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2. Is the rational allocation of resources possible under socialism in an advanced industrial economy. Explain.

No, it is not possible for a socialist economy to have an efficient, rational allocation of resources - even with an advanced industrial structure.

Under a socialist economy, private property with respect to means of production is abolished, taken from private owners, and given to a collective of the people: generally by ownership being transferred to the socialist state itself[1]. Government ownership will require central planning to take the place of what was private enterprise[2]. The new system will then have to rely heavily on central planning agents to make the economic decisions of value, product amount, and resource allocation. The problem that arises with the socialist model is that even if the workers and planners operate with the best of intentions with regard to planning and desire to support the common good, they cannot value commodities efficiently because there is no private bidding war over resources and no drive toward efficiency, brought on by free enterprising businesses in the market[3]. As a result they do not place resources at their optimal location because of this lack of proper value. The natural evaluation of value cannot be done by a planner and the ability to optimally place resources is lost as private businesses lose the market and drive toward self-interest that likely led the market to excellence prior to socialism. This causes

[1] AIERvideo. Economic Calculation in a Socialist Society, (2019, October 18)
[2] AIERvideo. Economic Calculation in a Socialist Society, (2019, October 18)
[3] AIERvideo. Economic Calculation in a Socialist Society, (2019, October 18)

massive waste, inefficiency, and results in a far cry from a standard of living within capitalist, competitive markets. In his article, *Economic Calculation in the Socialist Model*, Mises brings up the fact that these errors cannot be solved in a socialist structure. He states in a new socialist structure, “the appraisement process must grind to a halt […] in the absence of competitive bidding […] there is no possibility of assigning economic meaning to the […] natural resources and capital goods now in the hands of socialist central planners.”[4] In addition Mises notes, “the mind of one man alone--be it ever so cunning, is too weak to grasp the importance of any single one among the countlessly many goods of a higher order. No single man can ever master all the possibilities of production, innumerable as they are, as to be in a position to make straightway evident judgments of value without the aid of some system of computation.”[5] Mises accounts for the socialist structure’s “crude” ability to moderately compute value and survive is only accomplished by copying economies that still function under capitalism stating, “One of the most important consequences of the fact that centrally planned economies exist within a world market economy is that the planners can observe and crudely copy capitalist economies in deciding which technical processes can coexist in a reasonably coherent capital structure. Had the entire world, rather than isolated nations, existed under central planning for the last half century, the global capital structure would long since have crumbled irretrievably to dust and humanity been catapulted back to autarkic primitivism.”[6] Even if the socialist economy did not have a capitalist model to copy, it would have to rely heavily on the market’s final price structure under capitalism.

Adam Smith is considered by many to be the founder of modern economics in no small part to his idea of the “invisible hand”. This idea of the invisible hand, is widely accepted by the

[4] Mises, Economic Calculation in the Socialist Commonwealth, (1920), pg. 36
[5] Mises, Economic Calculation in the Socialist Commonwealth, (1920), pg. 12
[6] Mises, Economic Calculation in the Socialist Commonwealth, (1920), pg. 37

world's economists as true. Adam Smith wrote about an invisible hand in the market which forces supply to meet demand at optimal levels through market function, by price structure, and independent actors acting through self-interest. The allocation of resources by the competitive market forces is the best way to ensure resources are used most efficiently and it is in capitalistic markets where this happens. Socialist economies do not have this function. Socialist economies are forced to be inefficient and frozen in time, or look to making an attempt to copy capitalist markets. The free-market by means of capitalism is necessary for effective resource allocation.

3. In The Wealth of Nations, Adam Smith argues that "the division of labor is limited by the extent of the market." What did he mean by that?

To understand Adam Smith's statement, it helps to understand that he wrote his statement in 1776, when the industrial age was in its early stages. It's also necessary to break down the statement into two parts and explain each part. The phase "division of labor" refers to dividing the labor among more than one person or group. Prior to the industrial age, generally one person, made one item from beginning to end. Division of labor means that one aspect of the production of an item is done by one person, another person does another aspect, and so on, until the item is complete. The phrase "limited by the extent of the market" refers to the denseness in producers and consumers in an area. Smith understood that the size of the market had to be large enough to support division of labor. The larger the "populousness," the greater the extent labor can be divided and the greater the consumers to consume the products created. Smith wrote, "In the lone houses and very small villages which are scattered about in so desert a country as the Highlands of Scotland, every farmer must be butcher, baker and brewer for his own family."[7] Conversely, in a large market, like a city, division of labor produces more products, the surplus

[7] Smith, The Wealth of Nations, Book 1, Chapter 3

products are consumed by the populous. According to Smith, even spreading "opulence which extends itself to the lowest ranks of the people."[8]

Why don't modern economies show a perfect degree of specialization?

