

REALITIES OF SOCIALISM

RELYING ON EXAMPLES FROM POLAND

Classroom Lesson Plans



Created by
The Foundation for Teaching
Economics in Partnership
with the Fraser Institute

Overview

In partnership with Foundation for Teaching Economics, in the lesson, Realities of Socialism: Relying on Examples from Poland, you will be able to identify the major themes and shortcomings of socialism using examples from Poland. These lessons will cover the questions of what socialism is, how it's understood today, and its impacts in the past. These lessons include resources such as slide decks, activities, extended learning assignments, and more to assist in the classroom, whether it be in person or virtual. Lesson content can easily be integrated with economics courses, business courses, social studies courses, and more. These lessons are catered to a Canadian, high-school level curriculum.

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Lesson 1: Socialism Defined

Introduction

This lesson introduces students to the political economy of socialism and its goals. By using the Polish socialist experiment as a case study, students discover the four consistent problems of socialism: the control problem, the knowledge problem, the incentive problem and the pathologies of privilege.

Materials

Lesson 1 slide deck:

<https://docs.google.com/presentation/d/1MbJYjTBzBdoZLuPtunTQm4OXJwoUYtep/edit?usp=sharing&oid=116660462288476410506&rtpof=true&sd=true>

Optional: Lesson 1 **Background Information**. 1 copy per student (if assigned as student reading)

Key Terms

Control Problem	The difficulty central planners have in controlling human wants and desires.
Incentive Problem	The problem that occurs with central planning when individuals and central planners are not incentivized to serve the general interest.
Knowledge Problem	The idea that the information for economic planning is distributed across individual members of society and cannot be known by central planners.
Markets	A place or situation where buyers and sellers come together to voluntarily exchange goods and services.
Pathologies of Privilege	The problem that occurs in central planning when bureaucrats gain power, and some are privileged over others.
Price System	A decentralized system in which the forces of supply and demand determine the prices of goods and services.
Property Rights	Legal protection for the ownership of tangible or intangible resources. Property rights give the holder the ability to do with that property what they choose, including holding on to it, selling it or transferring it to someone else.
Socialism	A society in which the state controls resources and makes decisions about production and equitable distribution.

Objectives

Students will be able to

- Define socialism.
- Identify the goals of socialism.
- Explain the problems of knowledge, incentives and control that are present in centrally planned economies.

Time Required

45 minutes

Content Standards

CONTENT STANDARD 8: Role of Prices

Students will understand that prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

- Benchmark 4: Scarce goods and services are allocated in a market economy through the influence of prices on production and consumption decisions.

CONTENT STANDARD 9: Competition and Market Structure

Students will understand that Competition among sellers usually lowers costs and prices, and encourages producers to produce what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

- Benchmark 1: The pursuit of self-interest in competitive markets usually leads to choices and behaviour that also promote the national level of well-being.

CONTENT STANDARD 10: Institutions

Students will understand that Institutions evolve and are created to help individuals and groups accomplish their goals. Banks, labour unions, markets, corporations, legal systems, and not-for-profit organizations are examples of important institutions. A different kind of institution, clearly defined and enforced property rights, is essential to a market economy.

- Benchmark 1: Property rights, contract enforcement, standards for weights and measures, and liability rules affect incentives for people to produce and exchange goods and services.

Procedures

- Prior to this lesson, use **Activity 1 – A Survey: 4 Countries and You** to introduce the concept of socialism.
- Prepare by reading the **Background Information** included at the end of this lesson.
- Use the **Lesson 1 slide deck** to teach the key ideas about socialism, its goals as well as the problems of knowledge, control, and incentives.
- Alternate Activity: Assign the **Background Information** as a student reading.

Background Information

The following background information is quoted directly from the Fraser Institute publications of “The Road to Socialism and Back: An Economic History of Poland, 1939-2019” published as a part of the Realities of Socialism materials. For a complete copy of the readings please go to RealitiesofSocialism.Org.

For four decades during the latter half of the 20th Century Poland was the subject of a grand socio-economic experiment, that was the transformation of a mixed economy into a centrally planned, socialist state. That transition was reversed in the closing decade of the 20th Century back into a mixed economy.

The authors document the wide chasm between the goals of socialist ideology and the realities of the socialism that was experienced by the Polish people. They also document the transition back from a socialist to a mixed economy. While having its own pain, it did unleash the extraordinary productive power of the Polish people. The experiences of the Poles, like those of many behind the Iron Curtain demonstrate the value of economic freedom and the often-painful process of regaining lost freedoms.

Markets work because they permit economic decision makers to engage in rational economic calculation. This calculation depends on the constellation of relative prices and the accounting of profits and losses that emerge from the free choice of individuals trading property rights. This allows the sorting out of economically viable projects from technologically feasible ones. Without a **price system**, these calculations are impossible, and this sorting does not occur. Resources are systematically wasted and inefficiencies in production and exchange abound.

Mid-20th century much economic thinking was blind to the basic point that the price system depends on the **property rights** arrangements within which it operates. It is a change in thinking about property rights and price systems that both shed light on the reasons for the failing socialist economies of the 1980's and 1990's and informed the transitions from socialism back to mixed economies. But it is one thing to state or understand this basic formula for markets to work and quite another to sustain it in the face of political pressures of a new class of interest groups. As memories fade and as the number of living witnesses to the socialist experiment dwindle, the temptation to jump back on the road to socialism grows stronger.

The Political Economy of Socialism

In a socialist regime, the state owns and operates the means of production. The main goals of **socialism** are the ultimate eradication of want from human experience, and material and social equality between individuals. In Marx's view, this new order is supposed to come about through natural historical processes, whereby the capitalistic stage of society is replaced by the socialistic stage and, eventually, the communist stage in which the state withers away. Lenin, however, believed that capitalist forces would suppress revolutionary notions and that a revolutionary vanguard needed to seize power by force and establish a dictatorship of the proletariat.

Private property would eventually become a relic of the past and all individuals would be able to obtain desired goods and services at will. These goods and services would be provided by the central planners,

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who would be capable of correctly estimating the needs of the population and effectively providing for these needs through the appropriate mechanisms.

This, at least was the goal of Socialism, but the reality was that a number of challenges face the socialist planners attempting to realise the goal. Those problems are: The control problem, the knowledge problem and the incentive problem. These challenges give rise to what the authors call the pathologies of privilege.

Ironically, the socialist states of Poland and others bore a striking resemblance to Marx's indictment of **capitalism**. Through he thought it capable of "massive" and "colossal productive forces" Marx believed that capitalism would ultimately lead to stagnation, inequality, materialist obsession, worker alienation, environmental degradation, political suppression, crisis and revolt.

The Control Problem

Above all, central planning requires control. To state the obvious, every human is different. We each have our own interests, abilities, and plans. In a market economy, people are free to make their own plans, fitting them in with the plans of others through a process of mutual adjustment. But in a centrally planned economy, the planner who wishes to reallocate capital of labour must override the individual plans of people. In Adam Smith's famous metaphor, the central planner:

Seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board. He does not consider that the pieces upon the chess-board have no other principle of motion besides that which the hand impresses upon them; but that, in the great chess-board of human society, every single piece has a principle of motion of its own, altogether different from that which legislature might choose to impress upon it. (A. Smith 1759 Vfl.II.42)

In impressing their own plans upon individuals, planners must exercise a great deal of control. And to do this they must apply force or the threat of force. Once leaders obtain this power they are liable to abuse it.

