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ECONOMIC SYSTEMS AS MEASURED BY INFLATION AND GROWTH

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BY

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AN EMPIRICAL EXAMINATION OF THE PERFORMANCE OF VARIOUS  
ECONOMIC SYSTEMS AS MEASURED BY INFLATION AND GROWTH

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CHAPTER I

Introduction

A comparative analysis of economic systems . . . is characterized by its special viewpoint, derived from its task to point out the differences of the various systems in structure, operation, and achievement and to be applied to much of the total area of economics.<sup>1</sup>

As Carl Landauer contends, the comparison of economic systems is the only effective way to measure and judge the efficiency of a particular system. The comparative method, however, is not without its weaknesses. "Efficiency" can only be measured in the attainment of similar goals, and the comparative method very readily illuminates the differences in the goals of the various economic systems. Differences in goals are also present between various countries employing the same economic system. Even when the goals are the same, the priority placed on the goals may differ. One also has problems in measuring the attainment of goals when this achievement cannot be stated in quantifiable terms. For

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<sup>1</sup>Carl Landauer, "Significance of Comparative Analysis of Economic Systems," Neue Perspektiven aus Wirtschaft und Recht: Festschrift für Hans Schaffer, ed. by Carsten Peter Claussen (Berlin: Duncker & Humblot, 1966), p. 79.

example, how would one measure how effectively a particular system meets the goal of "freedom"? The achievement of this goal is not quantifiable, but one can state the relative freedom of one system to another.

In the process of measuring the economic performance, one can make use of the economic indicators which can be expressed in numerical terms giving an indication of real growth rates and inflation. The process of determining economic performance for particular countries has been employed for some time, and the techniques used to gather the necessary data have been greatly improved. The addition of the comparative concept should provide useful new dimensions in the measurement of economic performance of the basic economic systems.

#### Purpose

The purpose of this study is threefold. The first is to develop a methodology with which to approach the study of comparative economic systems. There is not general agreement among economists regarding which method is most effective in the comparison of systems. Especially in the comparison of economic performance, one must derive a method that is both realistic and applicable in existing systems. The various "pure theory" methods will be compared to the methodology developed by Spiethoff and Max Weber. The methodology derived from Weber and Spiethoff will be defended



as being both a theoretical and a realistic approach to the study of economic systems.

The second major purpose of the study is to attempt to describe the basic economic systems present in the world since World War II. Economic systems are continually changing and evolving, and the study of existing systems proves useful in developing the essential features of the various systems. The portion of the study devoted to this purpose will compare the existing forms of communism, capitalism, socialism, and traditionalism to the classical definitions and concepts of the systems. In addition the different forms of systems are present as sub-systems, and some of these sub-systems will be described.

Finally, the primary purpose of the study is to examine the economic performance evidenced by the economic systems in the last two decades. Representative countries will be selected for the basic systems, and the economic performance of the economies will be used as an indication of the performance of their respective economic systems. Quantitative measures will be applied to the various indicators of growth and stability, and these indicators will be compared within and between the economic systems of capitalism, socialism, communism, and traditionalism.

#### Hypotheses to be Tested

The two following hypotheses will be tested statistically in this study:

1. The performance of the various national economies within the same economic system is not statistically different from one another.
2. The economic performance of the different systems as indicated by the national economies is not statistically different.

The basic idea represented by the above hypotheses is that the economic system is of basic importance in the economic performance of an economy. If this is true, then it is reasonable to predict that the performance of the economies within the same system should be the same. Also, the different systems should result in differing performances. The assumption is made that one goal common to all economic systems is good economic performance in the areas of real growth and price stability.

#### Scope of the Study

The time period included in the statistical testing of the hypotheses will be the post World War II period of the years 1950 through and including 1967. These two decades were chosen because of the availability of the data and because there is not the large disruption of a world war. In many cases even in these two decades, data is not readily available for the countries included in the study. The decade of 1958-1967 provides the largest amount of data and will be used separately when data on other years is insufficient. Although the economic systems in some countries went through major changes, most countries experienced only evolutionary changes in economic organization. Twenty years.

provide a time period of sufficient length to indicate basic differences between the economic systems without allowing for too many major changes in the systems which would make the study less meaningful.

The performance indicators which will be used to measure economic progress of the economies are divided into two major groups. The first group consists of measures of real economic growth rates. The increase of per capita Gross National Product should give the best overall picture of economic growth, but others will be used to supplement this primary indicator. Real per capita growth rates will be compared for National Income, Private Consumption, Gross Domestic Product, and Gross Fixed Capital formation when data is available. The ratio of Gross Domestic Fixed Capital to Gross Domestic Product will be employed to measure the emphasis on economic development, and the ratio of Private Consumption to Gross Domestic Product will be used to indicate some differences in the various economic systems.

The second major type of performance indicator is used to show the price stability of the economic systems. The primary indicator used is the price index. Not only will the rates of inflation play an important role, but the change in rates of inflation should contribute to the stability measurement. Since price stability and growth are goals found in most economic systems, these two types of indicators appear to be the most useful in the comparison of different

systems. Also, the achievement of these goals can be more easily quantified than other social or economic goals which a system might have.

Not all countries in the world will be used in the statistical study, but an effort will be made to provide data from countries which are most representative of their respective economic systems. Certain criteria will be used in the selection of a country for inclusion in the study. First, data must be available to provide the performance indicators as described above. Secondly, the country's economic system must be representative of that basic form of economic system. Thirdly, the economic system must have remained relatively constant over the twenty-year period included in the study. Finally, the assumption of economic growth as a goal must be valid for the country.

The four basic systems of mixed capitalism, democratic socialism, traditionalism, and communism will be the economic systems which will be compared in the study. Although each of the above can be broken down into sub-systems and sub-sub-systems, the major classifications are those most widely accepted in the literature of comparative economic systems. Also, the four systems are those suggested by the use of economic Gestalt methods and the typification process described in Chapter II.

### Limitations of the Study

In judging the economic performance of the economic systems, one must measure the performance in terms of common goals. In this case the assumption is made that economic growth and stability are goals common to each of the economic systems. Although the validity of the assumption appears certain since all economic systems are built around the idea of providing the satisfaction of human wants, the corollary assumption of equal priority of these goals is less tenable.

Our comparison of performance can achieve only two things: It can point out where each system excels the other in meeting certain goals, and it may suggest the extent to which one purpose is sacrificed for another; it may also enable us to decide that we prefer one particular system, because we support the goal which it approaches more closely than do the other systems.<sup>2</sup>

The results of this study should indicate the effectiveness of the economic systems in obtaining these economic goals and may indicate the priority of the performance goals in the respective systems.

The greatest limitation of a study of this type centers around the data which must be used to measure the economic performance of the various countries. The most obvious problem is the lack of data for certain countries or time periods. In the selection of the countries one of the criteria used was the availability of data so most of the countries will have a large portion of the data that

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<sup>2</sup>Landauer, "Significance of Comparative Analysis," p. 7.

will be needed for this time period. Since the study is primarily concerned with average rates of growth, unavailable data would not necessarily change the results significantly. The validity of the data which is available will also be challenged. United Nations data will be used for most of the countries in the free world while special studies will be used for the data of the communist countries. Although the data may be subject to question, one must use the best data available for the type of research this paper is providing.

The research is designed to test the stated hypotheses and cannot effectively determine all of the factors responsible for the differences in performance of the different systems. The resource mix will not be the same for each of the countries included, but a portion of this problem can be eliminated by using per capita data when available. Also, by including several countries for each system the resource mix between the economic systems will be more comparable than between individual countries. Differences in the amount of accumulated capital will be considered in an effort to isolate the effects of these variations.

#### Organization

The methodology utilized in the study and classification of the various economic systems is developed in Chapter II. Using this methodology a study of the basic systems will be presented in the next two chapters. Both

the classical and modern systems will be outlined as ideal and real type models with primary attention being given to the institutions and goals. Chapter III examines the democratic systems of capitalism and socialism, and Chapter IV describes communism and traditionalism. The presentation of the prototypes and preliminary analysis of the hypotheses are presented in Chapter V. The presentation of the data and results of the statistical work constitute Chapter VI. The conclusions will be discussed in Chapter VII.

## CHAPTER II

### METHODOLOGY OF COMPARATIVE ECONOMIC SYSTEMS

#### Introduction

In approaching the problem of what type of methodology should be used in the classification of economic systems, one must first examine what an economic system is. A representative definition of an economic system is provided by Carl Landauer.

An economic system may be defined as the sum total of the devices by which the preferences among alternative purposes of economic activities are coordinated for the achievement of these purposes. The central problem of any economic system is the allocation of resources.<sup>1</sup>

Underlying all economic systems one finds the usual economic problem of the "scarcity of goods and unlimited human wants." The economic system must provide a method for the production and the allocation of the goods and services. The definition given by Landauer, however, speaks of "the sum total of devices" which includes noneconomic, as well as economic, devices having an influence on economic

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<sup>1</sup>Carl Landauer, "Significance of Comparative Analysis of Economic Systems," Neue Perspektiven aus Wirtschaft und Recht Festschrift für Hans Schaffer, ed. by Carsten Peter Claussen (Berlin: Bunker & Humblot, 1966), p. 80.



actions and alternatives. Every economic system works within a framework of the social, political, and legal systems of the society, but it is often studied simply as a separate entity. Should one confine the study of comparative economic systems to the pure economic actions, actors, and results, or should the other influences be part of the methodology of dealing with this study? An approach which will serve the present study more effectively is to consider the economic system as a system established by a controlling group, animated by a definite spirit and regulated by a specific organization which is applying a specific technical knowledge leading to a definite production.

The purpose of this chapter is to look at the various forms of pure theory methodology and to compare the use of pure theory to economic Gestalt theory. Four different methods of pure theory enumerated by Arthur Schweitzer are discussed as they are used in the study of comparative economic systems. Spiethoff's economic Gestalt theory is presented as a possible alternative to the pure theory approach. In the application of Gestalt theory to a comparison of economic systems, classification criteria are suggested to provide a framework for researching and classifying national economies.

Comparison of Two Methods

Pure Theory Approach

"Pure theory emphasizes the isolation of specific phenomena and the relations which may exist are disregarded."<sup>2</sup> In pure economic theory one is primarily interested in the examination of uniformities which can be detected, measured and explained. The study of economic systems provides an opportunity to measure the uniformities of various economic systems and the countries within the systems. Uniformities are also present throughout a span of time. "Pure theory starts from data which have an axiomatic character, and conclusions are reached by a process of logical deduction: the student draws conclusions about effects by taking given data as causes."<sup>3</sup> Pure theory provides an objective method with which to examine the economic data of the various economic systems.

Professor Schweitzer presents four methods which have been suggested as providing the necessary link between pure economic theory and the study of comparative economic systems.<sup>4</sup> The first approach is the National Economic

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<sup>2</sup>Arthur Spiethoff, "Pure Theory and Economic Gestalt Theory; Ideal Types and Real Types," Enterprise and Secular Change: Readings in Economic History, ed. for the American Economic Association and the Economic History Association by Frederic C. Lane and Jelle C. Riemersma (Homewood: Richard D. Irwin, Inc., 1953), p. 445.

<sup>3</sup>Ibid., p. 445.

<sup>4</sup>Arthur Schweitzer, "Approaches to Comparative Economics," A paper presented at the Southern Economic

Approach in which there is a homogeneity of goals and activities toward production and consumption. The differences between the various national economies are caused by only two agents, nature and the political powers.

"Since foreign trade is expected to minimize the differences originated by nature, the primary cause for persistent economic differences is thus attributed to political diversity among nations."<sup>5</sup> The study of comparative economics in the National Economic Approach would appear to be more political than economic in scope, and one begins to feel as if he should study political science in preparation for the study of comparative economic systems. Because of the assumption of pure competition, one cannot avoid the determining assumption of the homogeneity of economic goals and activities of production and consumption.

In the second pure method, the ideal axioms of modern welfare theory have been applied to all actual economies in the Axiomatic Approach. In the traditional manner the axioms are applied to the economies of the "free" national economies to measure the efficiency with which the resources are used in the production process. Even in the "most ruthless dictatorships" the followers of this approach have found a method to use the axioms to measure, not

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Association, November 13, 1964, p. 2. See also the appendix to Schweitzer's Big Business in the Third Reich (Bloomington, Indiana: Indiana University Press, 1964).

<sup>5</sup>Ibid., p. 3.

efficiency, but inefficiencies. For example, in the Soviet Union prices based on standards of cost are determined. After an adjustment has been made for the turnover tax and any subsidies, the "cost" price is compared to the actual price to measure the inefficiency the government has experienced. Goals of the different economies are not used as a possible explanation for the "indicated inefficiency." Comparative economics using this approach is reduced to a welfare approach to measuring comparative efficiencies.

Realizing that economic systems are generally mixtures of two or more various economic systems, some Keynesians have extended the use of macro-theory to study these "mixed" systems. The Dualist Approach establishes two sectors in each economy. The capitalist sector is composed of the private sector, and the activities of all governments are included in the socialist sector. The hypothesis is that the lack of aggregate demand in the capitalist sector is directly responsible for the growth of the socialist sector of the economy. All types of government activity are treated homogeneously in the socialist sector, and the reasons for growth of the sector are attributed to the lack of aggregate demand in the private sector. Using this framework, one can easily see the increasing size of the socialist sectors in many of the world's national economies. The causal effect is, however, one of hypothesis rather than of world reality.

The final method discussed by Schweitzer as being used in the area of pure theory is the Command Approach. This analytical framework is designed for the analysis of the command economies where an artificial method of allocation of resources is established in place of the market system. The basic assumption of the Command Approach centers on the efficiency of the market system in the allocation of resources. By establishing a command system, the rulers have built in a large amount of waste which would not be found in the market system. "Neoclassical theory is assigned the dual role of providing a direct explanation of the market economy, and of explaining the wastage of the command economy."<sup>6</sup> Since the two different types of economies are examined with one type of theory (and that theory designed for market economies), apparent waste is produced in the command economy. The basic assumption that all economies are governed by neo-classical principles limits the effectiveness of the use of the Command Approach, especially in comparing such diverse systems as Soviet Communism and United States Capitalism.

Certainly one could come up with several other methods in which pure theory could be linked to the study of economic systems, but these four seem to be representative of the application of pure theory. As is evident in the discussion of the approaches above, there appear several limitations in

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<sup>6</sup>Ibid., p. 6.

the use of pure theory to describe actual economies. The interest of the pure theorist in extracting uniformities is the most hampering of the limitations. Comparative economic systems studies examine a heterogeneous set of economic actions. The treatment of all systems as like elements removes the study from actual economies to models of economic relationships in the mind of the theorist. One is interested in the common elements of the different systems which produce uniformities, but the singularities often provide the analyst with the more realistic answers to the questions under study.

Since all economic systems operate in a world of political, social, and psychological forces, one finds that often economic results cannot be attributed to economic causes. Max Weber suggested that man is motivated by various levels of goals. The economic interest goals give rise to a rational action designed for material gain. If this were the only goal type, economic theory would be sufficient to analyse economic systems. Man, however, is motivated by belief goals, traditional goals, and emotional goals which introduce economic irrationality.<sup>7</sup> In these cases the economist must leave the area of pure theory for the explanation of the economic organization. If we can agree with Spiethoff that the "foremost and principal task of scholars

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<sup>7</sup>Max Weber, The Theory of Social and Economic Organization (New York: Free Press, 1964), p. 127.

is the search for causes,"<sup>8</sup> the limitation of pure economic theory becomes self-evident because the causes of different economic actions are often explained by noneconomic phenomena.

One final limitation of the use of pure economic theory is apparent. ". . . a number of different economic theories have been developed; there exists not just one theory. A wide range of theories, from Smith to Keynes and Schumpeter, shows the fecundity of the deductive imagination."<sup>9</sup> The different theories provide many ways of treating the problems, but none of them can handle the totality required in the study of economic systems.

Since the comparison of economic systems involves both singularities and uniformities, the method of pure economic theory must be used for the extraction of the uniformities, but cannot be used effectively as a method to explain the totality including the singularities.

#### Economic Typification Theory

To develop a working methodology which could be used as a theory to explain the uniformities of the economic

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<sup>8</sup>Arthur Spiethoff, "Pure Theory," p. 449.

<sup>9</sup>Frederic C. Lane and Jelle C. Riemersma, "Introduction to Spiethoff," Enterprise and Secular Change: Readings in Economic History, ed. for the American Economic Association and the Economic History Association (Homewood: Richard D. Irwin, Inc., 1953), p. 431.

style and to remain true to reality, Arthur Spiethoff constructed a framework of economic Gestalt theory.<sup>10</sup>

This theory aims at the closest possible approximation to observable reality. It goes without saying that economic Gestalt theory cannot deal with reality as a whole. In that case it would lose sight of the uniformities, being confronted with the overwhelming multitude of historical singularities and their interrelations. It would cease to be theory.<sup>11</sup>

The effort is to obtain the essential features of the phenomena being studied without letting the irregular and inessential features make the study impossible. In this manner reality may be expressed in terms of uniformities and the primary singularities. This is done without abstracting the essential singularities out of the explanation as is done with pure theory.

Although very similar to the Spiethoff methodology, Max Weber's typification process better serves the function of understanding economic systems. The ability to logically combine theory and reality is present in both Weber's typification method and Spiethoff's Gestalt theory, but the typification process more correctly emphasizes the goals or motives animating economic actions. The understanding of the motives behind the event or phenomena is basic to the idea of the German concept of Verstehen, and this idea goes beyond the

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<sup>10</sup>Fritz Redlich, the translator, felt the term economic Gestalt theory was the best translation of anschauliche Theorie because the method of Spiethoff aimed at explaining the totality of the phenomena.

<sup>11</sup>Arthur Spiethoff, "Pure Theory," p. 445.



simple explanation of the causes as is done in the pure theory methodology. "Motivational causality . . . implies causal imputation: economic activities are seen as the result of or caused by certain motives. The word 'motive' means the totality of mental activities behind human action."<sup>12</sup> Collingwood expresses Verstehen as thinking as the actor. The Social Scientist

. . . investigating any event in the past, makes a distinction between what may be called the outside and the inside of an event . . . In the case of nature, this distinction does not arise. The events of nature are mere events, not the acts of agents whose thought the scientist endeavors to trace . . . the events of history are never mere phenomena, never mere spectacles for contemplation, but things which the historian looks, not at, but through, to discern the thought within them. In thus penetrating to the inside of events and detecting the thought which they express, the historian is doing something which the scientist need not and cannot do . . . For history, the object to be discovered is not the mere event, but the thought expressed in it. To discover the thought is already to understand it. The cause of the event for him, means the thought in the mind of the person by whose agency the event came about: and this is not something other than the event, it is inside the event itself.

But how does the historian discern the thoughts which he is trying to discover? There is only one way in which it can be done: By re-thinking them in his own mind. The historian of philosophy, reading Plato, is trying to know what Plato thought when he expressed himself in certain words. The only way in which he can do this is by thinking it for himself. This, in fact, is what we mean when we speak of "understanding" the words. So the historian of politics or warfare, presented with an account of certain actions done by Caesar, tries to understand these actions, that is, to discover what thoughts in Caesar's mind determined him to do them. This implies envisaging for himself

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<sup>12</sup>Ibid., p. 449.

the situation in which Caesar stood, and thinking for himself what Caesar thought about the situation and the possible ways of dealing with it. The history of thought, and therefore all history, is the re-enactment of past thought in the historian's own mind.<sup>13</sup>

Weber speaks of the relationship of economic motivation and the resulting economic action.

