On the Economic Theory of Socialism: Part Two

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On the Economic Theory of Socialism

PART TWO

5. THE ECONOMIST'S CASE FOR SOCIALISM

THE rules of consistency of decisions and of efficiency in carrying them out are in a socialist economy exactly the same as those that govern the actual behaviour of entrepreneurs on a purely competitive market. Competition forces entrepreneurs to act exactly as they would have to act were they managers of production in a socialist system. The fact that free competition tends to enforce rules of behaviour similar to those in an ideal planned economy makes competition the pet idea of the economist. But if competition enforces the same rules of allocating resources as would have to be accepted in a rationally conducted socialist economy, what is the use of bothering about socialism ? Why change the whole economic system if exactly the same result can be attained within the present system, if only it could be forced to maintain the competitive standard ?

The analogy between the distribution of resources in a competitive capitalist and a socialist economy is, however, purely formal. The *formal* principles are the same, but the *actual* distribution may be a quite different one. This difference is due to two features which distinguish a socialist economy from an economic system based on private ownership of the means of production and private enterprise.

One feature is the distribution of incomes (condition C in the determination of economic equilibrium). Only a socialist economy can distribute incomes so as to attain the maximum social welfare. In any system with private ownership of the means of production, the distribution of incomes is determined by the distribution of ownership of the ultimate productive resources. This distribution is an historical datum which originates independently of the requirements of the maximisation of social welfare. For instance, the distribution of landed property is different in countries where the big landed estates of the feudal epoch have been broken up by bourgeois and peasant revolutions than where they have been left intact. Under capitalism the distribution of the ownership of the ultimate productive resources is a very unequal one, a large part of the population owning only their labour power. Under such conditions demand price does not reflect the relative urgency of the needs of different persons [1] and the allocation of resources determined by the demand

[1] This criticism presupposes, of course, that the utility derived from a given income by different persons is comparable. The theory of economic equilibrium does not need any such assumption, for being an *explanation* of behaviour under given conditions, it is concerned only with individuals, each maximising his utility separately. But the possibility of such comparison is a postulate necessary (except in a Robinson Crusoe economy) if different equilibrium positions are to be interpreted in terms of *human welfare*. And such interpretation is required for choosing different economic *policies*. If this possibility is denied, any judgment as to the merits of economic policies, transcending the question of purely formal consistency of decisions and of efficiency in carrying them out, is impossible. In such case also no reason can be found why the allocation of

price offered for consumer's goods is far from attaining the maximum of social welfare. While some are starving others are allowed to indulge in luxury. In a socialist society the incomes of the consumers could be determined so as to maximise the total welfare of the whole population.

Free choice in consumption and free choice of occupation being assumed, the distribution of incomes maximising the total welfare of society has to satisfy the following two conditions: (1) the distribution has to be such that the same demand price offered by different consumers represents an equal urgency of need; this is attained if the marginal utility of income is the same for all consumers; (2) the distribution has to lead to such apportionment of the services of labour between the different occupations as to make the differences of the value of the marginal product of labour in the various occupations equal to the differences in the marginal disutility involved in their pursuit.[1] Assuming the marginal utility curves of income to be the same for all individuals, condition (1) is satisfied when all consumers have the same income. But condition (2) requires a differentiation of incomes, since, to secure the apportionment of labour services required, differences in the marginal disutility of the various occupations have to be compensated by differences in incomes. The contradiction, however, is only apparent. By putting leisure, safety, agreeableness of work, etc., into the utility scales of the individuals, the disutility of any occupation can be represented as opportunity cost. The choice of an occupation offering a lower money income, but also a smaller disutility, may be interpreted as the purchase of leisure, safety, agreeableness of work, etc., at a price equal to the difference of the money-income earned in that particular occupation and in others. Thus the differences of incomes required by condition (2) are only apparent. They represent prices paid by the individuals for different conditions of work. Instead of attaching to the various occupations different money incomes, the administration of a socialist economy might pay to any citizen the same money income and charge a price for the pursuit of each occupation. It becomes obvious that there is not only no contradiction between both conditions, but condition (2) is necessary to satisfy condition (1).[2]

resources ought to be based on the demand prices resulting from the free consumers' choices, rather than to the whim of a dictator. Any other preference scale chosen at random by the Central Planning Board would do equally well. To deny the comparability of the urgency of need of different persons and at the same time to regard the allocation of resources based on demand prices as the only one consistent with economic principles would be contradictory. It would be, as Mr. Dobb has rightly observed, a manoeuvre which enables " the scientific dignity of an ethical neutrality to be combined with an undiminished capacity to deliver judgments on practical affairs." (" The Problems of a Socialist Economy," *Economic Journal*, December, 1933, p. 591.) The logical fallacy of such a trick is easily exposed.

[1] Cf., however, the qualification contained in footnote 1 on p. 65 of Part One of this paper. If the total amount of labour performed is not limited by legislation or custom regulating the hours of work, etc., the value of the marginal product of labour in each occupation has to be *equal* to the marginal disutility.

[2] Thus Mr. Dobb is wrong when he maintains that these conditions are contradictory. Cf. *The Problems of a Socialist Economy*, pp. 591–2. Unless education and training for the different occupations are free, condition (1) is also necessary to satisfy condition (2), for if the marginal utility of income were not the same for all persons the value of the marginal product of the services of labour (which is equal to wages) would be higher, relatively to the disutility, in those occupations which have a higher cost of training. This happens in capitalist society where those who can afford expensive education and training are paid out of any proportion to the relative

Our argument holds strictly if the marginal utility curve of income is the same for all individuals.[1] Of course, this does not correspond to reality, and one might think of taking into account the differences between the marginal utility curves of income of different individuals by granting higher incomes to the more "sensitive" persons. But as such differences as to "sensitiveness" cannot be measured the scheme would be impracticable. Besides, the differences in "sensitiveness" existing in present society are chiefly due to the social barriers between classes, e.g. a Hungarian count being more "sensitive" than a Hungarian peasant. Such differences would disappear in the relatively homogeneous social stratification of a socialist society and all differences as to "sensitiveness" would be of purely individual character. Such individual differences may be assumed to be distributed according to the normal law of error.[2] Thus, basing the distribution of incomes on the assumption that all individuals have the same marginal utility curve of income, a socialist society would strike the right average in estimating the relative urgency of the needs of different persons, leaving only random errors, while the distribution of income in capitalist society introduces a constant error—a class bias in favour of the rich.

