Title	MACROECONOMIC PRESSURES, PRICE MECHANISM, CHOICE COEFFICIENTS AND PHYSICAL ALLOCATIONS IN A CENTRALLY PLANNED ECONOMY
Sub Title	
Author	FEIWEL, GEORGE R.
Publisher	Keio Economic Society, Keio University
Publication year	1979
Jtitle	Keio economic studies Vol.16, No.1/2 (1979.) ,p.31- 51
JaLC DOI	
Abstract	
Notes	
Genre	Journal Article
URL	https://koara.lib.keio.ac.jp/xoonips/modules/xoonips/detail.php?koara_id=AA00260492-19790001-0031

MACROECONOMIC PRESSURES, PRICE MECHANISM, CHOICE COEFFICIENTS AND PHYSICAL ALLOCATIONS IN A CENTRALLY PLANNED ECONOMY

GEORGE R. FEIWEL

Economic actors (producers, investors, consumers, policy-makers or planners, the government) make choices between alternative courses of action. That economic actors "make choices implies that they have alternatives, that what was chosen was not inevitable but was in fact only one in a range of opportunities. The opportunities available to a consumer are determined by the income he has and the prices he has to pay for commodities of different use-values. The opportunities available to a firm might be all the technologically feasible combinations of inputs and outputs, in the present and in the future."[1]

To make rational choices reliably "economic information" is required. Prices are perceived by the neoclassical economic theory as among the most important, if not strategic, of the economic variables and signals that condition the economic actors' mode of behavior, response and adaptation to change in economic conditions. "In order to show that price is a phenomenon incident to all forms of organization of society and to economic action in general, it is sufficient to look upon it as a coefficient of economic choice."[2] The role of prices as signals and "economic" summary measures to convey adequate information to the individual actors for the achievement of general economic equilibrium and efficient resource allocation is lucidly summarized by Professor Tjalling Koopmans.

> . . . price is regarded as a label, a signal, a piece of information that is attached to the good or service traded. This information expresses simultaneously the ultimate usefulness to consumers of this good, and foregone usefulness of other goods or services that could have been produced alternatively from the resources absorbed in making this good. Choices about methods of production and about amounts to be produced are based on this information; if these choices are to be good choices, the information used has to be accurate.[3]

With his great expository skill, the late Oskar Lange pointed to the consequences of using "wrong" prices (that fail to reflect conditions of both supply and demand) for resource allocation:

[1] K. J. Arrow, *Information and Economic Behavior*, Stockholm 1973, p. 5.

[2] J. A. Schumpeter "The Nature and Necessity of a Price System" in *Economic Reconstruction*, New York, 1934, p. 71.

[3] T. C. Koopmans *Uses of Prices*, Chicago, 1954, p. 2. Cf. his *Three Essays on the State of Economic Science*, New York 1957 and Nobel Lecture on "Concepts of Optimality and Their Uses" *American Economic Review*, June 1977, pp. 261–274.

> If the price of a scarce productive resource is planned too low and the price of an abundant resource is planned too high, the cost of production shown in the bookkeeping of the plants can be reduced by substituting the scarce resource for the abundant one. Considered from the point of view of the economy as a whole, such a substitution is a waste of resources and the reduction in the bookkeeping costs of the plants represents a decrease, not an increase, of their economic efficiency. The discrepancy between the cost accounting of the plants and their true economic efficiency can be avoided only by pricing the productive resources according to their scarcity relative to demand.[4]

Efficient producton (combination of inputs and output composition) can almost never be governed by exclusively technological considerations. For, as Joseph Schumpeter argued in order to choose between the various technically possible methods of production and output mixes, it would be necessary for the managers in a collectivist economy "to attribute values to the means of productions at their command which it would be possible to deduce from the coefficients of choice expressed by the comrades. The values would be essentially the same thing as the prices of the means of production in a capitalist organization." Thus, "an economic dimension is . . . always necessary for the guidance of production, and this economic dimension at all times and under all circumstances finds expression in coefficients of choice which are fundamentally the same thing as prices in a capitalist society."[5]

The term price has two meanings, as stressed by Wicksteed. In the ordinary sense, it means the exchange ratio of two commodities on a market, and, in the wider sense, "the terms on which alternatives are offered."[6] It is only prices in the generalized sense that are indispensable for an effective solution of the resource allocation problem.[7] Such choice indicators can be obtained without a market in the institutional sense. Three sets of data are required for a determinable solution of the resource allocation problem: (1) a preference function which guides choice and which may reflect planners', consumers', or interaction of both, preferences, (2) knowledge of the terms at which the alternatives are offered, and (3) the production function. If the data under 1 and 3 are given, 2 can be determined. There are, of course, other signals than prices for transmitting information about scarcities. Scarcity prices are not necessarily efficient prices and should not always and under all circumstances be used as guides for resource allocation.

The socialist economy provides a wide scope for price arrangements, and, obviously the existing varieties are only some of the theoretical alternatives. Physical planning may dispense with prices as choice coeffiecients. The economic question is the relative effieciency of such arrangements.

To be sure, efficiency is not an end of economic activity, merely a means for

[4] O. Lange, *The Working Principles of the Soviet Economy*, New York 1944, p. 14.

[5] Schumpeter, *op. cit.*, pp. 172–173.

[6] P. H. Wicksteed, *The Common Sense of Political Economy*, London, 1933, p. 28.

[7] O. Lange, "On the Economic Theory of Socialism" in *On the Economic Theory of Socialism* ed. by B. E. Lippincott, Minneapolis, Minn., 1938, p. 60.

accomplishing that end, however determined. But efficiency does matter. For a more effective husbandry of scarce resources enables the economy to achieve a higher realization of the ultimate ends of economic activity. The notion of economic efficiency is not equivalent with an optimum allocation and utilization of resources. The normative question concerns the ends to which resources ought to be deployed and how the product of economic activity ought to be distributed among the participants of the economic process and intertemporarily. A fundamental question is: Efficiency for what and for whom?

At first sight the classical Soviet price system seems "irrational," but one has to keep in mind how and for what purposes it was developed. The ever present conflict between the requisites of economic efficiency and the dictates of bureaucratic and financial expediency provides only a partial explanation. Whether the system suited well the requisites of mobilization of resources and of "extensive growth" is another matter. But even if the historical explanation is not questioned, it does not provide justification for continuing along roughly the same line. True, it is widely recognized not only by economists but also by official reformers that methodology of price formation would have to be fundamentally altered if prices were to serve as effective choice coefficients. It is remarkable that basic price reforms encounter formidable difficulties and opposition in the implementation stage and tend actually to end up as merely price revisions.

