

CAPITALISM OR SOCIALISM?

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Which is the best system? Well, both, or neither. All systems exhibit elements of both capitalism and socialism. They differ in the degree to which they depend on capitalist or socialist institutions. Imagine two different economies: one based on public ownership of the means of production, the other based on private property rights. The former is socialist and depends on the state to direct resource allocation, the latter is capitalist and depends on markets to direct resource allocation.

Now suppose that the socialist economy organizes itself by putting the state in control of all economic activity. This would look like an extreme version of the Soviet-style command economy. All production would be undertaken by state-run enterprises, all labor would be employed by the state, all distribution of goods and services, whether final goods or intermediate products, would be organized by the state. In essence, the state economic apparatus would hold a monopoly over all resource allocation, over all factors of production, including land, labor, and capital, and over all produced goods and services.

Now suppose that the capitalist economy organizes itself by putting private capitalists in control of all economic activity. In the most extreme version of concentrated wealth, all capital, including physical, human, and intellectual capital, would be controlled by one for-profit firm. It would employ all labor, invest all capital and supply all goods and services. In essence, the firm would hold a monopoly on all resource allocation, over all factors of production, including land, labor, and capital, and over all produced goods and services.

These two extreme versions of socialism and capitalism seem very similar. In one resource allocation is governed by the state's economic planning apparatus and in the other resource allocation is governed by the capitalist firm. Each extreme example is equally unlikely to exist as described above. In fact, all economic systems represent a combination of capitalist and socialist forms of resource allocation. They differ in the degree to which they incorporate capitalist and socialist principles. Why?

The answer is that socialist and capitalist governance mechanisms have different strengths and weaknesses. Societies need to exploit the strengths and avoid the weaknesses in their choices of economic and political institutions.

State governance tends to be centralized, hierarchical, and coercive. Either through taxation and spending decisions, or through regulation, government control represents a top-down authoritarian approach to getting things done. Authoritarian structures have the advantage of getting things done with relatively few resources spent in negotiation. Unfortunately, because of their top-down hierarchical nature, identifying what decisions are in the collective best interest is often difficult for the decision-makers at the top of the hierarchy. Therefore, state governance is most advantageous when faced with goal-oriented tasks. These are easily identified goals that are difficult to implement. For example, national defense against a known enemy is an easily identified goal that requires the mobilization of many resources. National defense is universally conducted by state actors exercising centralized control.

Capitalist governance in competitive markets tends to be decentralized and based on voluntary, mutually beneficial exchange. In voluntary exchanges, buyers and sellers reveal decisions that are in their mutual self-interest, solving the problem of identifying socially beneficial outcomes. Only you know the size and style of shoes that are best for you, and how much they are worth to you. Negotiating the purchase and sale of a pair of shoes is relatively straightforward and efficiently carried out by capitalist markets.

However, it can be difficult to negotiate the purchase and sale of some goods and services. For example, public goods like public health or national defense are difficult to negotiate because all who benefit cannot be forced to pay for the benefit they receive. When I purchase disease prevention or national defense you also benefit from the increased public safety, whether or not you contribute to my purchase. Capitalist markets result in underproduction of such public goods.

Therefore, capitalist market governance is most advantageous when faced with choices that are difficult to identify but easy to negotiate. Innovation in an environment of strong intellectual property rights is an example, as is the production and distribution of consumer goods. Inventors and consumers reveal their ideas and preferences through the market choices they make, and private property rights give them the opportunity to benefit from their choices. Innovation and consumer welfare flourish in systems based on capitalist markets founded on private property.

We need both the ability to promote the provision of public goods by state governance and the ability to promote private enterprise by capitalist market institutions. What is the appropriate mix of state and private, socialist and capitalist institutions?

The appropriate mix of state and private governance depends on the challenges society faces, and because those challenges change over time, the appropriate mix of state and private governance changes over time too. For example, during wartime all economic systems become more centralized and state-dominated. This is because the objectives are relatively easily identified (defeat the enemy) but require the mobilization of enormous resources, which would entail prohibitively costly negotiation in the context of voluntary market exchange. The U.S. placed private firms under state authority to divert production to military needs and instituted strict price controls and rationing for consumers.