Socialist thinkers were unphased by these concerns because they believed that socialism would make human nature. The New Socialist Man was to be intelligent, healthy, muscular, selfless and supremely dedicated to the cause. The advocates for economic freedom, by contrast, were much less utopian. For them the system of free enterprise serves human wants and desires, even if humans are deeply flawed. A Friedrich Hayek put it, Smith had advocated for a "system under which bad men can do least harm." Because **free enterprise** operates without any central command structure, it need not have perfect men and women at the helm.

The control problem suggests that socialism and **totalitarianism** go hand-in-hand. To exercise control over the behaviour of humans the state must erect a vast apparatus of coercion that can attract those who are willing to seek and maintain power through demagoguery. It is no accident that socialist states routinely employ secret police, a network of informants, forced labour camps, the threat of extradition and mass murder. In Poland even a comparatively "mild" variety of totalitarian socialism was terrifying.

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The Knowledge Problem

If the control problem requires planners to rearrange the members of society like so many chess pieces, the knowledge problem suggests that planners will not know where to put the pieces. The knowledge problem was first raised by the Austrian economist Ludwig von Mises in 1920 and elaborated on by fellow-Austrian Friedrich Hayek in 1945. As Mises and Hayek explained, useful economic knowledge often concerns what might seem to be trivial or mundane knowledge such as consumers' subjective preferences of workers' alternative job opportunities. This knowledge is highly dispersed; it is found in the subjective, often contradictory, beliefs of countless market participants.

This is not just a matter of communicating existing information up and down the chain of command. The type of knowledge involved in the knowledge problem is often tacit and contingent and cannot be communicated, even if one were instructed to do so. Examples include negotiating with a vendor, recounting the strategies of a complex workflow. This sort of knowledge is only gained through trial and error. Sometimes knowledge can only be known when a decision maker is faced with a decision. As the circumstances of price and available alternatives of products or materials change so too will the preferences of consumers in a market setting.

In a market setting, prices elicit this dispersed knowledge, turning it into signals to which others may react. For example, as prices rise it signals consumers that they should economize on the purchase of a good and it encourages entrepreneurs to explore alternative ways to satisfy consumer desires. In Hayek's words, this allows people to "fit their plans in with those of others" without any central coordination or coercion.

For this process to work, prices must emerge from the free choices of individuals exchanging rights over private property and, entrepreneurs must be allowed to try out new ideas, experiment with new products and production techniques. In this way, exchange helps sort between the technologically feasible and the economically valuable.

Because central planners set prices by dictate and have no market of private property to draw knowledge from, they are blind, guessing at the marginal value that consumers place on goods as well as the marginal opportunity cost of producers.

The Incentive Problem

The incentive problem compounds the control and knowledge problems. Simply put, most decisions makers in a socialist system are not incentivized to serve the general interest. In fact, many decisions makers can improve their positions by undermining the general interest.

As pointed out by economist Mancur Olson, when powerful dictators come to power, they have an incentive to maximize society's wealth because these dictators have an interest in the productivity and economic vitality of the societies they oversee. Olson and Peter Murrell described this encompassing interest.

Consider Stalin. At least to an approximation, he controlled the Soviet Union just as the owner of a firm in a market economy controls his firm. He had, as it were, a property right in his society that democratic politicians did not have in any of the societies of the West. Just as the owner of a firm has an incentive

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to make the firm as valuable and productive as possible, so Stalin had an incentive to make the domain he owned as productive and wealthy as he could.

They point out that beyond the resources to provide for the consumption of the leader there is also an interest in power, prestige and international influence. This can mean that the leader has an incentive to maximize the growth rate of a society while caring little for the welfare of the workers in the society. Their well-being needs only to be good enough to ensure a healthy and productive workforce. The more secure the leader is the more they will focus on long term growth and the less secure the more likely they are to claim assets for themselves.

When it comes to the incentives of subordinates in socialist societies they are often set by the hierarchical bureaucratic structure that central planning demands. Bureau chiefs and managers soon learn that can increase their own prestige and standing if they increase the size of the operation they oversee. Businesses in market economies can also grow heavy with bureaucratization. But in a competitive setting entrepreneurs and other firms can challenge and replace the bureaucratic firms with more efficient structures.

Entrepreneurship is another casualty of central planning. Though central planners may want to encourage entrepreneurship the systems incentives stand in the way. As Schumpeter explained, the role of the entrepreneur is to “reform or revolutionize the pattern of production.” Almost by definition innovation in product or process is a departure from the norm, a challenge to the plan. The socialist manager who departs from the plan risks missing his targets and therefore his onus, and even if he is willing to risk he gets no personal reward in a success.

The Pathologies of Privilege

As upper-level bureaucrats gain power a whole new set of problems emerge as some members of society are privileged over others. Socialism seeks to eliminate privilege and inequalities through official pay rates that set managers’ pay close to that of workers. In the socialist societies when official pay rates did not allow for inequalities they were manifested in the unequal access to scarce goods. This access to goods thus becomes a political issue where position can influence who is allowed to have access. This resulted in situations where shortages were planned in order to invite bribes from consumers and create favours for planners through access to “special stores” stocking western goods.

Seeking these privileges and inequalities in obtaining scarce goods can soon mean that a good deal of productive time, effort and resources are spent on ingratiating oneself to the higher authorities instead of creating wealth for society. This can lead to a number of perversions where the best minds are drawn to creating schemes to acquire privilege and wasteful competition amongst individuals can take place.

ACTIVITY 1 - A Survey: 4 Countries and You

Introduction

In this activity students participate in a survey answering questions about their feelings regarding various economic systems as well as methods for funding government. They then get to compare their results with those of a large research study across 4 countries, Australia, Canada, the United Kingdom, and the United States of America. They'll discover trends among those that support socialism and those that don't, as well as who is willing to support the methods necessary to pay for socialism.

Materials

Activity 1 Slide Deck –

https://docs.google.com/presentation/d/1govC1E32L8-mMI4t0cpDIC8TPGt5VCW7K5kdrJA_T430E/edit?usp=sharing

Key Terms

Capitalism	An economic system characterized by private property, individual decision making, and open, competitive markets.
Communism	A society in which there is no private property. Everything is owned in common and available to everyone as needed.
Fascism	A society and economic system led by a dictator.
Socialism	A society in which the state controls resources and makes decisions about production and equitable distribution.
Tax/Taxation	A mandatory financial charge imposed on citizens by the government.

Objectives

Students will be able to:

- Define Socialism using both traditional and modern definitions.
- Describe the relationship between age and support for socialism.
- Explain how support for socialism falls when linked to tax policies necessary to pay for it.

Time Required

45 minutes

Content Standards

CONTENT STANDARD 16: Role of Government and Market Failure

There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defence, address environmental

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concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also have direct or indirect effects on people's incomes.

- Benchmark 8: Government laws establish the rules and institutions in which markets operate. These include such things as property rights, collective bargaining rules, laws about discrimination, and laws regulating marriage and family life.
- Benchmark 9: Governments often redistribute income directly when individuals or interest groups are not satisfied with the income distribution resulting from markets; governments also redistribute income indirectly as side-effects of other government actions that affect prices or output levels for various goods and services.
- Benchmark 10: Different tax structures affect consumers and producers differently.
- Benchmark 11: Governments provide an alternative to private markets for supplying goods and services when it appears that the benefits to society of doing so outweigh the costs to society. Not all individuals will bear the same costs or share the same benefits of those policies.

