

CHAPTER VII

FINAL CONSIDERATIONS

We will begin this final chapter with an analysis of the contributions of three theorists – Durbin, Dickinson, and Lerner – who, in line with the approach Lange defined with his “classic model,” also attempted to formulate a “competitive” solution to the problem of socialist economic calculation. We will particularly focus on the innovations these authors sought to introduce, with respect to Lange’s model, and whether or not they were able to comprehend and answer the challenge originally issued by Mises. We will conclude that “market socialism” amounts to an essentially contradictory and hopeless attempt to achieve an absurd goal, to “square the circle.” This view is also held by a group of socialist theorists who, led by Maurice Dobb, have always pointed to the conflict between traditional socialism and the “competitive model,” and in fact, a secondary debate emerged, strictly in the socialist camp, between supporters and critics of “market socialism.” We will wind up the chapter with a few final thoughts on the true meaning of the impossibility of socialism and the contributions of Austrian theorists.

1. OTHER “MARKET SOCIALISM” THEORISTS

We devoted a large portion of the last chapter to a careful analysis of Oskar Lange’s proposals. Generally speaking, they are the most commonly cited and considered by the secondary sources which, thus far nearly always in a biased, erroneous manner, have described and commented on the controversy over socialist economic calculation. At the same time, the other “market socialism” theorists, more often than not, simply repeat Lange’s original arguments, though they modify the details slightly. From this group, we will study Durbin, Dickinson, and Lerner in some depth. Specifically, we will concentrate on determining whether any of them came to understand the true essence of Mises and Hayek’s challenge and were able to offer a theoretical solution to it. We will conclude that, apart from the fact that their

theoretical analyses merely involve small variations in detail with respect to Lange's "classic model," these market socialists failed lamentably in their attempt to solve the economic problem socialism poses.

Evan Frank Mottram Durbin

Durbin may have raised certain hopes initially, since he was in contact with the theoretical contributions of the Austrian school of his day, and he was able to clearly distinguish between the Austrian and the neoclassical-Walrasian paradigms. In addition, he wrote a treatise on economic depression which was profoundly influenced by the ideas F.A. Hayek had presented on the subject.¹ Nevertheless, we will see that despite this healthy "Austrian" influence, Durbin failed to grasp the heart of the socialism problem Mises and Hayek raised, and in fact, his "solution" was formulated in such strictly static terms as Lange's.

Durbin's contribution appears mainly in an article entitled, "Economic Calculus in a Planned Economy," which was published in December of 1936.² Durbin claims to be "almost certain" that the problem of economic calculation in a socialist economy could be resolved if the central planning board were to order the different production units to act in accordance with the following two *rules*: first, to calculate the marginal productivity of all movable factors of production; and second, to allocate productive factors for those uses for which marginal productivity is highest. Companies would be instructed to produce the highest volume compatible with "normal" profits ("average cost rule"). To minimize the possibilities of error involved in calculations of marginal productivity, Durbin deems it necessary to calculate the corresponding demand curves. Furthermore, he maintains that the interest rate should be established by the "free" new capital market, yet at no point does he clarify how such a market would function in a system in which private ownership of the means of production is prohibited.

¹ E.F.M. Durbin, *Purchasing Power and Trade Depression* (London: Chapman & Hall, 1933).

² It was printed in the *Economic Journal* (December 1936) and republished in *Problems of Economic Planning* (London: Routledge & Kegan Paul, 1968), 140-155. Also of interest is his article, "A Note on Mr. Lerner's 'Dynamical' Propositions," *Economic Journal*, no. 47 (September 1937): 577-581.

Finally, Durbin believes the economy should be organized in terms of large sectors, “trusts,” or monopolies which would be ordered to “compete” with each other.

We need not repeat here the arguments we have already expressed concerning the proposal of competitive “trusts” (originally defended by Heimann and Polanyi) and the possibilities of organizing a true capital market, based on the services of a monopolistic state bank, where there is no private ownership of the means of production. We have already closely analyzed these issues in earlier chapters. At this point, we should emphasize that Durbin’s proposal contains exactly the same error Lange and others had committed before, i.e. the presumption of a context of equilibrium in which no changes occur and all information necessary to calculate the marginal productivity of productive factors is given and easily attainable.

Indeed, the “rules” Durbin designed could serve as a rational guide for economic calculation if the information necessary to calculate the marginal productivity of each factor of production could be obtained in an environment in which there is no private ownership of the means of production nor freedom to exercise entrepreneurship without hindrance. Let us bear in mind that to calculate marginal productivity, one must make a purely entrepreneurial estimate concerning the following: first, which goods or services consumers will demand in the future and in what quantities; second, what specifications, characteristics, technological innovations, etc. must be included; third, what maximum prices can be charged in the market for these consumer goods and services once they have been produced; and fourth, what will be each good’s average period of production and what interest rate must be used to determine the present value of the corresponding future marginal-productivity values. Logically, the above information can only be generated in a competitive market, by the different economic agents who participate, and it is generated as they exercise their entrepreneurship without any institutional encumbrance. For this to occur, there must be true competition, but not among mysterious trusts or monopolies (it is unclear whether they would be organized horizontally or vertically), but at all inter and intrasectoral levels of society. Moreover, it is essential that any person be able to freely use his own entrepreneurial creativity to discover and generate, in an

attempt to earn entrepreneurial profits and avoid losses as far as possible, the (always practical, subjective, dispersed, and inarticulable) information necessary to perform the actions most conducive to his goals.

We should also remember that in the real world, the type and quantity of productive factors are not given, and not all can be divided into homogeneous units, but instead, depending on the imagination, desires, and ends of each entrepreneur, as well as the specific information he generates in accordance with his particular circumstances of time and place, what constitutes a “movable” factor of production and a relevant unit of this factor will vary from case to case, i.e. it will depend on the subjective perception of the entrepreneur in question. Moreover, the implicit assumption that the corresponding future demand curves are known or can somehow be calculated reveals Durbin’s profound ignorance of the manner in which market processes truly function in real life.

In fact, in a competitive market, there are no supply, demand, nor any other sorts of “curves” or “functions.” For the information necessary to draw or describe them does not exist, and therefore it is not available anywhere (not to a company or industry manager, nor much less to a scientist or central planning agency), not only because the information which would make up the “demand curve” is dispersed, but also because this information is not even forming constantly in the minds of the individual participants in the market. In other words, supply and demand curves can never be discovered in the market, simply because they do not exist. At most, they have a merely heuristic or interpretative value within economics, and any person, whether an expert in economics or not, who, almost without realizing it, begins to think of such functions or curves as real will commit serious errors. This is because information about the quantities that will be bought or sold at each price is not abstractly considered by each economic agent, nor is it stored in each person’s memory for all future circumstances. On the contrary, such information is strictly subjective and dispersed and only emerges at the specific moment an economic agent decides to make a purchase or a sale, as a result of the entrepreneurial process itself, along with numerous particular influences and circumstances which the agent involved in the transaction subjectively perceives. Hence, this information is created *ex novo* at that

moment; it did not exist before; and it will never be replicated. Therefore, at most, entrepreneurs in a real market economy try to estimate what could be viewed as certain isolated points along hypothetical future supply and demand “curves.” Still, this approach is not necessary for the formulation of price theory, nor do we find it appropriate, since it could somehow imply a recognition that such curves or functions exist or could exist in the future. If the entrepreneur acts correctly, he makes pure entrepreneurial profits; if he acts in error, he incurs losses. It is precisely the incentive of achieving the former and avoiding the latter which encourages the tendency of entrepreneurship to continuously create and discover the appropriate information. Without these incentives, the free exercise of entrepreneurship is impossible, and therefore, so is the creation of the information necessary to make coordinating decisions and rational calculations. Economic and social life, in all of its manifestations, including prices, arises from a combination of multiple human actions, and not from the intersection of mysterious “functions” or “curves,” which do not exist in real life and have been surreptitiously introduced in our science by a whole horde of “scientistic” thinkers who have come from the world of polytechnics and applied mathematics and have not yet managed to grasp the very harmful effects the use of their methods exerts on the economy.³

³ Thus, it is necessary to abandon the “functional theory” of price determination, which from the time of Marshall has always pervaded economics textbooks. Carl Menger first warned against this theory in his February 1884 letter to Leon Walras, in which he concluded that “la méthode mathématique est fausse.” (See E. Antonelli, “Léon Walras et Carl Menger à travers leur correspondance,” *Économie Appliquée* 6 [April-September 1953]: 282, and Emil Kauder’s comments on the topic in “Intellectual and Political Roots of the Older Austrian School,” *Zeitschrift für Nationalökonomie*, no. 17, pp. 411-425, reprinted in volume 1 of Stephen Littlechild’s *Austrian Economics* [Vermont: Edward Elgar, 1990], esp. 10-11.) Böhm-Bawerk later cautioned against the theory in volume 2 of *Capital and Interest*, pp. 233-235, where he criticizes the mechanical conception of supply and demand as mere “quantities” which depend on an independent variable (price), when in real life, supply and demand are the result of actual, concrete human decisions and actions. The functional, scientistic theory of price must therefore be replaced with a “genetic-causal,” or to be more precise, praxeological, theory of price, one in which prices derive from a *sequence of entrepreneurial human actions*. Such a theory would maintain and enhance the valid conclusions of the “functional” model while guarding against the serious risks and errors which normally result from this model. See Hans Mayer’s article, “Der Erkenntniswert der Funktionellen Preistheorien,” in *Die Wirtschaftstheorie der Gegenwart* (Vienna: Springer, 1932), 2:147-239b. See also Israel M. Kirzner’s related comments in his article, “Austrian School of Economics,” in *The New Palgrave: A Dictionary of Economics*, vol. 1, p. 148. Mises’s similar ideas appear particularly in his *Human Action*, 327-333. In addition, see the quotation in footnote 53 of chapter 5, along with our remarks. In Spain, a relatively recent example of harmful scientistic methodology based on “social engineering” and the use of mathematics in the field of economics is provided by socialist José Borrell Fontelles’s book, *La República de Taxonia* (Madrid: Ediciones Pirámide, 1992).

Hence, Durbin, like Lange and other socialist theorists, assumes economic agents have access, in objective form, to information the very creation of which is a theoretical impossibility in the absence of private ownership of the means of production and the free exercise of entrepreneurship. Without these institutions, the information will not be generated, the managers of the corresponding sectors will not be able to objectively follow Durbin's "rules," and the central planning agency will most certainly not be capable of monitoring and verifying whether or not these sectors are acting correctly, according to these rules. Thus, Durbin commits his gravest error when he explicitly asserts: "The ability to discover marginal products is not dependent upon the existence of any particular set of social institutions."⁴ Furthermore, if Durbin believes the information necessary to calculate marginal productivity will always be available, regardless of which social institutions are present (whether capitalist, socialist, or any combination of the two), then it is unclear why he rejects the Walrasian procedure proposed by Lange and based on the same assumption Durbin makes, i.e. that the necessary information is available in objective, unequivocal form. Moreover, Durbin holds that the "technical" difficulties in calculating the marginal productivity of the different factors are the same in a capitalist system as in a planned economy, and he refuses to recognize that the problem is not "technical" but economic, and to discuss any "practical" aspect beyond his own "theoretical" observations.⁵

Therefore, we see that, like Lange, Durbin views as "theory" only the marginalist model of equilibrium (though in his case, rather than the general Walrasian equilibrium, it is more the partial Marshallian equilibrium and the theory of marginal productivity), in which the information necessary for calculating the corresponding marginal productivities is presumed "given." He fails to see that this theory rests on suppositions which are so restrictive that they render the theory practically irrelevant. Durbin is unfamiliar not only with the formal theory of

⁴ E.F.M. Durbin, "Economic Calculus in a Planned Economy," in *Problems of Economic Planning*, 145.

⁵ "It may be very difficult to calculate marginal products. But the technical difficulties are the same for capitalist and planned economies alike. All difficulties that are not accountancy difficulties are

the social coordination processes entrepreneurship drives, but also with the role certain social institutions play by encouraging or restricting entrepreneurship, the economic analysis of property rights, and the theoretical problem posed, in the absence of entrepreneurial competition, by the dispersed, subjective nature of knowledge. It is not surprising that Durbin's attempt to solve the socialist economic calculation problem was unsuccessful, since his theoretical tools were unsuitable, both for understanding the problem Mises originally raised and for finding a feasible solution for it. Thus, we can conclude, as Hoff does in his brilliant critical analysis of Durbin's contribution,⁶ that "in his anxiety not 'to dogmatize on practical questions' he has overlooked the crux of the whole problem, namely, how the data on which the socialist trusts are to base their calculations are to be obtained."⁷

Henry Douglas Dickinson's Book, The Economics of Socialism

The publication in 1939 of Dickinson's book also augured well for the author's finally understanding, fully addressing, and attempting to answer Mises and Hayek's original challenge.⁸ The fact that in this book, Dickinson explicitly abandons the contentions he made in his 1933 article on price formation in a socialist system, and that he does so for precisely the essential reason his Austrian opponents had stressed to him (i.e. the information necessary to implement his proposal of a mathematical solution would never be available) seemed a hopeful

not susceptible to theoretical dogmatism." E.F.M. Durbin, "Economic Calculus in a Planned Economy," in *Problems of Economic Planning*, 143.

⁶ Durbin, who was still a young man when he tragically drowned in Cornwall in 1948, participated, along with J.E. Meade, Hugh Gaitskell, and to a lesser extent, Dickinson and Lerner, in building the ideological foundations for the English Labour Party following World War II (mostly through the so-called Fabian Society), and Durbin's daughter, Elisabeth Durbin, has analyzed his role in *New Jerusalem: The Labour Party and the Economics of Democratic Socialism* (London: Routledge and Kegan Paul, 1985). Most of these "ideologists" ended up defending a model based on interventionism and Keynesian-type macroeconomic planning within a social democratic context. Elisabeth Durbin also authored the brief article about her father which appears on p. 945 of volume 1 of *The New Palgrave: A Dictionary of Economics*. See also her book, *The Fabians, Mr. Keynes and the Economics of Democratic Socialism* (New York: Routledge and Kegan Paul, 1984). Incidentally, we should mention that Elisabeth Durbin sat on the examination board (with Israel Kirzner, Fritz Machlup, James Becker, and Gerald P. O'Driscoll) for Don Lavoie's doctoral thesis on the socialist economic calculation debate, which he read at New York University and which forms the basis of his brilliant *Rivalry and Central Planning*.

