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# History of Economic Thought

## X. Socialism

### The Socialist Calculation Debate

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# 1. The Golden Age of Marxism

## The Second International, 1889-1914

- International socialist organization
- Main centre of orthodox Marxism in Germany

### Main Developments

- The conflict with the anarchists
- The struggle over revisionism
- Decline of laissez-faire



## The Main Socialist Ideology

- Dominant in Germany
- France more eclectic
- Britain hardly touched by Marxist ideas
- A (the?) ideology of the workers' movements

## The Decline of Liberalism

- Abandonment of laissez-faire, minimal state ideas
- Abandonment of non-intervention in labour contracts, disputes
- Recognition of state intervention in the economy in principle
- Laissez-faire scarcely defended by the end of the 19<sup>th</sup> century



## Critique of Capitalism

- Technical progress is the deciding factor in human history
- Capitalism will inevitably develop to a point where socialism becomes inevitable
- Emergence of socialism requires organization of workers, political and economic struggle
- Workers must acquire class consciousness
- Capitalism will be swept away by revolution once the objective and the subjective factors mature

## Socialism

- Socialism means public ownership of the means of production and the abolition of exploitation
- Socialism is in the interest of all, but the working class is its standardbearer
- There will be no exploitation under socialism – there will be organized (centralized) administration of production, distribution
- The socialist revolution will be global



## Anarchist Positions

- Opposition to the state, to all “faceless social organizations”
- Anarchists argued Marxist socialism was tantamount to tyranny
- The state is bound to give rise to privilege, inequality, tyranny
- The state should be overthrown in a terrorist conspiracy – or we have to await the moral transformation of mankind

## The Goal of Anarchism

- Complete equality
- Complete decentralization of public life
- Anarchists excluded from Second International in 1893 and 1896



## Marxist Positions

- Capitalism is irreformable – political reforms only necessary to give working class “breathing room”, build class consciousness
  - Socialist parties can also support bourgeois republics against the “forces of reaction”
- A return to “organic community” requires forceful action by the proletariat

## The State and Socialism

- Centralized administration of production and materials will continue under socialism
- Without private property however, the state will cease to be a source of violence and inequality



## Origins of Revisionism

- The German SPD 1891 Erfurt Programme
- Agricultural question in Bavaria 1894
  - Local socialists favoured cooperation with peasants, farmers
  - Marxist orthodoxy: agriculture must follow development of industry (→ centralization, proletarianization of farmers)
- Success of British moderate socialism

## Eduard Bernstein (1850-1932)

- Theoretician of revisionism
- In England 1888-1901, close to Engels
- Influenced by Fabian socialism
- Became convinced that the idea of the breakdown of capitalism a doctrinaire illusion
- Argued for gradualism and reform, not revolution as the way to socialism
- “What is generally called the ultimate goal of socialism is nothing to me; the movement is everything”





## Debate over Bernstein

- Bernstein wrote series of articles in *Die Neue Zeit* from 1896
- Immediately attacked by Kautsky, Clara Zetkin, Rosa Luxemburg
- Large following in the German party
- Bernstein is the founder of interwar social democracy

## Bernstein's Critique

- Agriculture is not in fact developing as predicted by Marx
- Ditto on concentration, polarization, proletarianization
- There is concentration of enterprises – but not of wealth
- There is no tendency for crises under capitalism to become worse
- Social democracy will gradually socialize property – Marxists ideas on revolution wrong



## The First World War

- Second International had pledged international worker solidarity
- Marxism taught that wars were simply fought for capital, they did not concern labour
- Yet in 1914, almost all socialists in the warring countries rallied to their governments
- A few exceptions: Lenin, some German socialists (eventually)

## The Russian Revolution

- Lenin became the “pope” of orthodox Marxism in 1917
- Except not all Marxist agreed: split between communists and social democrats
- Third International: the communist international founded 1919



## 2. Leninism and the Russian Revolution

### Vladimir Ilyich Lenin

- 1870-1924; student in St Petersburg, professional revolutionary
- Converted to Marxism at a young age, key Marxist in Russia
- Eventually leader of the Revolution

### The Russian Revolution

- First revolution in March 1917
- Bolsheviks under Lenin seize power in palace coup in October
- They immediately act to institute a socialist economy



## Lenin the Orthodox Marxist

- Historical determinism: the material productive forces rule everything
- The bourgeoisie will first overwhelm the old order, paving the way for capitalism
- Capitalism carries the seed of its own destruction

## The Vanguard

- The proletariat cannot themselves develop socialism – they lack class consciousness
- The workers must be led and educated by a small intellectual cadre, the vanguard of the revolution
- The vanguard composes the core of the party, a centrally directed group of professional revolutionaries



## Determinism

Everybody knows that scientific socialism never painted any prospects for the future as such: it confined itself to analysing the present bourgeois regime, to studying the trend of development of the capitalist social organization, and that is all.

