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THE RISE AND FALL OF SOCIALISM

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1. Socialist Taxonomy

“Socialism” was first named by Saint-Simon in the 1820s: industrialisation and scientific discovery would reorganise productive society as a “...union of men engaged in useful work”, the “basis of true equality”. Griffiths (1924) could list over 260 definitions of socialism, reflecting its multi-dimensional nature. I propose to reduce its essential components to 4:

A) dominant public property and enterprise (state, co-operative or collective, local);

B) equality and an associated large share of social consumption;

C) economic participation and democracy;

D) social control over the main economic variables (income, consumption, accumulation, employment, growth, internal and external balance).
Take \(0\) = absence or strong attenuation, and \(1\) = significant presence, of each of these four elements. 16 alternative models can be generated: some never existed, others no longer exist, others still exist. Examples **ABCD** (*italics = never existed, underlined = existed only in the past, bold = still exists*).

If we leave aside utopian systems that never existed (**1111. Ideal maximalist socialist system, 1110. Full communism** in the economy of abundance not needing a plan, *and 1011. The Yugoslav model a’la Ward*), we are left with 4 basic models of socialism:


**1010. Yugoslavia in practice** (1950-1990)

**1101. China 1978-late '90s,** **1000. China today** since 2001; some post-socialist transition economies.
I will deal primarily with the Soviet-type model, its rise, evolution and collapse, though I would like to refer also to other socialist and social democratic models. The Soviet type model involves state property of the "commanding heights" of the economy, a lesser role for local and cooperative property and enterprise, absent or negligible private property.

Low commitment to equality: no wage levelling under Stalin (no uravnilovka); higher wages for shock-workers and the skilled; endemic excess demand at artificially low prices, with higher than equilibrium prices in black markets accessible to those with cash; privileges for the party nomenklatura; discretionary incentives awarded by enterprise managers. Democratic centralism, i.e. communist party political monopoly pervading the state and the economy at all levels, enhanced by the 1921 prohibition of factions.
Central planning of production and distribution, by branches, enterprises and products, primarily in physical terms; dual monetary circulation of cash for households, bank-money among enterprises; enterprises as one-man-managed administrative units; state monopoly of foreign trade. The system was fully developed in 1928-1932, after War Communism (1918-1921), the New Economic Policy experiment with markets and private property restoration (1921-1926), and rudimentary central planning (1926-1928). After the last War, enlargement to Central Eastern Europe and other countries reached about one third of world population and national income. Despite country and period variations it remained fundamentally unchanged. Naturally the rise of socialism is rooted in the drawbacks of capitalism.
2. Capitalism

Capitalism is one of the greatest social inventions of mankind. The combination of private property, free enterprise, market coordination of production and exchange, money, and wage labour was enhanced by the creation of joint-stock companies, fractional reserve banking, the state provision of law and order and public infrastructures, the opening of trade and investment relations between states and the development of financial markets.

The standard wage contract 1) can be terminated at short notice; 2) fixes a money wage per unit of time, with effort guaranteed by penalty of termination and competition by a large labour reserve army, while capital takes all the residual surplus; 3) gives the capitalist power to organise production at his complete discretion, deciding what and how to produce and sell.
The capitalist system promoted urbanisation, industrialisation, technical progress, economic growth and prosperity on an unprecedented scale: paradoxically the highest praise for capitalism can be found in Marx and Engels, *Manifesto of the Communist Party* (1848):

“The bourgeoisie, during its rule of scarce one hundred years, has created more massive and more colossal productive forces than have all preceding generations together. Subjection of Nature's forces to man, machinery, application of chemistry to industry and agriculture, steam-navigation, railways, electric telegraphs, clearing of whole continents for cultivation, canalisation of rivers, whole populations conjured out of the ground—what earlier century had even a presentiment (of) such productive forces... The bourgeoisie, by the rapid improvement of all instruments of production, by the immensely facilitated means of communication, draws all, even the most barbarian, nations into civilisation.”
At the same time Marx viewed capitalism as a form of systematic labour exploitation. Primitive societies were not exploitative because they exchanged goods roughly embodying the same amount of labour. Slavery was less exploitative than it seemed, for slaves’ consumption allowed them to recover some of their own labour that looked entirely unpaid. Feudalism was openly exploitative, for the amount of work performed by labourers for themselves and for their feudal masters was clearly stipulated and visible; whereas capitalism did not look exploitative at all, since all labour was paid for, but workers performed more work than was embodied in their means of consumption and a surplus unpaid labour was appropriated by capitalists. Marx neglects altogether entrepreneurship, uncertainty and risk and their rewards: a positive share of profits is sufficient to infer exploitation, without the unnecessary detour of his labour theory of value.
The replacement and growth of fixed capital would be necessary in any mode of production (including socialism, Pareto 1890): exploitation should be restricted at most to capitalists’ consumption. Marx regarded all profits, consumed or re-invested, as equally exploitative as originating in “primitive accumulation” ultimately rooted in theft, robbery, war conquest and other forms of violence.

