

Pathfinder

CENTER FOR EDUCATION AND RESEARCH IN FREE ENTERPRISE
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THE 'SYSTEM' IS STILL THE PROBLEM

Can the Soviet Union change? Of course it can. But this answer to the question, widely discussed by "experts" on the Soviet economy, tells us nothing. It is an easy answer to a poor question.

Russian history is replete with poorly posed questions and easy answers. More than 100 years ago Alexander Herzen asked: "Who is to blame?" This question repeats and repeats; only the answer changes. Capitalists, speculators, landed peasants, imperialists, Trotskyites, Stalinists, bureaucrats and a host of others have been blamed for the problems of the day.

At the turn of the century, V.I. Lenin changed Herzen's question to: "What is to be done?" His answer rejected peaceful change under the leadership of trade unions and resulted in violent revolution.

Revolution alone is not an answer. What was to be done after the revolution? Lenin chose to eliminate private property in the means of production and substitute state ownership. Seventy years later, Mikhail S. Gorbachev finally discovered what every peasant had discovered much earlier. The Soviet economic system works badly.

How badly? In truth, the experts know very little either about what is happening or what has happened to the Soviet economy. The reason is that probably the Soviets themselves don't have a very clear idea of their position. A dramatic illustration of our ignorance is the gap between recent estimates of Soviet per capita income. The CIA staff puts the average current income of a Soviet citizen at \$8,300 a year. A group of other Western experts thinks that the correct number is about \$3,000. The gap between these estimates is enormous—equal to the difference between the take-home in-

come of an average American in the Depression year of 1933 and relatively prosperous 1971.

Apparently the Soviets are not much better informed. According to Soviet statistics, the growth rate of real output fell from 6 percent to 2 percent between the 1960s and the 1980s. But Abel Aganbegyan, a leading economic adviser to Soviet leader Gorbachev, recently claimed that these statistics are based on myth and error. The true decline, according to Aganbegyan, is from 5 percent in the 1960s to zero in the 1980s.

Soviet population grows about 1 percent a year, so if Aganbegyan is right, per capita income has fallen for the past seven or eight years. Official estimates confirm that this happened last year, and some reports suggest that without sales of vodka and the higher oil prices of the 1970s, growth would have been stagnant for 20 years.

Confusion and uncertainty about the size and growth of the Soviet economy is not an accident. It reflects one of their basic problems. To compute total output or income, economists and accountants must have some way of adding together the value of thousands of different products produced each year.

The usual way in our economy is to use prices as weights. A product that costs twice as much as another counts for twice as much. But in the Soviet Union, prices bear no relation to value. About 500,000 prices are set by bureaucrats in Moscow. Many of the prices bear little relation to market prices in the West or to costs of production in the Soviet Union or to the way Soviet consumers value the goods and services. Without prices as weights, any computation of Soviet output is arbitrary. That's

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one reason that our experts can use very similar data to reach very different conclusions. Add the problems of quality, waste and over-reporting of production and you begin to see why the value of Soviet output is in doubt.

We may not be able to measure total output, but we can compare specific products. Aganbegyan estimates that in 1986 there were 47 cars and 90 telephones for every 1,000 Soviet citizens. The numbers for the United States are 580 cars and 790 telephones. Even when the Soviets have more of some things, more does not imply that they are better or more productive.

For example, the Soviets claim to have four times as many farm tractors as the United States, but they produce no more than 15 percent of U.S. agricultural output. A visitor to major Soviet cities in summer will find few of the fresh fruits and vegetables that fill U.S. supermarkets.

Enough. There is no doubt that the Soviet cupboard is not well stocked. They have recognized the problem at the highest level and have undertaken reforms.

The experts now speculate on the answers to questions such as: Will Gorbachev prevail over his supposed rival, Politburo member Yegor K. Ligachev? Will the bureaucracy prevent Gorbachev from carrying out his plan? Will Gorbachev retain power long enough to reform the Soviet economy?