The other feature which distinguishes a socialist economy from one based on private enterprise is the *comprehensiveness* of the items entering into the price system. What enters into the price system depends on the historically given set of institutions. As Professor Pigou has shown, there is frequently a divergence between the private cost borne by an entrepreneur and the social cost of production.[3] In the cost account of the private entrepreneur only those items enter for which he has to pay a price, while such items as the maintenance of the unemployed created when he discharges workers, the provision for the victims of occupational diseases and industrial accidents, etc., do not enter, or, as Professor J. M. Clark has shown, are diverted into social overhead costs.[4] On the other side there are the cases where private producers render services which are not included in the price of the product. An economic system based on private enterprise can take but very imperfect account of the alternatives sacrificed and realised in production. Most important alternatives, like life, security, and health of the workers, are sacrificed without being accounted for as a cost of production. A socialist economy would be able to put *all* the alternatives into its economic accounting. Thus it would evaluate *all* the services rendered by production and take into the

disutility of their work. Condition (2) would not work, however, in the case of exceptional talents (for instance, prominent artists or surgeons) which form a natural monopoly. In such cases the value of the marginal product of the services of labour must be necessarily out of any proportion to the marginal disutility. If rewarded according to the value of the marginal product of their services such persons would form a privileged group drawing very high incomes (as writers are in the Soviet Union). But a socialist society might also pay them incomes which are far below the value of the marginal product of their services without affecting the supply of those services.

[1] This does *not* imply that all individuals have the same utility scales, although it would follow from the latter assumption.

[2] Such differences in the marginal utility curves of income of different individuals as are not purely random but due to age, family status, infirmity, etc., would be easily recognised and incomes could be differentiated accordingly.

[3] Cf. *The Economics of Welfare*, third edition, London, 1929, Part II, chapter IX.

[4] See *Studies in the Economics of Overhead Costs*, Chicago, 1923, pp. 25–7, 397–403, and 463–4.

cost accounts *all* the alternatives sacrificed; as a result it would be also able to convert its social overhead costs into prime costs. By doing so it would avoid much of the social waste connected with private enterprise. As Professor Pigou has shown, much of this waste can be removed by proper legislation, taxation, and bounties also within the framework of the present economic system, but a socialist economy can do it with much greater thoroughness.

As a result of the possibility of taking into account *all* the alternatives a socialist economy would not be subjected to the fluctuations of the business cycle. Whatever the theoretical explanation of the business cycle, that cumulative shrinkage of demand and output caused by a cumulative reduction of purchasing power could be stopped in a socialist economy. In a socialist economy there can be, of course, grave mistakes and misdirection of investments and production. But such misdirections need not lead to shrinkage of output and unemployment of factors of production spreading over the whole economic system. A private entrepreneur *has* to close his plant when he incurs grave losses. In a socialist economy a mistake is a mistake, too, and has to be corrected. But in making the correction *all* the alternatives gained and sacrificed can be taken into account, and there is no need to correct losses in one part of the economic system by a procedure which creates still further losses by the secondary effect of a cumulative shrinkage of demand and of unemployment of factors of production. Mistakes can be *localised*, a partial over-production does not need to turn into a general one.[1] Thus the business cycle theorist would lose his subject of study in a socialist economy, but the knowledge accumulated by him would still be useful in finding out the ways to prevent mistakes and methods of correcting them, if made, which do not lead to further losses.

The possibility of determining the distribution of incomes so as to maximise social welfare and of taking *all* the alternatives into the economic account makes a socialist economy, from the economist's point of view, superior to a competitive régime with private ownership of the means of production and with private enterprise,[2] but especially superior to a competitive capitalist economy where a large part of the participants in the economic system are deprived of any property of productive resources other than their labour. However, the actual capitalist system is not one of perfect competition; it is one where oligopoly and monopolistic competition prevail. This adds a much more powerful argument to the economist's case for socialism. The wastes

[1] The decisions of the Central Planning Board being guided not by the aim to secure a maximum profit on each separate investment but by considerations of making the best use of all the productive resources available in the whole economic system, an amount of investment sufficient to provide full employment for all factors of production would be always maintained.

[2] The deficiencies due to inequality of incomes would be absent in a competitive system where the private ownership of the means of production is equally distributed among the population (Marx called such system " einfache Warenproduktion "). Such a system is incompatible with large-scale industry. But, on account of the approximate equality of incomes in such a system, a socialist economy could embody such a system partly into its own. Therefore, socialism does not need to abolish the private ownership of the means of production in small-scale industry and farming, provided large-scale production is not more economical in these particular fields. By appropriate legislation, taxes and bounties a socialist economy can induce those small-scale entrepreneurs to take *all* alternatives into consideration and avoid the danger of their causing serious business fluctuations.

of monopolistic competition have received so much attention in recent theoretical literature that there is no need to repeat the argument here. The capitalist system is far removed from the model of a competitive economy as elaborated by economic theory. And even if it would conform to it, it would be, as we have seen, far from maximising social welfare. Only a socialist economy can fully satisfy the claim made by many economists with regard to the achievements of free competition. The *formal* analogy, however, between the principles of distribution of resources in a socialist and in a competitive régime of private enterprise makes the scientific technique of the theory of economic equilibrium, which has been worked out for the latter, also applicable to the former. The actual capitalist system is much better described by the analysis of Mrs. Robinson and of Professor Chamberlin than by that of Walras and of Marshall. But the work of the latter two will be more useful in solving the problems of a socialist system. As a result, Professor Chamberlin and Mrs. Robinson face the danger of losing their jobs under socialism, unless they agree to be transferred to the department of economic history to provide students of history with the theoretical apparatus necessary to understand what will appear to a future generation as the craze and folly of a past epoch.

Against these advantages of a socialist economy the economist might put the disadvantage resulting from the arbitrariness of the rate of capital accumulation, if accumulation is performed "corporately." A rate of accumulation which does not reflect the preferences of the consumers as to the time-shape of the flow of income may be regarded as a diminution of social welfare. But it seems that this deficiency may be regarded as overbalanced by the advantages enumerated. Besides, saving is also in the present economic order determined only partly by pure utility considerations, and *the rate of saving is affected much more by the distribution of incomes, which is irrational from the economist's point of view.* Further, as Mr. Robertson has already shown,[1] and Mr. Keynes has elaborated in his analysis of the factors determining the total volume of employment,[2] in a capitalist economy the public's attempt to save may be frustrated by not being followed by an appropriate rate of investment, with the result that poverty instead of increased wealth results from the people's propensity to save. Thus the rate of accumulation determined "corporately" in a socialist society may prove to be, from the economic point of view, much more rational than the actual rate of saving in capitalist society is. There is also the argument which might be raised against socialism with regard to the efficiency of public officials as compared with private entrepreneurs as managers of production. Strictly speaking, 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 of economic theory and must therefore be dispensed with here. By doing so we do not mean, however, to deny its great importance. It seems to us, indeed, that the real danger of socialism is that of a bureaucratisation of economic life,

[1] Cf. *Banking Policy and the Price Level*, London, 1926, pp. 45–7, and *Money*, new edition, London, pp. 93–7.