Inequality of wealth and incomes was a defining feature of capitalism. Its redeeming feature was the financing of investment and growth: “Accumulate, accumulate! This is Moses and the Prophets” (Capital, Vol,I, ch.24). Marx modelled intersectoral flows and equilibrium conditions for a stationary and a growing economy in his two-sector reproduction schemes; he exaggerated its instability by assuming that profits would be reinvested in the same sector in which they originated.
Marx regarded capitalism as a totally chaotic and anarchic system, naturally generating unemployed resources and costly fluctuations, but he neglected automatic processes of economic adjustment, operating imperfectly, either too fast or too slowly, but typical of a capitalist system.

These are: the short-term Walrasian adjustment of prices to positive or negative excess demand; the medium-term Marshallian adjustment of enterprise output to price relatively to marginal cost; as well as the gradual longer-term adjustment of actual to desired capital stock, upwards via investment in new capital or downwards through the non-replacement of excess capital.

These processes, though imperfect, have made the capitalist system more flexible, though exposing it to the risk of possible more extreme episodes of unemployment, instability and stagnation.
Concern about inequality has been tempered by several considerations.

1. Persistent inequality has always been an inexorable feature of our past, only contrasted by outbursts of large scale violence: mass-mobilisation warfare, transformative revolutions, state collapse and catastrophic plagues (Scheidel 2017).

2. A conflict is alleged between efficiency and equality, which is deemed to reduce incentives to elicit effort and imagination for the benefit of society.

3. Inequality depends on the phases of capitalist growth, rising with industrialisation then peaking and falling with further growth (Kuznets’ curve).

4. There is widespread indifference about inequality compared with the much greater concern about poverty: “Poverty bothers me. Inequality does not. I just don’t care” (Buiter 2007).
4. Furman (2017) asks “Should Policymakers Care Whether Inequality Is Helpful or Harmful For Growth?” and answers No, because evidence is mixed, the real question is whether inequality reduction policies lower growth, which they do, and if inequality is harmful it is for spurious reasons.

The trouble is that the rich save more than the poor, and inequality eventually leads to a mismatch between savings and investment and secular stagnation (Hobson 1902, Hansen 1939, Summers 2015). More generally, capitalism is afflicted by unemployment: classical due to capital shortage, Keynesian due to a deficit of effective demand amplified by imperfect competition, and Schumpeterian due to “creative destruction” induced by technical progress.
Economic fluctuations are generated (to name but a few) by the interaction of multiplier and accelerator (Harrod-Domar knife-edge growth); the double impact of unemployment on wage growth relatively to productivity and therefore on profits, and the impact of profits on accumulation relatively to natural growth and therefore unemployment, even when capital is always fully utilised (Goodwin-Volterra); stability itself might become over time a source of instability, breeding over-optimism yielding an excessive rise in asset prices thus undermining it (a Minsky moment). Kornai (2014) regards the surplus nature of capitalism as a major engine of technical progress and innovation. He seems to under-estimate the role of the state and the military; it is highly questionable whether current rates of unemployment, worsened by the austerity policies enforced by the EU, is necessary to promote innovation.
3. Marx’s theory of modes of production

One of Marx’s main contributions to political economy is an evolutionary ("Darwinist", according to Engels) theory of *modes of production*, in our modern sense of *economic systems*.

Labour acting over nature leads to the development of *production forces* (natural and man-made resources and the state of technical knowledge). This development leads to the emergence of contradictions between the productive potential of society and the prevailing *productive relations* (e.g. rules about ownership, production organization, etc.). Productive relations are modified as a result.

Further contradictions arise between the economic basis and the *superstructure* of society, i.e. social relations and social consciousness (religion, ideology, culture, etc.), contributing to its legitimation.
Conflicts and contradictions between the various elements and their resolution lead to system evolutions (Lange, 1963).

Marx made three major errors: he believed that 1) there would be a final point of arrival for such an evolutionary course, i.e. full communism (with prevailing free goods, distribution according to needs, and no state) without classes, non-antagonistic, under which there would no longer be conflicts and contradictions; 2) there would be a linear progression of economic systems, from primitive societies to slavery to feudalism to capitalism, socialism and full communism; 3) that system evolution would be dominated by an extreme form of dialectical materialism, with a primary role for economic factors or economic determinism.
4. War Communism (1918-1921)

Contrary to expectations, socialism first arose in a large, labour abundant, underdeveloped economy, with an autocratic, despotic tradition, ravaged by a world war and civil war and operating in a hostile international environment.

The system established after the October Revolution was primarily a War Economy: rapid spontaneous expansion of state ownership, political control over the economy; labour militarisation; obligatory delivery and requisition of agricultural surplus; de-monetisation; organisation of the entire economy as centralised barter; abolition of private trade; compulsory consumer cooperatives; increasingly free services; direct allocation of inputs according to a system of priorities.
War Communism was partly dictated by emergency, partly a conscious design. It was marred by the multiplication of priorities, disruption of supplies, grain procurement difficulties, political pressures (strikes, absenteeism, opposition in the factories, Kronstadt etc.). It delivered survival but could not deliver reconstruction, let alone industrialization.