Individuals can make a difference. By rearranging some ministries, firing some petty and not so petty bureaucrats, changing some prices and exhorting everyone to greater efforts, Gorbachev, Ligachev or whoever, may be able to get some increases in output and some improvements in quality. Standards of living may rise.

However, the changes will not be a reform of the Soviet economy.

Again, the experts have been asking the wrong questions. The key issue for success or failure of reform is whether the Soviets will recognize and reverse Lenin's error and permit private ownership of the means of production. As Prof. Steve Pejovich of Texas A&M has pointed out, the problem in any economy is to introduce the proper incentives. Re-shuffling the ministers, deputy ministers, section chiefs and petty officials changes nothing of lasting importance.

If the incentives remain unchanged, the system remains unchanged, for the incentive structure is a large part of "the system." A private property system gives people incentives to use resources more efficiently. They know that the losses from waste, inefficiency and poor quality accrue to them.

Aganbegyan, in a recent book, assures us that nothing of this kind is on the agenda. Capital, land and labor will not respond to prices and profit op-

portunities. They will be used inefficiently, planned centrally.

Decades of socialism in Europe, Asia, Africa and Latin America have shown that the conjectures of Marx, Lenin, Mao and others are wrong. Some countries have done better than others, but there is not a single economic success story in the socialist world. Yet, some so-called experts and journalists in the West continue to look or hope for "good" socialists who will "do the right thing."

Why do these folk never learn that it is a system failure? Perhaps that's the most puzzling question of all.

—Allan H. Meltzer
J. M. Olin Professor
of Political Economy and Public Policy,
Carnegie Mellon University

Reprinted from Los Angeles Times, Sunday, May 29, 1988.

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FATAL JEANS

G. Kvanchiani was motivated by greed, the desire to own the jeans of a student at the local professional-technical college, when Kvanchiani stabbed him twice and killed him. Kvanchiani was drunk at the time and involved his nephew, a minor, in his plan. All these facts contributed to the court's decision to impose the death penalty, which was not open to appeal. (*Zarya Vostoka*, March 3, 1987)



Charles King, the Liberty Fund; Dr. William Mobley, President of Texas A&M University; and Dr. Steve Pejovich at the Hayek Symposium.

PERSONAL INSIGHT INTO THE SOVIET UNION

The only passage into the building goes past "The Watcher," who keeps track of who goes in and out.

The beds, scarcely more than cot-sized, are made of slats that fit together in grooves.

The communal toilets and open shower stalls are filthy and, even though the temperature outside is below zero, mosquitoes breed and buzz throughout the rooms.

These are not the impressions of a prison inmate, but of an American college student seeing her dormitory accommodations in the Soviet Union.

In spite of the personal discomfort while staying there, Texas A&M University economics student Anita van Tilburg struggled through difficult entrance exams and psychological testing because she wanted to understand the Soviet way of life and its multilayered economic system.

Unlike most Western students who have gone behind the Iron Curtain, van Tilburg has written down her experiences and her account has been published by the Center for Free Enterprise as *An American at a Soviet University: A Personal Experience*, No. 29, Public Issues Series, \$2.

"I couldn't see any point in studying in my room or in the library when I could be out practicing the language with real Russians or learning about the Soviet Union for myself. I didn't just want to read about the Soviet Union; I wanted to live it," said van Tilburg.

QUO VADIS, COMRADE MIKHAIL?

Probably the first of its kind on the market, *Quo Vadis, Comrade Mikhail?* is a comprehensive selection from magazines and journals about economic reforms in the Soviet Union.

Edited by Texas A&M economics students Sheila Amin of Lewisville, Texas, and David Park of Canada, the publication is part of a series of studies on the political economy published by the Center for Free Enterprise.

Amin, who graduated this spring with a 4.0 grade point average in economics, has received a fellowship to pursue a Ph.D. in economics at the University of Chicago.

