

# Economic Planning and Market Allocation in the Economy of the XXI Century

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**Abstract:** Today the market plays the major role in economies throughout the world. While economic planning also takes place, it plays a relatively marginal role in most countries. This paper makes a case that economies should move toward an expanding role for planning and a reduced role for market allocation over time. The paper reviews the strengths and weaknesses of Soviet central planning. It argues that a democratic and participatory type of planning would be most effective and would avoid overcome the problems that arose in Soviet central planning. Such a transition is necessary to build an economy that can satisfy human wants and needs in an environmentally sustainable manner.

**Keywords:** Planning, markets, allocation of resources, Soviet economy

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## **1. Introduction**

Today the market plays the major role in economies throughout the world. While economic planning also takes place, it plays a relatively marginal role in most countries. This paper makes a case that economies should move toward an expanding role for planning and a reduced role for market allocation over time. Such a transition is necessary to build an economy that can satisfy human wants and needs in an environmentally sustainable manner.

The topic of this paper – market allocation and economic planning – is closely related to the question of the role of private versus public ownership of enterprises. However, we will not look into that related question here.

## **2. What is Market Allocation and What is Economic Planning?**

People have always lived and produced in groups. That inevitably gives rise to a tension between individual desires and the needs of the group. Since individuals cannot survive alone, both satisfaction of individual material needs and assuring the welfare and reproduction of the group are required for a viable society.

In any self-reproducing group, from a hunter-gather band to a large contemporary nation-state, it is conventional to refer to three economic decisions that must be made: 1) What will be produced? 2) How will the available productive resources (labor, capital goods, and natural resources) be used to produce the outputs? 3) How will those produced goods be distributed among members of the society. Economists refer to the outcome of the foregoing three decisions as the “allocation of resources” in a society.

Allocation of resources also involves decisions about the time path of production and consumption. A part of the current period’s output can be devoted to investment, by

taking the form of goods and services that increase output in the future, such as more or better capital goods and education and training.

Analyses of the allocation of resources often make the simplifying assumption that final outputs go to individual consumers. However, not all final goods are directly distributed to individual consumers in society, since some go first to a collective entity that must decide how to distribute the goods to the final consumers. For example, the final distribution decisions for a part of the private goods produced, such as food, clothing, and housing, are made by families, restaurants, schools, charities, and collective living institutions such as monasteries. Each of the foregoing institutions follows some principle for the final distribution of the goods. For “public goods” such as parks and roads, governments decide to take part of the final output of the economy in the form of such goods and decide how to make them available to the users.

Two systems have been devised to allocate resources in contemporary society, market allocation and economic planning.<sup>1</sup> A system of market allocation means more than just the presence of market exchange in an economy. Market exchange refers to the purchase of goods/services for money. A society can have a role for market exchange without relying on market forces to play the primary role in allocating resources. A system of market allocation in a self-reproducing group is one in which the above allocation decisions are made through the pursuit of profit by producers as sellers of goods and buyers of inputs. That system also involves consumers acting based on self-

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<sup>1</sup> Earlier societies relied on other mechanisms of allocation based on custom/tradition or social status.

interest, but the driving force in this mode of allocation is the pursuit of profit by producers.

Economic planning refers to a system of allocation in which a collective agency or set of agencies makes a plan for the allocation of resources and oversees a process aimed at achieving the planned outcome. Actual results inevitably differ in various ways from intentions in any system of allocation of resources, and a system of economic planning does not mean that the actual allocation is “planned” in the sense of exactly matching the intention. However, it is the plan that drives the process, whose final outcome is also affected by unforeseen forces, just as under market forces the process is driven by pursuit of profit despite possible failure of actual profit to match expected profit.

The common uses of the terms “plan” and “market” can cause confusion and make it appear that the two systems are not distinct. In a system of market forces, individuals and organizations will make plans based on their own self-interest. In a system of economic planning, individuals and subgroups may engage in market exchange to obtain consumer goods and/or to find work. However, those considerations do not undermine the distinction between the two quite different modes of allocation.

### **3. Market Allocation**

Neoclassical economic theory asserts that market allocation is the optimal system for efficiency, equity in distribution of income, economic growth, and technological progress. The main claim has been for an optimal efficiency outcome.<sup>2</sup> However, after

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<sup>2</sup> Neoclassical theory has not produced a coherent analysis showing the superiority of competitive market allocation for technological progress. The traditional neoclassical argument for an equitable distributional outcome of competitive markets has never been persuasive and largely disappeared from the textbooks.

decades of efforts by leading neoclassical theorists to prove the optimal efficiency of competitive market allocation, they concluded that it cannot be proven based on any reasonable set of assumptions (Ackerman, 2002). The most that can be said for a system of market allocation is that it gives rise to a rough form of efficiency as producers are driven to minimize those costs of production that they must actually pay and must produce items that someone will want to buy.

