

The Possibility of Market Socialism

by John E. Roemer

Since the fall from power of Eastern Europe's ruling parties, during the amazing events of the autumn of 1989, most commentators in the West and the East alike have proclaimed the death of communism. If communism entails the dictatorship of a single party, the administrative and central allocation of most resources and commodities, and the ownership of all firms by the state, then I agree with the diagnosis. But such communism is only one possible variant of what can be called socialist society, in which firms are publicly owned and the state has considerable control over what Lenin dubbed "the commanding heights" of the economy. During the next seventy years, we may see the development of socialist economies that compare quite favorably with capitalist economies, not only with respect to the distribution of wealth and the eradication of poverty, but also with respect to the pattern of economic growth and political democracy. I say *may* see because I know of no forces ensuring that the kind of socialist society I shall describe here must come to be. On the other hand, I see no forces that make it impossible.

Many people believe that public ownership of firms implies the allocation of resources by a central body, without recourse to markets except perhaps at the retail level. But to me, public ownership means that the people, through a democratic political process, decide on how the social surplus will be used: on what investments the economy should make, and how profits should be distributed. So there is no reason why socialist economies cannot use markets to allocate resources. On my view, what sluggishness, inefficiency, and corruption have been seen in the economies of socialist states during the first seventy years of the socialist experiment can be largely explained by the absence of political democracy and the failure to use markets.

In brief, Eastern European countries can learn two things from the West: multiparty democracy and the use of markets to allocate resources. They would do well, however, to shun private ownership of capital.

Government Control of Investment

Market socialism is not a new idea. It was discussed by Oskar Lange in the 1930s, by Włodzimierz Brus in the 1970s, and by Alec Nove and others even more recently. The challenge is to design an economic mechanism in which (1) markets are used to allocate resources, including labor; (2) firms are publicly owned; and (3) government is able to control the commanding heights of the economy.

I take "the commanding heights" to be the pattern and level of investment, for investment is a capitalist economy's most volatile variable. This volatility explains the recessions and depressions that are characteristic of capitalism. Furthermore, the laissez-faire investment process does not achieve a socially desirable distribution of investment. In any market equilibrium, the total amount of investment must equal the total amount that citizens are willing to save. But people may not save as much as they should: they may underestimate their own needs later in life, or may suffer from weakness of will, or may not care sufficiently about future generations.

To compound the problem, many projects requiring massive social investment are public goods — the environment, for example, or a national public transportation system. Yet such investment is typically undersupplied by the market, even if people desire these goods. Economists like Lester Thurow accordingly argue that America's economic performance lags Japan's because the U.S. refuses to allow substantial government interference in the private sector's investment plan, whereas Japan relies on it. So public control of investment is insufficient to characterize socialism, although it is necessary.

In a recent work, my colleagues Ortuño and Silvestre and I have presented various blueprints showing how a market socialist economy would function. What follows is only a sketch.

Suppose that the government, through the public banking system, controls interest rates. It announces different interest rates at which public firms in different industrial sectors can borrow funds to invest, as well as an interest rate at which citizens can save or borrow. Unlike a capitalist economy, the state essentially subsidizes sectors in which it wants high investment by posting low interest rates for those sectors. It announces a high interest rate for citizens if it wants to encourage savings. Public firms are run by managers (elected by workers or appointed by government), who are instructed to *maximize profits*. Facing market prices and posted interest rates, managers use the profit criterion to decide upon their firm's level of investment.

Because of its interest-rate subsidy program, there will usually be a central bank deficit — assuming, that is, that the government aims at a total level of investment higher than would have been achieved in an unregulated capital market. For in this case it collects interest from firms that borrow at low rates and pays out interest to citizens who save at a high rate. The deficit is covered by taxation, which can be levied on either corporate profits or citizens' total income. A citizen's income consists of two parts: her wage income, derived from selling labor on a labor market whose prices are determined solely by supply and demand, and her social dividend, i.e., the fraction of corporate profits that she receives.

Can Market Socialism Work?

Can this economy work? It can indeed. For a given pattern and level of investment that the government wants to implement, there is a tax policy and set of interest rates consistent with a market equilibrium at which the desired pattern of investment is actually realized. In the market socialist economy, both citizens and firms act just as they would in a capitalist economy. Citizens sell their labor on labor markets for the going wage, and they spend their income as they choose, purchasing goods at market-clearing prices.