5. New Economic Policy (NEP, 1921-26)
Early in 1921 the X Party Congress established NEP: restoration of private production and trade (a tax in kind in agriculture, the remaining output freely used and traded; de-nationalisations, leasings including to former owners and foreigners; new firms with up to 20 workers), a balanced budget, the re-establishment of ordinary monetary flows and the stabilisation of the currency, convertibility, introduction of the principles of cost accounting and autonomy in state firms.
The superstructure rapidly adjusted to this new economic basis. Economic liberalization brought about complete political centralisation. Fearing the danger of capitalist restoration, all political parties other than the Bolsheviks were finally banned and, at the same Xth Congress that introduced NEP, Lenin's proposal that organized groups or faction within the party itself should be banned was approved and immediately acted upon.

NEP was the kind of mixed economy which today would enjoy IMF blessing. It delivered reconstruction, completed at some point between 1926 and 1928, according to criteria used. Growth was based mostly on the reactivation of existing capacity and the re-absorption of available factory labour; but gross investment was close to depreciation (Nove, 1969).
'Socialism in one country’ – not as a strategy but as a fact of life, given the failure of European revolutions - precluded any extensive use of foreign capital to finance capital accumulation. The Soviet Union had accumulated a substantial external debt, whose cost was mounting; terms of trade were unfavourable; agricultural exports were languishing. The tax in kind having been replaced with a money tax, agricultural procurements had to go through the market; the deterioration of agriculture's terms of trade had led to supply difficulties (the 'scissor crisis' of 1925. and similar subsequent difficulties). The problem was also that of generating capital accumulation within the socialized sector (Preobrazhensky's 'primitive socialist accumulation’). The expropriation of peasants and thriving Nepmen would have undermined NEP foundations.
The use of price incentives to obtain a higher marketed surplus would have led to the further development of a *kulak* class and the abandonment of the idea of using agriculture to finance primitive socialist accumulation.

Either the living standards of workers in the socialized sector would have to be compressed; or accumulation would have had to proceed at a slow pace, which would have caused the permanence if not the increase of labour unemployment, that had arisen and fluctuated during the NEP.

Ultimately there was a contradiction between the maintenance of the NEP mixed economy and the simultaneous achievement of economic growth, growth of the socialized sector, and minimum standards of socialist distribution. NEP was discarded in favour of state ownership and central planning.
In the second half of the 1920s there was a discussion on planning in which two schools emerged: The genetic school (e.g. Groman, Kondratieff, Bazarov) viewed planning as an extrapolation of past trends, subject to objective constraints including pre-War productive capacity; they viewed the plan as a forecast and attached importance to balanced growth.

The teleological or purposeful school (e.g. Strumilin) stressed the planner’s wide discretion, especially in the long run and at the cost of accumulation; planning was a deliberate act of change, an act of war even, to change the structure of the economy, and which might necessitate unbalanced growth.

Fel’dman developed Marx’s reproduction schemes into a model of growth acceleration in a closed economy.
6. The development of the Soviet-type model

Already in 1926-27 there is evidence of a re-centralization of the economy, with the preparation of material and financial balances, and “control figures”, from which Leontieff developed input-output tables. There were a number of plans, but no overall consolidated macro-economic planning.

1) In 1928 the first Five Year Plan is launched, together with shorter operational plans, of great ambition and encompassing the entire economy, for the accelerated industrialization of the country by means of massive capital accumulation. Plans are tight/taut, associated with a set of priorities for key products (the 'leading links') representing bottlenecks; the emphasis is on physical magnitudes, prices have a simple role of aggregation.
2) the forced collectivization of agriculture, which at an enormous human cost raised the supply of wage goods, without the cost that the improvement in terms of trade would have required, raised labour supply, allowed import substitution and agricultural exports.

3) Centralisation of supplies, through a sectoral structure, with the reorganization of the Supreme Council of the National Economy (Vesenkha) into three industrial People's Commissariats or Ministries. Their chief-departments (glavki) take on functional aspects (finance, supplies, investment). The number of Ministries (republican and all-Union) and their subdivisions, Gosplan’s specific tasks (e.g. short versus long-run) altered over time but the structure remained unchanged until 1957 Sovnarkhozy.
4) 'control by the rouble’, i.e. reinforcement of central control by means of the financial monitoring of plan implementation. In 1930-32 the Central Bank Gosbank acquired also the monopoly of short-term lending, enforced with the prohibition of direct financing of firms by suppliers and customers. Thus money and credit were to provide the payment flows corresponding to planned physical flows. Financial flows belonged to two separate circuits, one of cash for the payments of wages and the purchase of consumption goods, the other of bank money for purchases and deliveries of goods between enterprises.

5) the principle of economic accounting (or khozraschot) was retained, i.e. the covering of costs by receipts plus a planned profit (or loss).
Any additional profit would be syphoned off into the state budget by a turnover tax (practically a tax by difference, indistinguishable from profit), investment funds and most of the working capital being obtained either from retained profits or free of charge from the state budget (subject to the observance of official rules concerning the choice of techniques and amounting to a shadow capital charge). The retention of profit by enterprises was governed by, and did not govern, the rate of accumulation.