[2] Cf. *The General Theory of Employment, Interest and Money*, London, 1936.

and not the impossibility of coping with the problem of allocation of resources. Unfortunately, we do not see how the same, or even greater, danger can be averted under monopolistic capitalism.

However, 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 as such 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.* That capitalism has been the carrier of the greatest economic progress ever witnessed in the history of the human race the socialists are the last to deny. Indeed, there has scarcely ever been a more enthusiastic eulogy of the revolutionising achievements of the capitalist system than that contained in the Communist Manifesto. The bourgeoisie, states the Manifesto, " has been the first to show what man's activity can bring about. It has accomplished wonders far surpassing Egyptian pyramids, Roman aqueducts, and Gothic cathedrals ; it has conducted expeditions that put in the shade all former exoduses of nations and crusades. . . . The bourgeoisie, by the rapid improvement of all instruments of production, by the immensely facilitated means of communication, draws all, even the barbarian, nations into civilisation. . . . The bourgeoisie, during its rule of scarce one hundred years, has created more massive and more colossal productive forces than have all preceding generations together. Subjection of Nature's forces to man, machinery, application of chemistry to industry and agriculture, steam navigation, railways, electric telegraphs, clearing of whole continents for cultivation, canalisation of rivers, whole populations conjured out of the ground—what earlier century had even a presentiment that such productive forces slumbered in the lap of social labour ? " The question arises, however, whether the institutions of private property of the means of production and of private enterprise will continue indefinitely to foster economic progress, or whether, at a certain stage of technical development, they turn, from being promoters, into becoming shackles of further advance. The last is the contention of the socialists.

The unprecedented economic progress of the last 200 years is due to innovations increasing the productivity of a given combination of factors of production, or creating new commodities and services. The effects of such innovations on the profits of private enterprise are twofold : (1) the entrepreneur introducing an innovation gains an immediate, though under free competition only temporary, profit, or increase in profit ; (2) the entrepreneurs using the antiquated means of production, or producing competing goods which are replaced by the cheapening rivals, suffer losses which ultimately lead to a devaluation of the capital invested in their business ; on the other side there may be entrepreneurs who profit by new demand created in consequence of the innovation. In any case, each innovation is necessarily connected with a loss of value of certain old investments. In a competitive régime, with the parametric function of prices and with free entry of new firms into each industry, entrepreneurs and investors *have* to submit to the losses and devaluation of old investments resulting from innovations, for there is no possibility of counteracting it. The only way is to try to introduce innovations in their own business, which, in turn, inflict losses on others. But when business units become so large as to make the parametric function of prices and the possibility of free entry of new firms (and investments) into the industry ineffective, there arises a tendency to avoid a devaluation of the capital invested. A private enterprise, unless forced by competition to do otherwise, will introduce innovations only when the old capital invested is amortised, or if the reduction of cost is so pronounced as to offset the devaluation of the capital already invested, i.e. if the average total cost becomes lower than the average prime cost of producing with the old machinery or equipment. But such slowing up of technical progress is against the social interest.[1] The tendency to maintain the value of existing investments becomes even more powerful when the ownership of the capital invested is separated from the entrepreneurial function, as is increasingly the case in modern so-called *financial capitalism*. For the industrial enterprise has to replace the full value of the capital invested or to fail. This is strictly true if the financing of the enterprise has been made through bond issues, but even if it has been made by stock issues a pronounced decline of stock quotations injures its financial prestige.

But the maintenance of the value of invested capital is not compatible with cost-reducing innovations. This has been pointed out very brilliantly by Professor Robbins: " The maintenance of the value of invested capital may very well mean that producers who find prospects in one industry more attractive than the prospects in any others are prevented from entering it, that cost-reducing improvements of technique which would greatly cheapen the commodity to consumers are held up, that the ' wasteful competition ' of people who are content to serve the consumer for lower returns than before is prevented from reducing prices. Every schoolboy knows that the cheapness which comes from importing corn is incompatible with the maintenance of the value of the corn lands which would be cultivated if import were restricted. The platitudes of the theory of international trade do not lose any of their force if they are applied to domestic competition. The argument, for instance, that road transport diminishes the value of railway capital has just as much and just as little force as the argument that cheap food lowers the value of agricultural property. . . . Economic progress, in the sense of cheapening of commodities, is not compatible with the preservation of the value already invested in particular industries." [2] Therefore, when the maintenance of the value of the capital already invested becomes the chief concern of the entrepreneurs, further economic progress has to stop, or, at least, to slow down

[1] It is in the interest of society that *any* improvement available be introduced, irrespective of what happens to the value of capital already invested. If the improvement allows the commodity to be produced at an average total cost which is lower than the average prime cost of producing it with the old machinery, a replacement of the old machinery by the new is obviously in the interest of the public. But even if the average total cost of the new method of production is not lower than the average prime cost of producing with the old machinery, its introduction is in the interest of the public. In such case both the old and the new machinery ought to be employed in production, the public getting the benefit of lower prices. The loss of value of the old capital invested is exactly compensated by the public's gain in consequence of price reduction. Cf. Pigou, *The Economics of Welfare*, third edition, London, 1929, pp. 190–2.

[2] *The Great Depression*, p. 141.

considerably. And in present capitalism the maintenance of the value of the particular investment has, indeed, become the chief concern. Accordingly, interventionism and restrictionism are the dominant economic policies.[1] But since innovations very frequently reduce the value of capital in other firms or industries rather than in that which introduces them, innovations cannot be stopped altogether. When the pressure of new innovations becomes so strong as to destroy the artificially preserved value of the old investments a frightful economic collapse is the result. The stability of the capitalist system is shaken by the alternation of attempts to stop economic progress in order to protect old investments and tremendous collapses when those attempts fail. The increasing instability of business conditions can be remedied only by either giving up the attempts to protect the value of old investments or by successfully stopping new innovations.

