personal services) that were

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<sup>13</sup> For instance an inquiry has established that in the USA the mortality rates in for-profit hospitals are higher than in non-profit hospitals. Source: BBC News Bulletin 27/05/2002.

unequally distributed.<sup>14</sup> This implies an involuntary, but important element of socialism, because of the socialization of a growing part of consumption, which basically is not rationed through purchasing power. (There is a kind of paradox here. In most cases the new goods are enjoyed individually, in the intimacy of one's homes, even if through the access to a virtual agora, while some of the kinds of consumption that the new ones are displacing--theatres, cinemas, concerts, conferences--represent forms of collective enjoyment, even if their prevailing character is, economically speaking, of being private or semi-private goods.) This could also contribute to explain why the Internet revolution has not brought about the increase of the growth rate of productivity that some had expected.<sup>15</sup> Simply, part of the "output" of Internet is made up by public goods that directly enter into the consumer utility function, and could be measured in theory in terms of the value of private goods that are displaced in the formation of real income, but in practice may be not adequately accounted for in national income accounting. The incentive problem of a society where an ever-increasing part of consumption is made up of public goods, for the enjoyment of which the only relevant constraint is the availability of free time, is obvious. The relative utility of leisure increases, with increasing negative effects on labour supply and on the creation of the tax base needed to finance, among others, the production of the public goods themselves.<sup>16</sup> In the limit, the only way out could be the re-introduction of such outdated revenue sources such as capitation, wealth taxes or state monopolies. An obvious additional second best measure could be, whenever possible

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<sup>14</sup> It should be noted however that a specific type of public goods consumption, such as the satisfaction deriving from the power and prestige and the territorial conquests of one's country, which could be achieved through investments in armies and wars, seems to play happily enough a lesser role in the present world than in a not distant past.

<sup>15</sup> For these kinds of issues one may refer to Gordon (2000). Unlike other authors (in particular those whose contributions are contained in the same issue of the *Journal of Economic Perspectives*) Gordon does have a reductive consideration of the potential impact of Internet and IT on productivity.

<sup>16</sup> See however Corneo (2001), according to whom there is a positive correlation in OECD countries between hours of work and hours of television viewing. This is explained by the existence of an inefficient equilibrium, which is dominated by another possible one, in which work hours are shorter and agents spend more time socializing; the welfare dominant equilibrium is blocked by the externality implicit in socialization (the availability of others to socialize increases the advantage of socialization). Another relevant consideration (which is made by Gordon, 2000) is that free time spent using

and not too costly, to tax the time used for accessing public goods, such as in particular, the time used for accessing the Internet.<sup>17</sup> But such a measure would be very unpopular, and could have intrinsic negative costs in terms of efficiency, given the quasi-public good nature of Internet access. In the end, given the contradiction between the efficiency objective pointing towards encouraging and possibly subsidizing the production of Internet contents, given their nature of public (or quasi public) goods, and the financial considerations leading to the taxation of the time spent on the Net, the actual situation where the Net is basically neither taxed nor subsidized may appear as a reasonable compromise, resulting in the minimization of transaction costs.

### ***7. Will Public Production Ever Become More Efficient Than Private Production?***

Let us turn now to the consideration of the relative efficiency of public vs. private production, both of public and of private goods. As long as the sentiment of individual responsibility and respect for the public interest grows with civil and economic progress, through the accumulation of human and social capital, one cannot exclude that public management of production could eventually become as efficient as the private capitalist one, or even more if people will prefer to work in the framework of a public rather than of a private organization. For instance, the number of those who dislike the specific business culture of private firms in general, and of corporations in particular, and would rather work, even at lower wages, in organizations with a different culture, aiming to the satisfaction of social needs or with a public principal, may increase in time. This kind of attitude could also prove itself being better compatible than the selfishness of some types of narrow business culture for building those relations of trusts and cooperation that are of fundamental importance for a successful market economy: Employees could be better motivated, and so more productive, if the purpose of the enterprise is seen as the creation of some social value rather than the creation of shareholder value. In the process the profitability of the firm could be enhanced too. The same kind of psychological attitude can also express itself in the private but communal production of public, in the sense of non-rival,

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new technologies is alternative not so much to work time and consumption of private good and services, but with other kinds of uses of free time (playing cards for instance).