⁷ T.J.B. Hoff, *Economic Calculation in the Socialist Society*, 224-229, especially the heading on p. 227.

⁸ H.D. Dickinson, *The Economics of Socialism* (London: Oxford University Press, 1939).

sign that Dickinson was capable of grasping all the implications of his new “intuition.”⁹ Moreover, Dickinson had a very attractive personality. Collard tells us he was “a much loved, unworldly, eccentric figure with a keen sense of fun and a most astute mind;”¹⁰ and Hayek, in his 1940 article, praises not only the comprehensive nature, but also the length, organization, conciseness, and clarity of Dickinson’s work, and adds that to read it and discuss its content was a true intellectual pleasure.¹¹ Finally, Dickinson’s openness and scientific honesty manifest themselves quite plainly in the highly favorable review he published in 1940 of the original Norwegian version of Trygve J.B. Hoff’s book.¹² Nevertheless, unfortunately, we could point out that many of Dickinson’s proposals coincide entirely with those Oskar Lange made earlier, and even so, Dickinson expressly cites Lange only in the bibliography of his book. For this reason, most of our criticisms of Lange in the last chapter also apply here, in Dickinson’s case.

As Don Lavoie has quite astutely shown,¹³ despite everything, Dickinson’s book basically maintains the former, static position of this author, and thus Dickinson remains unable to solve the economic calculation problem as Mises and Hayek had formulated it. This is particularly evident in the role which, according to Dickinson, both uncertainty and the entrepreneurial function would necessarily play in a socialist system. In fact, Dickinson believes that one of the advantages of the socialist system would be to reduce the uncertainty which typically emerges in the capitalist system as a result of the interaction between many

⁹ *The Economics of Socialism*, 104, where Dickinson indicates that the mathematical solution he proposed in 1933 was unfeasible, not because the corresponding system of equations could not possibly have been solved, but because he realized that “the data themselves which would have to be fed into the equation machine, are continually changing.”

¹⁰ See Collard’s article about Dickinson on p. 836 of volume 1 of *The New Palgrave: A Dictionary of Economics*.

¹¹ F.A. Hayek, “Socialist Calculation III: The Competitive Solution,” in *Individualism and Economic Order*, 185.

¹² This review, which appeared in the *Economic Journal*, no. 50 (June/September 1940): 270-274, dealt with Hoff’s book, published in Norwegian, *Okonomisk Kalkulasjon i Socialistiske Samfund* (Oslo: H. Ashekovg: 1938). (The work was later translated into English by M.A. Michael and published in London by William Hodge in 1949 under the title, *Economic Calculation in the Socialist Society*.) Dickinson concludes: “The author has produced a critical review, at a very high level of theoretical competence of practically everything that has been written on the subject in German and English.”

¹³ Don Lavoie, *Rivalry and Central Planning*, 135-139. Incidentally, the static conception of economics and the ensuing incapacity to understand the role and nature of uncertainty in a market economy, which are characteristic of Dickinson, are shared today by authors as prestigious as, for example, Kenneth J. Arrow, who, as we will see in footnote 55, considers uncertainty an obvious “failure” of the market and its price system.

separate decision-making entities. This supposed “reduction” in uncertainty would be achieved through the intervention of the central planning agency, which by imposing a series of conscious, direct production ratios via commands, would necessarily reduce the high levels of uncertainty normally present in the market. Dickinson again refers to the openness which would exist in a socialist system, as opposed to the typical behavior of companies in a capitalist system, which he asserts is characterized by excessive “secrecy” and a lack of “information transparency.”

In making these assertions, it is clear that Dickinson implicitly considers the central planning bureau capable of accessing information which would permit it to coordinate society from above, and thus to reduce the degree of uncertainty and the errors entrepreneurs normally commit. However, Dickinson never explains how this would be possible, especially in light of the fact that the information the planning agency needs to lessen uncertainty is not generated from above, but “from below,” i.e. at the level of the economic agents themselves. Also, as we know, such information is subjective, practical, dispersed, and inarticulable, and hence it cannot possibly be transmitted to a central planning body, or even created, in the absence of complete freedom for the exercise of entrepreneurship. Furthermore, when Dickinson advocates total “information transparency” and the publicizing of all the “commercial secrets” which are guarded in the capitalist system, he is implicitly assuming the information is objective and that once all of the data and “secrets” of the different economic agents were spread throughout the social framework, the level of uncertainty would drop significantly. However, we must consider that any economic agent can literally flood his competitors or colleagues with all the information concerning his plans without necessarily reducing the level of uncertainty. This is because it is only possible to flood others with information which can be articulated or transmitted in a formalized manner. Moreover, the data must be interpreted; all interpretations are subjective; and in countless situations, the economic agents and their competitors may not subjectively interpret the same data in exactly the same way, and thus the data could not take on the same subjective meaning it conveyed to the entrepreneur who originally “issued” the information. The limit could conceivably lie in a set of circumstances in which the entrepreneur

would not only transmit the information, but would also indicate how, in his subjective opinion, future events would unfold, and what the best course of action would be. If economic agents decided to follow the “intuitions” of the issuer, they would simply be giving up the chance to interpret the data themselves, and thus to personally exercise their entrepreneurship, and they would be limiting themselves to merely following the entrepreneurial leadership of another. The socialist system can only eliminate uncertainty via the “ostrich method,” that is, people must bury their heads in the sand and refuse to see uncertainty or recognize that it is not a “problem” (except in the absurd mental constructions of befuddled equilibrium theorists), but a social reality which is inherent in human nature and which man constantly faces through the exercise of his entrepreneurship.

We find another indication that Dickinson’s model remains essentially static in the way he attempts to deal with the level of uncertainty central planning could not eliminate. Dickinson proposes the establishment of an uncertainty surcharge which would enter into the total cost of production along with the other elements that “normally” comprise it. Although Dickinson admits it would be complicated to calculate this uncertainty surcharge, he believes it could be done by calculating the frequency of changes in the sales and prices of each good and service. With this proposal, Dickinson reveals that he has not yet grasped the essential difference between risk and uncertainty, a difference we covered in chapter 2.¹⁴ It involves unique events, with regard to which a possible frequency distribution cannot even be conceived to exist. The information economic agents create and test concerning what they believe may happen in the future is typically entrepreneurial, inarticulable, creative, and suited to possible alternatives, and thus it can never be compiled in a centralized manner in such a way as to permit the formulation of a frequency distribution.

Dickinson’s approach to the role “entrepreneurship” would have to play in the socialist system is, if possible, even less satisfactory. For in Dickinson’s model, entrepreneurship is a fundamentally ambiguous, crude caricature. Logically, private ownership of the means of

production is prohibited, and the central planning body is invested with vast powers, both to establish guidelines for the coordination of individual plans, and to distribute the corresponding financial funds, intervene in the labor market, monopolize advertising and propaganda, entirely control and direct international trade, etc. Furthermore, Dickinson views this coercive agency, which he calls the “Supreme Economic Council,” as not only “omnipresent and omniscient,” but also “omnipotent” in terms of its capacity to introduce changes whenever its members perceive the need for them.¹⁵ Nonetheless, the fact that the managers of the different companies in the socialist system are subjected to the planning bureau does not mean that Dickinson believes they would have no chance to freely make certain choices.¹⁶ In fact, Dickinson holds that each of the companies in the socialist system must have its corresponding capital, keep its own profit and loss account, and be “managed” by a method as similar as possible to that used for managing companies in the capitalist system.

Dickinson clearly realizes that it is necessary for managers to be financially responsible for the performance of their companies, and to share in both the losses and the profits. What our author neglects to explain is how this financial responsibility can be achieved in a system in which private ownership of the means of production is prevented by force. As we learned in chapter 2, wherever the means of production cannot be privately owned and man cannot freely obtain the benefit of his action, the coordinating entrepreneurship of social processes does not emerge. Furthermore, Dickinson maintains that even though the acquiring of profits is not necessarily a sign of entrepreneurial success, the incurring of losses is always a sign of a

¹⁴ In chapter 2, see the section entitled, “Creativity, Surprise, and Uncertainty” and footnotes 11 and 12.

¹⁵ See Dickinson, *The Economics of Socialism*, 103, 113, and 191. As to these adjectives (omniscient and omnipresent), which Dickinson assigns to the planning bureau, Mises makes the following ironic comment: “It is vain to comfort oneself with the hope that the organs of the collective economy will be ‘omnipresent’ and ‘omniscient.’ We do not deal in praxeology with the acts of omnipresent and omniscient Deity, but with the actions of men endowed with a human mind only. Such a mind cannot plan without economic calculation.” Ludwig von Mises, *Human Action*, 710. Fourteen pages earlier, on page 696, we read that “we may admit that the director or the board of directors are people of superior ability, wise and full of good intentions. But it would be nothing short of idiocy to assume that they are omniscient and infallible.”

¹⁶ “Because the managers of socialist industry will be governed in some choice by the direction laid down by the planning authority, it does not follow that they will have no choice at all.” See Dickinson, *The Economics of Socialism*, 217.

managerial failure or error.¹⁷ Logically, if this “intuition” of Dickinson’s is raised to the rank of principle, it is clear that managers will tend to be conservative officials who are invariably fearful about undertaking new activities, introducing technological and commercial innovations, modifying the production process, etc., since losses will always be viewed as an error and unfavorable for the professional career of the official, and possible profits may not be recognized as successes.

Dickinson seeks to solve the problem of motivating and rewarding managers by establishing a system of “bonuses” or financial payments which would be keyed to the results obtained by the company an official manages. Of course, such bonuses would not be identical to entrepreneurial profits, not only because that would mean, in practice, a reintroduction of the detested capitalist system, but also because, as we have just mentioned, Dickinson does not deem profits a sign of efficiency in all cases. With this proposal, Dickinson again falls into the trap of the static model. In fact, as we already know,¹⁸ the bonus system implicitly presupposes that the agency entrusted with awarding the bonuses has access to information which, due to its subjective, dispersed, and inarticulable nature, could never be accessible to the agency. To award bonuses based on results implies that it is possible to know whether these results are favorable or unfavorable. And if it is possible for a planning body to know whether results are favorable or unfavorable, clearly the exercise of entrepreneurship is not necessary to generate this information. However, if the free exercise of entrepreneurship must be permitted in order for the information to emerge, it makes no sense to establish a bonus system, because until this information has emerged, one cannot know if the exercise of entrepreneurship will be successful or not. This is precisely the essential argument Kirzner discovered and formulated against the different attempts (at this point, all failures) to establish incentive systems in socialist

¹⁷ For Dickinson, the essential principle would be that “although the making of profits is not necessarily a sign of success, the making of losses is a sign of failure.” Dickinson, *The Economics of Socialism*, 219.

¹⁸ See all of the critical arguments we presented concerning the bonus and incentive system at the end of criticism 7 of Lange’s classic model in chapter 6.

countries.¹⁹ Entrepreneurial success can only be judged subjectively, by the person who is exercising entrepreneurship. The actor measures it from an overall perspective and considers not only the corresponding financial profits, but also all of the other circumstances which he subjectively values as profit. Moreover, this profit arises continually, varies with respect to its amount and nature, and constantly guides the actions of the entrepreneur by providing him with information about the direction he should take. In contrast, the bonus system may, at most, be useful at a managerial level, but not at an entrepreneurial level. Bonuses are awarded *a posteriori*, based on objective information and according to a plan which has been established or agreed upon beforehand and articulated in a totally unequivocal fashion. Bonuses do not guide action, since they are awarded in a rigid and objective manner after the fact. Most of all, the granting of bonuses involves an interpretive judgment about events, a judgment which is only meaningful if made entrepreneurially, but not if it arises from the commands of a central planning agency (which lacks the information necessary to award bonuses in anything but an arbitrary manner), or if bonuses have been established beforehand for all cases and depend on the meeting of certain, more or less measurable criteria.

In brief, what Dickinson fails to understand is that the term “incentive” has two very different meanings. One can conceive of a strict, limited, and practically irrelevant meaning for the term “incentive,” which would refer to the design of mechanisms for motivating economic agents to make good use (according to the pre-established “rule”) *of the objective information already available to them*. It is not this meaning which we have attached to the term from the beginning of this book, but a much broader meaning, one which is also more precise and relevant to economics: in our view, *incentives* comprise all of the ends which can possibly be

¹⁹ In the words of Kirzner himself (see also footnote 70 of chapter 6): “Incentives to socialist managers deny the essential role of entrepreneurial discovery.” See *Discovery and the Capitalist Process*, 34-37. Don Lavoie, for his part, sums up the Austrian arguments against the socialist system of bonuses and incentives in the following manner: “This implies that the planning board that examines the individual profit and loss accounts must be in a position to distinguish genuine profit from monopoly gain in the standard sense. However, this evades the question under consideration, since the calculation argument contends that the planning board would lack the knowledge that decentralized initiative generates and that this knowledge is revealed only in profit and loss accounts. *There is no superior store of knowledge against which profit figures can be compared, so that the managers’ remuneration can be correspondingly altered.*” See Don Lavoie, *Rivalry and Central Planning*, 138-139.

imagined and created *ex novo*, and with respect to which people not only transmit the objective information they already possess, but (and this is much more important) they bring about the *constant creation and discovery of the subjective information they do not yet possess*, information essential to the achievement of the proposed ends. In a socialist system, although a clumsy attempt can be made to establish “incentives” in the first sense, each person is forcibly and systematically prevented from freely reaping the full benefits of his entrepreneurial activity, and thus it is impossible by definition to establish incentives in the second, broad, and true sense.

In addition, Dickinson recommends that bonuses or incentives be provided for technological experimentation and innovation, as if the central planning board could possess the quantity and quality of information necessary to enable its members to determine which projects are worth financing and which are not, as well as which results of experimentation indicate success and which do not. However, as Don Lavoie states: “The idea of specified incentives as a deliberate planning device is contradictory to the idea of experimentation as a genuinely decentralized discovery procedure. If the central planning board does not have the knowledge necessary to differentiate bold initiative from reckless gambling, it could not allocate incentives among managers to encourage the one and discourage the other.”²⁰ This very problem inevitably confronts those western governments which strive to encourage both scientific research and cultural and artistic development via subsidies and other state “incentives.” In all such cases, the corresponding government agencies end up granting the incentives and subsidies in a purely arbitrary manner, one which coincides perfectly with the predictions of the public choice school. In the absence of other, superior criteria, agencies provide incentives based on contacts and political influence, etc. and fail miserably to encourage valuable technological innovation or true cultural or artistic development.

