

COMMAND ECONOMY IN THEORY¹

1. NOTE ON ECONOMIC SYSTEMS

While there are few typical command economies left in the contemporary world, North Korea being the extreme case, the way they functioned and the reasons why they collapsed are still not too clear among wider circles of the academic community. Therefore it seems worth a while to outline the theoretical and practical aspects of the system in which the political priorities proved to be ultimately disastrous for the economic performance.

The comparative economic system analysis is rooted in the theory of systems. According to Ludwig von Bertalanffy, there are real systems, such as an atom, a dog or a galaxy, and conceptual systems, such as logics or music. Nevertheless he noticed that the difference between both kinds of systems is not as great as it seems. For instance ecological or economic systems are composed of real and conceptual components, such as nature, material goods, concepts, and values².

Frederick L. Pryor distinguished three major structural elements in economic systems: 1 – property (degree and pattern of nationalization, distribution of ownership, separation of ownership and control, and various aspects of centralization of control rights), 2 – motivation (goals of important property right holders or decision-makers and incentives to which they respond), 3 – information (information available to the various property right holders and types of information networks link these decision-makers to one another)³.

¹ This article is an extended version of a part of Chapter 13 of my book on *East Central Europe. A Concise History*, ISP PAN, Warsaw 2015.

² L. von Bertalanffy, *General system theory: foundations development, applications*, George Braziller, New York 1976, *passim*.

³ F.L. Pryor, *Property and Industrial Organization in Communist and Capitalist Nations*, Indiana University Press, Bloomington 1973, pp. 337 ff.

Vaclav Holesovsky thought economic systems to be subsystems in wider social systems, because 'there exists no special class of activities that are strictly economic, and other classes are strictly political, artistic, educational, religious, play-centered, and so on'. He distinguished the following elements of economic systems: 1 – resources, such as air, water, land, physical, chemical or biological properties of organic and inorganic things. Labor is also a resource, but very specific since it belongs to people who are not only producers and consumers but also persons. Technology is a resource but also a result of human work. The same refers to entrepreneurship which is a cultural and psychological rather than material element of economic systems; 2 – participants: individual people, groups, economic units (firms transforming inputs into outputs, households transforming outputs into real satisfaction, and the government providing collective goods such as safety); 3 – objectives and preferences: motivation in the decision-making processes. I would distinguish two major kinds of motivation: profit and power; 4 – hierarchy between participants since they are usually teams in which somebody has to make decisions for the whole unit; 5 – organization of the whole system. Holesovsky called it centralization and decentralization⁴. One should probably add rules or law. For instance, the weakness of contractual morality in Russia was an important factor checking capitalist accumulation in this country⁵. Further on Holesovsky suggested two classifications of economic systems: according to the type of ownership and according to the mode of allocation. As systems distinguished according to the type of ownership (authority to make decisions related to the use of the objects of ownership) he mentioned for instance feudalism, slavery, communes, capitalist partnership, corporate capitalism, tribal economies, Yugoslav self-management, forced labor camps and others. As systems distinguished according to the mode of allocation (the way resources are organized to be processed and the way the final products are distributed) he mentioned for example tribal economies, the Inca system, the Russian *mir*, craft guilds, cartels, Fascist regimentation, and centrally administered systems. Noteworthy, Holesovsky omitted free market capitalism of the 19th century⁶.

⁴ V. Holesovsky, *Economic Systems. Analysis and Comparison*, McGraw-Hill Book Co., New York 1977, p. 15.

⁵ A. Gerschenkron, *Economic Backwardness in Historical Perspective*, Praeger, New York 1965, pp. 19–20.

⁶ V. Holesovsky, *Economic Systems...*, *op. cit.*, pp. 38–85. Cf. also: A. Eckstein (ed.), *Comparison of Economic Systems. Theoretical and Methodological Approaches*, University of California Press, Berkeley 1971; G. Grossman, *Economic Systems*, Englewood Cliffs,

2. MARXIST-LENINIST-STALINIST LEGACY

The Soviet system of command or coercive economy was created on the foundations of the backward Russian economy, Marxism-Leninism and specific features added by the paranoid personality of Stalin.

The traditional Russian economy was troubled by the phenomenon known as the ‘vicious circle of backwardness’. The per capita income was very low and the substitution of labor by capital never really paid due to extremely low costs of labor. Nevertheless, thanks to a rapid industrialization since the 1880s, by 1917 Russia had the fifth largest industrial complex in the world. During the First World War and the Civil War of the years 1917–20 the damage was so intense that in 1920 the industrial output in Russia accounted for only about 15% of the 1913 level⁷. Accelerated industrialization was resumed under Stalin, according to the plans that were hotly debated in the 1920s.