I

Roughly, in the traditional Soviet-type economy (STE) prices are more or less arbitrarily set; they are rigid for prolonged time spans; price formation is divorced from plan construction; prices tend to be inconsistent with other instruments of plan execution; domestic prices are dissociated from world market prices; and producers', prices are insulated from consumers' prices—the dual price system. When the logic of physical planning is carried to an extreme, prices should be neutral and producers insensitive to them. As the system developed, producers' prices became more than merely weights to aggregate heterogeneous output and the planner vacillated between circumventing "wrong" prices by a more direct detailed determination of output, and attempting to neutralize sensitive prices or to strengthen their effect by stressing this or that desideratum. Naturally, the planner wants production to be elastic to some prices and inelastic to others and this is a source of many inconsistencies. Executants will make whatever decisions they can on the basis of existing prices (and will try to influence new prices to their own advantage). It is irrational to ask executants to care or know of the opportunity cost to the economy of underpriced or not entirely accounted for inputs—just as it is to appeal to the consumer to be parsimonuous in his consumption of subsidized goods. One of the most expedient measures of reducing the distorting impact of prices is to narrow down the periphery's sphere of decision-making.

In the economist's world of free and unimpeded mechanism of the world market, the forces of competition should equate the country's internal and world market relative price structure. Thus, in principle, domestic prices should reflect the proportions and scarcity relations on the world market. In the traditional STEs domestic prices do not correspond to world market price ratios and producers' (industrial wholesale) prices are separated from consumers' (retail) prices. To the extent that production decisions are influenced by official actual prices (as contrasted with shadow or black-market prices and physical allocations and commands) this obfuscates economic calculation and distorts comparative costs and benefits of indirect production. For prices on Western markets, as imperfect as they are, reflect more or less marginal opportunity costs for the country's effective export and import substitution, and tend to stimulate diffusion of world technical progress. The dissociation of domestic prices from those prevailing on Western markets provides certain benefits, including almost complete shiedling from imported cost inflation. But the costs are high in terms of static and dynamic efficiency. Thus, most STE reform blueprints provided for internal prices to be brought into some correspondence with relative prices on Western markets; but, with notable exception of Yugoslavia, only a limited attempt was made to align domestic with world market prices. The half-measure reforms preserved largely the split between internal and external price patterns. Even in Hungary—where the reform was relatively most advanced—the attempt to establish a realistic concordance between domestic and foreign trade prices was only partly successful.

The STE price system provides an opportunity of insulating changes in some prices from others; of having different prices for one product depending on the sphere of circulation; of using different standards in price formation; and, in general, of manipulating the "budget constraint" on industrial management, income distribution, real purchasing power of households, and the size of the economic surplus to be extracted. For example, retail prices of consumer goods can be insulated from changes in their factory prices or vice-versa. The application of divergent principles of price formation for producers' and consumers' goods has involved widely diffrentiated taxes and subsidies. However, in practice the total insulation has not been carried out and the actual system seems to be considerably more flexible than its rigid design.

The traditional planning system requires for variety of reasons periodic price revisions (basically updating factory or wholesale prices to reflect cost increases but without major departures from the traditional cost-plus approach). Significant as the modifications in practice are, they are quite distinct from reform of principles and basic methodology of price formation and establishment of rules for price flexibility for really important products. Revisions eliminate some distortions and shortcomings and tighten up the system. Not surprisingly, elimination of some accumulated inconsistencies tends to create new ones. For instance, the revision may set limits on planned profitability, but usually, as result of cost inflation, ex post profits significantly exceed ex ante. Recently, comprehensive price revisions

have been accompanied by fairly limited lessening of control for less consequential products (aiming to instill the system with greater flexibility to adapt itself to users needs).

II

Importantly, the dual price system is characterized not only by a divergent and separately moving price level of producer and consumer goods (with the bulk of surplus collected in the form of tunover tax in consumers prices) but also by different principles of price formation.[8] The prices of producer goods are, as a rule, computed on the basis of the average attributable branch production costs (with the notorious failure to account adequately for costs of capital employed, rent, depreciation and obsolescence, meagre returns for entrepreneurship and various skills) plus a small "profit" markup on costs to impose a budget constraint, but not to empty the system of incentives. In setting consumers' prices an attempt is made to find the level and relative structure of prices that equates demand with available supply for each commodity ("neoclassical prices"). But prices are strongly conditioned by political and distributional considerations, restricting and distorting the use of the pricing mechanism. Thus, in practice, the relative prices of consumer goods frequently seem to be nowhere near their microeconomic equilibria in (partial) markets. With prices below equilibria, there is excess demand, buyers compete among themselve for the sellers' favors, and black-market profiteers appear. The budget collects a whopping share in the form of tunover tax—the difference between the average production costs plus an insignificant "profit" markup (the factory price) and the price at which the product is sold to the domestic trade organ. Upon sale of the product, the bank automatically extracts from the industrial enterprise the turnover tax which is transferred to the state budget. Thus the firm's revenue is generated ex-turnover tax.

Such a system tends to indicate spurious relative contributions of various sectors, branches, and activities to national production; it distorts distributive shares; it understates the share of resources channelled to capital formation; and it obfuscates efficiency calculus. In fact, the national income accounts understate the share of branches producing producer goods and overstate that of light and food industry branches. Similarly the share of accumulation in national income is understated and that of consumption is overstated. Instead of promoting technical progress, the artificially low prices of producer goods further waste of materials and capital goods.

The dual price system gives rise to considerable subsidies which, for reasons of planning and financial expedience, tend to be concentrated at the early stages of

[8] Cf. G. R. Reiwel, *The Economics of a Socialist Enterprise*, New York, 1965, pp. 57–64 and references therein.

the production process (e.g. mining) and on fewer items in basic industries. But such prices of basic inputs artifically lower production costs (hence prices) at the successive processing stages. One of the principal aims of price revisions has been to reduce subsides (which, with rigid prices, grew due to wage increases outpacing nonuniform productivity gains in various activities, deteriorating geological conditions, and rising marginal costs). With deficits or low profit rates, current operation of the producer goods branches was subsidized and development was wholly financed by the budget which redistributed funds for capital formation.

The nature of costs, prices, and profit is a cardinal question. If the price is a derivative of costs, its constituents are cost elements which themselves are not independent variables. The cost of a given commodity cannot be said to be price determining since the constituent cost elements are determined by prices. Planners allocate inputs and then set prices. Effective prices cannot be set unless inputs were beforehand allocated efficiently to various uses.