Action will be said to be "economically oriented" so far as, according to its subjective meaning, it is concerned with the satisfaction of a desire for "utilities" (Nutzleistungen). "Economic action" (Wirtschaften) is a peaceful use of the actor's control over resources, which is primarily economically oriented.<sup>14</sup>

Rationality is introduced through rational motivation to economic means. Actions which are economically oriented may include activities that are not generally considered as economic. For example, political actions, including wars, often serve economic means and are based on economic goals. Technology is generally economically oriented with the economic action determining the ends and technology providing the means. Goals are evidenced through economic orientation which in turn produces economic actions.

In the comparison of economic systems, the motivational causes are examined in terms of "goals," as will be explained below. The inductive framework provides the structure, but the explanation of the motives is the

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<sup>13</sup>R. G. Collingwood, The Idea of History (New York: Oxford University Press, 1956), pp. 214-15.

<sup>14</sup>Max Weber, The Theory of Social and Economic Organization (New York: Free Press, 1964), p. 158.

investigation of the spirit of the system. For example, one would find it impossible to "understand" the economic system of pre-war Germany without knowing the motives, or "goals," behind the various power blocks.

Historians try to break down the uniformities and generalities of the economic styles and systems,<sup>15</sup> but the typification method investigates real situations, distills the significant features, and highlights the generalities without losing the features necessary to define the system. To use the typification method one has to examine the totality of the economic system. Each of the parts (social, economic, political, etc.) is studied, but one must recognize the importance of researching the relationships of the parts to each other and to the total system.

The concept of economic style is not built for the use of (positivistic) historians who wish to picture the events of economic history in their uniqueness. On the other hand, it is not a construct like the deliberately unrealistic models of pure theory. A real type reflects a specific pattern of economic life and embodies its essential properties.<sup>16</sup>

The advantages of the use of the typification theory in economic systems are evident. The methodology outlined by Weber provides a usable approach which can work with the generalities, but it also allows for different conditions

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<sup>15</sup>See Louis Gottschalk, "Categories of Historiographical Generalization," Generalization in the Writing of History (Chicago: University of Chicago Press, 1963), pp. 113-30.

<sup>16</sup>Arthur Spiethoff, "Pure Theory," p. 457.

surrounding the economic systems. Instead of working with theoretical systems which have never existed, the uniformities of current or past systems are researched.

Most of the writers consulted agree or imply that the actually existing economic systems constitute the core of comparative economics. The aim is not to deal with the pure or closed economy, or to build hypothetical thought models, but to ascertain and interpret the central characteristics of actual economies.<sup>17</sup>

In an effort to use the concept of economic typification in the area of economic systems, one must distill the essential features of the economic system from the non-essential singularities. Studying all of the events and features of a particular system in its totality is not of use in the comparative analysis. One must rely on a framework of the essential features which can be compared to the essential features of another system. The typological method provides a tool for the distillation process in the selection of the core features used in the comparison. Two approaches are used for typification. The first approach constructs the essential features of an economic system around intended actions with an assumption of rational economic behavior on the part of the economic actors. The second involves the study of a particular economy at a particular time period and selecting the features necessary to represent the economic style or system. Although the underlying assumptions

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<sup>17</sup> Arthur Schweitzer, "The Scope of Comparative Economics," A paper presented to the Association for Comparative Economics, December 30, 1964.

of the two methods differ, both prove useful to the comparison of economic systems, and the two are not necessarily in conflict with one another. Used correctly the two approaches complement each other.

Max Weber begins the typification process with the rationality that "for the purposes of a typological scientific analysis it is convenient to treat all irrational, affectually determined elements of behavior as factors of deviation from a conceptually pure type of rational action."<sup>18</sup> The ideal type constructed by Weber is a theoretical model which assumes perfect rationality of the part of the actors. The assumption of rationality negates the possibility of describing real world economic systems, but a purely formal system is built which is somewhat analogous to the models built in the study of natural sciences.

This conceptual pattern brings together certain relationships and events of historical life into a complex, which is conceived as an internally consistent system. Substantively, this construct in itself is like a utopia which has been arrived at by the analytical accentuation of certain elements of reality.<sup>19</sup>

Instead of being a representation of reality, the ideal type is used as a model which can be utilized as a comparison of reality. The term "ideal" does not imply any perfection

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<sup>18</sup>Max Weber, The Theory of Social and Economic Organization (New York: The Free Press, 1964), p. 92.

<sup>19</sup>Max Weber, The Methodology of the Social Sciences, translated and edited by Edward A. Shils and Henry A. Finch (New York: The Free Press, 1949), p. 90.

other than one of logic, and the ideal type is not a goal to achieve but a standard to be used as a measuring rod from which deviations are measured. Although the ideal types are not found in the real world, the comparative economists enhance their understanding of real world phenomena through the utilization of them.

The second approach is not "simply derived from experience, but is predicated on intimate knowledge of economic reality. Its aim is to mirror economic life as a specific set of economic institutions, economic life in its concreteness."<sup>20</sup> Spiethoff uses the real type as a typological approach to economic typification theory, and he shows how real types are derived from the application of typification theory to economic history. The real types of Spiethoff are essentially the same as Weber's prototypes derived from the cultural history of the economy. Because the construct so defined is derived from past or existing economic systems, the model is an historical one rather than theoretical and must be characteristic of an actual economic system. Recurrency is the basic criterion employed by Weber in the selection of which features of the economic system are essential and which are nonessential or accidental features.

An inherent concept in using real types is that of motivational causality. The motivational relationships

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<sup>20</sup>Arthur Spiethoff, "Pure Theory," p. 452.

between the economic actors are researched, and the standard of rationality is not assumed.

The specific characteristics selected for the determination of a style model of type 1 (real type) serve the function of elucidating why that specific pattern of economic life came into existence and persists; they are meant to explain causally the work of a concrete pattern of economic life.<sup>21</sup>

Professor Schweitzer views the noneconomic factors as integral parts of the study of economic systems and essential to the typification methodology of Weber.

Persistent noneconomic factors that penetrate into systems will be counted among the variables of the theory. The major goals of the most influential groups have to be regarded as the strategic independent variables, while the specific institutionalizations of these goals will be most significant dependent variables.<sup>22</sup>

The first step in Weber's typification method is an historical investigation which illuminates the core features of the economic system. The criteria used to select the core features from the historical evidence are recurrency and essence. If the feature cannot be removed from the typification without changing the model, the feature should be considered as a "core" feature essential to the model. Core features are suggested by a recurring presence within the investigation. A model derived through typification may be used to study the evolution of an economic system, and a

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<sup>21</sup>Arthur Speithoff, "Pure Theory," p. 458.

<sup>22</sup>Arthur Schweitzer, "Typological Method in Economics: Max Weber's Contribution," History of Political Economy, Volume 2, No. 1 (Spring 1970), p. 74.

dynamic characteristic is provided through this "comparative statics" technique. In the present study typification is used to compare different systems in the same time period.

In the study of economic systems, both the real type and the ideal type may be used. One must recognize that one cannot speak simply of systems, but must see the levels of systems and sub-systems represented. At the highest level of abstraction, one finds four or five basic systems. Each of these is, or has been in the past, represented by several sub-systems. The process of sub-dividing systems continues until the national economy is reached. Even at this level it is necessary to note that more than one economic system may be represented in a country. For example, one could define a capitalistic sector as well as a traditional sector in many of the Latin American countries. At the higher levels of abstraction one finds more pure theory helpful, but the use of typification theory is necessary to keep the analysis from being void of reality. At the lower levels of abstraction, one finds that a system more representative of reality can be constructed. In the selection of the core features necessary to define either the real or the ideal types, one can use classification criteria to guide the research for the core features. The classification criteria used in the classification of systems point up the significant features which are common to all systems, and the variations of these elements create the



various classification schemes known in the traditional comparative economic systems literature.

#### Typification Methods

Recognizing the need for criteria in the classification of economic systems, one should be cognizant of the various types of classification schemes that have traditionally been used. Henry M. Oliver, Jr. has surveyed the various methods in an article in which he "looks at the classificatory criteria, classificatory frameworks, and classifications employed by eight recent books on economic systems."<sup>23</sup>

Oliver claims that the most basic of all classification schemes is illustrated in Economics of the World Today<sup>24</sup> in which all of the economies are divided into "market" and "command" economies. Although other differences in economies are noted, the one basic criteria of the allocation of resources is used to identify the economic system. Lynn Turgeon uses a similar approach as he divides the economies into "noncapitalist-oriented" and "capitalist-oriented," using the Soviet Union and the United States as

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<sup>23</sup>Henry M. Oliver, "The Concept and the Classification of Economic Systems," Economic Systems and Public Policy: Essays in Honor of Calvin Bryce Hoover, ed. by Robert S. Smith and Frank T. deVyver (Durham: Duke University Press, 1966), p. 37.

<sup>24</sup>Clair Wilcox, Willis D. Weatherford, Jr., and Holland Hunter, Economics of the World Today (New York: Randam House, 1962).

the basic prototypes of each system. Other countries with their mixed systems are clustered around one or the other of these two. Manuel Gottlieb feels that the simplicity of this type of classification scheme renders the analysis useless.

Perhaps the sin of monism is the most heinous. The sin takes effect in defining an economic system with reference only to one or two key features and assuming that structurally significant variation in other features does not occur or is marginal and random in import.<sup>25</sup>

Morris Bornstein in Comparative Economic Systems: Models and Cases<sup>26</sup> adds property to the criteria of the market while Wiles elaborates on these two in The Political Economy of Communism.<sup>27</sup> Landauer uses the building blocks of market, property, solidarity, and tradition in Contemporary Economic Systems: A Comparative Analysis.<sup>28</sup> The classification system of Marshall Goldman<sup>29</sup> builds on the ideas of Landauer by the addition of goals and institutional

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<sup>25</sup>Manuel Gottlieb, "The Theory of an Economic System," American Economic Review/Supplement, XLIII (May, 1953), p. 350.

<sup>26</sup>Morris Bornstein, ed., Comparative Economic Systems: Models and Cases (Homewood, Illinois: Richard D. Irwin, Inc., 1965).

<sup>27</sup>P. J. D. Wiles, The Political Economy of Communism (Cambridge, Mass.: Harvard University Press, 1962).

<sup>28</sup>Carl Landauer, Contemporary Economic Systems: A Comparative Analysis (Philadelphia: J. B. Lippincott Company, 1964).

<sup>29</sup>Marshall Goldman, ed., Comparative Economic Systems: A Reader (New York: Random House, 1964).

arrangements. In Economic Systems: A Comparative Analysis,<sup>30</sup> George Halm also emphasizes the role of goals.

The last book on the list, Arthur Schweitzer's Big Business and the Third Reich,<sup>31</sup> differs considerably from the others in that it strongly reflects the influence of Max Weber's method of classification and argues for "deliberate linkage" of economics with sociology and political science.<sup>32</sup>

In his classification scheme, power and goals play a central role. Even in the study which is limited to a short period in history, Schweitzer enumerates several types of capitalism and fascism. Most of the variations in the systems are differences in goals and the power structure of the major groups rather than in the property structure and the allocation mechanism. The methodology of Schweitzer more closely approaches economic typification theory than any of the others as he researches not only the economic data, but the social and political environment as well. As the theory is presented it is checked for validity with the history of the period.

For our purpose the different criteria used by Schweitzer most completely demonstrate the criteria needed for the study of comparative economic systems using the

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<sup>30</sup>George Halm, Economic Systems: A Comparative Analysis (New York: Rinehart, 1958).

<sup>31</sup>Arthur Schweitzer, Big Business in the Third Reich, (Bloomington, Indiana: Indiana University Press, 1964).

<sup>32</sup>Henry M. Oliver, "The Concept and Classification of Economic Systems," p. 48.

typification methodology. The usual criteria of market and property structure are necessary, especially in pointing up the uniformities. The singularities are more often established in the examination of the financial structure, power groups, labor force organization, and the goals most prevalent in society. The latter criteria includes the overall ideology of the political systems with power.

### Conclusion

The general agreement of the various economists working in the area of comparative economic analysis is that the research should concentrate around actual economic systems of the past or existing systems. The use of the pure economic methodology presents many limitations because all economic systems must operate in a framework of social and political forces. Max Weber's economic typification theory provides an appropriate substitute for pure economic theory without surrendering the concept of a theoretical treatment. The theory of the typification methodology is tested by a continuing comparison to reality. The uniformities are not lost, but the research is given a deeper importance by the study of the essential singularities necessary to describe and explain the economic style. A process of typification can be used effectively to establish the essential features of the system.

## CHAPTER III

### DEMOCRATIC ECONOMIC SYSTEMS

#### Introduction

A complete description of the basic economic systems of either the ideal or real type is beyond the scope of this paper, but it is necessary to delineate among the four basic systems of which the study is made. The present chapter discusses the "ends and means," or goals and institutions, of the two economic systems which were in the ideal or classical sense, and are in the modern economies, constructed within a democratic form of government utilizing a "free market system" for the distribution of goods to the consumer. The two systems discussed below are capitalism and democratic socialism.

In the case of both capitalism and socialism, one necessarily must describe both the ideal and the real prototypes system since the blueprints of the classical systems (the ideal types) have had significant alterations in the implementation of the modern economic systems. John Kenneth Galbraith commented on the degree of change in the capitalist economic system.

By the early decades of the present century the task of constructing this model of a capitalist

society regulated by competition was virtually complete. It was an intellectual achievement of a high order . . . Few of the original architects of the competitive model would have defended it as a description of the world as it is--or was.<sup>1</sup>

The methodology constructed in the preceding chapter is used to illustrate the models. First the goals of the system are determined to guide in the description of the means of achieving success. The primary institutions and the interrelationship of the institutions are described as they pertain to the "ends" or goals of the system. One learns that more discrepancy is often noticed between the classical and modern concepts of the institutions than in the corresponding goals.

#### Classical Capitalism--The Ideal Type

Capitalism, in the classical sense, is a system of private property in producer and consumer goods, freedom of contract and perfect competition, with government intervention in economic affairs restricted essentially to the protection of property, enforcement of contracts and the prevention of fraud.<sup>2</sup>

The world of Adam Smith has never been recorded in history, and the "invisible hand" has eternally been aided by a "visible hand" of some form of government intervention.

Paradoxically the spirit of the "new system" devised by Adam Smith to return the greatest benefits to

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<sup>1</sup>John Kenneth Galbraith, American Capitalism (Boston: Houghton Mifflin Company, 1956), p. 16.

<sup>2</sup>Carl Landauer, Contemporary Economic Systems (New York: J. B. Lippincott Company, 1964), p. 3.

society was based on love of self. The new breed of capitalist entrepreneur was to meet the needs of others by trying to fulfill his own selfish desires.

It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantage.<sup>3</sup>

The drive of individuals and their individual economic growth was justified from a moral and religious background by Luther and Calvin as described by Max Weber in The Protestant Ethic and the Spirit of Capitalism.

The spirit or moving force in Smith's laissez faire capitalism shifts the suspicion of evil from the individual to the government. "Smith could see in his own lifetime that the 'public virtues' of rulers were far more wicked in their effects on society than the 'private vices' of either producers or consumers."<sup>4</sup> The elevation of the individual consumer and producer was an important contribution of Smith's scheme. The profit was given the role as the prime economic motivator of man, and through his search for profit motivated by self-love, man makes his contribution to society.

From the standpoint of the economic analyst, the chief merit of the classics consists in their

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<sup>3</sup> Adam Smith, The Wealth of Nations, I (New York: Dutton, 1964), p. 13.

<sup>4</sup> John Chamberlain, The Roots of Capitalism (Princeton: D. Van Nostrand Company, Inc., 1959), p. 19.

dispelling, along with many other gross errors, the naive idea that economic activity in capitalist society, because it turns on the profit motive, must by virtue of that fact alone necessarily run counter to the interests of consumers; or, to put it differently, that money making necessarily deflects producing from its social goal; or finally, that private profits, both in themselves and through the distortion of the economic process they induce, are always a net loss to all excepting those who receive them and would therefore constitute a net gain to be reaped by socialization.<sup>5</sup>

If the spirit of classical capitalism was to provide for the good of society through self-interest of the individual consumer, what were the economic institutions that provided the framework?

The market, which is the characteristic institution of capitalism, expresses a relationship of buyer and seller. It is, in effect, what results when free choice is applied to the disposition of property--or of what is made with the use of property, by "mixing" labor with it. . . . So we come back to property as the base for liberty.<sup>6</sup>

Writing at a time when vestiges of the English feudal system were still present, it is somewhat surprising that Smith could so readily make the ownership and protection of private property the basis for classical capitalism. He often attacked the feudalistic land practices of primogeniture and entail. The fact that land and its ownership was an integral part of his system indicates the influence of the Physiocrats and the important role of agriculture in the Eighteenth Century.

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<sup>5</sup> Joseph A. Schumpeter, Capitalism, Socialism, and Democracy (3rd ed.; New York: Harper & Row, 1950), pp. 76-76.

<sup>6</sup> Chamberlain, The Roots of Capitalism, p. 25.



The market structure also was conceived in the laissez faire world of personal liberty. Competition was studied as the only form of market structure for the capitalist with ease of entry providing an "invisible hand" to protect the consumers. In the minds of the classical economists pure competition was the market resulting from a large number of producers and consumers with the effect that no one producer nor any one consumer could affect the price. Pure competition set the lowest price possible protecting the consumer. Pure competition not only protected the rights and freedom of the consumer, but it provided the most efficient method of both production and the allocation of goods.

The free market structure also was extended to the labor force. Man was to have the liberty of selling his services in a free market. Smith elaborated a great deal on the place of labor in the classical economic system. One integral part of Smith's concept of labor, the utility for society derived from self-love of the individual, was described as demonstrating the goals of capitalism. While preserving the freedom of the individuals, society benefits from a division of labor. In addition to this type of division of labor, Smith writes of a division of labor within the production units of the economy. "The pin factory" illustration is used to indicate the savings possible from the organization of the labor force achieved through the division of work.

In an effort to preserve the liberty of the individual, Smith outlines a very limited role to be played by the government. The functions of government are restricted to those areas which are of benefit to society as a whole and would not be provided by private concerns. The first duty is the preservation of the country in the world community. In addition to a national defense, Smith contends that the government must protect individuals from injustices within the country. Another and separate discussion outlines the duty to protect the commercial entities from illegal actions. However, Smith explained that the individual must be protected from the monopoly power of the commercial enterprises. In many cases the monopoly power was granted by the state, but in others the power was derived from price collusion. "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."<sup>7</sup> The defense roles of the government are complemented by the provision of education and public works which would not be provided by the private sector. Education of the youth, as well as religious instruction, should be provided for society. For the preservation and promotion of commerce, such things as roads, bridges, and canals should be constructed, but Smith contends these can and should be financed by tolls collected from the users.

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<sup>7</sup>Adam Smith, The Wealth of Nations, Vol. I (London: J. M. Dent and Sons Ltd., 1910), p. 117.

The primary classical institution exemplified in the laissez faire market supports and amplifies the goals of classical capitalism. The framework of institutions constructed by the classical economists provides an organizational blueprint while the goals provide the motivating force. In an effort to see how closely the classical blueprint has been followed, one needs to typify the modern capitalistic systems.

#### Modern Capitalism--The Real Type

Although history has never recorded the "atomistic capitalism" of Adam Smith, one finds that the modern concept of capitalism is farther removed from Smith's model than the capitalism of the Eighteenth and Nineteenth Centuries. Evolution has been experienced in both the "means" and the "ends" of capitalism, or the "institutions" and the "goals." The most referred to system of the new capitalism is demonstrated in the economy of the United States.