## Socialist Consciousness

The history of all countries shows that the working class, exclusively by its own efforts, is able to develop only trade-union consciousness... The theory of socialism, however, grew out of the philosophic... theories elaborated by educated representatives of the propertied classes, by intellectuals...

Since there can be no question of an independent [working class ideology], the only choice is – either bourgeois or socialist ideology.



## **Bolsheviks Seize Power**

- Fall of the Tsar in the February Revolution
- Provisional government of Kerensky, Soviets form
- Bolsheviks under Lenin seize power in the October Revolution

## **A Socialist Economy at Last**

- War communism 1917-21: central planning gone wild
- War on exchange economy and money
- Coercive requisitioning of grain, food “surpluses” from farmers
  - Peasants widely resisted, revolted
- Impossible to calculate what was surplus: result was widespread terror and famine
- Free trade in grain tantamount to capitalism in Russia - unacceptable



We know that one of the main sources of capitalism is freedom to trade in grain in the country, and it is this source that has been the ruin of all previous republics. Today the last, decisive battle against capitalism and against freedom to trade is being fought, and for us this is a truly basic battle between capitalism and socialism. If we win this fight there will be no return to capitalism and the former system, no return to what has been in the past. Such a return will be impossible so long as there is a war against the bourgeoisie, against profiteering and against petty proprietorship...

Freedom to trade in grain is a return to capitalism, to the full power of the landowners and capitalists, to a savage struggle of people for profit, to the “free” enrichment of the few, to the poverty of the masses, to eternal bondage.



## The NEP

- Instituted 1921 – the New Economic Policy
- A massive retreat: private ownership and trade de facto legalized
- “NEP”-men emerged, driving a quasi-capitalist economy in the 1920s

## The Kulaks

- Pejorative for rich farmers
- A “Kulak class” developed in the 1920s, driving agricultural development
- Stalin’s dekulakization 1929-32 was a return to “pure” Leninism
  - The result was again disastrous: famine and millions dead
- The NEP was only a strategic retreat to retain power





## **Nikolay Bukharin (1888-1938)**

- Product of the intellectual class, exiled from Russia for revolutionary activity
- Wrote *The Economic Theory of the Leisure Class* (1914/19) against the Austrian school

## **Bukharin and War Communism**

- The chief advocate of coercion, requisitions
- Hoped that the socialist state could manage without money, markets
- Insisted on the economic dictatorship of the proletariat
- The organization of society is based on coercion of the peasants and the workers
- No exploitation, since it's impossible for the working class to exploit itself
- Economic life based on mass terror not a transient necessity, rather the permanent principle of socialist organization

## **Bukharin and NEP**

- Became the chief ideologist of the NEP once Lenin changed his tune
- Political and economic reasons for supporting NEP – to enforce/accelerate industrialization
- The kulaks a necessary evil: they the most productive peasants



### 3. The First Arguments Against Socialism

#### The Incentive Problem

- This is the “classic” problem

#### Böhm-Bawerk’s Critique

- Critique of Marx
- Arguing against Böhm-Bawerk became key to socialist economists
- *Capital and Interest*, vol. I (1884); *Karl Marx and the Close of His System* (1896)



## Who Will Take Out the Trash?

- In the absence of personal rewards, who will do dirty or dangerous jobs?
- The capitalist system deals with the problem by compensating accordingly (compensating differentials)
- Egalitarian socialism cannot do so

## Socialist Responses

- Working in a socialist society will be reward enough in itself
  - Man will develop to a higher stage unconcerned with personal rewards
  - *Homo sovieticus*
- Special distinctions, orders, will be reward enough (Fourier)



## Incoherence of Marx

- Why only products of labour? Products of nature also exchanged
- Why disregard use-value? Why focus on the labour-content of a commodity to exclusion of everything else?
- Contradiction between *Capital* vols. I and III
- Value in Marx does not explain prices – it's a useless term

## The Full Product of Labour

- Let's just assume for argument's sake that only labour is a productive factor
- Then the Marxist claim that labour is the source of all value seems more plausible
- The full product of labour should then go to labour
- But the full product of labour *can* go to labour – provided the labourers are prepared to wait for the end of the production process
- The capitalists advance wages to labourers in advance – hence, they only receive the discounted product
- But this discount is not exploitation



## 4. The Calculation Debate

### Early Discussions

- Enrico Barone
- Otto Neurath

### Mises's Challenge

- Economic calculation, and hence rational economy, is strictly impossible under socialism

### The Debate

- Socialist propositions
- Hayek's contribution



## Economic Calculation

- In a centrally planned economy, how can you know whether production is planned rationally?
- I.e., how can you calculate whether you make the best possible use of scarce means?