The central planner (c.p.) can determine administratively what constitutes a cost element and assign appropriate values. But to determine at what economic, as distinct from accounting, cost the production of a good is secured one needs to take into account implicit (opportunity) costs.[9] But the state budget carries some of the costs of inputs and relative price stability is ensured primarily through redistribution of funds and subsidizing of priority activities, with failure to account fully for costs of inputs employed. Thus prices calculated on the basis of average (and sometimes individual) costs do not give proper weight to marginal opportunity costs of all inputs. Even those costs that are explicity accounted for are based on more or less arbitrary prices of inputs. In many cases the cost basis is considered merely a "point of departure" for price determination. Many deviations from costs are allowed to take into account the relative technical "use values," to enhance or curtail usage in view of relative shortages or surpluses, or to alleviate balance of payments, etc. This raises the question of what the rules really are and to what extent prices are arbitrary.

Backwardness is perpetuated by the practice of setting prices of new products on the basis of planned production costs plus a meagre profit markup. These prices remain unchanged for years. The longer the same product is produced at a growing rate, the greater the cost reduction and the higher the profit. Under the traditional system the enterprise is thus vitally interested in continuing production of obsolete, and therefore highly profitable, products for as long as it possibly can, and in not adopting—or delaying the adoption of—new, and therefore less profitable, products. In addition, because factory prices of new goods are determined on the basis of their planned production costs (and in come cases also in accordance with some norms specifying the weight and size of products), even if enterprises adopted new products, they are not interested in subsequently improving their quality and reducing their planned production costs. Their interest dictates exactly the

[9] Cf. L. Kantorovitch *The Best Use of Economic Resources*, Oxford 1965.

opposite: The adoption of new products with inferior technical parameters and lower quality (because they are easier and faster to produce) and submission of highest possible cost estimates. By its very nature the factory price is designed to cover planned production costs, irrespective of real "use values" of the products, which should be roughly reflected in the retail price. These are some of the determinants of the technical retardation of certain branches, and of the continuous production of obsolete, ineffective, and expensive producer and consumer goods.

The crux of the matter is dynamic inefficiency of the entire economic system, which can only be attenuated by a radical price reform. For it requires a fundamental shift in growth strategy and consistent changes in the economy's modus operandi to instill the spirit of innovation and risk taking at all levels of economic activity. Variants of traditional STEs have not only failed to introduce the necessary stimuli for generating technical and organizational progress from below but feature built-in obstacles to implementation of technical progress imposed from above. The system-made obstacles to technical progress derive primarily from the distruptive effect of its introduction on current production activity, which is at the forefront of attention. Apart from the weighty problem of faulty and "inflexible" prices, these impediments include preponderant stress (dejure or defacto) on plan fulfillment, the incentive system and performance criteria supporting it; orientation to short term benefits, mobility of personnel, weak rewards for entrepreneurial and innovational activity, lack of motivation to improve skills and central restrictions on major output profile and techniques. As I have argued elsewhere, the underlying factor is the high pressure economy that, despite official rhetoric regarding technical progress and the extension of planning horizon, still stresses quantity at the cost of quality, and current plan fulfillment at the cost of long term benefits, and results in instability even in the short run, so that executants have to provide larger reserves for current plan fulfillment which otherwise could have been used for technical-progress measures. In the final analysis the rate of innovation and pattern of adaptation depend not only on the working arrangements for resource allocation but, in a most significant sense, on the rate and pattern of utilization of resources in the system, on the content of macropolicy (central plan) and rates and frequency of shifts, and on the different response of economic actors under varied conditions and rates of change of pressure or slack in the economy.

III

The population can only consume a part of what it produces. To ensure appropriate capital accumulation and macroeconomic stability, the c.p. should choose a certain aggregate price-wage ratio (markup). Thus the price level of consumer goods should help to yield the needed surplus over the wage fund exapnded. The problem is of finding an effective device for extracting the surplus.

Turnover tax is such a device. The nature of turnover tax, and even its very name is a controversial issue in socialist economic literature. Whether or not it is classified as a tax is rather immaterial, for essentially it does perform the function of a sales tax in syphoning off purchasing power and thus reducing real income. It appears that for political and incentive reasons (primarily to maintain the gross wage illusion), the original designers of the Soviet system preferred indirect reduction of spending power (turnover tax) to direct (income) taxes or lower nominal wages.

One of the outstanding features of the dual price system is the vast differentiation of turnover tax. Turnover tax separates the price that the consumer pays (retail) from the price that the producer receives (factory). Turnover tax is computed as the difference between the retail price (less distribution costs and markups) and the factory price. It is collected at the producer's when the product is sold to the trade organ, hence the consumer is unaware of its size. If the turnover tax were levied as a uniform percentage rate on all goods, the relative price ratios would be unaffected. As it is, the process of computing and levying turnover tax is complex, cumbersome and quite prone to manipulations. To insure inflow of revenue to the state purse, the financial authorities are apt to be swayed by expediency and control considerations.

The turnover taxes and profitability of various goods do not vary proportionately, so that prices of some goods include a high profitability and relatively low turnover tax, and those of others include a low profitability and high turnover tax. The producers are interested in selling their goods at the highest possible factory prices while purchasers aim at buying them at the lowest possible retail prices. Both tendencies naturally encroach on the amount of turnover tax collected as the difference between them. Such a collection of turnover tax creates a buffer zone between producers' and consumers' prices, rendering the producer largely insensitive to the changes on consumers' markets. Quality differentiation is often not reflected in profitability rates, but rather in turnover tax variance, and the producers remain unaffected by producing low-quality output. It is the turnover tax, rather than profit, that is linked to demand, but since the producer remains unaffected by its magnitude, there is a rift between him and the market for his goods, disorienting him, so that stocks of certain goods build up and others are perpetually in short supply.

Reformers operate within the framework inherited from the traditional system. Even should they wish, they cannot lower the existing wage level (and strong pressures are exerted to satisfy the expected "normal" increases). Similarly, consequential direct taxes to reduce disposable income are political dynamite. Consequently, reduction of purchasing power via the turnover tax still appears to be the more expedient course. The reforms in STEs envisaged a reduced fiscal role of turnover tax and the new taxes (profits tax, capital charge, etc.) were to constitute the core of the tax system. But a relatively higher share of profit tax as a source of budgetary revenue is not indicative of decentralization. It is only an alternative method of collecting "financial accumulation." With the increased level

of producers' prices (including larger profit markups), the budget syphons off larger amounts of profit from producer goods' producers. Concurrently with quasi stable consumers' prices and increasing producers' prices, the production costs of consumer goods rise and the turnover tax is reduced. Throughout Eastern Europe reform designs called for elimination or substantial reduction of the widely differentiated turnover taxes and of the vast and burdensome subsidies. In practice the results were very disappointing. Even in Hungary, where bolder reform redesign was attempted, consumers' prices continued to be seperated from producers' prices by a cumbersome network of highly differentiated (but reduced in number) turnover taxes and subsidies.