In his approach to entrepreneurship, Dickinson explicitly and implicitly assumes that full information is available, that society is static, and that change never occurs. These

²⁰ Don Lavoie, *Rivalry and Central Planning*, 139.

assumptions transform all economic problems into mere technical issues simple managers can resolve. Throughout this book, we have strongly criticized such suppositions, and they reveal Dickinson's inability to confront the problem of calculation in socialist economies. As Mises puts it, "the capitalist system is not a managerial system; it is an entrepreneurial system,"²¹ and Dickinson is among those who confuse the entrepreneurial function with the managerial function, and who therefore inevitably close their eyes to the true economic problem.

Finally, it is curious to note Dickinson's naiveté in believing his system would make it possible to establish, for the first time in the history of humanity, real "individualism" and "freedom," in other words, a sort of "libertarian socialism" with great intellectual appeal.²² Nevertheless, given the enormous power the central planning agency would invariably have in Dickinson's model, together with his characteristic arbitrariness, propaganda manipulation, and incapacity to perform economic calculation, his socialist system would be, at the very least, a very authoritarian system in which individual freedom would suffer dreadfully and there would be no chance of a truly democratic system functioning. In fact, Dickinson himself admits (and these are his exact words) that "in a socialist society the distinction, always artificial, between economics and politics will break down; the economic and the political machinery of society will fuse into one."²³ As Hayek has shown,²⁴ this assertion of Dickinson's sums up one of those doctrines most energetically espoused by Nazis and fascists. If we cannot distinguish politics from economics, it will be imperative that a sole, prevailing value scale regarding every matter of human life be imposed on all agents and members of society, which, as is logical, could only be achieved through the widespread use of force and coercion. Indeed "politics" always refers to systematic and institutional coercion, force, and commands (i.e. to *socialism* as we have

²¹ Ludwig von Mises, *Human Action*, 708. On p. 709, Mises adds: "One cannot play speculation and investment. The speculators and investors expose their own wealth, their own destiny ... If one relieves them of this responsibility, one deprives them of their very character. They are no longer businessmen, but just a group of men to whom the director has handed over his main task, the supreme direction of economic affairs. Then they – and not the nominal director – become the true directors and have to face the same problem the nominal director could not solve: the problem of calculation."

²² Dickinson, *The Economics of Socialism*, 26.

²³ Dickinson, *The Economics of Socialism*, 235.

²⁴ See F.A. Hayek, "Socialist Calculation III: The Competitive Solution," in *Individualism and Economic Order*, 206-207.

defined it throughout this book), while “economics” refers to voluntary contracts, the free exercise of entrepreneurship, and the peaceful pursuit by all individuals of the most varied ends, within a legal context of exchange and cooperation. The great marvel of life in a capitalist society driven by the force of entrepreneurship lies in the fact that each person or economic agent in such a society learns to voluntarily discipline and modify his behavior in terms of the needs and desires of others, all in an environment in which each person pursues the richest and most varied and unpredictable ends. Clearly, this is something Dickinson never desired nor was able to understand.

The Contribution of Abba Ptachya Lerner to the Debate

The contributions of Lerner to the debate did not take the form of explicit replies to the books and articles of Mises or Hayek, but instead they simply appeared in a series of articles Lerner published in the 1930s, in which he commented on and criticized the proposals of the other socialist theorists who participated in the debate, particularly Lange, Durbin, Dickinson, and Dobb.²⁵ In addition, Lerner later made a number of observations relevant to our topic in his book, *The Economics of Control*, which was published in 1944.²⁶

In his articles, Lerner attempts to tackle not only the problems of statics, but also the “dynamic” problems which the socialist economy poses. Moreover, in his book, *The Economics of Control*, he expressly mentions²⁷ that total planning would require a centralized knowledge of what goes on at each factory, of daily variations in supply and demand, and of changes in technical knowledge within all branches of production. Lerner also explains that because a central planning agency cannot conceivably acquire such knowledge, the only option is to rely on the “mechanism” of prices. However, despite these observations, Lerner’s

²⁵ Those articles of Lerner’s which are most relevant to the socialist economic calculation debate are the following: “Economic Theory and Socialist Economy,” *Review of Economic Studies*, no. 2 (October 1934): 51-61; “A Rejoinder,” *Review of Economic Studies*, no. 2 (February 1935): 152-154; “A Note on Socialist Economics,” *Review of Economic Studies*, no. 4 (October 1936): 72-76; “Statics and Dynamics in Socialist Economics,” *Economic Journal*, no. 47 (June 1937): 253-270; and finally, “Theory and Practice of Socialist Economics,” *Review of Economic Studies*, no. 6 (October 1938): 71-75.

²⁶ Abba P. Lerner, *The Economics of Control: Principles of Welfare Economics* (New York: Macmillan, 1944).

contribution, like those of the other market socialists, is still explicitly and implicitly based on the assumption that all of the information necessary to implement his proposal would necessarily be available, and thus Lerner manages neither to answer the challenge of Mises and Hayek nor in turn to solve the socialist economic calculation problem. Furthermore, we could even point out that Lerner was the most extremist in terms of defending the equilibrium model as a “theoretical” foundation for socialism and ignoring and denying the need to study the truly interesting problems entrepreneurship raises. Let us consider three concrete examples which very clearly illustrate this characteristic position of Lerner’s.

First, we must mention Lerner’s critical analysis of the cost rules formulated earlier by different market socialists, in general, and by Taylor, Lange, and Durbin, in particular. In fact, Lerner criticizes Taylor’s use of the principle of equating price with total average costs. He also criticizes the focus of Lange’s rules, for their aim of simulating the market “mechanism” more than the final state toward which the market tends; and he is especially critical of the application of Durbin’s rules, which, according to Lerner, signify a return to the practical principle of establishing prices in terms of average costs, since managers are required to produce the highest volume compatible with obtaining a “normal” level of profits.²⁸

According to Lerner, it is not so important to find a practical rule as to directly pursue the final objective of the socialist system, which can only be done by insuring that no factor or resource is used to produce a good or service while the production of others more highly valued is neglected. The only way to insure this is to order managers to make prices equal to marginal costs in all cases ($MC=P$), a principle which, though it coincides with Lange’s second rule, must be followed exclusively and without the obsession Lerner believes Lange had with simulating the functioning of a competitive market. According to Lerner, it is unnecessary to insist, as

²⁷ A.P. Lerner, *The Economics of Control*, 119.

²⁸ Tibor Scitovsky, “Lerner’s Contribution to Economics,” *Journal of Economic Literature* 22, no. 4 (December 1984): 1547-1571, esp. p. 1552. Scitovsky provides a summary of the socialist economic calculation debate and Lerner’s participation in it (p. 1551) which reveals not only Scitovsky’s complete lack of understanding as to the content of the debate, but also the fact that he used only certain secondary sources that give accounts which do not correspond with the actual unfolding of events. That certain distinguished economists continue to write such things at this stage of the game is altogether

Durbin does, that managers obtain “normal” profits, since such profits are simply a sign of static equilibrium, and what the socialist system really needs is a guide for the allocation of productive resources in a “dynamic” world. Therefore, we see that Lerner’s so-called “dynamic analysis” is limited to an attempt to find a rule applicable, in his opinion, to all of the circumstances which arise on a daily basis in a socialist economy. Paradoxically, Lerner’s solution is as static as those Durbin, Lange, and Dickinson proposed, and hence, we could repeat here all of the detailed criticism we expressed earlier concerning the rule of establishing prices based on marginal costs. At this point, it is enough to repeat that marginal costs are not “objective” in the sense that they are given and can be unequivocally observed by a third party. On the contrary, they are a typical example of entrepreneurial information, i.e. information gradually generated in a subjective, dispersed, tacit, practical, and inarticulable manner in the minds of those who freely exercise their human action or entrepreneurship, and therefore it cannot be supposed that information about costs is created or discovered by managers who cannot freely exercise their entrepreneurship, due to the elimination of private ownership of the means of production. It is even more absurd to assume that such information can be transmitted to the central planning body and that this body is somehow capable of monitoring the compliance of the different industry managers with the rule ($MC=P$).

Second, curiously, Lerner himself realizes that the relevant prices which must be taken into account in his rule ($MC=P$) are not “present” prices (which have already emerged in the market, even in the recent past), but future prices as economic agents foresee them (“expected future prices”).²⁹ Therefore, Lerner’s fundamental rule must be established in such a way that each manager equates prices to marginal costs according to his own *expectations*. Nonetheless, not only is it impossible for these expectations to arise if managers cannot freely exercise their entrepreneurship (due to the absence of private ownership of the means of production), but it is also theoretically impossible for a bureaucratic inspector and member of the central planning

disappointing. On Lerner, see also Karen Vaughn’s interesting introduction to T.J.B. Hoff’s book, *Economic Calculation in the Socialist Economy*, pp. 24-26, and chap. 12 of the same book, pp. 224-236.

²⁹ Abba P. Lerner, “Statics and Dynamics in Socialist Economics,” 253, 269, 270.

bureau to objectively monitor whether or not the rule is being followed (that is, whether or not each manager is acting correctly “in accordance with his own expectations”). Hence, Lerner intuits an idea that is basically correct, but he fails to realize that it demolishes his entire proposal and reduces it to utter nonsense.

Third, Lerner views the issue of whether the central planning agency will be able to estimate future marginal costs more or less accurately than the entrepreneurs who act in a competitive society as a “sociological” or “practical” issue and one that therefore does not belong to the field of “economic theory.”³⁰ Moreover, Lerner expressly criticizes Durbin’s attempt to analyze the practical effects socialism would have on incentives and the behavior of managers in the socialist system. Lerner remarks jokingly that with this endeavor, Durbin was attempting to solve a problem which was completely unrelated to the theoretical possibility of economic calculation in socialist economies.³¹ It is obvious that the one answering the wrong question, and with analytical tools and “theoretical” conclusions unsuitable for tackling the problem Hayek and Mises raised as to the impossibility of rational economic calculation in a socialist system is Lerner himself. Indeed, when he hides behind a hypothetical system in which economic agents are instructed to act in a certain way, yet he neglects to consider whether or not they will be able to act in this way based on the information they can create and the incentives which motivate them, Lerner deliberately alienates himself from the relevant theoretical problems and takes refuge in the aseptic nirvana of general equilibrium and welfare economics.

Lerner’s obsession with equilibrium and statics is especially evident in his criticism of Oskar Lange, whom he sees as unnecessarily trying to reproduce or simulate the mechanisms of competition, when in Lerner’s opinion the truly important matter is to articulate the conditions

³⁰ In Lerner’s own words: “The question is then the sociological one, whether the socialist trust is able to estimate this future value more accurately or less accurately than the competitive owner of the hired instrument, and here we leave pure economic theory.” See *Statics and Dynamics in Socialist Economics*, 269.

³¹ In fact, Lerner facetiously compared Durbin to the “schoolboy in the examination room who wrote ‘I do not know the social effects of the French Revolution, but the following were the kings of England’” (“A Rejoinder,” 1938, p. 75).

necessary to define the “socialist ideal” from the perspective of “welfare economics,” regardless of the method used to achieve this ideal. In fact, the goal is no longer even to establish a model of “perfect” competition (though such a model of “competition” has nothing to do with the competition which emerges between entrepreneurs in real life), but to define as clearly as possible the nirvana or “paradise” described by “welfare economics,” while the discovery of the practical systems most appropriate for reaching this “paradise” via coercion is left to sociology, psychology, and politics.³² Hence, Lerner insists that rather than simulating a system of “perfect competition in equilibrium” by trial and error or any other method, it is important to try to achieve the social optimum *directly* by instructing managers to equate prices to marginal costs.

Of all the theorists we have analyzed up to this point, Lerner was perhaps the most mesmerized by the neoclassical model of general equilibrium and welfare economics, even to the point that he deemed any analysis which did not refer to the assumptions, implications, and formal exposition of welfare economics to fall outside the scope of “theory.” This explains his sole, insistent recommendation that company managers be instructed to follow the dictates of welfare economics, and with precisely this objective, he wrote his 1944 work, *Economics of Control*, as a practical manual for interventionism, a recipe book for neoclassical equilibrium and welfare economics, to be used directly in the practice of social engineering by the bureaucrats of the central intervention or planning agency, to aid them and facilitate their “arduous task” of systematically coercing the rest of the citizenry in the area of economics.³³

³² On p. 74 of the 1936 article, “A Note on Socialist Economics,” Lerner writes: “Methodologically my objection is that Dr. Lange takes the state of competitive equilibrium as his *end*, while in reality it is only a *means* to the end. He fails to go behind perfect competitive equilibrium and to aim at what is really wanted. Even though it be true that if the state of classical static perfectly competitive equilibrium were reached and maintained in its entirety the social optimum which is the *real* end would thereby be attained, *it does not follow that it is by aiming at this equilibrium that one can approach most nearly the social optimum that is desired.*”

³³ Another sign of the static nature of Lerner’s analysis, in the sense that he assumes the intervention or planning agency has access to all of the information necessary to act, lies in his development of the theory of the “productive speculator,” who would perform a beneficial function, to be preserved in a “controlled” economy, and who must be distinguished from the “monopolistic or aggressive” speculator, whose function must be neutralized by the mechanism Lerner calls “counterspeculation” (*Economics of Control*, 69, 70). What Lerner neglects to mention is that, because the difference he attempts to establish rests entirely on the subjective reasons for the speculative activity,

Lerner fails to realize that by reasoning in this manner, he falls into a trap he built himself. Indeed, the marvelous ivory tower of welfare economics keeps him isolated in perfect stagnancy from the real economic problems posed by socialism and offers him complete “immunity” (or at least he believes so) to the theoretical criticisms Mises and Hayek formulated. Nevertheless, the view from the ivory tower is not clear, but opaque, and Lerner thus lacks the analytical tools necessary not only to solve the crucial economic problems, but also to perceive them. His isolation in the paradigm of welfare economics is so profound that Lerner even considers the differences which separate the real world from the equilibrium model of “perfect competition” to be a clear “defect” or “failure” of the capitalist system (which socialism is at least potentially capable of forcibly correcting), rather than a defect of the very analytical tools of the model. In other words, if the world does not behave as the theory of nirvana predicts, let us destroy the world and construct nirvana, but let us never try to amend the theory in an attempt to understand and explain how the real world works and what happens in it.³⁴ Hence, a criticism Tadeusz Kowalik levels at Lange applies fully to Lerner as well:³⁵ Kowalik asserts

there is no possibility whatsoever of objectively distinguishing between the two types of speculation, since there is no objective, unequivocal criterion that permits us to identify and interpret subjective human motivations. As Murray N. Rothbard shows in his analysis of monopoly in *Man, Economy and State* (Los Angeles: Nash Publishing, 1972), vol. 2, chap. 10, pp. 586-620, the distinction between “competition” prices and “monopoly” prices is theoretically absurd. Because the second are defined based on the first, and the equilibrium prices which, hypothetically, would have prevailed in a “perfectly competitive” market are unknown in real life, there is no objective, theoretical criterion for determining whether a monopoly exists. Furthermore, as Kirzner has revealed (*Competition and Entrepreneurship*, chap. 3, pp. 88-134), the problem of “competition” versus “monopoly,” both understood in the static sense as states or models of equilibrium, is irrelevant and absurd, since what is theoretically important is to analyze whether or not there exists a *real process* driven by the competitive force of entrepreneurship and unhindered by government restrictions, regardless of whether the result of entrepreneurial creativity appears at times to take the form of a “monopoly” or an “oligopoly.”