Thus the Eisenhower administration, having inherited the evolutionary transformation of the organization and control of industry which gave rise to the New Deal and Fair Deal and having accepted most of the economic measures of the New Deal and Fair Deal, in its actual economic policies signaled the permanence of the changed economic system. This new system might be variously called the Mixed Economy, Welfare Capitalism, Progressive Capitalism or simply the Organizational Economy, to distinguish it from the individual-enterprise, laissez faire, private-property economy of old-style capitalism.<sup>8</sup>

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<sup>8</sup> Calvin B. Hoover, The Economy, Liberty and The State, Anchor Books (Garden City: Doubleday and Co., 1961), p. 270.

In the present study, the author prefers the term "Mixed Capitalism" connoting that many of the goals and institutions of the ideal type of capitalism still permeate the present economic system though changed in nature and mixed with aspects of other economic systems.

Before examining in detail the institutional changes which have caused the many aberrations of capitalism, one would be wise to examine the shift from the goal of self-interest to include a goal to provide for social good. "It is a measure of the magnitude of the disaster to the old system that when oligopoly or crypto-monopoly is assumed it no longer follows that any of the old goals of social efficiency are realized."<sup>9</sup> Because of and effecting changes in the institutional framework of capitalism, new goals are found in mixed capitalism. These are often defined as growth, price stability, and security. The depression of the 1930's drastically evidenced some weaknesses in the laissez faire capitalism as the large corporations had modified it. The fallacy of Say's Law was one of the most evident. Instead of opportunity derived from freedom, men allowed the government to provide economic security, especially when this could be provided by the full employment of resources in the economy.

Another spirit of capitalism was manifest in the form of innovation as described by both Schumpeter and

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<sup>9</sup>John Kenneth Galbraith, American Capitalism (Boston: Houghton Mifflin Company, 1956), p. 43.

Galbraith. As technological changes and other types of innovation provided for a better life through more goods and services provided in a fully employed economy, innovation became a moving force in the new capitalistic economy.

Technology means the systematic application of scientific or other organized knowledge to practical tasks. Its most important consequence, at least for purposes of economics, is in forcing the division and subdivision of any such task into its component parts.<sup>10</sup>

Six consequences of the subdivision of tasks are enumerated by Galbraith.<sup>11</sup> First, the time from the beginning to completion of the task is increased. Concomitant with the lengthening of the production process is a requirement for increased capital. The third consequence of dividing the tasks necessitated by technology is the inflexibility resulting from the increased employment of capital. Specialization of manpower is the fourth result with an accompanying need for organization being the fifth. Finally, the increased complexity demanded by the increasing technology associated with the production process demands a longer and more detailed planning function. As technology becomes the means for increased production through task division, technology also becomes an end in and of itself. Emphasis is placed on technology for the sake of technology.

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<sup>10</sup>John Kenneth Galbraith, The New Industrial State (New York: New American Library, Inc., 1968), p. 24.

<sup>11</sup>Ibid., pp. 25-28.

Schumpeter regarded technology and innovation as the moving force of capitalism.

The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumer goods, the new methods of production and transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates.<sup>12</sup>

Price competition is replaced by a completion of new technology, new products, and new organizations utilizing the new technology and new inputs. Schumpeter visualizes the "Crumbling Walls" of capitalism to be produced by the automating and depersonalization of technology and innovation.

The principal characteristic change in the property structure of capitalism is the separation of ownership and management. This change comes with, and to a large extent because of, the concentration of property. According to Hoover, although studies often indicate that labor's share of income has remained constant over the past decades, the labor share of property has been on the decline.<sup>13</sup> Because of the change in property structure, one finds corresponding change in the classical concept of capitalism.

The emergence of the large corporation as the dominant organizational form of private property in production greatly strengthened the tendency of the intellectual to think in terms of the conflict between "capital" and the public. He no longer thinks of this conflict, however, in terms

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<sup>12</sup>Joseph R. Schumpeter, Capitalism, Socialism, and Democracy (New York: Harper and Row, Publishers, Inc., 1962), p. 83.

<sup>13</sup>Hoover, Economy, Liberty, and the State, p. 207.

of the interests of the individual capitalist-producer versus the public. To most intellectuals the conflict has become one between the public and the capitalist corporation. There is little recognition that an even greater conflict of interest might exist between the public and the management of a nationalized industry or between the management and the workers in the industry. Any sympathy or admiration which in the past might have been felt for the capitalist as an individual owner-producer is not likely to be extended to the corporation. Indeed as a growing proportion of the population became employees rather than individual producers, and as stockholders come to feel less and less identification with the corporation, the person who thinks of the corporation as "we" becomes rarer and rarer. To almost everyone the corporation becomes an anonymous "it" or "they."<sup>14</sup>

What then happens to competition when big business becomes the typical market institution? "The price system will fulfill its function only if competition prevails, that is, if the individual producer has to adapt himself to price changes and cannot control them."<sup>15</sup> One might ask whether competition is absent from mixed capitalism?

Economists are at long last emerging from the stage in which price competition was all they saw. As soon as quality competition and sales effort are admitted into the saved precincts of theory, the price variable is ousted from its dominant position.<sup>16</sup>

With industrialization progressing to the stage where many industries are dominated by a few sellers, "each seller shares the common in secure and certain prices; it is to

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<sup>14</sup>Ibid., p. 363.

<sup>15</sup>F. A. Hayek, The Road to Serfdom (Chicago: University of Chicago Press, 1944), p. 49.

<sup>16</sup>Schumpeter, Capitalism, Socialism, and Democracy, p. 84.

the advantage of none to disrupt this mutual security system."<sup>17</sup> The mature corporation views price control as necessary to insure profits in an atmosphere where technology has caused a lengthening of the production process and a deepening of capital is required with the new techniques. Price competition has been greatly reduced by the concentration of business, but a new type of competition has emerged. Galbraith contends that because of the opulence associated with the mature economy, product differentiation becomes a strong element in competition. Another form of competition manifests itself in the form of "countervailing power." The answer is that competition is not absent but that it has greatly changed.

The concentration of property brings the economic system farther and farther from "atomistic" competition on which the classical system was based.

With many notable exceptions--agriculture, the textile and garment industries, soft coal mining, wholesale and retail trade, shoe manufacturing--the number of firms participating in a business is likely to be at its maximum within a few years or even a few months after the business is born. Thereafter there is, typically, a steady decline until a point of stability is reached with a handful of massive survivors and, usually a fringe of smaller hangers-on. Thenceforward the changes in the industry are in the relative positions of the established firms. This is not the universal pattern of development, but it is a typical one.<sup>18</sup>

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<sup>17</sup>Galbraith, New Industrial State, p. 41.

<sup>18</sup>Galbriath, American Capitalism, p. 33.



Competition in the classical sense requires that a large number of sellers sell to a large number of buyers with no individual buyer or seller in a position to influence the price. With only four major automobile companies in that industry, one could not conceive that any of the four would not be able to affect prices. The automobile industry is not as much the exception as it is the typical market structure of mixed capitalism.

The five hundred largest corporations produce close to half of all the goods and services that are available annually in the United States. . . . in the characteristic market of the industrial system there are only a handful of sellers. The domestic automobile market is shared by four firms and dominated by three. Markets for primary aluminum, copper, rubber, cigarettes, soap and detergents, whiskey, heavy electrical gear, structural steel, cans, computers, aircraft engines, sugar, biscuits, pig iron, iron, tinsplate, trucks and a host of other items are each dominated by four firms. Nearly all are examples of the mature corporation with which we are concerned. Such is the industrial system.<sup>19</sup>

Just as changes have evolved in the market of goods and services, the labor sector has been greatly changed by the establishment of big business. The power of the corporation left labor in a vulnerable position with very little strength to be used against the monopsonists of labor. The government was called on to give legitimacy to labor unions, but it was not until the 1930's that labor forces were allowed to construct an opposing power, which was brought by unionization.

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<sup>19</sup>Galbraith, The New Industrial State, pp. 14, 190.

The operation of countervailing power is to be seen with the greatest clarity in the labor market where it is also most fully developed. Because of his comparative immobility, the individual worker has long been highly vulnerable to private economic power. . . . The economic power that the worker faced in the sale of his labor--the competition of many sellers dealing with few buyers--made it necessary that he organize for his own protection.<sup>20</sup>

And organize he did, with the help of the government and changes of various economic institutions. Now, one recognizes that the economic power of the large corporations is checked by the countervailing power of the unions.

Just as government played an important role in the labor sector of the economy, many other economic sectors have felt the impact of government participation in the economy. The federal government of the United States, for example, passed an Employment Act of 1946 which established it as one of the guiding forces of the economy. In the declaration of policy in the 1946 piece of legislation one finds Congress accepting the burden of directing the economy.

The Congress declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be

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<sup>20</sup>Ibid., p. 114.

afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.<sup>21</sup>

The legislation was passed as the result of several factors. First, the Great Depression of the 1930's in the United States destroyed the concept of automatic maintenance of full employment which had been so extensively used by the classical writers. Keynes pointed out that employment depends on effective demand. As employment increases, income increases, but consumption will rise less than income leaving a gap which produces unemployment. Investment must increase the amount of the difference to provide full employment. The increase in investment is not "automatic" although some forces of taxation, government welfare, and unemployment benefits automatically tend to provide for full employment. A fall in consumption may not be counteracted by an increase in investment as the classical writers asserted, and the result would be unemployment. World War II provided full employment, but not without inflationary pressures. Many felt the economy would suffer a relapse in the post war period. The theoretical base provided by J. M. Keynes acted as a basis for constructing the legislation.

The legislation which finally emerged . . . wisely abstained from diagnosing depression as

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<sup>21</sup>Economic Report of the President (Washington, D.C.: United States Government Printing Office, 1966), p. 170.

the disease and public works as the cure, but instead concentrated on establishing the principle of continuing Government responsibility to appraise and review economic developments, diagnose problems, and prescribe appropriate remedies.<sup>22</sup>

In the evaluation of twenty years under the act, the Council of Economic Advisors in 1966 outlined some of the successes and failures in meeting the goals of the act. One finds it inconceivable that the government will remove itself from the economic role outlined in the Employment Act of 1946.

The government in modern capitalism plays a much more extensive and intensive role than those envisioned by Adam Smith. The change of this institution has been an evolutionary process with the government playing a larger role in the economy through controls, restrictions, guidance and spending.

The economics most representative of modern capitalism as typified above are found in Australia, Canada, West Germany, Japan, and the United States. These countries are used in this study because their goals and institutions more closely fit the goals and institutions of capitalism and are representative of this system.

#### Classical Democratic Socialism--The Ideal Type

The second economic system based on freedom for the individual and couched in a democratic form of government is that of socialism, which system will be termed "democratic

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<sup>22</sup>Ibid., p. 171.

socialism" to prevent confusion. Marx also writes of the socialist system which is a transitional stage to pure communism. Democratic socialism is to be differentiated from the Marxian stage not only by goals but also by the power centers and the institutions. Democratic socialism, as is true of capitalism, differs in concept from the classical scheme. For this reason it is necessary to elaborate on the goals and institutions of both ideal and real types of democratic socialism.

By socialist society we shall designate an institutional pattern in which the control over means of production and over production itself is vested with a central authority--or, as we may say, in which as a matter of principle, the economic affairs of society belong to the public and not to the private sphere. Socialism has been called an intellectual Proteus.<sup>23</sup>

In addition to the collective ownership of the means of production, classical democratic socialism denotes a freedom of choice in the majority of the consumers' markets. What, then, is the goal of a system of public ownership and democracy? In general one can say that the democratic socialist system was conceived in order to benefit society and the workers within that society while preserving the identity and freedom of the individual. This purpose is to be accomplished by returning to society the profits derived from production. The idealistic Fabians constructed their socialism around the following concept.

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<sup>23</sup>Schumpeter, Capitalism, Socialism, and Democracy, p. 167.

If capital can be socialized, Labor will benefit by it fully; but while Capital is left in the hands of a few, Poverty must be the lot of many. . . . The time approaches when Capital can be made public property, no longer at the disposal of a few, but owned by the community for the benefit of all.<sup>24</sup>

The Fabian Society in England first expounded on the theory of democratic socialism. The group was lead by such intellectuals as George Bernard Shaw, Beatrice and Sidney Webb, G. D. H. Cole and Annie Besant. The socialism of the Fabian Society was not of the Marxist variety, and revolution, except through evolutionary democratic processes, did not appeal to the society. Instead, the beginnings of socialism were already apparent in capitalism. Private property had not been an institution which eliminated poverty but just the reverse.

With one law alone--the law of rent--they destroyed the whole series of assumptions upon which private property is based. The apriorist notion that among free competitors wealth must go to the industrious, and poverty be the just and natural punishment of the lazy and improvident, proved as illusory as the apparent flatness of the earth.<sup>25</sup>

The crux of the socialist discussion centered on the elimination of the disparity in income caused by the private appropriation of rent.

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<sup>24</sup>Allan G. Gruchy, Comparative Economic Systems (Boston: Houghton Mifflin Company, 1966), p. 448.

<sup>25</sup>George Bernard Shaw, Fabian Essays, reprinted in Comparative Economic Systems: A Reader, edited by Marshall I. Goldman (New York: Random House, 1964), p. 99.

The argument was that the profit earned from the means of production were not earned as wages, but were unearned income which individuals did not have a right to claim.

What the achievement of Socialism involves economically, is the transfer of rent from the class which now appropriates it to the whole people. Rent being that part of the produce which is individually unearned, this is the only equitable method of disposing of it. There is no means of getting rid of economic rent . . . The economic object of Socialism is not, of course, to equalize farmers and shopkeepers in couples, but to carry out the principle over the whole community by collecting all rents and throwing them into the national treasury.<sup>26</sup>

Theoretically nationalization of production is to be used as a means to achieve a "higher" freedom, that of economic freedom. Hayek expresses the spirit of democratic socialism in his Road to Serfdom. The goal is an idealistic one as indicated by the tone of the Hayek passage.

To allay these suspicions and to harness to its cart the strongest of all political motives, the craving for freedom, socialism began increasingly to make use of the promise of a "new freedom." The coming of socialism was to be the leap from the realm of necessity to the realm of freedom. It was to bring "economic freedom," without which the political freedom already gained was "not worth having." Only socialism was capable of effecting the consummation of the age-long struggle for freedom in which the attainment of political freedom was but a first step.<sup>27</sup>

According to the theory of Oskar Lange socialism will produce the capitalistic type of competitive market in consumer goods and in labor while other production goods

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<sup>26</sup>Ibid., pp. 100-01.

<sup>27</sup>Hayek, The Road to Serfdom, p. 19.

such as capital are priced by the Central Planning Board. "The prices for capital goods and productive resources outside of labor are thus prices in the generalized sense, i.e. mere indices of alternatives available, fixed for accounting purposes."<sup>28</sup> The problem of the socialistic market centers on the combination of the planned producers market and the competitive market of the consumer goods and labor. Since the incomes of the consumer and consumer demands are determined by the market, the "prices" of the producers goods must be set in such a manner that the most efficient means of production are achieved with a goal of maximizing total utility to society being the guiding principle as opposed to profit maximization. The rule for determining output is the competitive rule that the marginal cost should be equal to the price. This illustrates the importance of establishing prices for producer goods that reflect true costs since this determines marginal cost. Ludwig von Mises argues that the absence of a market in the sector of producing goods makes it impossible to achieve the most efficient methods of production since the market forces cannot be simulated by a Central Planning Board. Lange contends that the establishment of prices for the production goods could be used for the establishment of production functions that could guide the managers in a

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<sup>28</sup> Oskar Lange, On the Economic Theory of Socialism (Minneapolis: University of Minnesota Press, 1938), p. 73.



capitalistic system. Schumpeter tends to agree that socialism can work.

There is nothing wrong with the pure logic of socialism. And this is so obvious that it would not have occurred to me to insist on it were it not for the fact that it has been denied and the still more curious fact that orthodox socialists, until they were taught their business by economists of strongly bourgeois views and sympathies failed to produce an answer that would meet scientific requirements.<sup>29</sup>

Labor in the classical socialist market is provided the same freedom as realized in the competitive society. Freedom of movement is insured and wages are based on the type of job and its related supply and demand.

The income of consumers is composed of two parts: one part being the receipts for the labor services performed and the other part being a social dividend constituting the individual's share in the income derived from the capital and the natural resources owned by society.<sup>30</sup>

In this way labor is paid more than its marginal revenue product. The production of this type of welfare is one of the key features of classical socialism and an equalizing factor without the loss of freedom. Also, Pigou<sup>31</sup> argues that socialism provides a more stable employment which is less subject to large amounts of unemployment than capitalism, thus providing an additional welfare feature of

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<sup>29</sup>Schumpeter, Capitalism, Socialism, and Democracy, p. 172.

<sup>30</sup>Lange, On the Economic Theory of Socialism, p. 73.

<sup>31</sup>A. C. Pigou, Socialism Versus Capitalism (London: Macmillan and Company, Ltd., 1964), p. 47.

socialism. Although the frictional unemployment would not be significantly different in the socialist state as opposed to the capitalist, unemployment resulting from fluctuations in industrial investment would be lower. Under the capitalist system, investment decisions which cause employment fluctuations are not considered as a cost. The investment decisions of socialism are made by the state, and unemployment would be considered as a cost to society, and it would be the responsibility of the state to consider the cost of unemployment when making investment decisions.

Although much of the labor sector is "capitalistic" in nature, classical socialism does not give the same type of treatment to property. The rent derived from property is to benefit the socialist community and would accrue to the state.

All that is commercial or capitalistic about ground rent, in both its economic and its sociological associations, and all that can possibly be sympathetic to the advocate of private property (private income, the landlord and so on) has been completely removed.<sup>32</sup>

The same is true of the means of providing goods and services which under classical socialism are to be owned by the people, who would then benefit from the economic rent.

The transition to a socialist system presents a theoretical problem in collective ownership of property as

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<sup>32</sup>Schumpeter, Capitalism, Socialism, and Democracy, p. 181.

a means of redistribution. Pigou<sup>33</sup> points out that confiscation of private property would render to the state about one-third of the total income which could be used to provide a more equitable distribution of income. The democratic socialist writers, however, did not propose that confiscation be used as the transitional device. The transition problem is then quite apparent.

They propose to purchase the means of production from their present holders at a fair valuation; that is, they propose to hand over to them government scrip, the interest on which, when allowance has been made for diminished risk of loss, will be roughly equivalent to what the private holders are now receiving as income from their property. In other words, apart from minor adjustments, the distribution of income among persons will be exactly the same after the introduction of socialism as it was before.<sup>34</sup>

Of course, once this initial purchase has been completed strong fiscal measures such as death taxes and steep graduated income taxes could be used to help redistribute the income. However, the problem remains that the government purchase of private property would not have an immediate effect on equality of income.

The government, after having taken over private property (whether by confiscation or purchase), then must assume its new role dictated by a socialist economic system. The implementation of a Central Planning Board as a substitute for the market and management provided through

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<sup>33</sup>Pigou, Socialism Versus Capitalism, p. 25.

<sup>34</sup>Ibid., p. 26.

capitalism would be an essential element of government. The establishment of price indexes would be no small responsibility and gives an indication of the many new economic problems associated with government ownership. One cannot help but envision a large bureaucracy evolving. The central planning inherent in a socialist system was not completely recognized by the framers of socialism and was not given the attention which it demands.<sup>35</sup> The problems are associated with the institutional framework or techniques rather than with the goals of classical socialism.