By the same token, firms maximize profits without government's directing either the composition of output or the allocation of goods to consumers. Firms are given no instructions concerning the amount of labor to hire, or goods to produce, or investment to make. Only one thing is forbidden: a black capital market. (For example, a firm able to borrow

from the central bank at 3 percent is not allowed to lend, at 5 percent, to a firm able to borrow from the bank only at 7 percent.)

Citizens' incomes are more equal in a market socialist equilibrium than a capitalist one because the profits of firms are distributed more equally. Granted, incomes are not entirely equal: differences due to differential values of labor remain. But the two chief goals of socialism — control over the investment process and a relatively equal distribution of income — are still achieved, even while all economic transactions are decentralized to the level of individual firms and consumers.

Objections and Replies

This view of market socialism will surely meet challenges. Let me try to anticipate and reply to some of them:

1. *Private ownership of firms, by shareholders who can trade their stock, is necessary to ensure that managers maximize profits. Managers of public firms in socialist countries only try to feather their own nests.*

It seems likely that managers of public enterprises (in the Soviet Union, for example) try to do as they are told. Yet what they are told to do isn't feasible. Managers are forced to barter and bribe for inputs they cannot obtain through official channels. When they are able to acquire what they need on markets and must sell their output to realize profits, a managerial culture will develop in which a successful manager will be seen as one who provides quality products and runs an efficient enterprise, as is the case in advanced capitalist countries. Banks, to whom firms must come for investment funds, will monitor the performance of managers much as they do in capitalist Japan today.

2. *The government will not hold public firms to hard budget constraints. It will bail out failing firms, thus preventing the market from fulfilling its function of eliminating inefficient operators.*

Government bails out big private firms in capitalist countries, too. So I imagine that large firms in both advanced capitalist and socialist economies will continue to be underwritten by governments. The other key to producing

efficiently run firms, besides managerial culture, is competition. The international market provides the needed competition if the sector is involved in international trade. In South Korea, for example, international competition has made publicly owned steel firms some of the most competitive steel producers in the world. If a sector produces goods that are not internationally traded, then domestic competition may be necessary to promote efficiency.

3. *In socialist countries, each sector will be dominated by one or a few large public firms. Firms will behave as monopolists or oligopolists, not as price-taking competitors.*

This point does require some amendment to the model I've proposed. Of course, we can say that the government should create a number of public firms in each sector whose technology is not characterized by large scale economies (natural monopoly). But there are other solutions that may be more realistic: encourage the formation of private firms, or worker-owned firms, or both. The latter could be subsidized by taxes. Drawn by the subsidy, some workers would choose to leave the public enterprise, using their knowledge of its technology to set up competing firms of their own.

4. *In a market socialist economy, innovation will be rare. Only entrepreneurs, with the lure of monopoly profits, create new commodities.*

If this is true, then the socialist economy would require not only worker-owned firms but possibly a private sector as well. Successful private firms should be nationalized, with proper compensation to their owners, after they reach a certain size. Their founders would still make personal fortunes sufficient to bring forth their entrepreneurial ideas.

5. *The economy you have described isn't socialist. The vast majority of citizens will still be wage workers with no control over production. Only an economy with democratically run firms can be socialist.*

Socialism isn't characterized by local ownership of firms by workers, but rather by public ownership, which means that citizens as a whole control the distribution of profits. An economy with only a worker-owned sector and without government intervention is not, in my view, socialist.

Democracy and Public Debate

Democracy, as we understand it today, is not simply a matter of majority rule. Democratic procedures supplement majoritarianism with constitutional restraints that, in turn, oblige majorities to submit their decisions to ongoing criticism. Not any "will," but only a will formed in uncensored public discussion, is (and should be) granted sovereign authority. The First Amendment, one might say, ensures that the electoral majority will remain a majority capable of learning. Stated differently, a legally guaranteed right of opposition provides an essential precondition for the formation of a democratic public opinion. Popular sovereignty is meaningless without rules organizing and protecting disagreement: consent confers no authority unless the possibility of unpunished dissent is institutionally guaranteed. Indeed, unanimity on political questions

may be a sign of irrationality rather than of rational agreement. As Mill wrote, "unity of opinion, unless resulting from the fullest and freest comparison of opposite opinions, is not desirable." For the sake of collective rationality, "a perpetual and standing Opposition" must be kept up. This way of thinking implies that the government has an affirmative obligation to protect and even encourage the expression of rival views. In the absence of public disagreement, of a civil kind, policies are likely to be unintelligent as well as badly skewed toward private interests.

