

**MARKET VERSUS PLAN**  
**THE INTER-WAR SOCIALIST**  
**CALCULATION DEBATE**

**By Mick Brooks**

First the development of the socialist calculation debate is outlined. It is asserted that the challenge by Mises and his supporters as to the viability of a planned economy was adequately answered by the socialists in the neoclassical terms in which it was presented to them. The 'market socialist' reply, however, raised real problems of its own. Criticisms of these socialist solutions converged from right and left.

The nature of economic rationality originally raised by Mises is then discussed. It is emphasised that the rationality derived from neo-classical concepts is capitalist rationality.

Questions relating to the nature of economic thought are taken up. It is argued that neo-classical economics is a system of tautologies derived from market economies and is therefore incapable of being used to assess a planned economy.

The limits to the neo-classical theory of value and costs are then stressed. Finally instances of market failure are referred to. What is important is to discuss how far such 'waste', widely

recognised in standard discussions of welfare economics, is  
inherent in economic activity or specific to a market economy.

## Introduction

This is an analytical history of a debate which raised fundamental questions of economic theory. The issues raised have once again become topical. Apart from the revival of the socialist calculation debate in labour movement circles over recent years, during the course of writing the 'crisis of the planned economies' has become a hot news item. The question is approached here from the standpoint of classical marxism.

After outlining the history of the debate, the issues raised during its course are then taken up. It is not possible of course to discuss all the views put forward during the inter-war period and since on questions which are quite fundamental to economics. We intend to concentrate particularly on the proposals of the Austrian strand of neo-classical economics which was both dominant on the anti-socialist side and most conscious of its own political implications. As Lavoie (1985: 6) correctly points out "most histories of thought treat the Austrian tradition of economics as a branch of neo-classical economics parallel to the Marshallian and Walrasian branches, and it seems that this was the view of the Austrian economists themselves at the time of the debate". As we shall see, the debate accelerated the process of differentiation between the Austrian school and the neo-classical mainstream.

Lavoie's book opens with the statement that "the socialist calculation debate is widely acknowledged to have been the most

important theoretical controversy in the field of comparative economics". (ibid p1). Taking part in the debate shaped the subsequent patterns of thought and preoccupations of the participants and of economics generally into the post-war period.

### Dramatis personae

The problems of economic calculation in a socialist community were first brought to international notice in 1920 by Mises, an outstanding representative of the Austrian school.

Mises' attack was based on a discussion already taking place in German on the feasibility of a planned economy. Among others who contributed on the anti-socialist side was Max Weber. The English language debate was more sharply formulated as a result, and provides ample scope to discuss the issues which arose. Mises' critique of socialism implied that a planned economy would necessarily slide into chaos. We can surmise that his 1920 essay was influenced by the view then general in the West that the Soviet Union under War Communism was on the point of collapse or capitalist restoration. He intended to dance on its grave. This is also Lavoie's interpretation. (ibid p4).

The perspective before Hayek in 1935 was rather different. Capitalism had gone into its deepest crisis ever, while Stalin's Russia under the Five Year Plans seemed to be surging ahead. Hayek, a follower of Mises and an outstanding theorist in his own right, was able to apply the same approach to this new situation and to develop the arguments to deal with its critics.

Building on Mises' basic arguments about the impossibility of rational calculation under socialism and the problem of incentives, Hayek added the issue of complexity of the planning process and the perception of the market as a necessary institution for the dissemination of knowledge.

The socialists who opposed them, with the sole exception of Dobb, did not regard themselves as marxists. They were university trained in neo-classical economics and attempted to apply it to the problems of a planned economy. In fact they represented a new generation of intellectuals, who in Britain were organised in various think tanks around the Labour Party. Durbin and Dickinson were associated with Gaitskell, whose 1931 memorandum on the practicalities of a socialist programme raised all the basic questions which were discussed in their writing. Barbara Wootton's political activity is well known.

Dobb's intervention was quite different. He defended the twists and turns of the line of the Communist International and explicitly offered the Soviet Union as a model for socialist development. Nevertheless, his academic work took him into the labyrinth of welfare economics. As Bergson (1948: 444) remarks: "he makes free use of orthodox value theory in his analysis of socialist resource allocation" and adds "in Dobb's analysis the labour theory is not so much an analytic tool as excess baggage". Schumpeter (1954: 884) commented that Dobb: "cannot be described as marxist as far as economic analysis is concerned". Widely regarded as a supporter of the Bukharin faction, in 1928 Dobb's *Russian Economic Development* defended universal price calculation in a socialist economy. He repudiated this at the time of the

first Five Year Plan. Nevertheless there are consistent themes in his work which differentiate him from the 'market socialists', as we shall call them.

### Aftermath

Increasingly during the debate Hayek retreated into the mists of metaphysics as he developed the anti-socialists' further lines of defence. He began to formulate the argument that the community was incapable of developing a common scale of values. It followed that a plan could only be implemented by the state imposing its own scale upon those of the citizenry. This of course was the theme of the Road to Serfdom (1944).

The other major participants were also affected in their intellectual development by their intervention in the debate. After the war Lange offered his services to Polish stalinism, by which he was undoubtedly changed but which he was perhaps able to influence with some of his pre-war concepts. Dobb continued to work within welfare economics, his work nevertheless reflecting the changes in economic policy and thinking in the Soviet Union.

