

Original Research Article

From Hegemony to Harmony: Evolution of Economic Theories in Response to Global Shifts

Abstract: This paper explores the evolution of economic theory in response to historical events and societal needs, focusing on the shift in attitudes toward planned economies. It argues that the changes in economic thought are micro-level reflections of macro-level trends. In the 20th century, major global events such as the rise and fall of Soviet socialism, the decline of British hegemony, and the ascendancy of American dominance shaped the trajectory of economic theories. The study examines how capitalism adapted to socialism through government intervention and eventually reverted to liberalism after the socialist experiment's failure. This paper also draws parallels between past and present geopolitical and economic dynamics, highlighting the similarities between early 20th-century British-German relations and current U.S.-China tensions. It discusses how China's response to U.S. protectionism and the need to craft a unique economic narrative are crucial in this context. Furthermore, the study critiques the extremes of planned and laissez-faire market economies, advocating for a balanced approach that integrates free market principles with government intervention. It underscores the importance of developing new economic theories that reflect China's unique experiences and can guide future development both domestically and globally. Finally, this paper calls for innovative theoretical frameworks to better describe the government's role in economic operations, emphasizing the need for China to assert intellectual leadership in the field of economics to avoid Western dominance and ensure the discipline's relevance to contemporary challenges.

Keywords: Economic Theory, Planned Economy, Government Intervention, Capitalism vs. Socialism, 20th Century Economic History

1. Introduction

The debate over economic calculation in socialist economies was a pivotal academic discussion in the 1930s, significantly shaping the field of comparative economics. This debate not only laid the foundational framework and methodology for comparative economics but also profoundly influenced related fields such as socialist economics, welfare economics, and the history of economic thought. Among the notable contributions, Oscar Lange's theories emerged as

precursors to market socialism, substantially impacting the economic structures of European countries.

Throughout this prolonged academic discourse, theories pertaining to planned economies were extensively developed. In response, liberal economics evolved, giving rise to influential schools such as Keynesianism and Neoclassical economics. The rapid and iterative development of economic theory in the 20th century also brought about substantial evolution in the economic development policies of various nations.

The study of socialist economics extends beyond merely examining socialism; it encompasses the exploration of ideas and their derivatives that have significantly contributed to the advancement of capitalism. However, following the collapse of the Soviet Union, the Western world entered an era described as the "end of history," during which economic theory experienced limited development. Mainstream economists have struggled to explain the rapid growth of China's economy, a phenomenon that demands a return to the foundational academic debates and a reassessment of core elements of economic development.

This paper aims to revisit the academic debate on socialist economic development to explore potential directions for future economic theory. Prior to the establishment of the Soviet Union, the concept of a socialist planned economy was not deemed essential within the economics profession. Utopian socialism and early socialist practices, such as the Paris Commune, failed to produce stable regimes or complete economic systems. It was not until the publication of Engels' "The Development of Socialism from Fantasy to Science" in 1880 that a coherent economic theory of socialism was articulated. Engels identified the fundamental contradiction of modern capitalism as the tension between social mass production and capitalist private ownership of the

means of production. This contradiction manifested in the antagonistic relationship between the bourgeoisie and the proletariat, as well as the conflict between organization within capitalist enterprises and the overall anarchy of the capitalist economy, inevitably leading to severe economic crises. Engels argued that public ownership of the means of production was essential to resolve these contradictions.

Despite the theoretical advancements, by the late 19th century, the theory of socialist public ownership was not perceived as a significant threat by capitalist economic circles, largely due to the failures of utopian socialist experiments and the evident superiority of capitalist private ownership during the Second Industrial Revolution. At that time, capitalist economists were more preoccupied with constructing new marginal theories of value and reshaping classical economics following the failure of Ricardo's labor theory of value.

However, the shift in attitudes toward planned economies was influenced by significant historical events in the 20th century. The first half of the century witnessed the collapse of the British-dominated world order, challenged by Germany and dismantled by the United States and the Soviet Union. The second half was characterized by bipolar competition between the United States and the Soviet Union, culminating in a new world order established by the United States. The European colonists' quest for global dominance began with Britain's adoption of mercantilism, leading to trade protectionism and military conflicts. However, the mercantilist approach faced challenges, particularly during the Continental Blockade imposed by Napoleon, which exposed the inefficacy of trade protectionism against more developed trade methods. As Britain lagged in the Second Industrial Revolution, its comparative advantage diminished, compelling a departure from classical liberalism in favor of policies aimed at resource

redistribution to maintain its global hegemony.