Modern economies do not show a perfect degree of specialization because perfect specialization may bring economies to failure when circumstances change. One problem is demand for the product may shift so that there is a reduced demand or no demand for a product at all. For example, currently most vehicles are powered by gasoline. The trend is to find alternate sources of power for vehicles, reducing the need for gasoline. Eventually, possibly stopping the need for gasoline all together. A second problem is relying on a resource from another economy makes your economy reliant on another economy. They could withhold the resource, damaging your economy for political reasons. An example of this was the energy crisis in the 1970's. The energy crisis was caused because "Arab members of OPEC placed an embargo on the U.S. in response to its support of Israel and the Yom Kippur War."[9] Conversely, the receiving economy may realize this vulnerability and adjust away from the vulnerability. For example, the US is currently less dependent on foreign oil. Another problem of a perfect degree of specialization is natural disasters.[10] For example, the banana is the world's favorite fruit. Currently, bananas are a major export commodity for multiple countries (Ecuador $3.3 billion, Philippines $1.9 billion, Colombia $1.6 billion).[11] Currently, a fungus called Tropical Race 4 (TR4) is destroying the species of banana most exported. Scientists have been trying to stop the fungus for the past 30 years, since it was discovered, but little progress has been made.[12] If these

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8 Smith, The Wealth of Nations, Book 1, Chapter 1
9 Ryssdal, How an oil shortage in the 1970s shaped today's economic policy (2016)
10 Kalemli-Ozcan,Sorensen,Yosha, Risk Sharing and Industrial Specialization, Regional and International evidence (2003), pg
11 Workman, Bananas Exports by Country
12 Chris, Rosie, Bananas Fighting Deadly Fungus in Global Crisis

countries were perfectly specialized in banana production, something as simple as this fungus would devastate the country's economy.

What is the relationship between specialization under the division of labor and investment in human capital?

The relationship between specialization under the division of labor and investment in human capital is positively correlated. The advancement of one will lead to the promotion of another and economic progress, and increased efficiency will be a result. "Human capital is important because it is perceived to increase productivity and thus profitability. So the more a company invests in its employees (i.e., in their education and training), the more productive and profitable it could be."[13] This can be observed by comparing how much more specialized workers have become in the last hundred years, and scale that with the investment in capital that has occurred over that time. Investment in human capital through ensuring better training, education, health, and capital is the driver- the means that allows for specialized work. "The trend toward greater specialization and division of labor with economic progress is in part explained by increasing indivisibilities of human capital investments."[14] - Sherwin Rosen

13 Kenton, Human Capital, (2020)

14 Rosen, S. Specialization and Human Capital, (1983), pg. 48

4. How is economics a positive science? How is it not? What are the limits of this positive science in providing guidance to policy-makers?

Economics is a positive science in some ways, but not all ways. Positive economics are about matters of fact. Positive economic statements can claim a relationship that is generally verifiable or refutable by evidence. In other words, something that can be proven or disproven by looking at the available statistical evidence. For example, the statement: 'The purchasing power of currency decreases as the supply of currency increases.' Zimbabwe money is an excellent example of this. Between 2006 and 2009, the country of Zimbabwe changed the "value" of its currency. Initially a few Zimbabwe dollars could buy a loaf of bread. By the end, the Zimbabwe government was printing 100 Trillion dollar bills. The purchasing power of the 100 Trillion dollar bills was not enough to buy a loaf of bread. Because there was so much Zimbabwe money in circulation, the actual purchasing power of the currency became almost worthless. Positive economics makes no assessment based on value judgements.

Economics can also not be a positive science in some ways, referred to as normative economics. Normative economics is what people think sounds economical based on their wants, values and beliefs. Normative economics is making a statement while inserting your wants, values and beliefs into the statement. Normative economic statements can't be verified or tested. For example, the statement: 'Wealthy people should pay a higher percentage in taxes, than poor people.' Although the statement is widely accepted as fact, there is no way to prove or disprove it. It (normative analysis) is based on value judgements. Per John Hicks, "Positive economics can be, and ought to be, the same for all men; one's welfare [normative] economics will inevitably be different according as one is a liberal or a socialist, a nationalist or an internationalist, a christian or a pagan."[15]

The limits of economics to providing guidance to policy-makers is that "while positive economics can help people understand what is currently happening, it is much more difficult to use similar modes of thinking to predict the future and influence policies to ensure overall improvements."[16] In other words, positive economics helps us to understand what is happening now, but using that same information to make changes to the system may not have the anticipated results. Other unrecognized causes may have a bearing on the result as economics does not lend itself as readily to fields of study as easily as those of the hard sciences.

Economics is also limited in its positive analysis as the analysis has no judgment value. Per Buchanan, "This characteristic behavior of the political economist is, or should be, ethically neutral; the indicated results are influenced by his own value scale only insofar as this reflects his membership in the larger group."[17] As Shifa Fathima covers in his work *Positive Versus Normative Economics - An Empirical Study*, positive analysis will not provide an answer as to proceed. It can only describe the potential relationships of the policy that is being discussed because it [positive analysis]"does not provide any guidance on what policy should be followed."[18] "Normative economics is [the] branch that expresses value or normative judgments

[15] Hicks, The Foundations of Welfare Economies (1939), pg 696
[16] Investopedia, What are some of the limitations and drawbacks of economics as a field? (2018)
[17] Buchanan, J.M. (1959). Positive Economics, Welfare Economics, and Political Economy., pg. 127
[18] Fathima, J. S. (2014). Positive Versus Normative Economics, pg. 71

about economic fairness. It focuses on what the outcome of the economy or goals of public policy should be."[19]

[19] Fathima, J. S. (2014). Positive Versus Normative Economics, pg. 71

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