³⁴ See p. 129 (footnote 8) of Don Lavoie’s *Rivalry and Central Planning*, where he refers to Abba P. Lerner’s article, “The Concept of Monopoly and the Measurement of Monopoly Power,” published in the *Review of Economic Studies*, no. 1 (1934): 157-175. See also our article, “La Crisis del Paradigma Walrasiano,” published in *El País* (Madrid, December 17, 1990): 36.

³⁵ Indeed, Kowalik states that near the end of Lange’s life, he received a letter from him (dated August 14, 1964), in which Lange wrote: “What is called optimal allocation is a second-rate matter, what is really of prime importance is that of *incentives for the growth of productive forces* (accumulation and progress in technology); this is the true meaning of so to say ‘rationality.’” Kowalik concludes: “It seems that he must have lacked the indispensable tools to solve this question or even to present it in detail.” See Kowalik’s article on the “Lange-Lerner Mechanism,” in *The New Palgrave: A Dictionary of Economics*, vol. 3, p. 131. Also, Kowalik indicates that at some points in Lange’s life, he appears to have shared Lerner’s conclusions. In his 1938 work, “The Economist’s Case for Socialism,” Lange wrote: “The really important point in discussing the economic merits of socialism is not that of comparing the equilibrium position of a socialist and of a capitalist economy with respect to social welfare. Interesting

that Lange lacked the analytical tools necessary not only to solve the problem of socialist economic calculation, but also to understand and examine the truly significant economic problems.³⁶

as such a comparison is for the economic theorist, it is not the real issue in the discussion of socialism. The real issue is *whether the further maintenance of the capitalist system is compatible with economic progress.*" In reality, Lange did not believe the capitalist system could maintain the pace of economic growth and technological innovation it had boasted from the Industrial Revolution to the Great Depression. He would hardly have believed that a little over a generation after his death, the essential economic problem would take a 180-degree turn, as it would become clear that it is the socialist system, not capitalism, which is incompatible with both economic progress and technological innovation (and obviously with freedom and democracy).

³⁶ The case of Milton Friedman is interesting, because he is an author who uses the analytical tools typical of an equilibrium economist of the modern neoclassical paradigm, and yet, he is an ardent defender of capitalism as opposed to socialist systems. As a result, in the theoretical studies in which Friedman criticizes socialism, he is able neither to grasp the core of the theoretical challenge Mises issued (which Friedman almost never cites and often scorns), nor to explain the theoretical essence of the impossibility of socialist economic calculation. In fact, Friedman lacks a developed theory of entrepreneurship, and hence, of the functioning of the dynamic processes which operate in the market and are always driven by entrepreneurship. Therefore, his "critical analyses" of socialism are simply an amalgam of empirical anecdotes and interpretations regarding what goes on in the real socialist world, or vague observations about the problem the absence of "incentives" (understood in the "strict" sense we so criticized when discussing Dickinson) poses in socialist economies. A clear sign of Milton Friedman's analytical inadequacies in this area is provided by his work, *Market or Plan?* (London: Center for Research into Communist Economies, 1984). In this brief pamphlet, Friedman even praises Lange's writings and calls Lerner's book, *The Economics of Control*, "an admirable book that has much to teach about the operation of a free market; indeed, much more, I believe, than about their actual objective, how to run a socialist state" (p. 12). Friedman does not realize that if the writings of Lerner and Lange are irrelevant to the building of theoretical foundations for a socialist system, it is precisely due to their profound lack of understanding about how the capitalist system really works. To put it another way, Mises and Hayek were able to construct an entire theory surrounding the impossibility of socialism precisely because they had profound theoretical knowledge about how the capitalist system really works. Hence, we strongly suspect that Friedman's praise of Lerner's book reveals Friedman's own theoretical poverty with respect to his conception of the dynamic market processes entrepreneurship drives. Moreover, Friedman unnecessarily objectifies the price system and considers it a marvelous "transmitter" of (apparently objective) information, along with the "incentive" necessary to use this information properly. He has not comprehended that the problem is a different one, that prices neither "create" nor "transmit" information, and that the human mind alone can perform these functions, within the context of an entrepreneurial action. He has not understood that the marvel of the market is not that the price system acts "efficiently" in transmitting information (Friedman, 9-10), but that the market is a process which, driven by the innate entrepreneurial force of every human being, constantly creates new information in light of the new goals each person sets, and gives rise to a coordinating process among people as they interact with each other, a process through which we all unconsciously learn to adapt our behavior to the ends, desires, and circumstances of others. In other words, rather than transmit information, prices create profit opportunities which are seized through entrepreneurship, the force that creates and transmits new information, and thus coordinates the entire social process. Finally, Friedman indicates (p. 14) that the fundamental problem in a socialist system is that of monitoring whether or not economic agents comply with the pre-established "rules." This is not the problem. The basic problem, as we know, is that the absence of freedom to exercise entrepreneurship prevents the generation of the information necessary for rational economic calculation and the above coordinating process to play a role in decision-making. In just two places, and quite in passing, Friedman refers to the essential economic problem we are explaining, but he gives it secondary importance and does not analyze it in detail nor study all of its implications. In one place, he mentions that it would be difficult for the central planning bureau to obtain the information necessary for it to supervise managers (p. 14), though he fails to realize that this sort of information would not be created even at the level of management. In his review of Lerner's book, *The Economics of Control* (see the *Journal of Political Economy*, no. 55 [October 1947]: 405-416), when

2. “MARKET SOCIALISM”: THE IMPOSSIBLE SQUARING OF THE CIRCLE

In view of our analysis of the proposals of Oskar Lange and the rest of the “market socialists” of his school,³⁷ we can conclude that theoretically and practically, only two alternatives exist: either people enjoy complete freedom to exercise entrepreneurship (in a context in which private ownership of the means of production is recognized and defended, and there are no restrictions beyond the minimum of traditional rules of criminal and private law necessary to avoid both the asystematic assault on human action and breaches of contract); or there is systematic, widespread coercion of entrepreneurship in more or less broad areas of the market and society, and specifically, private ownership of the means of production is prevented. In the latter case, it is impossible to freely exercise entrepreneurship in the affected social areas, particularly that of the means of production, and the inexorable result is that the rational

Milton Friedman studies the “institutional mechanisms” for attaining an optimum, he vaguely criticizes Lerner for not taking into account that profits are a guideline for action, and they serve to determine an entrepreneur’s capacity to command resources. Nevertheless, neither in these instances nor in any other has Friedman been able to explain the reason behind the theoretical impossibility that the system Lange and Lerner propose could work. This explains Friedman’s tendency to take refuge in the non-economic implications (political and ethical implications, or those regarding personal freedom) of the institutional reforms proposed by socialists; it also explains the marked weakness of his theoretical criticism of socialism. This lengthy set of observations was necessary, because Friedman is often identified with Hayek and Mises and considered a member of the same school, and the result has been great confusion among economists from the West and the former Eastern bloc who have not yet studied the problem in depth, and thus have not yet perceived the profound, radical differences between Friedman’s theoretical paradigm and that of Hayek and Mises. The criticism of Friedman can in general be extended to the rest of the Chicago theorists, who are obsessed with empiricism and focused on a phantasmagorical, objectivist equilibrium (of Ricardian and Marshallian origin), and hence do not imagine there to be any problem of information in the market beyond the high “transaction costs” of acquiring it. This is an error, because it involves the implicit assumption that the actor is able to assess *a priori* the expected costs and benefits of his process of seeking information. That is, it absurdly implies that the actor knows *a priori* the future worth of information he does not yet possess, and consequently, it renders an understanding of entrepreneurship and its theoretical implications for the economy wholly impossible. The errors of the Chicago school go back to Frank H. Knight, who stated: “Socialism is a political problem, to be discussed in terms of social and political psychology, and economic theory has relatively little to say about it” (Frank H. Knight, “Review of Ludwig von Mises’ *Socialism*,” *Journal of Political Economy*, no. 46 [April 1938]: 267-268). Rothbard has brilliantly explained that at the root of this conceptual error lies not only the above obsession with equilibrium, but also the absence of a true theory of capital, since, following J.B. Clark, the Chicago school has always viewed capital as a mythical fund which lacks a temporal structure and reproduces itself automatically, regardless of any sort of human entrepreneurial decisions. See Murray N. Rothbard, “The End of Socialism and The Calculation Debate Revisited,” *The Review of Austrian Economics* 5, no. 2 (1991): 60-62.

³⁷ In 1948, soon after Lange and Lerner made their contributions, James E. Meade published his book, *Planning and the Price Mechanism: The Liberal-Socialist Solution* (London: George Allen and Unwin, 1948), in which he presents an analysis and proposals which are very similar to those of Lange and Lerner, and hence we must view Meade as a member of the group we have analyzed in the main text.

economic calculation we have already described in detail in our analysis becomes unachievable in any of them. As we have shown, the second type of system renders impossible both social coordination and economic calculation, both of which can only take place in a system of complete freedom for the exercise of human action. What “market socialists” have attempted, with phantasmagorical results, is to formulate a “theoretical synthesis” in which a socialist system is established (one characterized by systematic aggression against human action and by public ownership of the means of production), yet the existence of a “market” is maintained. For ideological, romantic, ethical, or political reasons, they stubbornly refuse to abandon socialism, and because Mises and Hayek’s criticisms have made a strong impact on them, they seek to reintroduce the market into their models, in the vain hope of attaining “the best of both worlds,” and of making their ideal more popular and attractive.

Nevertheless, what socialists do not wish to understand is that the mere, violent restriction of free human action in any social area, especially that of the factors or means of production, is enough to keep the market, which is the quintessential social institution, from functioning in a coordinated manner and from generating the practical information necessary for economic calculation. In short, what “market socialists” fail to comprehend is that systematic violence cannot be employed with impunity against the very essence of our humanness: our capacity to act freely in any particular set of circumstances, at any time and in any place.

At least “market socialists” have not comprehended this until recently, for Brus and Laski (who have described themselves as “ex-naïve reformers” and who for many years defended “market socialism”), following Temkin, have endorsed these words written by Mises: “What these neosocialists suggest is really paradoxical. They want to abolish private control of the means of production, market exchange, market prices and competition. But at the same time they want to organize the socialist utopia in such a way that people could act as if these things were still present. They want people to play market as children play war, railroad, or school. They do not comprehend how such childish play differs from the real thing it tries to imitate ... *A socialist system with a market and market prices is as self-contradictory as is the notion of a triangular square.*” More recently, following Mises’s example, Anthony de Jasay has more

graphically concluded that “market socialism” is “...an open contradiction in terms, much like hot snow, wanton virgin, fat skeleton, round square.”³⁸

One can only fathom why this obsession with “squaring the circle” (which all “market socialism” entails) has been the object of scientific interest and effort if one considers the three following factors: first, the strong, stubborn, political-ideological motivation to avoid abandoning the socialist ideal, for emotional, romantic, ethical, or political reasons; second, the use of the neoclassical equilibrium model, which describes the real functioning of the capitalist market in only a very limited, poor, and confusing manner, and which involves the assumption that all necessary information is available, and thus suggests that a socialist system could operate on the same theoretical premises as the static model; and third, the express renunciation and even condemnation of the theoretical analysis of how human action really functions in environments that lack private ownership of the means of production, under the pretext that considerations about incentives and motivations are “foreign” to the field of economic “theory.”

Some socialist authors, at most, propose the introduction of “bonuses” or “incentives” which clumsily simulate the entrepreneurial profits of the market, yet these authors fail to understand why the managers in a socialist system would not act like the entrepreneurs in a market economy, if these managers receive the generic order to do just that, or to “act in a coordinated manner,” or “for the common good,” etc. (And if economists themselves make this mistake, what can we expect of non-specialists?) These theorists do not understand that general directives, no matter how well-intentioned, are useless when concrete decisions must be made in the face of specific problems which arise at a particular time and in a particular place. They do not comprehend that if all people simply devoted themselves to acting under coercive instructions (both “obvious” and empty) to “work for the common good,” or to “coordinate social processes,” or even to “love thy neighbor,” we would necessarily end up acting in a discoordinated manner, against the common good, and to the grave detriment of neighbors near

³⁸ Włodzimierz Brus and Kazimierz Laski, *From Marx to the Market: Socialism in Search of an Economic System*, 167-168. The quotation is taken from Mises’s *Human Action*, 706-707, 710. Anthony de Jasay’s excerpt comes from *Market Socialism: A Scrutiny. This Square Circle*, 35.

and far. This is because it would be impossible to creatively perceive the different profit opportunities in each set of concrete circumstances and to assess and compare them in light of potential subjective costs.