IV

The Hungarian reformers were fully aware that a sweeping price reform was necessary and the area received priority treatment but in practice the measures were cautious and disappointing.[10] The blueprint provided for gradual transformation of centrally set prices into controlled market prices, whose first step was the introduction of the four-tier price construct (1-centrally fixed, 2-maximum, 3-upper and lower limits, and 4-free prices). During implementation the share of goods for which flexible prices were allowed was disappointing, and "free" price-setting was shackled by many restrictions, with controls over these prices reinforced through effective controls over prices of key input components. Under conditions of a sellers' market which persisted for many goods, prices reached immediately and remained at the upper limit, so that they were *de facto* indistinguishable form centrally fixed. With the overwhelming bulk of prices in the rigid or nearly rigid category, the movement of "free prices" was distorting. To maintain many of the fixed prices, a number of activities had to be heavily subsidized and tax reductions were allowed. In fact, during the post-reform period the amount of subsidies rose and tax rates were manipulated for reasons of financial expediency. The dual price system was not abolished and there was little success in linking domestic to world market prices. Consumers' prices continued to be separated from producers' prices. Much was said about the conflict between price stability and requisites of efficiency. But in practice the system continued to uphold stability. At the outset the state guaranteed maintenance of retail prices of basic necessities and stipulated that the real income of the majority of the population cannot be lowered. The scope for introducing the neceessary changes was severely circumscribed. Thus improvement in relative structure of consumers' prices "*has not come about*," and in many cases new distortions were introduced. In practice, the promulgated scope of decentralization in price setting was fairly limited.

[10] Cf. I. Friss, ed., *Reform of the Economic Mechanism in Hungary*, Budapets, 1969; O. Gado, ed. *Reform of the Economic Mechanism in Hungary*, Budapest, 1972; Friss, *East European Economics*, 3 (1973), p. 16.

In all STEs there is a detectable shift in the interpretation of cost elements, in the methodology of cost determination, and in the techniques of calculation. In practice the methodological innovations tend to be limited. The introduction of the capital charge—whether treated as cost element or deducted from profit—is far more important than the ideologidal and doctrinal connotations. In general the charge does not reflect opportunity cost of capital at the margin and discriminatory rates tend to be used. On efficiency grounds, the capital charge (in excess of recovery cost of the investment) should be equal to (uniform) marginal efficiency of investment in all uses throughout the system.[11] And to the extent that the charge is underrated, the resulting profit cannot serve as a yardstick for judging comparative efficiency, for extra capital-using producers will show higher profit. Despite inconsistencies and arbitrariness, and non-uniformity, there is a noticeable attempt to introduce a measure of determinism in the base to which the profit markup is related— a shift from the traditional markup on average costs. There is also an attempt to set more realistic depreciation rates (more allowance for obsolesence) with considerable work done to revalue the capital stock. Various rental charges are made in more or less disguised form. One can stress either the new elements and direction of change or the timidity and inconsistency of departures from the old. But considerable advances (in most countries of the region) are undeniable.

In an open system efficiency can be gauged by exposing enterprises to international competition and by measuring profitability in terms of prices that more or less reflect conditions in the world market. The creation of a strong link between domestic and world market prices has a long literature in STEs.[12] World market prices were allowed to penetrate domestic price structure at varied rates in different countries, and substantial differences could be observed.[13] Despite the increasing "consideration" of world market prices in the process of price determination and revision, there is considerable inconsistency in linking domestic to foreign trade prices. The 1965 reform and subsequent measures in Yugoslavia had a greater impact on the domestic set of prices than in any other East European country. Domestic prices of goods that were (potentially) subject to foreign trade were administratively fixed on the basis of foreign exchange prices, converted at a uniform and reasonably realistic exchange rate. This resulted in a significant change in the relative price structure.[14]

[11] Cf. A. Bergson, *Economics of Soviet Planning*, New Haven, 1964, pp. 250–74.

[12] Cf. M. Kalecki and S. Polaczek, *Gospodarka planowa*, 4 (1957), pp. 18–22; J. Zachariasz, *Finanse*, 6 (1956); and F. Pryor, *The Communist Foreign Trade System*, Cambridge, Mass., 1963, p. 24.

[13] Cf. Pryor, Property *and Industrial Organization in Communist and Capitalist Nations*, Bloomington, Ind., 1973.

[14] Cf. D. Milenkovitch *Plan and Market in Yugoslav Thought*, New Haven, 1971, A. Bajt, "Yugoslav Economic Reforms, Monetary and Production Mechanism, "*Economics of Planning*, VII, 3 (1967), pp. 201–18; E. Neuberger, "The Yugoslav Visible Hand System; Why it is no More?" International Development Research Center, Indiana University, Working Paper No. 3, April 1971, International Bank of Development *Yugoslavia*, Baltimore, 1975.

Despite some progress, the Hungarian reformers did not succeed in their limited attempt at establishing a realistic congruence between domestic and foreign trade prices.[15] Here we cannot do more than merely indicate some of the problems encountered. The identification of the world market price is not a simple matter. World market prices can really be ascertained only for raw materials, typical semifabricates, and more or less homogenous products. This raises the question of setting prices for such products as complex machinery and equipment, ships, and other items for which no actual world market price exists. Thus it appears that the relative "power to negotiate" and noneconomic considerations play a much greater role than the firm basis or rules in determining the price. The identification of the world market price is not merely a difficult technical question, but in many cases there is a wide set from which one can choose. What matters then are the politics of selection and the various corrections and adjustments the price undergoes.

With some oversimplification, a STE faces two kinds of foreign markets: (1) the Council of Mutual Economic Assistance (CMEA) or "ruble trade market"—the dollar can be used in intra-CMEA trade, but ruble balances are nonconvertible in trade with the West—there is only fairly limited convertibility of ruble balances among CMEA partners and bilateral arrangements predominante; and (2) the Western (and third world) trade market where the generally acceptable currency is the dollar.[16] Generally dollar price proportions differ considerably from ruble price proportions. World market prices are translated into the domestic price structure via exchange coefficients, and the latter assume considerable importance. To enable them to make more realistic foreign trade decisions, the Hungarians have established separate foreign exchange conversion coefficients for hard and soft currency areas to reflect different conditions on each of the markets (indicating that the ruble is over-valued in relation to the dollar).