The most influential assessment of the debate, by Bergson (1948: 412), showed the socialists to have won a splendid victory: "By now it seems generally agreed that the argument on these questions advanced by Mises himself is ....without much force".

Yet the fate of these doctrines is paradoxical. The standard anti-communist economic histories of the Soviet Union by such as

Wiles (1962) and Nove (1970) have uncritically appropriated the critique of Mises and company. In 1983 Nove's *Economics of Feasible Socialism*, an influential book, particularly in Labour Party intellectual circles, unveiled the problems of calculation, of complexity and of incentives as an invincible argument against a planned economy.

### Some definitions and qualifications

The case for a planned economy can be stated very simply. A basic feature of capitalism is that it is an unplanned system of generalised commodity production. Marx (1962: 316) exploited its ironies in the following passage:

"The very same bourgeois mentality which extols the manufacturing division of labour denounces just as loudly every kind of deliberate social control and regulation of the social process of production....It is characteristic that the inspired apologists of the factory system can find nothing worse to say of any proposal for the general organisation of social labour, than that it would transform the whole of society into a factory."

By planned production then we mean that resources are allocated *ex ante*, as happens in a factory, and not found in the market, *ex post*.

This essay should in no sense be regarded as a general discussion on the relative merits of capitalism and socialism,



even in regard to strictly economic matters. Its purpose is much more narrowly conceived. 'Capitalism versus socialism' is a much more broad and general question and cannot be resolved just by comparing the market economy with a plan of production. Clearly there is an overlap, since under capitalism relations between classes appear as market relations. For the sake of simplicity, however, it should be noted that we assume that capitalism is incompatible with planning the economy as a whole (though individual capitalists of course attempt to plan). This assumption was shared by all the participants in the inter-war debate, from both right and left.

It might be asked whether a post-capitalist economy will necessarily be governed by a plan of production. Again, this was the assumption of all the participants in the inter-war debate, though many had different conceptions of what planning was and how it would be undertaken. Though we have differentiated 'plan' from 'socialism', all the debaters who regarded themselves as socialists advocated planning in some form, and were criticised by their opponents for doing so. Therefore we may identify the two terms for shorthand purposes during our description of the debate. This view is qualified somewhat in our discussion of the 'politics of planning'.

We intend to neglect entirely what Marx (1966(2): 15) called the "higher phase of communist society", where each individual gives according to their ability and takes according to their needs. In so far as we deal with a post-capitalist planned economy: "what we have to deal with here is a communist society, not as it has developed on its own foundations, but on the

contrary, just as it emerges from capitalist society; which is therefore, in every respect, economically, morally and intellectually still stamped with the birth marks of the old society from whose womb it comes.

In the debate the socialists accepted Mises' definition of socialism (as against communism) as a society where the predominant means of production are communally owned but there continues to be a labour and a consumer goods market. This seems to derive from Marx's description of the "lower phase of communism" in Critique of the Gotha Programme (1966(2)) - which was later called socialism by Lenin in State and Revolution (1976(1)), and as such passed into usage in the international communist movement. More likely, however, it comes from Kautsky's (1907) pamphlet On the Day after the Social Revolution.

The next preliminary is to discuss whether markets and money will exist under socialism as we have defined it. It is important to understand that this lower phase of communism is not inaugurated by the seizure of state power by the working class. Lenin, to the day of his death, did not refer to the Soviet Union as socialist. And in many of his works (eg. State and Revolution (1976(1)) and Politics in the Era of the Dictatorship of the Proletariat (1976(2)) he refers to an entire "epoch" or "era" between the seizure of state power and entry onto the stage of socialist development. It is necessary to point this out since pro-capitalist critics and those who defend what they call "actually existing socialism" both persist in referring to every post-capitalist society as immediately socialist.

The founding fathers of marxism believed there would not be

commodity production, money and market relations under socialism. Thus, for instance, Engels in *Anti-Duhring* (1959: 427) in the section on 'Socialism': "the useful effects of the various articles of consumption, compared with one another and with the quantities of labour required for their production, will in the end determine the plan. People will be able to manage everything very simply, without the intervention of much vaunted 'value'."

He was emphatic that the law of value regulates only a commodity producing society.

For our part we emphasise that we are discussing post-capitalist societies in transition to socialism where market and plan co-exist. We will not discuss socialism as defined by Lenin here.

Since it is accepted that markets and a plan will exist side by side for a whole period, in what sense are we discussing 'market versus plan'? The participants in the inter-war debate recognised that they were discussing societies with different laws of motion. There would have been no point in debating the question otherwise.

#### Review of the literature. The attack on socialism.

As Joan Robinson has reminded us: "The whole point of utility was to justify *laissez faire*". (1962: 53). It remained for neo-classical economists to marshall their basic assumptions and demonstrate their incompatibility with belief in the

viability of a planned economy. Though Pierson had achieved this in 1902, it was Mises who first brought this line of attack to international notice. The central thrust of his assault was on the question of economic calculation, or in other words on the rationality of a planned economy. His most important work was *Economic Calculation in a Socialist Community* (in Hayek 1935); his larger work *Socialism* (1936) mainly repeated the same arguments on this point. The rest of the latter book was devoted to unoriginal anti-socialist dogmas and prejudices.