In contrast, members of the Austrian school have been tirelessly devising and perfecting an alternative paradigm in the field of economic science; they have been developing, in formal, abstract (though non-mathematical) terms, an entire general theory on the behavior of (real, non-mechanical) human action in society and its different implications. A key element in this theory is the very exercise of human action or entrepreneurship, which constantly uncovers new ends and means and generates information which permits rational, decentralized decision-making, and thus, coordination among all human beings, and in turn, the emergence of an extremely complex social network. Theorists from the countries of the former Eastern bloc, in particular, are increasingly studying, commenting on, and popularizing this paradigm, and they view the theoretical works of Mises and Hayek as more relevant, and cite them more, than those of the great western neoclassical theorists, like Samuelson, or even members of the Chicago school, like Friedman. To the extent that this is occurring, it is not surprising that a growing number of former “market socialists” are abandoning their old positions.³⁹ “Market socialism”

³⁹ We must agree with Arthur Seldon that it is surprising that the best-known “market socialists” continue to be socialists at all. In fact, Seldon states: “I cannot therefore see why Nove remains a socialist. That revelation also applies to other market socialists – Ota Sik of Czechoslovakia (now teaching in Switzerland), Brus, the Polish economist (now at Oxford), Kornai of Hungary (now in Budapest), Kolakowski (also at Oxford) and others.” See Brian Crozier and Arthur Seldon, “After a Hundred Years: Time to Bury Socialism,” in *Socialism Explained* (London: The Sherwood Press, 1984), 61. However, in defence of the eminent economists Seldon mentions, we must admit that, from 1984 to the present, practically all of them, with the possible exception of Nove, have ceased to be socialists. Nove may make the definitive transition once he no longer conceives the market in the “perfect competition” terms characteristic of the neoclassical paradigm and, like the other theorists, absorbs more and more of the Austrian theory of market processes. Alec Nove’s best-known book is perhaps *The Economics of Feasible Socialism* (London: Allen and Unwin, 1983). This book is particularly admirable due to its classification of the inefficiencies of socialist systems. Its main defect lies in Nove’s poorly grounded critical analysis of capitalist systems (concerning which he points out problems of income inequality, inflation, a lack of “democracy,” and failure in the area of “externalities”), a result of interpretation errors rooted in the inadequate analytical tools (of neoclassical slant, and focused on equilibrium) Nove uses to interpret the situation in capitalist systems. Hence, we indicated above that as Alec Nove becomes more familiar with the dynamic Austrian theory of entrepreneurial processes, his ideas will most likely take the same direction those of other very distinguished authors, like Kornai and Brus, have already taken. As to the type of socialism Nove proposes (a “feasible” sort, in the sense that he believes it could be established in one human lifetime), he offers nothing new, besides a confused amalgam composed of the nationalization of basic sectors, the focusing of planning on areas where “externalities” exist, the promotion of cooperatives in small and medium-sized industries, and the

has failed as a proposed solution to the problem of socialist economic calculation, both in theory and in repeated attempts at practical reform in the socialist systems of Eastern Europe, and consequently, the very theorists who until recently had defended it are abandoning it in all directions as a model to follow.⁴⁰

boosting of “competition” whenever possible. In Nove’s model, markets are permitted to operate, but within a framework of all sorts of controls. In any case, today Nove’s book is quite outdated, not only because he considered the ideal road toward socialism to be that Hungary embarked on in 1968, but also because he was unable to foresee the significant events which unfolded between 1989 and 1991, and he neglected to answer any of the detailed criticisms of “market socialism” covered in the text. Finally, we should mention that very hopeful signs exist regarding Nove’s “conversion.” In an article he wrote in March 1988 and devoted to examining and commenting on his book, *The Economics of Feasible Socialism* (“‘Feasible Socialism’ Revisited,” chap. 16 of *Studies in Economics and Russia* [London: Macmillan, 1990]), Nove explicitly recognizes the validity of “some” of the “Austrian” criticisms of “market socialism” and the neoclassical paradigm and concludes: “So, there is no harm in admitting that the Kirzner type of criticism hits the target” (p. 237). Nine months later, in December 1988, in his article, “Soviet Reforms and Western Neoclassical Economics” (chap. 17 of *Studies in Economics and Russia*), Nove admits without reservation that “...the Austrians are surely more relevant to Soviet reforms than is the neoclassical paradigm,” and concludes with the following cryptic assertion: “One need not to accept their [the Austrians’] conclusions, but one must take their arguments seriously” (!) (p. 250).

⁴⁰ The extent to which the thinking of Mises and Hayek is pervading even that of former Marxists is clear in articles like Geoff Mulgen’s “The Power of the Weak,” which appeared in the December 1988 edition of *Marxism Today* (perhaps the most prestigious journal of British socialists). In this article, Mulgen states that the institutions socialists have traditionally held most dear (the state, unions, political parties, etc.) are management systems which are rigid, inflexible, centralized, hierarchical, and thus, profoundly *antihuman*. Therefore, following Hayek’s teachings, he leans toward what he calls “weak power systems,” because they waste much less “human energy,” make use of cooperation and competition, are decentralized, can be connected together in a complex system or network, and transmit information efficiently. He believes that in the future, the English Labour Movement should be oriented to these decentralized structures and the market, and the institutions socialists have traditionally defended should be abandoned. Moreover, Mulgen even intuitively understands our fundamental argument against the possibility of using present or future computer capacity to make socialist economic calculation possible (since the decentralized use of any computer capacity would give rise to such a volume and variety of information that the same capacity could not take account of it all in a centralized manner) when he asserts that “Lange was wrong because technology runs up against the context in which information is produced.” Mulgen adds that centralized computer systems distort information, while in contrast, decentralized systems offer incentives to create and transmit information accurately, apart from the fact that entrepreneurs are constantly revolutionizing computer processing and monitoring techniques, while central planners, in the best of cases, invariably lag behind entrepreneurs in this field. In view of this sign of the theoretical dismantling of socialism, it is disheartening that authors like David Miller (*Market, State and Community: Theoretical Foundations of Market Socialism* [Oxford: Clarendon Press, 1989]) are still determined to construct the utopian ideal of “market socialism.” It would be difficult to find anything original in Miller’s contribution, which is based on the coercive establishment of a “competitive” system of cooperatives which the workers would manage “democratically.” Miller is not an economist, nor has he studied the economic calculation debate, and he completely misses the reasons such a system could not work (people are not free to exercise entrepreneurship, because the means of production are not privately owned, and the information necessary to calculate efficiently and to coordinate the entire system is not generated). Nonetheless, Miller is honest enough to declare his skepticism about the possibility that such a system would be at least as efficient as competitive capitalism, and he indicates that therefore, the crucial arguments in favor of his “market socialism” must be of another sort: the greater “justice,” “freedom,” and “democracy” it would provide in the workplace (p. 14). In light of the above, it would be better to debate with such authors in the field of political philosophy or ethical theory, rather than in that of economic science. For a critique of this and other recent attempts to revive “market socialism,” see Anthony de Jasay’s work, *Market*

3. MAURICE H. DOBB AND THE COMPLETE SUPPRESSION OF INDIVIDUAL FREEDOM

We have waited until the end to analyze a position of certain theoretical interest, which from the beginning has had its main proponent in Maurice Dobb. Dobb begins by more or less explicitly recognizing the impossibility of socialist economic calculation, but then he concludes that both this impossibility and the inefficiency it involves are irrelevant. In other words, he decides they constitute a “cost” which must not be taken into account, given that the socialist ideal must be pursued per se, for ethical, ideological, and political reasons, regardless of the results. Hence, supporters of this position label as “hypocritical” or “naïve” those “market socialists” who strive to introduce as many capitalist mechanisms as possible into the socialist system. Defenders of this view wish to call things by their name and avoid deceiving anyone: socialism either means the complete suppression of autonomy and individual freedom, or it is not socialism.⁴¹

What these theorists desire, in the purest socialist tradition, is to forcibly impose upon all people their own particular view of the way the world should be. Furthermore, these theorists have realized that the clumsy, partial imitation in a socialist system of elements characteristic of a market economy, far from alleviating the economic calculation problem, makes it much more obvious and difficult. In fact, if decentralized decision-making is permitted at a certain level, the problem posed by the impossibility of centralizing dispersed knowledge manifests itself much more clearly and intensely, and thus, gives the impression that the problems of social coordination have worsened (if this is not actually the case). In contrast, if all freedoms (including consumers’ freedom of choice and workers’ freedom of choice regarding jobs) are suppressed, and economic agents are forcibly prevented from making any other type of autonomous decision, and a unified plan for all social spheres is imposed from

Socialism: A Scrutiny. This Square Circle. See also footnote 4 of chapter 6 of this book. Also of interest, in German, is Martin Feucht’s book, *Theorie des Konkurrenz-sozialismus* (Stuttgart: G. Fischer, 1983).

⁴¹ In the words of Maurice H. Dobb himself: “Either planning means overriding the autonomy of separate decisions, or it apparently means nothing at all.” See the chapter entitled, “Economic Law in the

above, then although the problem of socialist economic calculation, as we know, cannot be solved, it becomes largely hidden, and the degree of social “coordination” and “adjustment” appears to be much greater.⁴²

Let us imagine a “society” which functions at mere subsistence level and rests on simple economic relationships imposed completely from above by force and by the actual elimination of those who oppose the “regime.” We can even suppose that the brutal dictator would be assisted by the strongest computer in his task of supervising compliance with his instructions. Under these circumstances, economic calculation appears considerably more straightforward: people would do what the dictator ordered; he would choose the production combinations; and everyone else would simply obey, like slaves, and follow the instructions received from above. As Mises has plainly shown,⁴³ even under these extreme conditions, which are the most “favorable” conceivable in terms of the feasibility of socialist economic calculation, it is clear that the problem calculation poses in such a system could not be resolved, since the dictator would still lack a rational guide for making decisions. In other words, he would never know if his pre-established ends could be achieved in a more suitable, expedient manner via different combinations of factors and products or different decisions. However, *if the dictator does not care*; that is, if this type of socialism not only eliminates consumers’ freedom to choose between consumer goods and services, workers’ freedom to choose between jobs, and private ownership of the means of production, but it also (implicitly or explicitly) is

Socialist Economy,” in *Political Economy and Capitalism: Some Essays in Economic Tradition* (London: Routledge and Kegan Paul, 1937), 279.

⁴² Paul M. Sweezy holds that to attempt to introduce decentralization into a socialist system would only serve to replicate there “...some of the worst features of capitalism and fail to take advantage of the constructive possibilities of economic planning.” See Paul M. Sweezy, *Socialism* (New York: McGraw-Hill, 1949), 233. Thus, what Sweezy has in mind is a system of total planning, including concrete directives to the managers of the different industries regarding how they should carry out the corresponding sectoral and entrepreneurial plans. To Sweezy, all planning theory is based on political decisions (i.e. on the forcible imposition of the dictator’s criteria). He fails to grasp the problem (of arbitrary decision-making) economic calculation poses in a socialist system, and in practice, it makes no difference to him, since he believes that once the objectives of the plan have been established, the quantity and quality of the corresponding factors of production will be “automatically” determined by the planners and will be forcibly imposed on the different sectors and companies. See the comments on Sweezy’s position in “The Theory of Planning according to Sweezy,” in *Socialism and International Economic Order*, by Elisabeth L. Tamedly (Caldwell, Idaho: The Caxton Printers, 1969), 143-145.

⁴³ Ludwig von Mises, *Human Action*, 695-701.

meant to have no economic purpose, or efficiency is viewed as an irrelevant concession to the conservation of the system itself, then the economic calculation problem could be deemed “solved,” though not by making calculation possible, but instead by the contrived alternative of defining “calculation” as precisely no calculation at all, and as the constant imposition of the dictator’s capricious desires on everyone else.

It is not surprising that the theorists of this school, who view competition and socialist central planning as radically incompatible, have been particularly critical when judging so-called “market socialism.” Thus, the curious debate which arose between Maurice Dobb and the “market socialists,” especially Abba P. Lerner.⁴⁴ Curiously, Dobb agrees on this point with the theorists of the Austrian school, and he even ironically criticizes market socialists’ use of the general equilibrium model and, within the neoclassical paradigm, their assumption that so many “similarities” exist between the capitalist and socialist systems that no formal difference exists between them. Dobb does not see the problem in terms of neoclassical equilibrium analysis; for him, it hinges on the radical differences between the “institutions” of the socialist system and those of the capitalist system, and specifically, on the fact that socialism involves the forcible abolition of all the institutions characteristic of the capitalist system.⁴⁵ Dobb even highlights the fundamental ambiguity of the “solutions” proposed by “market socialists,” who seek to reconcile the irreconcilable, and, depending upon their best interest, their current

⁴⁴ The main articles of Maurice Dobb concerning this debate are: “Economic Theory and the Problems of a Socialist Economy,” *Economic Journal*, no. 43 (1933): 588-598; and “Economic Theory and Socialist Economy: A Reply,” *Review of Economic Studies*, no. 2 (1935): 144-151. These articles and other relevant contributions were compiled in the book, *On Economic Theory and Socialism: Collected Papers* (London: Routledge and Kegan Paul, 1955).

⁴⁵ In the words of Dobb himself: “Naturally, if matters are formulated in a sufficiently formal way, the ‘similarities’ between one economic system and another will be paramount and the contrasting ‘differences’ will disappear. It is the fashion in economic theory today for propositions to be cast in such a formal mould, and so devoid of realistic content, that essential differences disappear. The distinctive qualities of the laws of a socialist economy and of a capitalist economy ... are not, of course, given in the rules of algebra, but in assumptions depending on differences existing in the real world.” See “Economic Theory and Socialist Economy: A Reply,” 144-145. Moreover, it is interesting to note that Dobb himself admits that he initially believed the problem of economic calculation in a socialist system could be resolved through a procedure similar to that Dickinson proposes, but that later, upon perceiving the consequences which would result for the socialist system, he abandoned his initial position. Indeed, in his 1933 article, he criticizes Dickinson’s model as “static” in words Hayek himself could have written. In fact, Dobb asserts that to attempt to apply the postulates of static equilibrium to a world in constant flux is a “barren feat of abstraction;” and that economics is much more than “a formal technique..., a

environment, and the type of argument they are considering, emphasize in their models either the characteristics typical of the market or the advantages of socialist planning. Thus, during their debate, Dobb labeled Lerner an “invisible opponent,” since whenever possible, and with great ability, Lerner used the simple and curious dialectical device we have just described to avoid the issues raised.⁴⁶

In short, Dobb argues that the central authority should fix all prices, that these prices should be forcibly imposed at all levels, and that consumer sovereignty and freedom of choice in the workplace should be prevented. If we take into account that this central authority pursues no goal other than to remain in power, the question of whether or not “economic calculation” is possible may seem irrelevant. In this sense, Dobb’s proposal is both less contradictory and more realistic and “honest” than that of many “market socialists.” It is less contradictory and more realistic in the sense that it rests not on the formal analysis of equilibrium, but on the true institutions of socialism, which as we know, are based on systematic and all-encompassing coercion, which corresponds exactly with the political design of the model from the time of its revolutionary beginnings. Dobb’s proposal is more “honest” than that of the “market socialists” in the sense that he does not strive to conceal the true face of socialism, but bases this system plainly and simply on the brutal repression and restriction of free human action.⁴⁷

system of functional equations, a branch of applied mathematics, postulating a formal relationship between certain quantities.” See “Economic Theory and the Problems of a Socialist Economy,” 589.

