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On the Workability of Market Socialism

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In their preceding paper, Shleifer and Vishny argue that the theoretical case for market socialism "simply does not work"—indeed that it can never work—primarily for three reasons:

(a) "Under all forms of market socialism . . . the state ultimately controls the firms and hence the state's objectives must determine resource allocation."

(b) These objectives are such that governmental interest in economic efficiency is fundamentally implausible.

(c) Under socialism the government pursuing objectives that are inherent in the democratic process is likely to damage the economy much more than the same government under capitalism.

We strongly disagree with these three points. We shall argue that point a ignores the elaborate attempt in some recent market socialism proposals (including our own in the Summer 1992 issue of this journal) to take firms out of the orbit of state control, and that points b and c display a rather simple-minded (though popular in mainstream economics) theory of the state. We claim there are theoretical and empirical grounds for the belief that in some cases democratic socialism mitigates problems of economic inefficiency better than capitalism.

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Insulating the Firm from Undue Government Interference

Private property in financial and industrial assets is merely an institution which enables the government credibly to commit itself not to interfere in the economy. This institution may be embodied in a constitutional provision, and in legislation, courts, and other checks and balances, which render it costly for the government to take over the economy by nationalizing assets. The view of Shleifer and Vishny, and indeed of much of mainstream economics, seems to be that private property is the unique institution capable of sheltering the economy from undue state interference. But this is an unwarranted generalization based on two observations: that private property "works" and that bureaucratic, non-competitive, non-democratic central administration does not work. The ultimate guarantee—which can never be complete—that a given institution will shelter the economy from inefficient government intervention must be competition between political parties in a democratic environment. The government or party must fear being thrown out by a citizenry that will not tolerate unconstitutional behavior, and of permanently losing its reputation as a representative of the people, should it abrogate the legislative and constitutional provisions. This guarantee is, of course, better the stronger is the tradition of democracy in the country.

But there is no a priori reason that institutions other than private property cannot be erected to insulate private actors from undue state interference, institutions which could have different distributional consequences than private ownership. In the Summer 1992 issue of this journal, we proposed an incentive-compatible model of market socialism where competitive allocation of most commodities and resources was combined with a competitive political process, without replacing public ownership (in large firms) by traditional private ownership. In that paper we have quite explicitly tried to distinguish our proposal from earlier market-socialist ideas by emphasizing the crucial delinking of the management of large firms from state control; as we have described in our introduction on the history of market socialism in Bardhan and Roemer (1993) our proposal belongs to the fifth generation in the evolution of the market-socialist idea.

Much of our earlier paper in this journal was devoted to designing mechanisms of denationalization without privatization (Bardhan and Roemer, 1992). We proposed two ways of organizing market socialism: the *keiretsu* system of interlocking firms and the coupon stock market. In either of these systems, the enterprise is a joint stock company and decisions are decentralized at the enterprise level. The management is controlled by representatives of equity-owning workers, other affiliate firms (or mutual funds) and a main bank which orchestrates the monitoring. Banks are partly owned by the government, but partly by pension funds, insurance companies and other banks. We discussed in detail the various kinds of safeguards against executive interference in the operations of the banks. These safeguards are not foolproof and will operate with differential effectiveness in different political cultures. They primarily take the form of credible precommitments to and constitutional protections of the banks' autonomy.

Shleifer and Vishny dismiss all such safeguards rather casually as "smoke and mirrors." This nihilistic view belies not merely much of modern economic theory, which is devoted to designing institutions that will lead self-interested players to arrive at efficient outcomes, but also the plethora of political conventions and checks and balances through which democratic governments tend to precommit against undue interference.

Contrary to the charge made by Shleifer and Vishny that proposals for market socialism "obfuscate the importance of politicians' intentions," a major focus in our paper has been to design institutions and safeguards in the face of such intentions.[1]

Government Sometimes Seeks Efficiency

Without minimizing the issue of the evil designs of politicians and their pork-barrels, we would like to point out that mainstream economics has swung too much from its earlier naive presumption of a government optimizing social welfare to that of preoccupation with total malfeasance and patronage politics. The popular theories of the predatory or the rentier state derived from the public choice literature have obvious applicability in some cases, but are better at explaining failures than success stories.

After all, there are many cases where the state has shown some institutional coherence in the pursuit of collective economic goals, including goals of dynamic efficiency. For example, there have been some dramatic cases of state-led economic growth in the recent history of East Asia: the "developmental states" of Japan, South Korea and Taiwan, and most recently, the village and township enterprises owned by local governments in China are cases in point. It is true that in a democratic polity it is difficult to insulate the pursuit of economic efficiency from the ravages of pressure group politics, but the cases of postwar Japan, Austria, and the Scandinavian countries suggest that such insulation is not impossible in many sectors. (For a more detailed discussion of the issues in this and the preceding paragraph see the symposium on the "State and Economic Development" in the Summer 1990 issue of this journal and the symposium on "Democracy and Development" in the Summer 1993 issue.)

[1] In fact, many zealots of privatization do not show much sensitivity to this question of politicians' intentions when they support programs of bargain-basement sales of public enterprises to allies and clients of political bosses, converting public monopolies into lucrative private monopolies. Such cases of "crony capitalism" have not been infrequent in the recent rush to privatization in different parts of the world.

Democratic Socialism vs. Democratic Capitalism

Shleifer and Vishny claim that a democratic government does more damage under socialism than under capitalism, because under socialism the government has access to a larger part of the cash flow relative to the rest of the economy than under capitalism and thus has more money to pursue politically motivated inefficient projects. By this logic, the states in which government revenue is the largest fraction of GDP should be the most inefficient. Yet among industrial countries, the social-democratic countries where tax revenue as a proportion of GNP is nearly twice as large as in the United States are not the most inefficient. If anything, by most measures of economic growth or human development index (as computed, say, in the Human Development Report produced by the United Nations Development Program) most of them have performed better than the United States over the last few decades.

Moreover, democratic capitalism brings problems of its own. Shleifer and Vishny overlook the damage done to productive efficiency by a greater degree of economic inequality associated with concentrated private property rights. Across countries, some statistical studies have found a negative relationship between income inequality and the rate of economic growth; for example, in Cukierman, Hercowitz, and Leiderman (1992), see the papers by Persson and Tabellini and by Alesina and Rodrik. Democratic socialism is likely to have less inequality than democratic capitalism. This more egalitarian set-up makes it somewhat easier to overcome coordination failures in team production in the workplace, as well as in management of a whole host of "commons" problems. Shared sacrifices in macroeconomic policy adjustments are easier to bring about in more egalitarian contexts. In Bardhan and Roemer (1992) we have also argued that in an interest-group model of democracy the levels of certain profit-inducing public "bads" (like industrial pollution generated in the process of profitable economic activities) are likely to be lower when profits are more equally distributed, as in our market socialist regime, than under capitalism where profits are concentrated.[2] By ignoring these arguments, Shleifer and Vishny have failed to make a convincing case that under democracy socialism is more damaging to efficiency than capitalism.

Conclusion

The final paragraph of the Shleifer and Vishny paper suggests that the academic advocates of market socialism in the West are acting as unwitting supporters of the ex-nomenklatura in eastern Europe, "who inevitably talk about Sweden" but are only pursuing their vested interest in preserving the status quo. We take objection to such ascriptions of guilt by terminological

[2]For a general equilibrium analysis of this issue see Roemer (1994, section 8).

association. Their claim is every bit as unfair as attempts that have been made by others to brand the intellectual defenders of capitalism as the unwitting supporters of the Mafia-style racketeers who are now thriving in eastern Europe.

References

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