<sup>17</sup> See Anderberg, Andersson, Balestrino, 2000.

goods, of which excludability is not sought, even if concretely possible, where a motivation, which can be appreciated as “socialist”, is to be part of a community of producers and consumers, without the pursuit of a private gain. This obviously applies to the Linux-Thornvald open-source model, as opposite to the rival Bill Gates-Microsoft, and in particular to that remarkable great social and cultural endeavour of our times that is the production and diffusion of Wikipedia. We have here private production for the generation of public goods, where the individualistic profit motive is moderated by a communitarian philosophy aiming to a, partly at least, disinterested (and anonymous!) pursuit of communitarian objectives.<sup>18</sup> A kind of partial “transition from a civilization based on money and competition to one based on cooperation and participation” (Brus and Kowalik, 1983, p. 245).

Aside from the latter case, and turning to the production of private goods, if the possible future higher efficiency of public production leads, as it should in a market economy, to higher profitability, public enterprises, or mixed enterprises with public control, being more profitable, in equitable competition without bending rules or budget constraints in favour of anybody, could grow more rapidly than the private ones, and in the contest of the two systems some sort of the socialism of the means could anew appear, partially at least, as a viable alternative.<sup>19</sup>

As we have already mentioned, in the experience of Western economies in general the public sector has been characterized by lower efficiency. In the countries of the old Soviet bloc the socialist system did not arise from the factual demonstration of the superiority of public towards private production, but from the prohibition of private

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<sup>18</sup> There is nothing essentially new into it (aside from anonymity), as it is akin to the motivation of political or philanthropic activity at its best, or even to some aspects of the possible motivation of entrepreneurial activity as such.

<sup>19</sup> But is the ideology of public service compatible with the one of profit making? They are not necessarily mutually exclusive, once profits are seen as a measure of economic efficiency and the source of the means through which the pursuit of public service can be increased. Obviously there are many reasons to deny the significance of profit as an adequate measure of entrepreneurial efficiency. Unfortunately, it seems that no better rule of thumb for measuring performance does exist. In the end it is on the formation of profit (or surplus value) that the possibility of enterprise development and, in the aggregate, of the development of the economic system as a whole, depends. It is up to the state to determine, however imperfectly, the rules and the conditions that make entrepreneurial profit a relatively adequate (if by far imperfect) social efficiency index of economic performance. Here again we have to deal with the fallacy of

ownership and entrepreneurship, implemented through repression, requisition, and the introduction of radical limitations to the freedom of contract.<sup>20</sup> This has blocked the competition between different forms of ownership and organization and deprived the economy from the innovative contribution of private and decentralized entrepreneurship. As a matter of fact the supporters of socialist transformation had a reductive view of the role of private entrepreneurship and of capitalist forms of production. For them the role of capitalists was essentially to cash in the benefit of the ownership of the means of production and the exploitation of the proletariat. Nationalization was the process through which those benefits were to be transferred to society at large and the exploitation of the proletariat ended. But nationalization of private means of production after the taking of power was not really at the heart of the socialist system, since without prohibition and suppression of markets for productive resources the competition of private entrepreneurship could have been able to reassert itself: so prohibition and suppression was really at the heart. No consideration was given to the creative and innovative powers of private entrepreneurship lost through its prohibition.<sup>21</sup> But the contest continued outside the borders of the socialist block.

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(im)perfection: if an index is imperfect, this is no sufficient reason to throw it away if it has some practical significance, and no better exists.

<sup>20</sup> In general mutually agreed contracts should be in the interest of the parties involved, provided the information on the object of the contract is adequate. Prohibition may be justified in order to defend the interest of one of the parties in case of deceit, or because of the externalities it produces (such as on societal values or the political system) or because of ethical motives. In the case of real socialism the main reason to outlaw employment by private entrepreneurs (and so private entrepreneurship itself) appears to be the last, as private employment leads, according to the Marxian viewpoint, to exploitation. Moreover, according to the Marxist viewpoint private markets were originating negative systemic externalities, with the “anarchy of the market”, and the hindrance to the “further development of productive forces” associated to modern capitalism; the situation could have been different however if they were operating in the framework of a mixed economy with strong state dominance. The motive could not have been that private enterprises were less productive or would offer worse employment conditions than the state industry, since in this case their scope would have been severely constrained by the competition of the latter, with no need for prohibition at all.