A system of market allocation has three key problems. First, it does not take account of the non-market interdependencies among individuals and subgroups, which play no role in market allocation decisions. Only the wants of the buyer and costs that the seller must pay enter into the process. The effects on third parties or the community as a whole are not taken into account in market allocation.

Second, market allocation inevitably generates unequal power relations. The usual theoretical model of a competitive market has no power relations among participants. Each prospective buyer just decides whether or not to buy the product at the going price, and each seller just decides whether or not to sell the product at the going price. However, the reality is different. Some producers exercise significant power over customers, and not only in cases of monopoly power due to small numbers of producers of a product. Producers often have more information about a product than consumers, which gives the producer an advantage.

Unequal power is even more prevalent in the exchange between workers and employers. Normally a market economy has significant unemployment which gives the upper hand to the producer over prospective sellers of labor-power, which can lead to

increasing inequality of income between workers and employers.<sup>3</sup> In addition, as Marx pointed out, the seller of labor-power to a producer is selling something that inheres in the seller's person. As a result, the buyer owns and controls the seller's person for the workday and has the right to give orders which the worker must obey.

Third, market allocation generates systematic pressure to make decisions that damage the natural environment. The pursuit of profit leads to treating the natural environment as a free waste disposal site. A production method that protects the natural environment will normally be more costly to the producer than one that damages it. Environmental damage has various short-run and long-run costs to society that are not taken into account in market allocation. The most serious example is global climate change resulting from economic activity, which is now threatening to impose huge costs on society in the near future.

The more realistic advocates of market allocation admit that it must include some role for state planning to account for some of the above mentioned problems of market allocation. A common view holds that the best system is market allocation along with state intervention to correct such problems as extreme income inequality, monopoly power, and externalities such as environmentally harmful practices. However, that overlooks the problems resulting from empowering producers to seek maximum profit.

One way of gaining high profits is to push costs of production onto others whom the producer need not pay. That means producers have a powerful incentive to create

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<sup>3</sup> We are using the convenient distinction, introduced by Marx (1967), between "labor-power," which is the capacity to engage in labor that a worker sells to a producer, from "labor," which is the process of producing an output.

harms including environmental damage. Further, a system of market allocation empowers producers to resist restrictions on their imposition of negative externalities. In the inevitable tension between individual desires and the needs of group, even a system of market allocation with some state intervention cannot be effective at meeting the needs of society as a whole in the long-run. This is a serious problem in light of the threat of climate change.

#### **4. Soviet Economic Planning<sup>4</sup>**

Economic planning faces stiff criticism today, largely based on common interpretations of the performance of Soviet central planning. Critics charge that economic planning is inherently inefficient, that it denies individual choice, and that it leads to economic stagnation and technological backwardness. Advocates of market allocation often characterize economic planning as a system of “command” which is contrasted to the “free choice” of a market economy. Soviet central planning did have significant inefficiencies and did limit individual choice for consumers, although it did not bring stagnation until some fifty years after it had been installed. However, a system of economic planning need not have those two problems, which arise if a planning system disempowers individuals and subgroups.

An assessment of Soviet central planning provides lessons for avoiding such problems in a future system of economic planning. Soviet central planning did have significant economic achievements. It brought rapid economic advance for some fifty

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<sup>4</sup> The source for claims about the Soviet economy and its development is Kotz and Weir (2007).

years. After it was put in place in 1928, Soviet society was transformed by 1940 from a rural, agricultural one to an urban, industrialized one. That was the fastest industrialization in history up to that time, with the possible exception of Japan. After World War II Soviet economic growth resumed, and the Soviet economy constructed an urban consumer society with a modest level of material comfort. In 1960 about half of Soviet families owned a radio, one out of ten a television set, and only one out of twenty-five a refrigerator. In 1985 there was an average of one each per family. By 1975 Soviet output was greater than that of the US in crude and rolled steel, cement, metalcutting and metalforming machines, combines, tractors, wheat, fish, hogs, milk, and cotton. By the 1980s the Soviet Union had more doctors and hospital beds per capita than the U.S.

During 1950-75 the Soviet economy grew significantly faster than the U.S. economy based on estimates by the US Central Intelligence Agency. If Soviet and US economic growth rates during 1950-75 had continued thereafter, Soviet gross national product would have surpassed that of the U.S. in 2011. Technology advanced rapidly under central planning, and the USSR became a world leader in a number of key areas including space exploration, weapons, industrial machinery, and eye surgery equipment. Western transnational corporations purchased Soviet metallurgy technologies. The Washington D.C. metro system, built in the 1970s, used Soviet manufactured seamless rail-laying machines to construct the tracks.

In the 1960s-70s U.S. elites were worried that the Soviet planned economy was on track to catch up with and surpass the U.S. economy. The usual account argued that, while central planning had proved to bring faster economic growth, it was achieved at the expense of consumer sovereignty and individual freedom.