Procedures

1. Use slides 1-3 to explain that students will be answering survey questions that were part of a research study done by Leger, A Canadian Market Research and Analytics Company, across 4 countries: Australia, Canada, the United Kingdom, and the United States.
 - NOTE: The google slides are prepared with Pear Deck so you can reveal students' answers, you can also do this with Nearpod, poll anywhere, or other similar teacher polling tools.
2. Ask questions 1 through 4 and have students answer in PearDeck (or other polling tool) their feelings about **Fascism, Communism, Socialism** and **Capitalism**. Go through all 4 questions without revealing answers or showing student results (slides 4-7).
3. Return to slide 4 and show student results for each question, drawing attention to trends, majorities, etc.
4. Use slides 8-12 to show the results of the survey participants at large. As you move from slide to slide, ask students to identify trends or conclusions they can draw from the charts.
 - NOTE: These results focus on socialism as that was the focus of the study.
5. On slide 13, have students give their best definition of socialism on PearDeck (or other polling tool). After they've had a couple minutes to generate an answer, reveal their answers anonymously and read several or many of them, focusing on those that reference equity, equality, fair, collectively, etc.
6. Use slides 14 and 15 to provide a more traditional and then more modern definition of socialism. Make comparisons to some of the definitions students wrote.
7. Use slides 16-19 to illustrate how many survey participants believe socialism means more government services, a guaranteed annual income, or both.

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8. Use slides 21-24 to ask survey questions 6-9, regarding different **taxation** methods to pay for socialism. Have students provide their answers in PearDeck (or other polling tool).
9. Use slides 25 - 28 to reveal survey participants results for support of different **taxation** methods to pay for students. As you show charts, ask students to identify trends they notice.

Conclusion

There is strong support for **socialism** amongst 18-34 year olds, while the majority of older individuals don't support socialism. Today, younger individuals define socialism as more government spending, meaning more services and/or guaranteed annual income. While people generally want someone else to pay for socialism, there is weak support for the broad-based **tax** increases that would be necessary to support it.

Younger adults want what they perceive Sweden and Denmark to have, but in Denmark and Sweden even the middle class pay 55% of their income for services. They perceive themselves as market economies that pay for education and health care.

Lesson 2: A Short History of Poland

Introduction

For four decades during the latter half of the 20th Century Poland was the subject of a grand socio-economic experiment, that was the transformation of a mixed economy into a centrally planned, socialist state. This lesson documents the wide chasm between the goals of socialist ideology and the realities of the socialism that was experienced by the Polish people. It also shows the transition back from a socialist to a mixed economy.

Materials

Lesson 2 slide deck:

https://docs.google.com/presentation/d/1kMPL_fQOowpA9R3HCrWdW0iMjy8u9tZJ/edit?usp=sharing&oid=116660462288476410506&rtmpof=true&sd=true

Optional: Lesson 2 **Background Information**. 1 copy per student (if assigned as student reading)

Key Terms

Inflation	A general increase in the price level.
Market	A place or situation where buyers and sellers come together to voluntarily exchange goods and services.
Market Economy	An economic system characterized by private property, individual decision making, and open, competitive markets.
Nationalization	The process of taking private property and transferring ownership to the state.
Price System	A decentralized system in which the forces of supply and demand determine the prices of goods and services.
Private Enterprise	A system wherein businesses are managed by independent companies or private individuals rather than by the state.
Property Rights	Legal protection for the ownership of tangible or intangible resources. Property rights give the holder the ability to do with that property what they choose, including holding on to it, selling it or transferring it to someone else.
Real Gross Domestic Product	The market value of all goods and services produced in a nation in a year, adjusted for inflation.
Socialism	A society in which the state controls resources and makes decisions about production and equitable distribution.
Shortage	A situation where the quantity demanded exceeds the quantity supplied.

Objectives

Students will be able to

- Identify examples of nationalization that occurred in Poland under Soviet control.
- Describe the relationship between the lack of prices and shortages.
- Explain how a transition back to markets alleviated the Polish economic crisis.

Time Required

45 minutes

Content Standards

CONTENT STANDARD 8: Role of Prices

Students will understand that prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

- Benchmark 4: Scarce goods and services are allocated in a market economy through the influence of prices on production and consumption decisions.

CONTENT STANDARD 9: Competition and Market Structure

Students will understand that Competition among sellers usually lowers costs and prices, and encourages producers to produce what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

- Benchmark 1: The pursuit of self-interest in competitive markets usually leads to choices and behaviour that also promote the national level of well-being.

CONTENT STANDARD 10: Institutions

Students will understand that Institutions evolve and are created to help individuals and groups accomplish their goals. Banks, labour unions, markets, corporations, legal systems, and not-for-profit organizations are examples of important institutions. A different kind of institution, clearly defined and enforced property rights, is essential to a market economy.

- Benchmark 1: Property rights, contract enforcement, standards for weights and measures, and liability rules affect incentives for people to produce and exchange goods and services.

Procedures

- Prior to this lesson, use **Activity 2 – Let’s Make it Fair** to illustrate how difficult it is for centrally planned economies to overcome the knowledge problem.
- Prepare by reading the **Background Information** included at the end of this lesson.
- Use the **Lesson 2 slide deck** to teach the key ideas about the socialism experiment in Poland.
- Alternate Activity: Assign the **Background Information** as a student reading.

Background Information

The following background information is quoted directly from the Fraser Institute publications of “The Road to Socialism and Back: An Economic History of Poland, 1939-2019” published as a part of the Realities of Socialism materials. For a complete copy of the readings please go to RealitiesofSocialism.org.

For four decades during the latter half of the 20th Century Poland was the subject of a grand socio-economic experiment, that was the transformation of a mixed economy into a centrally planned, socialist state. The authors document the wide chasm between the goals of socialist ideology and the realities of the socialism that was experienced by the Polish people. They also document the transition back from a socialist to a mixed economy. While having its own pain, it did unleash the extraordinary productive power of the Polish people. The experiences of the Poles, like those of many behind the Iron Curtain demonstrate the value of economic freedom and the often-painful process of regaining lost freedoms.

The earlier lesson, Socialism Defined, identified the four challenges that Socialism has not been able to overcome in the numerous countries where it has been pursued. Those challenges are: The Control Problem, The Knowledge Problem, the Incentive Problem and the Pathologies of Privilege that arise because of the control, knowledge and incentive problems.

For a full explanation of those problems see Socialism Defined in the previous lesson.

Succumbing to Soviet Control

Poland succumbs to Soviet control In September 1939, in accordance with the Molotov-Ribbentrop Pact, Germany invaded Poland from the West while the Soviets invaded Poland from the East. Within a month, the occupiers were in control, dividing the nation down the middle and annexing the occupied territories to their respective empires.

In the West, the Germans summarily executed tens of thousands of Poles in Hitler’s first attempt at ethnic cleansing (Rossino, 2003). In the East, in what became known as the Katyn Massacre, the Soviets killed 14,587 prisoners of war, burying them in mass graves in the Katyn forest (Paczkowski, 1999: 369). In total, about 30,000 Poles were shot by the Soviets during the occupation; between 330,000 and 340,000 were deported, sent to work in Soviet factories or mines; 90,000 to 100,000 died in deportation camps. Unfortunately, the Poles were no strangers to foreign occupation, having previously been invaded and partitioned by tsarist Russia, Austria, and Prussia.

In 1941, the Germans double-crossed their former allies, invading the Soviet Union and ending the non-aggression pact between the two nations. For the next three years, the Germans controlled the entirety of Poland, prosecuting a reign of terror against the local population, targeting Polish Jews, Romani, and other ethnic groups for mass murder and subjugation.

Poland was devastated by World War II. Over 6 million Poles lost their lives. Thirty-eight percent of Poland’s pre-war assets were destroyed. Sixty percent of all establishments, 38 percent of all rail lines, 20 percent of all arms, 43 percent of all cultural assets, and 55 percent of all medical facilities were lost. When the Soviets finally reinvaded in the summer of 1944, they established control through the communist Polish Committee of National Liberation. Stalin assured his Western allies that a post-war

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Poland would retain its sovereignty and that the nation's fate would be decided by free and fair elections.