⁴⁶ To be specific, Dobb remarked that he was “embarrassed by a sense of battling with an invisible opponent.” (See his 1935 “Reply,” p. 144.) Several of Lerner’s comments on the establishment of the price system in a socialist system provide examples of his evasive strategy. In his 1934 article, “Economic Theory and Socialist Economy,” p. 55, he states: “The competitive price system has to be *adapted* to a socialist society. If it is applied *in toto* we have not a socialist but a competitive society.” Nevertheless, shortly afterward, in his “A Rejoinder” (1935, p. 152), Lerner contradicts himself when he asserts: “And by a price system I do mean a price system. Not a mere *a posteriori* juggling with figures by auditors, but prices which will have to be taken into consideration by managers of factories in organizing production.”

⁴⁷ Years later, Dobb modified his position somewhat when he ambiguously introduced a certain level of decentralization and even competition in decision-making. However, Dobb did not formally specify what this slight decentralization would consist of, and from a theoretical standpoint, the position we believe to be of true interest is the one he held in the 1930s, which is the one we have been commenting on and will refer to in the future as “Dobb’s classic model.”

Hoff, in the context of his critical analysis of Dobb's position, offers the following helpful example of it:⁴⁸ He writes that the use of molybdenum in the production of toy swords, or of high quality lenses in elementary-school microscopes would undoubtedly be considered a poor allocation of resources in a society in which the satisfaction of the desires of consumers (or of the dictator himself) mattered, and in which, therefore, such metal and lenses could produce much greater satisfaction (to consumers or to the dictator himself) if they were devoted to other ends. Nevertheless, such an allocation would not be viewed as "inefficient" or "uneconomic" if the goal were, for example, to provide children with the best technical equipment possible, or to favor at any cost the workers who produce the lenses. Hence, we see that illogical and inefficient choices do not appear so if objectives are arbitrarily set in each case, or indeed, if no objectives exist at all. Moreover, as we know, the differences between real and "democratic" socialism are inevitably just a matter of degree, not of kind, and therefore, this arbitrary behavior is not exclusive to the most extreme socialist societies, but recurs constantly in all of the interventionary measures which are implemented in western countries.⁴⁹

Hayek, for his part, devoted an entire section⁵⁰ of his 1935 article on the state of the debate to a detailed analysis of Maurice Dobb's position, in which he praises Dobb's courage and honesty in explaining the true implications of socialism.⁵¹ However, Hayek wishes to stress

⁴⁸ Trygve J.B. Hoff, *Economic Calculation in the Socialist Society*, chap. 14. The example of the molybdenum swords appears on pp. 278-279.

⁴⁹ Amartya Sen interprets Dobb's true mindset as follows: Dobb deemed equality of the results to be much more important than efficiency (and thus he left issues of efficiency in the background). Sen also mentions that Dobb viewed the coercive planning of investment as much more important than a supposedly perfect microeconomic adjustment. The argument that issues of "efficiency" must be subordinated to those of equality has become common currency among members of the leftist intelligentsia, who have now resigned themselves to the fact that socialism cannot compete with capitalism in terms of the creation of wealth. Nonetheless, the intellectuals who adopt this position forget: 1) that efficiency and ethics are two sides of the same coin, i.e. what is inefficient cannot be just, and nothing is more efficient than morality; 2) that the cost of the egalitarianism they propose is not only widespread poverty, but the most brutal repression of human action; 3) that historical experience teaches that far from reducing inequality, coercion often increases and aggravates it; and 4) that nothing is more unjust, immoral, and unethical than to impose equality by force, since man has a natural, inalienable right to think up new ends and to reap the fruits of his own entrepreneurial creativity. Amartya Sen, "Maurice Herbert Dobb," *The New Palgrave: A Dictionary of Economics*, vol. 1, pp. 910-912.

⁵⁰ "Abrogation of the Sovereignty of Consumers," section 4 of "The Present State of the Debate," *Collectivist Economic Planning*, 214-217.

⁵¹ "Dr. Maurice Dobb has recently followed this to its logical conclusion by asserting that it would be worth the price of abandoning the freedom of the consumer if by the sacrifice socialism could be made possible. This is undoubtedly a very *courageous* step. In the past, socialists have consistently

that for socialist economic calculation to be possible in Dobb's model, not only would consumers' and workers' free choice have to be thwarted, but we would also have to *assume that the socialist dictator lacks any scale of goals for his action*. This is so, because once we suppose that the dictator has a set aim, then we can assert that even in Dobb's model, rational economic calculation would be impossible for the dictator, since he would lack an objective guide to tell him whether or not, when pursuing a certain end with his decisions, he is overlooking other set objectives of greater value to him. In this sense, Hayek once more agrees fully with Mises, who expressly states that the problem of economic calculation requires the dictator to at least have decided what his ends are and their relative importance on his value scale.⁵² If we assume this to be the case, economic calculation becomes impossible, since the dictator would lack a rational guide to indicate whether or not he, by making certain decisions, is neglecting the achievement of ends he values more.⁵³

protested against any suggestion that life under socialism would be like life in a barracks, subject to *regimentation of every detail*. Now Dr. Dobb considers these views as obsolete." See F.A. Hayek, "The Present State of the Debate," in *Collectivist Economic Planning*, 215.

⁵² "We assume that the director has made up his mind with regard to the valuation of ultimate ends." Ludwig von Mises, *Human Action*, 696.

⁵³ In Hayek's own words: "The dictator, who himself ranges in order the different needs of the members of the society according to his views about their merits, has saved himself the trouble of finding out what people really prefer and avoided the *impossible task of combining the individual scales into an agreed common scale which expresses the general ideas of justice*. But if he wants to follow this norm with any degree of rationality or consistency, if he wants to realize what he considers to be the ends of the community, he will have to solve all the problems which we have discussed already." See Hayek, "The Present State of the Debate," in *Collectivist Economic Planning*, 216-217. Thus, incidentally, we see here that as early as 1935, Hayek appears to have made precursory mention of "Arrow's impossibility theorem" when he wrote of the impossible task of combining individual value scales into a common scale which would express general ideals of justice, a scale all would agree on. However, it is certain that Hayek did not attribute this impossibility to reasons of pure logic within a static context in which all necessary information is considered given and subject to predetermined conditions (as in Arrow's theorem), but rather to a much more general and profound cause: individual preferences cannot possibly be formed and transmitted in a non-entrepreneurial context (and this, the essential problem which dispersed, subjective, and inarticulate information poses, lies at the heart of the Austrian criticism of socialist economic calculation). Therefore, the following alternatives exist: first, the socialist dictator could constantly impose his arbitrary wishes on society, without yielding to any pre-established end (as in the arbitrary, anarchical destructionism of Dobb's "classic model"); second, the dictator might first have established his own value scale with its corresponding hierarchy (rational economic calculation would be impossible for the dictator himself); third, the dictator could try to discover the general objectives pursued by the citizenry, according to a scale accepted by all (this is theoretically impossible, given the dispersed nature of knowledge and the strictly subjective and entrepreneurial manner in which it is generated, and Arrow's impossibility theorem would apply as well under static conditions); or fourth, the dictator could establish public ownership of the means of production, yet as far as possible, encourage economic agents to make their decisions in a decentralized way (this would be the solution of "market socialists," and it is theoretically impossible also, because the practical information necessary for rational

Whether economic calculation is impossible because the dictator first decides what his objectives are and rates them in importance, or we artificially maintain that no problem of economic calculation exists, since no end of a certain importance with respect to others is pursued, clearly the allocation of resources in Dobb's model would be purely arbitrary, and the inefficiencies would be of such magnitude that the model amounts to no more than a model of, to use Mises's term, *destructionism*, i.e. the total destruction or annihilation of civilization and the reduction of humanity to a state of almost unimaginable slavery and terror.⁵⁴

It is true that from a strictly economic standpoint,⁵⁵ one cannot judge the determination of an individual to whom the cost of the socialist system does not matter as long as socialism is achieved, and in fact, as we have seen, at the end of his seminal 1920 article, Mises asserts that in this case, his argument against socialist economic calculation will not be taken into account.

economic calculation would not be generated, as entrepreneurship would not be completely free, and profit could not act as an incentive like in a capitalist system).

⁵⁴ Mises sees *destructionism* as the essence of socialism: "Socialism is not the pioneer of a better and finer world, but the spoiler of what thousands of years of civilization have created. It does not build; it destroys. For destruction is the essence of it." (Ludwig von Mises, *Socialism*, 44.) Hence, any attempt at systematic, institutional coercion of free entrepreneurial interaction is truly a crime against humanity, in view of the terrible consequences which invariably follow from such social experiments in the long term. Indeed, all of the great human tragedies of the last century which were not due to natural causes (and even many of these, to the extent that their effects could have been more easily mitigated in some other way) originated directly or indirectly from the often well-intentioned desire to realize the socialist utopia. Obviously, significant *differences of degree* exist with respect to the intensity with which such an ideal may be pursued, but we must never forget that the differences between, for example, the genocide committed by the Soviet state, national socialism, communist China, or Pol Pot against their people, and the destructive consequences (which lead to constant conflict, social violence, and moral corruption) characteristic of "democratic socialism" and the paradoxically named "welfare state," though quite substantial, are differences merely of degree, but not of kind. For the intellectual error and destructionism which lie at the core of "real" socialism and those which constitute the essence of "democratic" or "interventionary" socialism are basically the same. See our related article, "El Fracaso del Estado 'Social,'" *ABC* (Madrid), 8 April 1991, pp. 102-103.

⁵⁵ In addition, Dobb states: "The advantage of the planned economy *per se* consists in removing the uncertainties inherent in a market with diffused and autonomous decisions, or it consists in nothing at all." See Maurice H. Dobb, "Review of Brutzkus and Hayek," *Economic Journal*, no. 45 (1935): 535. This statement of Dobb's fits in perfectly with his dictatorial model of socialism, in which he attempts to dodge the problem of economic calculation via the simple, forcible imposition of the dictator's arbitrary wishes. Indeed, as we saw in chapter 2, one of the essential features of human action is the creative nature of its results, and thus, the future is always uncertain and open to the creative imagination of entrepreneurs. Hence, the only way to get rid of the uncertainty of the future is to forcibly crush people's capacity to freely act. The "advantage" Dobb associates with central planning is based on "eliminating" uncertainty by suppressing free human action, and thus, freezing the future. It is a case of "curing" the supposed sickness by killing the patient. Curiously, Dobb's approach to uncertainty is very similar to that of neoclassical equilibrium economists, who consider it a bothersome "defect" of the market because it does not easily fit into their "models." For example, Kenneth J. Arrow states: "There is one particular *failure* of the price system which I want to stress. I refer to the presence of uncertainty." (See *The Limits of Organization* [New York, 1974], 33.)

Nevertheless, one wonders how many followers of the socialist ideal at the grass-roots or the political level would still be willing to support it if they were aware of its true implications.⁵⁶ We must also ask how far the socialist model can be maintained by the use of force at each specific historical stage and what the possibilities are of keeping a certain country or geographic area isolated from the rest of the world, so that its people do not discover what they are really giving up by allowing themselves to be tricked or deceived by their government's official propaganda. All of these questions are of great interest and relevance, particularly with respect to the estimation, in each historical case, of the possibilities of a democratic or revolutionary conquest of power and of a socialist regime's retaining power. Still, none of the questions detract at all from the soundness of Mises and Hayek's theoretical challenge, which has completely exposed the fact that socialism necessarily involves widespread impoverishment of the masses, because it does not permit calculation in terms of economic efficiency, and also the fact that ultimately, socialism is an impossible system incapable of achieving the glorious ends which, with the purpose of tricking the public, have usually been associated with it, at least until now.

⁵⁶ Let us remember that Oskar Lange, in his *On the Economic Theory of Socialism*, also mentions the possibility of eliminating the "free" market for consumer goods and services, and he asserts that under such circumstances, his system of trial and error and parametric prices would still function perfectly, providing parametric prices were extended not only to production goods and factors, but also to consumer goods and services. In this case, the planning body should also modify prices whenever surpluses or shortages of consumer goods occur in the absence of rationing. (Plainly, this system would not permit economic calculation, for all of the reasons we explained in our analysis of Lange's proposal.) Though in this article Lange indicates that the fact that he discusses the theoretical possibility of eliminating the freedom of consumers does not mean he defends it (as he considers it undemocratic), we already know that at the end of his life he gradually leaned more and more toward the Stalinist solution, in which the desires of consumers are disregarded almost entirely, and the problem of economic calculation is fictitiously reduced to a coercive imposition of the plan at all levels. In German, Herbert Zassenhaus, in his "Über die Ökonomische Theorie der Planwirtschaft," published in vol. 5 of *Zeitschrift für Nationalökonomie* in 1935 (and an English translation, "On the Theory of Economic Planning," *International Economic Papers*, no. 6 [1956]: 88-107), also defends a system of socialist economic calculation based fundamentally on eliminating consumers' freedom of choice and on a mathematical sort of solution in which decentralized competition is maintained at a certain level. Zassenhaus's writings are characterized by a lack of clarity and especially by a lack of realism, since in his view, communities remain constantly static.