(6) prices or price-fixing criteria were decided centrally; production goods were available to enterprises at those prices via direct planned allocation; consumption goods were available to consumers at those prices subject to availability. Persistent and endemic shortages developed, leading to retrading at higher, black market prices if feasible.
7) One-man management (*edinonachalie*), in theory ending at the end of the 1920s, in practice much later – then in practice a 'triangle' made by the union, the party cell and the manager. The director and other managerial officers had not only a salary but also performance-related progressive bonuses for the fulfilment and over-fulfilment of various indicators, mostly expressed in physical units, in terms of gross output, except for the use of constant (rather than actual current) prices for the aggregation of heterogeneous products of the same enterprise.

8) The transformation of trade unions from organs for the promotion of workers' class interest to production-minded institutions, with a narrow role in welfare and social insurance, and totally subservient to (transmission belts of) government wishes.
9) the rejection of egalitarian principles (*uravnilovka*) in the structure of wages and other material rewards, (given above all the scarcity of skilled labour), as well as in privileged access to consumption goods for selected categories, and the widespread use of piece-rate payment systems. There were also non-material incentives relying on 'socialist emulation', shock workers, and other initiatives for the mobilization of labour and working effort.

10) The systematic undertaking of capital accumulation on an increasing scale, with priority to industry over agriculture, heavy over light industry, sectors producing production goods rather than consumption goods. "'Accumulate! Accumulate!': the maxim that Marx had associated with capitalism, became the maxim of those who claimed to be his followers' (Hicks, 1966).
In the Soviet Union the rapid increase in investment began in 1928, and continued up to 1936 with only one year of relaxation in 1933. Abram Bergson's calculations of the share of accumulation in national income (including services) at current prices came to 23% in 1928, 21% in 1937, 23% in 1950 and 24% in 1955.

11) Foreign trade: ease of plan implementation naturally leads central planners to favour autarkic or quasi-autarkic structures. In the process of plan construction first the necessary import requirements of planned levels of gross output are estimated by commodity groups, then export plans are adapted to foreign currency requirements of the import plan. If a deficit emerges, over what can be financed out of reserves or fresh borrowing, if import substitution cannot fill the gap output plans are scaled down.
Exports are regarded as a "necessary evil", as a withdrawal from the domestic market. Planned trade is undertaken through large import-export state enterprises, specialised by commodity group thus enjoying strong market power, operating not on behalf of producers but on their own account.

7. Central-Eastern Europe
After the last War the basic Soviet-type model was exported to Central-Eastern Europe and other world economies, encompassing up to one third of world income and population in the 1970s. Many of the new members of the bloc had already achieved significant industrialisation and lacked the autocratic tradition of the USSR, but with minor variations the basic model remained the same – except for the Yugoslav adoption, soon after the break with Moscow in 1948, of “associationist” market socialism.
The same accumulation policy was followed: Soviet and Eastern European investment share in their net national material product was for so long within small margins of 25 per cent, that United Nations sources refer to that as a 'pragmatic rule' (UN-ECE, 1967).

There was planned trade integration within the socialist trading bloc - CMEA or Council of Mutual Economic Assistance (also Comecon only in Western literature; used to include the USSR, the East European Six, Mongolia, Cuba and Vietnam) - as the result of the coordination of national plans. Even within CMEA, however, trade flows tend to be bilaterally cleared (moreover within groups of hard and soft commodities) and there is no common currency. Domestic currencies are not convertible into commodities (outside the sphere of consumer purchases by nationals), let alone other currencies.
Exchange rates have a purely accounting role, subsidies and taxes tend to make all planned exports equally profitable to producers and imports competitive with domestic substitutes whenever they available; the economy is effectively insulated from prices and exchange rate fluctuations.

Trade balances are expressed and carried over (at a token interest charge) in the so-called transferable rouble, which is not convertible in Soviet commodities let alone transferable to countries other than the Soviet Union, without prior mutual agreement; intra-CMEA trade prices are usually indexed with a lag to a moving average of international prices in convertible currencies. All in all, foreign trade transactions are administratively determined and there is no automatic mechanism transmitting to producers signals about trade opportunities and inducing them to take advantage of any such opportunities.
7. Expectations and performance

The system was expected to offer ex-ante coordination of economic decisions (i.e. equilibrium), greater efficiency, economic growth and full employment without inflation, greater equality.

Economic growth was very impressive in the USSR from 1928 until about 1960, and in East-Europe from the completion of post-war reconstruction about 1950 to the mid-'sixties, at a cost of large and rising shares of capital accumulation in national income. After that growth slowed down significantly, fluctuations and actual decline appeared in spite of continued accelerated capital accumulation.

Taut planning never allowed ex-ante equilibrium. Internal and external imbalances were endemic.
Inflation was never eliminated, except for a brief spell after the last War. There were hidden (under-recorded or unrecorded) inflation, and repressed inflation, i.e. persistent, endemic shortages. 35mn man-years were said to be lost queueing in the USSR in the late 1980s.