When Stalin gained total control of the party, he urged to build as quickly as possible the country’s industrial and military power to ensure security of ‘socialism in one country’. He proceeded in three main directions. Firstly, it was the mobilization of all resources in the countryside, including collectivization of agriculture and deportation of millions of peasants (*kulaks*) to concentration camps. Secondly, it was elimination of the remains of private enterprise and subordination of the whole state economic hierarchy to the task of accelerated capital formation; in this way a highly centralized command economy was created on the grounds of an almost complete state ownership of means of production. Thirdly, the police terror was aimed at consolidating all the economic efforts. For instance in 1932 death penalty was introduced for robbery of the state property along with the obligation to have internal passports. Thus the Soviet citizens became the *glebae adscripti*. As a result of an unprecedented development of police terror the number of prisoners of the Gulag grew from about 900,000 in 1930 to about 12,000,000 in 1945 and about 15,000,000 in 1950. Including POWs and ‘free’ colonists forced to settle down in Siberia and elsewhere the number of the Soviet

N.J.: Prentice-Hall, Inc., 1974; J.H. Montias, *The Structure of Economic Systems*, Yale University Press, New Haven 1976; E. Neuberger, W. Duffy, *Comparative Economic Systems: A Decision-making Approach*, Allyn and Bacon, Boston 1976.

⁷ Cf. N. Spulber, *Soviet Strategy for Economic Growth*, Indiana University Press, Bloomington 1964; A. Erlich, *The Soviet Industrialization Debate 1924–1928*, Harvard University Press, Cambridge 1960.

forced laborers amounted to about 20,000,000 in 1950 (about 10% of the population)⁸.

Ever since the Soviet economy has always been in a hurry to raise itself from backwardness to industrial and military power. Nevertheless, the method of the Soviet industrialization was quite opposite to that of the first industrial revolution in England and elsewhere. While the industrial revolution of the 18th century grew naturally on the soil of the market economy and was started in the consumer industries which created not only supply (e.g. textiles, shirts) but also demand (wages), the Soviet industrialization was forced from above at the costs of mass consumers and referred primarily to the heavy industrial complex.

The Soviet economy as shaped in the 1930s can be depicted as an enormous bureaucratic pyramid. All the significant decisions were always made at the top. Even a surprising number of detailed decisions were made by the dictators themselves. For instance Nikita Khrushchev planned to grow corn in Siberia. Decisions of the dictators, their politburos or planning commissions were then transmitted via extensive intermediate levels of economic bureaucracy to the bottom tier, consisting of millions of individual enterprises in all branches of the national economy, whose main task was to carry out directives from above⁹.

By the end of the 1930s the Soviets have created a unique political dictatorship but also a unique type of a command economy. When in 1945 the Soviet armies occupied vast territories of East Central Europe the Soviet type of a command economy was to be introduced into countries which had formerly been less developed than Western Europe but which had a long tradition of the rule of law and private property rights.

3. SYSTEMS LIMITED BY DEMAND AND BY RESOURCES

According to Janos Kornai, there are two types of contemporary economic systems: those limited by demand and those limited by resources¹⁰. For systems limited by demand it is characteristic to face surplus of capital, labor, power, raw materials etc. but they face a shortage of demand. In systems limited by resources the productive capacity is determined by the

⁸ S. Rosefielde, *An Assessment of the Sources and Uses of Gulag Forced Labour 1929–1956*, „Soviet Studies”, Vol. xxxiii, No. 1, p. 65.

⁹ G. Grossman, *Economic Systems...*, *op. cit.*, pp. 94–111.

¹⁰ J. Kornai, *Niedobór w gospodarce*, PWE, Warsaw 1985, pp. 58 ff.

resource in the shortest supply, even if other resources are available. Shortage of any resource results in a decrease of output by the enterprise or in a forced substitution: utilization of a resource of worse quality or adjustment of the structure of production to available resources. These effects are rapidly transmitted to other enterprises. Because of forced substitution shortage in one field involves other shortages what detaches the real supply from what was planned. Shortage has not only material effects, it also increases nervousness and confusion what leads to an even less effective utilization of the still available resources. The first type of economic systems is usually associated with modern market economies, the second one with the centrally controlled economies.

The market system can be characterized by the following features. Firstly, it is based on pluralism of ownership and independence of economic units what leads to, secondly, the domination of horizontal contacts between firms, institutions, and households which determine prices in a free game of supply and demand, even if this game is sometimes limited by monopolies or government intervention. Thirdly, it is based on the exchange of values (there are few relations free of charge) what is a certain shortcoming of the market mechanism since the market does not appreciate ‘merit goods’ (such as education, culture, health service, recreation etc.) or limits universal access to these goods. Fourthly, the market system is dominated by remunerative motivation, while normative or coercive incentives are marginal¹¹.