Park, who will receive his bachelor's degree in August and is a member of Texas A&M's Corps of Cadets, will pursue a Ph.D. at George Mason University.

Dr. Steve Pejovich, the Center's director who also has experienced life in the Soviet Union, says her account is the best and most accurate example of student life for Soviets.

"I thought people might be interested in reading about the Soviet Union from the point of view of a student and not a tourist," said van Tilburg. "When you're a tourist, you're taken to see things they want you to see and you're discouraged from exploring on your own."

"It's a once-in-a-lifetime chance and I pushed the boundaries and did everything I possibly could to understand it all better," she added.

By meeting ordinary Russians, standing with them in the ever-present lines and listening to their gossip, she said she was able to understand the many layers of Soviet society, the joys, sorrows and fears.

With the number of Americans studying in the Soviet Union at any one time limited to around 200, van Tilburg said she felt very honored to have even been accepted. She was one of only 37 students nationwide accepted to the program.

The dorm she shared with a Russian roommate, a majestic brown building featuring statues of bare-chested maidens supporting the second floor, was rumored to have been a brothel during the time of Peter the Great.

"The students did an excellent job of making selections for the publication based on the credibility of the author and the readability of the text," said Dr. Steve Pejovich, Center director.

He suggested that the material makes excellent supplemental reading in comparative economics and political science classes as well as a useful tool for professionals and intellectuals. The issue also would be useful for high school students who would like to understand the full implications of Gorbachev's reform policies. High school teachers may find this text useful as they explain the mechanics of *glasnost* to students.

Quo Vadis, Comrade Mikhail? is now available and may be ordered from the Center for \$5.95.

It's very advantageous for a Russian to be chosen to room with foreign students, particularly Westerners, because they have access to the clothes and books, cosmetics, medicines and other items the students bring with them from home, she explained.

Van Tilburg discovered four different sectors of the Soviet economy: a heavy goods/military/industrial sector; a consumer goods sector; an agricultural sector; and the black market.

"The black market is the only economic system that works incredibly well. Everyone I met dealt in some way outside the official economy and chances are that you would be approached by someone with offers to change money or buy or make a trade for your coat, shoes, jeans or watch," she said.

Originally, van Tilburg said she had no idea that she would find the multilayered economic system but she heard over and over again in Russian—"It is impossible to buy, but you can acquire it."

"Everyone I met and got to know admitted to having to turn to the black market at one time or another. They all felt that without the unofficial economy, the social system would completely fall apart. The black market acts as a safety-valve, allowing citizens to get things that the state cannot or will not provide," van Tilburg said.

Although the country is bound up with senseless rules that can be circumvented with a little ingenuity, van Tilburg said she will mostly remember the closeness and generosity of unofficial Russia and the hardships that breed intense friendships.

This summer, she will intern at the Cato Institute in Washington, where she will conduct research in the Library of Congress. The program is sponsored by the Center for Free Enterprise.

This issue of the Public Issues Series will prove helpful to high school history and economics teachers as they explain the Soviet system to students. Van Tilburg's description is easy to read while providing insights into the Soviet social and economic systems. In today's interdependent world, it is important for students to understand the Soviet system in addition to the capitalist system.

—Kathie Krause
Office of Public Information
Texas A&M University

REFLECTIONS ON HOW (AND WHEN AND WHY) THE WEST GREW RICH

In *How the West Grew Rich* (Rosenberg and Birdzell, 1986), Nathan Rosenberg and L. E. Birdzell, Jr., deal with two of the major issues of modern economic history: what explains the original onset of economic growth in the western world, and why this economic growth was able to continue, without decline or stagnation, for several centuries, and, indeed, to experience sharp acceleration over time.

The West is rather broadly defined as those areas where, in the last 200 years "progress and prosperity have touched the lives of somewhat more than the upper tenth of the population—Western Europe, the United States, Canada, Australia, Japan, and a few other places."