Full employment was implemented in the Soviet Union in 1928-29 through massive labour mobilisation and redeployment regardless of skills and locations. Labour was often underemployed, or hoarded, but the universal Soviet and East European picture was one of labour shortage not unemployment (other than minor frictional and seasonal). Presumably full employment was a continued major target, but was obtained as a by-product of ambitious policies of accumulation and growth, by default, or by “serendipity” (Hanson, 1985).
Until the late 1960s observers spoke of microeconomic inefficiency offset by macroeconomic rationality. Inefficiency soon became recognised, by native economists and politicians even more clearly and forcefully than by Western critics.

Basically the system ignoring or distorting prices neglected all opportunities of substitutability in consumption and in the choice of production techniques, as well as in the structure of foreign trade. Thus material intensity and especially energy increased in spite of their world price rise, which these countries wasted. Investment gestation periods were excessive; investment, including costly imported machinery, was obsolete by the time of installation or remained idle for labour shortages. There were absurd biases in the quality and assortment of output.
Hare and Hughes (1991) showed that on the eve of transition in Czechoslovakia, Hungary and Poland, between a fifth and a quarter of manufacturing production exhibited negative value added at world prices (using 1988-9 data on inputs, outputs and exchange rates). Japan bought Soviet machinery for scrap, and aluminium from the socialist bloc was sold internationally at less than the international price of the energy it embodied.

Health and environmental standards were high but unobserved. Feshbach 1992 talks of a Soviet “Ecocide”.

The system conquered space but became unable to provide for the basic needs of the population for food, clothes and shoes, let alone pizza, hamburgers, jeans and soft drinks, high tech consumers, or motorcars.
8. Reform attempts and their failure

Tatu (1987) argues that the system was constructed “not to change [but] to resist any imaginable social, technical or human pressure, both internal and international”, “it is so perfect that it is impossible to remove a single stone without destroying the whole system”.

Yet – besides Yugoslavia – after 1953 there were countless attempts at reform: e.g. Soviet 1957 regional decentralisation; GDR vertically integrated sectors; Poland 1956 economic and political reform; Hungary 1956 and Czechoslovakia 1968, repressed militarily; Gierek’s large corporations; Hungary’s New Economic Mechanism (after 1968); Polish plans 1980-81; Gorbachev’s perestroika from 1985, down to Shatalin’s 500 days Plan 1990.
There were experiments with currency reforms, the use of mathematical methods in planning, wholesale trade of inputs, dual pricing, private enterprise and cooperatives promotion, material incentives, quality control, use of international prices.

Repeated, often radical reform attempts failed; - they were piecemeal improvements, that did not amount to a systemic change; - they were resisted by managers and party officials for fear of losing power and control; - their effectiveness was hopelessly handicapped by widespread endemic shortages; - substantial resources were needed to restore market-clearing, reduce external debt and finance capacity restructuring; Gorbachev’s efforts clashed with the low price of Soviet oil and gas exports.
Fig. 1 The mechanism of political and economic fluctuations in the socialist system.
9. The original sin of socialism

Without doubt the original sin of socialism was committed by Bukharin and Rosa Luxemburg, for whom “socialism marks the end of political economy as a science”. They were followed by Hilferding and by the majority of Bolshevik economists. This sin is the origin of the decisionism and the voluntarism typical of economic management in the Soviet Union and in the countries that adopted its system, that eventually led to the Fall.

This is the foundation of the victory of the teleological school of planning as an act of war, of Stalin’s “There is no fortress that a Bolshevik cannot conquer”, the planners’ arithmetic of “2 + 2 = 5” (the first five-year plan was realised in four years, regardless of cost).
By the 1970s realised socialism in Poland was boasting that “Polak wszystko potrafi” (A Pole is capable of anything).

Aiming at impossible targets one might occasionally obtain more than otherwise, but defying the laws of physics is by and large a losing strategy: aiming at the Moon misses all desirable targets within reach.

This is also the foundation of the system of priorities, of investment over consumption, industry over agriculture, investment in heavy over light industry, so as to produce steel to produce more steel and ever more steel, regardless of the needs of the population. Many other targets were given priority, and as a result nothing at all had effective priority.

*Priorities* in the plural are an oxymoron:
Priorities mean that the actual or opportunity costs of alternative targets are ignored or neglected: an uneconomic system is built on ignoring any trade-off between alternative targets in economic choice.

In its most spectacular and damaging form, the violation of economic laws in the socialist system consists in the adoption of the impossible target of maintaining low and stable prices, while goods are available in quantities lower than those necessary to validate such prices given their demand. Hence the inevitability of shortages, queues, black markets – which impeded the introduction of market elements in the reform projects of the socialist bloc. When reality could not be forced to comply, change was faked: fake genetic miracles were claimed; fake plan realizations announced.
10. The Fall: Sudden, Unexpected, Contagious

The fall of Berlin’s Wall (9/11/1989) is usually taken as the icon and the date of the collapse of the Soviet-style political and economic system. In truth the beginning of the end can be dated at 6 February 1989, when the Round Table of representatives of the Polish government and the Solidarity opposition first met in Warsaw. At the beginning of April this joint commission agreed to hold the first contested elections in the whole bloc since the end of the last War. On 4 June the resounding defeat of the government coalition partners – the communist party and the Peasants Party – that obtained the 60% of parliamentary seats reserved to them in the lower Chamber but not a single contested seat or a Senate seat.
By September 1989 Tadeusz Mazowiecki had established the first non-communist government in post-War Eastern Europe, undertaking a radical transition process to a market economy, with private ownership and enterprise, open to international trade and investment.