<sup>21</sup> See for instance Lange’ viewpoint in his writings on socialist transformation (Lange 1973, in particular Lange 1938); this does not detract to Lange’s great achievements, among others, in the socialist calculation debate. But that debate itself was alien to the basic considerations of the opportunities for grassroots innovation and above all of the incentives for entrepreneurship (both public and private). The consequence was that “Socialist countries have been relatively successful in developing traditional industries ... but they have failed to show even a single case of leap-frogging into a

One must consider here that while in Western economies competition to capitalist firms remained open in principle to firms privately organized according to alternative principles (such as cooperatives or non profit of any sort), as well as, in a number of countries, to state-owned enterprises, this kind of competition between different forms of entrepreneurship was not allowed in the East: non-socialist firms were either completely outlawed or severely restricted. Hence, when eventually real socialism collapsed, this meant the defeat of a comprehensive system of production, with no ready available alternatives. This may partly explain the severity of the consequences of the fall and why transition was much easier in countries where a limited private production sector was allowed. The forcible suppression of organizational competition and of the tool of progress given by rival competition, independent of the type of ownership, has led in the end to the doom of the socialist regimes, as they could not bring about those higher living standards that their citizens were able to observe in the West. However, if competition between different types of entrepreneurship is maintained, in case non-capitalist entrepreneurship were one day to prove more efficient, at least in some sectors of the economy, the process of privatization of the economy could reverse. In this evolutionary perspective every artificial intervention to alter the equality in the rules of competition between enterprises characterized by different ownership structures should be rejected.

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comparatively new and promising field. ... The only widely known new product originating in a socialist country is probably the Rubik cube” (Brus and Kowalik, 1983, p. 250). Obviously the above excludes military production: the T34 in the II World War was considered a better tank than the German counterparts, and Kalashnikov is a household name for an assault rifle in many parts of the world... On the other hand decentralized entrepreneurship does not need to assume the canonical capitalist forms. The township and village enterprises that were so important in engineering the transformation of the Chinese economy at the beginning of the new course after 1978, and lift dramatically the Chinese economy from the Maoist low, were an example of local public-private entrepreneurship, with “fuzzy” ownership rights, as well as an avenue of spontaneously engineered institutional innovation (originally accepted by the Chinese leadership in an experimental mood). The employee self-managed companies that sprung out of the Polish privatization, according to Kowalik (2001, pp. 233-237), “performed so ... surprisingly efficiently: their rate of gross return and net profitability was on average considerable higher than those seen on other privatization paths” (p. 233). On this more in what follows.

### ***8. Public Production, Private Production, Efficiency and Egalitarianism***

For those who have an intrinsic preference for socialism of the means, the greater, or even equal, efficiency of public enterprises could be a sufficient condition for the choice of a socialist system, as in this case their preference could be satisfied without sacrificing efficiency.<sup>22</sup> It would not be a necessary condition, insofar as those who have an intrinsic preference for a socialist system could be ready to sacrifice efficiency in order to bring about its implementation. But if preferences were socialist in the aims only (for instance, greater weight given to equality) and a socialist system were to allow the attainment of greater equality for every efficiency level, the attainment of a non-lower efficiency level would be a sufficient condition for bringing about the implementation of a socialist system. This in theory. In practice the divergence in efficiency that has been shown in history is such that only a clear demonstration of a change in the nature and functioning of public enterprises could bring back into play socialism of the means as a choice alternative. All depends however on the structure of social preferences. If socialism of the means were acknowledged as the most suitable instrument to bring about egalitarian outcomes, and the social preference system is bent very much toward equality, this could lead to the reintroduction of classical socialist solutions. However, what we have learned of income inequality under capitalism and socialism suggests that distributional structures no less unequal than those in the countries of real socialism (as far at least personal income distribution is concerned) could be brought about even in capitalist economies, in presence of suitable redistributive policies.<sup>23</sup> But the issue is far from