Nevertheless, once they established control over the country, the Soviets held fraudulent elections and established a one-party socialist regime run by the Polish United Workers' Party, merging the party with the formerly independent Socialist Party in 1948. Bolesław Bierut, who considered himself a student of Stalinism, became the leader of Poland for the first decade of communist rule.

To ensure control over the country, Constantine Rokossovsky, a Polish-born Soviet marshal, was appointed commander-in-chief of the Polish army and minister of defence in 1949. All high military positions in Poland were awarded to Russian officers, ensuring near-complete dominance by the Soviets. Polish factories were dismantled and shipped to the USSR under the theory that the Soviets were entitled to them since the Germans had used them during the war. In total, the Soviets estimated that they took about \$500 million worth of industrial equipment from the Poles.

Nationalization

The elimination of **private property** began in 1944 through both direct and indirect **nationalization**. Indirect nationalization generally took the form of confiscatory taxes on property reaching as high as 85 percent of income. Over time this forced property owners to renounce their property for the benefit of the state. Direct nationalization began in 1944 with a series of laws passed under the auspices of the Soviet-backed Polish Committee of National Liberation, stipulating confiscation of German property on Polish territory. In time, additional laws nationalized most economic activity in Poland.

The nationalization of property in Warsaw in 1945 is illustrative. There, according to the Decree on Use and Ownership of Immovable Property in Warsaw of October 26, 1945, all immovable property within the city was expropriated. And although a former property owner could attempt to acquire a perpetual lease in formerly owned buildings, this was essentially impossible to attain.

Nationalization of private property was extended to the agricultural sector, although over time, the regime eased restrictions on ownership of private agricultural plots.

The process of nationalization in the late 1940s thus set the framework of property relationships in Poland until the collapse of the regime. For the next four and a half decades, Poles could not exchange fixed productive property such as factories or shops. Nor could they enter into contracts concerning their use or exclude others from using these assets.

Because of these changes, the most common types of firms during the socialist regime were state-owned firms, firms owned by regional authorities, and cooperatives (Kornai, 1992). The bureaucracy fully controlled state-owned firms. Bureaucrats set the prices of goods, hired managers, determined the supply chain, and exercised other control rights over these firms. And since state-owned firms are, by definition, owned by the state, they could not be sold or leased out. Because profits and losses in these firms accrued to central authorities there was little incentive to either maximize value creation or minimize resource consumption. Firms owned by regional authorities differed from state-owned firms only in their responsibility to regional bureaucracies, although in the end, the ultimate arbiter of decision-making was still the central government bureaucratic apparatus.

The result was a "culture of growth" in which "strong material incentives dominate; relatively large income inequalities are maintained, ideals of competition, promotion, success, power and economic

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efficiency are cultivated”. Especially in the first years of power, this culture of growth stressed breakneck industrialization and investment. Planners believed that, left to their own devices, workers would consume too much of their incomes. By restraining consumption, they believed a planned economy could encourage the appropriate level of savings and investment. Today’s sacrifices would yield tomorrow’s plenty.

Impact on Natural Resources and the Environment

Not only did socialist planners believe that workers in a **market economy** would not save and invest enough on their own, but they also believed that enterprises in a market economy would not invest in the right ways. These enterprises, planners thought, would direct too much capital to frivolous consumption goods and not enough to heavy industry. As a result, socialist planners in Poland and elsewhere prioritized heavy industry, channeling society’s resources to coal, iron, utilities, and other producer’s goods. Without market-determined signals of prices, profit, and loss, planners often focused on what Poles called “production for production sake”. And lacking any better metric, planners rewarded managers for sheer weight. As Clark and Wildavsky put it: Polish planning can be summarized in two words: Weight counts. By 1985, the emphasis on weight was so evident that even Soviet leaders like Mikhail Gorbachev were complaining that their economies used twice as much metal, 23 percent more fuel, and 30 percent more raw materials for each unit of output.

This same thinking was imposed on the exploitation of natural resources. Given the emphasis on production for production’s sake, planners paid little attention to natural resource stewardship. Socialist economies push to industrialize relied on a merciless exploitation (some would say short-sighted plundering) of the countries’ natural resources of land, water, and minerals, and processing these resources in a rather wasteful way to produce poor quality products using methods of production which appeared to be what had been significantly more capital- and labour-intensive than need be.

The socialist record of pollution was notorious and industrial pollution in Poland was especially bad. A 1991 article in the Washington Post described Warsaw’s tap water this way: “It spurts yellowish-brown from the tap, laced with heavy metals, coalmine salts and organic carcinogens. It stains the sink, tastes soapy and smells like a wet sock that has been fished out of a heavily chlorinated swimming pool.”

Labour, Goods and Services

The administration of Bolesław Bierut—who controlled Poland as president and later as president and party leader from 1947 until his death in 1956—made its own attempts to absorb surplus labour. His law on work discipline marked the official beginning of the open battle with worker crime and the dawn of Stalinism in the factories. Though drunkenness and leaving the workplace during the day were also addressed, the focus of the law was absenteeism. Just as production targets focused on weight, employment targets focused on hours. In other words, planners attempted to maximize labour inputs, not labour outputs.

The Man of Steel, Joseph Stalin, suffered a stroke on March 1, 1953, and died four days later. Once he had eliminated and sidelined his rivals, Nikita Khrushchev became the new leader of the Soviet Union and began to pursue a softer approach to governing. This new approach was famously signaled by Khrushchev’s “Secret Speech” of February 25, 1956, in which he exhaustively recounted and denounced Stalin’s crimes. At the same time, public anger with socialist leadership was beginning to boil over in Poland. **Shortages** were endemic to the Polish socialist economy and these shortages often lead to violent protests and regime change. Angry over stagnant living standards, continued Soviet dominance,

Background Information: Socialism Defined

and persistent shortages of food and other necessities, rioters took to the streets of Poland in the spring and summer of 1956. These protests would prove to be the most important resistance to the communist regime up until the Solidarity protests of 1981.

In 1956 the Soviets permitted Władysław Gomułka, a once-jailed leader of the moderate faction of the Party, to take control of the country. Though a committed communist and central planner, Gomułka permitted some liberalization. For example, he repealed the draconian labour discipline laws, though employment remained mandatory for all able-bodied persons 18 years or older.

The Polish economic system revolved around the communist Polish United Workers' Party which set policies and goals for the entire country. The Planning Commission formulated the plans, although other bureaucratic agencies such as the Council of Ministers, the Economic Committee, and the Economic Council also took part in the process. During the plan articulation phase, the Planning Commission estimated the desired output in terms of the aggregate volume of goods to be manufactured throughout the plan's timeline by the main sectors of the economy (heavy industry, agriculture, chemicals, automotive, etc.). The plan also included an outline of how the goods were to be used and the appropriate distribution of raw inputs and semi-finished materials across industries. The plan incorporated assessments of the necessary labour hours and wages to be paid for different kinds of work.

The state had to erect a vast apparatus of suppression to deal with the control problem inherent to central planning. The nation's top economic central planner, Hilary Minc, waged a war against private economic activity that became known as the "battle for trade." They created a secret service, the "Bezpieka," that employed 34,000 people by 1952. The Bezpieka, in turn, relied on a network of 26,000 informants, turning Pole against Pole.

However, in time, both the knowledge and incentive problems began to undermine the system's productivity and stability. Because prices, profit, and loss did not emerge from the free choices of **market** participants, central planners had no way of knowing what workers thought about different employment options or how consumers thought about different purchasing options. Without this information, the central plan was nothing more than guesswork.