The general westward movement of European economic growth is usually seen to begin with the economic leadership of Italian cities and the Low Countries by around the 14th or 15th century; a shift to Portugal and Spain after 1500; by 1600, Holland assumes leadership; then, sometime in the second half of the 18th century, it is England; 100 years later it is the United States, and today—Japan?

China, perhaps the richest large country in the world in the 14th century, now has a per capita income of less than 3 percent of that of the industrial market economies. India, with possibly a per capita income equal to England's at the end of the 16th century, in 1979 had a per capita income equal to 2 percent of that of the industrial market economies, while the component parts of the Ottoman Empire are generally toward the bottom income standard of the World Bank's middle income countries.

Most historians seem to place the transition to western dominance somewhere between 1300 and 1500. It is also generally agreed that any initial lead was quite small relative to the differences we now observe, with industrial market economies now having a per capita income level about 41 times that of the low-income countries.

Rosenberg and Birdzell present a three-stage pattern of economic growth, each with differing causes and consequences. In the late Medieval and Early Modern Eras, starting with the Italian cities of the 12th century, trade in com-

modities across political boundaries was the key. In the era of the classical Industrial Revolution, 1750-1880, when England was the West's economic leader, the rise of the factory system and the applications of empirical innovations were critical. After 1880, when the U.S. assumed western leadership, scientific research became the key to economic development.

"If what we know adds up to three cheers for capitalism that's just too bad." Rosenberg and Birdzell trace the changing economic fortunes of the West to the expansion of political freedom, and argue that this economic expansion was possible because it was based upon improving the economic conditions of the less well-off members of society and bettering their living conditions. Thus, capitalist freedom not only was necessary for economic growth, but it also generated a more equitable distribution of income and political power than alternative socio-economic systems.

Rosenberg and Birdzell draw upon the economic model of (competition) in two critical senses in linking the western political system to western economic development. The first concerns the advantage of the western system of nation-states, each large enough to impose its political and economic power over a sufficiently large area to be effective and important, but none so large and monolithic that it becomes an empire with both the static and the dynamic inefficiencies analogous to those of the monopolistic firm. The political fragmentation and decentralization of power in Europe, as contrasted with the centralization of the Chinese and Islamic empires, led to multiple sources of decision making and a pluralism and diversity of responses.

It was the emergence of an economic sphere free from political and religious influences that provided the basic conditions of economic development, so that economic growth was most rapid where the government was weakest and the population most free. There was a market economy, with individuals free to make decisions in regard to consumption and production, and, in general, there was freedom from arbitrary political acts and confiscations of private property.

Historically, one of the most distinc-

tive features of capitalist economies has been the practice of decentralizing authority over investments to substantial numbers of individuals who stand to make large personal gains if their decisions are right, who stand to lose heavily if their decisions are wrong, and *who lack the economic or political power to prevent at least some others from proving them wrong*. Indeed, this particular cluster of features is among the strongest candidates for *the definition of capitalism*.

In tracing the basis of Western European political fragmentation, Rosenberg and Birdzell have some good things to say about feudalism and the dispersion of power, with the absence of a single power center to control trade, which it generated. More traditional is their praise for the rise of towns where the merchant class flourished, property rights were developed and enforced, and the concept of political freedom developed.

The role of religion in Western European expansion had pronounced effects. Debated are the correlation between the presence of Protestantism and economic growth. Rosenberg and Birdzell provide an important role for Protestantism in providing the moral and ethical system for economic behavior, it being "somewhat better suited to economic growth than the older Catholic teaching."

How the West Grew Rich is a most fertile work of comparative economic history. It provides many new insights and interesting interpretations of the historical past as well as of the current world economic situation. Central to its arguments, and linking Rosenberg and Birdzell's views of the past, present and future, are the critical roles of political decentralization and individual freedom in the achievement of economic growth in the West. Political decentralization and individual freedom were central to western economic development, whether economic growth was dependent upon the expansion of trade or upon the outcome of scientific and technological change.