The basic premises of his argument are very simple. They were accurately restated by Sweezy in his own book *Socialism* (1949: 223).

"1) under capitalism resources are allocated to various industries and the appropriate means of production are determined through the medium of a price system, which in turn is regulated by the market competition of independent owners of the means of production...

"2) under socialism all means of production are the property of the community as a whole

"3) since therefore there are no independent owners to compete in the market, it follows that there can be no pricing of the means of production under socialism

"4) without prices for the means of production rational economic calculation is impossible

"5) hence, finally, socialism is bound to fail".

Mises begins with a discussion about using labour units as a method of calculation and labour tokens as a means of distribution. He shares this preoccupation with Pierson and the

other early generation of anti-socialist writers. Mises seems to have been polemicising as much against the perspectives for in natura planning of such as Neurath (1919) (inspired by interventionism during the First World War) as against Marx. Mises concludes (1936: 119): "without calculation economic activity is impossible. Since under socialism economic calculation is impossible, under socialism there can be no economic activity in our sense of the word...it would no longer do to speak of rational production. In the absence of criteria of rationality, production could not be consciously economical."

When Mises speaks of "economic calculation" he is harking back to the fundamental notion of opportunity cost. Since resources are scarce, it is necessary to choose between alternatives. Choice depends upon the relative scarcity ('value') of resources. For instance if you intend to get a hole dug, whether you employ one man with a JCB or a whole gang with shovels depends upon the relative cost of labour power and capital. There is no choice which is 'correct' in all circumstances.

Mises concentrated on the need for a common denominator in evaluating costs. This could only be money. He accepted that the value of 'factors' were imputed from that of the final product they contribute to produce, in the neo-classical manner. The nature of value, and particularly the subjective nature of costs is an important underlying issue in the debate. Mises thus responded to the socialist challenge by spelling out what markets do. The debate therefore raised all the underlying theoretical issues as to the nature and object of economics.

Heyek, intervening at a later stage in the debate, had a much more lively awareness of the central issues as they had been debated. Hayek's (1935(1)) introduction to Collectivist Economic Planning, entitled The Nature and History of the Problem is a fuller and more articulate defence of Mises's proposition. He begins with the ends of economic activity. Implicitly he accepts Robbins' (1935: 16) definition of economics as the: "science which studies human behaviour as the relationship between ends and scarce means which have alternative uses." Of course he assumes consumer sovereignty - that the individual chooses their ends. They do so within a framework of given market prices. They do not approach the market with any preconception as to what they want independent of the price of these wants compared with alternatives.

Hayek therefore draws a clear distinction between the activity of an engineer whose end is given and that of an economist.

Economic calculation can also be applied to the means of achieving these ends. Here again we are confronted by alternatives with production methods different with respect to money cost.

Moreover the relative prices of both consumer goods and capital goods are all interdependent. Hayek (1945: 525) therefore feels entitled to refer to the market as a "means-end structure". Each price is dependent upon every other.

In other words though, as Hayek emphasises, the individual is confronted with given prices, these prices change in order to reflect changes in preferences, and these changes gradually

eliminate deviations from equilibrium. This is what Lange (1967: 402) later described as the "feedback principle", comparing it with the servo-mechanism of a computer. Thus the data, as Hayek observes, is continually changing.

The process through which proportionality is established in a market economy is of course the operation of the laws of supply and demand. Hayek finally emphasises the role of supply and demand factors upon prices.

This analysis in effect defines markets as processing "two kinds of information: first, information about what people want; second, information about the economic costs of meeting those wants" - a standard definition from an Economist 'Schools Brief' (11/10/86: 90). The modern emphasis on markets as providing signals owes much to Hayek's work and in particular to the clarification provided by the inter-war debate.

The Austrian approach enables Hayek (1935(2): 209) to marshal some interesting defences of his position: "It follows that the excellence, from a technological point of view, of some parts of the Russian industrial equipment, which most strikes the casual observer and which is commonly regarded as evidence of success, has little significance in so far as the answer to the central question is concerned".

In fact he is able to imply that such technical success is a mark of deep economic irrationality - without of course providing a shred of evidence.

Most notably Hayek's introduction (1935(1): 36-37) modifies Mises' original position on the grounds that: "Mises had originally used the somewhat loose statement that socialism

was impossible, while what he meant was that socialism made rational calculation impossible. Of course any proposed course of action is possible in the strict sense of the word, ie. 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." He goes on: "the real difficulty here is, of course, that for most people the decision on this point will depend on the extent to which the impossibility of rational calculation would lead to a reduction of output in a centrally directed economy compared with that of a competitive system...it must be admitted that there is no simple way to prove how great that difference would be."

The reader may not find this argument against socialism as devastating as Hayek evidently intended it to be.