The prospects for change were especially bright after the Polish economist Oscar Lange became the head of the newly created State Economic Council. Lange was a thoroughgoing socialist. Lange believed that the knowledge problem could be overcome by incorporating market pricing tools within the socialist framework. The State Economic Council, under Lange's leadership, recommended that the economic structure be decentralized, permitting factories and enterprises to make decisions regarding investment and new production. They also recommended that **private enterprise** be permitted in retail trade, handicrafts, services, and small-scale production. Though Lange's ideas were adopted in Hungary (where they permitted higher levels of economic growth), they were thoroughly rejected by the Gomułka regime in Lange's native Poland. Hence, at the height of the socialist regime in the 1950s, '60s, and '70s, the main instruments for the coordination of economic activity in Poland were government plans informed by statistics that did not necessarily reflect the subjective preferences of the Polish people. Prices for producer and consumer goods produced by state firms (that is, a vast majority of goods) were set centrally by the planning authorities.

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One of the principles of price setting in Poland called for stable prices to keep inflation from eroding consumers purchasing power. This prevented prices from adjusting to changed resource prices and production technologies. Citizens often went without basic consumer goods, had to wait weeks and even years to obtain certain items, and grew accustomed to paying bribes or pilfering from their apartments or places of employment.

Political and Economic Crisis

Poland slipped into economic and then political crisis on a regular basis. As Koryś (2018) points out, “the scale and scope of the protests were larger in each successive wave: in 1956, the protests took place in Poznań and then Warszawa, in 1970, in all the main cities on the coast (Gdańsk, Gdynia, Szczecin, Elbląg) and a few cities in other regions, in 1980—all over Poland”.

Socialist Poland’s worst economic and political crisis began in the early 1980s. The economy contracted sharply, and the country was gripped by dangerous shortages and civil unrest. **Real gross domestic product** contracted for three straight years beginning in 1980, including by 10 percent in 1981. Americans of a certain age will recall the recession of 1982 as especially painful and yet it pales in comparison to what the Poles experienced. Real GDP per capita fell by 18 percent from 1980 to 1982. Investment fell by 50 percent and consumption by 15 percent (World Bank, 1987: xi). The collapse was so steep that per capita GDP did not get back to 1979 levels until 1985. As production collapsed, Poles encountered shortages of nearly all products, but especially of soap, coffee, sugar, laundry detergent, cigarettes, rubber, transportation, and—above all—meat. The already meager meat allotments were reduced by 20 percent in the summer of 1981 to just 3 kg per person per month and citizens stood in line for days and even weeks for basic necessities. As had happened before, the economic pain turned to political unrest. But several factors bolstered the protests of the early 1980s. Ironically, one factor was exposure to markets.

The next key step toward reform occurred in August of 1980 when the authorities at the Lenin Shipyard in Gdańsk made the fateful decision to fire a 51-year-old worker named Anna Walentynowicz. Once celebrated by party leadership as a model worker, she had a strong sense of social justice and spoke out when she saw a supervisor steal money from the worker’s bonus fund. She was fired for impugning her superior. Outraged at her treatment, workers at the shipyard went on strike while Walentynowicz worked with the charismatic electrician, Lech Wałęsa, to form a union that would eventually become known as Solidarity. Within a year, 10 million Poles were members of Solidarity, representing one-third of the working-age population. The movement gained steam just as economic conditions worsened; Solidarity’s publications fuelled further outrage.

In mid-1981 Solidarity organized widespread hunger demonstrations. Most of the participants in these peaceful protests were women and their children. Their banners read “We want to eat,” “How do you eat ration coupons,” and, in an obvious reference to the closing lines of the Communist Manifesto, “The hungry of all countries—unite.” The regime’s response was swift and merciless. On December 13, 1981, General Wojciech Jaruzelski, the First Secretary of the Polish United Workers’ Party and the de facto head of the government, declared martial law. During the night he sent 80,000 soldiers and 60,000 militiamen and secret police to round up the troublemakers. In all, some 200,000 Poles were fined, 10,000 were arrested, and 3,500 were ultimately sent to prison.

All public meetings, demonstrations, and strikes were banned and the government imposed a news blackout. Solidarity was eventually outlawed. To justify these heavy-handed tactics, Jaruzelski

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repeatedly warned that if order was not restored then the Soviets might invade at any moment as they had done in East Germany in 1953, Hungary in 1956, and in Czechoslovakia in 1968. Under the so-called Brezhnev Doctrine, announced in the last of these interventions, the Soviets had asserted the right to intervene militarily if any socialist state wavered in its commitment to the cause.

The economy began to grow again in the second half of the 1980s, but shortages persisted. And **inflation**, already a problem, spiraled out of control. From 1981 onward, the Polish annual inflation rate never dipped below 15 percent. And as the decade ended, inflation spiked to more than 250 percent and then to nearly 600 percent. As so often happens, policy makers attempted to tame inflation through price controls rather than by addressing its root causes in monetary policy. In 1982, the government introduced the “tax on excessive payroll payments” which came to be known by the acronym popiwiek. Under popiwiek, firms were levied heavy taxes if they raised wages significantly more than the price level.

The Solidarity movement had given voice to what many had long felt: Socialism had failed in its promise to deliver prosperity and equality. Instead, socialist Poland had come to resemble Marx’s worst characterizations of capitalism. It was not just a poor society, but a profoundly unequal one, with great luxuries for some and shortages for the rest. Instead of serving the needs of the humble worker, it catered to the desires of its largest enterprises, indulging their insatiable hunger for investment at the expense of the environment and the consumer.

Transition back to a Market Economy

The ascendance of Mikhail Gorbachev as the General Secretary of the Communist Party of the Soviet Union was a catalyst for Polish reform. Gorbachev’s perestroika (reconstruction) and glasnost (openness) signaled newfound Soviet tolerance for change. At the same time, the general secretary renounced the Brezhnev Doctrine, which had threatened Soviet force against any communist bloc nation that abandoned communism. The turning point in the liberation of the country came after the Polish Round Table negotiations in the spring of 1989 between the ruling elite and the opposition. The agreement that the parties struck at the Round Table talks re-established Parliament and the Office of the President. Shortly thereafter, on June 4th, 1989, general parliamentary elections were held symbolically marking the end of socialist rule in the country and the beginning of the Third Polish Republic.

It may be tempting, in retrospect, to think of the reforms as an experiment. But after the four-decade experiment with socialism, the Poles didn’t see it that way. In his parliamentary address shortly before he was elected the first non-Communist prime minister in the Eastern bloc, Mazowiecki put it this way: “I am fully aware of the great effort that repairing the economy will require of the new government and everybody. The long-term, strategic goal of government’s activities will be restoring to Poland economic institutions long known and tested. I understand by this a return to a market-oriented economy and a role for the state similar to that in economically developed countries. Poland cannot afford ideological experiments any longer.”

Mazowiecki selected Leszek Balcerowicz as deputy prime minister and minister of finance. A western-educated economist, Balcerowicz led Poland’s transition to a market-oriented economy, pushing for as quick a change as possible. In 1990, the country held direct presidential elections, and Solidarity’s Lech Wałęsa was chosen to be Poland’s president. The first free parliamentary elections were held a year later in 1991.

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The new government set the country on a new path. Their guide was the Washington Consensus, a set of widely accepted reforms to help nations transition from a socialist to a market economy. Broadly, the Washington Consensus called for: 1. Fiscal discipline, 2. Substitution of broad-based spending (such as spending on public goods) for narrow spending on subsidies, 3. A broadened tax base with lower marginal rates, 4. Market-determined interest rates, 5. Competitive exchange rates, 6. Liberalized trade, 7. Liberalized foreign direct investment, 8. Privatization of state enterprises, 9. The elimination of anticompetitive regulations, and 10. Legal security of property rights. The Consensus was based on a market-oriented restructuring of the economy that gave priority to macro-economic stability. Advocates hoped that these measures would unleash market forces and spur economic growth, increasing Poles' standard of living.