The economic theories of socialism, particularly those proposed by Oskar Lange, argued for the feasibility of planned economies achieving optimal resource allocation, akin to perfectly competitive markets. However, the practical challenges and the ideological shifts following World War II and the Prague Spring of 1968 led to a decline in the acceptance of planned economies. The rise of neoliberalism and the focus on market economies further marginalized the discussion on planned economies, despite their theoretical validity.

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After the Cold War, globalization has significantly reshaped international business strategies, driven by the liberalization of trade policies, technological advancements, and the integration of global markets. The reduction of trade barriers and the establishment of free trade agreements have facilitated the movement of goods, services, and capital across borders, leading to increased economic interdependence among nations. For instance, the North American Free Trade Agreement (NAFTA) and the World Trade Organization (WTO) have played pivotal roles in promoting free trade and reducing tariffs, thereby encouraging multinational corporations to expand their operations globally. However, the benefits of globalization have not been uniformly distributed, leading to shifts in trade policies as countries seek to protect their domestic industries. The rise of protectionist measures, such as tariffs and trade wars, particularly between major economies like the United States and China, has created a volatile trade environment. These shifting trade policies necessitate adaptive international business strategies, where companies must navigate complex regulatory landscapes, reassess supply chain dynamics, and innovate to maintain competitive advantage in a rapidly changing global market (Puślecki,

2019).

This paper seeks to re-examine the historical and theoretical contexts of the socialist economic calculation debate, exploring its implications for contemporary economic theory and the rapid development of economies like China.

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Analysis tools used in the research

The 20th century witnessed significant shifts in global economic power, marked by the decline of British hegemony and the rise of American dominance. Understanding these shifts requires a deep dive into the concept of comparative advantage, which explains why countries engage in trade and how they benefit from specializing in the production of goods for which they have a lower opportunity cost.

Opportunity Cost of Good A (in terms of Good B) = $\frac{\text{Quantity of Good B}}{\text{Quantity of Good A}}$

For instance, during the early 20th century, Britain and the United States exhibited different opportunity costs in producing industrial goods. Britain, having established industries, faced higher costs when shifting resources to new industries compared to the U.S., which had more flexible and abundant resources. By calculating the opportunity costs, we can see why the U.S. focused on emerging technologies and industries where it held a comparative advantage.

When analyzing the shift from British to American economic dominance, the concept of comparative advantage is crucial. By calculating the opportunity cost of producing various goods, we can understand why the United States emerged as the new hegemon. For instance, the opportunity cost of producing steel in Britain versus the United States can be represented

as $\frac{\text{Quantity of textiles}}{\text{Quantity of steel}}$. This explains why the U.S. focused on industries where it had a lower

opportunity cost compared to Britain.

To further understand the economic transitions of the 20th century, particularly during the Cold War era, the Solow Growth Model provides valuable insights into the long-term growth patterns of nations. This model helps us understand the contributions of capital, labor, and productivity to GDP growth.

$$Y = AK^\alpha L^{1-\alpha}$$

where Y is the output, A is the total factor productivity, K is the capital input, L is the labor input, and α is the output elasticity of capital.

The Solow Growth Model highlights how different countries, such as the United States and the Soviet Union, managed their economic inputs to drive growth. For example, during the mid-20th century, the U.S. significantly invested in capital (K) and technology (A), leading to higher productivity (Y) compared to the Soviet Union, which focused more on labor (L) and less on technological advancements. By comparing the total factor productivity (TFP) between the two nations, we can better understand the economic trajectories and the eventual outcomes of their economic policies.

To compare the long-term economic growth of the United States and the Soviet Union during the Cold War, we can use the Solow Growth Model. The model,

$$Y = AK^\alpha L^{1-\alpha}$$

helps us understand the contributions of capital, labor, and productivity to each country's GDP growth. The United States' significant investment in capital and technology led to higher productivity compared to the Soviet Union, which focused more on labor and less on technological advancements.

Another critical aspect of understanding the global economic shifts is analyzing the balance of payments, which reflects a country's economic transactions with the rest of the world.

Current Account+Capital Account+Financial Account=0

The balance of payments is a critical indicator of a country's economic interactions with the rest of the world. For instance, analyzing the balance of payments can help explain how the United States financed its growth post-World War II. The formula, $\text{Current Account} + \text{Capital Account} + \text{Financial Account} = 0$, shows how trade balances and capital flows influenced economic policies. During the mid-20th century, the U.S. maintained a favorable balance of payments through robust capital inflows and financial account surpluses, enabling it to sustain its economic expansion and solidify its hegemonic status.