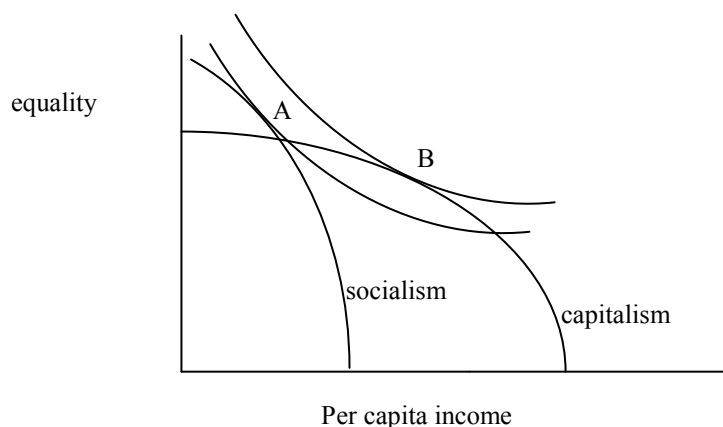
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<sup>22</sup> Obviously, other non-economic factors enter in the choice between public and private, in particular those relating to the economic conditions for political and cultural pluralism. Generally speaking the latter is associated with the existence of a private market economy, also because historically under a socialist system public control of information and cultural production and strict censorship did apply. On the other hand this is no automatic guarantee of effective pluralism, as is demonstrated, as a clear-cut case, by the overwhelming control of mass media by a single tycoon, leader at the same time of the strongest political party, in Italy. Moreover one could envisage, even in a system with overwhelming public ownership, some decentralization in decision-making, and competition between enterprises owned by different public entities, as well as liberty of entry and organization for private cultural and information activities.

<sup>23</sup> This is not entirely certain, however. For one, socialist countries were at lower development levels. Therefore the significance of the comparison is affected by the long-drawn question of the relationship between development and distribution. Moreover there are a host of statistical problems that derive from some fundamental



simple. In different economic systems, independently of preferences, the effective trade-off between efficiency (however defined) and equality can be different. This trade-off can also be different nowadays in relation to the past, because of the changes intervened in the international and technological context. Thus, even if preferences are unchanged, the choice between efficiency and equality could in practice lead to a different mix, with an increased weight given to the first, bringing about at the same time higher income levels and higher levels of social preferences, at the cost, however, of higher inequality, as expounded in the following figure:



*Alternative choices between equality and per capita income above subsistence level (as an efficiency index), with given preferences, but in two different systems, or contexts, that variously favour equality or efficiency.*

(It must be noted that the preferences that are represented are relatively egalitarian, as the indifference curves are relatively flat, even if not to the point of being lexicographic.) As to the shape of the frontiers, which can be assumed as deriving from the effective specific characteristics of the functioning of the two systems, there is no pretension to realism, and they can be drawn making the most various assumptions. For the sake of the argument it is enough to assume that the tangency point with the map of indifference curves is placed in capitalism to the southeast of that of socialism and corresponds to a higher indifference curve. One may note that the degree of “socialism” of preferences is given by the flatness of the indifference curves. In case they were more “socialist”, and thus flatter, than those drawn here, the tangency point corresponding to the highest indifference curve could correspond to the choice of a socialist system. But, according to the experience of socialist countries, even there the degree of socialism of preferences has not been strong enough to compensate for the reduction in the average living standards and in the scope of consumer choices, in relation to those believed to be possible in the long run with a different system. Of course there are a lot of further questions concerning political institutions, but these are out of the scope of the present paper.

differences in the two systems to be compared, which are usually disregarded, in particular how to make allowance for the different structure of the prices consumer goods, and the limitations to the availability of the latter under real socialism. On these issues see Chilosi, 1994. For the data concerning the comparisons in income distribution between western market economies and the countries of real socialism, see Atkinson and Micklewright, 1992; Chilosi, 1990, and the literature quoted there.

Obviously, the preference structure can be system-dependent, but it is far from obvious in what sense it would be. It is not obvious that the instauration of a socialist system, for instance, would alter the preferences in favour of equality, even more if the public understands that, as in the case of the figure, the choice in favour of equality is to the detriment of the average living standards. The preference structure itself could in fact be altered by the effective outcomes. For instance, the awareness of the stronger inequalities in a market economy could determine a flattening of the indifference curves, as a consequence of the moral indignation that this fact may generate.<sup>24</sup>