## Beyond the Problems of Contract or Coercion

- This goes beyond the problem as previously stated in terms of contract and hegemony
- How can we measure and control productive activity?
- Can we say that the output is worth more, more useful to society than some alternative the resources could have produced?



## Enrico Barone 1908

- Calculation is possible in general equilibrium
- Solve the equations in a Walrasian system

## Otto Neurath 1919

- There is no calculation problem, we can have a “natural economy”
- We can simply do calculation in kind, i.e., money and market exchange not necessary
- Clearly question-begging – the units are always incommensurable
- Neurath served the short-lived Bavarian republic in the Central Economic Office, working on socialization



## The Problem of Economic Calculation

- 1920 article, expanded into 1922 book *Socialism*
  - This book converted a generation away from socialism (Hayek)
- Mises here laid down his fundamental challenge to socialism
- Economic calculation depends on reducing the factors of production to a common denominator
- Exchange and market prices solves the problem in a free economy

## The Impossibility of Calculation under Socialism

- Private ownership and free exchange are necessary for market prices
- These are by definition excluded in a socialist economy





## The Problem of Actual Socialism

- How can this conclusion square with the actual existence of socialist entities?
- Socialist enterprises and countries exist in a “sea” of capitalism
- They can look at prices established outside themselves
- Soviet Russia can look to world market prices; the post office to domestic prices

## Islands of Computational Chaos

- The smaller the socialised entity is, the better it can calculate
- The larger, the more chaotic will economic life become
  - Outside prices will have less reference to reality within
- Socialists correct: only a worldwide revolution can establish pure socialism, because only so can money prices be eliminated



It is characteristic of socialism that the distribution of consumption goods must be independent of the question of production and of its economic conditions. It is irreconcilable with the nature of the communal ownership of production goods that it should rely even for a part of its distribution upon the economic imputation of the yield to the particular factors of production (...) it lies in the very nature of socialist production that the shares of the particular factors of production in the national dividend cannot be ascertained, and that it is impossible in fact to gauge the relationship between expenditure and income.



[Monetary calculation] enables us to extend to all goods of a higher order the judgment of value, which is bound up and clearly evident in, the case of goods ready for consumption, or at best production goods of the lowest order. It renders their value capable of computation and thereby gives us the primary basis for all economic operations with goods of a higher order (...)

There are two conditions governing the possibility of calculating value in terms of money. Firstly, not only must goods of a lower, but also those of a higher order, come within the ambit of exchange (...) The second condition is that there exists in fact a universally employed medium of exchange – namely, money – which plays the same part as a medium in the exchange of production goods also. If this were not the case, it would not be possible to reduce all exchange-relationships to a common denominator.



Without economic calculation there can be no economy. Hence, in a socialist state wherein the pursuit of economic calculation is impossible, there can be – in our sense of the term – no economy whatsoever. In trivial and secondary matters rational conduct might still be possible, but in general it would be impossible to speak of rational production any more. There would be no means of determining what was rational, and hence it is obvious that production could never be directed by economic considerations. Thus in the socialist commonwealth every economic change becomes and undertaking whose success can be neither appraised in advance nor later retrospectively determined. There is only groping in the dark. Socialism is the abolition of rational economy.



## Soviet Responses

- Calculation in kind in separate branches
- Calculation in terms of labour

## Karl Polanyi

- Society owns the means of production
- The means are administered by the workers directly involved in each industry
- This is really a system of syndicalism, not socialism

## Karl Kautsky

- The socialist state can look to historic prices from the pre-socialist epoch
- Historic prices will become increasingly at variance with reality
- Kautsky does not explain how they will be adjusted



## The Knowledge Problem

- Friedrich Hayek and Lionel Robbins' development of Mises' argument
- Social production under division of labour means drawing on huge stores of knowledge
- Such knowledge is often tacit and dispersed
- The price system in a market society coordinates all the necessary knowledge
- Hayek's example: the entrepreneur does not know why there is less tin, he just sees the price is higher and therefore restricts production

## Knowledge or Calculation

- The central planning board could try to assemble all the necessary technical knowledge etc.
- But the facts on the ground would change before they could compute equilibrium conditions
- Mises's argument is more fundamental: absent prices based on exchange of private property, production will take place in the dark, chaotically



## Oskar Lange (1904-65) and Market Socialism

- Central planning board could set prices at random, adjust
  - Looking at shortages and surpluses
  - Walras's auctioneer
- Managers of socialist enterprises can then act in a profit-maximizing way

## Mises's and Hayek's Critique

- The knowledge problem formulated partly in response to Lange
- Market socialism fundamentally misunderstands the market
- The market is guided by profit and loss – but without private property, managers will experience neither
  - They cannot lose their capital, they cannot increase it
- Market socialism is a purely bureaucratic scheme



## 5. References

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