Institutional reforms removed economic regulations and restrictions on private activity, eliminated the central allocation of resources, permitted price liberalization, and opened foreign trade, moving Poland closer to a **market economy**. Institutional policy also sought to privatize the state sector by breaking up domestic monopolies, establishing an independent central bank, and commercializing the financial and insurance sectors. These policies were implemented jointly, since all three policies complemented one another.

Privatization was a crucial step in institutional restructuring. In 1985 the state sector produced close to 82 percent of total output in Poland, and 71 percent of all employment was in state-owned enterprises. If reformers sought to transform the structure of their economy in accordance with the Washington Consensus model, it was essential for Poland to privatize state enterprises. It took close to 10 months to select the appropriate framework. In the end, the privatization law adopted in July of 1990 authorized several privatization strategies.

Poland experienced macroeconomic instability at the beginning of the transition. Prices and wages were liberalized while monetary policy remained accommodative. The liberalization of 90 percent of all prices between 1989 and 1991 unleashed extraordinary inflationary pressures. The annual inflation rate rose to 251 percent in 1989 and 586 percent in 1990, but then gradually declined to 70 percent in 1991 and 28 percent in 1995 (IMF, 2021). The decline in inflation was a monetary phenomenon. The rate of growth of the broad money supply declined from 509 percent in 1989 to 36 percent in 1995 (World Bank, 2021).

None of this is to suggest that reform was easy. Immediately following the implementation of the Balcerowicz Plan in January 1990, Poland entered what János Kornai has termed a “transformational recession.” Unfortunately, this type of downturn occurred in all post-socialist nations. In the case of Poland, GDP declined by 7.2 percent in 1990, and by another 7.0 percent in 1991 (IMF, 2021).

But not everyone gained. While GDP would soon recover, unemployment remained relatively high for the next two decades. Compared with the US, European nations are known for having relatively high structural unemployment rates. While the Polish unemployment rate generally declined throughout the 1990s, it began to rise again in 1998, peaking at 20 percent in 2002. Thereafter it fell, settling near the rates of France, Italy, and other OECD nations for several years and then finally drifting down from 2013 onward to levels comparable to the United States.

Poland's real GDP grew from \$181 billion in 1991 to \$570 billion in 2019 (World Bank, constant 2015 US\$). More significantly, real GDP per capita grew from \$8,493 in 1991 to \$31,985 in 2019 (2017 US\$).

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From 1970 through 1991, real GDP per capita grew at about 1.8 percent per year. At this rate, it would take 38 years to double. However, from 1991 onward, real GDP per capita grew more than twice as fast, at an average annual rate of 4.7 percent per year. At this rate, GDP per capita doubles every 14.8 years.

In 2004, income inequality—as measured by the Gini coefficient—was higher in Poland than in the average OECD nation. But by 2008, the two figures were comparable, and in more recent years Polish income inequality has been lower than in the average OECD nation. Much of this change seems to have been driven by the post-transition rise, and subsequent fall, in poverty. The share of the population living on less than \$6.85 per day (in 2017 international dollars), rose precipitously after the transition, but quickly fell and has since tapered off. Note, further, that while the poverty rate in Poland in 2019 (2.63 percent) was slightly higher than the poverty rate just before the transition (1.88 percent), it is well below the 10 percent peak in the mid-1980s.

Conclusion

Today, Poles enjoy a relatively high level of economic freedom. They are taxed and regulated, but not significantly more so than most. The Polish social safety net is comparable to that of other OECD nations and manifestly better than the safety net of the socialist era. In sum, the Polish experience demonstrates the value of economic freedom and the immiserating consequences of its denial.

ACTIVITY 2 - LET'S MAKE IT FAIR

Introduction

In this activity students participate in a socialist society and try to achieve a fair allocation of stickers and candy by making production and pricing decisions as a collective, only to discover how the **knowledge problem**, and positions of power and privilege prevent their desired outcome.

Materials

Activity 2 Slide Deck - https://docs.google.com/presentation/d/108FUFZuc-vbqhr1wocDd-XiRMM5V_UO48GnSu79PMjA/edit?usp=sharing

Visuals 1.1, 1.2 and 1.3 (included in Activity 2 Slide Deck)

Handout 1: Production Manager Worksheet (3 copies)

Handout 2: Life Circumstance Cards (2 copies each for classes of 36 or less)

Bingo Chips (20 per student) - See slides for example (or other small objects like dried beans or macaroni)

Candy - a large assortment of small candies, approximately 4 per student

Stickers - a large assortment of stickers, approximately 4 per student

Key Terms

Knowledge Problem	The idea that the information for economic planning is distributed across individual members of society and cannot be known by central planners.
Markets	A place or situation where buyers and sellers come together to voluntarily exchange goods and services.
Scarcity	The nature of having unlimited wants and needs and limited resources with which to fulfill them.
Self-Interest	The act of seeking one's own personal gain.
Socialism	A society in which the state controls resources and makes decisions about production and equitable distribution.

Objectives

Students will be able to:

- Describe how centrally planned economies fail to achieve equitable or fair outcomes.
- Define the knowledge problem.
- Explain how markets help overcome the knowledge problem.

Time Required

45 minutes

Content Standards

CONTENT STANDARD 8: Role of Prices

Students will understand that prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

- Benchmark 4: Scarce goods and services are allocated in a market economy through the influence of prices on production and consumption decisions.

Procedures

Explain to students that they live in a two-good **socialist** economy that produces stickers and candy. That means that as a society, they collectively own the means of production and will be making decisions about production and price.

Explain that like any economy they face **scarcity** because resources are limited.

Tell them that as a class they will decide how many stickers and how much candy to produce.

1. Share with the entire class the limits to their resources using VISUAL 1-2.1 (small class), VISUAL 1-2.2 (medium sized class), or VISUAL 1-2.3 (large classes). This illustrates the combinations of stickers and candy they can produce.
2. Pass out 10 bingo chips to serve as the currency, or *Equalabees*, to each student.
3. Explain that because they are a socialist country, and everyone owns the resources, they will have 5 minutes to decide as a class how many stickers and how much candy to produce with the limited resources. AND to help ensure a fair distribution of their production they will also decide on a price for stickers and a price for candy.
4. Give the students five minutes. (It is highly likely that things will be fairly chaotic as they try to collectively make these production and pricing decisions)
5. Towards the end of the five minutes, call the class to order and explain they will not have enough time if this is what is going to happen, so you will appoint Production Managers to make the decisions. Choose 2 or 3 students. Point out that while the teacher is appointing the students in the interest of time, they could have gone through an election process to decide who the decision makers would be.
6. Let the appointed Production Managers stay in the room to do their work, perhaps in one corner of the room. This allows other students a chance to influence any decisions if they can figure out a way to do so.
7. Give Production Managers 4 minutes and then have them announce their production and pricing decisions.