But the problem is not confined to the rationale of the relative shadow rates set, for the link between domestic and foreign prices is often more tenuous than claimed. Prices are distorted by widespread and differential subsidies and preferential treatment. Export promoting schemes, protective tariffs, and all kinds of restrictions inhibit import activity.[17] Import-using enterprises pay in domestic currency the equivalent of the actual price paid for imports abroad. Subject to numerous exceptions, changes in foreign prices of imports should affect the domestic prices paid by import-users. But domestic and import prices should generally be the same for those commodities whose domestic prices are fixed or

[15] Cf. *Figyelo*, March 18, 1970; R. Portes, *Soviet Studies* XXIV, 2 (1972), p. 644., D. Granick *Enterprise Guidance in Eastern Europe*, Princeton, 1975.

[16] Cf. P. Wiles, *Communist International Economics*, New York, 1969 and M. Kaser *Comecon* London, 1967.

[17] B. Balassa, "The Firm in the New Economic Mechanism in Hungary, in *Plan and Market*, ed. by M. Borstein, New Haven, 1973. Cf. G. Lauter, *The Manager and Economic Reforms in Hungary*, New York, 1972.

limited (e.g., most of the raw materials imported for the chemical industry).[18]

The world market prices chosen are not the current Western market prices, but frequently some averages of previous years, the adoption of the base depends on the movement of prices and on the preponderant interpretation of what the "representative" prices are. One of the major problems is the rise in world market prices, particularly of raw materials and fuels. Domestic prices of those inputs tend to be fixed to neutralize the effect of increases on domestic prices and on the consumer price level in particular. If the government wishes to insulate the domestic price structure from this impact, the state budget has to cover the difference. The alternative is to allow the impact to affect the domestic price structure with an almost certain jump in the prices of major goods affecting living standards. But neutralization of the impact of world inflation can be achieved only by various types of budgetary subsidies which weaken and distort the allocative function of prices.

Obviously the importance of linking domestic price formation to foreign trade prices depends on the sensitivity of the economy to foreign trade prices, the flexibility allowed in shifting the geographical and commodity composition of foreign trade, and the periphery's real shere of decision-making. For example, the pressure to undertake major steps to improve foreign trade is not as strong in Bulgaria (which contrary to other STEs, is a beneficiary of trade with the USSR) as it is in Hungary, and perhaps the scope of maneuverability is much narrower. Parenthetically, it appears that various kinds of formal and informal import and export restrictions imposed on Hungarian firms actually make the problem of alignment of domestic with world market prices less urgent.

V

It cannot be overemphasized that the high pressure economy tends to invalidate the general principles of economic calculation in general and effective allocation of resources by the market mechanism in particular. An overheated economy, the result of stipulating excessive growth rate in relation to real possibilities, becomes the source of two mutually propelling difficulties: the emergence and perpetuation of bottlenecks, and the prevention and often impossibility of introducing and applying a set of economic instruments which could palpably increase economic efficiency, take advantage of idle resources, speed technical dynamism and "motivational efficiency," and thus contribute to increasing the rate of growth without excessive strains. Experience manifestly demonstrates that excessive tautness and the ensuing disturbances in the interbranch and interenterprise flows considerably weaken economic incentives. Moreover, demands for centralization (or retrenchment from previous partial devolution of decision making to the plan

[18] Cf. B. Csikos-Nagy, "The New Hungarian Price System," in *Reform of the Economic Mechanism in Hungary*, ed. by Friss, p. 193.

executants) tend to be more vigorous with faster postulated growth rates. With development rush, there is far greater danger of ill synchronization of individual sectors, branches and activities, resulting in growth ceilings and bottlenecks (e.g. the disparity between the growing import needs and export possibilities). An economy that has to cope with these problems reverts to more strict central controls than one developing at a more moderate pace and more "balanced" pattern.[19]

A distinctive characteristic of modern economic growth in the industrialized capitalist economies is that the high growth rates of per capita national production were accomplished primarily by improvements in quality—and to a much lesser extent by increased quantity—of inputs; that is, essentially by a rise in productivity traceable to technical dynamism and organizational know-how.[20] Traditionally, the Soviet-type mode of development relied primarily on quantitative ("extensive") growth, propelled largely by huge investment, employment and other inputs with fairly disappointing increases in productivity. Investment was used as the principal growth determinant and accorded priority on all fronts. Thus the most sensitive spot of the national economic plan was the stupendous investment undertaking. The taut investment plan induced unrealistic assumptions in other activities. As a consequence, bottlenecks emerged, promoted by a forced and abrupt overexpansion of certain activities that was bound to prolong the gestation periods of investments and fruitition of output, to raise the cost of an incremental unit of output, and to lower the investment efficiency index.

In STEs inflationary foreces are generated by the industrialization rush and affected by working arrangements. Accelerated industrialization drives are usually associated with growing disparity between a rapidly expanding wage fund and sluggish supply of consumer goods. While investment leads to enhanced purchasing power, it also means cuts in the production of consumer goods. The latter can be procured by imports, but increased investment strains the balance of payments by generating greater requirements for imports of producer goods. In the end, not only industrial consumer goods cannot be imported, but imports of raw materials for consumer goods production are also constrained, while some consumer goods are being exported to pay for the imports.

Usually an increase in the rate of investment is accompanied by a growth of employment in the investment (investment-supporting activity) sector. Even without a change in wage rates this would produce a rise in the total wage fund in this sector. The average wage rate in this sector is usually above that in the economy as a whole, so that even without a rise of overall wage rates, the reallocation of labor from lower to higher than average wage sectors boosts the wage fund. Intensified industrialization is usually supported by material inducements to speed up the process of transformation and by using the allocative

[19] Kalecki, *Z zagdnien gospodarczo-spolecznych Polski Ludowej* Warsaw, 1964, pp. 17–19, Cf. J. Kornai *Rush Versus Harmonic Growth*, Amsterdam 1972.

[20] S. Kuznets, *Modern Economic Growth*, New Haven, 1967.

function of wages (premiums) to lure labor to priority activities. An overheated economy with interruptions of inter-enterprise flows, poor quality of material inputs, and unreliable industrial services, is conductive to waste of labor and overtime. To attract and keep skilled labor various semi-legal monetary inducements are offered.

