

Lecture 2. Choice, Scarcity, and Exchange

THE TWENTIETH-CENTURY'S NATURAL EXPERIMENT

My view is that at least 80% of our current economic prosperity here in the industrial core of the world economy is due to our market economy, and is due *directly* to our harnessing of the human propensity to truck, barter, and exchange to fuel a decentralized economic system based on private property, individual specialization, and monetary market exchange.

I think this because, starting in Petrograd in early November 1917, a subset of the human race was the subject of a natural experiment: the High Stalinist “natural experiment” of attempting to get rid of the market economy and replace it with “rational” central planning.

Karl Marx, you see, thought that market economies were merely devices—clever but inhuman and diabolical devices—to mask and obscure the extraction of surplus value from the workers by the ruling class. Under ancient slavery, Marx said, it was clear how the rich got their wealth: they owned the poor as slaves, took what the slaves made, and beat or killed them if they resisted. Under medieval serfdom, Marx said, it was clear how the rich got their wealth: the knights kept the poor tied to the land they farmed, and demanded feudal tithes and corvee labor in return for “protecting” them against other knights.

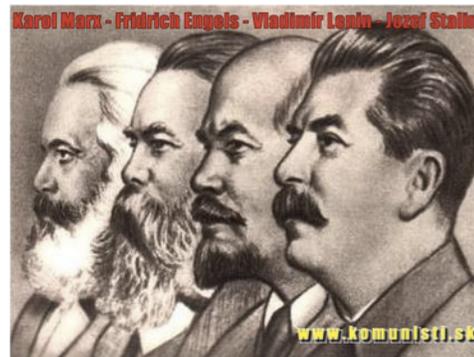
Under market capitalism, Marx said, it looks as though everybody is equal, and that every contract and economic agreement is voluntary. But when some—the capitalists—are very rich

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J. Bradford DeLong, Lanwei Yang, and a cast of thousands...

<https://bspa.berkeley.edu/portal/site/807cbf25-1161-4508-8c1e-5b71c42e5fe1>
<http://delong.typepad.com/sdj/econ-1-spring-2012/>

The High Stalinist Experiment



How Much Does Market Organization Matter?

- We have a 20th century “natural experiment”
- High Stalinist central planning
 - Marx’s suspicion of markets as surplus-extraction devices
 - Hence, the communists said, we won’t have any
 - We will reproduce the Rathenau-Ludendorff World War I Imperial German war economy
 - Communes, economies of scale, GOSPLAN, etc.
- Effect: you throw away a five-fold amplification of productivity by eschewing the market



and the workers are very poor, the bargains that they will strike will be as unequal and as oppressive as ancient slavery and medieval feudalism. It is actually not equal at all. Equality under the law—equal rights to make bargains and contracts—is a cruel deception.

Much better, Marx said, to abolish private ownership of the means of production and market exchange. Much better, Marx said, to have everything administered fairly according to a common plan. Then you won't need an oppressive government to protect the property and rank of the rich from the poor, and so the state will "wither away." And the narrow horizons of bourgeois private-property definitions of "justice" will be crossed: we will no longer say that goods should be allocated according to fair and mutually-agreed on bargains, but rather instead:

society will inscribe on its banners: "From each according to their ability, to each according to their need!"

How well did this work? How well did eliminating markets on the grounds that Marx was suspicious that they were merely obfuscating surplus extraction devices do?

Not well at all. We had a 20th century "natural experiment" involving nearly two billion people—most of them experimented on involuntarily. And so now we see.

The High-Stalinists abolished the market economy. They replaced it with a generalized version of the Rathenau-Ludendorff World War I Imperial German war command economy. They tried to take as much advantage as possible of economies of scale—to be sure that production was coordinated so that machines did not stand idle but were instead used on the widest possible scale. They devoted immense material resources to organizing five-year plans for industrial development to try to rationalize production. They devoted immense resources to trying to root out corruption and "wrecking"—sending millions of people to labor camps or to their deaths or both for economic sabotage in order to raise productivity.

And when all was said and done, they found that their economies were less than 20% as productive as those of the market economies on the other side of the Iron Curtain.

And that five-fold productivity gap almost surely understates the true gap. Communist economies copied a lot of technology from the market economies of the North Atlantic and gave back little. Market economies appeared superior not just in static productive efficiency but in dynamic invention, innovation, and technological progress as well.