2. Feasibility analysis for planned economy

Ludwig von Mises's 1920 article "Economic Calculation in the Socialist Commonwealth" is often regarded as the seminal critique of a socialist planned economy (Mises, 1920). At the time of its publication, the feasibility of a socialist economy was a hotly debated topic, especially with the recent establishment of the Soviet Union. Mises's work ignited significant discourse within the European capitalist academic community, positing that a planned economy is inherently unfeasible.

Mises argued that replacing private ownership with public ownership would eliminate markets, competition, and the supply-demand mechanism. Without true market interactions, accurate price information cannot be generated. This lack of reliable price data impedes decision-makers from allocating resources efficiently, leading to misallocation, inefficiency, and eventual systemic

collapse.

As a prominent figure of the Austrian School of Economics and an ardent advocate of extreme liberalism, Mises's views reflected the broader skepticism of planned economies among European scholars of the era. In the early 20th century, there was no empirical evidence to support the feasibility of a planned economy, and the Soviet Union was embroiled in the Red and White Civil War. Data from this period showed that Soviet economic output under wartime communism lagged significantly behind pre-World War I Tsarist Russia (Markevich & Harrison, 2011).

The debate took a pivotal turn with Lenin's death and Stalin's implementation of the first Five-Year Plan. This plan rapidly industrialized the Soviet Union, coinciding with the Great Depression in capitalist countries. The stark contrast between the Soviet Union's apparent success and the economic turmoil in the West had a profound impact on global economic thought. Journalists like Walter Duranty of *The New York Times* highlighted the Soviet achievements, influencing Western perceptions and policies, such as Franklin Roosevelt's recognition of the Soviet Union in 1933 (Taylor, 1990).

In the 1930s, scholars supportive of planned economies gained prominence. Dickinson (1933) argued that prices in a planned economy could be set by the Central Planning Commission based on estimated marginal costs. Durbin (1936) and Lerner (1937) further demonstrated that planned economies could achieve resource allocation efficiency comparable to market economies. Lange's influential works (1936-37) proposed that central planning could mimic market price discovery through a process of "trial and error."

However, the post-World War II era saw a decline in the enthusiasm for government intervention. Keynesian predictions of high post-war unemployment were proven wrong, as the US

experienced low unemployment rates despite reduced government spending (Taylor, Ronald, 2016). This period marked the beginning of a shift away from the planned economy model. Hayek's "Competitive Outcomes" (1940) highlighted the impracticality of collecting and processing the vast amounts of economic information required for effective central planning. The inability to capture all valuable data and the resulting inefficiencies were key points of critique. Additionally, the Prague Spring of 1968 and subsequent events exposed the authoritarian aspects of planned economies and further eroded their theoretical appeal.

By the 1980s, academic interest in planned economies waned. The consensus evolved towards finding a middle ground between market and planned economies, acknowledging the theoretical appeal of both but recognizing the practical challenges. Theories such as transaction cost economics highlighted the necessity of certain market structures within capitalist systems.

3. From historical perspective

The discourse on the feasibility of planned economies has long been a pivotal focus within European and American capitalist academic circles. This inquiry, although deeply rooted in economic theory, often overlooks the profound influence of historical contexts. The publication of Ludwig von Mises's critique of planned economies in 1920 occurred at a time when socialism had not yet demonstrated practical success, and theoretical frameworks for a socialist planned economy were still nascent. Given these circumstances, it is essential to explore why Mises, a staunch advocate of ultra-liberalism, felt compelled to publish a treatise against planned economies at that particular juncture.

The First World War, as the first major global conflict, significantly altered economic landscapes

and theories. Governments across the world engaged in extensive borrowing and spending to finance the war, which classical economics had largely ignored. This shift underscored the economic importance of government intervention, leading to the emergence of Keynesian economics. John Maynard Keynes's seminal work, "The General Theory of Employment, Interest, and Money" (1936), addressed these new realities, emphasizing the need for government intervention in the economy to maintain stability and promote growth (Metzler, 1951).

The end of the First World War marked a period of temporary calm, soon disrupted by the economic turmoil of the interwar years. Stalin's implementation of the first Five-Year Plan in the Soviet Union transformed the country from an agrarian society into an industrialized state. This rapid development stood in stark contrast to the capitalist world, which was grappling with the Great Depression. The economic distress in capitalist countries fueled the rise of extremist ideologies, most notably the Nazis in Germany (Fankner, 2013).