The tendency to increase employment is not sufficiently counteracted by command and monetary restrictions on the enterprise liquidity. During the course of plan implementation the workers benefit from "excessive" purchasing power, as compared to the diminished production of consumer goods. Pressures to exceed the wage fund are created both in the producer and consumer goods sectors and are, intensified by the investement drive. The latter increasingly absorbs resources originally destined for current consumption, resulting in underfulfillment of the plan for consumer goods, and in a deficiency of materials and equipment (domestic or imported) for the consumer goods branches. The real test comes not only at the blueprint stage, but when the leaders are confronted with the dilemma of sacrificing part of the resources designated for growth-promoting activities (thereats of inroads into the capital formation plans).

In an attempt to mitigate the inflationary pressures that arise as a result of overheating in the economy, the c.p. endeavors to contain the rise in wages and employment. However, in this he is severly constrained by his own mechansim of plan construction and implementation that not only does not oppose households' pressures to raise their living standards by means of increasing the number of gainfully employed, but also provides its own pressures for expanding employment, giving rise to the phenomenon of disguised unemployment in industry.[21]

Despite the important role played by controls of income flows, the c.p. has great difficulties in restraining growth of the wage fund; the ex-post wage fund usually exceeds ex-ante. The spending power is also increased by the private income of peasants and the "private sector" in general—a good part of which is uncontrollable. The illegal or unreported income appears to be of considerable importance, although its size is difficult to ascertain. Such income is also derived from various system-induced economic crimes of more or less serious nature and from a widespread network of graft payments.

The problem of matching the income flows with supply of goods and services is complicated by the fact that a part of the output of consumer goods cannot be sold at prevailing prices because it is shoddy and of poor quality. Thus for a number of reasons, excess aggregate effective demand tends to prevail, for the increase in purchasing power tends to outpace the increase of available consumer goods. The problem is aggravated by the prevailing relative price structure and the absence of an effective nonprice output adjustment mechanism. The c.p.'s field of maneuver is limited for nominal wages cannot be reduced—indueed, a certain minimum

[21] See Feiwel, *Soviet Studies*, XXVI, 3 (1974), pp. 344–62.

"normal" increase is expected at certain given intervals. Also price increases—at least for necessities—are politically inadvisable. Whatever the political advantages of price reduction, practiced in some STEs, it must be viewed in the light of the persisting disequeilibria on the consumer market. This, together with the lack of success in controlling the size of the wage fund, tends to aggrevate the shortage-prone system. A better way to raise living standards would be to increase wages and to let consumer prices approach equilibria in partial markets.

Inflationary pressures can surface under various guises. The authorities cannot avoid latent price increases which take various forms. Under conditions of excess demand, the producer lowers the quality or use value of goods so that *de facto* the consumer gets less per unit of expenditure. Real purchasing power declines, for now a larger expenditure is required to get the same utility. Producers tend to modify slightly the product (without commensurately affecting the quality) and the price authorities raise the relative price. At the same time the production of the cheaper product (which is still in demand) is discontinued. This spurious product differentiation is usually not in response to demand, but dictated by the producer's interests and often restricts choice. Thus it is not sufficient to examine the dynamics of overall consumption, but also its composition, for the structure shifts towards more expensive goods. Welfare is reduced when the available options are norrowed down. The consumer is then forced to buy the goods that are available instead of those that he really wants, or he is forced to postpone purchases. Thus arises the problem of *forced substitution* and savings. Shopping becomes a nightmare and the consumer pays a high price in annoyance, mistreatment, and waste of time. Purchasing power then cannot be equated with shopping power. This also gives rise to all sorts of graft, under-the-counter sales, and purchases from artisans. Inflation is also introduced through various "private" markets (e.g., buying and selling of private homes, antiques, jewelery, etc.) and the black markets (especially in sevices and repairs), where prices are considerably higher than the official price lists and tend to rise in relation to the increasing shortages on the official market. Consumers, increasingly frustrated by their pursuit of officially low-priced but unavailable or low quality goods, tend to revert to unofficial markets to procure used goods, to barter new goods, to commission custom-made goods, and to employ all sorts of intermediaries and speculators. The prices actually paid are not reflected in statistics. Although the center tends to take into account only the price changes it effects, the population is not only fully aware of latent inflation, but tends to overrate it.[22]

Market-type reforms tend to increase the risk of open inflation. One of the problems of using the allocative function of wages (premiums) to spur labor's performance is that in order for it to perform an incentive role the premium has to be sufficiently large, but then it would add to the difficulties in controlling spending

[22] Cf. *Rabotnichesko Delo*, Nov. 20, 1973; Csikos-Nagy, *Socialist Economic Policy*, Budapest, 1973; pp. 170–75; J. Kornai, *Rush Versus Hlarmonic Growth*, Amsterdam 1972, pp. 67 ff.; and W. F. Robinson, *The Pattern of Economic Reform in Hungary*, New York, 1973.

power. It is not certain that the extra pay would correspond to increased productivity which would be translated into an increased flow of consumer goods. But this is not an indictment, but rather an argument for effective macro and incomes policies. The poor record of Western economies in containing inflation is not sufficient evidence that the problem cannot be resolved more effectively in a socialist economy with a built-in market mechanism. Those who oppose market type reforms usually point to the inflationary upsurge of prices, substantial unemployment, and a deteriorating balance of payments in post-1965 Yugoslavia. But the argument emphasizes the peculiarities of the decentralized institutional arrangements and underrates mismanagement of macropolicy and structural factors. Also the critics of the Hungarian "new economic mechanism" pointed to the danger of inflation. These fears circumscribed the implementation of the blueprint. Reportedly, the postulution of relatively stable price level of consumer prices was one of the "main bounds on the 1968 price reform" in Hungary.[23] In Yugoslavia, inflation was denounced, (reminiscent of President Ford's statement, in another context) as "the enemy number one" of socialist society and its overcoming a key political priority. The concern about inflation is understandable (particularly pronounced in China). But it needs to be emphasized that the rise (actual or latent) of the general price level is hardly a meaningful measure of aggregate economic cost, nor is a stable price level a measure of aggregate gain.