### ***9. The Relevance of the Third Sector***

The evolutionary argument can also apply to specific non-capitalist entrepreneurial forms that normally are considered to have a socialist character, such as cooperatives. These have a role to play, aside from a marginal existence, artificially fostered by ad hoc policy measures, as long as they are able to successfully compete at equal conditions with the capitalist firms of traditional type. Moreover, the problem of how to organize the competition to capitalist entrepreneurship by the possible non-capitalist entrepreneurial forms that may spring from collective initiatives in the framework of civil society is trivial, as the basic organizational principle on which this competition can be based is simply the fundamental principle of the freedom of contract. More complex issues are implied by the organization of the competition by state entrepreneurship. Enterprises with a state majority ownership could be free to organize themselves, provided they could pay their ways and not depend on public subsidies for their survival. Their growth should be dependent on their possibilities for self-financing, and for drawing resources in the financial markets and, thus, in the end, on their ability to generate profits. One could also avoid to actively privatize the existing state-owned firms, while avoiding to finance them from the public purse, leaving to the market the decision whether their relative importance in the economy should grow or should sink, or whether, in order to survive, they should change their

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<sup>24</sup> An ample empirical inquiry has shown a marked orientation in favour of equality in the economies in transition, much more than in Western Europe (Shrcke, 2001). Thus, it seems that persistence of the distributional values of the previous system did continue to prevail there.

ownership structure, turning to privately owned capital.<sup>25</sup> For those firms that enjoy monopoly rents the solution is not privatization as such, but the elimination of monopoly power. Private monopolies are no any better, even with respect to efficiency, than public monopolies. A difficult issue is how to organize the freedom of entry of publicly owned enterprises, in name of pluralism and of the competition of different entrepreneurial forms. One could for instance attribute the power of establishing them to the authorities of local self-government, in the framework of the general freedom of economic initiative. But obviously there should be some kind of limitation as to their continuing financing by the founders instead than, say, from retained profits. Similar considerations could be made with respect to mixed-ownership enterprises.

### ***10. The Argument of Systemic Externalities***

It remains, for the supporters of socialism of the means, the countervailing argument of the systemic externalities, according to which success in bringing about socialism could follow only after the complete suppression of capitalist institutions. A motive could refer to the dynamics of organized interests and pressure groups altering the conditions of competition, possibly “capturing” those in charge of determining and enforcing these conditions. But in reality every existing organization enters in this kind of dynamics. Non-capitalist types of firms, such as cooperatives or non-profit, not to speak of state-owned enterprises, may succeed in building forms of social representation and defensive lobbying that by no means are less effective than those of capitalist firms. An additional motive could be the possible relationship between economic institutions and social preferences, whose nature however is neither obvious nor of simple determination.<sup>26</sup> The same applies to possible changes in individual values and personality induced by the nature of the social and economic system.

On the whole the argument of systemic externalities is rather worn-out. The suspicion is that in practice its real justification lies in the objective of suppressing the terms of comparison for judging success or failure. One could also be wary of the justification

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<sup>25</sup> This was the solution, Darwinian in character, that I proposed, at the beginning of the transition process, for the transformation of the socialist economies, obviously accompanied by the abolition of the prohibitions to private entrepreneurial activities (cf. Chilosi, 1990).

of the special support to be given to given types of organization of economic activity (cooperative, with elements of industrial democracy, small firms vs. big firms etc.) with the argument of the political and social externalities. Often these arguments and the ensuing subsidization of “non profit” are the reflection of a preconceived ideological aversion towards entrepreneurial profit, derogatorily identified with “speculation”, such as one could find, disgracefully, even in the Italian Constitution (art. 45). The argument is dangerous because it justifies every possible intervention altering the competition between alternative forms of productive organizations. In reality, measures of this kind do not help the alternative organizational forms to develop all their supposed potential, favouring rather their lingering in a protective niche, the extent of which depends on the actual transfers of resources (possibly in the indirect form of fiscal exemptions) from the more productive organizational forms. If one sees in the development of non-capitalist forms of entrepreneurship an opportunity for an eventual transformation of the overall organization of productive processes, one cannot make their survival conditional on the existence of other organizational forms from which they are able to suck resources. If they are considered as a permanent minor organizational feature, their continuous non-self sufficiency and subsidization can jeopardize their legitimization. It should also be considered that special concessions for given organizational forms induce distortion of the apparent entrepreneurial form, with the purpose of taking advantage of those special conditions. The latter then may de facto apply to those who should not be entitled, unless a host of specific limitations, controls and verifications of a bureaucratic nature are introduced. But this would hinder the development and expansion of those entrepreneurial forms that in the first instance one would like to favour and promote. A specific automatic support for no profit would however remain: as much as profit taxes apply to *distributed* profits, a non-profit organization by definition does not distribute profits, and the surplus it is able to create is not diminished by the tax. Thus no-profit growth could be favoured by two circumstances: 1) profits are not distributed (even if the negative side of the coin of course is that this prevents them to be financed through equity); 2) profits are not subjected to the taxation on distributed profits, since no profit is distributed.