How Much Does Market Organization Matter?

East-Block Country	GDP per Capita	Matched West-Block Country	GDP per Capita	Percentage Gap
N. Korea	\$700	S. Korea	\$7,660	91%
China	\$490	Taiwan	\$9,500	95%
Vietnam	\$170	Philippines	\$850	80%
Cambodia	\$150	Thailand	\$2,110	93%
Georgia	\$580	Turkey	\$2,970	80%
Russia	\$2,340	Finland	\$19,300	88%
Bulgaria	\$1,140	Greece	\$7,390	85%
Yugoslavia	\$3,240	Italy	\$19,840	84%
Hungary	\$3,350	Austria	\$23,510	86%
Czech Republic	\$2,710	Germany	\$23,560	88%
Poland	\$2,260	Sweden	\$24,740	91%
Cuba	\$460	Mexico	\$3,610	88%
Geometric Mean:	\$930		\$8,030	88%

And, of course, societies in which personal freedom was limited and millions lived or died by the whims of paranoid dictators were even less attractive in total than their relative economic performance alone would indicate. Market economies, with protections of private property and thus alternative centers of power to the government, have proved to be necessary even if not sufficient preconditions for personal liberty and for safety from arbitrary execution.

But let's take the five-fold edge in productive efficiency of market over command economies as our starting point. How are we to understand this enormous edge?

THE ECONOMIC PROBLEM

We do not have the power and the resources to make everything that we might want. That by itself does not create a problem. Where there is no scarcity—or where we don't care that there is scarcity—there is no problem, no “economic problem.” So we cannot make everything. Who cares if we have enough of what we want and don't value what we cannot make?

The answer is: “nobody.” Nobody would care. There would not be an economic problem.

The question of where the economic problem came from puzzled the early economists. Why, they asked, did air and water (remember: unlike in California, fresh water is incredibly plentiful all year around in the northwest European original heartland of economics), which were necessities for human life have no economic value on the market? Why did diamonds and gold—which nobody could eat, after all—have immense value?

Indeed, we can imagine societies in which there is no economic problem. If we were to move to the Anarres of Ursula K. LeGuin's Nobel Prize-winning science fiction novel *The Dispossessed: An Ambiguous Utopia*, we would find that on Anarres diamonds and gold had no value whatsoever either. Why not? Because on Anarres people had been trained from birth to reject all desires for more than a Spartan existence as “propertarian,” and thus illegitimate. (The Spartans did get there first: although it is interesting to note that I cannot recall a single example in the ancient literature of an attempt to bribe a Spartan commander that failed.) Whether and in what sense the inhabitants of Anarres are “free” or “happy” is left by Ursula K. LeGuin as an exercise for her readers.

John Maynard Keynes, in a talk he gave eighty years ago, thought that by now we would have solved the economic problem. That we would have more than enough of pretty much anything

The Economic Problem

- Stuff:
 - What...
 - How...
 - For whom...
- We can't make everything
- Where there is no scarcity—or where we don't care that there is scarcity—there is no economic problem
- Where there is, and where we care, there is an economic problem:
 - Ursula K. LeGuin: Urras and Anarres
 - Jan Wenner vs. Paul Allen



that we wanted, and that getting-and-spending and planning-and-economizing would be a relatively small part of our lives:

[I]n the long run... mankind is solving its economic problem.... [T]he standard of life in progressive countries one hundred years hence will be between four and eight times as high as it is to-day.... Now it is true that the needs of human beings may seem to be insatiable. But they fall into two classes --those needs which are absolute in the sense that we feel them whatever the situation of our fellow human beings may be, and those which are relative in the sense that we feel them only if their satisfaction lifts us above, makes us feel superior to, our fellows. Needs of the second class... may indeed be insatiable.... But this is not so true of the absolute needs-a point may soon be reached, much sooner perhaps than we are all of us aware of, when these needs are satisfied in the sense that we prefer to devote our further energies to non-economic purposes.... [T]he economic problem may be solved, or be at least within sight of solution, within a hundred years. This means that the economic problem is not-if we look into the future-the permanent problem of the human race....