Leszek Balcerowicz described the basic distinction between the command and market economies. There are, in his opinion, four basic elements of the command economic system. Firstly, there is a hierarchically organized, state-owned monopoly of various economic activities. Since the central command center has a limited knowledge of individual economic units, the planned economy inevitably reduces the number of subjects it has to deal with. This can be achieved only by creation of a multi-layer structure in which units performing similar tasks are closely interrelated. As a result, the supply of goods is strongly monopolized and the information channels extended. The overwhelming nationalization is frequently thought to be the basic reason for attitudes of enterprise management and employees leading to the ‘economics of shortage’. Secondly, the command system is based on prices fixed by state administration. Since it is the ambition of the central command center to determine the size and structure of output, there is no need for market prices. In such a system the market mechanism could deviate the output structure

¹¹ L. Balcerowicz, *Systemy gospodarcze*, SGPiS, Warsaw 1989, pp. 148–199.

from that desired by the center. Moreover, with the strong monopoly of supply, free prices would mean inflation. Thirdly, there is the 'soft budget constraint', which means that in case of any real or alleged trouble the enterprise may easily get support from the budget. As the enterprise is not the owner of its assets, its management must obey the rules received from above, but at the same time the management may, right or wrong, claim its failure to be a result of an unfavorable situation within the central plan (prices, allotment of funds, manpower etc.). Fourthly, the command economy is strictly isolated from the external markets by the state foreign trade monopoly. The export and import transactions have to go through special foreign trade enterprises. Such trade is time-consuming and not flexible, while the economic effects of home enterprises are not comparable with costs and prices abroad, as foreign currencies are strictly controlled and their rates are fixed voluntarily by the state, just like the home prices.

The command system as described above works relatively well in countries with simple economic structures, in times of war, postwar reconstruction or in countries disposing of abundance of cheap resources of manpower, raw materials, and natural environment. Even there, however, it produces a social and political system which ultimately becomes the most serious check to modernization and rationalization of economy. Since the whole system is based on a hierarchical structure of power and a decision-making monopoly, economic decisions are made according to the political criteria. Maintenance and strengthening of power becomes the basic criterion of economic decisions. Economic planning degenerates due to absolute voluntarism of political rulers.

4. FORM OF OWNERSHIP

One of the basic distinctions of the command systems is the form of property ownership. This criterion was particularly stressed by Marx, but it holds true for most modern economies as well. Ownership refers to the right of control, use, disposal, and benefit from tangible or intangible assets. In the case of a private owner these rights rest with an individual. Nevertheless the private property rights are usually confined by numerous restrictions, such as property and income taxes, building, housing, safety, and sanitary codes, nuisance abatement regulations, labor laws etc. Last but not least, the state always has a power to force the owner to sell his property or a part of it to the state for legitimate public purposes (roads, railways, canals etc.) against more

or less fair compensation. Therefore there is no such a thing as an absolute right of private property.

Private ownership has important functions. Firstly, it plays a major role in determining the distribution of wealth, income, and power in a society. Secondly, it helps determine the degree of decentralization of economic decisions and thus is the foundation of market relations. Thirdly, it preserves and maintains the society's capital since private owners look after their own. Fourthly, by the mechanism of personal gains private ownership is a strong incentive for the continued increase of the society's capital. Fifthly, it provides the owners with economic and political security, although in some cases this security is also threatened by the very market mechanism. Private ownership should be treated as a means to certain ends and not an end itself¹². Otherwise the market mechanism may lead to serious abuse as was clearly the case in the recent economic depression that started in 2008¹³. In contemporary market economies private ownership is complicated by the corporate or communal forms of ownership in which rights belong to a group of people who emerge managements responsible for making decisions. In the case of public property the problem is even more complicated since the number of owners is not precisely defined and the range of their property rights is not clearly defined. Ultimately the national property belongs to all members of the nation, but there are various political ways of emerging the nation's representatives and, besides, the state sector cannot function as one, huge enterprise. The necessity to divide state-owned property into smaller enterprises complicates the nature and exercise of public property rights.

It is useful here to quote seven types of ownership of means of production as specified by Balcerowicz. First, it is a centralized state property. Second, it is a decentralized state property. In both types enterprises are (a) established by the state which also (b) appoints management; (c) there are no individual shareholders, so even if the enterprise has the shape of a stock company the only owner is the state; the only difference between these types is the range of autonomy in current decision-making, sometimes even referring to investment decisions; on the whole the three common features determine

¹² G. Grossman, *Economic Systems...*, *op. cit.*, pp. 20–23.

¹³ The extent to which this depression was caused by the shortcomings of the market economy and to what extent it was a result of the lack of the market mechanism is a matter of serious debates. In my opinion, it all boils down to the basic limitation of freedom in the classical liberal theory: freedom of some actors may not limit the freedom of choice of other actors. One of such limitation mechanisms refers to disinformation.

subordination of this type of property to the state requisitioning procedure). Third, there is an employee self-management property of the Yugoslav type. Fourth, there is a true cooperative property based on (a) wide autonomy of the enterprise, (b) decisions made by the cooperative self-management based on employees who (c) are shareholders but (d) influence decisions regardless of the size of share. Fifth, there is a joint stock form property in which the influence on decisions depends on the share in the company's capital and which are largely independent from the government. Sixth, there may be an individual property based on hired labor, and, seventh, individual property based on the owner's labor.