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<sup>26</sup> See in this respect Bowles, 1998.

### ***11. Institutional Experiments and Transition***

Even if the basic institutional foundations of a system (presently the capitalist one) have turned out as winners in the systemic contest, we are still left with the issue of what kind of specific institutional varieties and combinations of them would bring about the best results. That a system can gradually and successfully be transformed through experiments and insertion of original elements deriving from another system, until, possibly, changing into a fundamentally different one is shown by the lesson of the progressive Chinese transformation after 1978. Similarly, in the future the capitalist economies could well undergo a gradual transformation in an opposite direction, whenever the conditions that have been discussed above for a successful transition towards non-capitalist forms of entrepreneurship are met. This approach, of gradual and empirically founded institutional transformation, could have been hardly able to solve the problem of institutional transformation in the countries of Central and Eastern Europe after the demise of the Soviet model. In the case of China we have institutional experiments that in case of favourable results are expanded and could be restricted initially to a part only of a country with a huge population and territory, because of the territorially instead of sectorially based structure of socialist planning, in the framework of a political and social system that has stability and internal consistency.<sup>27</sup> This was taking place in a context of great economic backwardness, where at the basis of the economic system, after the liquidation of the communes, there was the productive unit made up by the peasant family.<sup>28</sup> But

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<sup>27</sup> Cf. Roland, 2000, p. 57. The great advantage of territorially limited reform is that it can pay due attention to a set of interrelations that more difficultly could be managed in a national framework without introducing strong elements of irreversibility. In a limited territory the costs (non only economic, but political and social as well) associated to reform reversal are much lower than when the reform applies to the whole economy.

<sup>28</sup> Moreover, one should not downplay the relevance of the tradition of the autonomous role of the peasant village (cf. Krug, 2000a, p. 12). This tradition of autonomy has allowed the local communities to develop its economic and organizational potentialities, stimulating the institutional innovations that lie at the basis of the Township and Village Enterprises. The nature of the latter is somewhat controversial, but, under the appearance of the formal municipal ownership, complex contractual relationships could be hidden, making of these enterprises masked forms of private or mixed entrepreneurship, remedying, at the same time, for the institutional restrictions to a market for those capital goods whose ownership remains public (cf. Krug, 2000b; Oxford Analytica, 2001) and for the absence of adequate legal guarantees against the predatory tendencies of public authorities (cf. Sun, 2002, p. 252). One may refer to the latter source for describing and explaining the evolutionary trend of township-village

whenever the legitimation of the previous system collapses abruptly, in much more advanced economic contexts, gradual processes of transformation are much more difficult to sustain, and a natural tendency to engender a great leap forward arises, sometimes in the same vein as the old voluntaristic fallacy.<sup>29</sup>

### ***12. The future of Capitalism and Socialism***

In the end, considering the future of capitalism and of socialism we must exert caution. Everybody can have the hindsight of the past, but nobody has the hindsight of the future, and so many false predictions have been made, even by prominent authorities, in the past. The only comfort is that posterity will certainly not read our speculations here, and even in the improbable case it will, we will not there to bear the brunt of their possibly well deserved criticism. Speculation about the immediate future may be risky, but about the distant future has the advantage, in the end, to be harmless, for the speculator at least.

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enterprises towards the transformation into ownership structures where public participation was progressively lower.

<sup>29</sup> A problem with gradual reform lies in the institutional compatibilities that it can engender. For instance, a problem, in the case of liberalization of private entrepreneurship, lies in the fact that in an economic system with price control and unbalanced market, private activity can profitably concentrate on mere arbitrage. In the case of China this issue is solved through liberalization at the margin, without destroying in a sudden and radical way the old system of compulsory consignments and of price controls, as has taken place in various Eastern European countries that have adopted the big-bang strategy, with adverse social and economic effects. On these issues cf. Roland (2000), ch. 6, pp. 131-152.

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