#### Modern Democratic Socialism

"Socialism today cannot be considered a clearly definable system either existing or postulated, but only a tendency to look more favorably on some measures and less favorably on others than is done by the supporters of capitalism or communism."<sup>36</sup> One finds that the existing socialist economies are guided by goals which are not too far different from the underlying motivators of the classical writers or in some cases--mixed capitalism. Freedom is stressed as the primary ingredient of the consumer market segment while nationalization of industry is to promote the general economic welfare of society as a whole. "They want a society in which the elements of antagonism play a smaller

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<sup>35</sup>The reader is referred to an excellent discussion of some of the problems in Pigou, Socialism Versus Capitalism, Chapter VII.

<sup>36</sup>Landauer, Contemporary Economic Systems, p. 231.

role than in capitalist society, and the elements of conscious human solidarity play a greater one."<sup>37</sup> Although one sees the evolution towards this goal in the capitalist society, the difference between the two is to be found in the intensity of feeling and the degree to which action has been taken in moving toward the achievement of the goal. In the Scandinavian countries public enterprise is utilized in conjunction with the private enterprise segment most efficiently to produce the largest amount of national output. The goal of large national output is directed at the whole of society rather than at individuals and at times takes precedence over the goal of individual freedom. The conflict of goals is one noted in the classical blueprint of socialism and is presently demonstrated in socialist countries.

One cannot discuss the socialist market without including the government institution since in classical and modern socialism these two institutions are interrelated. "Today nearly half the total gross investment [in Britain] is financed by the public authorities."<sup>38</sup> A great deal of the government participation is found in the welfare programs such as those found in the Scandinavian countries where the programs are directed at family welfare, workers protection and welfare, social housing, health, and social assistance. Government participation in these programs necessarily

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<sup>37</sup>Ibid., p. 297.

<sup>38</sup>Hoover, Economy, Liberty, and the State, p. 157.

reduces private enterprise in areas such as medicine, housing, and insurance. The extensive welfare system of socialism is a manifestation of the ideology of promoting the general welfare of the nation. The achievement of the goal of providing for national welfare may appear to conflict with the goal of individual freedom since most of the programs now in existence are compulsory programs. However, Clark Lee Allen correctly contends that "economic freedom may be viewed simply as the availability of alternatives."<sup>39</sup> Poverty or ignorance are often more restrictive of economic freedom than public statutes. Viewing freedom for the individual in this light, the socialist goal of maximum social benefit as expressed in welfare programs is paramount to individual freedom goals.

In regard to nationalization of industry, one concludes that there has been a large amount of government ownership of the large industries in the socialist countries since World War II. The types of industry nationalized are, to a degree, similar in Great Britain and the Scandinavian countries. The primary industries of transportation, communication, power, natural resources and financial are nationalized in almost all of the socialist countries. In addition to the primary industries, the auxiliary undertakings

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<sup>39</sup>Clark Lee Allen, "Economic Freedom and Public Policy," in Economic Systems and Public Policy: Essays in Honor of Calvin Bryce Hoover edited by Robert S. Smith and Frank Tide Vyver (Durham, N.C.: Duke University Press, 1966), p. 7.

which are an integral part of the primary industries are brought under national ownership. Naturally, the financial nature of these industries and the large amount of capital required has a great effect on the capital market which again illustrates the effect of nationalization on the private sector.

Government control of the economy in an effort to direct it has a similar influence on private industry. In all of the economies of socialism, one finds a concerted effort to plan and guide the economy. Although one finds the government of a capitalist country makes some effort to guide the economy, the socialist government is much more direct and the efforts more extensive than those of their capitalist counterparts. Investment taxes are used more extensively to soften the effects of cycles as well as of the large government investments. The labor force is manipulated to some extent through government programs of retraining and relocation.

The difference in the socialist government intervention and that of the capitalist countries is one of degree and direct action. Although the goals of government intervention are similar, the active and direct participation of the socialist governments is absent in the capitalist system. For example, the recession of the early 1960's was caused, to a large extent, by a calculated government slowdown in Britain resulting in only 2 per cent unemployment. In the

United States unemployment reached 6 per cent, and the recession was in response to the actions in the private sector.

These efforts to promote national economic welfare are directed in England by the National Development Council which began operation in 1962 and by similar agencies in the Scandinavian countries. These boards are directed to achieve maximum economic development while preserving the "soundness" of the economy. In England,

. . . the Council itself is made up of some twenty industrialists (representing public as well as private enterprises), trade unionists and independent members, with the Chancellor of the Exchequer as chairman. These boards act as investigators, pressure groups, target-setters, and market researchers.<sup>40</sup>

Planning for the growth of the economy and using the extensive public role in the economy, these groups are in a stronger position to influence the economy than, for example, the Council of Economic Advisors. The goals of socialism allow for government intervention.

Although one is impressed with the degree of government ownership and control of the economy through its participation in the extensive welfare programs, ownership of the major industries, huge investments in the economy and the direction of the economy through planning boards, the majority of economic activity is still found in the

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<sup>40</sup>Jan S. Prybyla, ed., Comparative Economic Systems (New York: Appleton-Century-Crofts, 1969), p. 177.



private sector. Private industry is found primarily in the small retail outlets, repair services, and agriculture. Even in these areas one notices government involvement.

The socialist government and economy is greatly influenced by, and also influences, the labor movement typical in socialism. The degree of centralization and organization is markedly higher in the socialist countries than in the capitalist countries. The union membership as a percentage of non-agriculture employment in 1954 ranged from a low of 47 per cent in the United Kingdom to a high of 62 per cent in Sweden as compared to the United States of 34 per cent.<sup>41</sup> Although the labor movement in all of the western countries began as both a political and economic movement, the capitalist countries have evolved into institutions based primarily on economic foundations while the socialist labor unions are political as well as economical. The political involvement is used to direct the distribution of income more to the workers. The interest in wage earners income and welfare benefits again is the demonstration of socialist goals. "The traditional meaning of socialism, collective ownership of the means of production, is no longer applicable as a basic criterion since practically all socialist parties in the Western World refuse to put primary emphasis on this postulate."<sup>42</sup> Private property is still

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<sup>41</sup>Gruchy, Comparative Economic Systems, p. 313.

<sup>42</sup>Landauer, Contemporary Economic Systems, p. 231.

dominant in the typical, modern socialist country. The governments tend to allow private businesses to operate on a private basis as long as their actions are in support of the national goals. In the areas where this is not found to be the case, national controls or restrictions are used such as in the case of price and wage controls. Most often the private concern is used as the form of business modified through government controls.

Although one can see socialism as being successful to some degree in the redistribution of income, the socialist system has not enjoyed the same success in the distribution of property. In most of the socialist countries about half of the wealth is held by the top 10 per cent of the population. Even where high property and death taxes are used, the income from the privately held property is sufficiently high to maintain concentrated ownership.

The nationalization program in the socialist countries has highlighted many problems associated with nationalization. First, the splitting of the Social Democratic parties into Communist and non-Communist factions has eroded the solidarity of the nationalization forces. Also, the Labor Party has recognized that the benefits of nationalization have not been derived, especially in the reduction of income inequality. Thirdly, the management of the nationalized firms has been similar to government bureaucracy. In addition unemployment had not been high in the private sector so this advantage

of nationalization was minimized. Finally, nationalization of firms did not provide the same results as the nationalization of an entire industry.

The countries which were most representative of democratic socialism in the post World War II period are Great Britain, Sweden, Norway, and Denmark. Although it has been demonstrated that these countries are not good approximations of classical socialism, the goals and institutions are socialistic and more closely approximate socialism than capitalism or authoritarian socialism. Denis A. Flagg found these countries to have a high degree of government ownership and welfare.<sup>43</sup> In addition Myron H. Ross points out a higher degree of central planning than is found in the typical capitalist country.<sup>44</sup>

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<sup>43</sup> Denis A. Flagg and Virginia G. Flagg, "An Empirical Application of Measures of Socialism to Different Nations," Western Economic Journal, VIII, No. 3 (1970), 233-40.

<sup>44</sup> Myron H. Ross, "Fluctuations in Economic Activity: Planned and Free-Market Economies, 1950-60: Comment /followed by G. J. Staller's Reply/", American Economic Review, LV (March, 1965), 158-64.

## CHAPTER IV

### THE TRADITIONAL AND COMMUNIST ECONOMIC SYSTEMS

#### Introduction

The economic systems of the traditional society and the communist countries are couched in a non-democratic political system. The traditional economic system and the communist economic system are discussed in this chapter. The goals and institutions of the two systems are enumerated, as was done for the democratic economic systems of the previous chapter. Although much could be written about the various goals and institutions, only the factors which are significant and necessary for the definition of the system are utilized in this chapter. The ideal type of communism is compared to the modern communist system where the Soviet Union is the prototype.

#### Traditional Economic System

"A traditional society is one whose structure is developed within limited production functions, based on pre-Newtonian science and technology, and on pre-Newtonian attitudes toward physical world."<sup>1</sup> When one examines the

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<sup>1</sup>W. W. Rostow, The Stages of Economic Growth (Cambridge: The University Press, 1967), p. 4.

traditional economic system,<sup>2</sup> the traditional system is found to be the more characteristic system of the economies of history and modern day society. The modern traditional society is not far different from the feudalistic systems of medieval Europe. "Economic progress is not inevitable, nor has it been typical of human societies. Stagnation has, perhaps, been the more normal condition of economic life. Resistance to change is strong in every society and medieval Europe was no exception."<sup>3</sup> Rostow, in his description of the traditional society, does not contend that an increase in output cannot occur in the traditional society, but that the means of output are "primitive," that output per head will not increase a great deal, and that most of the increase in output will be due to the use of more natural resources. Also, one will find that a high proportion of resources will be utilized in the agricultural sector.

The modern traditional economic system is typically characterized by both a technical and sociological dualism which has been of particular interest to some development economists. Dr. J. H. Boeke has constructed a theory of sociological dualism which he defines as "the clashing of an imported social system with an indigenous social system of

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<sup>2</sup>The term "traditional" is used to denote the type of system which is typified below.

<sup>3</sup>Dudley Dillard, The Economics of J. M. Keynes, The Theory of a Monetary Policy (London: Crosby Lockwood & Son Ltd., 1966), p. 26.

another style. Most frequently the imported social system is high capitalism. But it may be socialism or communism just as well, or a blending of them."<sup>4</sup> The underlying thesis is that the invading system is one of the Western culture based on a goal of unlimited needs, and the indigenous sector has confined itself to the maintenance of the status quo, or limited needs. In this type of situation, workers in the traditional society, Boeke contends, will not be motivated to work more in the case of increased hourly wages, but because of their limited needs will actually work less. Boeke's theory has been criticized because of some of the policy implications, but the concept of social dualism does give insight into twentieth century traditional economies.

Hagan<sup>5</sup> uses the dualism concept to characterize the idealized form of a peasant society.

A peasant society, he (Hagan) says, is first of all a dual society. It consists of a number of agricultural villages with one or more centers, which are trading cities or the king's courts. There is little migration into or out of each village. The occupation of the majority of people is small-scale agriculture, although there are a few craftsmen and traders. The family form is usually the extended family. Relationships among villages 'may be limited to a trickle of trade.' The elite live in the center, except for a few officials, teachers and rent collectors who represent the

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<sup>4</sup>J. H. Boeke, Economics and Economic Policy of Dual Societies (New York: 1953), p. vi.

<sup>5</sup>Benjamin Higgins, Economic Development, Principles, Problems, and Policies (New York: W. W. Norton & Company, 1959), p. 302.

central government in the villages. The society has little contact with foreign countries, 'though a small trickle of trade, and with it a small trickle of ideas across national borders, occurs.'<sup>6</sup>

Notice, the above characteristics are of the ideal type while the prototype of the traditional society follows below.

In addition to the social dualism model of Boeke, Benjamin Higgins has developed a model of technological dualism. "The two sectors are the industrial sector (mines, oil fields, refineries, etc.) and a rural sector engaged in production of foodstuffs and in handicrafts or very small industries. The first of these sectors is capital intensive."<sup>7</sup> The second sector is very labor intensive, and the production functions along with their technical coefficients are quite different. Instead of replacing the idea of social dualism, technical dualism complements and strengthens Boeke's model.

The interrelationships between the two sectors provide an interesting area of study both for the development and systems economists. For the development of the industrial sector, labor must be drawn away from the traditional sector and made useful through investment in human capital for the new types of work necessary in the industrialist enterprises. The two sectors within the economy provide sub-systems of the more general traditional system of which

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<sup>6</sup>Ibid., p. 303.

<sup>7</sup>Ibid., p. 326.

the presence of the two sectors is an integral characteristic. An important area for further research is an analysis of how the interaction of the two sectors influence the traditional economic system and its evolution towards an advanced system of capitalism, socialism, or communism.

Can one apply the concept of the traditional economic system with a justification from the methodology of economic systems in Chapter II? The author feels that the use of the traditional economic system is completely in keeping with the methodology, because by its use one can determine the motivating goals of the system, and the institutions which are characteristic of a traditional economy.

Max Weber<sup>8</sup> illustrated the methodology of typification in the case of the early feudal system. The basic goal of the economic system of the feudal society (seigniorialism) was one of maintaining the status quo. Production was to be sufficient to maintain a traditional life style for all of society. The social caste system was to be protected with the nobility being served by the serfs.

With a decentralized political system, the manor was the political and economic production unit of seigniorialism. Noblemen were granted the manor in return for political and military allegiance to the king. The work order of the manor was primarily serfs with some free peasants. If the work

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<sup>8</sup>Max Weber, General Economic History, translated by Frank H. Knight (Glencoe, Illinois: The Free Press, 1950), Chapters III and IV.



order was peasant, the land was to be rented from the nobleman with any surplus being taxed as additional rent. In general the manor was a self-sufficient production unit with farming, hunting, and small craft shops providing the needs of the manor.

City markets were permanent markets regulated by the merchant and craft guilds. The city markets provided the goods and services required in the urban areas primarily through small shops which were both retailers and producers. The status quo was maintained in the form of guild associations which served as the regulating agency determining entrance and quality standards.

One can construct the ideal type of feudalism by selecting the core features most representative of the economy. First, the production was designed to perpetuate the status quo. Secondly, the basic work order was based on a form of slavery (serfdom). The political system was a decentralized system of political and military power. The fourth core feature was a code of social honor which personalized the political and military relationships among the nobility. The manor system was the basic political and economic unit. The sixth core feature was that the total product was to be consumed. The seventh and final core feature required that the tools of warfare were to be produced and owned exclusively by the upper-class who had spent most of their life learning the skills of warfare.

Many similarities are evident between medieval England and the modern traditional society, especially in the goals. The n-achievement factor developed by Professor McClelland is an attempt at measurement of human motives and represents the achievement ideas and images of the people within a country. He has found that this score or measurement is significantly lower for people in the countries with a traditional economic system than that found in the more advanced countries.<sup>9</sup> This indicates a lack of individuals with an "entrepreneurial motivational complex." The significance of this study on the examination of goals motivating the system is obvious. The people have neither the desire nor ability for the progressive development found in advanced countries.

The lack of obvious opportunity feeds on itself, and the goals become oriented towards the status quo.

The value system of these societies was generally geared to what might be called a long-run fatalism; that is, the assumption that the range of possibilities open to one's grandchildren would be just about what it had been for one's grandparents. But this long-run fatalism by no means excluded the short-run option that, within a considerable range, it was possible and legitimate for the individual to strive to improve his lot within his lifetime.<sup>10</sup>

The status quo goal for the society is prevalent within most of the countries with a traditional economic system.

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<sup>9</sup>Higgins, Economic Development, Principles, Problems and Policies, p. 255.

<sup>10</sup>Robert C. Meier, William T. Newell, and Harold L. Pazer, Simulation in Business and Economics (Englewood Cliffs: Prentice-Hall, Inc., 1969), p. 14.

The goals of the traditional economic system vary by the status of the individual. The power groups view the export trade as an opportunity for increased wealth and power. The tendency is to encourage trade even at the expense of creating a situation in which their country becomes even more dependent on the dominant countries which are using trade as a form of exploitation. The small land holders concentrate on a goal of providing a better life for their children and maintaining their own position of independence. More land can mean better education and a better economic situation for future generations. The large majority of the people, however, must be content with status quo, and the goals remain constant.

With the introduction of the modern sector, there has been developing a desire for products and the life style of the Western world. The goals, although possibly now in the process of transition, are presently status quo oriented. The resources are not readily available, either human, raw materials or capital. One finds the fatalistic attitude remaining whether it be justified or not. "The people of the underdeveloped areas are more eager to consume the goods of the Western world, than they are to duplicate the saving and the quantity and quality of work which have produced the higher standard of living in the West."<sup>11</sup> The wishes

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<sup>11</sup>Higgins, Economic Development, Principles, Problems and Policies, p. 255.

or dreams have not yet been transformed into the motivating force that could be classified as a goal of the system.

The market institution of the traditional economic system can be divided into the dual sectors analogous to those mentioned above. But a third sector must be included in the discussion of the market system because in practically all of these countries the international market is a large segment of the commercial enterprise.

The first sector is the market found in the rural areas and the small villages. The commodities traded are primarily the necessities of food and clothing, and a very competitive market exists in many areas. The "one price" system is often absent with a great deal of bargaining resulting. Products brought to the villages from the industrial sector are mostly sold in a monopoly market since the demand is not large enough for more than one outlet.

In addition to the village markets, the rural market includes the trade that transpires between the large land owners and the tenant farmers. The trade is one based on an imbalance of power in which the land owner uses the market to his advantage. Goods are sold by the owner to the tenant farmer, often at inflated prices. This market is used by the land owner to maintain his power relationship by keeping the tenant in debt to him. In Puerto Rico,

. . . the small farm store, owned by the patron, helped to insure a steady labor supply. Not only did it keep the tenant in debt to the owner so it was impossible for him to move away, it also was

a source of income which returned to the landlord almost all of the money paid out by him in wages.<sup>12</sup>

As the industrialized sector grows larger, the effect of the rural sector is generally detrimental.

Imagine, for example, a typical underdeveloped country exporting, say petroleum and plantation products; importing textiles, other consumer durables, and luxury foodstuffs; producing rice, fish, and handicraft products in the rural sector and trading in these. Favorable development in the industrialized sector (improved techniques, higher world market prices) will not increase the demand for the output of the rural sector. Indeed, in so far as the rise in income of the industrialized sector is shared by domestic workers, the demand for output of the rural sector may even fall as these workers substitute 'superior' imported consumers' goods for home produced ones. On the other hand, any favorable development in the rural sector will increase the demand for industrial products imported into that sector (either from outside the country or from the industrial sector of the same country) and reduce the demand for output of the rural sector.<sup>13</sup>

Almost all of the countries with a traditional economic system have one or more cities in which a more Western type of market exists. The competition is stronger, and more goods meet more consumers. These are the expanding markets which bring about the kind of changes described in the above quote. A major part of the industrial market is the international market which is of prime importance to the economic well being of the country.

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<sup>12</sup>T. D. Curtis, Land Reform, Democracy and Economic Interest in Puerto Rico (Tucson: University of Arizona Press, 1966), p. 21.

<sup>13</sup>Higgins, Economic Development, Principles, Problems, and Policies, p. 382.