VI

A dynamic economic system is evolving; present events are the result of preceding developments, which contribute, in turn, to the further development of the system. A dynamic economy is characterized by continuity and change. One of the basic problems is limited capacity of the system to adapt itself to change. The traditional system is never completely protected and sufficiently isolated from changing conditions in a dynamic world. With rigid prices, distortions manifest themselves with increasing intensity and removal of some of them becomes unavoidable. Periodic, one-shot, price revisions are required, inter alia, to mitigate the general and cumulative price distortions which initially appeared to be only faulty particular microeconomic cases. If, for no other reasons, fiscal expediency and control require strict limits on the peripery's liquidity (the budget constraint) and elimination of subsidies (or at least their concentration on fewer activities). In turn, financial rearrangements require modified prices. The increased stress on the self-supporting economic unit requires increased markups. But such an enlargement of enterprise liquidity makes it less susceptible to control. Still there is a world of difference between the periodic price revisions, which mainly aim at removing the subventions in the sphere of producer goods production and

[23] B. Csikos-Nagy "The New Hungarian Price System" in Friss (ed.) *Reform of the Economic Mechanism in Hungary*, Budapest 1969, p. 138.

at bringing producers' prices closer to costs, and the kind of price reform required to support an effective economic reform.

Price reform is a part of an overall economic reform and should be consistent with it. Just as it would be counterproductive to widen the scope of decisions at production levels without scarcity prices; provision of such prices without devolution of at least short-run production decisions would not be enough. A shift away from crude quantitative indices necessarily leads to greater reliance on prices as tools of economic calculation. In this respect the issue of congruence between tools of economic calculation at the center and the periphery assumes growing importance. By fixing or manipulating prices, the c.p. can influence the periphery's decisions. The issue is to make price-setting more consistent with plan construction and with the other instruments of plan execution (such as performance criteria, incentives, etc.), and also to allow for more flexibility to reflect changing environment and desiderata.

This raises the question of alternative methods of generating prices. Scarity (equilibrium) prices do not necessarily have to be formed on the market in its institutional sense. Such prices may be set up by a Lange-type CPB which performs the function of the market, or by the interaction of electric wires (obtained as the dual solution of a mathematical programming problem).[24] Not every scarcity price is necessarily an efficient price, for it might not account, for example, for externalities, social costs, market failures, etc., which should be taken into account, however imperfectly, in an optimal plan and in a Lange-type or genuine market by means of taxes, subsidies, etc.[25]

The touchstones of a price reform are: abolition of the dual price system; the extent to which producers' prices reflect scarcity; and the correspondence of domestic prices to the price structure on world markets. But prices which more readily reflect dynamic production conditions cannot be equated with efficiency, nor can the administrative locus of price-fixing be necessarily equated with arbitrariness. The question is not only of the principles underlying periodic price re-alignments, but of procedures for price mobility. The problem of the traditional system is not so much initially fallacious prices, but absence of a mechanism of adjustment towards equilibrium.

If prices are to be parameters for the periphery, each actor should be powerless to affect perceptibly the outcome. The c.p. fears that decentralization would strengthen the subunits' opportunities to manipulate prices. The planning process involves *bargaining* between participants, and the outcome depends on the relative power of the parties and on access to reliable information. Increased horizontal relations can only subject the seller to the "discipline of the market" if the economy is not overheated. The negotiated price depends on the relative power of

[24] O. Lange *Zycie Godpodarcze*, 43, 1965 and Feiwel "On the Economic Theory of Socialism: Reflections on Lange's Contribution", *Kykos* No. 3, 1972, pp. 601–618.

[25] Cf. Feiwel *The Soviet Quest For Economic Efficiency*, New York, 1972, Chapter 4.

negotiators. This depends on the *states of disequilibrium*, industrial structure, reciprocal choice of trading partners, etc. Often contractual parties merely fill out details in assignments predetermined by superiors. This sort of "adaptation to the specific conditions on the spot" is very restrictive, because, rather than satisfying each other, the actors are interested in "satisfying" their superiors.

With the persistance of fallacious, irrational (even from the vantage of planners preferences), and rigid price system, naturally the most expedient measures of reducing the distorting impact of "wrong coefficients of economic choice" is to narrow down the periphery's sphere of decision-making and give considerable weight to the indicators of physical planning and commands.

VII

Evidently, the legacies of traditional approach to planning and managing the economy are particularly overwhelming in pricing.

In STEs prices of producer goods perform very limited allocative functions and the bulk of allocations is centrally made. Reforms attempted to strengthen the allocative (informational) function of prices, but their success was limited. Broadly speaking the reforms attempted to modify direct centralism (traditional STE) into indirect centralism, but not into market socialism (Lange-type). Consistency requires that a reform either provide effective prices or the system will swing back to direct centralism. To the extent that producers' prices are below clearing levels, excess demand pressures will be exerted and physical allocation will necessarily remain and flourish. The dissipation of resources will be prevented by direct allocation to priority uses. Depending on the pay-off, the producer may seek to avoid production of underpriced scarce products and binding assignments in natura will proliferate. Thus partial decentralization, without appropriate price reform leads to creeping and cumulative recentralization.

On welfare grounds a system where consumers can spend their income freely is preferable to one without freedom of consumer's choice.[26] Production should be guided by consumer demand (as revealed in demand prices), which in a modified version would mean that production be sensitive to "consumer sovereignty," while key decisions on the structure of consumption are made at the center. Even the milder version is largely missed in direct centralism. Despite the exhortations to bring production more in line with consumer demand and some progress, the consumer still has little influence on what is produced. There are serious obstacles in adapting production, to demand even in spheres that do not encroach on the central planners prerogatives. To be sure, the central planner is not always interested in overruling consumer's preferences, if for no other reason than that should the same "value" of consumption be produced with smaller resources, the savings could be used to advance his own objectives. Essentially the system will

[26] O. Lange "On the Economic Theory of Socialism", pp. 98–104.

lack any specific set of rules that would make production more responsive to market conditions. Such a mechanism should not only ensure that changes in demand *invariably* lead to changes in production, but also that the producer be interested in aggressive innovation and that he should influence demand by providing the market with better products. In order for the market to influence the pattern of production, producers' prices should be brought into proportion with consumers' prices. The turnover tax should become a uniform rate on retail prices, so that producers' price ratios approximate consumers' price ratios, and tax collecion is shifted closer to final sale. Here also there are serious practical difficulties. Recall, even where more daring reforms were introduced (e.g., Hungary) traditional turnover tax continued to prevail partly due to the restricted scope of alterations allowed in the level and pattern of consumers' prices.