The stark differences between the planned economy of the Soviet Union and the capitalist economies prompted significant reevaluations of economic thought. Classical liberalism, which advocated for laissez-faire capitalism, was criticized for its alignment with social Darwinism and its perceived role in fostering extremism. The economic crises of the mid-20th century underscored the need for state intervention, as proposed by Keynesian economics. However, the Vietnam War and subsequent events highlighted the limitations and challenges of overreliance on government intervention (Harman, 1999).

By the 1970s, neoliberalism began to gain prominence as a response to the perceived failures of Keynesianism. Neoliberalism advocated for deregulation and market-driven economic policies while maintaining some degree of government intervention to provide a stable framework for

market activities. The collapse of the Bretton Woods system and the oil crisis of the 1970s further exposed the limitations of Keynesian policies and underscored the importance of considering the role of money and interest rates in economic activities.

As the Cold War drew to a close and the Soviet Union collapsed, the debate over planned economies lost its prominence. The failures of fully planned economies, coupled with the challenges faced by laissez-faire capitalism, highlighted the complexities of economic governance. By this time, the academic consensus had shifted towards finding a balanced approach that combined market dynamics with selective state intervention. The ideological battles of the mid-20th century gave way to a more pragmatic understanding of economic policy, recognizing that both extremes—full market economy and fully planned economy—were theoretically feasible but practically challenging to implement.

The historical journey from the aftermath of the First World War to the end of the Cold War reveals the intricate interplay between economic theories and historical events. The initial opposition to planned economies by figures like Mises was deeply rooted in the historical context of post-war economic realities and the ideological battles of the time. Over the decades, as the world witnessed the successes and failures of different economic systems, the debate evolved, leading to a nuanced understanding that transcended ideological extremes. Today, the focus lies on achieving a pragmatic balance that harnesses the strengths of both market and planned economies to address the dynamic challenges of the modern world.

4. The historical inevitability of the transformation of academic mainstream

In the preceding sections, I have contended that significant historical events of the 20th century

substantially influenced the changing attitudes towards planned economies. However, examining this from a broader macro perspective reveals that these historical events themselves are manifestations of overarching social development trends. Consequently, the development and evolution of academic theories are, in many ways, an inevitable response to these broader trends. The first half of the 20th century witnessed the collapse of the British-dominated global order, challenged initially by Germany and eventually dismantled by the United States and the Soviet Union. This period was characterized by seismic geopolitical shifts and the realignment of global power structures. The second half of the century saw the bipolar competition between the United States and the Soviet Union, culminating in the establishment of a new world order dominated by the United States.

With the advent of the Age of Discovery, European colonists began to carve up the world. Britain was the first European nation to adopt mercantilism, driven by the necessity to build national war capabilities and counter Spain's trade blockade. Queen Elizabeth I's policies, such as the Statement of the Common Welfare of the Kingdom of England and the Trade and Navigation Acts, aimed to protect national trade and shipping through state intervention.

However, as Britain rose to global preeminence following the defeat of the Spanish Armada, the mercantilist approach of state-protected trade made enemies worldwide. Countries with superior military power found that using force was a more effective means of securing raw materials and markets than commercial competition, as evidenced by the Anglo-Dutch Wars.

The introduction of mercantilism by Louis XIV of France led to direct confrontations with Britain, the greatest sea power, and France, the greatest land power. This conflict reached a critical point when France supported American independence. The Continental Blockade by Napoleon

further demonstrated the limitations of mercantilism. The British re-export trade through Tsarist Russia showed that goods from Britain did not disappear under the blockade but continued to circulate, highlighting the inefficacy of trade protectionism against increasingly sophisticated trade methods. This realization paved the way for the ideology of free trade, as any economically rational actor would find mercantilist policies intolerable when faced with more efficient alternatives.

In the second half of the 19th century, Britain failed to keep pace with the Second Industrial Revolution, losing its comparative advantage to the United States and Germany. According to classical liberal economic theory, less productive economies like Britain were destined to fall behind more productive ones. For Britain, this meant a loss of control over global resources and markets, necessitating a departure from classical liberalism.

The United States and Germany, recognizing that Britain would not relinquish resources and markets willingly, sought their own place in the global order. Germany's attempt to bypass British maritime supremacy with the Baghdad-Berlin railway highlighted the necessity of military power to protect economic interests. The outbreak of World War I underscored the inevitability of such conflicts given the development of productive forces.

Mises's 1920 critique of planned economies emerged in a world increasingly leaning towards government intervention. However, by the time Keynes published his seminal work in 1936, Britain had already lost its global preeminence. The aftermath of World War I and the Great Depression necessitated a shift towards state intervention, but the gap in national power between Britain and the United States remained insurmountable.