A professor<sup>14</sup> from the University of Chile stresses the strong dependence established through the international trade market. The trade is monopolistic with the countries of the traditional economic system suffering from the imbalance of power. The dominant countries are free to establish the terms of trade. The surplus generated in the traditional countries is transferred to the dominant countries. Although much of the capital used in production is brought into the underdeveloped country, much of the financing is done from within the dependent country. Using the imbalance of power, the dominant nation can exploit both the labor and financial resources of the traditional society. "The result is to limit the development of their internal market and their technical and cultural capacity."<sup>15</sup>

The export trade does not always have the desired effect on the economy which the development economist would hope. Instead of producing a strong educational, training and industrialization program within the country, the methods of increasing production are often simply adding more land and more labor to an already labor and land intensive production process. One beneficial spin-off from the export trade is a good public transportation system. However, the import and export market often adds to the dualism within

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<sup>14</sup>Theotonio Dos Santos, "The Structure of Dependence," American Economic Review, LX, No. 2 (May, 1970), 231-36.

<sup>15</sup>Ibid., p. 231.

the country rather than to the advancement of the total economy.

In a summation of the traditional economic system market, one of the countries of the study, Ceylon, provides a good typification of this type of market.

To even a greater extent than in Western countries, retail markets do not fit neatly into the textbook models. The government is the sole importer of rice and sugar and sells rationed quantities of subsidized rice through officially sponsored co-operative stores, and imports and distributes products through a marketing organization that has the power to impose maximum and minimum prices upon the companies that compete with it. Westernized retail houses with standardized and trademarked items usually sell their merchandise at quoted prices, but elsewhere bargaining is common. In Colombo and a few other towns outlets range from fairly large department stores to a very small shops and stalls in farmers' markets; in most towns all outlets are quite small. Except in Colombo the volume of business transacted within an area is usually so slight as to enforce spatial monopoly or oligopoly, and in many lines even Colombo's sales are too few for multiple sellers. Class divisions and language barriers as well as imperfect knowledge limit both current competition and the entry of new firms; and the lack of a strong tradition of business enterprise plus the relatively low prestige which trade enjoys among the better-educated Ceylonese also tends to keep profits from efficiently fulfilling their textbook functions.<sup>16</sup>

Countries which have a traditional economic system have unskilled labor as their most abundant factor of production. The surpluses of untrained and unskilled labor are found both in the rural and industrial sectors, but it

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<sup>16</sup> Henry M. Oliver, Jr., "The Economy of Ceylon," in Economic Systems of the Commonwealth, ed. by Calvin B. Hoover (Durham: Duke University Press, 1962), p. 210.

is more obvious in the urban areas. Because of the high seasonality of work in the rural sector, nearly all of the laborers can be used during the peak work load periods. The underemployment is as widespread as unemployment for this reason. Workers are employed, but the amount of employment available is less than the desired amount.

In regard to the problem of labor, Western technology has often been more of a hindrance than a help.

Unfortunately, technological research has been carried on mainly in countries where labor is a relatively scarce factor. Technological progress is regarded as a synonym for labor-saving devices. Little scientific endeavor has been directed toward raising production in countries where capital is scarce and labor abundant, and where consequently, labor-saving devices make little sense. No advanced technology has yet been discovered which is suited to the factor-proportions of underdeveloped countries.<sup>17</sup>

Paradoxically, while the surpluses are found in the labor sector, it is in just that sector that we see a real shortage. The need is for labor with any kinds of skills and training. The traditional system country has a dearth of professional, technical, and managerial people. Even craftsmen and low grade technicians are in short supply. Capital can be considered as both real capital and human capital. Investment in human capital is general education, special job skills, and training required to be an effective worker.

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<sup>17</sup>Higgins, Economic Development, Principles, Problems, and Policies, p. 258.



From this point of view, it may well be, as Professor Kuznets suggests, that instead of a difference in net capital formation proportions between 10 per cent in rich and, say, 3 per cent in poor countries, the true difference is closer to between 20 per cent or over and 3 per cent.<sup>18</sup>

The government as an institution in the traditional system countries is not well established and political instability is common.

Although central political rule--in one form or another--often existed in traditional societies, transcending the relatively self-sufficient regions, the centre of gravity of political power generally lay in the regions, in the hand of those who owned or controlled the land. The landowner maintained fluctuating but usually profound influence over such central political power as existed, backed by its entourage of civil servants and soldiers, imbued with attitudes and controlled by interests transcending the regions.<sup>19</sup>

The poor connection in terms of communication and transportation limits the extent to which the government can control the outlying regions. In addition, the poverty of the rural sector limits the interest which the government would have in these areas.

The government does provide some services in the traditional economic system. One of the primary services is found in the construction of an infrastructure. Roads and other forms of transportation are constructed along with communication systems in an effort to derive an economic gain of the raw material resources. Government participation

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<sup>18</sup>Meier, Simulation in Business and Economics, p. 268.

<sup>19</sup>Rostow, The Stages of Economic Growth, p. 6.

has been greater in the areas of transportation and communication than in establishing networks of power.<sup>20</sup> These activities of government involve long range planning and investment which has proved troublesome since the payoff is not realized for years and also since the implementation of the plans are often hampered by the instability of the government.

Most countries have established a central bank, but this government agency is somewhat divorced from the commercial banking system. In most countries the central banks lend less than 10 per cent of their loans to the commercial banks. The principal activity of the central banks consist in guiding the economy through suggestions and advice given to the commercial banks.

The institutions of the traditional economic system are found to be generally in keeping with the goals. The dichotomy is found in the technical and sociological dualism which splits the economy into the rural and industrial sectors. The countries for which data was available that demonstrate the economic goals and institutions of the traditional economic system are Ceylon, Chile, Colombia, Dominican Republic, Honduras, Paraguay, Peru, Tunisia and Guatemala.

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<sup>20</sup>Meier, Simulation in Business and Economics, p. 447.

### Classical Concepts of Communism

Schwartz comments, "At the very outset, one is struck by a curious fact: for all the many decades of discussion and propaganda about communism, nowhere is there any clear, simple and generally accepted blueprint explaining what a Communist society would be like."<sup>21</sup> The purpose of this first portion on communism is to examine some of the concepts of classical communism. The transition stage of socialism as envisioned by Lenin and Marx will also be considered since the Communist nations still admit that they have not yet achieved full communism. If the classical writers did little to satisfy Harry Schwartz in their discussion of communism, they did even less in planning the transitional phase of socialism.

### Marxist Economics

The goals of the early communist movement were goals of Utopia. The society was to develop to the supreme state of living and human intercourse where each member of society would give to the central storehouse according to his ability. The goal of a utopian society would be achieved through the removal of repression of the capitalists. In the provision of the utopian state, the two primary institutions which

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<sup>21</sup>Harry Schwartz, "What's Communism? Is It Being Achieved?" in The Soviet Crucible, ed. by Samuel Hendel (3rd ed.; Princeton: D. Van Nostrand Company, Inc., 1967), p. 377.

the classical communists elucidated were the state and the ownership of property.

The basis of the Marxist theory is the labor embodied theory of value which he used to show the disintegration of capitalism. Labor alone creates value, and the capitalist profit is derived from the surplus value created by labor. Since surplus value (profits) is created by exploitation through the use of capital, the competitive system would encourage the concentration of capital. The accumulation of capital in the form of labor-saving devices reduces the need for human resources. As one capitalist gains an advantage through more intensive use of capital, the competitive system forces other capitalists to also utilize more capital. The unemployment resulting from this process forces wages down and leads to the increased misery of the workers and a larger portion of the labor force unemployed. The continuation of the process is dictated by the capitalist system. The increased misery and unemployment will eventually result in a combined effort of the repressed to destroy the whole system.

The state was an instrument of the system and an instrument of class oppression. However, Marx realized that even a classless society would need an organization to discharge the functions of maintaining order and providing services for the general welfare of society. He insisted that this would not be a State because he defined "State" as an instrument for oppression. The State would be replaced

by an organization which he labeled "the dictatorship of the proletariat." The dictatorship would serve the people as a protection against "counter-revolutionary" forces.

One other economic institution that is mentioned briefly in the writings of Marx is the labor force. The primary idea presented in this connection is that all would be required to work and since the profits would go to all of society through the state, no one would be exploited through the process of production. The only exception to this rule was the children, which Marx contended had been treated unfairly by the capitalist. The communist state would provide a free, universal education for all children in public schools.

Marx stated in the Communist Manifesto that the "theory of the Communists may be summed up in one sentence: Abolition of private property."<sup>22</sup> The underlying idea was that property was owned and controlled by the capitalists and was being used by the bourgeoisie as a means of repression of the working people. Under communism all property would be owned by the people and used for all of the people. Capital is not a private good and is not to be owned as private property, but it is a social good to be owned and controlled by society. Land, according to Marx, would be

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<sup>22</sup>Karl Marx and Friedrich Engels, "The Communist Manifesto," in Comparative Economic Systems: A Reader, edited by Marshall I. Goldman (New York: Random House, 1964), p. 221.

owned by the state, and the application of all rents on all lands would be put to public use. In order to protect society from the possibility of individual members accumulating goods, a very progressive income tax would be imposed, and all rights of inheritance would be abolished.

### Lenin's Contributions to Marx

Lenin more firmly established the idea of the state as a necessary institution of the transition stage in the march to full communism. The state would be used to repress the small minority of the bourgeoisie. Lenin contends that this use of the state is necessary to provide the freedom promised by communism. Only through the continuing protection of the masses from the bourgeoisie could true freedom be realized. Democracy was to be an integral part of the freedom provided under the communist rule. In the sense that the government was to be democratic, the state was not an institution to "govern" but the state was to be representative of the people and was designed simply to administer. Only after the establishment of the "dictatorship of the proletariat" could democracy be established for the poor.

Although Lenin used the writings of Marx in an opportunistic sense, one should not fail to realize that he firmly believed in the Marxist ideology. Lenin added much to the Communist doctrine which is evident in modern communism. The theory of revolution and the role of the Communist Party are discussed as the major additions of Lenin.

Lenin established the idea that the Communist Party was the vanguard of the working-class and was the organization that could bring about revolution. As such, it was necessary that the party be united, working towards common goals. To maintain the working power of the party, it must constantly purge itself of the undesirable opportunistic elements. The party must be well disciplined and knowledgeable of revolutionary theory with a political and economic program. The necessity for unification dictated that the party be centrally controlled during the period of revolution.

The spirit and enthusiasm of the younger communists was useful, but Lenin realized that the Communist Party must establish a base of power before revolution could be achieved. The "abstract communism" must be replaced through government organizations and labor unions to provide for the practical mass political action. The drive for power could not be met merely through agitation and propaganda, but would require a most difficult form of compromise. While adhering strictly to communist doctrine, the practical compromises must be accepted when these could provide the basis of attracting the support of the large population which would make revolution a reality. Workers were encouraged to assist by working within the trade unions while others worked in political organizations.

Stalin's Contributions  
to Marxist Theory

Stalin's greatest contribution to Marxist theory was his doctrine of socialism in one country. The theory was established on an idea of Lenin which stated that unequal development was characteristic of capitalism. The necessity of establishing the doctrine was evident to Stalin as he saw the capitalist power surrounding Russia leaving little hope for including Western Europe in the revolution at that time. The defense of the Soviet Union and the need for support from the peasants required collectivization. Socialism could succeed only by establishing the security of the "new order." However, once the strength is established, Stalin contended that the communist movement would continue as other countries could be freed from the chains of capitalist imperialism.

In addition to socialism in one country, Stalin rationalized the maintenance of the state in the transition period of authoritarian Socialism. The argument was again one of strength and protection. As long as the capitalists have power, the communists must have the services of the state to assure that the communist movement could continue. Within the country the state was to provide for cultural and economic organization, but the armed services were necessary to protect the socialists from capitalist interventions.



Khrushchev

After the terror of the purges and the war years, the emphasis was placed on collective leadership. The "cult of personality" was condemned by Khrushchev, and he proposed a collective leadership of the government. While proposing the idea of collective leadership, he was managing to gain the power which was necessary for him to emerge as the leader of the Soviet Union.

The doctrine of "peaceful coexistence" is perhaps Khrushchev's most important to the Marxist theory. He felt that the stage had been reached where the competition between the communists and capitalists could be realized without the necessity of military force. By evaluating the economic success of both systems, Khrushchev contended that the communist system would best develop the productive use of capital and labor. The evidence would be convincing to the degree that the necessity of military conflict could be eliminated.

The primary institution of the communist economy which was not described by Marx and the others was the communist price system. This, as is indicated in the discussion of modern communism, has been a problem that is very much evident today. Even in the transitional state of socialism, the requirement of central planning and resource allocation has necessitated some changes in the basic economic system.

Modern Communism

An important question is what, if any, has been and continues to be the significance of Marxist theory for an understanding of the Soviet system. The fact is that, although far-reaching changes have occurred in the U.S.S.R. since the death of Stalin there has been little reconsideration of the conception, long and generally favored in the West, that however variously Soviet history may be explained or appraised, commitment to Marxist theory on the part of Soviet leaders forms little or no relevant part of that explanation or appraisal.<sup>23</sup>

Although the polycentric power structure of modern communism makes it impossible to categorize all communist countries, "the Soviet economy is the prototype of the economies of the communist-bloc nations."<sup>24</sup> In the following discussion of the goals and institutions of modern communism, the Soviet economy will be used primarily with reference to the distinguishing features of the other economies. The polycentrism is more that of political alignment than of the economic system.

"In the Soviet view, technological progress is not only virtually synonymous with human progress, but it is also an overriding national goal and a major element of legitimation of Communist rule in Russia."<sup>25</sup> The goal of

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<sup>23</sup> Samuel Hendel, "The Role of Theory," in The Soviet Crucible, ed. by Samuel Hendel (3rd ed.; Princeton: D. Van Nostrand Company, Inc., 1967), p. 408.

<sup>24</sup> Allan G. Gruchy, Comparative Economic Systems (Boston: Houghton Mifflin Company, 1966), p. 606.

<sup>25</sup> Gregory Grossman, "Innovation and Information in the Soviet Economy," American Economic Association Papers and Proceedings, LVI (May, 1966), 118.

technological progress is used as the reason for many actions by the State, e.g. the dearth of consumer goods within the economy. In addition technological progress is seen as the means of increasing the power of Communism in the world community and eventually of alleviating poverty in the Communist world.

The technological interest has been primarily in the area of heavy industry in an effort to build a strong industrial basis for the communist system. Stalin emphasized heavy industry nearly to the exclusion of all other sectors. His heirs, however, have given more attention to light industry and agriculture providing more for the consumers in order to gain populous support. Even today heavy industry still gets top priority because it is only through a large industrial system that the goals of communism can be reached.

The goals of technology and broad based industrialization might be seen as sub-goals of the primary goal of communism. "The political system of the Soviet Union is designed to give the executive a maximum of power for the purpose of effecting an economic transformation."<sup>26</sup> The utilization of the economic transformation for the retention of power appears to be omnipresent. The preservation of power for the communist nations, the Communist Party, and

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<sup>26</sup> Carl Landauer, Contemporary Economic Systems, A Comparative Analysis (Philadelphia: J. B. Lippincott Company, 1964), p. 421.

the leaders is one of the goals present throughout communist history. Khrushchchev felt that the power of the communist bloc nations was firmly entrenched and felt that this could be maintained with a policy of "peaceful coexistence," but indicated that any means that were necessary would be used to maintain this position of power. He justified the theory by maintaining that the superiority of the communist system over the capitalist system would be evident. The class struggle would not be eliminated, but it would not necessarily be violent. In addition to the external preservation of power, the Communist Party is organized to provide for the preservation of the power of the executive leaders within the system. The Communist Party utilizes their interpretation of the Marxist ideology as their justification for actions and the retention of power. Most economic actions and institutions in the Soviet government are established with these goals in the center of the plans.

In the examination of the market system found under the rule of communism, one finds it helpful to divide the market into the producer goods sector and the consumer goods sector. "Prices for producer goods are administratively set (or, at least, approved) according to complicated principles and procedures which may have their rationale but in any case do not purport to seek either scarcity or equilibrium levels."<sup>27</sup> Prices, however, are not the only

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<sup>27</sup>Grossman, "Innovation and Information," p. 119.

consideration of the market for producers goods. One may not buy producers goods without an allocation which is given by the central planning authorities. The allocation is often the overriding element of exchange, with prices playing a secondary role. In the case of producers goods, the price system is irrational because the price does not adequately represent real cost and yields an inefficient allocation of resources. For day-to-day production decisions, the most important economic information consists of plan targets, supply allocations, and success indicators.

The Soviet Union has established a somewhat similar market in the area of Consumers Market. It has, however, maintained an open market in most cases. Some goods, for example health and education, are distributed in the form of free communal consumption. For other goods most prices are established by the government at two levels of distribution. The retail price is set at approximately twice the wholesale price. The difference between the two prices is composed of distribution costs, a small amount of planned profit, and a turnover tax.

The size of the turnover tax suggests that almost half of the retail price of most goods is unrelated to cost. The purpose of the turnover tax appears to be twofold: (1) to accumulate money for government expenditures, a function of most taxes; (2) to serve as an instrument for regulating demand.<sup>28</sup>

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<sup>28</sup>Marshall I. Goldman, Soviet Marketing (Glencoe, Illinois: The Free Press, 1963), p. 86.

In the consumers markets, the two basic categories of retail outlets are the government owned and operated stores and the farmer's markets (Kolkhoz). The government controlled outlets are divided into the government stores and the consumer cooperatives. One should not be misled by nomenclature because the two types are essentially the same. Government stores are more predominant in the larger cities and are the larger outlets. Although the consumers cooperatives are controlled by another bureaucratic network, both types are completely regulated by the Ministry of Trade.

The farmer's markets (Kolkhoz) is a free market in which excess produce is brought to the villages. While the government purchases almost all of the farm produce, the workers are allowed to market the remainder. The kolkhoz markets sell less than 10 per cent<sup>29</sup> of the retail markets, and the past two decades have seen a decline in the importance of this free trade. However, the Kolkhoz provides an importance source of produce in the rural areas.

Professor Bergson<sup>30</sup> contends that the price system is nondiscriminatory. There is a form of discrimination in the prices between the rural and the urban markets with prices being somewhat lower in the latter. Also, the prices in the government store seem somewhat lower than in the

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<sup>29</sup>Ibid., p. 45.

<sup>30</sup>Abram Bergson, The Economics of Soviet Planning (New Haven and London: Yale University Press, 1964), p. 67.

consumers cooperatives. The price system does violate the efficiency rule that the prices be set at clearing levels. The communist price levels have remained static except in certain instances where a price reduction is allowed to move accumulated goods and when general price changes are effected. With the introduction of the Liberman proposals discussed below, the wholesale and retail prices were changed on a mass scale in the late 1960's.

The markets of the Soviet Union require an extensive planning apparatus to function as an allocator of resources.

The Soviet national planning apparatus is best conceived of as a hierarchical pyramid at the apex of which is (1965) the U.S.S.R. Supreme Economic Council. Below this top planning organization, the planning apparatus broadens through a number of 'staff' and 'line' administrative layers at the national, republic, regional, provincial, district, city, and local levels. At each lower level, the planning activity is spread over a larger number of planning organizations until the bottom of the hierarchical pyramid is reached, where are found the planning departments of many thousands of operating plants and other establishments.<sup>31</sup>

A detailed analysis of the planning apparatus is beyond the scope of this study, but one should note a few implications of the economic system.