Background Information: Socialism Defined

8. While the Production Managers are deciding, ask two more students to serve as storekeepers to sell the stickers and candy. Send them to the appropriate desk that will serve as each store, or make their desk the store and give them the stickers and/or candy along with a blank piece of paper where they can post the price announced by the Production Managers. Then have them count out the number of stickers or candy they are allowed to sell (as announced by the production managers).
9. Announce that a trading round is now open, and students can purchase what they want of stickers and candy. Try not to refer to the trading round as a market.
10. Leave trading open for a few minutes so that all students who want to purchase something have an opportunity to do so.
11. Announce that the economy is closed and ask everyone to return to their seats.
12. Debrief the round with questions about whether or not everyone is happy/satisfied and if they were able to purchase what they wanted. If they were not able to purchase what they wanted, why was that so? *It is likely that many students were unable to purchase exactly what they wanted.*

Were they able to purchase as much of each item as they might have liked? *No, because resources are limited or the decision makers picked the wrong prices, or both.*
13. Explain to the class that they have another chance to see if they can raise the level of satisfaction that each person enjoyed, and hopefully we have learned some things that will help us improve.
14. Keep the same Production Managers and explain that the teacher chose them specifically because he/she thought they could make the best decisions about production and prices. To help in that the teacher has prepared a list of questions for the Production Managers to answer so they will have better information for the next round. Give them each a copy of HANDOUT 1-2.1., Production Manager Worksheet.
15. In addition, explain to the class that as time passes from round one to round two, for some students, circumstances have changed so you are going to pass out a Life Circumstances card (HANDOUT 1-2.2) to each student which may influence whether they'll want more or fewer stickers or candy. Pass out 10 additional Equalabees to each student so everyone has at least 10 again. Also explain that if asked by one of the Production Managers they are free to share the information on their Life Circumstance Card. (The Life Circumstance Cards will direct a few students to buy more stickers and most to buy more candy so that if Production Managers ask, they may get different answers from different students.)
16. Production Managers can gather information from individual students, but they cannot ask the entire class for a group response.
17. Announce that Trading Round 2 is open. Leave the round open until most students have had time to purchase a good or goods or the stores run out!

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DEBRIEFING QUESTIONS

1. Who was in charge? (*Everyone.*)
2. Who were the decision makers? (*Everyone may have chosen the Production Managers, but those Production Managers were the ultimate decision makers.*)
3. Is everyone happy? Why not? (*Probably not.*)
4. Was the allocation equal? (*No.*)
5. Is that a good thing? Why or why not? (*No, not everyone got something.*)
6. Was the outcome fair? Why or why not? (*No, people didn't get what they wanted, some got a lot, and some people went without.*)
7. Was the outcome desirable? Why or why not? (*No, not everyone was happy*)
8. Why didn't we have a more fair or desirable outcome? (*Production Managers don't have all the information.*) Point out that this is referred to as the **knowledge problem**, the idea that the information for economic planning is distributed across individual members of society and cannot be known by central planners.
9. Who does have the necessary information? (*The individual citizens in the room.*)
10. Is it practical/possible to have all the necessary information? (*No, even if they could acquire each person's wants, desires, and ability to pay at one moment in time, it would change in another moment.*)
11. Were you forced or coerced to make the decisions you made in the activity? (*No.*)
12. Were there people in positions of power or privilege? (*Yes. Shopkeepers/Production Managers Watch for examples during the game of advantages they get or take that you can refer to here.*)
13. Regarding shopkeepers, whose interests do they represent first and foremost? Theirs or citizens'? (*Theirs.*)
14. Regarding Production Ministers, interests do they represent first and foremost? Theirs or citizens'? (*Theirs.*)
15. Can this be changed? (*Answers will vary, but it's unlikely Production Managers would be any less **self-interested** than the rest of the society?*)
16. Is there anything else that could be done to make the outcome more desirable? (*Answers will vary. If students don't bring it up, mention that "**markets do allow individuals to pursue their own self-interest and some socialist driven societies do choose markets as a means of allocating goods and services.**"*)

Conclusion

Socialism is often seen as a way to achieve a more fair distribution of the goods produced. Even when there is not state coercion there is still what Friedrich Hayek would call the **knowledge problem**. The information necessary to answer questions like what to produce and at what price to sell is highly localized and widely dispersed. It's impossible for the decision makers to have all that information for the group, and individuals are left wanting and dissatisfied. Likewise, even when the group is deciding, there are still those individuals in positions of power and privilege that prevent the outcome from being fair or even desirable. While not perfect, **markets**, through prices, allow buyers and sellers to communicate their desires and willingness to participate, or in other words, pursue their own **self-interest**, achieving a more desirable outcome for society.

Visual 1.1 (Smaller classes)

Production Possibilities

Choose 1 production combination alternative below.

Stickers	Candy
20	0
18	4
16	8
14	12
12	16
10	20
8	24
6	28
3	32
2	36
0	40

Visual 1.2 (Medium-sized Classes)

Production Possibilities

Choose 1 production combination alternative below.

Stickers	Candy
27	0
25	4
22	10
20	14
18	18
16	22
12	30
10	34
7	40
5	44
3	48
2	50
0	54

Visual 1.3 (Larger Classes)

Production Possibilities

Choose 1 production combination alternative below.

Stickers	Candy
30	0
27	6
24	12
21	18
18	24
20	20
17	26
14	32
11	38
8	44
5	50
2	56
0	60

HANDOUT 1

Life Circumstance Cards

<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 2 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 4 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>
<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 6 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 2 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>
<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 4 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 6 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>
<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 2 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more candy this round. In fact, you need <u> 4 </u> more candies than you had the last ROUND.</p> <p>Stickers are not that important to you this round.</p>

HANDOUT 1

Life Circumstance Cards

<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 1 </u> more sticker than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 2 </u> more stickers than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>
<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 3 </u> more stickers than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 1 </u> more sticker than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>
<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 1 </u> more sticker than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 2 </u> more stickers than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>
<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 3 </u> more stickers than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>	<p>LIFE CIRCUMSTANCE CARD</p> <p>You need more stickers this round. In fact, you need <u> 1 </u> more sticker than you had the last ROUND.</p> <p>Candy is not that important to you this round.</p>

Handout 2 - Production Manager Worksheet

1. How many students are in the room?
2. How many purchased stickers?
3. How many purchased candy?
4. Were there candy or stickers that went unpurchased, if so how many?
5. Were prices of stickers and pens equal or unequal?
6. Gather any information you would like from individual students.
7. Decide on the number of stickers and number of candies to produce.
8. Decide on the prices of stickers and candy.
9. Provide this information to the teacher.

Lesson 3: Pathologies of Privilege

Introduction

The inability of the various Socialist experiments to overcome the problems of control, knowledge and incentives invariably led to what the authors of *The Realities of Socialism* refer to as “Pathologies of Privilege”. This lesson illustrates how difficult it is for central planners to successfully plan and direct the economy, as it requires control of not only what was produced and how production took place, but also control of the citizens, their wants and desires as well as their actions in and out of the economy.

Materials

Lesson 3 slide deck:

<https://docs.google.com/presentation/d/1rrxh-p0k445HQzqcn7H1tKfyUFapIRAP/edit?usp=sharing&oid=116660462288476410506&rtfpof=true&sd=true>

Optional: Lesson 3 **Background Information**. 1 copy per student (if assigned as student reading)

Key Terms

Black Market	The exchange of goods and services in an illegal, uncontrolled and unregulated manner.
Bureaucracy	A system of government wherein power is divided among different departments and officials
Control Problem	The difficulty central planners have in controlling human
Incentive Problem	The problem that occurs with central planning when individuals and central planners are not incentivized to serve the general interest.
Knowledge Problem	The idea that the information for economic planning is distributed across individual members of society and cannot be known by central planners.
Pathologies of Privilege	The problem that occurs in central planning when bureaucrats gain power, and they are privileged over others.
Shortage	The situation that arises when the quantity demanded of a good or service exceeds the quantity supplied.
Surplus	The situation that arises when quantity supplied of a good or service exceeds the quantity demanded.

Objectives

Students will be able to

- Define socialism.
- Identify the goals of socialism.
- Explain the problems of knowledge, incentives and control that are present in centrally planned economies.

Time Required

45 minutes

Content Standards

CONTENT STANDARD 4: Incentives

People usually respond predictably to positive and negative incentives.