For Germany, the Treaty of Versailles and the rise of extreme nationalism turned state

intervention into a doctrine for mobilization in preparation for another global conflict. By the time Keynesian economics gained traction, the geopolitical landscape had irrevocably shifted, allowing the United States to emerge as the new world hegemon.

The Cold War era required Western Europe to counter the appeal of communism, necessitating stronger government intervention in economic affairs. This period saw a blend of market economics with state intervention to ensure stability and counter Soviet influence. The Marshall Plan and subsequent European reindustrialization exemplified this approach, with the United States leading the way in technological innovation and economic development.

By the 1980s, the debate over planned economies had largely subsided, given the practical incorporation of both market and planned economy elements in successful economic systems. The collapse of the Soviet Union in 1991 provided new ammunition against planned economies, reinforcing the narrative of their infeasibility.

The evolution of economic theories and practices throughout the 20th century reflects a dynamic interplay between historical events and ideological shifts. The collapse of classical liberalism, the rise of state intervention, and the eventual dominance of neoliberalism illustrate the constant search for a balance between market freedom and government control. The historical trajectory from mercantilism to neoliberalism underscores the inevitability of change driven by broader social and economic forces, shaping the academic discourse and practical applications of economic policy.

5. Conclusion and prospect

The evolution of economic theory represents scholars' responses to contemporary economic

challenges. The widespread adoption of particular theories reflects society's choice of solutions, but fundamentally, these theories emerge as micro-level manifestations of broader macro-level trends.

The overarching trend of the 20th century was shaped by the successes and failures of the Soviet socialist experiment and the capitalist world's response to communism. The decline of British hegemony and the rise of American dominance can be seen as capitalism's adaptations to the challenge posed by socialism. Traditional colonialism-based hegemony proved ineffective against socialism; only by adopting elements of socialism, such as government intervention, could capitalism withstand the socialist challenge, identify socialism's practical flaws, and eventually overcome it. With the collapse of the Soviet Union, liberalism, which favors rentiers, re-emerged as the dominant ideology. Thus, it is not any specific doctrine that drives social development, but rather the needs of social development that select the prevailing doctrine.

As we face unprecedented global changes, historical patterns are resurfacing. When a dominant power lags in productivity but uses military force to suppress rising challengers, and when those challengers achieve higher economic efficiency, we see echoes of early 20th-century dynamics. Today, as the United States turns to protectionism and even mercantilism, China faces the critical question of how to respond. If China resorts to enhanced state intervention, trade protectionism, and great power competition, it risks repeating the pre-World War I scenario. Just as Britain intervened in Germany's Baghdad-Berlin railway project, the U.S. could similarly obstruct China's Belt and Road Initiative.

In the current geopolitical climate, interpretations of the free market are dominated by the United States. Actions like the U.S. Senate Foreign Relations Committee's 2023 support for

stripping China of its developing country status, or the characterization of Xinjiang cotton as undemocratic, challenge China to define its own economic narrative.

Historical review suggests that China must avoid the extremes of a planned economy and a laissez-faire market economy. Instead, China must find a way to integrate free market principles with government intervention. This organic combination is crucial as neoliberalism faces potential obsolescence. The Third Plenary Session of the 18th CPC Central Committee emphasized the need for economic restructuring, highlighting the importance of balancing government and market roles. However, this provides only a political economy framework. In microeconomics and macroeconomics, China needs theories that reflect the uniqueness of socialism with Chinese characteristics.

For instance, practical initiatives like the Vegetable Basket Project and new energy subsidies highlight the nuanced role of government intervention in China compared to Western approaches. Understanding why China's new energy subsidy policies succeeded while similar policies in the U.S. had limited impact requires robust theoretical frameworks. Additionally, the government's role in diverse projects, like those in Dushan County, needs to be comprehensively analyzed to distinguish the benefits and drawbacks of government involvement in economic activities.

The challenge lies in developing a theory that accurately describes the government's role in economic operations, guiding future development not only for China but also for other developing nations and the global community. As China's national strength grows and Western influence wanes, this process will accelerate. Yet, as Western social platforms begin to extol China's experiences, there will be a discrepancy between Western interpretations and China's own narrative needs. If China fails to propose its own economic theories, the West will continue to

dominate the intellectual landscape, potentially undermining the future development of economics as a discipline.

For the future of the global community, for China's continued development, and for the advancement of Chinese economics, it is imperative to study societal needs and pioneer innovative economic theories. By doing so, China can assert its intellectual leadership and ensure that the theoretical foundations of economics reflect its unique experiences and perspectives.

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