The three first types of property belong to the command systems, while the three last ones to the market economy. The cooperative property is more likely to appear in its true form in the market economy, although sometimes autonomic cooperatives were tolerated in the command economies along with marginal private entrepreneurship. Nevertheless in this case all these autonomic types of property were only marginal and their autonomy was a matter of changing regulations¹⁴.

Generally speaking, market economies have the prevailing share of private ownership, while the command economies are dominated by the state ownership. In 1960 the percentage share of government ownership in the national property of the United States was 22%, in Japan it was 33%, in France it was 59% and in the USSR it was practically close to 100%¹⁵. Prevailing state ownership is a foundation of the command economy but the correlation is not complete. The Nazi economy in Germany from 1933 to 1945 may be called a command economy with the prevailing private ownership, while the Yugoslav command economy was to an extent market driven with the prevailing public ownership.

While market economies are, generally speaking, decentralized systems and command economies are centralized systems, the degree of centralization of decisions in both systems may differ. In the market system centralization of economic decisions and functions usually means a transfer of decisions from independent economic units to some governmental bodies and a transfer from a lower level of government to a higher one or monopolization. In the command system centralization essentially means the moving of decisions from the lower to the higher levels of administration. Centralization in the command economy is necessary to impose the will of the decision-making bodies

¹⁴ L. Balcerowicz, *Systemy gospodarcze...*, *op. cit.*, pp. 89–108.

¹⁵ F.L. Pryor, *Property and Industrial Organization...*, *op. cit.*, pp. 14–15.

on the subordinate units but it is not very effective due to the bureaucratic logic of minimizing risk¹⁶. Decentralization means shortening of information channels, lower costs, greater speed and less risk of distortion of information. Centralization usually limits initiative and responsibility, as well as tends to justify itself what frequently prompts further centralization. On the other hand centralization has also some advantages. Firstly, it may safeguard or promote collective interests and priorities. Secondly, it allows for a quick, large-scale transfer of resources, what is desired especially in times of war or accelerated industrialization under adverse conditions (for instance abundance of manpower). Thirdly, it takes into account the external economies, or spheres of social life which are usually disregarded by individual firms (river regulation, environmental protection, infrastructure etc.). Fourthly, it may moderate socially disruptive and harmful results of social bargaining in the marketplace (support for the farms, antimonopoly legislation, intervention in labor disputes, public works for the unemployed etc.)¹⁷. All economic systems face the problem of centralization and decentralization, but this does not change the general difference in terms of centralization between the market and command economies.

5. METHOD OF COORDINATION

The most important aspect of adjustment in any economic system is the coordination of the activities of millions of individual participating units. There are basically three such coordination or regulation mechanisms: tradition, market and command¹⁸. In pre-modern times tradition determined such basic economic relations as slavery, serf duties, minting currencies and so forth. In modern economy the role of tradition was diminished but also plays a role, for instance in the case of charity, tipping, some aspects of the employer-employee relations or professional standards. But the two basic methods of coordination or allocation include those based on the market mechanism and on coercion or command.

The market mechanism has been at the center of attention of economies for centuries but there is no clear definition of it. According to Gregory Grossman, it satisfies three conditions. Firstly, individual economic units by

¹⁶ P.H. Dembinski, *The Logic of the Planned Economy*, Clarendon Press, Oxford 1991, p. 106.

¹⁷ . Grossman, *Economic Systems...*, *op. cit.*, pp. 32–35.

¹⁸ *Ibidem*, pp. 18 ff.

and large decide themselves what, how, where, and when to produce and consume. Secondly, they act with reference to the universal terms which they can only exceptionally influence – prices in the broadest sense of the word (prices, wages, rates of exchange, tax rates, interests and so on). Thirdly, prices are more or less determined by supply and demand for individual goods and factors, the final result being as a rule an equilibrium of demand and supply at certain prices. This describes the basic idea of Adam Smith's 'invisible hand'.

In the command economy individual economic units – mostly firms and not the households – are ordered what, when, where, how and how much to produce and to consume. These commands derive from attempts to direct the economy as a whole toward definite goals. These attempts, called the planning, have never been too accurate because modern economic life is too complicated for any decision-making center to master. The bureaucratic control and regulation could have been effective in ancient Egypt of the pharaohs with its small number of products and services to be gathered and distributed, but not given the complexity of contemporary economic life.

Essential for understanding mechanisms of coordination are types of motivation. Generally speaking, there are three basic ways in which an individual may be motivated in his economic activities: remuneration for his performance, command to do something: to pay taxes or to contribute labor as a slave (coercive incentive) and realization of common good or ideals (normative incentive)¹⁹. In market economies remuneration prevails but other motifs can also be noticed. In command economies the domination of command usually deforms the first and the third type of motivation.