### Complexity

We see that Hayek is beginning to explore other themes. Though planning is not impossible it is very complicated. The problem of complexity arising from the market as a source of information represents, as Lange (1964: 63) put it: "a second line of defence". Hayek raised the spectre of the solutions of hundreds of thousands of simultaneous equations, Robbins of millions. They were evidently referring back to the work of Barone, a follower of Pareto, who had shown in 1908 that if a



scale of wants, available capital and a productivity of capital coefficient were given, a series of simultaneous equations could simulate the working out of a position of optimum allocation of resources provided by a perfectly competitive market (a 'Pareto optimum'). Barone (1935: 267-) was no socialist, as the concluding remarks of his essay show. He hinted darkly that: "an army of officials would appear" and ended with the bizarre comment that we "cannot talk about organised production and free love". Evidently his essay was conceived as a simple intellectual exercise.

In fact with the exception of Dickinson (1933) none of the socialists who responded to Mises' challenge used this framework. Dickinson specifically repudiated this approach in *Economics of Socialism* (1939) on the grounds that the data would be constantly changing - one of Hayek's favourite points.

Nevertheless Hayek and Robbins continued to belabour the issue. This was despite the fact that Taylor's (1964: 51, 53) pioneering defence of the possibility of socialist planning combined with a free market in labour and consumer goods as early as 1928 had clearly and specifically been based on solution of the problem of factor pricing through trial and error. He describes it as: "the method which consists in trying out a series of hypothetical solutions till one is found which proves a success...A too high valuation of any factor would cause the stock of that factor to show a surplus at the end of the productive period...a too low valuation of any factor in the tables would be certain to cause a deficit in the stock of that factor. Surplus or deficit, one or the other

would result from every wrong valuation of a factor".

### Incentives

The anti-socialists raised as a third string to their bow the question of incentives to managers of nationalised enterprises. Lange (1964: 109) replied: "these public officials must be compared with corporation officials under capitalism and not with private small-scale entrepreneurs. The argument thus loses much of its force. The discussion of this argument belongs to the field of sociology rather than economic theory".

We merely note in passing that Pigou (1937: 101) that doyen of Cambridge economics opined on this issue that: "socialism should be allotted, I think, some more marks than its rival." Certainly Hayek's assertion that the departments of big corporations act towards each other as firms are supposed to do in the market is quite incredible and could only be defended by those like Hayek with an unlimited contempt for empirical enquiry.

It hardly seems necessary to do more than quote Shaw (from a letter to The Times in reply to Mallock) on "the obvious fact that interest is paid mostly to people who could not invent a wheelbarrow much less a locomotive". No more than rustic ignorance is "the notion that the people who are now spending, in weekend hotels, on motor cars or in Switzerland, the Riviera and Algeria the remarkable increase in unearned incomes recently noted, have ever invented

anything, ever directed anything, ever even selected their own investments without the aid of a stockbroker or a solicitor, or even as much as seen the industries from which their incomes derive". (quoted in Dobb 1966: 7).

What lay behind this dismissal of the question of incentives by the socialists of course was the recognition that the development of monopoly capitalism had led to a separation of ownership and control. As far as we have been able to ascertain Hayek never even addressed the growth of monopoly in his voluminous writings - implicitly a powerful critique of the whole Austrian approach. Mises, for instance, was still asserting in 1949 that:

"capitalism is not a managerial system; it is an entrepreneurial system." Nor did Hayek ask himself whether his examples (for instance of the unique knowledge of a tramp steamer skipper) are of more than of marginal significance in a world of great corporations.

#### Review of the Literature. The Socialist Response.

The socialists who picked up the gauntlet thrown down by Mises were working entirely within the canons of welfare economics. They denied that a society of abundance could ever exist (note that we have specifically excluded this question from our purview) and accepted Robbins' classic definition of the function of economic science. Indeed both Hall's (1937) and Dickinson's (1939) books start with a chapter on "the economic problem". Both works then continue to grind through the basic precepts of neo-

classical economics. Most of the other participants, too, emphasise the role of economic calculation as an eternally valid method. In a word, the socialists present themselves as more consistent neo-classical economists than their opponents.

Dickinson (1933: 247) even avers that: "only in a socialist community is it possible to realise the true principles from economic valuation" and "the beautiful systems of economic equilibrium described by Bohm-Bawerk...are not descriptions of society as it is but prophetic visions of the socialist economy of the future".

The reason why socialism was envisaged as providing a better approximation to the ideals of welfare economics will be dealt with later.

We are being offered utopias in the strict sense. No means of getting from the present to the ideal state presented is outlined. The major exception to this is Lange's work, which rather resembles a prize essay on the subject "reconcile socialism with the precepts of welfare economics". Since Lange was in many respects the most rigorous and aware of the basic issues of welfare economics (to which he was a major contributor in the 1930s) we will use his presentation most extensively.

The basic solution to the problem of pricing capital goods was again very simple. Since the prices of 'factors' in neo-classical theory are held to be imputed from the value of final goods, what is the problem with accounting prices being imputed arbitrarily by the Central Planning Authority and varied by trial and error? The neo-classical opponents of socialism were hoist on their own petard.

Lange (1964: 59-60) begins with what he calls the "parametric" function of prices. Though prices are supposed to be the resultant of choices by producers and consumers, under perfect competition they confront both as given. He quotes Wicksteed to show that 'price' has two meanings: "It may mean either price in the ordinary sense, ie. the exchange ratio of two commodities on a market, or it may have the generalised meaning of 'terms on which alternatives are offered'." He goes on: "To solve the problem three data are needed: 1) a preference scale which guides the acts of choice; 2) knowledge of the 'terms on which alternatives are offered'; 3) knowledge of the amount of resources available."