Within three-four months a domino effect made other Soviet type regimes in Eastern Europe fall, bloodlessly except for a brief episode in Romania. They fell “like rotten apples off a tree” (Lavigne 1990).

German reunification (de facto in November 1989, de jure on 3/10/1990) was accompanied by other dis-integration and re-integration events: within two years Comecon and the Warsaw Pact had disintegrated; after the failed putsch of August 1991 the USSR disintegrated in December 1991.
Yugoslavia disintegrated in conflict and in 1993 the Czech and Slovak republics split. Eastern European countries reintegrated into the world economy and especially Europe, acquiring membership in successive waves (2004, 2007, and later). NATO enlarged to the East, violating Bush’s commitments to the USSR; the EBRD, set up in 1991 to assist the transition, today operates in 29 countries.

The process was fast and accelerating. An International Herald Tribune cartoon showed a man watching the news on TV: “Gosh! I must have pressed Fast-Forward!”

Nobody had anticipated the speed, depth and breadth of these processes, let alone its possible timing. Presumed anticipations have been dubbed “accidental prophecies” (Laqueur 1996), without scientific foundations, based on wrong premises.
Amalrik (1969) had forecast the USSR dissolution to happen in the Orwellian 1984, as a result of social and ethnic conflicts and war with China; Todd (1976) based his forecasts on demographic trends such as the increase in Soviet infant mortality. Carrere d’Encausse (1978) announced the end of the USSR at an unspecified date as a result of the high birth rate in Islamic republics of Central Asia. Levin (1977) forecast the Soviet collapse for 14 July 1989, amazingly accurate within a couple of weeks; but he had added simply a round two centuries to the date of the French Revolution.

In June 1981 I prospected an economic crisis in Eastern Europe at a CREES Seminar in Birmingham, severely criticised and accused of unduly generalising Polish problems. I was so unsure of my conjecture that I published that lecture over three years later.
The only, improbable premonition of what happened in 1989 was published by an Italian satirical weekly *Il Male (Evil)*, in two issues in 1980: a *Pravda spoof*, with prophetic news of Soviet disintegration ("No more Union, no more Soviet, no more Socialist, only republics"), the fall of the communist regime and the restoration of capitalism, with political and religious freedoms, the return of old aristocratic and royal families, the restitution of nationalised assets to their legitimate owners including the Church, privatisations.

A *Bild spoof*, which actually anticipated German re-unification.

Only the fervid imagination of satirists was capable of not so much forecasting but even imagining what happened for real in 1989.
11. Transition and its debacle

It was widely expected that the post-socialist transition would lead to early significant improvements in the level and growth of people’s consumption and income. This was a plausible expectation: the new system would generate market-clearing prices in domestic and international transactions, revive the incentives to follow them thanks to the appropriation of profits by owners of private enterprises, and unleash and discipline entrepreneurship.

Few practitioners of the transition contemplated disruption. Those that did anticipated at most a one-digit temporary decline followed by accelerated growth and catching up with other market economies.
Instead the transition process was accompanied by a deep and often protracted ‘transformation recession’ (Kornai’s label). Only Laski (1990) had anticipated it.

Poland experienced the shortest and smallest fall in income (17% of 1989 GDP in just under three years) recovering its 1989 level in 1996 and moving rapidly ahead, while Georgia had the largest and most prolonged fall (75% by 1994 before reversing, and still below the 1989 level) – leaving aside the transition countries that experienced war (with Bosnia and Herzegovina at over 80% GDP loss and still not fully recovered).

This unexpected statistical record provoked three contrasting reactions: disbelief to the point of denial, belief coupled with acceptance of its necessity, belief coupled with rejection of its necessity.
The initial response was that the transformation recession was by and large a statistical illusion, due to changes in conventions and enterprise behaviour.

In the old system there was universal reporting by enterprises that had an incentive to exaggerate gross production achievements, to avoid penalties involved by failure to reach planned targets and to reap the bonuses deriving from plan overfulfilment.

In the new system there was incomplete sample coverage of producers under-reporting net results in order to avoid tax. A significant amount of production took place in the black or grey economy, simply going unreported. And people benefited from an increase of their consumer surplus, from having access to a broader range of goods, while price increases were to some extent justified by quality increases.
These considerations cannot be dismissed, but can easily be overplayed. There was an illegal grey/black economy already under central planning; its newly-found legality led to at least some of it surfacing, thus unduly boosting the performance of the new system.

Consumer surplus is not and has never been included in national income accounting anywhere in the world, and there is no reason to begin accounting for it now.