The rapid Soviet development through the mid 1970s was accompanied by full employment and stable prices. Central planning provided a high degree of individual material security with guaranteed jobs and a universal pension system. Urban apartment rents averaged less than 10% of income. Health care and education through university were free. The planned economy produced many high quality public goods, such as the Moscow metro system whose stations resembled art museums.

The Soviet economy had many problems in that period, including consumer goods that were often of low quality, assortments of consumer goods that failed to match consumer wishes, shortages of many goods, and other inefficiencies. The rapid growth was accompanied by severe environmental damage. Soviet officials had special access to higher quality goods, which irked working people. However, as long as the system continued to bring rapid economic growth and rising living standards, the problems did not threaten the stability of the system.

The many well-known problems of Soviet central planning were a result of its highly centralized and top-down character within an undemocratic political structure. Those features of the Soviet version of economic planning also account for the sharp slowdown in Soviet economic growth and technological advance after 1975. During 1975 to 1985 Soviet GNP grew at about 2% per year, slower than the US economy. Reform efforts during 1985 to 1989 failed to improve economic performance. Kotz and Weir (2007) argued that an effective reform of Soviet socialism could have restored rapid economic progress as well as resolving the long-standing economic problems. However, political developments intervened, and in 1990-91 central planning was dismantled, while no effective new mechanism was put in its place. The result was the first actual decline in

economic output since 1928 apart from the years of World War II.

### **5. Democratic Participatory Planning**

An alternative type of economic planning, called democratic participatory planning (DPP), would avoid the problems that afflicted Soviet central planning. DPP is a form of economic planning based on wide participation in decision-making by representatives of those who are affected by an economic decision. A detailed model of such a system is provided by Devine (1988).<sup>5</sup>

DPP would include a mixture of central, regional, and local planning bodies, with economic decisions made at the lowest level possible given the need to include all affected parties in the decision. Each planning body would have a board with representatives of the groups affected by the plans, including representatives of social goals such environmental sustainability and gender equality. At the lowest level of the production system, each enterprise board would include representatives of workers, customers, and the local community. The aim would be to have multiple producers of each product to the extent consistent with scale economies, and each industry would have a board with representative of the enterprises in the industry along with the other affected groups.

DPP is based on a recognition that conflicting interests are inherent in a large-scale society, which implies that economic planning cannot be a purely technical process run by impartial experts. Each adult individual is a worker, a consumer, and a member of a

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<sup>5</sup> Another widely discussed model of DPP, that differs in key respects from Devine's model, was proposed by Albert and Hahnel (1991). The discussion in this article relies on the model in Devine (1988).

community, and in each role the interests of a person are different. As a worker, each person wants good pay; a workday that does not exhaust the worker; and a work process that is safe, healthy, and rewarding. As a consumer, each person wants a high quality product at an affordable price. As a community member, each person wants local enterprises to not damage the local environment. There is no “optimum” set of decisions given the inevitable conflicting interests. DPP calls for the affected parties to negotiate and strive to reach compromises that are acceptable to all parties, in a process that would encourage each party to understand and sympathize with the needs of others as well as attending to one’s own needs. That decision-making process is called “negotiated coordination.”

DPP should be free of the problems of Soviet-type central planning while also avoiding the problems of market allocation. It would internalize externalities such as environmental damage. Production methods that reduce costs through greater efficiency would be adopted but not those that reduce an enterprise’s costs by shifting them to a third party or damaging the environment. Environmentally harmful production methods would be rejected by representatives of the community. Unsafe production methods would be rejected by workers representatives. Unsafe products would be called out by consumer representatives.

DPP would achieve a balance between individual and public goods based on the expressed wishes of the participants in the planning process. It would bring a high degree of individual economic security. It could bring rapid economic progress through public investment in science and technology along with programs to provide financing for those who want to develop a new product or production process. Recent advances in

communication and information-processing technologies will make DPP more efficient than it would have been several decades ago. DPP could bring rapid economic growth by directing a large share of social output to investment and providing incentives for enterprises to increase productivity over time. However, it would not generate the structural compulsion to produce ever more goods independent of human wants and needs that emerges from the process of competition in pursuit of profit that is the driver of market allocation. Eliminating a structural compulsion to endlessly produce more and more goods is essential if disastrous global climate change is to be averted so that human civilization can survive on this planet.

## **6. Concluding Comment**

A future for humankind requires a movement away from market allocation toward allocation through economic planning. For economic planning to be effective and sustainable, it must take the form of DPP. We cannot avoid the tension between individual desires and collective needs. Every individual is also a member of the collective and is affected by the degree of satisfaction of collective needs.

A potential problem with a system of DPP is the possibility of the development of unequal power relations. Power could gravitate toward those who are involved in making decisions at the center, who could evolve into a dominant class in society. To forestall such an evolution will require the institutionalization of democracy and a bottom-up flow of power. It will require an independent mass media that can keep the public well informed. Not least, it will require a vigilant population that actively guards its rights and powers.

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