—Stanley L. Engerman
University of Rochester

These are excerpts from a paper presented at the Interlaken Seminar on Analysis and Ideology.



RUSSELL PERRY DIES

Russell Perry, a member of the Center for Free Enterprise's National Advisory Board, died on April 10, 1988.

He was an honored member of the Dallas community where he was a prominent lawyer, businessman and civic leader. He founded the law firm of Rubinstein and Perry after completing a successful 24-year tenure as Chief Executive Officer of Republic Financial Services, Inc. He received a number of distinguished awards including Headliner of the Year, the Linz Award, Distinguished Salesman, Person of Vision, Torch of Liberty and the Horatio Alger Award.

Perry was a staunch advocate of the free enterprise system. He liked to claim he couldn't have gotten off the farm as a young kid if it weren't for the free enterprise system.

Russell Perry will be sorely missed by the Center and all its friends.

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CENTER NEWS

The second Hayek Symposium was held June 4-7 in Freiburg, West Germany. The Symposium was attended by 35 invited scholars from the U.S. and Europe, including three graduate students from Texas A&M. Dr. William Mobley, President of Texas A&M University, greeted the participants on behalf of Texas A&M at the opening dinner on June 4.

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Dr. Pejovich spoke on "An Income Tax in Texas" at a conference sponsored by the Select Committee on Tax Equity in Austin on June 30, and "The Quality of Life in Eastern Europe" at a seminar arranged by the Discussion Club in St. Louis, Mo. Also, on July 14, Dr. Pejovich gave a paper on "Institutions and Bureaucracy: Obstacles to Economic Reform in the USSR" at the Conference on Economy and Power in Interlaken, Switzerland.



Dr. Pejovich with Hayek Symposium participants.

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Economic Education**ALFRED E. CHALK
AWARDS PRESENTED**

Each year the Department of Economics recognizes the outstanding undergraduate and graduate student with the Alfred E. Chalk Award. Undergraduates are selected on the basis of their achievements in the major and graduate students on the basis of their overall development as professionals. The award carries a cash prize of \$500 and the students' names are engraved on a plaque in the department office.

This year, **Sheila Amin** received the Alfred E. Chalk Undergraduate Award. Sheila has distinguished herself academically and with her service to Texas A&M. She graduated with a 4.0 grade point average.

Sheila has won every major academic award that the College of Liberal Arts and the Department of Economics have to offer. In her junior year she was singled out to receive the Phi Kappa Phi Award, which is given to the outstanding junior in the College of Liberal Arts, and the Gathright Award in her senior year. The Department of Economics also awarded her the Neal Hahn Memorial Scholarship

two years in a row. The award is given to the outstanding economics major in the junior and senior classes. All the courses Sheila has taken in the Department of Economics have been honors courses. This fall, she plans to enroll in the University of Chicago Ph.D. program as an Earhart Fellow.

During his graduate studies at Texas A&M, **Peter Locke**, Chalk Graduate Award winner, compiled a 3.9 grade point average in the Ph.D. program, with only two Bs in his course work. Peter also proved an effective teacher. His dissertation was titled "The Allocation of Risk and the Distribution of Profits." According to Dr. Locke, the dissertation created a theory to analyze the choice of which agents become wage earners and which become residual recipients—those who earn profits or bear losses. The analysis incorporates Frank Knight's ideas of profit and loss into the neoclassical framework. Although competition drives entrepreneurs to profit-share with the owners of resources such as land, labor or capital in the model, they end up worse off as a group compared to zero profit-sharing.

Dr. Locke is now an assistant professor at Tulane University in New Orleans. He teaches economic principles, macroeconomic theory and financial markets.

His current research focuses on agents with diverse subjective probabilities.



Dr. Pejovich and Sheila Amin, Alfred Chalk Award recipient and Earhart Fellow.

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