Will this be a benefit? If one believes at all in the real values of life, the prospect at least opens up the possibility of benefit.... The strenuous purposeful money-makers may carry all of us along with them into the lap of economic abundance. But it will be those people, who can keep alive, and cultivate into a fuller perfection, the art of life itself and do not sell themselves for the means of life, who will be able to enjoy the abundance when it comes.

Yet there is no country and no people, I think, who can look forward to the age of leisure and of abundance without a dread. For we have been trained too long to strive and not to enjoy....

There are changes in other spheres too which we must expect to come. When the accumulation of wealth is no longer of high social importance, there will be great changes in the code of morals. We shall be able to rid ourselves of many of the pseudo-moral principles which have hag-ridden us for two hundred years, by which we have exalted some of the most distasteful of human qualities into the position of the highest virtues. We shall be able to afford to dare to assess the money-motive at its true value. The love of money as a possession -as distinguished from the love of money as a means to the enjoyments and realities of life -will be recognised for what it is, a somewhat disgusting morbidity, one of those semicriminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease. All kinds of social customs and economic practices, affecting the distribution of wealth and of economic rewards and penalties, which we now maintain at all costs, however distasteful and unjust they may be in themselves, because they are tremendously useful in promoting the accumulation of capital, we shall then be free, at last, to discard...

Although, he said, that utopia was not for his day or indeed for the next generation:

But beware! The time for all this is not yet. For at least another hundred years we must pretend to ourselves and to every one that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and usury and precaution must be our gods for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight.

How does Keynes's prediction look today? Not well. We are vastly richer than people were in 1930. But the economic problem is still very much with us. You remember Jann Wenner, the founder of *Rolling Stone*?

I had a fascinating conversation recently with Jann Wenner, the founder of Rolling Stone. Here's a guy who's probably got three or four hundred million dollars--he's got a Gulfstream II and a house here and a house there, and you can't imagine what trappings he could want from the next level. But he's got this gleam in his eye because he's telling me about how he spent the weekend with Paul Allen. He said that Paul Allen didn't have a GII, he had two 757s. They flew over to, like, Nice, and then they got into Paul's helicopter, which took them to Paul's boat, which stays sort of off the coast of southern France. And I could tell that Jann was picturing himself at the next level--the multi-billionaire. And I was fascinated by that because, holy shit, if that's not enough for Jann, why do I think I'm going to be able to get off the conveyor belt?

I think that when we do get off of the conveyor belt, we simply don't notice it—we take what we have for granted, and focus our attention on what we do not have. There are four categories, after all: things not worth mentioning, necessities, conveniences, and luxuries. Over time necessities become things not worth mentioning—the idea that an American today would not have enough calories is as foreign to us as the idea that there might not be enough air was foreign to our ancestors five hundred years ago. Over time conveniences become necessities. Over time luxuries become conveniences. And over time we invent new luxuries to aspire to, and to work hard to attain.

Thus most of the time most of what we produce is both scarce and desired. After all, if it is not scarce why should any of us spend any of our limited work-time making more of it? And if it is not desired why would any of us spend any more of our limited work-time making more of it? Almost by definition, therefore, most of our work-time and most of our attention will be focused on commodities for which there is an “economic problem”: that some of us at least would like to have more of them, and yet there is not enough for everybody to have all that they want.

The fact of scarcity almost immediately induces another fact: the fact of necessary choices. To take resources and use them to produce more of one scarce and valued commodity is necessarily not to use them to produce some other commodity—also scarce and also valued. Thus everything has a cost: the “opportunity cost” of what the resources used for it could have been used for had they been devoted to some alternative.

You all are spending four—well, perhaps 4 1/2, given the university's reaction to the state fiscal crisis and the difficulty in getting into what courses you want when you need to take them—years here at Berkeley. What is the “opportunity cost” of attending Cal? The \$10K a year in tuition and fees is a small part of it. The big part of it is the money you are not making at the full-time

What Do We Care About?

- We care about choices between things we value
- “Opportunity cost”
 - What is the “opportunity cost” of attending Cal?
 - Cash cost plus foregone wages plus foregone valuable experience plus tied to Berkeley plus not a boring job...
 - What is the “opportunity cost” of drinking a cup of coffee?
 - You can't spend the time and money taking yoga lessons



job you would be likely to have were you not at Berkeley. When there is scarcity, there are always choices to be made. And to choose one path is to forego others—maybe not for you so much as for other people, who cannot use for their own purposes the resources you consume.