In both kinds of economic systems there is always a mixture of all the three basic motivations. Coercion is rather poorly suited to stimulate creativity. If applied alone, it alienates the individual turning him into an unwilling machine, a malingerer or even a saboteur. Nevertheless coercion has proved to be a powerful motivation in times of war or in systems based on a hierarchical subordination of the individual to the ruling center. An unfortunate exception is the 'economic coercion' in market economies when the abundance of labor allows the entrepreneur to dictate work conditions and thus to enforce higher efficiency. Normative power is something else because it is largely dependent on the individual's consent to perform action because of some higher ideals or values he shares with the community. Sometimes the normative power of the social rules is strongly connected with the coercive

¹⁹ A. Etzioni, *A Comparative Analysis of Complex Organizations*, Ill.: The Free Press, Glencoe 1961, pp. 3–82.

power of the system which imposes its values and punishes for noncompliance (e.g. Stalinism). Normative motivation is more likely to be genuine in small voluntary communities such as religious orders or the Israeli *kibbutz* than in large systems in which normative power is connected with coercion.

The market methods of coordination are more connected with the remunerative incentives, while the command methods rely on coercive and normative power. The real condition of the command system is therefore power based on the ownership of the means of production, on the political monopoly and on the control of information flows. In this sense the Marxist model of triple domination of the bourgeoisie has really been materialized in communism in the shape of a triple domination of the ruling *nomenklatura* which monopolized various sources of power, including also scientific expertise, armed forces and police, education, moral authorities, and ideological symbols.

Planning as a method of large scale coordination has always required coercion. Communist party programs stated that overwhelming nationalization and the monopoly of power were two prerequisites of effective economic planning. The command system's planning ability was always nothing else than the power to requisition goods and services from the society. The term 'requisitioning' indicates that the system not just appropriated the necessary resources, but claimed the right to use them any time for what it believed to be the greater good of the society, and in reality –for the greater good of the system. Of course, there were and there are geographical and natural limits of requisitioning. Firstly, it was limited by national frontiers, beyond which the system could obtain goods and services only by means of trade. Foreign trade partners were not ready to accept the internal rules of requisitioning. Therefore, to isolate the internal system from the unfamiliar and uncomfortable contacts with the outside world, special agencies were established to deal with foreign trade, under special control of the system. Thus the foreign trade monopoly was established in all command economies as another crucial foundation of the command system. Secondly, inside its geographical frontiers the command system's requisitioning power was also limited by ecology. This was very rarely realized by ideologists and politicians who claimed to possess special skills in mastering nature, so the natural environment was usually treated as a free resource and thoroughly destroyed.

Market and command methods of coordination can be considered from two basic points of view: efficiency and justice. From its beginning, capitalism was connected with a new concept of human nature. Adam Smith stressed human self-love as a central motive for human action. The same referred to

John Stuart Mill²⁰. In recent times capitalism is also associated with freedom. According to the US President Woodrow Wilson, 'If America is not to have free enterprise, then she can have freedom of no sort whatsoever'²¹. In fact market exchanges have to be voluntary. Coercive exchanges, such as theft or taxation, are not market exchanges. For a century after publication of Smith's 'The Wealth of Nations' both critics and supporters of the market economy usually agreed that more wealth was realized with free market than with any nonmarket alternative known at that time and that by a higher efficiency the system is likely to safeguard more freedom to the individual than any other. At the end of the 19th century an alternative to market economy and capitalism was created: socialism. Its theoreticians came to think that more social justice would be achieved if the economy was brought under control of the whole society. These theoreticians were usually convinced that more justice would mean more efficiency and thus more freedom. This dream has not come true in any command economy. Nationalization and state control brought about expropriation and lower income stratification. Some authors thought this to be more justice. But at the same time the command system proved to be less efficient than the market system and failed to materialize the freedom which the prophets of socialism predicted.

In the command system the mechanism of coordination is based on the state bureaucracy. It is the task of the central economic decision-making body to periodically formulate plans including the size and structure of output, consumption, exports and imports, central balance sheets of resources and to issue commands to the subordinate economic units (ministries, associations, factories). The command system prices are, therefore, fixed regardless of the supply and demand mechanism. Due to the inaccuracy of information and specific behavior of lower managements, the decision-making center has to coordinate all economic activities also 'ex post', in the course of realization of the plan targets. This system is complicated by shortage of information. The information barrier of the command coordination results in several problems. Aggregation of supply and demand is necessary which means that their detailed quality and time structure are usually ignored, Therefore it is up to the suppliers and recipients to fix these details. The balance sheets of resources and plan targets are prepared on the grounds of information sup-

²⁰ R. Schmitt, *The Desire for Private Gain*, [in:] T.R. Machan (ed.), *The Main Debate. Communism versus Capitalism*, Random House, New York 1987, p. 163.