(Note the similarity of this to Barone's data from which the series of simultaneous equations were to be worked out.) Since (1) and (3) are given as in capitalism, (2) can be derived from the production functions: "the technical possibilities of transformation of one commodity into another". (ibid p60)

Lange goes on to exorcise the ghost of solving millions of equations used by Hayek and Robbins: "The only 'equations' which would have to be 'solved' would be those of the consumers and managers of production. They are exactly the same 'equations' which are 'solved' in the present economic system and the persons who do the 'solving' are the same also. Consumers 'solve' them by spending their income so as to get out of it the maximum total utility; and the managers of production 'solve' them by finding the combination of

factors that minimises average cost and the scale of output that equalises marginal cost and the price of the product. They 'solve' them by a method of trial and error, making (or imagining) small variations at the margin as Marshall used to say, and watching what effect those variations have either on the total utility or on the cost of production. And only a few of them have been graduated in higher mathematics. Professor Hayek and Professor Robbins themselves 'solve' at least hundreds of equations daily, for instance in buying a newspaper or in deciding to take a meal in a restaurant, and presumably they do not use determinants or Jacobians for that purpose. And each entrepreneur who hires or discharges a worker or who buys a bale of cotton 'solves equations' too. Exactly the same kind and number of 'equations', no less and no more have to be 'solved' in a socialist as in a capitalist economy, and exactly the same persons, the consumers and managers of production plants have to 'solve' them." (ibid p.88-89)

We have quoted at length here because Lange excellently demystifies the problem handed to the socialists by Hayek and the Austrians.

Following from this it was a simple matter to show that Mises had confused the two meanings of 'price' in the narrow sense with 'price' in the wider sense of an index of alternatives. It is only in the latter sense that 'prices' are indispensable for the allocation of resources. It follows that: "the accounting prices in a socialist economy, far from being arbitrary, have quite the same objective character as the market

prices in a regime of competition." (ibid p82). Lange, like most of the socialists, accepted that historically given prices would provide the basis in practice for the accounting prices of capital. He envisages a society where "the Central Planning Board performs the function of the market". It imposes rules on a society where, by consumers maximising their utility and producers their profit, an equilibrium with the optimum allocation of resources as envisaged by Pareto is reached.

Managers of state-owned firms must choose the combination of factors which minimises the average cost of production. A second rule determines the scale of output at the point where marginal costs equals price. The output of the industry is fixed in exactly the same way.

Thus the picture presented by Lange and his co-thinkers was of a post-capitalist society dominated by rules rather than by planning, as Sweezy (1949) quite rightly remarks. As an exercise in taking the premises of neo-classical economics (which were after all developed to defend the capitalist system) and using them against the protagonists its effect was devastating. But in what sense was this a realistic picture of a post-capitalist society?

It became increasingly clear on both sides that the solution was to a problem - the optimum allocation of resources in a state of static equilibrium under conditions of perfect competition - which quite simply does not and cannot exist. The unrealistic and impossible assumptions of perfect competition - no historical time, perfect knowledge, no externalities, homogeneous goods and no economies of scale - have been outlined so often it seems

pointless to repeat them here.

Finally, the victory of the socialists up to this point in the debate was 'pyrrhic', to quote Dobb, since rent, interest, unequal incomes determined by market forces, one man management of factories and many other phenomena which had been denounced by socialists for generations re-emerged. It was also a moot point whether the problem of mass unemployment would exist.

As to further proposals, the market socialists all recognised that in practice the rate of investment would be fixed by conscious decision of the Central Planning Authority and not 'automatically' by the rate of interest (see below).

Moreover, all the socialists had developed a critique of capitalist society because of the wider social implications (positive and negative externalities) of economic activity that were ignored in decisions taken by individual firms. This had led them to propose quite extensive sectors of economic activity which could be provided free. Dickinson's (1939) list involves cases where increased consumption would increase social welfare as a whole; where services would not be wasted if provided free; and where the 'free' service does not compete with marketed commodities. All basic wants, he suggests, could come into this category. Secondly, there are cases where collective needs must be provided communally as they are consumed in common (ie. public goods). Finally, there are goods where individual enjoyment is bound up with other's - such as concert halls or phone lines. Clearly the principles laid down, though vague, can be interpreted to take large areas of economic activity out of market provision.



There is some justification then in Hayek's grumble about the large number of "arbitrary elements" injected into the market socialist project.

### Dobb's intervention

In the first place Dobb built on the perception held by the market socialists that the rate of investment is inevitably an 'arbitrary' element even in a 'market socialist' economy. Basing his case on the argument that the Central Planning Authority must set the rate of investment he goes on to point out that this necessarily means central planning of at least the major direction of investment and its nature and purpose. He goes on to point out that actual investment decisions are necessarily concrete, not deriving from general economic laws.

Here we come up against another problem in Dobb's voluminous writings on planning over a long period. What role has economic decision-making (in the sense of the word used by Hayek and Co) to play in a planned economy? In Political Economy and Capitalism (1940: 319) he grants that it will be "very small or non-existent and at any rate...rapidly diminishing". Most importantly, investment changes relative prices throughout the economy and destroys equilibrium positions as society is in constant change. Rather than dealing with static equilibrium we are discussing dynamics of economic development.