But holding back technical progress would involve the capitalist system in a new set of difficulties because of capital accumulation finding no outlet in profitable investment opportunities. Without technical progress (of the labour-saving kind), discovery of new natural resources, or considerable increase in population (and the latter two are not sufficient in our day to outbalance a lack of the first) the marginal *net* productivity of capital is liable to reach a level insufficient to compensate the liquidity preference of the capital-holders. This result will be even more accentuated when a part of the industries enjoy a monopoly position which enables them to protect the value of their investments, for new capital finding free entry only into those industries where free competition still prevails depresses the marginal *net* productivity of capital much more than would otherwise be the case. As substantiated by Mr. Keynes' brilliant analysis,[2] this would lead to a deflationary pressure resulting in chronic unemployment of the factors of production. To prevent such chronic unemployment the State would have to undertake great public investments, replacing thus the private capitalist where the latter refuses to enter because of the low rate of return on the investment. Unless further capital accumulation is prohibited effectively, the State would have to replace the private capitalists more and more in their function as investors. Thus the capitalist system seems to face an unescapable dilemma : holding back technical progress leads, through the exhaustion of profitable investment opportunities, to a state of chronic unemployment which can be remedied only by a policy of public investments on an ever-increasing scale, while a continuance of technical progress leads to the instability due to the policy of protecting the value of old investments which has been previously described.

It seems to us that the tendency to maintain the value of old investment can be removed successfully only by the abolition of private entreprise and of

[1] The protection of monopoly privileges and of particular investments is also the chief source of the imperialist rivalries of the Great Powers.

[2] Cf. *The General Theory of Employment*, pp. 217–21 and 308–9. It ought to be mentioned that the difficulties involved for the capitalist system in capital accumulation finding no outlet in profitable investment-opportunities were discussed, though without having reached any definite conclusions, by a long series of writers of the Marxist school : Tugan-Baranowski, Hilferding, Rosa Luxemburg, Otto Bauer, Bucharin, Sternberg, Grossmann, and Strachey are only the most important of them. Those writers have, however, been much more successful in explaining the bearing of those difficulties on the imperialist policy of the capitalist states.

the private ownership of capital and natural resources, at least in those industries where such tendency prevails. Two other ways of removing it are conceivable.

One way would be the return to free competition. This way, however, does not seem to be possible because of the large size of modern business units. In a system based on the pursuit of private profit each entrepreneur has the natural tendency to exploit all possibilities of increasing his profit. The tendency to restrict competition is as natural for private enterprise as the tendency to protect the value of old investments is natural for private ownership of capital. As Adam Smith long ago remarked : " The interest of dealers in any particular branch of trade or manufacturers is always in some respect different from, or even opposite to, that of the public. To widen the market and to narrow the competition is always the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public, but to narrow the competition must be always against it." [1] Or in another passage : " People of the same trade seldom meet together, even for merriment or diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." [2] No private entrepreneur or private capitalist can be expected to renounce voluntarily an opportunity to raise his profit or the value of his investment :

" Al mondo non fur mai persone ratte
a far lor pro ed a fuggir lor danno."
(*Inferno*, canto II.)

The system of free competition is a rather peculiar one. Its mechanism is one of *fooling* entrepreneurs. It requires the pursuit of maximum profit in order to function, but it destroys profits when they are actually pursued by a larger number of people. However, this game of blindman's buff with the pursuit of maximum profit is possible only as long as the size of the business unit is small and the number of entrepreneurs is consequently large. But with the growth of large-scale industry and the centralisation of financial control the pursuit of maximum profit destroys free competition. The picture would not be complete without adding that political interference in economic life is frequently used to protect profits or investments.[3] This political intervention is also a result of the growing size of industrial and financial units. Small-scale enterprises are too small to be politically significant, but the economic power of big corporations and banking interests is too large not to have serious political consequences. As long as the maximisation of profit is the basis of all business activities it is unavoidable that industrial and financial corporations should try to use their economic power to increase profits or the value of their investments by proper State intervention.[4] And unless the executive and

[1] *Wealth of the Nations*, vol. I, p. 250, of Cannan's third edition, London, 1922.

[2] Ibid., p. 130.

[3] Such political interference plays a much greater rôle in Europe than in the United States.

[4] This has also an important influence on the selection of business leaders. Under free competition the most successful leader of a business enterprise is he who is able to produce at the lowest cost. With interventionism and restrictionism the best business man is he who knows how best to influence in his interest the decisions of the organs of the State (for instance, in getting tariffs, government subsidies or orders, advantageous import quotas, etc.). A special ability in

legislative organs of the State are abstract metaphysical entities beyond the reach of any earthly influence, they will yield to the pressure of those powers. A return to free competition could be accomplished only by splitting up the large-scale business units to destroy their economic and political power. This could be attained only at the cost of giving up large-scale production and the great economic achievements of mass production which are associated with it. Such an artificially maintained system of free competition would have to prohibit the use of advanced technology.

The other way would be the control of production and investments by the government with the purpose of preventing monopoly and restrictionism. Such control would signify planning of production and investment without removing private enterprise and private ownership of the means of production. However, such planning can scarcely be successful. The great economic power of corporations and banks being what it is, it would be rather they who would control the public planning authorities than the reverse. The result would be planning for monopoly and restrictionism, the reverse of what was aimed at. But even if this could be avoided, such control would be unsuccessful. To retain private property and private enterprise and to force them to do things different from those required by the pursuit of maximum profit would involve a terrific amount of *regimentation* of investment and enterprise. To realise this one has but to consider that government control preventing restrictionist preservation of the value of old investments would have to force producers to act in a way which imposes on them actual *losses* of capital. This would upset the financial structure of modern capitalist industry. The constant friction between capitalists and entrepreneurs on the one side and the controlling government authorities on the other side would paralyse business. Besides, the corporations and big banks could use their economic power to defy the government authorities (for instance, by closing their plants, withdrawing investments, or other kinds of economic sabotage). As a result the government would have either to yield, and thus to give up any effective interference with the pursuit of maximum profit, or to transfer the defying corporations and banks into public ownership and management. The latter would lead straight to socialism.

Thus, monopoly, restrictionism, and interventionism can be done away with only together with private enterprise and the private ownership of the means of production, which, from being promoters, have turned into obstacles of economic progress. This does not imply the necessity, or wisdom, of abolishing private enterprise and private property of the means of production in those fields where real competition still prevails, i.e. in small-scale industry and farming. But the most important part of modern economic life is just as far removed from free competition as it is from socialism : [1] it is choked up with

this direction may well compensate the incapacity to produce at a low cost. The best lobbyist becomes the most successful business leader. What formerly was regarded as a special trait of the munitions industry becomes in interventionist capitalism the general rule.