4. IN WHAT SENSE IS SOCIALISM IMPOSSIBLE?

In chapter 3, we showed that socialism is an intellectual error because it is theoretically impossible to adjust social behaviors via a system of institutional coercion against free human interaction. In other words, the thesis of this book is that without freedom to exercise entrepreneurship, the information necessary for rational economic calculation (i.e. decision-making which is not arbitrary, since the information relevant in each case is subjectively considered) is not created, nor is it possible for economic agents to learn to discipline their behavior in terms of the needs and circumstances of others (social coordination). This thesis coincides exactly with that of Ludwig von Mises, beginning with his 1920 article. Indeed, for Mises, “rational” indicates decision-making based on the necessary, relevant information, concerning both the ends to be pursued, as well as the means and the expected opportunity costs. Mises demonstrates that only in a competitive environment in which freedom of enterprise and private ownership of the means of production exist is this information gradually and entrepreneurially generated and transmitted. Hence, in the absence of free markets, private ownership of the means of production, and the free exercise of entrepreneurship, information is not generated, and totally arbitrary decisions are made (on either a centralized or a decentralized basis). It is precisely in this way that we should interpret these words of Mises: “As soon as one gives up the conception of the freely established monetary price for goods of a higher order, *rational production becomes completely impossible*. Every step that takes us away from private ownership of the means of production and from the use of money also takes us away from rational economics.”⁵⁷ He also writes, for the reasons noted, that “*socialism is the abolition of rational economy*.”⁵⁸ However, what Mises never asserts, contrary to the partial and

⁵⁷ Ludwig von Mises, “Economic Calculation in the Socialist Commonwealth,” *Collectivist Economic Planning*, 104.

⁵⁸ Ludwig von Mises, “Economic Calculation in the Socialist Commonwealth,” in *Collectivist Economic Planning*, 110. We must admit that Mises presents his thesis in slightly more “extreme” terms in the German edition of his book on *Socialism*. Thus, on p. 197 of the second German edition, published in 1932 and reprinted in 1981 (Munich: Philosophia Verlag), we read: “Der Kapitalismus ist die einzig denkbare und mögliche Gestalt arbeitsteilenden gesellschaftlichen Wirtschaft.” This assertion that “capitalism is the only conceivable form of social economy” is slightly softened in the English translation, where the literal rendering of the above is followed by a phrase we italicize here: “Capitalism is the only conceivable form of social economy *which is appropriate to the fulfilment of the demands*

opportunistic interpretations some of his opponents have placed on his work, is that it is impossible to attempt to realize any utopia, in general, and the socialist system, in particular, through the use of force. Quite the opposite is true: Mises maintains that the theoretical knowledge that it is impossible to perform economic calculation in the socialist system will only make an impression on those who mistakenly believe that this system can achieve a higher degree of efficiency, economic development, and civilization than the capitalist system, but it will not affect those who defend socialism out of envy or for emotional, “ethical,” or “ascetic” reasons. In fact, in 1920, Mises wrote the following: “The knowledge of the fact that rational economic activity is *impossible* in a socialist commonwealth cannot, of course, be used as an argument either for or against socialism. Whoever is prepared himself to enter upon socialism on *ethical* grounds on the supposition that the provision of goods of a lower order for human beings under a system of a common ownership of the means of production is diminished, or whoever is guided by *ascetic* ideals in his desire for socialism, will not allow himself to be influenced in his endeavours by what we have said ... *But he who expects a rational economic system from socialism will be forced to re-examine his views.*”⁵⁹

Hayek maintains, in full agreement with Mises, that it is, in a sense, “possible” to undertake any course of action, no matter how crazy or absurd, and that from this point of view, an attempt may even be made to bring a socialist system into practice, but that from a theoretical perspective, the question of the “impossibility of socialism” focuses merely on whether the socialist course of action is consistent with the objectives it is designed to achieve: specifically, social and economic development which is as coordinated and harmonious as that achieved

which society makes of any economic organization” (p. 194 of the English edition). The English formulation is a bit more precise than the German, though we find that the German version agrees perfectly with what Mises had written earlier in his article on economic calculation, since for Mises, “social economy” means “rational economy.” On p. 117 of the German version, there appears another sentence which is slightly softened in the English translation. In German, we read: “Der Versuch, die Welt sozialistisch zu gestalten, könnte die Zivilisation zertrümmern, er wird aber nie zur Aufrichtung eines sozialistischen Gemeinwesens führen können.” Then, on p. 118 of the English translation, we read: “It would never set up a *successful* socialist community.” The adjective “successful” has been added. Despite these slight variations which appear in the English version as compared to the German version of Mises’s book on *Socialism*, we believe Mises’s idea is perfectly reflected in his 1920 article and that it does not change substantially in his subsequent writings.

through the capitalist system, and if possible, more so. Nevertheless, if the goal is to end “market anarchy” by overcoming the “inefficiencies” of the market through coercion and a centralized, rational economic plan, clearly socialism, as it cannot achieve this objective, is, in the above terms, an *impossibility*. To put it another way, because the socialist system renders *impossible* both rational economic calculation and adjusted behavior among social agents, such a system cannot possibly accomplish the goal of surpassing the capitalist system in coordination and efficiency. Finally, Hayek recognizes that the impossibility of achieving economic efficiency and the general decline in development which inevitably go hand-in-hand with the impossibility of socialist economic calculation may not change the desires of those who continue to support socialism for other (religious, emotional, ethical, or political) reasons, though in this case economic science provides helpful knowledge and a very valuable service even to this second group of people, since it shows them the true *costs* of their political, ethical, or ideological choices and can help them to revise or strengthen them, as the case may be.⁶⁰

At any rate, there is no question that Mises and Hayek’s analysis was a real bombshell for all who, both experts and non-experts in economics, eagerly and naively supported socialism with the idea that it would be a panacea for all social problems and would permit a degree of economic efficiency and development unheard of under capitalism. There is also no question that for most people, the fact that socialism involves widespread impoverishment and a loss of efficiency is a powerful, and in many cases definitive, argument for abandoning socialism as an

⁵⁹ Ludwig von Mises, “Economic Calculation in the Socialist Commonwealth,” *Collectivist Economic Planning*, 130.

⁶⁰ Hayek reproaches Mises for sometimes using the expression “socialism is impossible” when what he really means is that rational economic calculation is impossible in a socialist system. We do not find this reproach wholly justified, in light of certain explicit assertions Mises makes, which we have included in the text. (It is only in his book on *Socialism* that Mises uses some expressions similar to the one Hayek mentions, but if one considers their general context, no doubt exists as to their meaning.) “Many of the objections made at first were really more a quibbling about words caused by the fact that Mises had occasionally used the somewhat loose statement that socialism was impossible, while what he meant was that socialism made rational calculations impossible. Of course any proposed course of action, if the proposal has any meaning at all, is possible in the strict sense of the word, i.e. it may be tried. The question can only be whether it will lead to the expected results, that is whether the proposed course of action is consistent with the aims which it is intended to serve.” F.A. Hayek, “Nature and History of the Problem,” *Collectivist Economic Planning*, 36. Curiously, nowadays, when revolutionary changes in the countries of the former Eastern bloc have done away with socialism, the general expression “socialism is impossible” has gained widespread colloquial usage.

ideal. Nonetheless, we cannot ignore the fact that as an ideal, socialism has an important ethical, and even “religious,” component, and therefore, we must approach it from the perspective of social ethics. For this reason, more and more research efforts are being dedicated to the analysis of whether or not socialism is an ethically admissible system, regardless of the theoretical problems of economic efficiency we have already described. In fact, from the standpoint of at least one of the areas of social ethics which have been analyzed (that of natural law), there are potent reasons to believe that the socialist ideal is radically contrary to the nature of man (and this appears inevitable, since socialism is based on the exercise of violence and systematic coercion against the most intimate and essential characteristic of human beings: their capacity to freely act). Based on this argument, the socialist system would be not only theoretically unsound, but also ethically inadmissible (i.e. immoral and unjust), and hence, “in the long run,” it would be impossible to implement consistently and would be inexorably condemned to failure because it contradicts human nature. From this perspective, science and ethics are simply two sides of the same coin, and a consistent order exists in the world, in which the conclusions reached in different fields, scientific, historical-evolutionary, and ethical, invariably tend to converge.⁶¹

⁶¹ On this topic, we must mention, particularly, the contributions made in the field of social ethics by Israel M. Kirzner (*Discovery, Capitalism and Distributive Justice* [London: Basil Blackwell, 1989]) and Hans-Hermann Hoppe (*A Theory of Capitalism and Socialism* [Holland: Kluwer Academic Publishers, 1989]). Both authors (to whose works we should perhaps add Robert Nozick’s slightly outdated, though still very notable book, *Anarchy, State and Utopia* [New York: Basic Books, 1974]) reveal that socialism is not only theoretically impossible, but also ethically inadmissible. Kirzner bases this conclusion on the stimulating theory that every person has a natural right to reap the fruits of his own entrepreneurial creativity, and Hoppe bases it on the Habermasian axiom that argumentation with another human being always means the acceptance and implicit recognition of the individuality of “the other I” and of his ownership rights to his being, thoughts, and accomplishments, and from this axiom, Hoppe logically deduces an entire theory of property rights and capitalism. On our theory of the *three* different but complementary *levels* on which to study social reality (theoretical, historical-evolutionary, and ethical), see our introduction to volume 1 of F.A. Hayek’s *Obras Completas* (Madrid: Unión Editorial, 1990), 23-24. The immorality of socialism can be understood in different ways, depending upon the level considered. In other words, socialism is immoral in at least three different senses. First, from a theoretical standpoint, socialism is immoral, since, as a social system, it prevents the generation of information the system itself needs in order to achieve its chosen ends. Second, from an evolutionary perspective, there is nothing more immoral than socialism, as it consists of a constructivist utopia which disregards the value of traditional laws and customs (*mos-moris*, custom). Third, from an ethical viewpoint, socialism is an assault on the most essential principle of human nature: man’s capacity to act freely and creatively, and to reap the fruits of his entrepreneurial creativity.

If economic science shows that rational economic calculation is impossible in the socialist system, and if the theoretical analysis of social ethics shows that socialism is also impossible because it contradicts human nature, then what conclusions can be drawn from a historical-interpretative study of socialist experiences up to this point? The task is to clarify whether or not the historical events which have taken place in socialist countries fit in with Mises and Hayek's theoretical analysis of socialism. According to this analysis, what we can expect from the introduction of a socialist system, in which people are not free to exercise entrepreneurship, and precisely to the extent that this freedom is restricted, is a widespread poor allocation of resources and productive factors, in the sense that certain lines of production will be expanded excessively, to the detriment of others which provide goods and services the population may need more. Also, there will be an excessive focus on certain projects, and the only justification offered will be strictly of a technical or technological nature, and such projects will be launched without consideration for the costs they involve. Paradoxically, this uncontrolled tendency to implement projects for strictly "technical" reasons will preclude the generalized introduction of new and economically more advantageous technologies and production methods which could be discovered and actually tried in the presence of complete freedom to exercise entrepreneurship.⁶² In short, the arbitrary low interest rate will lead to

⁶² Hoff has stressed that any tendency away from entrepreneurship and toward socialism gives greater prominence at all social levels, both explicitly and implicitly, to the technical mentality characteristic of an engineer. Once we eliminate considerations of entrepreneurial profit and cost, it is almost inevitable to attach disproportionate importance to "technical" considerations. This phenomenon occurs not only at the level of the different industries and sectors, but also at the general level of society as a whole. Indeed, socialist politicians and officials inexorably end up believing they are extraordinary "social engineers" capable of adjusting society at will and introducing the "change" necessary to reach increasing levels of economic and social development. Hoff concludes: "A product which is technically perfect is ex-hypothesi ideal for its purpose from the technical point of view: it gives joy to the engineers and technical experts and can even give laymen aesthetic pleasure, but it must be insisted that the production of a technically perfect article is economically irrational and an economic misuse of labour and material, if this would have satisfied more needs had they been used for another purpose." Hoff, *Economic Calculation in the Socialist Society*, p. 141 (last sentence of footnote 8). Paradoxically, the attempt to introduce the latest technological innovations in each sector of production without giving the necessary consideration to cost will eventually delay the technological development of society, since the technological innovations which would be truly advantageous to it (those which would be discovered and introduced entrepreneurially) are not discovered and cannot be applied at the appropriate time and place. For his part, D.T. Armentano insists that the socialist planner cannot possibly know which project is more economical and efficient, and thus, his decisions will tend to be discoordinated, both intra- and intertemporally, whether or not he tries to justify or "dress up" his decision with technical considerations. Referring to Mises's famous example of the socialist manager who must choose between the construction

excessive investment in the most capital-intensive industries, to the detriment of consumer goods and services. In general, irrationality and social discoordination will extend to all levels, and therefore, other things being equal, the same amount of effort and social support will result in a much lower standard of living and in far fewer and lower quality consumer goods and services in a socialist system than in a capitalist system. In other words, other things being equal, the socialist system can only approach the capitalist system by incurring much higher, and even unnecessary and completely disproportionate, costs to people, the environment, and, in general, all of the productive factors.

Though this is not the place to carry out an in-depth analysis of the historical experiences provided by socialist systems, at this point we can mention that the historical interpretation of such events illustrates and agrees fully with the *a priori* conclusions of the economic theory of socialism as Mises and Hayek developed it. In fact, socialist governments have proven incapable of rationally coordinating their economic and social decisions, of maintaining a minimum degree of adjustment and efficiency,⁶³ of satisfying citizens' desire for consumer goods and services, and of fostering the economic, technological, and cultural development of their societies. Indeed, the distortions and contradictions of the socialist systems of the former Eastern bloc became so obvious to most of the population that the popular clamor for the abandonment of socialism and the reintroduction of capitalism was unbearable for the former regimes, which collapsed one after the other. In this sense, the fall of socialism in Eastern bloc countries must indeed be viewed as a great scientific triumph and an illustration, without precedent in the history of social science, of the theoretical analysis of socialism which members of the Austrian school of economics have been developing since the 1920s. Nevertheless, now that we have pointed out the credit which the above historical events brought

of a power plant which uses oil and another which uses nuclear energy, he concludes that "if and when the power plant is built at a particular point with particular resources, it will represent an 'arbitrary' and not an economic decision," since the information about prices and costs which in a free, entrepreneurially driven market would be spontaneously generated is not available. See "Resource Allocation Problems under Socialism," in *Theory of Economic Systems: Capitalism, Socialism, Corporation*, ed. William P. Snavely (Columbus, Ohio: Merrill, 1969), 133-134.