²¹ Quoted according to: D. Horowitz (ed.), *Containment and Revolution*, Beacon Press, Boston 1967, p. 28. Cf. also: F.A. Hayek, *Individualism and Economic Order*, H. Regnery Co., Chicago 1948; J.M. Montias, *The Structure of Economic...*, *op. cit.*

plied by the economic units which tend to distort this information for their benefit. Not all resources and products can be specified or even aggregated (e.g. spare parts). Some of them must be left for the economic units to negotiate. Horizontal negotiations between economic units cannot be controlled by the planning apparatus. These negotiations have only a 'quasi-market' nature because the negotiating parties are subject to hierarchical control of the size and structure of output. This is why economic units frequently ask their superiors to influence potential suppliers. The command system cannot entirely eliminate the free market of consumer goods since it includes independent households. Even if it is suppressed, the market mechanism in the consumer market survives in the shape of black market, its prices burdened by the cost of risk. The degree of control of the command coordination may be bigger or smaller, which depends on the precision and honesty of the bureaucratic apparatus or the degree of coercion exercised by the center.

The market economy is based on a link between the decision-making powers of enterprises and their responsibility. In order to survive the market enterprise is constantly forced to answer three questions: what, how and for whom it should produce. In the command economy these questions are answered in an entirely different way. Firstly, it is up to the decision-making center to decide what the enterprise is to produce. The funds that enterprises receive for their activities are also closely connected with the planned targets. Secondly, the enterprise is in a much better situation as to how it is expected to fulfill the plan target. The management knows best its own technological potential and chances and also has almost a monopoly on the information it supplies the center. Even if the center wants to impose certain solutions, the management always has a room of maneuver, if only in the shape of distortion of information. Thirdly, the enterprise is expected to supply its output to other state enterprises, but its management can choose those which one it prefers.

This logic results from the seller's market immanent in the command economy. In the command system, which is an economy of shortage, 'the seller thinks he supplies the buyer with something really "serious" (...). What he receives in return he does not treat as anything really "serious"'. The effects of the seller's market are as follows: the seller prefers buyers who do not make trouble, thence buyers must tolerate sellers who do not keep terms, such as quality, promptness of delivery and so forth. Moreover, this situation stimulates buyers to reach out to the sellers, not only in terms of words but also deeds, for instance with services connected with the purchase. Since most state-owned enterprises are buyers and sellers at the same time, they usually create a chain of mutual 'invisible' services. Frequently they join 'banks of

common benefits'²². Thus the pricing mechanism in the command system implies a lot of extra bargaining whose results – ‘common benefits’ – are not counted in the statistical price evidence. Although modern market economies are also dominated by monopolies, the state-owned enterprises in command economies are even closer to the position of an ideal monopolist. As a result the producer in the command economy produced what was ‘the easiest and the most comfortable to him and not to the consumer’²³.

Kornai presented a model of a market in which lines are formed to buy products. Lines are a normal phenomenon in the command systems. As long as their length is stable, they do not indicate a particular crisis of the system. Microeconomic organizations have to get used to the lines which may occur even if the output and income are growing. It is only a sudden increase of the length of lines that indicates that something is going wrong²⁴.

The experience of two or three generations living in ‘real socialism’, as the communist command economies were official called, included shortages in the consumer market. These shortages have developed a special instinctive behavior. Even if people realized that forced savings were a loss, interest being usually lower than the rate of inflation, they had to keep some savings if they wanted to acquire an apartment or other goods sold on the pre-payment principle. Also to be able to buy an article of short supply, when it ‘was thrown into the market’, as the saying went, some extra cash was needed to be kept and it was usually better to keep it in a savings account than at home. Plain state robbery, such as the currency exchange without full compensation (e.g. Poland in 1950), made the money-users really desperate. They could not make either way: keeping cash at home could lead to an even bigger loss. Generations of socialist consumers were used to ‘hunting’ for goods. The common reaction was: if you see a shop without a line, do not bother to see what they do not have, but if there is a line in front of a shop, be quick and stand at the end to ask what is available or expected.

If all economic units could fulfill all their duties both in terms of quantity and quality, the command system would have no problems in planning. Since this has not been the case, the system had to choose between allowing enterprises to act as economic agents (which would, however, require their full freedom of action, resignation from influencing prices, and ultimately – appropriation) or else it had to subordinate the enterprises to its strict control.

²² J. Kornai, *Niedobór w gospodarce*, op. cit., pp. 115–116 and 157.

²³ E. Lipiński, *Problemy, pytania, wątpliwości*, PWE, Warsaw 1981, p. 648.

²⁴ J. Kornai, *Niedobór w gospodarce*, op. cit., pp. 179–184.

In the first case the system would cease to be a command economy and become a market economy, so for ideological reasons, and also for the egoist motivation of the state bureaucracy or *nomenklatura*, the system remained hardly changed.

Since the command system is based on the labor theory of value and as it does not need market mechanism to tune broadly understood prices, it would most likely prefer to do without prices at all and see the whole economy administered only in physical units. But to compensate the inadequacy and lack of precision in the planning procedures, it must keep prices as a way of aggregation or accounting. In treating labor requisitioned from households as the only source of value the command system falls into its own trap: in theory the whole value of labor should be returned to households. Having set the prices of goods in accordance with the labor theory of value, the system would not have access to the goods it needs, since the purchasing power of the households should be sufficient to buy up everything they produced. Therefore total wages must be less than the value of production at least for replacement investments. The difference that the system deducts from the value of goods manufactured by the households is, according to Oskar Lange, 'the price the consumer has to pay for living in a socialist society'²⁵. Indeed, it was always a heavy price. In order to be able to derive some surplus value from the 'socialist' economy the system adjusted the accounting method. The return on labor was divided into two parts: that paid to the worker in the form of wages and that which theoretically belonged to the worker but which the system appropriated to help build the 'promised society'. Consumer goods were usually priced above their labor value, while investment goods which the government bought and sold within its own sector of the economy were always priced much lower.

The coordination mechanism in a perfect market economy is different. The market mechanism tends to bring the amount of goods demanded and the amount supplied into equality thus permitting a generally orderly and efficient use of resources and satisfaction of needs. The market coordination mechanism has a lot of advantages but there are serious shortcomings of the market mechanism as well. Firstly, it has a tendency toward less than full employment. Secondly, aggregating separate individual decisions, it has a tendency toward instability (prosperity or depression, inflation or deflation). Thirdly, it neglects external economies (e.g. education of workers, environmental protection). Fourthly, market pricing allows fraud or deception of buyers (e.g. advertising unhealthy products). Fifth, it usually implies

²⁵ Quote according to: P.H. Dembinski, *The Logic of the Planned Economy*, *op. cit.*, p. 98.

a 'short time horizon' of individual decisions what may lead to inefficient use of resources. Sixth, the market pricing tends to bias production in favor of marketable products – sometimes creating artificial demand – at the costs of valuable products. The command system changed the nature of some of the market system problems but also added new problems, such as overutilization of resources and high costs of economic growth.

6. 'SOFT BUDGET CONSTRAINT'

Another specific phenomenon of the command economies is the 'soft budget constraint'. In market economies enterprises can survive if they succeed in ensuring that their revenues at least equal their expenditure. Since in the command economy all enterprises belong to the same owner, it is essential for the whole system to balance revenues and expenditures. Thence it is virtually impossible to draw a clear line between the budget, individual enterprises and its state environment. State enterprises are also the largest purchasers of other state enterprises. This means that in most cases the state purchaser buys from the state seller. Ultimately the same money means budget revenues and spending. By means of overwhelming nationalization the architects of the command system extended the functions of the budget which became not only a balance sheet of the traditional government revenues and expenditures but also a balance sheet of the whole economy.

Division of the whole state economy into enterprises became a necessity for the Bolshevik government soon after the revolution, when the policy of strict, bureaucratic control of acquisition and distribution of goods failed during the War Communism of the years 1918–1921, despite a mammoth bureaucratic apparatus which had developed out of the desire to bring all economic activities under state control. From the early 1920s the Soviet government considered introduction of a method to separate the revenues and expenditures of enterprises or at least their net incomes from the budget. Under a system called *khazraschet*, finally introduced in the 1930s, enterprises had to keep comprehensive accounts of their production costs and to make their receipts exceed their costs²⁶. The new system helped, but only a little. Since plan targets and prices were fixed by the state, the enterprise's freedom of action was practically

²⁶ Although Alec Nove's, *An Economic History of the U.S.S.R.* (Pelikan Books, 1972) is to some extent biased as it ignores the use of forced labor, his remarks on the *khazraschet* may be accepted (p. 87, 212 and 265).

none. The *khazraschet* system was nothing more than an accounting method. It could not change the lack of the decision-making power of enterprises, raise their responsibility and efficiency. Moreover, since the approved method of accounting treated government grants and other subsidies as income, the accounting units could easily be prevented from making a loss. In case of trouble the managements could claim that the prices fixed for their goods were particularly unfavorable and that problems were not their fault. This is how the 'soft budget constraint' was created. Certainty that in case of trouble the central authorities may give the enterprise management with good connections 'above' a helping hand, has had a demoralizing effect on the rationality of microeconomic decisions in command economies. Stories of directors who sought a way to produce a deficit in their enterprises to receive more funds from 'above', well reflected the absurd reality of 'socialism'.

In a perfect market economy the management is responsible for the net result of the enterprise. In the command economy enterprises are responsible only for the output. Once they obtain the plan targets, they do not have to bother about profitability and the market. Their major headache is how to acquire sufficient resources, but the financial side of their activity is never the real problem. In the command economy the enterprise is not threatened with extinction. If it fails to balance receipts and expenditures, the whole system must bear all the risk and cover all enterprise failures. The absence of clearly defined responsibility makes the enterprise managers think not in terms of the net income but mainly in terms of minimizing the risk of not fulfilling the plan. In a way enterprise managements are an enemy of the command economy. Their attention and energy is mostly directed toward security and personal interest and diverted away from efficiency. In practice they were usually engaged in a struggle with the requisitioning practices of the upper strata of the bureaucratic apparatus which wanted to impose their requisitioning powers. They were also sensitive to the bank-of-common-benefit methods or pure bribery.

As a result of the 'soft budget constraint' money plays a very specific role in command economies. During the War Communism the Bolshevik leaders assumed that money would be altogether eliminated. These plans failed, but the command economy went a long way towards depriving money of its basic functions. Pawel Dembinski distinguished four spheres of economic relations in command economies: 1 – the external sphere (relationships between the socialized sector and other countries), 2 – the socialized sphere (relationships between enterprises), 3 – the consumer sphere (relationships between enterprises and households), and 4 – the private sphere (relationships between

households). There are also four basic uses of money whose conditions are as follows: 1 – as a unit of account money should be an abstract unit used at least by one of the partners in an economic transaction, 2 – as a means of payment it must be acknowledged by both partners, 3 – as a store of wealth it must function as a means of payment and in addition its holder must be able to decide when he will use it, 4 – as a standard of value it must be used by both partners to express their valuations concerning the transaction. While in the private sphere all functions of money are represented, in the consumer sphere only the three former ones, in the socialized sphere only two former ones and in the external sphere only the first function.

Since it is impossible to introduce planning based on purely physical units, money proves to be indispensable. Thence the command system uses money as an essential instrument for affecting controls and adjustments at the microeconomic level. The system of financial relations of enterprises with the ‘center’ is then extremely complicated by imposition of various categories of expenditures (supplies, investments, payroll and so on) which are made subject to different regulations. Thus the mono-bank is given the right to control the monetary resources of enterprises so that the system can balance its accounts at the macroeconomic level without constant changing prices or endangering the requisitioning process. As a result the enterprise is in a paradoxical situation: it has an almost unlimited liquidity (‘soft budget constraint’), but cannot use it as it wishes since almost every transaction has to be approved by the mono-bank²⁷.

* * *

The above analysis of the command economy has little to do with the traditional ‘political economy of socialism’ taught in communist countries. One of the main problems of these countries was that the political control made it almost impossible to rationally analyze the shortcomings of the command economy. A clear proof of this is the complete lack of theoretical works on the subject published under communism. The only exception is the Kornai’s book. Without a clear understanding of these shortcomings the command economies could hardly be reformed, if such reforms were possible at all without a radical change of the systemic paradigm.

²⁷ P.H. Dembinski, *The Logic of the Planned Economy*, op. cit., pp. 115–126.

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COMMAND ECONOMY IN THEORY

Summary

The article presents a theoretical analysis of a command economy from a historical perspective. Presenting the Soviet system, the author refers to the Marxist-Leninist-Stalinist heritage. This is the spirit of the author's analysis of the system limited by demand or available resources and a discussion of the forms of property and the methods of co-ordination used in the command system as well as the specific system of budget development. At the same time, the author emphasises that there is a lack of theoretical analyses of the then used economic system as they were not conducted at that time, and thus there are no indicators that would make it possible to lay down guidelines on reforming such a system.

GOSPPDARKA NAKAZOWA W TEORII

Streszczenie

Niniejszy artykuł przedstawia teoretyczną analizę gospodarki nakazowej w ujęciu historycznym. Autor odwołuje się do marksistowsko-leninowsko-stalinowskiego dziedzictwa przedstawiając system sowiecki. W tym duchu autor analizuje system ograniczany popytem lub dostępnymi środkami, omawiając także formy własności i metody koordynacji wykorzystywane w systemie nakazowym oraz specyficzny system kreacji budżetu. Jednocześnie autor podkreśla, że brakuje aktualnie przeprowadzanych analiz teoretycznych na temat stosowanego systemu gospodarczego, a tym samym brak wskaźników umożliwiających tworzenie założeń reformatorskich dla takiego systemu.

КОМАНДНАЯ ЭКОНОМИКА В ТЕОРИИ

Резюме

Настоящая статья представляет теоретический анализ командной экономики с исторической перспективы. Автор обращается к марксистско-ленинско-сталинскому наследию при освещении советской системы. В этом духе автор анализирует систему, ограниченную спросом либо доступными сред-

ствами, обращаясь к системе собственности и методам координации, используемым в командной экономике, а также специфической системе создания бюджета. При этом автор подчёркивает, что отсутствуют теоретические исследования, касающиеся функционирующей на этой основе экономической системы, в связи с чем отсутствуют показатели, дающие возможность создания реформаторских основ для данной системы.