[1] According to the United States Senate Report on " Industrial Prices and Their Relative Inflexibility " (74th Congress, 1st Session, Doc. No. 13, p. 10), written by Professor G. C. Means, in the United States, " more than one half of all manufacturing activity is carried on by 200 big corporations, while big corporations dominate the railroad and public utility fields and play an

restrictionism of all sorts. When this state of things will have become unbearable, when its incompatibility with economic progress will have become obvious, and when it will be recognised that it is impossible to return to free competition, or to have successful public control of enterprise and of investment without taking them out of private hands, then socialism will remain as the only solution available. Of course, this solution will be opposed by those classes who have a vested interest in the *status quo*. The socialist solution can, therefore, be carried out only after the political power of those classes has been broken.

6. ON THE POLICY OF TRANSITION

The preceding treatment of the allocation of resources and of pricing in a socialist economy refers to a socialist system already *established*. The question does not present any special theoretical difficulty if a sector of small-scale private enterprise and private ownership of means of production is embodied in the socialist economy. However, on grounds which result from our previous discussion of the problem, this sector should satisfy the following three conditions: (1) free competition must reign in it; (2) the amount of means of production owned by a private producer (or of the capital owned by a private shareholder in socialised industries) must not be so large as to cause a considerable inequality in the distribution of incomes; and (3) the small-scale production must not be, in the long run, more expensive than large-scale production. But the problem of *transition* from capitalism to socialism presents some special problems. Most of those problems refer to the economic measures made necessary by the political strategy of carrying through the transformation of the economic and social order. But there are also some problems which are of a purely economic character and which, therefore, deserve the attention of the economist.

The first question is whether the transfer into public property and management of the means of production and enterprises to be socialised should be the first or the last stage of the policy of transition. In our opinion it should be the first stage. The socialist government must start its policy of transition right away with the *socialisation* of the industries and banks in question. This follows from what has been said before on the possibility of successful government control of private enterprise and private investment. If the socialist government would attempt to control or supervise them while leaving them in private hands, there would emerge all the difficulties of forcing a private entrepreneur or capitalist to act differently than the pursuit of profit commands. In the best case the constant friction between the supervising government agencies and the entrepreneurs and capitalists would paralyse business. After such an unsuccessful attempt the socialist government would have either to give up its socialist aims or to proceed to socialisation.

important rôle in the fields of construction and distribution." Cf. also A. A. Berle and G. C. Means, *The Modern Corporation and Private Property*, New York, 1933, Book I, chap. III, and A. R. Burns, *The Decline of Competition*, New York, 1936.

The opinion is almost generally accepted that the process of socialisation must be as gradual as possible in order to avoid grave economic disturbance. Not only right-wing socialists but also left-wing socialists and communists [1] hold this theory of economic *gradualism*. While the latter two regard a speedy socialisation as necessary on grounds of political strategy, they nevertheless usually admit that, as far as economic considerations alone go, a gradual socialisation is decidedly preferable. Unfortunately, the economist cannot share this theory of economic gradualism. An economic system based on private enterprise and private property of the means of production can work only as long as the security of private property and of income derived from property and from enterprise is maintained. The very existence of a government bent on introducing socialism is a constant threat to this security. Therefore, the capitalist economy cannot function under a socialist government unless the government is socialist in name only. If the socialist government socialises the coal mines to-day and declares that the textile industry is going to be socialised after five years, we can be quite certain that the textile industry will be ruined before it will be socialised. For the owners threatened with expropriation have no inducement to make the necessary investments and improvements and to manage them efficiently. And no government supervision or administrative measures can cope effectively with the passive resistance and sabotage of the owners and managers. There may be exceptions in the case of industries managed by technicians rather than by business men. Those technicians, if assured that they will keep their places, may be quite sympathetic to the idea of transfer of the industry into public ownership. Also a scheme of proper compensation for expropriated owners may help to solve the difficulty. But to be fully effective the compensation would have to be so high as to cover the full value of the objects expropriated. The capital value of these objects having been maintained on an artificially high level by monopolistic and restrictionist practices, the compensation would have to be far in excess of the value of these objects in a socialist economy (and also under free competition in capitalism). This would impose on the socialist government a financial burden which would make any further advance in the socialisation programme almost impossible. Therefore, a comprehensive socialisation programme can scarcely be achieved by gradual steps. A socialist government really intent upon socialism has to decide to carry out its socialisation programme *at one stroke*, or to give it up altogether.[2] The very coming into power of such a government must cause a financial panic and economic collapse. Therefore, the socialist government must either guarantee the immunity of private property and private enterprise in order to enable the capitalist economy to function normally, in doing which it gives up its socialist aims, or it must go through resolutely with its socialisation programme at maximum

[1] How far the Russian Bolsheviks before taking power conceived socialisation as a gradual process can be seen from Lenin's pamphlet " The Threatening Catastrophe and How to Fight It " (*Works*, vol. XXI, Book I).

[2] This is true of any policy aiming at a radical change in property relations, not only of socialisation. For instance, an agrarian revolution like that taking place in Spain and due in many countries of Eastern Central Europe cannot proceed gradually if agricultural production is not to be ruined by many years of uncertainty.

speed.[1] Any hesitation, any vacillation and indecision provokes the inevitable economic catastrophe.[2] Socialism is not an economic policy for the timid.

On the other hand, as a complement to its resolute policy of speedy socialisation, the socialist government has to declare in an unmistakable way what sorts of property and enterprise are going to remain in private hands and to *guarantee their absolute security.* To avoid the growth of an atmosphere of panic in the sector of private property and private enterprise the socialist government may have to prove the seriousness of its intentions by some immediate deeds in favour of the small entrepreneurs and small property holders (including holders of saving deposits and small stock and bondholders). It has to make it absolutely clear to everybody that socialism is not directed against private property as such, but only against that special type of private property which creates social privileges to the detriment of the great majority of the people or creates obstacles to economic progress, and that, consequently, all private property in the means of production and private enterprise which does have a *useful social function* will enjoy the full protection and support of the socialist State.

We have seen that a socialist government faces the dilemma of either carrying out socialisation by a great and bold stroke, or giving up its socialist aims altogether. If it does the latter it remains socialist in name only, its real function being the administration of the capitalist economy, which can be done successfully only if the property of the capitalists and the freedom of the capitalist entrepreneurs to realise their profits are safeguarded. In such a case the socialists would do much better to turn over the office to a capitalist government which, having the confidence of the business world, is more fit to administer a capitalist society.

There exists, however, a special situation where a socialist government, even if it has not got the power to achieve a comprehensive socialisation, may have a useful task to fulfil, a task which a capitalist government may be unable to carry out. If the marginal efficiency of capital (as defined by Mr. Keynes [3]) is very low and the liquidity preference of the capitalists is very high, as usually is the case in a depression, a bold programme of public investments is needed to restore employment to a higher level. In principle, there is no reason why a capitalist government should not be able to perform those investments. But since they have to be effected without regard to the low rate of return upon them, i.e. in violation of the fundamental principle of the capitalist economy that investments ought to be made for profit only, they may appear to all the capitalist parties as "unsound." Thus it may take a socialist government,

[1] In the necessity to choose between these two alternatives lay the tragedy of all right-wing socialist governments.