Excerpted from Stephen Holmes, "Liberal Constraints on Private Power?: Reflections on the Origins and Rationale of Access Regulation," in *Democracy and the Mass Media*, ed. Judith Lichtenberg (Cambridge: Cambridge University Press, 1990).

6. In order to know what interest rates to set, so that they can influence firms' investment decisions as they wish to, the planners in a market socialist economy must know all the parameters of their economy: the technologies of firms, the preferences and labor skills of citizens. But they can never have such information. The virtue of capitalist market economies is that no economic actor needs so much knowledge.

Although, strictly speaking, this is true, the central planners will at least have estimates of demand, good information about the skills available in the working population, and some knowledge of technologies. So while the equilibrium that markets find, given a fixed set of interest rates, will not be exactly what the planners were aiming at, it will come close. As the planners watch the markets, they will adjust interest rates, just as the Federal Reserve Board adjusts the discount rate in our own economy.

Conclusion

It is too soon to say that market socialism will emerge in an Eastern European country or in the Soviet Union. The nationalist turmoils in the U.S.S.R. make it impossible to predict the outcome of any experiments with political democracy and the widespread introduction of markets. As for Eastern Europe, the experience with "communism" in certain countries has produced a deep cynicism that may preclude market socialist experiments in the near future. The

conditions for the emergence of market socialism are therefore far from optimal.

Nevertheless, I think that market socialism is on the historical agenda, although it may first appear in Scandinavia or Western Europe. Despite the clamor about privatization in recent years, the last century has witnessed a pronounced secular trend towards the increasing participation of the state in the economies of advanced capitalist countries. The trend will continue, for in these countries the working class keenly desires economic security, and its members have come to expect much more than capitalism can provide. As the environmental movement grows stronger, democratic control of investment may well become the political order of the day.

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Post-Communist Constitutionalism

by Karol Sołtan

Timothy Garton Ash had the right idea when he ended a recent article on the Revolution of 1989 by quoting the opening lines of *Pan Tadeusz*, a famous Polish poem by Adam Mickiewicz: "Lithuania, my fatherland! You are like health. / How much to cherish you only those can know, who have lost you." The nations now emerging from communism have learned to cherish more deeply the tradition of constitutional republicanism because they lost it under communist rule. Replace Lithuania with Europe, Ash suggests, and you will understand the politics of the Revolution of 1989. And Europe is above all a symbol for the liberal, the democratic, and the constitutionalist political and economic ideals.

Faith in these ideals shines through the events of 1989 in Eastern and Central Europe. In the West this faith is less intense after long years of the secure acceptance and successful functioning of independent courts, free markets, democratic politics, and other institutions of constitutional republicanism. In the East constitutional republicanism is now a deeply cherished faith, while in the West it is an institutional reality, accepted but perhaps less deeply loved. From the East we can relearn the value of constitutionalism, but its meaning must still be learned in the West. What the West, and the United States in particular, lacks in constitutionalist passion, it makes up for in the practical experience necessary for designing stable institutions. Those practical lessons will be especially important in Eastern and Central Europe when the

democratic faith runs into serious crises and begins to weaken.

A True Political Test

The moment of disillusionment is likely to arrive soon, especially where communism collapsed most dramatically. The nonviolent mass politics of idealism will be replaced by day-to-day politics: manipulation, pandering to special interests, interminable squabbling, senseless last-minute compromises. Disillusionment may also arise from economic failure, or from bitter conflict between nationalities and ethnic groups, or in response to old and new forms of hatred and irrationality. The idealists will adapt, or they will be outmaneuvered, or they will withdraw to better-protected higher terrain.

The moment of disillusionment will be dangerous — a true political test. Constitutionalist commitments will then either disintegrate, or they will be transformed and take root. At that moment it will not be enough to have in place a democratically elected parliament or a market. Such institutions by themselves have often been borrowed in the past, but have succumbed to dictatorship or degenerated, in new settings, into caricatures of their former selves. Constitutionalism is a broader answer to political disillusionment, not confined to a few institutions. It is a collection of strategies that limit the politics of narrow interest in order to serve larger ideals,