Parallel price and quality increases were not necessarily an improvement for all. The availability and quality of public services plummeted. Transition performance was boosted to a great extent by the growth in formerly underprovided and underpriced services, and by real revaluation of the currency initially undervalued. A single long queue for jobs replaced the former queues for goods. Inequality and poverty increased.
The second response to the transformation recession was that it was indeed real, but unavoidable. The transition was like ‘turning a fish soup back into an aquarium’, in Poland it was likened to ‘turning vodka back into potatoes’: it simply had to be costly.

Others referred to the recession as a form of Schumpeter’s ‘creative destruction’, except that there had been no actual capacity destruction as there had been in wartime to justify this proposition. On the contrary, destruction of value-subtracting activities should have boosted national income instead of reducing it, while competition and investment in innovation were missing anyway.

Shleifer and Treisman (On the Road without a Map, 2000) justify the recession as due to the unprecedented nature of the transition.
On uncharted territory we can all easily get lost, but we knew very well where we were, and all the conceivable advantages and drawbacks of the Soviet-type system; we knew what was going increasingly wrong with that system; we had – unlike any earlier transition – complete maps of the alternative points of arrival of the transition, i.e. the various versions of available models of capitalism.

Therefore we knew precisely what had to be changed to implement the transition from where we were to the target model. What we did not know was the desirable speed of the transition and therefore, in case of a non-instantaneous transition, the appropriate sequencing of the necessary moves.

In one respect, however, transition politics rather than economics necessarily involved disruption.
International trade was greatly disrupted by the economic and monetary disintegration associated with the transition. Comecon disintegration (1991) involved a switch to trade payments in hard currencies and therefore balanced trade. The USSR split into its 15 component Republics (1992) led to 15 republican currencies, first as rouble substitutes then as proper domestic (inconvertible) currencies, without the buffer of inter-republican transfers and with a relative prices shock. Mundell attributes much of the unprecedented recession to monetary disintegration.

The different target models and stages of transition reached and intended by different countries and republics made the preservation of Comecon, USSR, CSSR and Yugoslavia, politically impossible.
If the transition recession was slightly exaggerated by statistics and to some extent due to monetary disintegration, its main thrust was due to unnecessary poor policies:

- the uncritical acceptance of the hyperliberal model of capitalism;
- misplaced emphasis on the Washington policies applied in the 1980s in Latin America (price liberalisation, trade opening, privatisation);
- misplaced emphasis on the merits of shock therapy versus gradualism;
- “state desertion” of public enterprises and more generally of building market institutions (Nuti 2013).
12. The debacle of social democracy

The label Social-democracy applies to a fully capitalist economy with active government economic policy, some (minority) public ownership, monetary and fiscal policy promoting investment and employment, some direct controls, welfare state provisions for health, education, pensions and housing, with measures of income re-distribution to alleviate inequality and poverty, on the basis of a moral imperative – although similar policies and achievements are to be credited to conservative-liberal governments from Bismarck to Macmillan, seeking social peace in a capitalist environment.

Social-democracy also suffered from the pretence that economic laws can be suspended or ignored.
This applies both to the extreme left – with Potere Operaio in Italy promising a life as *rentiers* to all workers adopting their misguided strategy of “refusal to work”, or with the May 1968 Parisian slogan “Soyez réalistes, demandez l’impossible” – and to democratic socialism. For instance, at the time of the Blackpool Labour Party Conference in 1949, Bevan declared that "The language of priorities is the religion of socialism", confirming the muddled thinking and the neglect of a proper economic assessment of policy alternatives by social-democratic leaders.

For a long time, until New Labour came to power in the UK (1997) rarely if ever did social-democrats consider whether there might be feasibility limits to the welfare state; or the possibility and implications of opportunistic behaviour (“moral hazard”).
Whether a capitalist economy might prosper and grow without profit margins sufficient to both finance and attract investment. Whether an economy open to trade and (both inward and outward) investment flows should not worry about its own international competitiveness. Whether there might be limits – though flexible, but therefore dangerously uncertain – to public expenditure, financed by rising public debt or by rising inflation. Whether public enterprises have a growth-promotion role not only in the production of energy and steel, but also in the doubtful case of processed foods and textiles.

Trade Unions are in a conflict of interest with the rest of the population that do not belong to them – representing mostly men and employed men at that.
Trade Unions everywhere are still leaning towards impossible claims, especially in demanding the preservation of jobs in non-viable, even bankrupt companies and industries in a crisis, although they should be aware of the economic implications of their negotiating stances.

Unions have often recognised that there are limits to the compatibility of wage claims with inflation restraint and the promotion of employment and growth. (Italian Unions recognising that the wage rate is not *a/the* “independent variable” of the capitalist market economy.)

Towards the end of the 1990s the Fall of the Wall and the victory, seemingly definitive at the time, of hyper-liberalism, provoked a late and exaggerated conversion of social-democracy to hyper-liberalism.
This happened first in the transition countries by right and left governments alike, then in western Europe under the leadership of New Labour and its Third Way, replicated by the German *Neue Mitte*. By the end of 1998 13 out of the then 15 EU members (not Ireland and Spain) had social-democratic or left-wing coalition governments; social-democrats also held a dominant position in the European Parliament, which they promptly lost in 1999.