[2] This was brought out clearly by the experience of the first eight months after the Bolsheviks got into power in Russia. The Soviet Government tried honestly to avoid speedy and wholesale socialisation of industries. An economic collapse was the result. Most of the socialisation decrees during those months were emergency measures which had to be taken because the old owners were unable to run their factories without the necessary security of property and profit and without the necessary authority over the workers. For details see Dobb, *Russian Economic Development since the Revolution*, New York, 1928, chapter II.

[3] Cf. *The General Theory of the Employment*, chap. 11.

free from the ballast of bourgeois prejudices about economic policies,[1] to restore the capitalist economy. In such circumstances the socialists might form a government with a Labour Plan to attack unemployment and the depression. But as soon as the Labour Plan is carried out the socialist government faces its unescapable dilemma: either the socialist government uses the popularity it has won through its success in handling the depression and unemployment for a general attack on the capitalist system (the opportunity for it may come, for instance, when the capitalists, who suffered the socialist government in a period of panic, want to get rid of it), or it degenerates into becoming purely the administrator of capitalist society. Thus a Labour Plan is either a start for the wholesale attack on the capitalist system, or it must end in a betrayal of socialism.

Marshall placed caution among the chief qualities an economist should have. Speaking of the rights of property he observed: " It is the part of responsible men to proceed cautiously and tentatively in abrogating or modifying even such rights as may seem to be inappropriate to the ideal conditions of social life." [2] But he did not fail to indicate that the great founders of modern economics were strong not only in caution but also in courage.[3] Caution is the great virtue of the economist who is concerned with minor improvements in the existing economic system. The delicate mechanism of supply and demand may be damaged and the initiative and efficiency of business men may be undermined by an improvident step. But the economist who is called to advise a socialist government faces a different task, and the qualities needed for this task are different, too. For there exists only one economic policy which he can commend to a socialist government as likely to lead to success. This is a policy of *revolutionary courage.*

APPENDIX

THE ALLOCATION OF RESOURCES UNDER SOCIALISM IN MARXIST LITERATURE

It is interesting to see how the problem of allocation of resources in a socialist economy is solved by the leading writers of the socialist movement and to compare it with the solution offered by modern economic theory. As the theoretical foundations of the socialist movement have been elaborated chiefly by the Marxists, it is their views which are of foremost interest. For this purpose let us review briefly the statements of some of the most prominent of them.

[1] It ought to be mentioned, however, that sometimes socialist governments have proved to be affected much more by the bourgeois prejudices regarding economic and financial policies than capitalist governments often are. The reason for it was that by the " soundness " of their policies they wanted to make up for the lack of confidence of the business and financial world. It need not be said that even at this price a socialist government scarcely wins the sympathy of the big capitalist and financial interests while it forfeits its only chance of success in its economic policies.

[2] *Principles of Economics*, eighth edition, London, 1930, p. 48.

[3] Ibid., p. 47.

To begin with Marx, it is not difficult to prove by quotations that he was well aware of the problem, though he tried to solve it in a rather unsatisfactory way. Discussing the economics of Robinson Crusoe he writes: "Moderate though he be, yet some few wants he has to satisfy, and must therefore do a little useful work of various sorts. . . . Necessity itself compels him to apportion his time accurately between his different kinds of work. . . . This our friend Robinson soon learns by experience, and having rescued a watch, ledger, and pen and ink from the wreck, commences, like a true-born Briton, to keep a set of books. His stock book contains a list of the objects of utility that belong to him, of the operations necessary for their production, and, lastly, of the labour-time that definite quantities of those objects have, on the average, cost him. All the relations between Robinson and the objects that form this wealth of his own creation are here so simple and clear as to be intelligible without exertion even to Mr. Sedley Taylor. And yet those relations contain all that is essential to the determination of value." [1] And he continues: "Let us now picture to ourselves, by way of change, a community of free individuals, carrying on their work with the means of production in common. . . . All the characteristics of Robinson's labour are here repeated, but with this difference, that they are social instead of individual. . . . The total product of our community is a social product. One portion serves as fresh means of production and remains social. But another portion is consumed by the members as means of subsistence. The mode of this distribution will vary with the productive organisation of the community, and the degree of historical development attained by the producers. We will assume, but merely for the sake of a parallel with the production of commodities, that the share of each producer in the means of subsistence is determined by his labour-time. Labour-time would, in that case, play a double part. Its apportionment in accordance with a definite social plan maintains the proper proportion between the different kinds of work to be done and the various wants of the community. On the other hand, it also serves as a measure of the portion of common labour borne by each individual and of his share in the part of the total product destined for individual consumption." [2] Each worker would enjoy freedom of choice in consumption within the limits thus determined: "He receives from society a voucher that he has contributed such and such a quantity of labour (after deduction from his labour for the common fund) and draws through this voucher on the social storehouse as much of the means of consumption as costs the same quantity of labour." [3] The importance of the problem of allocating resources is stated very clearly in a letter written in 1868 to Kugelmann: "Every child knows that a country which ceased to work, I will not say for a year, but for a few weeks, would die. Every child knows, too, that the mass of products corresponding to the different needs require different and quantitatively determined masses of the total labour of society. That this necessity of distributing social labour in definite proportions cannot be done

[1] *Capital*, vol. I, edited by Untermann, Chicago, Kerr, 1908, p. 88 (p. 43 of the sixth German edition, Hamburg, Meissner, 1909).

[2] *Capital*, vol. I, pp. 90–1 (p. 45 of the sixth German edition).

[3] *Critique of the Gotha Programme*, London, 1933, p. 29. (I have had to correct the translation, which is inaccurate.)

away with by the *particular form* of social production, but can only change the *form it assumes*, is self-evident. No natural laws can be done away with. What can change, in changing historical circumstances, is the *form* in which these laws operate. And the form in which this particular division of labour operates, in a state of society where the interconnection of social labour is manifested in the *private exchange* of the individual products of labour, is precisely the *exchange value* of these products." [1]

The places quoted show that Marx was fully aware of the problem of allocation of resources in a socialist economy. However, he seems to have thought of labour as of the only kind of scarce resource to be distributed between different uses and wanted to solve the problem by the labour theory of value. The unsatisfactory character of this solution need not be argued here, after all our preceding discussion of the subject. Professor Pierson and Professor Mises have certainly merited the gratitude of the student of the problem by exposing the inadequacy of this simplicist solution.[2] But even accepting the labour theory of value as a basis for the solution of the problem, the question of utility (or of demand) cannot be avoided, or the amounts of the various goods to be produced would be indeterminate. This was recognised clearly by Engels: " The utility yielded by the various consumption goods, weighted against each other and against the amount of labour required to produce them, will ultimately determine the plan." [3] Whoever knows the rôle the concept of " gesellschaftliches Beduerfnis " plays in the third volume of *Das Kapital* has to admit that Marx was well aware of the rôle demand (or utility) has in determining the allocation of resources, though, not unlike Ricardo,[4] he was not able to find a clear functional expression of the law of demand. The limitations of Marx and Engels are those of the classical economists.