Benchmark 1: Acting as consumers, producers, workers, savers, investors, and citizens, people respond to incentives in order to allocate their scarce resources in ways that provide them the highest possible net benefits.

CONTENT STANDARD 8: Role of Prices

Students will understand that prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

- Benchmark 4: Scarce goods and services are allocated in a market economy through the influence of prices on production and consumption decisions.

CONTENT STANDARD 9: Competition and Market Structure

Students will understand that Competition among sellers usually lowers costs and prices, and encourages producers to produce what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

- Benchmark 1: The pursuit of self-interest in competitive markets usually leads to choices and behaviour that also promote the national level of well-being.

Procedures

- Prepare by reading the **Background Information** included at the end of this lesson.
- Use the **Lesson 3 slide deck** to teach the key ideas about the pathologies of privilege.
- Alternate Activity: Assign the **Background Information** as a student reading.

Background Information

The following background information is quoted directly from the Fraser Institute publications of “The Road to Socialism and Back: An Economic History of Poland, 1939-2019” published as a part of the Realities of Socialism materials. For a complete copy of the readings please go to RealitiesofSocialism.org.

The inability of the various Socialist experiments to overcome the problems of control, knowledge and incentives invariably led to what the authors of *The Realities of Socialism* refer to as Pathologies of Privilege. This term refers to the situation that occurs in centrally planned economies when bureaucrats gain power, and they are privileged over all other citizens.

To successfully plan and direct the economy central planners had to deal with the **control problem**. Not only did they have to control what was produced and how that production took place, but they also had to control the citizens, their wants and desires as well as their actions in and out of the economy. In most socialist economies the failure to satisfy consumers and attain economic growth led to increasing degrees of control. Control of what consumers might desire by limiting what products were even available in the shops and markets, and control of the means and processes of production and even control of human labour and where individuals were allowed to work.

As that control increases there is movement little by little to a more totalitarian state. Often the first strategy of control is to eliminate private property, then private choice of consumption and finally even private choice of labour effort and thought. Some examples of the control in Poland and across the USSR included deportation, imprisonment, and even execution of individuals. These drastic tactics lead to a society that was run by fear and the distrust of the government and your neighbour. In Poland and the USSR every aspect of life was channeled toward a collective state directed will rather than individual desire and efforts. This included schooling, farming, and how factory labour was organized.

The **knowledge problem** and the inability to get the necessary information to the central planners led to a growing **bureaucracy** of ministries with thousands of workers who tried to gather, and in some cases create, the information needed by the central planners. But as in Adam Smiths’ example of pieces on a chess board, the information was constantly changing and there were no market signals of price to convey that information to the central planners.

Poland and the USSR had hundreds of examples of how information failed to get to the right planners. **Shortages** and **surpluses** of goods were endemic and empty shop shelves on one hand along with long lines of citizens waiting for goods were a common sight. The quota system of output led to many measurements of production by weight or perhaps the number of items produced. However, no quota system can measure quality and consumer desire. Only the success or failure of a product in the marketplace can do that.

As the knowledge problem became more pronounced over time, so did the **incentive problem**. Though scarcity and failure are facts of life, socialist planners effectively ignored them. As one author put it, “Failure, in the true sense of the word, is impossible.” As a result, firms in socialist Poland were incentivized not to keep their costs down: they did not expect to go bankrupt when their costs exceeded their profits.

Background Information: Socialism Defined

Instead, their survival depended on the favour of the bureaucratic authorities, who had a different criterion for the entities' survival: the fulfillment of predetermined output targets. And since the fulfillment of the plan was an essential goal, the state allowed sustained losses on the part of some firms and consistently granted subsidies to keep them afloat. Losses were either covered automatically, or its administratively controlled prices would be adjusted from time to time to equal its costs.

What was demanded from existing SOEs [state-owned enterprises] was fulfillment of its production plan. Investment decisions prescribed firstly what capacity was to be created and when production was to begin; expected profitability did not play any essential role. There was of course a cost target, but exceeding it was ignored. What was punished was the failure to meet production output targets.

Since the planning authorities determined firms' production processes, the incentive structure encouraged intensive bargaining between the bureaucratic entities, further undermining the efficient use of productive resources and making it difficult to satisfy consumer demands. Given the allotted inputs, firms were expected to produce their assigned output targets, and faced the possibility of punishment if they failed. The socialist system incentivized managers to report lower than actual output capacity. This allowed them to receive a lower production target and to request higher-than-necessary quantities of inputs which they could then sell on the black market. This strategy reduced the risk that managers would fall short of the plan, allowing them to avoid punishment and increasing their chances of receiving a bonus.

The effects of the state-sponsored budget constraint on the allocation of resources were predictable. On the one hand, inspired by the output targets and dictates of the bureaucratic apparatus, input demands from firms soared, often beyond the quantities necessary for the actual production. The problem got worse over time as the least profitable industries in Poland received the most financial support and attracted the most workers, siphoning resources away from more profitable enterprises.

In addition to this misallocation of resources, an informal market, outside the centrally planned economy developed. Considering their inability to deliver "to each according to his needs" socialist systems inevitably give rise to "parallel" or "second" economies. These second economies, better known as **black markets**, operated outside of the state planned and controlled economy. The state adopted an ambivalent, and at times contradictory, approach to these illicit markets, referred to as the "Second Poland." On the one hand, it attempted to suppress it. On the other hand, it tolerated some degree of "benign plan violation" since it would be impossible to fulfil the plan without going outside of it. The irony, as we have described, is that black markets held the socialist system together since the only way for managers to internalize profit was to sell rationed goods on the black market. Though this helped address the control problem by securing the loyalty (or at least quiescence) of local managers, it incentivized a culture of corruption that spread through the population.

The problems of control, knowledge, and incentives led to the fourth problem with socialist economies, the **pathologies of privilege**. It was only through the privilege of position or illicit behaviour that a person could better themselves in the Socialist system. The term "nomenklatura" first originated in Soviet Russia, but it came to be used in all socialist economies. It referred, at first, to a list of positions throughout society that were so important that the party alone retained the right to fill them. In time, it also came to refer to the occupants of these positions. Hence the nomenklatura comprised party and government officials at the helm of the party, the bureaucratic and planning agencies, and the heads of state-controlled enterprises. These were the party's trusted elite who were entitled to the top positions.

Realities of Socialism – Lesson 1: Socialism Defined

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Background Information: Socialism Defined

In Poland, a nation of 30 million, there were about 70,000 members of the nomenklatura in the 1950s and 130,000 in the 1970s. They were in the top one-half of one percent. And having access to key positions in economic and bureaucratic agencies endowed the group with influence and personal benefits such as access to consumer goods and other services that ordinary workers could not obtain. They also had access to luxurious summer resorts, spas, hunting grounds, special medical care, and their own retirement benefits. The elite did not pay taxes; and the party made sure that this fact was a state secret. These privileges were a way around the officially “flat” pay structure and they helped the regime address the control problem inherent to central planning.

Some of the privileges were extraordinary. Consider Maciej Szczepanski, who oversaw national broadcasting. He had ten luxury residences, a 32-acre sheep farm, a hunting lodge with more than a million dollars’ worth of antiques, a 40-room mansion in Warsaw, a yacht, a villa in Kenya, and an office with a swimming pool and sauna.

At the same time, the shortage economy forced non-elites to sacrifice their morals and commodify their relationships. As one observer put it: “one can make a generalization that everybody in Poland who has the chance engages in a good deal of stealing, cheating, and supplementing his or her income by illegal means.” Cheating could take many forms: “goods snatched from workplaces, private services rendered during work hours; private utilization of state machines, tools, or transport, procuring goods ‘under the counter.’”