The new project of Blair and Schroeder claims commitment to traditional socialist values: “*Fairness and social justice; liberty and equality of opportunity; solidarity and responsibility to others: these values are timeless. Social democracy will never sacrifice them*” (Blair and Schroeder, 1999).

However it differed from social-democracy in three major respects:
1) Acceptance of the primacy and desirability of markets, fully recognising their global nature in the modern world. “The market is part of the social organisation we desire, not just a necessary means which we reluctantly admit that we need, and need to master” (Karlsson 1999). Thus they were oblivious to the distribution implications of market allocations.

2) Rejection of public ownership and public enterprise, supporting private entrepreneurship and continued privatisation. “Government does all it can to support enterprise but never believes it is a substitute for enterprise... we want a society which celebrates successful entrepreneurs just as it does artists and footballers – and values creativity in all spheres of life” (Blair and Schroeder, 1999). And, above all,
3) Affordability, i.e. fiscal discipline and monetary restraint, rejecting both Keynesian policies of public deficit and debt, and inflationary monetary expansion. “Sound public finance should be a badge of pride for social democrats”. “... deficit spending cannot be used to overcome structural weaknesses in the economy that are a barrier to faster growth and higher employment. Social democrats also must not tolerate excessive levels of public sector debt. Increased indebtedness represents an unfair burden on future generations. It could have unwelcome distributive effects. All the money spent on servicing high public sector debt is not available to be spent on other priorities [sic] including increased investment in education, training or the transport infrastructure”. (Blair and Schroeder 1999).
They argued to remove all traditional instruments of economic policy (direct controls, price and investment policy of public enterprises, taxation and monetary policy) from economic governance.

Yet they did not move fast or far enough in some respects: they still talked of “priorities”, aimed at a 35 hours week without wage reductions, wanted to reduce pensionable age in an ageing society, proposed a Tobin tax unenforceable in the cyberage.

And all of them went much too far in unconditionally endorsing hyper-liberalism (see Nuti 1999), and unconditional globalisation including free movement of capital and labour in a world without borders. They helped to deliver the worst economic, financial and political crisis in the modern age.
13. What Next?

Our DOC-RI research project considers two possible outcomes of current trends: one is growing inequality generating social tensions eventually becoming unbearable and leading to a social revolution, re-establishing familiar adverse historical process; the other is the successful establishment of a “new socialism”, with the pursuit of more egalitarian policies by some countries, remaining market economies but with more redistribution, more regulation and taxation, more public property, becoming more competitive and driving their less enlightened competitors “out of business”.

But there may be a different outcome: of greater, though much impoverished equality enforced through mass-migrations in a world *de facto* without borders.
A world without borders was part of the communist utopia, to be reached after the universal adoption of world communism. But today the mounting irresistible pressure of international migration, unsuccessfully contrasted by national policies, raises the possibility of such a scenario under global capitalism.

Many regard it as desirable even in current conditions, in view of the expected net gains in terms of efficiency and in spite of undoubted gross of losses on the part of displaced national workers and employers in the country or origin. The displacement would last for a long period while global investment is insufficient to ensure full employment and in a situation of lack of global governance institutions capable of global taxation and redistribution necessary to over-compensate losers.
Moreover migrants automatically and freely appropriate a share of existing social capital in the host country, whether defined as social physical infrastructure, or social welfare provisions, or cultural cohesion and trust (in which last case they destroy social capital without appropriating it).

The free appropriation (or destruction) of social capital by migrants would be acceptable under global full communism, but is unacceptable in a world where the ownership of private capital is universally and fiercely protected. Again, compensation of losers would require transfers both across borders and from the poor to the rich, therefore impractical and undesirable. The natives dispossessed of their expected share of social capital sooner or later are bound to object and resist their further dispossession.
Chilosi (2002 and 2017) investigates a world with unrestricted international migrations and is highly sceptical about its benefits.

With open borders, migration would start and go on until living standards in the host country and all the countries characterised by a lower standard are roughly equalised (travel costs of legal migration being low and tendentially falling).

Emitting countries would not necessarily benefit, for they would tend to lose the more capable and entrepreneurial labourers, though would gain from their remittances. The host country would gain from the availability of cheap labour and the higher wages of complementary labour, but substitute (unskilled) labour would suffer.
The host country would become more unequal and unjust, and probably violent, or it might preserve equality only at the cost of impoverishment, lowering its pre-immigration incomes.

Immigrant groups will raise their political power in the host country to their own advantage, in virtue of demographic trends, organisation or initiative, dispossessing others and perhaps close the borders to further migration.

Economically valuable open borders are being closed by host countries ending further, often economically desirable migration. Forcible re-patriation policies cause rising socio-economic disruption.

A world without borders under capitalism is a far less desirable than one of controlled migration.
Those escaping from war and environmental catastrophes must be accepted and protected; the acceptance of economic migrants must rest within the limits of host countries’ willingness and capacity to take them.

The prospect of inequality reduction in a world without borders is not an attractive alternative to those considered in Popov (2017). The realisation of “new socialism” faces all the risks of “socialism in one country” and uncontrolled migration.