From Marx and Engels let us pass to Kautsky, who more than anybody else has contributed to the propagation of Marxian ideas the world over. In a lecture on " The Day after the Revolution," [5] given in 1902, which to a

[1] Cf. *The Correspondence of Marx and Engels*, International Publishers, New York, p. 246. This and some other statements disprove the generally accepted view that Marx regarded *all* economic laws as being of an historico-relative character. His position seems to have been, however, that the economic laws of universal validity are so self-evident that there is scarcely need for a special scientific technique for their study and economic science ought to concentrate, therefore, upon investigating the particular form these laws assume in a definite institutional framework. Cf. also Engels, *Anti-Dühring*, twelfth edition, Berlin, 1923, pp. 149–50.

[2] Cf. Pierson, " The Problem of Value in the Socialist Society," reprinted in *Collectivist Economic Planning*, p. 76 *et seq.*, and Mises, *Economic Calculation in the Socialist Commonwealth*, ibid. p. 113 *et seq.*

[3] *Anti-Dühring*, pp. 335–6. With some benevolent interpretation this statement of Engels may be regarded, indeed, as containing all the essentials of the modern solution. Interpreting the amount of labour necessary to produce a certain good as the *marginal* amount, all costs may be reduced, in long-period equilibrium, to labour-costs. The prices of the services of natural resources may be regarded as differential rents, and if capital accumulation has been carried on as far as to reduce the marginal *net* productivity of capital to zero (as a socialist society would tend to do, cf. p. 65 of Part One), interest charges are eliminated. Thus the production of each commodity has to be carried so far as to make the ratio of the marginal amount of labour used in producing the different commodities equal to the ratio of the marginal utilities (and of the prices) of those commodities. But such long-period solution eliminating interest would be of little use for practical purposes.

[4] *Vide* Ricardo's treatment of demand in connection with the theory of rent.

[5] Published as a second part of the booklet *The Social Revolution* (quoted according to the edition by Kerr, Chicago, 1910).

certain extent was an answer to Professor Pierson's challenge, Kautsky formulates his view as to the rôle of money and prices in a socialist economy. He makes it quite clear that, as a result of freedom of choice in consumption and of freedom of choice of occupation, money and prices have to exist also in a socialist economy. " Money [he says] is the simplest means known up to the present time which makes it possible in as complicated a mechanism as that of the modern productive process, with its tremendous far-reaching division of labour, to secure the circulation of products and their distribution to the individual members of society. It is the means which makes it possible for each one to satisfy his necessities according to his individual inclination (to be sure within the bounds of his economic power)." [1] And with regard to the allocation of labour to the different industries in a socialist economy he observes: " Since the labourers cannot be assigned by military discipline and against their wishes to the various branches of industry, so it may happen that too many labourers rush into certain branches of industry while a lack of labourers is the rule in the others. The necessary balance can then only be brought about by the reduction of wages where there are too many labourers and the raising of them in those branches of industry where there is a lack of labourers until the point is reached where every branch has as many labourers as it can use." [2] Unfortunately, Kautsky did not enter into the question of the criteria to be used in planning production. However, he carried his ideas farther in his book *The Labour Revolution,* written in 1922.[3] Raising again the point that socialism does not imply the abolition of money, he states very clearly the connection of the problem with the freedom of choice in consumption: " Without money only two kinds of economy are possible: First of all the primitive economy already mentioned. Adapted to modern dimensions, this would mean that the whole of productive activity in the State would form a single factory, under one central control, which would assign its task to each single business, collect all the products of the entire population, and assign to each business its means of production and to each consumer his means of consumption in kind. The ideal of such a condition is the prison or the barracks. This barbarous monotony lurks in fact behind the ideas of the ' natural economy ' of Socialism." [4] Quoting a socialist enthusiast of " natural economy " who finds no difficulty in rationing consumption, Kautsky remarks: " Assuredly not, if the entire life of a civilised man is to be reduced to war rations, and everybody to have the same quantity of bread, meat, accommodation, clothes, personal taste not playing any part and distinctions not being observed, although there is to be special cooking for poets and children. Unfortunately, we are not told how many hundredweights of books are to be allotted to each citizen in the course of a year, and how frequently the inhabitants of each house are to go to the cinematograph." [5] The other kind of socialist economy which might do without money is, according to Kautsky, that where all commodities would be free goods.[6]

[1] *The Social Revolution,* p. 129.
[2] Ibid., pp. 134–5.
[3] New York, 1925. The title of the German original is: *Die proletarische Revolution und ihr Programm,* Berlin, 1922.
[4] Loc. cit., p. 260. [5] Ibid., p. 260. [6] Ibid., p. 261.

Kautsky also recognises the necessity of a price system for cost accounting. Like all Marxists of the old school he uses the labour theory of value as a basis for elucidating the problem of the distribution of resources in a socialist economy. But what is most important, he quite explicitly admits the practical impossibility of calculating the amount of labour socially necessary to produce a given commodity: "Consider what colossal labour would be involved in calculating for each product the amount of labour it had cost from its initial to its final stage, including transport and other incidental labour." [1] Hence the necessity of a price system: "The appraisement of commodities according to the labour contained in them, which could not be achieved by the most complicated State machine imaginable, we find to be an accomplished fact in the shape of the transmitted prices, as the result of a long historical process, imperfect and inexact, but nevertheless the only practical foundation for the smooth functioning of the economic process of circulation." [2] Thus money priees are the basis of economic accounting: "Whatever may be the lines upon which a socialist society is organised, very careful accountancy would be required. . . . This object would be quite impossible of attainment if the incomings and outcomings were entered *in kind*." [3] The great leader of orthodox Marxism in pre-war times knows, of course, very well the distinction between the Marxian concept of capitalism and that of a money economy: "Thousands of years passed before a capitalist mode of production came into existence. As the measure of value and means of circulation of products money will continue to exist in a socialist society until the dawn of that blessed second phase of communism which we do not yet know whether will be ever more than a pious wish, similar to the Millennial Kingdom." [4] Finally, he concludes: "The monetary system is a machine which is indispensable for the function of a society with a widely ramified division of labour. . . . It would be a relapse into barbarism to destroy this machine, in order to resort to the primitive expedients of natural economy. This method of combating capitalism recalls the simple workers of the first decades of the last century who thought they would make an end to capitalist exploitation if they smashed the machines which they found to hand. It is not our desire to destroy the machines, but to render them serviceable to society, so that they may be shaped into a means of the emancipation of labour." [5]