⁶³ Logically, we do not conceive of "efficiency" in Paretian maximization terms, but as an attribute of entrepreneurial coordination within creative environments where uncertainty is present.

to the arguments of Ludwig von Mises and the satisfaction they offered Hayek, the other Austrian economists, and few others, we must add that because the Austrian theoretical analysis showed *a priori* that socialism could not work, since it rests on an intellectual error, and that socialism would necessarily cause all sorts of social maladjustments and distortions, it is a terrible tragedy that millions of people had to endure so many years of unspeakable suffering to demonstrate historically something which from the beginning, the theoretical contributions of the Austrian school indicated would inevitably occur. Particular responsibility for this human suffering belongs not only to most members of the scientific community itself, who negligently overlooked and even fraudulently *concealed* the content of the Austrian analysis of socialism, but also to a clumsy and antiquated, though still predominant, positivism, according to which, experience *alone*, regardless of any theory, would be capable of revealing the survival possibilities of any social system.⁶⁴ With the glorious exception of Mises, Hayek, the rest of their school, and few others, the near entirety of the social science community betrayed humanity, as its members failed, at the very least, to fulfill their vital scientific duty to notify and warn citizens about the dangers which derive from the socialist ideal. Therefore, it is essential that we make a very healthy and educational *acknowledgement* of scientific accountability, which, before the citizenry and in view of the future of the history of economic thought, situates each theorist in his rightful place, regardless of the fame, name, or popularity he may have acquired at other times and in other contexts.

Some words of caution are necessary regarding our comments on the historical interpretation of socialist experiences. This is because, unlike many “positivist” theorists, we do not assume or believe empirical evidence alone suffices to confirm or refute a scientific theory in the field of economics. We have deliberately asserted that historical studies

⁶⁴ For example, this clumsy “positivist scientism” amounts to an obsession and pervades the American educational system and academic world in general, and all contributions of the Chicago school, in particular, including those of one of its most prominent members, George Stigler, who feels that both parties to the debate failed to perceive the “empirical” consequences of their respective positions and that only “empirical evidence” can resolve the existing differences between the defenders of capitalism and socialism. (*The Citizen and the State* [Chicago: University of Chicago Press, 1975], 1-13.) See the excellent criticism of Stigler’s position Norman P. Barry voices in his “The Economics and Philosophy of Socialism,” *Il Politico* (University of Pavia) year 49, no. 4 (1984): 573-592.

“illustrate” and “agree” with the theoretical conclusions, but not that they “confirm” or “demonstrate the validity” of such conclusions.⁶⁵ Actually, though we will not reproduce here the analysis of the logical inadequacies of “positivist methodology,”⁶⁶ it is clear that experience in the social world is always historical, that is, it is always associated with highly complex events in which innumerable “variables” operate and cannot be directly observed, but only interpreted in light of a prior theory. Also, the interpretation of historical events will vary depending upon the theory, so it becomes crucial to establish beforehand, by methodological procedures other than positivist ones, theories which permit an accurate interpretation of reality. Hence, indisputable historical evidence does not exist, much less evidence which proves or disproves a theory. Furthermore, even if the opposite were true, the theoretical discussion in general, and the discussion about socialism in particular, lead to extremely valuable conclusions, which, had they been taken into account in time, would have avoided, as we have already mentioned, not only decades and decades of unsuccessful efforts, but also numerous conflicts of all sorts and an unspeakable amount of human suffering. Therefore, to *wait* for history to “confirm” whether or not an economic system is feasible is not only a logical

⁶⁵ See the interesting observations Fritz Machlup makes in “Testing versus Illustrating,” in *The Economics of Information and Human Capital*, vol. 3 of *Knowledge: Its Creation, Distribution and Economic Significance*, 231-232.

⁶⁶ A summary of the critical analysis of positivist methodology and of the most relevant writings appears in our article, “Método y Crisis en la Ciencia Económica,” *Hacienda Pública Española*, no. 74 (1982): 33-48, reprinted in vol. 1 of our *Lecturas de Economía Política* (Madrid: Unión Editorial, 1986), 11-33. The methodological ideas of the Austrian school were refined as the debate on socialist economic calculation progressed, and the complete formulation of the criticism of positivist methodology can be considered one of the most valuable by-products of this debate, since for precisely the same reasons that socialism is an intellectual error (the impossibility of acquiring the necessary practical information in a centralized manner), in economics it is not possible to directly observe empirical events, nor to empirically verify any theory, nor, in short, to make specific predictions, as to time and place, concerning future events. This is because the object of research in economics comprises the ideas and knowledge human beings have and create about what they do, and this information is in constant flux, is highly complex, and cannot be measured, observed, nor acquired by a scientist (nor a central planning bureau). If it were possible to measure social events and empirically confirm economic theories, socialism would be possible, and vice versa: socialism is impossible for the same reasons positivist methodology is inapplicable. Thus, given their “spiritual” nature, the “events” of social reality can only be interpreted historically, which always requires a prior theory. On these fascinating points, see the thirty-three bibliographical references which accompany our article, “Método,” cited above, and especially, Mises’s *Theory and History* (Yale: Yale University Press, 1957), and Hayek’s “The Facts of the Social Sciences,” in *Individualism and Economic Order*, 57-76, and *The Counter-Revolution of Science* (Glencoe, Illinois: Free Press, 1952), an excellent reprint of which appeared in 1979 (Indianapolis: Liberty Press). A helpful, dispassionate explanation of the Austrian methodological paradigm appears in Bruce Caldwell,

impracticality, since history cannot confirm nor refute any theory, but it also involves the absurdity of foregoing *a priori* the teachings of accurate theories developed outside of experience, and furthermore, it invites the trial of any absurdity or utopia, with disproportionate human costs,⁶⁷ on the pretext of permitting the analysis of the corresponding “experimental results.”

The above comments were necessary, because although at the time of this initial writing (1990-1991), the collapse of the socialist systems in Eastern European countries and the trends reflected there over recent decades do, in general, fully confirm the “predictions” which could be inferred from Mises and Hayek’s teachings on socialism, this has not always been the case,⁶⁸ and in certain historical periods, there has even been a widespread belief to the contrary, i.e. that the course of events in Eastern European countries clearly “refuted” the theory of the impossibility of socialism as formulated by the Austrians. Moreover, occasionally it has been written that even Hayek⁶⁹ and Robbins,⁷⁰ in view of the practical functioning of socialism in the

Beyond Positivism: Economic Methodology in the Twentieth Century (London: George Allen and Unwin, 1982), esp. pp. 117-138.

⁶⁷ Mises stresses that the teachings of Soviet experience do not suffice to establish any theoretical argument regarding socialism, and he concludes that “the fallacies implied in a system of abstract reasoning – such as socialism is – cannot be smashed otherwise than by abstract reasoning.” *Socialism*, 535.

⁶⁸ The popular interpretation of historical events has, on occasion, been comparatively “easier.” Such was the case, for example, with the obvious failures of the poorly named “war communism,” failures which obliged Lenin to adopt the “New Political Economy” in 1921. The historical events of recent years, which culminated in the collapse of all of the communist regimes in the countries of the former Eastern bloc, also suggest an obvious interpretation. Perhaps the task of interpreting historical events is more complicated in other periods, however, even in such instances, careful study invariably confirms the theses of the theory on the impossibility of socialist economic calculation. On this point, see, for example, the section entitled, “Does Russia Refute Mises?” included in David Ramsay Steel’s article, “The Failure of Bolshevism and its Aftermath,” *Journal of Libertarian Studies* 5, no. 1 (winter 1981): 105-106.

⁶⁹ To Hayek, this version is nothing but a “scandalous misrepresentation” of the facts (see footnote 25, chap. 5), and a particularly clear one if we consider that the comments his critics use to justify the above “withdrawal” are comments Hayek made not only in passing, but also with the obvious aim of maintaining the traditional academic courtesy he has always demonstrated, by allowing his opponents, at least on paper, to avoid total defeat. It is in this sense that we must interpret not only the observations which appear on p. 187 of *Individualism and Economic Order*, but also those on pp. 238 and 242 of the article on the “Present State of the Debate” (*Collectivist Economic Planning*), in which we read: “But while this makes it illegitimate to say that these proposals are impossible in any absolute sense, it remains not the less true that these very serious obstacles to the achievement of the desired end exist and that there seems to be no way in which they can be overcome...” (p. 238.) “No one would want to exclude every possibility that a solution may yet be found. But in our present state of knowledge serious doubt must remain whether such solution can be found” (p. 242.) Hence, it is not surprising that over forty years after the most significant part of the economic calculation debate, Hayek, in his 1982 article, was not capable of maintaining his typical patience and courtesy with his intellectual opponents,

Soviet Union, abandoned Mises's extreme position and took refuge in a "second line of defense" which consisted of the assertion that although socialism could "work" (i.e. that it was not "impossible"), in practice it would necessarily pose severe problems of inefficiency. As we already know, this interpretation is completely erroneous, since neither Mises nor Hayek withdrew at any time to a "second line of defense." On the contrary, they always believed events in the Soviet Union fully confirmed the Misesian theory of socialism, even in those historical periods in which the failures and inadequacies of the socialist system were better concealed and less obvious.⁷¹

5. FINAL CONCLUSIONS

In light of all that has been said about the debate on socialist economic calculation, we can conclude that none of the socialist theorists was capable of satisfactorily answering the challenge Mises and Hayek posed. In most instances, they did not even manage to grasp the true meaning of this challenge. They moved in the context of the neoclassical-Walrasian

who continued to place gross misinterpretations on his supposed "withdrawal" to a "second line of defense." Hayek himself expressly recognized that his expressions of courtesy and gentlemanlike behavior were used by opponents with little scientific honesty, and that he would not have repeated the error of risking misunderstandings for the sake of good academic manners: "I might, perhaps, also add that J.A. Schumpeter then accused me with respect to that book of 'politeness to a fault' because I 'hardly ever attributed to opponents anything beyond intellectual error.' I mention this as an apology in the case that, on encountering the same empty phrases more than 30 years later, I should not be able to command quite the same patience and forbearance." See "The New Confusion about Planning," chap. 14 of *New Studies in Philosophy, Politics, Economics and the History of Ideas*, 235.

⁷⁰ There is no legitimate basis for a belief that Robbins, in any sense, withdrew to a "second line of defense" when faced with the practical evidence. On the contrary, not only does Robbins explicitly recognize (footnote 1, p. 148 of *The Great Depression*) that his argument very closely follows the one Mises develops in his book on *Socialism* (to the English translation of which Robbins actually made a large contribution, as he prepared an initial draft of some of the most important parts and then handed his draft over to his friend, J. Kahane, for the definitive writing), but also, nearly forty years later, when the then Lord Robbins wrote his autobiography, he explicitly stuck to his opinion and recognized the validity of Mises's argument on the impossibility of socialist economic calculation, as originally formulated in 1920. In the words of Robbins himself: "Mises' main contentions that without a price system of some sort, a complex collectivist society is without the necessary guidance and that, within the general framework of such a society, attempts to institute price systems which have meaning and incentive in a dynamic context are liable to conflict with the main intention of collectivism – these still seem to me to be true and to be borne out by the whole history of totalitarian societies since they were propounded." See Lionel Robbins, *Autobiography of an Economist* (London: Macmillan, 1971), 107. See also *Political Economy, Past and Present* (New York: Columbia University Press), 135-150.

⁷¹ Such considerable fluctuations in the level of difficulty involved in interpreting events from experience also occur, and even more dramatically, in the case of the effects which the interventionism

paradigm, and they used analytical tools which greatly hindered their understanding of the true problems which arise in a system in which private ownership of the means of production is absent, as is freedom to exercise entrepreneurship. Also, the shift (which sprang, in turn, from the above situation) toward problems of statics kept them from perceiving and examining the true problems involved, and it produced the false sense that these problems had been “theoretically resolved.” Consequently, the true theoretical challenge Mises and Hayek issued went unanswered, and it has yet to be satisfactorily answered even today, as socialist theorists themselves have increasingly begun to acknowledge. Moreover, the unfolding of social, economic, and political events throughout the twentieth century has fully confirmed the theoretical contributions of Mises and Hayek on the theory of socialism, although most economists from western countries still hold that the debate was concluded and settled in the early 1940s. From that time on, different lines of research have been pursued, both in “comparative systems,” and in the theory of the “reform of socialist systems” and the development of planometrics. Nevertheless, this research has been marred by a near total ignorance of the theoretical problems Mises and Hayek analyzed in the course of the debate, and this ignorance has largely contributed to the fruitlessness and failure of all of these lines of research.

On the Austrian side, not only the theorists originally involved in the debate (mainly Mises and Hayek), but also a growing number of young economists, have continued to develop a highly productive set of theories the scientific origin of which can be traced to the debate. In this sense, a multitude of scientific consequences have followed from the debate, which has proved highly fruitful for economic science, and thus it is particularly important to analyze the different areas of economics which have already been enriched by contributions originally intuited or developed as a result of the debate on socialist economic calculation. We have already cited most of these young authors at different points in this book, whenever their

and social democracy of western countries exert, and therefore, in these contexts, the assistance of theory is, if possible, even more essential than in the case of so-called “real” socialism.

contributions have been relevant, though we will have to leave a more profound and detailed study of their work for another time.

The current situation, which has undoubtedly emerged from the historical events witnessed recently by the world with the collapse of the socialist regimes in the countries of Eastern Europe, is giving rise to a generalized rethinking of the “traditional” version of the debate, along the main lines of argument presented in this book. A highly significant role in this rethinking process is being played not only by an increasing number of western economists, but also by most of the scholars who until recently were considered the top theorists in socialist countries. We hope that if this research trend in the field of the history of economic thought continues, a widespread consensus will soon be reached concerning the need to modify the assessment and conclusions which until now have prevailed regarding the “socialist economic calculation debate.” If so, we will consider it a great honor and source of satisfaction to have contributed our own small grain of sand to the destruction of what has simply been another pernicious, unjustified myth of economic science.