The managers (as sellers) prefer a state of seller's market, for a hungry buyer is less choosy and troublesome. Shortages force the consumer to find a solution and adapt himself to the system. As supply of consumer goods increases quantitatively, the buyer becomes more choosy. Overstocking forces the planner to use "downward price flexibility" as a device to get rid of unwanted goods. But upward price adjustments to choke off excess demand for some goods are unpopular. Interestingly, the Hungarian experience showed that the process of learning to adapt to the signals of the market was inordinately protracted and drastic price changes, rather than marginal variations, were required to elicit the desired response.[27] Since such large price changes are often prohibitive, the workability and elasticity of the mechanism tends to be overrated by market-oriented economists.[28]

In a larger perspective, the workability of the market in STEs has to be viewed under conditions of an overheated economy. The market works best under conditions of slack. The market method is not only ineffective when massive redirection of resources is required (as in a war economy), but it is also not forceful enough under conditions of strain, and to accomplish large-scale unusual adjustments, without undue time-lags and costs of waiting.[29] Assume, for example, that serious shortages of rolled steel have arisen. What could be expected from an increase in prices? The prices of capital goods and of some consumers' durables (e.g. automobiles) would have to be increased. If investment funds are not increased, the higher prices of capital goods would reduce the physical volume of investment, but it would not be easy to predict to what extent such a reduction in investment would influence the curtailment of demand for rolled steel. The situation would be similar in consumer durables. Price increases would reduce demand, but again it would be difficult to predict to what extent and after what

[27] Cf. R. Portes "Economic Reforms in Hungary" *American Economic Review* No. 2, 1970, p. 312, CF L. Csapo "The Hungarian Reform" in E. Kirschen (Ed.) *Economic Policies Compared, West & East*, Vol. I, Amsterdam, 1975.

[28] J. Kornai, *Anti-Equilibrium*, Amsterdam, 1971, passim.

[29] L. Robbins, *The Economic Problem in Peace and War*, London, 1947.

lapse of time. In order to equilibrate demand with the reduced supply of rolled steel, prices would have to be raised so that the reduction of demand from these two sources would be sufficient. This can only be achieved by trial and error. Moreover, should there be no considerable reduction in demand of the producer whose output is particularly "steel-intensive" (e.g., railroad cars or automobiles), the general reduction of investment and consumption would have to be very high. Such equilibrium would only be achieved with a time-lag during which the use of steel would exceed supply, and stocks would be depleted. It has been suggested that a much simpler and more expedient procedure would be to limit investment, taking into account general priorities and "steel-intensity," and also restrict production of durables. In case of the latter, prices would also be increased to the level where demand is more or less equilibrated with supply. As a result the distribution of steel among the various branches would be reduced and the production plans would be modified. Even with this method an increase in prices of rolled steel would be indicated if the shortages were of a recurring nature. Kalecki maintained that a centrally planned economy can overcome the major failures of the capitalist economy and the price mechanism may prove to be a characteristic feature of such a system.[30] Kalecki envisaged that the centrally planned (socialist) economy would solve the cardinal problems of effective demand and full and effective resource utilization, by determining appropriate relations between prices and costs (wages). Output and employment of human resources and productive capacity would not be limited by insufficiency of effective demand but primarily by availability of resources and knowledge how to use them and effective working arrangements for resource allocation and utilization. The question that really preoccupied Kalecki was how to deploy economic resources to enhance the real progress (manifested, inter alia, in the composition and intertemporal pattern of full employment output) which could be equitably shared by various strata of society.

The potential (efficiency) and limits (inefficiency) of the market in resource allocation is a vast subject.[31] The available state of knowledge of what the market can and cannot do and the macroeconomic condtitions for its effective operation would have to be analyzed in another article. One of the important questions is whether the mainstream (neoclassical) economics provides a therotical norm or conceptual framework to guide economic reformers in centrally planned economies.[32] If, at first we focus our attention merely on the major macroeconomic failure of market economy (output, employment and price instabilities), it is evident that a centrally planned economy could resort to a flexibility of prices in relation to wages, in order to maintain full-employment equilibrium, instead of relying on the production and employment contraction mechanism which serves to achieve "underemployment" equilibrium in a market economy. The centrally

[30] Cf. G. Feiwel, *Intellectual Capital of Michal Kalecki*, Knoxville, 1975.

[31] Cf. K. J. Arrow, *The Viability and Equity of Capitalism*, Vancover, 1976. L. Silk, *Capitalism*, New York, 1976 and Feiwel *Industrialization and Planning Under Polish Socialism*, New York, 1971.

[32] Cf. Feiwel, *Journal of Economic Literature*, December 1974, pp. 1322–1326.

planned economy provides an opportunity for resolving simultaneously the formidable problems of effective demand, capital accumulation, and income distribution. Appropriate conditions and safeguards are really needed to ensure that the potential is translated into reality.

In a modern capitalist economy, the oligopolistic and monopolistic factors involved in price formation significantly affect distribution (i.e. relation between prices and wage costs) in the course of the business cycle and even in the long-run process of growth.[33] In a centrally planned (socialist) economy, prices of consumer goods could be fixed by planning authorities in relation to wage costs in such a way as to achieve full utilization of productive capacity and "tolerable distribution," both in the short and in the long run. In practice, however, there appear to be major difficulties and institutional obstacles to even "moderately frequent and significant" price changes. In most of the existing socialist economies, there seems to be a deeply rooted propensity to effect changes by varying output, which is itself not objectionable if it were not for the institutionally correlated, inordinately protracted time-lags. There is a proverbial reluctance to rely on the "controlled price mechanism." It is probably true that the planners are less reluctant to revert to downward price adjustments and once they do, they advertise them loudly—rather than to upward changes. Various camouflage devices are used to disguise price increases in order to limit the increase of real wages or household incomes. Indeed, the planners have sometimes resorted to deliberate creation of unemployment, while underatilization of resources is commonplace. But what is being done is in sharp contradiction to what can be done.

Whatever the rationale of actual policies pursued, it is instructive to reflect on the following statement by Michal Kalecki:

"It is useful to consider what the effect of a reduction in investment in a socialist system would be. The workers released from the production of investment goods would be employed in consumption goods industries. The increased supply of these goods would be absorbed by means of a reduction of their prices. Since profits of the socialist industries would be equal to investment, prices would have to be reduced to the point where the decline in profits would be equal to the fall in the value of investment . . . Full employment would be maintained through the reduction of prices in relation to costs. In the capitalist system, however, the price-cost relationship . . . is maintained and profits fall by the same amount as investment plus capitalists' consumption through the reduction in output and employment. It is indeed paradoxical that, while the apologists of capitalism usually consider the "price mechanism" to be the great advantage of the capitalist system, price flexibility proves to be a characteristic feature of the socialist economy."[34]

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[33] Cf. M. Kalecki, *Theory of Evonomic Dynamics*, New York, 1965, Cf. P. Sylos-Labini, *Oligopoly and Technical Progress*, Cambridge, Mass., 1969.

[34] Kalecki, *Theory of Economic Dynamics*, pp. 62–63.