But are perhaps these views of Kautsky's a heretical deviation from the orthodox line of Marxist thought? Maybe they are not representative for modern Marxists, a large part of whom are bitter opponents of the political strategy advocated by him? Let us examine the views of another group of Marxist leaders. The following quotation from Trotsky to begin with: "If there existed the universal mind that projected itself into the scientific fancy of Laplace . . . such a mind could, of course, draw up *a priori* a faultless and an exhaustive economic plan, beginning with the number of hectares of wheat and down to the last button for a vest. In truth, the bureaucracy often conceives that just such a mind is at its disposal; that is why it so easily frees itself from the control of the market and of Soviet democracy. But in reality

[1] *The Labour Revolution*, p. 264. [2] Ibid., p. 267. [3] Ibid., p. 262.
[4] Ibid., p. 262. [5] Ibid., p. 270.

the bureaucracy errs frightfully in this appraisal of its spiritual resources. . . . The innumerable living participants of economy, State as well as private, collective as well as individual, must give notice of their needs and of their relative strength not only through the statistical determination of plan commissions but by the direct pressure of supply and demand. The plan is checked and to a considerable measure realised through the market. The regulation of the market itself must depend upon the tendencies that are brought out through its medium. The blueprints brought out by the offices must demonstrate their economic expediency through commercial calculation." [1] And after the critic of the Soviet economic policy let us listen to its leader. In discussing the problem of Soviet trade Stalin observes: "Then we have to overcome prejudices of another kind. I refer to the Leftist chatter . . . about Soviet trade being a superseded stage. . . . These people, who are as far removed from Marxism as heaven is from earth, evidently do not realise that we shall have money for a long time to come, until the first stage of communism, i.e. the socialist stage of development, has been completed." [2]

But Marx anticipated also a second phase of communism (which sometimes is also called communism *sensu stricto* while the first phase is called socialism) in which the distribution of incomes is quite divorced from the labour services performed by the individual and based on the principle "from each according to his capacity, to each according to his need." [3] Bertrand Russell calls this form of distribution very aptly "free sharing." [4] Free sharing presupposes, of course, that the commodities in question are practically free goods. An outstanding Marxist like Kautsky speaks, therefore, with irony of "that blessed second phase of communism which we do not yet know whether will ever be more than a pious wish, similar to the Millennial Kingdom," while Lenin [5] and Stalin believe seriously in the possibility of such a stage of economic evolution in the future.

The idea of distributing goods and services by free sharing sounds utopian, indeed. However, if applied to only a part of commodities free sharing is by no means such economic nonsense as might appear at a first glance. The demand for many commodities becomes, from a certain point on, quite inelastic. If the price of such a commodity is below and the consumer's income is above a certain minimum the commodity is treated by the consumer *as if* it were a free good. The commodity is consumed in such quantity that the want it serves to satisfy is perfectly *saturated*. Take, for instance, salt. Well-to-do people do the same with bread or with heating in winter. They do not stop eating bread at a point where the marginal utility of a slice is equal to the marginal utility of its price, nor do they turn down the heat by virtue of a similar consideration. Or would a decline of the price of soap to zero induce them to be so much more liberal in its use? Even if the price were zero, the amount of salt, bread, fuel, and soap consumed by well-to-do people would

[1] *Soviet Economy in Danger*, Pioneer Publishers, New York, 1932, pp. 29–30.

[2] "Report on the work of the Central Committee of the Communist Party of the Soviet Union made to the Seventeenth Party Congress held in Moscow, January 26 to February 10, 1937."

[3] *Critique of the Gotha Programme*, p. 31.

[4] See *Roads to Freedom*, London, 1919, p. 107 *et seq.*

[5] Cf. "The State and Revolution," chapter V (4) (*Works*, vol. XXI, Book II.).

not increase noticeably. With such commodities saturation is reached even at a positive price. If the price is already so low, and incomes so high, that the quantity consumed of those commodities is equal to the *saturation* amount, free sharing can be used as a method of distribution.[1] Certain services are distributed in this way already in our present society. If a part of the commodities and services is distributed by free sharing, the price system needs to be confined only to the rest of them. However, though the demand for the commodities distributed by free sharing is, within limits, a fixed quantity, a cost has to be accounted for in order to be able to find out the best combination of factors and the optimum scale of output in producing them. The money income of the consumers must be reduced by an equivalent of the cost of production of these commodities. This means simply that free sharing provides, so to speak, a " socialised sector " of consumption the cost of which is met by taxation (for the reduction of consumers' money-incomes which has just been mentioned is exactly the taxation to cover the consumption by free sharing). Such a sector exists also in capitalist society, comprising, for instance, free education, free medical service by social insurance, public parks, and all the collective wants in Cassel's sense (e.g. street lighting). It is quite conceivable that as wealth increases this sector increases, too, and an increasing number of commodities is distributed by free sharing until, finally, all the prime necessaries of life are provided for in this way, the distribution by the price system being confined to better qualities and luxuries. Thus Marx's second phase of communism may be gradually approached.

The statements quoted are sufficient to prove that the leading writers of the Marxist school were and are quite aware of the necessity of the price system in a socialist economy. It is, therefore, very much exaggerated to say that the Marxian socialists did not see the problem and offered no solution. The truth is that they saw and solved the problem only within the limits of the labour theory of value, being thus subject to all the limitations of the classical theory. But it ought to be mentioned that in Italy, due to the influence of Pareto, the socialist writers were much more advanced in this field. The difference between the traditional Marxist and the modern position on the problem is thus but a difference as to the technique applied. Only the technique provided by the modern method of marginal analysis enables us to solve the problem satisfactorily. Professor Mises' challenge has had the great merit of having induced the socialists to look for a more satisfactory solution of the problem, and it is only too true that many of them became aware of its very existence only after this challenge. But, as we have seen, those of the socialists who did not or do not realise the necessity and importance of an adequate price system and economic accountancy in the socialist economy are backward not only with regard to the present state of economic analysis : they do not even reach up to the great heritage of Marxian doctrine.

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[1] See Russell, *Roads to Freedom*, pp. 109–10.