In the same work Dobb cites the main failing of capitalism as lack of foreknowledge. Naturally, since we cannot foresee the

future, uncertainty in all things cannot be abolished. Yet there exists an important area of what is called 'secondary uncertainty' - that is uncertainty of individuals about the likely behaviour of others because of the atomised decision-making process in a market economy. He ticks off four different effects of secondary uncertainty which can be overcome by a planned economy, causing investment decisions to be taken differently from a capitalist economy.

First, there is the effect of parallel or rival investment (by others) on entrepreneurs' own decisions. Secondly, there is the problem of anticipating complementary investment. As Dobb points out, infrastructure is an essential precondition for investment activity, particularly in a newly developing area. Capitalism typically develops a whole series of related investment areas and markets together - for instance car production, roads and petroleum. Thirdly, there is the level of investment and saving in an economy as a whole, which in a market economy characteristically develops in cycles. Finally, there are problems associated with anticipating the future rate of interest, a crucial determinant for present investment decisions. (ibid pp278-).

Elsewhere (1939: 596) Dobb uses the example of a pursuit curve to show the way lack of foresight affects the dynamics of capitalist investment. The point is that he is dealing not with static problems of allocative efficiency but with society in change. From this vantage point: "what are problems of cost become ones of allocation." (1940: 45). He therefore denounces the decision of the market socialists to impute accounting prices

to capital goods as a "Heath Robinson device", insisting that the rates of investment, saving and interest be treated as a unitary decision by the planning authority.

#### Hayek's counter-offensive

Surprisingly, the same point is taken up by Hayek (1940: 131), who denounces the market socialists for: "an excessive preoccupation with problems of pure theory of stationary equilibrium". These are almost the same words Dobb (1939) uses and it is a criticism which had already arisen within the ranks of the market socialists (eg Lerner 1937: 254). Yet Austrian theory also holds that there is a tendency to equilibrium over time. If it did not, there could quite simply not be a criterion of optimality with which to criticise the planned economy. And it is problems of change which Hayek principally raises in objection to Lange and Dickinson. His main objection seems to be the practical one as to how quickly the imputed prices of capital goods are to be varied. This second wave or counter-critique also differs from his first onslaught in that he now raises the notion that the prices of factors reflect entrepreneurs' expectations about the economy and have to be discovered through speculation. He singles out the role of entrepreneurs (after the manner of Mises' praise of the "creative few") compared with the bureaucratic lassitude of state managers. We have already ruled the question of incentives out as a complete red herring.

Hayek responded to the debate by asserting that the socialists had significantly climbed down over the necessity of the market. This is not strictly true in the sense that his opponents in the debate had never put forward in natura planning or calculations in labour time as a serious alternative. Certainly Elizabeth Durbin (1984: 108) quotes Lachman, a young student of Hayek at the LSE as saying he "felt like a junior officer in a war which was being lost". Shapiro (1986:139-) sums up the novel points offered in Hayek's counter offensive. Hayek emphasises not only the amount of information to be assimilated, but also the fact that this information is continually changing. It is the interdependence of these two problems in his view which makes central planning so complex. We shall discuss later (in the section on costs) whether costs are objectively given to the economic agent or remain to be found by entrepreneurial activity.

At one point Hayek (1940: 132) completely gives the game away. He points out that: "much machinery, most buildings and ships and many parts of other products are hardly ever produced for a market but only on a special contract". It is odd to find Hayek here agreeing with Marx and Engels on the obsolescence of market relations. Finally, to the obvious argument that pre-existing capital prices would be used as a basis for calculation by the Central Planning Authority, Hayek (1935: 213) argues that this would be impossible after the chaos following a revolution, presumably in consequence of the changes in income distribution and hence the structure of demand, though this is not clear from his account.

Both left and right had identified basic weaknesses in

Lange's and other market socialists' solution to the problem posed by Mises. They relied on the postulate of static equilibrium. Yet Mises added in the 1936 edition of his book the perception that socialism would have no problem under stationary conditions. Whereas Lange's solution dealt quite adequately with the production of given commodities, what was to happen if there was a shift in the whole pattern of demand? The entrepreneur in those circumstances would have to switch to a different line of production if that were technically possible, or withdraw his capital altogether from that sector. But it was not clear how the manager of a state-owned firm would exercise that initiative. Lange might justifiably complain that by appealing to static equilibrium analysis he was merely applying concepts of 'economic science' as they were taught to millions of people throughout the capitalist world. The terms of debate were being shifted against him.

#### The dissemination of information

To the three basic objections against planning - the problem of calculation, of complexity and of incentives - was to be added a fourth, the dissemination of information. The Austrian strand of neo-classical theory had always been the most militantly pro-capitalist, and Hayek (1945: 519) worked up this further theme in

his later articles and summed it up in *The price system* as a mechanism for using knowledge. He states: "the 'data' from which the economic calculus starts are never for the whole society 'given' to a single mind which could work out the implications, and can never be so given". He goes on: "the sort of knowledge with which I have been concerned is knowledge of the kind which by its nature cannot enter into statistics and therefore cannot be conveyed to any central authority in statistical form". (ibid p524).