The planners of the Soviet Union looked to the capitalist countries for techniques of planning after the death of Stalin. One of the most important contributions to Planning was input-output analysis originally developed

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<sup>31</sup>Gruchy, Comparative Economic Systems, p. 653.

by Wassily Leontief. The increasingly complex interrelationships of resource need and supply in the Soviet Union have been simplified to an extent by the construction of input-output plans. The input-output table shows the technical relationships between the resources necessary to produce the required output. Since these relationships are constructed on present technology, they are evolving, but remain relatively stable. Because of the necessary interdependence, plans constructed by input-output analysis assume that the inputs required will be forthcoming. Changes in either available input or required output necessitates a reformulation of the input-output plan. Equilibrium is therefore the basic requirement of the mathematical technique.

The Russians have prepared a succession of input-output tables of increasing size and refinement. The latest stage in their experimentation is to use the input-output table to generate the levels of output and its allocation implicit in the plan targets for some future year and then to check these against the plan worked out in the actual planning process. The results are said to be encouragingly close but the Russians are apparently not yet willing to trust actual operational planning to the computer.<sup>32</sup>

The Soviet planning system is designed to solve the same basic economic problems the capitalist price system solves--what to produce, in what ways, and for whom. The two basic types of plans are long term plans of five, seven,

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<sup>32</sup>Robert W. Campbell, Soviet Economic Power: Its Organization, Growth, and Challenge (Boston: Houghton Mifflin Company, 1966), pp. 50-51.



or more years and the current or annual plans. The long term plans are goal oriented, and the annual plans are operation oriented. Planning is a continuous process covering all areas of economic activity; but, in keeping with the communist goals, heavy emphasis is placed on individual plans.

The Soviet approach to short-term (output) and long-term (expansion) planning is predominantly technical. It implies

- 1) Direct determination by the policy makers of both final outputs and some key intermediate products in physical terms.
- 2) Quantitative explanation of the production functions and gradation of technical efficiency of the available plants.
- 3) Direct allocation of scarce resources in relation to the selected output and expansion targets.
- 4) Reliance on a whole set of commands concerning investment, outputs, procurement, wage levels, and use of variously adjusted prices in order to reinforce the physical technical provisions of the plan.
- 5) Utilization of market mechanisms for deploying labor according to the plan and for the distribution of consumers' goods.
- 6) Loose coordination between the set of physical balances concerning a variety of products and the monetary balances concerning certain macroeconomic magnitudes, such as investment and the income and expenditures of the population.<sup>33</sup>

Planning is a necessary and central part of the communist economic system. The plans utilize an enormous amount of statistics, which in the past have been unreliable and have produced unwieldy models. One has seen the evidence

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<sup>33</sup>Nicholas Spulber, The Soviet Economy, Structure, Principles, Problems (New York: W. W. Norton & Company, Inc., 1962), pp. 47-48.

of some changes in the system of planning, and the Liberman proposals are an integral part of the recent changes.

The potentialities and possibilities available in mass standardization have always been regarded as a great source of economic efficiency to the true theorists. Efficiencies could be realized because time and energy would not have to be wasted with such mundane activities as model changes or other changes merely used for consumer satisfaction but which did not add to the efficiency or operation of the item. The production methods could be perfected, and the optimum mix of the factors of production could be realized with the proper use of the scientist and engineer. "It was not exactly surprising, therefore, to find that the Russians did in fact begin to excel in many fields of production and that output increased rapidly, especially in those areas like steel production, to which they decided to devote their chief attention."<sup>34</sup>

In the 1950's the Soviet economy, having recovered from the effects of World War II, seemed to prove that the theorists were correct regarding the potentialities of mass standardization made possible with centralized planning. "Gross national product increased at an average annual rate of about 7 per cent, and industrial output rose more than

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<sup>34</sup>Marshall I. Goldman, "The Economy at the Crossroads," Survey (October, 1965), p. 126.

10 per cent annually."<sup>35</sup> The migration of the workers from the rural areas to industrial centers greatly increased the labor productivity and industrial output. The growth age of the 1950's came to somewhat of an abrupt halt at the turn of the decade. Part of the abruptness of the halt was due to the weighting system used in the statistics which exaggerated the growth. Also, the improvement in quality of recent years cannot be given adequate attention in the converted use of statistics. But there were much more basic reasons for the slowdown. "The Soviet Union suffered from exhaustion of easily-accessible or already-existing resources of minerals, timber, and transport."<sup>36</sup> To expand to other resources, large investments would be needed in the infrastructure. Another reason is the fact that the attention was changing from the industries of steel and coal to more exotic industries such as nonferrous metals, plastics, petroleum, electronics and chemicals. These newer industries could not utilize effectively the apparatus designed for mass standardization and centralized planning.

As the economy becomes increasingly more complex, the planning function itself becomes somewhat unwieldy.

In brief, the Soviet economy today faces an enormous organizational and institutional problem, the problem of finding a workable degree of centralization

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<sup>35</sup>Gertrude E. Schroeder, "Soviet Economic 'Reforms': A Study in Contradictions," Soviet Studies (July, 1968), p. 2.

<sup>36</sup>Alec Nove, Soviet Politics Since Khrushchev, p. 80.

(or decentralization) under new and changing conditions . . . The sheer bulk of the planning job, as it is now carried on in the Soviet Union can be mathematically likened to the square of the number of commodities plus the square of the number of economic units. As both products and producing units multiply with the economy's growth, the task of planning swells much faster.<sup>37</sup>

Not only the mechanics of the planning process has come under fire, but also the indicators that are emphasized by the Soviets. The fulfillment of the output target received primary emphasis, with the managers who are able to meet or surpass the output plans getting the rewards of the system. According to Harry G. Shaffer this particular system has several shortcomings.<sup>38</sup> With the emphasis being placed on output, there is a tendency to hide and hold in reserve the true productive capacity of the plant. In addition, because of the need for capital, a "good" manager will try to get as much as possible and will produce those goods which will help him fulfill his output plan without the attention being given to the quality and usefulness of the commodity. Even Khrushchev brought this out when he vividly described the abuses of the plan in 1959.

It has become the tradition to produce not beautiful chandeliers to adorn homes, but the heaviest chandeliers possible. This is because the heavier the chandeliers produced, the more a factory gets since its output is calculated in tons. So the factories

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<sup>37</sup>Gregory Grossman, "The Soviet Economy," Problems of Communism (March-April, 1963), p. 41.

<sup>38</sup>Harry G. Shaffer, "What Price Economic Reforms?" Problems of Communism (May-June, 1963), pp. 19-21.

make chandeliers weighing hundreds of kilograms and fulfill the plan. But who needs such a plan?<sup>39</sup>

In addition to producing the wrong goods, the Soviet economist Professor Yevsei Liberman felt this "incentive-system . . . is a direct impediment to increasing product quality or mastering new products."<sup>40</sup>

When the slowdown occurred in the Soviet economy, the leaders started trying to correct the ills. The "output incentive" had been under attack by the Soviet economists for some time. There were several economists suggesting reforms, but for this paper only one economist will be considered. He is Professor Yevsei Liberman, the economist whose name gave the title "Libermanism" to the reform school of economists. Liberman started writing about the reforms as early as 1948, and during the strong economy of the 1950's was predicting a slowdown due to sectorial shifts which finally occurred, but he was able to get his writings recognized only after the trouble occurred. Probably his most meaningful article was "Enterprise Profits as Basis for Incentive Payments" in Pravda, September 9, 1962, in which he outlined his primary proposals for reform.

Liberman is interested in solving one of the major problems set forth in the Party Program. This problem he

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<sup>39</sup>Harry Schwartz, The Soviet Economy Since Stalin, p. 141.

<sup>40</sup>Yevsei Liberman, "Enterprise Profits as Basis for Incentive Payments," The Current Digest of the Soviet Press (October 3, 1962), p. 14.

sees as "the formation of a system of planning and assessing the work of enterprises so that they have a vital interest in higher plan assignments, in the introduction of new technology and in improving the quality of output - in a word, in achieving the greatest production efficiency."<sup>41</sup> One should note here that what he was interested in was a plan that would cure the ills of the old planning system. A new plan would call for improved technology and would be more compatible with the more modern industries of electronics and chemicals.

The plan which he proposed still involved the party's assigning output requirements and assortments or mix of the products. At this point the enterprise would receive a certain amount of autonomy in that the decision as how to meet the output requirements. "On the basis of volume and assortment assignments they receive, the enterprises themselves should draw up the final plan, covering labor productivity and number of workers, wages, production costs, accumulations, capital investments, and new technology."<sup>42</sup> Instead of output being the index upon which incentive is based, profitability now comes to the front as the primary index on which incentive would be based.

What this means is that the more profitability shown by the enterprise, the greater would be the incentive paid

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<sup>41</sup>Ibid., p. 13.

<sup>42</sup>Ibid.

by the party. For example, if profitability went up by a factor of ten, then the incentive might be doubled. This example shows that much of the increased profit would go to the Party, but some would be used as an incentive for the company. According to the Liberman proposal, the company would receive incentive based on the plan which it sets up. If they do not reach the planned objective, the incentive would be based on the amount of profit actually realized, but if the profitability was greater than the set objective, the incentive would be based on the profit half-way between the objective and the profit realized, thus encouraging the setting of a high objective.

"The best general yardstick of efficiency to choose would be profitability, in the form of a percentage of capital. Why? Because this is the most complex standard of measurement."<sup>43</sup> This type of plan would make it necessary for the enterprise to make the best possible use of the factors of production--land, labor, capital, and entrepreneurship. Excess capital equipment and labor would lower profits, and these are the things which were being requested under the old planning system. Also, enterprises would not be so eager and devote so much attention to trying to lower the output requirements. The lowering of output would in general lower the firm's potential for making profits.

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<sup>43</sup>Yevsei Liberman, "Liberman's Reply to Critics of Profits Proposal," The Current Digest of the Soviet Press, December 5, 1962, p. 17.

Again, one of the shortcomings of the output incentive plan would be eliminated.

Liberian further asserts that his proposed plan would relieve the administration of the centralized planning from "the petty tutelage over enterprises." Under his plan, economic measures would be substituted for the more costly and less effective ones which are purely administrative.

Firms would not have a chance to concentrate on those items which are the most profitable because no incentive pay would be given unless the required output and assortment is provided. Also, new products would be encouraged by additions to or reductions to incentives based on the relative amount of new products and new technology incorporated in the firm.

One should be careful not to identify the Liberman plan with capitalism. Liberman was very careful to make sure that people did not misunderstand his use of profits in the Soviet system.

Some economists say that profit should not be made too conspicuous, that this is supposedly a capitalist index. This is not so! Our profit has nothing in common with capitalist profit. Our profits . . . is the result and at the same the measure (in monetary terms) of the actual effectiveness of labor expenditures.<sup>44</sup>

The profits are created not for the good of the management, but, as under capitalism, are to be returned to the owners

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<sup>44</sup>Yevsei Liberman, "Enterprise Profits as Basis for Incentive Payments," The Current Digest of the Soviet Press, October 3, 1962, p. 14.



of the capital. Naturally, in the Soviet Union, profits are created for the benefit of the masses. "Profitability of Soviet enterprises is their ability to yield a net income for society, and it is, therefore, a qualitative index, and its measure can be only a relative value."<sup>45</sup>

#### Economic Reforms in Practice

The debate went on among the economists for several years. "Finally, a cautious but perhaps a desperate Khrushchev decided to permit tryouts of some of the proposals in a non-priority sector of the economy."<sup>46</sup> The tryouts began on a small scale with two large clothing firms being selected for the experiment in 1964. The new rules established a great degree of freedom for the managers to operate the plants in a way which they felt would be the best manner to meet the new success criterion. As suggested under the Liberman proposal, output and assortment mix were established by the party leaders, but profitability was set as the measure for success. The experiment was widened in 1965, as approximately 400 consumer goods firms and their supplies as well as a few plants in other industries were added to the experimental firms.

Although the firms met with the expected problems of implementing new methods and measurements, a degree of

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<sup>45</sup>Yevsei Liberman, "Profit as the Servant of Communism," in The Soviet Crucible, ed. by Samuel Hendel, p. 340.

<sup>46</sup>Schroeder, "Soviet Economic 'Reforms,'" p. 3.

success was obtained. Enough success was obtained that in September of 1965 at Party Plenum Premier Kosygin proposed a sweeping series of reforms to be introduced on a gradual basis, but to be completed by 1968 in the industrial sector.

Several major provisions for the reform were set forward in the conference. First, the regional economic councils were replaced with 23 industrial ministries. The enterprises, as had been suggested in the Liberman proposal, were given a larger share of the planning function. Before the Party Plenum, there were some 35 to 40 key indicators, but all of these except eight were turned over to the enterprises. The eight remaining in the hands of the central planners are physical output of the principal products, sales, profits and profitability, wage fund, payments into the state budget, capital investment from centralized funds, tasks for the introduction of new technology, and material supplies. The third provision adopted was the heart of the Liberman proposal. The output incentive was replaced with profits and profitability for measurement of success of an enterprise and as a basis for determining the bonuses which are to be paid for good management. Also, a charge was introduced for the use of invested capital. Finally, it was stipulated that the reform of industrial prices which had been in process for some time would be completed.<sup>47</sup>

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<sup>47</sup>Ibid., p. 4.

In a speech<sup>48</sup> regarding the economic reforms, Kosygin first described the achievements of the Soviet successes in electronics, metallurgy, chemicals and other modern fields. Weaknesses of the economy were pointed out as being temporary, but the planning procedures were in need of study and revision, according to the Premier.

The forms of industrial management, planning and incentive now in effect no longer conform to present-day technical-economic conditions and to the level of development of production forces. The economic initiative and rights of enterprises are constricted, and they have insufficient responsibility.<sup>49</sup>

The resolution coming out of Plenary session of the C. P. S. U. Central Committee seemed in many cases to be a simple repeat of the Kosygin speech.

This (economic reform) ensures further expansion of democratic principles of management, creates the economic prerequisites for the broader participation of the masses in the management of production and their influence on the results of the economic work of enterprises.<sup>50</sup>

The anticipation which followed the adoption of these proposals was somewhat greater than the implementation. The instructions regarding the reform were started in the early part of 1966. In reality 1966 was an extension of the experiments started in 1964. It was not until early 1967

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<sup>48</sup>Kosygin, "Kosygin Speaks to 23rd Congress," Current Digest of the Soviet Press, October 13, 1965, p. 6.

<sup>49</sup>Ibid.

<sup>50</sup>C. P. S. U. - Central Committee, "Resolutions on Industrial Management, 23rd Congress," The Current Digest of the Soviet Press, October 13, 1965, p. 16.

that the first complete Ministry was converted. Now, the timetable calls for "the main part" of the industrial sector to be completed in 1968.

In the area of price changes, the timetable has been followed more closely. The prices for consumer goods were established in late 1966 and early 1967 with the heavy industrial prices some six months later. The resulting change in the wholesale price index was an increase of approximately 8 per cent.

One thing to note about the implementation of the reform is that any modifications made in the original ideas have been in the direction of being less liberal. In discussing the political aspect of the reform, C. Olgin attaches the label of "pessimist" to those who feel the reform will involve no change and the label of "optimist" to those who believe in the reform, thinking that there will be real structural changes in the planning process. He brings out that even in the U. S. S. R. there are nearly an equal number of the "optimists" and "pessimists." "The actual information on the implementation of the reform tends in itself, at first sight to support the 'pessimists' rather than the 'optimists.'"<sup>51</sup>

There are already several real improvements which have come with the implementation of the reform. The number

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<sup>51</sup>C. Olgin, "The 'Economic Reform': The Political Aspect," Bulletin of the Institute for the Study of USSR, November, 1967, p. 13.

of indices has been reduced, interest for capital has been incorporated, more material incentives are being used, and the prices being used are certainly an improvement.

Down to the present, however, the scope of the reforms has been somewhat limited. The implementation has been a tight rope walk between economic and political feasibility. The power of the central planners has not yet been reduced exemplifying the fact that the bureaucracy surrenders power reluctantly in any country.

The labor market, as indicated above, is not as structured or planned as the markets for consumer or producer goods (a major exception being that the mobility of collective farmers is administratively restricted).

At one time there was much that was compulsory: laborers were drafted for work and not allowed to shift employment without permission. This labor draft, however, was primarily a wartime measure - although unfortunately for the Soviet worker, there were some officials in the U. S. S. R. who did not realize that the war had ended until after Stalin died in 1953. Soviet citizens are still required to carry labor workbooks and internal passports, but compulsory job assignment was ultimately abolished in 1956. There is now considerable labor mobility in the Soviet Union. In fact, a persistent complaint is that there is too much.<sup>52</sup>

Although the communist worker is given the choice as to what type of work he will do, he is influenced by a number of factors. The education and training for many positions is limited to a select group of people. In addition material

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<sup>52</sup>Marshall I. Goldman, Comparative Economic Systems, p. 412.

incentives are used to increase the number of workers flowing into jobs where there is a critical shortage.

As a result of the labor policy in the Soviet Union, there has been and continues to be a large migration to the urban areas, and the number of skilled and highly skilled employees continues to increase. More emphasis is placed on the "non-productive" fields of science, education, health, culture and similar fields as the planners recognize the increasing importance of these areas to economic growth. Labor production is increasing quite rapidly, and the participation in the labor force, including women, remains quite high as the concept of "socially useful labor" remains a central point of focus in Soviet labor policy.

The communist property structure, unlike the labor force, is not couched in anything resembling a free market. The core of the property structure is the state or public sector in which are found all of the major state-owned and state-operated industry. This large inner core contains mining, heavy industry, communications, power, construction, retail stores in the cities, and the large state farms. Surrounding the public sector is a sizable area of cooperative enterprise which includes the collective farms and the producers' and consumers' cooperatives. The private property is restricted to the activities of individual artisans or craftsmen, individual peasants who own small farms in the

very remote regions. The large state sector is growing at the expense of both the private and cooperative sector.

The role of the government in the communist economic system has already demonstrated its importance and active participation in the determination of the markets, labor, and property. The fact that the Soviet and other communist states operate authoritatively is evident in almost every aspect of economic life. Strict discipline and absolute authority of the state are established through the means of the Communist Party, which was first established as a revolutionary class party, but is now more concerned with administration. The power over the political and economic forces resides in the party, and the party permeates all government and economic institutions.

The most active and politically-conscious citizens in the ranks of the working class, working peasants and working intelligentsia voluntarily unite in the Communist Party of the Soviet Union, which is the vanguard of the working people in this struggle to build communist society and is the leading core of all organizations of the working people, both government and non-government.<sup>53</sup>

The Communist Party overrides any notion of democracy as the party is centrally controlled and is seen as the only representative of the people. Although "democratic voting" is provided, ballots contain only one name for each position.

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<sup>53</sup>The Constitution of the U. S. S. R., Article 126, in The Soviet Crucible, ed. by Samuel Hendel, p. 431.

The purpose of the Communist Party is not representation, but of providing cohesion. As the implementation agent of the Marxist ideology, the Party provides a rationalizing force. Niles Hansen contends that this is quite similar to the concept of Weber's Protestant ethic.

Thus, although the Communist and capitalist systems are externally different, each has required a religious (or ideological) component to motivate methodical, rational application of human means towards economic ends; and the effects of the metaphysical orientation have been quite similar.<sup>54</sup>

Since 1956 the government of communism has gone through several transitions. First, the governments have experienced a general rise of expectations from the people which it governs, and the people have been given some more, especially in terms of consumer goods. Secondly, there has been a generally declining interest in the use of Marxist-Leninist ideology. Finally, the Soviet domination of world communism has given away to a polycentric pattern of power, which power in larger amounts to Communist countries other than the Soviet Union.

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<sup>54</sup>Niles Hansen, "The Protestant Ethic as a General Precondition for Economic Development," Canadian Journal of Economic and Political Science, XXIX, No. 4 (Nov., 1963), 471.



## CHAPTER V

### THE TYPIFICATION MODELS

#### Introduction

From the study of the goals and institutions of the four economic systems presented in Chapters III and IV, one can construct the typification models which summarize the core features of each economic system. The purpose of the present chapter is to present a concise statement of the core features of each system and to analyze the models to determine the a priori expectations of economic performance as measured by growth and price stability. The typification models should suggest what results can be expected from the statistical analysis of the data.

The typification models are constructed as representative of the typical economy described by the system. The essential features of each economic system are derived from the study of the economic system. No attempt is made to describe any one manifestation of the economic system as produced by a single country, but the core features are both theoretical and realistic interpretations of the goals and institutions of the system.

Mixed Capitalism

The goals of a typical capitalist system are primarily based on individual freedom. Freedom is stressed in all of the institutions, and economic freedom is provided through good performance of growth and price stability. The goals are expressed by the government's acceptance of the responsibility of providing an atmosphere conducive to real economic growth, price stability, full employment, and a favorable balance of international payments. Innovation plays an important role, and a minimum level of economic security is the goal for each individual.

The property structure is a mixture of the large corporation in which management is separated from ownership and a larger private property structure composed of individual entrepreneurs. The functions of government require government ownership in those areas not served by the private sector. Although most of the property is held by individuals, the large corporations dominate the markets with less and less emphasis on price competition. The market for both consumer goods and producer goods is free and open. The labor market in the typical capitalist country is free with large labor organizations. The commercial instruments and financial market is well developed to facilitate the corporate structure. The government institution provides the traditional functions of defense, maintaining order within the country, and providing education. The additional

responsibilities associated with "mixed capitalism" include providing for growth and stability in the economy and a minimum level of economic security for each individual.

### Democratic Socialism

The goals of democratic socialism stress providing for social welfare. The freedom of the individual is obtained by securing adequate economic resources for each and every individual. To provide for the greatest amount of social welfare, the typical socialist society emphasizes a goal of steady economic growth with price stability.

The property structure of democratic socialism is one designed to produce the greatest amount of social welfare while preserving the economic and political freedom of the individual. In the typical socialist country the primary industries of production, transportation and communication, and finance are nationalized. Private property prevails in all other areas of enterprise. The functions of the socialist government extend beyond the traditional areas to include the ownership and management of nationalized industry and the provision of economic security for all people. The latter includes social welfare programs such as health and education. The government is charged with the responsibility of directing the economy towards good economic performance. In an effort to maintain high social welfare, the government endeavors to redistribute income through

taxation. The work order is essentially well organized in strong labor unions. A large portion of the labor force is represented by centralized national labor unions.

#### Traditionalist System

The goals typical of the traditionalist system are oriented to the maintenance of the status quo. However, one finds that the goals evident in the traditional system are dependent on the class structure. The elite can realize a goal of individual profit even in a status quo oriented society. Small land owners exemplify a goal of independence for themselves and a better life for future generations. However, the majority of the population are typically landless peasants dependent on a large landowner. For these, the only goal recognizable is one of preserving the status quo.

An essential feature of the traditionalist system is the presence of a dual sector. In addition to the undeveloped economy, an advanced industrial sector is found, primarily in the urban areas. This advanced sector may be capitalist, socialist, communist, or a mixture of these. The dual sector gives rise to a three sector market. The urban market, the rural market, and the international markets reflect the influence of the developed economy imported from advanced, foreign countries. The rural market is typified by the village market characterized by competitive bargaining and the landowner's store characterized by the monopoly power of the landowner.

Class structure dominates the property structure, the work force, and the government institutions. Property is generally held in either very large plantations or very small plots. The large landowners use tenant farmers or peasants as labor on the plantations. These tenant farmers typically are living at a subsistence level while the independent farmers who own but a few acres seldom have a much higher income. A core feature of the traditionalist system is the lack of skills and training of the work force. The large landowners also dominate the government which is principally regional with the central government politically unstable and unsuccessful in providing the infrastructure necessary for economic development.

#### Communism

The goals of communism can be summarized as a continuing struggle for power. The striving for power is manifested in a goal for communist domination of the world, a goal of the various countries to gain control of the communist world, and a goal of each communist leader to gain more personal power. The communist doctrine stresses technological progress and industrialization as the means to achieve the communist goals.

The institutional framework is designed to achieve these goals and is dominated by the state. The goods in the industrial market are produced by state firms to be sold to state firms. Consumer goods are marketed through

state owned and operated stores at prices established by the state. The established prices are not designed to reach an equilibrium level of supply and demand but to produce an allocation of goods in keeping with the sophisticated economic plans. All property with minor exceptions, is controlled and owned by the state, and labor is generally allocated to meet the demands of the state. The Communist Party maintains the power of the government institutions and is the central economic and political power of the communist system. The state serves the traditional functions of government, but is more concerned with providing the allocation of resources and energies to achieve the goals of the communist society in the most expedient manner.

#### A Priori Expectations

The typifications suggest certain expectations of the statistical analysis regarding performance as measured by growth and inflation. The purpose of the present section is to derive a priori inference from the goals and institutions of the various economic systems. This section can examine what performances should be indicated by the expressed goals of the system while the following chapter will measure the attainment of the goals by actual, historical performance.

The capitalist, socialist, and communist systems all have an expressed goal of economic growth. The emphasis placed on growth by the capitalist and socialist countries

is similar. These two systems blend the goal of economic growth with a goal of preserving the freedom of the individual. In addition more attention is given to consumer goods than in the countries of the communist system. Because of these factors one would expect the growth performance demonstrated by capitalism and socialism to be much the same. The goal of providing for heavy industry and large capital formation in the communist countries to the exclusion of large amounts of consumer goods should produce a different result. A larger amount of growth should be expected in the measures of production and income.

The goals and institutions of the traditional system would suggest very limited growth if any. The fatalistic acceptance of present economic conditions limits the energy expended to provide for growth. Also, the subsistence level of living in the traditional countries eliminates the possibility of the large savings required for capital expansion necessary to provide economic growth. This, along with limited capital and an almost non-existent infrastructure, would indicate a very low growth rate in the traditional countries.

From the typification models, one can also derive a priori expectations of the ratio of capital investment to gross domestic product. The communist system's goal of industrialization, even to the exclusion of consumption, would indicate the largest ratio of capital to production.

On the other extreme, the traditionalist countries should exhibit the smallest ratio since little savings can be generated to produce capital. One would expect the ratios of the capitalist and socialist systems to be similar because both systems are typified by developed countries. The goals of both of these systems stress economic growth but not to the exclusion of individual freedom. Therefore, one would predict that the amount of production utilized for capital development in the capitalist and socialist countries would be greater than the traditional countries but not as large as that of the communist countries.

One can also derive a priori expectations from typification concerning the amount of gross domestic product derived from private consumption. The private consumption ratio should delineate between the capitalist and socialist sectors. Nationalization of industry in the socialist countries would suggest that private expenditures in the socialist countries would produce a smaller ratio than that of the capitalist system. The communist goals and institutions should produce the smallest amount of private expenditures in relation to domestic product while the spending of the traditionalist system would be almost entirely private.

Price stability can also be studied in the typification models. Very stable prices can be expected to emanate from the communist system due to the government establishment of prices. Because of the goal of price stability in the



socialist and capitalist countries, these systems should produce relative small amounts of inflation. The free market system in these countries, however, would suggest that some instability would be present. The lack of a developed market in the traditionalist countries would result in a high degree of price stability.

#### Conclusion

Although the typification models do not enable one to predict exact measures of performance, the models provide a basis for making certain a priori predictions about relative growth and price stability between the economic systems. One would expect the largest growth rate and most stable prices from the communist countries and the least from the traditional system. The performance of the capitalist and socialist systems should be similar with a significant difference in the ratio of private expenditures. The following chapter provides a statistical measure of the a priori expectations.

## CHAPTER VI

### ANALYSIS OF DATA

#### Introduction

The data and the results of the statistical analysis of the hypotheses are presented in this chapter. The first section is a presentation of the data used to measure the economic performance of growth and inflation. The second section is the measurement of the differences of economic performance between the countries within the various systems, and the third section is a measurement of the differences between the systems. Although the statistical results are presented in the present chapter, the analysis and the derivation of conclusions and inferences are developed in the concluding chapter.

#### Available Data

The sources of data for the non-communist countries provide a degree of comparability. Although the data are subject to criticism, the United Nations<sup>1</sup> data were considered to be the best available data for a study of comparative

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<sup>1</sup>United Nations Statistical Office, Yearbook of National Accounts Statistics (New York: United Nations, 1957-1968).

performance. The criteria for the measurements were established by the United Nations, and the data should reflect the application of common criteria. The price data provided by the International Monetary Fund<sup>2</sup> should reflect a similar attribute.

The communist countries are not included in the reports of the United Nations and the International Monetary Fund. The use of official publications of the communist countries is unacceptable for a comparison of performance with non-communist countries for several reasons cited by Robert Campbell.<sup>3</sup> These reasons are illustrated by an examination of the industrial output for the Soviet Union.

The first difficulty encountered is one of double-counting of industrial output. "In any year total output of industry is figured by first determining the value of output of every industrial enterprise and then adding these together."<sup>4</sup> The double-counting is obvious in the Soviet accounting procedure. "Another influence which exaggerates the Soviet measure of growth has been failure to correct adequately for changes in the price level."<sup>5</sup> The Soviet

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<sup>2</sup>International Monetary Fund, International Financial Statistics (Washington, D.C.: International Monetary Fund, 1955-1966).

<sup>3</sup>Robert W. Campbell, Soviet Economic Power: Its Organization, Growth and Challenge (Boston: Houghton Mifflin Company, 1966), pp. 112-23.

<sup>4</sup>Ibid., p. 115.

<sup>5</sup>Ibid., p. 115.

Union has relied heavily on the 1926-27 price level to establish constant prices. As new products were introduced, the prices were created for the 1926-27 period which greatly distorted the true present value of output. The final bias introduced by the Soviet index is the weighting system on which it is based. By using the 1926-27 price level, one finds a bias introduced because the "mix" of goods has changed. The weighting system produces the third problem which makes the Soviet data unacceptable. The studies used in providing the communist data have attempted to eliminate these difficulties of the communist data.

#### Indicators of Economic Growth

The five basic indicators of economic growth used for comparison in the study are Gross National Product (GNP), Gross Domestic Product (GDP), Gross Domestic Capital Formation (GDCF), National Income (NI), and Private Consumption (PC). The growth rates for each of these are calculated on a per capita basis. The change is calculated as the ratio of the difference of year two minus year one divided by the per capita rate for year one. The calculation is shown in the example of calculation of GNP where:

AGNP = GNP in year one.

BGNP = GNP in year two.

APOP = Population in year one.

BPOP = Population in year two.

$$\text{Growth Rate} = \frac{\frac{\text{BGNP}}{\text{BPOP}} - \frac{\text{AGNP}}{\text{APOP}}}{\frac{\text{AGNP}}{\text{APOP}}} \times 100.0$$

(In per cent)

Tables 6.1-6.5 present the data on these five major growth indicators for the non-communist systems. Included in the tables are the number of observations available for the period from 1950-1968 and the mean growth rate for this period. Included, also, is the standard deviation which provides a measure of dispersion.

The mean growth rate is computed by taking the arithmetic average of the growth rates computed for each year. Although this computation may introduce a positive bias, the statistical analysis should not be distorted. The same bias will be present for all countries since all of the data is treated in the same manner. Since a comparison is required for the yearly growth rates, the computation was necessary. The loss of independence in the error terms violates an assumption of the analysis of variance, but the validity of the F-test is affected very little by the correlation of the error terms.

In addition to these five primary growth indicators, two ratios are used to illustrate the use of the output. The first is a ratio of Gross Domestic Capital Formation to Gross Domestic Product. These ratios for the non-communist countries are given in Table 6.6. The ratio of capital formation to product provides some information as to how much attention is being given to future growth.

TABLE 6.1

ANNUAL, PER CAPITA GROWTH RATE OF  
GROSS NATIONAL PRODUCT

System and Country	No. of Observations	Mean Growth Rate of GNP	Standrad Deviation
<u>TRADITIONAL</u>	110	1.5276	3.5004
Ceylon	--		
Chile	16	1.4636	3.6268
Colombia	14	1.2926	1.6157
Dominican Rep.	14	0.7730	6.7809
Guatemala	14	1.5588	2.9640
Honduras	17	1.8201	2.8907
Paraguay	14	1.1886	2.5723
Peru	14	2.8024	2.3737
Tunisia	7	1.0087	3.2383
<u>CAPITALIST</u>	64	4.3070	4.1549
Australia	--		
Canada	17	2.1459	3.2936
Germany, Federal			
Republic of	16	4.8918	3.2369
Japan	14	8.7557	3.9217
United States	17	2.2541	2.7764
<u>SOCIALIST</u>	43	2.8349	2.0712
Denmark	17	3.0032	2.7466
Norway	14	3.1761	1.4256
Sweden	--		
United Kingdom	12	2.1985	1.5400

TABLE 6.2

ANNUAL, PER CAPITA GROWTH RATE OF  
GROSS DOMESTIC PRODUCT

System and Country	No. of Obser- vations	Mean Growth Rate of GDP	Standard Deviation
<u>TRADITIONAL</u>	118	1.5275	4.2144
Ceylon	13	1.1376	3.2198
Chile	15	1.6717	3.2925
Colombia	14	1.3524	1.3745
Dominican Rep.	14	0.7921	6.7074
Guatemala	14	1.6006	2.9758
Honduras	17	1.5988	7.1196
Paraguay	14	1.2774	2.6192
Peru	10	3.1397	2.9338
Tunisia	7	1.6414	3.2224
<u>CAPITALIST</u>	57	2.7703	3.0055
Australia	9	2.4283	2.4501
Canada	17	2.1225	3.1954
Germany, Federal Republic of	14	4.4233	3.0258
Japan	--		
United States	17	2.2377	2.7860
<u>SOCIALIST</u>	63	2.9829	1.9635
Denmark	17	3.0021	2.7421
Norway	14	3.2759	1.4157
Sweden	15	3.4447	1.7294
United Kingdom	17	2.3150	1.5573

TABLE 6.3

ANNUAL, PER CAPITA GROWTH RATE OF  
GROSS DOMESTIC CAPITAL FORMATION

System and Country	No. of Observations	Mean Growth Rate of GDCF	Standard Deviation
<u>TRADITIONAL</u>	116	2.9788	15.5557
Ceylon	16	0.5673	8.0438
Chile	15	0.8244	8.5101
Colombia	14	-0.7624	10.5545
Dominican Rep.	14	4.9130	31.7565
Guatemala	14	5.5523	17.1028
Honduras	17	4.4278	13.6698
Paraguay	5	8.3214	14.4376
Peru	14	2.3783	14.0686
Tunisia	7	5.4406	7.7066
<u>CAPITALIST</u>	74	5.3377	7.7785
Australia	9	4.2049	4.2882
Canada	17	2.8387	7.1429
Germany, Federal Republic of	17	6.3490	6.4876
Japan	14	12.5147	10.3230
United States	17	1.5149	4.2572
<u>SOCIALIST</u>	63	6.0641	16.7188
Denmark	17	5.8835	7.4932
Norway	14	4.0745	4.3759
Sweden	15	5.6099	3.5933
United Kingdom	17	8.2842	31.4832



TABLE 6.4

ANNUAL, PER CAPITA GROWTH RATE OF  
NATIONAL INCOME

System and Country	No. of Obser- vations	Mean Growth Rate of NI	Standard Deviation
<u>TRADITIONAL</u>	124	4.7001	5.6815
Ceylon	16	3.8828	4.5437
Chile	17	4.1158	5.9636
Colombia	14	5.8878	6.0563
Dominican Rep.	14	4.9347	8.9971
Guatemala	14	4.3729	3.5155
Honduras	16	3.7189	4.2621
Paraguay	13	5.2792	4.9972
Peru	13	7.0656	6.4797
Tunisia	7	2.5716	5.2158
<u>CAPITALIST</u>	74	6.0279	3.9923
Australia	9	5.0930	3.9026
Canada	17	4.8384	3.4522
Germany, Federal Republic of	17	6.9832	3.8711
Japan	14	9.3039	3.9808
United States	17	4.0592	2.9751
<u>SOCIALIST</u>	48	3.3342	3.3504
Denmark	17	3.6648	4.0236
Norway	14	3.9705	3.8396
Sweden	--		
United Kingdom	17	2.4795	1.8867

TABLE 6.5

ANNUAL, PER CAPITA GROWTH RATE OF  
PRIVATE CONSUMPTION

System and Country	No. of Observations	Mean Growth Rate of PC	Standard Deviation
<u>TRADITIONAL</u>	125	1.7310	4.5744
Ceylon	16	1.0185	5.0734
Chile	15	2.3431	3.5755
Colombia	14	1.5194	2.7994
Dominican Rep.	14	1.5216	8.3365
Guatemala	14	1.0963	3.0009
Honduras	17	1.7138	2.8654
Paraguay	14	1.5687	4.8457
Peru	14	3.8334	4.0792
Tunisia	7	0.3215	5.1235
<u>CAPITALIST</u>	65	3.9762	3.0567
Australia	--		
Canada	17	2.1678	1.9770
Germany, Federal Republic of	17	5.0559	3.1550
Japan	14	7.1427	1.5795
United States	17	2.0972	2.0608
<u>SOCIALIST</u>	63	2.5229	2.0409
Denmark	17	2.5881	3.1983
Norway	14	2.6920	1.3225
Sweden	15	2.8753	1.3164
United Kingdom	17	2.0076	1.5954

TABLE 6.6

RATIO OF GROSS DOMESTIC CAPITAL FORMATION TO  
GROSS DOMESTIC PRODUCT

System and Country	No. of Obser- vations	Mean Ratio of GDCF to GDP	Standard Deviation
<u>TRADITIONAL</u>	114	15.1666	4.4366
Ceylon	15	12.7688	1.7636
Chile	17	12.7085	3.3188
Colombia	14	18.8331	3.7515
Dominican Rep.	14	14.6440	3.7850
Guatemala	14	12.1864	2.0977
Honduras	17	13.8090	2.0782
Paraguay	6	12.7230	2.1714
Peru	10	20.4998	3.1300
Tunisia	7	23.7218	2.1606
<u>CAPITALIST</u>	58	21.6664	3.6774
Australia	9	26.1077	1.3529
Canada	17	22.7335	1.8169
Germany, Federal Republic of	15	23.3217	1.9282
Japan	--		
United States	17	16.7878	0.7383
<u>SOCIALIST</u>	63	21.3514	5.5570
Denmark	17	19.7111	3.1727
Norway	14	29.4578	1.0659
Sweden	15	22.1861	1.5881
United Kingdom	17	15.5796	3.1715

Since economic development is a function of capital formation, this ratio is indicative of economic development within the country.

On the other side of the use of a country's output, a ratio is established between Private Consumption and Gross Domestic Product. This ratio, which is illustrated in Table 6.7, provides information regarding the amount of the total product which the private sector uses for consumption.

The growth data available for the communist countries is fragmented and available only in special reports. Table 6.8 lists the available indicators of growth in the communist countries. The Soviet Data is derived from studies of Abraham Becker and Stanley F. Cohn.<sup>6</sup> The statistics for the East European countries is derived from a study by Maurice Earnst.<sup>7</sup>

#### Indicators of Economic Stability

The primary indicators of economic stability used in this report are the annual change in the Consumer Price Index and the Wholesale Price Index. The computation is

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<sup>6</sup>Abraham S. Becker, Soviet National Income, 1953-1964 (Berkeley: University of California Press, 1969), and Stanley H. Cohn, "Analysis of the Soviet Growth Model," The Soviet Economy, ed. by Morris Bornstein and D. F. Fusfeld (3rd ed.; Homewood: Richard D. Irwin, Inc., 1970).

<sup>7</sup>Maurice Earnst in a study for U.S. Congress, Joint Economic Committee, New Directions in the Soviet Economy (Washington, D.C.: U.S. Government Printing Office, 1966), pp. 875-916.

TABLE 6.7

RATIO OF PRIVATE CONSUMPTION TO  
GROSS DOMESTIC PRODUCT

System and Country	No. of Observations	Mean Ratio of PC to GDP	Standard Deviation
<u>TRADITIONAL</u>	122	75.7679	5.2101
Ceylon	15	75.2659	4.9214
Chile	17	76.0159	4.1205
Colombia	14	73.9534	1.8602
Dominican Rep.	14	71.9184	4.1418
Guatemala	14	81.7517	1.5371
Honduras	17	79.3311	4.0815
Paraguay	14	79.5157	2.3455
Peru	10	68.1331	2.1072
Tunisia	7	70.3765	2.5367
<u>CAPITALIST</u>	49	62.2782	1.5759
Australia	--		
Canada	17	63.0344	1.4210
Germany, Federal			
Republic of	15	60.5858	1.0361
Japan	--		
United States	17	63.0155	0.7880
<u>SOCIALIST</u>	63	63.3833	4.6902
Denmark	17	67.6785	1.1081
Norway	14	57.3241	1.6450
Sweden	15	60.0313	2.1288
United Kingdom	17	67.0358	1.1897

TABLE 6.8

AVERAGE PER CAPITA GROWTH RATES FOR  
COMMUNIST COUNTRIES

Country	GNP	Private Consumption	CDCF/ GNP	PC/ GNP
Soviet Union	6.2	4.0	26.3	49.3
Bulgaria	5.9	N.A.	31.0	N.A.
Czechoslovakia	4.0	N.A.	26.2	N.A.
East Germany	5.1	N.A.	19.2	N.A.
Hungary	4.8	N.A.	25.8	N.A.
Poland	4.9	N.A.	24.8	N.A.
Rumania	<u>5.7</u>	N.A.	<u>N.A.</u>	N.A.
Average All Countries	5.2		25.51	
Standard Deviation	1.855		8.465	
Range	2.2		11.8	

simply a ratio of the difference in the index between year two and year one to the index for year one. Table 6.9 and 6.10 provide the data for the non-communist countries. The mean growth rates of the price indexes are arithmetic averages of the annual growth rates. As in the computation of the growth rates for the growth indicators, the statistical problems of a positive bias and the loss of independence will have very little effect on the F-test used in analysis of variance. Because the prices in the communist countries are administratively set by the central planning agencies, the data is not meaningful in a study of this nature. Since

TABLE 6.9

PER CENT CHANGES IN THE  
CONSUMERS PRICE INDEX

System and Country	No. of Observations	Mean Growth Rate of CPI	Standard Deviation
<u>TRADITIONAL</u>	123	8.3934	13.5954
Ceylon	17	1.0055	1.5458
Chile	17	32.9786	20.0695
Colombia	14	9.3475	9.0575
Dominican Rep.	14	0.9927	3.9548
Guatemala	14	0.3761	1.4075
Honduras	16	2.5212	3.6574
Paraguay	13	10.4407	8.3419
Peru	13	8.3275	3.4586
Tunisia	5	4.0616	1.5647
<u>CAPITALIST</u>	74	2.4851	2.1732
Australia	9	2.3131	1.3829
Canada	17	2.2569	2.4439
Germany, Federal Republic of	17	2.2397	1.9174
Japan	14	3.7791	2.7026
United States	17	1.9842	1.7720
<u>SOCIALIST</u>	62	3.7506	2.2893
Denmark	16	4.1451	3.0785
Norway	14	3.4017	1.6912
Sweden	15	3.4834	1.6801
United Kingdom	17	3.9024	2.4392

TABLE 6.10

PER CENT CHANGES IN THE  
WHOLESALE PRICE INDEX

System and Country	No. of Observations	Mean Growth Rate of WPI	Standard Deviation
<u>TRADITIONAL</u>	73	11.6163	16.8431
Ceylon	--		
Chile	17	32.8061	21.4167
Colombia	14	11.2231	7.9535
Dominican Rep.	14	1.2995	5.8391
Guatemala	14	0.1456	2.2893
Honduras	--		
Paraguay	--		
Peru	9	9.1879	8.0553
Tunisia	5	6.0486	3.8318
<u>CAPITALIST</u>	65	1.3134	3.5249
Australia	--		
Canada	17	1.4701	3.9358
Germany, Federal			
Republic of	17	1.7982	4.4217
Japan	14	0.5220	2.5930
United States	17	1.3237	2.8931
<u>SOCIALIST</u>	56	1.7405	4.2928
Denmark	17	2.6302	6.8179
Norway	14	1.8540	1.8785
Sweden	15	1.5750	2.8741
United Kingdom	10	0.3175	2.8671



the prices of the communist countries are not determined by the market system, a comparison with the other countries will not be provided.

#### Test of Hypothesis I

The first hypothesis tested in the study was stated as follows:

The performance of the various national economies within the same economic system is not statistically different from one another.

The results of the statistical analysis for the first hypothesis are recorded in Tables 6.11 and 6.12. Table 6.11 is confined to a measurement of the performance differences in growth. In the seven indicators chosen for the non-communist countries, there was general acceptance of the hypothesis for the traditional and socialist systems while the capitalist countries showed a wider variation in performance. An exception was the ratios of private consumption and investment to gross domestic product which indicated a significant difference of performance for all three systems.

Although the analysis of variance could not be used for the communist countries, one finds that both the range and dispersion within the system is small. In both the measurement of GNP and ratio of investment to GNP all non-communist countries were within one standard deviation of the mean.

Table 6.12 gives the results of the analysis of variance on the two measures of economic stability.

TABLE 6.11

RESULTS OF ANALYSIS OF VARIANCE OF  
GROWTH INDICATORS

GROWTH INDICATOR System	F Ratio	Degrees of Freedom		Significance		
		Between	Within	10%	5%	1%
<u>GROSS NATIONAL PRODUCT</u>						
Traditional	0.4097	7	102	No	No	No
Capitalist	13.2592	3	60	Yes	Yes	Yes
Socialist	0.8050	2	40	No	No	No
<u>GROSS DOMESTIC PRODUCT</u>						
Traditional	0.2498	8	109	No	No	No
Capitalist	1.9921	3	53	No	No	No
Socialist	1.0387	3	59	No	No	No
<u>GROSS DOMESTIC CAPITAL FORMATION</u>						
Traditional	0.3601	8	107	No	No	No
Capitalist	5.7532	4	69	Yes	Yes	Yes
Socialist	0.1635	3	59	No	No	No
<u>NATIONAL INCOME</u>						
Traditional	0.6144	8	115	No	No	No
Capitalist	5.0522	4	69	Yes	Yes	Yes
Socialist	0.8841	2	45	No	No	No
<u>PRIVATE CONSUMPTION</u>						
Traditional	0.5618	8	116	No	No	No
Capitalist	17.4061	3	61	Yes	Yes	Yes
Socialist	0.5358	3	59	No	No	No
<u>RATIO OF INVESTMENT TO GDP</u>						
Traditional	21.0184	8	105	Yes	Yes	Yes
Capitalist	90.2054	3	54	Yes	Yes	Yes
Socialist	81.5328	3	59	Yes	Yes	Yes

TABLE 6.11--Continued

GROWTH INDICATOR System	F Ratio	Degrees of Freedom		Significance		
		Between	Within	10%	5%	1%
<u>RATIO OF PRIVATE CONSUMPTION TO GDP</u>						
Traditional	20.8619	8	113	Yes	Yes	Yes
Capitalist	24.8690	2	46	Yes	Yes	Yes
Socialist	170.6804	3	59	Yes	Yes	Yes

TABLE 6.12

RESULTS OF ANALYSIS OF VARIANCE OF  
PRICE INDICATORS

PRICE INDICATOR System	F Ratio	Degrees of Freedom		Significance		
		Between	Within	10%	5%	1%
<u>CONSUMER PRICE INDEX</u>						
Traditional	21.5841	8	114	Yes	Yes	Yes
Capitalist	1.6370	4	69	No	No	No
Socialist	0.3482	3	58	No	No	No
<u>WHOLESALE PRICE INDEX</u>						
Traditional	16.1888	5	67	Yes	Yes	Yes
Capitalist	0.3428	3	61	No	No	No
Socialist	0.6071	3	52	No	No	No

Significant differences were found within the traditional economic system with the capitalist and socialist countries demonstrating a high degree of homogeneity.

Test of Hypothesis II

The second hypothesis tested in the study was stated as follows:

The economic performances of the different systems as indicated by the national economies are not statistically different.

The results of the analysis of variance tests used for this hypothesis are recorded in Table 6.13. Except for the major exception of gross domestic capital formation, the differences in general cannot be attributed to chance. The results indicate that the null hypothesis should be rejected.

With regard to the communist countries, the growth as measured in gross national product (5.20 per cent annual average) appears to be larger than the socialist rate of 4.3 which is the next highest. The 25.5 per cent of gross national product devoted to investment also appears significantly larger than the 21.7 per cent of the socialist countries. The figures may be somewhat misleading because the growth rates of the communist countries during the latter years have been appreciably lower than in the 1950's. The growth of private consumption is the same as that of the socialist countries, but the amount of gross national output allowed for private consumption is significantly lower.

Conclusion

The significance of the results is explained in the final chapter. The purpose of the present chapter was simply

TABLE 6.13

RESULTS FOR ANALYSIS VARIANCE FOR  
NON-COMMUNIST SYSTEMS

PERFORMANCE INDICATORS	F Ratio	Degrees of Freedom		Significance		
		Between	Within	10%	5%	1%
<u>GROWTH INDICATORS</u>						
Gross National Product	12.9613	2	214	Yes	Yes	Yes
Gross Domestic Product	4.5991	2	235	Yes	Yes	No
Gross Domestic Capital Formation	1.1939	2	250	No	No	No
National Income	4.6286	2	243	Yes	Yes	Yes
Private Consumption	7.8090	2	250	Yes	Yes	Yes
Ratio of Investment to GDP	55.7424	2	232	Yes	Yes	Yes
Ratio of Private Consumption to GDP	235.0552	2	231	Yes	Yes	Yes
<u>PRICE INDICATORS</u>						
Consumers	10.4199	2	258	Yes	Yes	Yes
Wholesale	19.9933	2	191	Yes	Yes	Yes

to record the data and the output of the statistical tests of analysis of variance. The dearth of data for communist countries is evident and the conclusions that can be made are thus limited.

## CHAPTER VII

### CONCLUSIONS AND RECOMMENDATIONS

#### Introduction

The conclusions which can be drawn from a study such as this are many and varied. The purpose of the present chapter is to present the conclusions which have been drawn from the presentation of a methodology of comparative economic systems, the examination and comparison of the classical and modern economic systems, and the results of the statistical analysis of the performance indicators of growth and inflation. In addition, one finds many areas which are in need of further research which is outside the scope of this work. The final part of this chapter will be used to present some ideas for further research.

#### Methodology

In developing a methodology for approaching the comparison of economic systems, one first delineates between pure theory and real world systems. Pure theory alone is not sufficient for comparison of existing systems since none conform to the ideal models. Pure theory must be complemented by an examination of the essential features of existing

systems. With the use of both, one can illustrate the uniformities and singularities found within each system. Since economic systems are found couched in a social and political framework, the goals of an economy are an essential ingredient in the characterization of the economic system and must be considered along with, and in relation to, the economic institutions.

The methodology which was constructed in Chapter II as a combination of various approaches was centered around the use of typification theory elucidated by Max Weber. The resulting methodology proved extremely useful in detecting the essential economic features in terms of goals and institutions. In the comparison of the classical model and the present system, one may use this methodology to see the evolution of the ends and means of the systems. The methods work equally well for all of the various systems because each has a particular institutional framework and motivating force.

#### Classical vs. Modern Systems

The most evident conclusion that can be drawn from the study of the classical and modern economic systems is the idealism of the classical systems. Each system has evolved into a workable system, but in doing so, has seemingly moved farther and farther away from the concepts outlined in the classical writings. The plans of the early writers, although logically consistent, have not proved adaptable to

human experience. Not only have the institutions been established in a form different from the classical conception, but the motivating goals have also changed in character and importance.

Although many differences were enumerated in the study, some striking similarities were brought forth. First, one sees some similarities between the classical and modern systems. Goals, while changing in importance and priority, were revealed as a "thread" which runs through the evolutionary process. Because of some external effects and shifting of goals, the institutions have been constantly changing. However, one often finds the same basic framework. The second similarity evident in the typification of the economic systems is the compatibility of the goals and institutions. Although not consistently true, one finds that often the goals are found as the center of the institutional framework. The final area of similarity evolves in the comparison of the existing systems. The goals and institutions of one system often are exhibited in a totally different system. The form is often changed but homogeneity is quite frequently present.

The comparison of the classical and modern systems provide insight as to the evolutionary processes which are acting upon the economic system. Through a proper understanding of the evolutionary process one can gain information as to future evolution. The prediction of the future must



make cognizance of not only the institutional framework, but also the goals and ideology which are integral to the system. The "convergence thesis" examined in this light appears less plausible than when only the institutions are compared.

In the comparison of existing systems, the problem of delineating between the socialist and capitalist system is highlighted. The socialist goal of public ownership has not been implemented. At the same time, the goal of individual freedom in capitalism has been supplemented with a goal of security for all. The emergence of this goal has provided for a continuing growth of the public sector in the capitalist economies.

#### Analysis of the Statistical Results

The conclusions produced from the statistical comparison of the growth and inflation indicators are elucidating. It appears that there is a great deal of homogeneity in the performance of the national economies within the same economic system. The growth indicators demonstrate that the homogeneity is particularly pronounced in the traditional and capitalist systems and to a lesser degree in socialism. The ratios of investment and private consumption to total output show much heterogeneity in all systems. The information available for the communist countries also tends to support the hypothesis of comparable performance within the system.

The price indicators indicate the problems of inflation in the traditional countries. Although this fact has been known, the analysis of this study points to the degree of heterogeneity within the traditional system.

The conclusions derived from the statistical comparison of the performances of the individual systems do not support the second hypothesis. In all of the indicators except growth of expenditures on capital investment, a significant difference was demonstrated at the 5 per cent level. In the case of domestic product, the difference was not significant at the 1 per cent level. An examination of the data shows the capitalist and socialist systems demonstrate a similar magnitude of performance. The two ratios of investment and private consumption to domestic output show the largest amount of dissimilarity. By the total analysis, one concludes that there is a difference of performance in growth and inflation between the various economic systems. However, one should not infer a cause and effect relationship from the study. Differences in the economic system provide one possible factor which could be responsible, but many other factors are present which could also help to explain the differences of performance.

In looking at the communist growth rate, one finds strong evidence that the rate of growth is diminishing. If one were to take only the decade of the 1960's, the difference between the communist rate of growth and the capitalist or socialist growth rates would be much less significant.

The a priori analysis is generally supported by the statistical results. The per capita, real growth rate of the traditional system was very close to zero while the highest real growth rate was recorded by the communist countries. The growth rates of the capitalist and democratic socialist countries were very similar. The capital formation of the developed countries indicate a propensity and ability of providing for future development, and the traditional countries exhibited an inability to save for capital accumulation. The capital formation of the communist countries illustrates the goal of heavy industrialization.

The price stability measured also supports the expectations derived from the analysis of the typification models. The poorly developed market system of the traditional economies exhibited an unstable price system. Although a moderate amount of inflation was found in both the capitalist and socialist countries, these countries in general have not had problems with price stability.

The typification models served well to predict the results of the statistical analysis of the economic performance of growth and price stability. Incorporating both theory and realism, the models succinctly outline the essential features of the typical economy. Through the expression system, one can effectively analyze the expected performance of the various economic systems.

Recommendations for Further Research

The most obvious extension of this study is a more complete analysis of the system as a factor of economic growth. Having shown that there is a significant difference in the performance of economic systems, one would be interested in knowing to what extent the system factor is responsible for the difference. Many problems would be encountered in isolating the effect of the system. For example, if capital accumulation is a major factor of growth, one would have to isolate how much of a factor the economic system was in capital accumulation to show the indirect effects as well as the direct effects of a system.

To offer a more complete analysis of the system's effect on growth and inflation, one would need to define the systems more explicitly in terms of sub-systems. Instead of using four main systems as was done in the present study, a further refinement would be made to include many sub-systems. As was noted earlier, economic systems do not necessarily conform to political boundaries. In a study using the sub-systems, data within a country might have to be split between two sub-systems. An example of the existence of multiple systems within a country is found in most of the traditional countries. In these countries, one would have to differentiate between the capitalist like sector and the rural sector which is strictly traditional.

A logical extension of the above study would be to determine the effect of each sub-system on the economic development of a country. One would need to describe completely each sub-system and quantitatively measure the economic performance. The determination of the interrelationships of the sub-systems would be the next phase. From this, one could draw some inferences as to the portion of total growth each sub-system contributed. In addition to being an interesting comparative systems research project, some indications of proper development policy could be derived. The problems of research in this area are evident. The isolation of the sub-systems, the gathering of the necessary data, and the definition of the interrelationships would all prove to be tremendous obstacles.

Since many countries do not closely fit the typification of any of the modern systems, research could help show the differences between the ones which do follow the typification and the ones which do not. In the analysis of this problem, one could typify the four systems and also typify four corresponding "imperfect forms" of the same four systems. These eight systems could be used to demonstrate differences between the model systems and the "imperfect form" found in many countries. The above typification would provide more points on the continuum of economic systems.

Finally, some logical extensions can be made utilizing the same methodology of this study. As more data become

available for the communist countries, the statistical analysis should be repeated to give a more complete picture of the performance of the communist system in relation to the other systems. The problem at the present time is that the data is fragmented and not presented in the form of the data from the other countries, making it impossible to give the communist system a complete treatment in terms of comparing economic performance.

Also, if employment data were available for all of the countries, this information could be used as an added indicator to measure economic stability. Because of the problems of measuring employment, the data presently available is far from complete and would not provide a useful comparison either within or between the various economic systems. However, employment is an essential element in measuring economic stability since one common goal of all economic systems is to provide work for the people who want it.

Also, using the same methodology, one could drop the assumption of commonality of goals and measure achievement towards the individual goals, both expressed and implied, of the different systems. Although the assumption of the common goals of inflation and growth appears valid, one finds that different emphasis is placed on the goals of the economic systems. One could measure the effect and strength of the various goals as demonstrated through the performance measurements established for the goals.

The empirical measurement and comparison of economic systems is difficult at best. Assumptions must be made and questionable data must be utilized. Even with the problems one faces in measuring performance and making comparisons, the author feels that it is worthwhile to make such an attempt. Although the study has not produced conclusive results, meaningful inferences can be made. The study also provides insight into the problem of quantitatively comparing systems and some directions that can be pursued to further our understanding of the relationship between the system and economic performance.

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