On the other hand, innovation-based growth favors market solutions by private entrepreneurs and firms because the innovations and inventions are by their nature difficult to identify and intellectual property rights and markets provide the incentives to adopt feasible and cost-efficient technological progress. Socialist systems like the USSR found it impossible to promote growth through innovation and ultimately failed, and contemporary China seeks to adapt market institutions to its socialist economy to promote modern technology-based growth.

In fact, all economic systems include state and market institutions, centralized and decentralized governance. They differ in the proportions of each. There is no ideal system, and a mix of institutions that succeeds in one set of circumstances will struggle when circumstances change.

Consider one of the most existential challenges humankind faces today – climate change. Some of the goals, like reducing carbon emissions, are relatively easily identified.

However, the best ways to accomplish these objectives may depend on technologies and innovations that are not yet known. Therefore, this challenge calls for a mix of public and private institutions. Government regulation can force the adoption of known emission-reducing solutions like reducing dependence on coal and other fossil fuel energy sources and raising fuel efficiency standards. Market solutions can be encouraged through cap-and-trade policies and tax subsidies for energy-saving innovations.

Another existential challenge is the global pandemic. The pandemic presents what we call a 'goal-oriented task.' These are challenges in which the desired end is clear and the way to achieve that result is known. Society's problem is to mobilize the resources to reach the goal. Markets mobilize resources through price signals. Demand for the goods and services needed increases, prices for those goods and services rise, and suppliers increase supply to meet the need. Although in theory markets can accomplish these tasks, in practice they are time-consuming and cumbersome. Governments, which are by nature hierarchical and coercive, can mobilize resources to achieve a known goal via established methods more rapidly and at less cost than markets. This is why a government response to the pandemic is called for.

Consider what state and federal governments in the US are doing. The federal government has ordered automobile manufacturers to produce ventilators. It is subsidizing firms to guarantee employment. States are directing what firms must continue to operate and which ones must close. Governments are exhorting citizens on the proper ways to wash hands, sneeze and cough, greet one another, space ourselves, etc. The state provided checks to most of the population, subsidized particular sectors such as airlines and tourism, and provided free universal diagnostic medical services.

On the other hand, the US federal response has employed markets to govern the distribution of medical equipment like ventilators and Personal Protective Equipment (PPE) to states and hospitals. This has turned out to be costly and inefficient, as the individual agents negotiate the purchase of these items, frequently bidding against one another. A centralized state-directed distribution would have been more effective. Where innovation is required, however, the market solution has worked. Multiple vaccines developed by private pharmaceutical firms are showing promise for rapid availability.

The answer to the question that motivates this essay is that economic systems are neither capitalist nor socialist. States and markets have existed for all of known human history. Each serves a purpose but neither serves all purposes. Dogmatic allegiance to either state solutions or market solutions guarantees that we will not find the mix of institutions that have a chance to succeed in addressing the challenges that face us. We need a political system that allows us to take advantage of the strengths of both public and private governance institutions, and also allows us to reform those institutions as the challenges that we face change.

КАПИТАЛИЗМ ИЛИ СОЦИАЛИЗМ?

Все экономические системы включают элементы капитализма и социализма. Они различаются степенью интеграции капиталистических и социалистических принципов. Государственное управление характеризуется централизованностью, иерархичностью

и принудительностью. Капиталистическое управление на конкурентных рынках обычно децентрализовано и основано на добровольном взаимовыгодном обмене. Общества нуждаются как в предоставлении общественных благ посредством государственного управления, так и в продвижении частного предпринимательства посредством капиталистических рыночных институтов. Подходящее сочетание государственного и частного управления зависит от проблем, с которыми сталкивается общество, и, поскольку эти проблемы меняются со временем, соответствующее сочетание государственного и частного управления также меняется со временем.

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**УСТОЙЧИВОЕ РАЗВИТИЕ ЭКОНОМИКИ:
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Для научных работников, докторантов, аспирантов, действующих практиков и студентов учреждений высшего образования, изучающих экономические дисциплины.

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