Recently Lavoie (1985) and Shapiro (1986) have attempted to prove that the notion of the market as a necessary institution in spreading knowledge was explicit in Mises' original formulation and did not represent a "second line of defence" as Lange asserted.

The problem with this view is that Mises categorically stated that socialism was impossible, a formulation which Hayek was forced to correct while raising the issue of complexity and the related one of knowledge. Let us call in witness Lionel Robbins (1971: 107), a close collaborator of Mises in the debate and a (partially) penitent sinner: "I think it was a pity that

(Mises) stated his denials in terms which were liable to suggest that productive activity of any kind was impossible in a totalitarian system - which is obviously not true."

Hayek's most recent discussion of socialist calculation in *The Fatal Conceit* (1988: 85-88), (which raises the issue of knowledge dissemination as the sole and fundamental objection) states that he began this line of enquiry in 1936 - after the publication of *Collectivist Economic Planning*. Certainly his articles on the

subject post-date 1935.

It seems that recognition that the Austrian school is not simply a slight variant of the neo-classical orthodoxy is partly a product of the debate itself. Surely the views of Lavoie and Shapiro downgrade the originality of Hayek's insight.

The source for this insight may be somewhat unexpected. The Left Opposition's critique of forced collectivisation and the way the first Five Year Plan was implemented focussed on the incapacity of the bureaucracy to plan, monitor and supervise all economic activity in a nation of over 200 million people.

Later we quote Trotsky more fully (1976: 113) from 1932: "If

there existed the universal mind that projected itself into the scientific fantasy of Laplace...such a mind of course could a priori draw up a faultless and exhaustive economic plan".

This quote was injected into the debate in 1935 by Lerner in an effort to twit Dobb. This seems to be the first reference to the question of knowledge dissemination in the debate. Could it be argued that Leon Trotsky was the father of the modern Austrian school?

It is certainly a consequence of the division of labour that every worker is equipped with unique levels of knowledge. But, as a worker, she has no interest in communicating this to her employer - quite the contrary. The follower of Hayek will argue that all this is beside the point since we are dealing with market relations between firms, not relations in the workplace. It is accepted by the Austrian school that the other side of 'consumer sovereignty' is that the mass of producers (who also

make up most of the consumers) should be mindless helots at work. It is only 'the few', the entrepreneurs, who are the bearers of this useful knowledge.

To conclude our analysis, the critique of 'market socialism' converges from right and left.

### Wants and the Social System

Neo-classical economists refer to a 'scale of wants' or values or preference scale. It is clear that nobody has ever articulated their own scale of wants or written it down on the back of an envelope. Nor would it be possible to do so. There is no pre-existing scale of wants. People's scales of wants do not include items such as 'food' but articles such as bread, potatoes, pasta, steak, etc., and are totally dependent on their relative prices, as the theory of opportunity costs states. Clearly the 'scale of wants', the very foundation and end of economic activity has only a fleeting and nebulous existence.

For neo-classical economics consumption is the purpose of production. Wants are exogenously given and in principle infinite. We will not deal with the huge literature on the attempts to manipulate wants under modern capitalism. We will merely note with Marx (1971: 21): "mankind inevitably sets itself only such tasks as it is able to solve, since closer examination will always show that the problem itself arises



only when the material conditions for its solution are already present or at least in the course of formation".

It is highly likely that medieval peasants were bored during long winter nights, but unlikely that any of them were wishing someone would hurry up and invent television. Wants are determined by the development of the productive forces and by one's class position within society. "The consumer is no freer than the producer. His judgement depends on his means and his needs. Both of these are determined by his social position, which itself depends on the whole social organisation." (Marx 1967(2): 41).

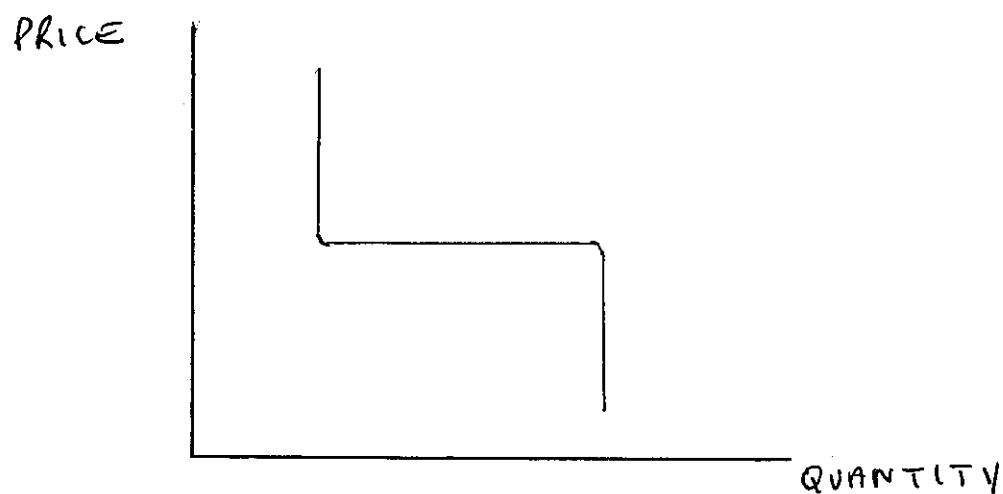
So wants are endogenous to the social system.

