Equality and Scarcity*

Prabhat Patnaik

Many would remember that the Soviet Union and other Eastern European socialist countries used to be characterized by long queues of consumers for several commodities. This was a source of much derision in the West and was attributed to the inefficiency of the socialist system of production, compared to capitalism where one just had to walk into a supermarket and buy whatever one wanted to.

As a matter of fact, far from being a symptom of inefficiency, the long consumer queues were a reflection of the highly egalitarian nature of the socialist societies; likewise, the free access to goods under capitalism is founded upon the extreme income inequality that prevails under this system. This point can be illustrated by an example where we deliberately choose numbers that are identical in every other respect except income distribution.

Take two economies S (under socialism) and C (under capitalism). Each invests 20 units and can produce 100 units of output. The upper 20 percent in S (consisting of socialist officialdom) has 30 percent of output and the lower 80 percent (consisting of workers) has the remaining 70 percent; by contrast the upper 20 per cent in C (consisting of capitalists and officials) has 60 per cent of output and the remaining 80 percent (consisting of workers) has 40 percent. The top segment in each economy consumes half of its income and the workers in each economy consume their entire income.

Now if the full capacity output of 100 is produced in S, then the total consumption demand will be 85 (consisting of half of 30 plus 70), and the total aggregate demand (inclusive of investment of 20) will be 105. By contrast, the total consumption demand in C will be 70 (half of 60 plus 40), and the total aggregate demand (inclusive of investment of 20) will be 90. In other words, if the full capacity output of 100 is produced, then there will be an excess demand of 5 in S, and a deficient demand of 10 in C.

The capitalist economy therefore will not be producing full capacity output because of demand deficiency. Instead it will produce only 66 2/3, since with this output and the same distributive shares, the capitalists will get 40 and the workers will get 26 2/3, so that total consumption will be 46 2/3, which together with the investment of 20 will exactly equal the output produced, 66 2/3. The actual employment therefore will be only two-thirds of what it would have been if full capacity output was being produced; there would in short be massive unemployment. Since there is no question of any shortage or excess demand (indeed the contrary) in this economy, consumers can simply march into any supermarket and buy whatever they like; there is no question of any queues for goods.

By contrast in the socialist economy, where production of 100 causes excess demand of 5, the full capacity output of 100 will be produced; but the question is how will such an economy cope with the excess demand of 5? The easy way of doing so would be simply to let prices rise, until the real incomes of some consumers have been squeezed sufficiently to reduce their purchases by 5; but typically this would mean a disproportionately large squeeze on the workers who will have very little cash balances to run down, for maintaining consumption. The entire excess demand of 5 then will be reduced at the expense of the workers. But compared to this, a proportionate reduction in everyone's consumption will be better; this is what the socialist economies did, by maintaining prices at the old level but instituting rationing, so that the reduction in demand by 5 could be more evenly shared out. It is this rationing which meant that people had to queue up for their purchases.

The fact that the socialist economies were characterized by queues was thus not caused by any inefficiencies of the system; on the contrary it was a reflection of the fact the system was concerned about keeping down the inequality in income distribution. It did so in two distinct ways: one, by keeping the base level of distribution relatively more equal; and two, by ensuring that if excess demand arose nonetheless, then its resolution took the form not of a price rise that would have been regressive, but of rationing at given prices. The queues were a result of this rationing.

No doubt there were many problems in the actual implementation of such a policy in the socialist economy, such as privileged access by some (State or Party functionaries) to the scarce goods, and the violation of the principle of equal rations for everybody by the institution of a "first-come-first-served" principle which had the effect of distributing the scarce good arbitrarily; but these do not negate the basic point that the observed scarcity of goods in a socialist economy was the result of a more egalitarian distribution of income. Likewise, the observed plenitude of goods under capitalism is the result of the fact that vast masses of the working people have too little purchasing power in their hands to buy these goods, which is both a cause and a consequence of the mass unemployment that invariably characterizes this system.

The well-known Hungarian economist Janos Kornai, a critic of the socialist system that existed in his country, had said: "classical capitalism is demand-constrained while classical socialism is resource-constrained", meaning that the latter fully utilizes all its resources including available labour. The reason he gave for this phenomenon was that under socialism since firms are assured of government subsidies, they face a "soft-budget constraint" that makes them over-spend on investment projects, without being too calculating about the prospective rate of return; under capitalism by contrast firms face a "hard budget constraint" that makes them cautious in undertaking investment.

While this may be true, there is an additional powerful reason that we have emphasised, for capitalism being demand-constrained and socialism resource-constrained; and that is the greater equality in income distribution under socialism. Put differently, since the level of aggregate demand in any economy (ignoring foreign trade) consists of two elements, the level of investment and the level of consumption as determined by the average ratio of consumption to income (or economy's propensity to consume as Keynes had put it), Kornai's explanation for the difference between capitalism and socialism refers only to the first element, while there is also a very important difference with regard to the second. The greater equality in income distribution under socialism means on average a higher consumption-income ratio, and hence a higher level of aggregate demand for any given level of investment (what economists call a higher "multiplier" for investment). This key aspect of socialist economies was missed by Kornai.

What, it may be asked, is the point in saying all this now, when socialism in the Soviet Union and Eastern Europe has collapsed? Well, a part of the reason is to remind ourselves that, notwithstanding all their limitations, the socialist economies constituted a group which achieved full employment, in contrast to what every other economy over the last two hundred years has done. This is because capitalism cannot, by its nature, achieve full employment, while socialist economies had a very different dynamics which allowed them to do so. That such economies existed should always be remembered.

The other part of the answer lies in the fact that the sharp contrast between capitalism and socialism also holds to a lesser extent between the dirigiste and neo-liberal regimes in third world countries like India; not that these countries achieved anything like full employment, but the dirigiste regimes had greater equality in income distribution because of which they faced problems of excess aggregate demand and had to resort to rationing of various goods. This was in contrast to the neo-liberal phase in these same economies that has seen a huge increase in income inequality and therefore a squeeze in the purchasing power in the hands of the working masses, which gives an entirely misleading impression of plenitude in supermarkets.

In India for instance, according to Chancel and Piketty, the share in national income of the top one per cent of population was as low as six percent in 1982, prior to the introduction of “liberalisation” that has been dated by many to 1985, but increased to 22 per cent in 2013, the highest in almost a century. Inflation under the neo-liberal regime therefore is not generally caused by excess demand; it is typically administered by the government through raising taxes on goods of common use rather than on capitalists’ wealth or profits.

But even this inflation is then sought to be controlled by imposing fiscal austerity (as if its cause was excess demand), which further worsens the unemployment situation without lowering inflation. The government of India is now in the process of pursuing such a mindless exercise.

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