This was certainly Schumpeter's (1939: 73) view. In his work *Business Cycles*, he states: "We will throughout act on the assumption that consumers' initiative in changing their tastes...is negligible and that all change in consumer taste is incidental to, and brought about by producers' action." Purchases and consumption patterns vary mainly not with mysterious exogenously given changes in taste or the weather (to use favourite neo-classical examples) but with purchasing power dictated by the stage of the boom-slump cycle.

A discussion took place after the Russian revolution on the role of demand in relation to the workings of the law of value. Rubin (1973: ch17) summarises its basic conclusion: that social need depends on value rather than value depending on social need. Value determines both the volume of demand and the quantity of supply and it is changes in value which lead to changes of supply and demand.

This accords with Marx (1966(1): 188): "qualitatively the

definite social wants are very elastic and changing. Their fixedness is only apparent. If the means of subsistence were cheaper, or money wages higher, the labourers would buy more of them and greater 'social need' would arise for them...". It seems therefore that Mandel (1986: 11), a contemporary critic of Nove's market socialism, goes too far when, in polemicising against the myth of unlimited and exogenously given wants, he asserts that consumption patterns are largely independent of the market. He puts forward the notion of a hierarchy of needs, appealing to the statistician Engel, and also calls in witness the 'saturation model' of Dobb, who suggests the demand curve for a wide variety of commodities (such as television sets) may look like diagram 1 below. Mandel expresses this as the marginal elasticity of demand tending to zero.



What seems to be true is that marginal price changes do not dramatically change the pattern of demand. Yet major shifts in relative prices such as those produced by the oil shock of 1974 and 1979 have had their effects. Resistance to changes in relative prices cannot just be attributed to inertia or what neo-classical economists might regard as irrational behaviour.

Neo-classical economics regards people as rational egoistic atoms. In addition to Adam Smith's 'invisible hand' and the 'visible hand' of corporate power (from Chandler), Okun has added to this lexicon the notion of the 'invisible handshake'. Mandel calls the same phenomenon "objective informal cooperation". 'Invisible handshake' seems an inappropriate expression for relations which are often quite literally short-sighted - such as loyalty to work-mates, the small local shop or to known suppliers. We are extremely reluctant to enter into this huge area of human behaviour so these remarks will be in the nature of basic cautions. People live in society. Nobody can deny that such relations are extremely important in shaping human behaviour. Nor can they be regarded as any less rational than the model assumed by economists. The fact is that they do cause people to behave differently.

### Rationality

Our survey of the literature began by raising the question of rational calculation. Hutchison (1965: 116) quotes Mises as laying down a "fundamental principle that everybody behaves rationally" (Grundprobleme der Nationalökonomie) and goes on to show that rationality is then defined by Mises as "how people behave". This vacuous definition, if taken seriously, would make

the whole onslaught by Mises and his school on the feasibility of socialism quite misplaced.

### Ends of economic activity

For neo-classical economics rationality can only refer to the means of achieving ends. Ends are given and cannot be subjected to a test of rationality. The matter is complicated by the principle of opportunity cost, by which people choose between existing alternatives at given prices. This is why Hayek (1945: 525) refers to value's "significance in view of the whole means-ends structure". The ends of economic activity are set in the scale of wants and rationality is taken to mean consistency or "optimising behaviour" (McAuley 1967:340) in attaining those wants. Any society can therefore be rational if it orders production so as to satisfy "its" wants. Nove (1966:273) quotes Stalin's reported desire that "his own" works be visible from Mars. As McAuley comments, Nove cannot deride this scale of values as irrational, though 'the man on the Clapham omnibus' would doubtless regard it as insane, and he would be right. Likewise it is impossible for the economists to denounce the desire of sections of the Federation of Conservative Students to legalise heroin so pushers can stand outside our schools and hand out free samples. This is no less insane, and entirely within the canons of consumer sovereignty.

The problem is that the scale of wants or preferences is tacit and invisible. Any economy which looks irrational from

outside can in fact be performing rationally according to a different scale of values from our own, rather than failing to optimise. This is important since most orthodox post-war critiques of the Soviet economy merely record the undoubted fact that it behaves differently from a capitalist economy as evidence of its deep-rooted irrationality. Schumpeter (1954: 114-15) had already remarked on the "habit economists have of setting

themselves up as judges of the rationality not only of means but of ends (motives); ie. to call rational ends (motives) that seem reasonable to themselves and to dispose of others as irrational".

Lange also deals with this question in Political Economy (1976: ch5). He shows how the very notion of rationality developed with a market economy. Lange, of course, believes that commodity production will continue under socialism, so a planned economy can share that rationality and develop it by applying it to the economy as a whole. He defines economic activity as: "the realisation of given ends by the use of certain means" (our emphasis) - an interesting variation on Robbins' classic definition. We believe that one major difference with a planned economy is that the scale of values is articulated and that economic activity begins with given ends, just as Marx believed human labour in general does.

The expression "planners preferences" has long entered the jargon alongside "consumers preferences" (consumer sovereignty). The problem is that the utilitarian basis of neo-classical economics is incurably individualistic. The attempt to draw up a 'social welfare function' seems to have foundered. As Ball (1979: