

The European Heritage in Economics and the Social Sciences
Series Editors: J. Backhaus · G. Chaloupek · Hans A. Frambach

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The First Socialization Debate (1918) and Early Efforts Towards Socialization

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The European Heritage in Economics and the Social Sciences

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The European heritage in economics and the social sciences is largely locked in languages other than English. Witness such classics as Storch's *Cours d'Economie Politique*, Wicksell's *Finanztheoretische Untersuchungen* and *Geld, Zins und Güterpreise* or Pareto's *Trattato di Sociologia Generale*. Since about 1937, partly caused by the forced exodus of many scholars from the German language countries and the international reactions to this event, English has become the undisputed primary language of economics and the social sciences. For about one generation, this language shift did not result in a loss of access to the European non-English sources. However, after foreign language requirements were dropped as entry pre-requisites for receiving the Ph.D. at major research universities, the European heritage in economics and the social sciences has become largely inaccessible to the vast majority of practicing scholars. In this series, we hope to publish works that address this problem in a threefold manner. An aspect of the European heritage in a language other than English should be critically documented and discussed, reconstructed and assessed from a modern scientific point of view, and tested with respect to its relevance for contemporary economic, social, or political discourse. We welcome submissions that fit this bill in order to make the European heritage in economics and the social sciences available to the international research community of scholars in economics and the social sciences.

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Introduction

When the First World War ended in 1918, Europe faced great challenges and an uncertain future. In the defeated Central Powers, the monarchic political systems collapsed. New states were formed in Central Europe after the dissolution of the Habsburg Empire and Czarist Russia. Parliamentary democracy was introduced in Germany and in Austria, whereas in Russia, and for a short period also in Hungary, Bolshevik revolutions with the goal to abolish the capitalist economic system and replace it by a socialist economic system caused political upheaval.

During the war, the majority of soldiers came from the working class. When the war ended, they were urging for adequate political representation, as well as changes in the economic and social system. While the most radical political forces on the left were striving for an introduction of the Rätssystem (Soviet/council system), following the Russian example introduced after the October Revolution of 1917, Social Democrats were determined to maintain the system of parliamentary democracy and the rule of law, where changes in the economic and social order would have to be enacted and implemented on the basis of decisions of the parliament. "Socialization" became the central concept of the political debate about the reform of the economic system. Socialists had the leading role, but traditional economic and social elites who had controlled the political system before the war were willing to make concessions to the working class and put forward their own concepts for socialization.

There was no consensus on the meaning of the concept of "socialization." From a radical Marxist perspective, socialization implied abolition of private ownership and (total or partial) nationalization of the means of production. In a wider sense, socialization meant that some form of control of the state or representative institutions of society (trade unions and business associations, consumer cooperatives, other types of cooperatives) would replace the prewar type of the liberal market economy. However, in view of the disastrous social and economic situation, there was some agreement at the political level that the efficiency of the national economy and the supply of goods and services to the population should not be even further endangered.

Given the initial complexity, before implementing specific socialization measures governments in Germany and in Austria established Socialization Commissions (Sozialisierungskommissionen) composed of experts, representatives of labor and business, and politicians. In Germany, a “Commission for the Preparations for the Socialization of the Industry” was set up in December 1918. It was chaired by Karl Kautsky, with Joseph Schumpeter, Emil Lederer, Rudolf Hilferding among its members. Its mandate was to analyze and to assess the economic risks of potential socialization measures under consideration. As early as February 1919, the commission submitted a first, preliminary report on the question of the socialization of coal mining, followed by the proposal for a “Law for the socialization of the coal mining” in March of that same year, which was never implemented. Due to different circumstances, the work of the commission was interrupted and resumed as “Second Socialization Commission” in March 1920 with increased membership, mostly practitioners from associations of business and labor, and representatives from political parties. Until its final dissolution in 1923, the commission worked out numerous suggestions for the implementation of socialization measures which, however, never had any direct political effect. The same is true with respect to the Austrian Socialization Commission. In the 1920s, issues of socialization gradually disappeared from the political agenda as well as from the theoretical debate.

The socialization debate was not confined to Germany and Austria. It also took place in other European countries in greater or lesser intensity. The idea of socialization was also popular in the victorious countries. For instance, the concept of “guild socialism” advocated by the British trade union movement played an important role in the socialization debates on the continent, as shown in the contributions on parallel debates in the Netherlands and in Italy in this volume.

The atmosphere of social unrest and political turmoil, which prevailed after the postwar years, deeply unsettled the old political and social elites, forcing them to consider and accept far-reaching concessions in the sociopolitical field, thus preparing the ground for social reform legislation which eventually laid the basis of the modern welfare state. It was this by-product which turned out to be the lasting effect of the socialization movement.

Moreover, while many of the numerous approaches at that time for establishing national economic control over a capitalist economy turned out to be unfeasible or unsustainable, they nevertheless anticipated what John Maynard Keynes later demanded, namely “The End of Laissez-Faire” capitalism, for which he, of course, offered his own theoretical foundation.

From today’s perspective, the experiment of “real existing socialism” has proven that socialization in the sense of central planning, governing and abolition of private property of the means of production is not an appropriate way to pursue the social ideals which had motivated the movement for socialization. However, in a long-term perspective the problems, which the movement addressed, particularly the uneven distribution of power, of income and wealth, the exploitation of human labor and insufficient living standards of large parts of the world’s population are pressing issues even today. Thus, it is not surprising that in the course of increasing

distributional inequalities within the global system of capitalism, the call for state intervention becomes stronger. Issues of control of the economy by society, of regulatory interventions and the indication of limits, are as relevant as they were a hundred years ago.

The one-hundred year anniversary of the Socialization Commission shall serve as an occasion to discuss basic issues of socialization once again, including the consideration of current developments, presenting the reader with contributions and assessments of socialization from different European countries (Austria, Germany, Holland, and Italy), and taking into account the hitherto only little-explored scientific insights into the subject.

The volume starts with an essay by **Hans A. Frambach**. The loud calls for more state influence seemed justified in the situation in Germany after WWI. Socialization appeared to many people as the only plausible way forward—it was the task of the commission to find out about its feasibility. Yet many circumstances existed, which in retrospect, suggested that the commission would fail right from the start. A clear political majority for the comprehensive socialization of the economy had never existed. The majority of the population wished for parliamentary democracy, and there was the belief that a constitutional revolution would bring more rather than less democracy. Because of their fear of aggravating the chaotic situation, the ruling parties acted carefully. They feared that there would be a lack of experienced persons to take on the tasks of the capitalist businessmen in case of nationalization and wanted to prevent a collapse of the state administration and national economy. The Socialization Commission itself classified nationalization as realistic only with respect to the coal mining sector. Nevertheless, important lessons can be learned today from the activities of the Socialization Commission. This is especially true concerning the tradeoff between regulation and control by the state on the one hand, and the necessity of maintaining economic performance and social stability on the other.

Rudolf Hilferding was a member of the Socialization Commission and later Reich Minister of Finance; he was also a skilled pediatrician, social democrat, and theoretician of Marxism. In his seminal book “Finance Capital,” he developed the concept of “Organized Capitalism” and laid down the foundations for the later theory of state monopoly capitalism. In his contribution, **Jan Greitens** describes Hilferding’s version of socialism and presents with due regard to his ideas during the time of the Socialization Commissions. Hilferding, remaining true to his theoretical principles, changed his position on how to realize socialism by abandoning a revolutionary transformation in favor of a gradual democratic process carried out by evolutionary means. Nevertheless, he adhered to the principle of planned production and disbelieved in the power of market competition. Furthermore, particular attention is paid to the great influence which Ferdinand Tönnies’ ideas on socialism and property had on Hilferding’s concepts, for example, those referring back to Tönnies’ concepts of community and society.

Heinrich Brauns, the Reich Minister of Labor in the Nineteen-Twenties, wanted to avoid a repeat of what took place in Russia, namely the transfer of private property into common property and expropriation without compensation. As an

ordained priest he engaged himself in the interest of the workers. Later, after studying political science and national economics, he became the most renowned speaker of the Volksverein and an influential member of the Center party, defending vehemently the position of the Christian unions. Being an advocate of capitalist principles, Brauns nevertheless saw great merit in the enforcement of labor rights and supported the idea. He also sympathized with the restriction and control of monopolistic power and the socialization of the coal mining industry. The change in Brauns' position from a partial supporter to a critical observer in the socialization topic is carefully documented and evaluated from an economic perspective by **Daniel Eissrich** in his contribution "[Visions of Socialization and Political Reality—The Position of Labour Minister Heinrich Brauns.](#)"

In his overview, **Karl-Heinz Schmidt** presents prominent views on socialization strategies in Germany since the first socialization debate; these concepts offer a long-term perspective of socialization based on solid economic theory. Included are selected writings from Franz Eulenburg that deal with measures for developing economic life toward a socialist order, Eduard Heimann's conceptual ideas on the sociological unification of people and central economic planning, Joseph Schumpeter's deliberate reflections about the relations of democracy and socialist society, Gisbert Rittig's theoretical considerations of socialization with its paramount role of the consumers, and Klaus Novy's cautious assessment of different socialization strategies.

The fundamental issue of how to organize the state and the economy in the time of crisis and misery at the end of WWI and the proclamation of the German Republic opened up a unique opportunity for the introduction of socialization. Within the First Socialization Commission, many questions about the implementation of economic and social means were discussed for assessing socialization. Of great importance was the participation of people in a socialist state of whatever kind, participation of workers, consumers, former owners, producers, tenants, and others. In their contribution, **Ursula** and **Jürgen Backhaus** focus on labor participation. In particular, they consider the proposals of two selected theoreticians of socialism: Eduard Heimann, the secretary of the First Socialization Commission, and Karl Korsch, a jurist and social philosopher, regarded as a significant innovator of Marxist philosophy and theory in the first half of the twentieth century. While Heimann saw socialism as a possible solution to handle the problem of the power concentration and monopolization of cartels, he disagreed that profits gained from innovation should be attributed to workers, because they are not based on the workers' activities (to this end he can be seen as a forerunner of the theory of entrepreneurial wage). Korsch, who represented the tradition of dialectic Marxism and endorsed the idea of transferring private property into common property to be distributed to different groups in society, saw the cooperative as the ideal form of a socialized company and considered different aspects of worker participation. It is shown that in the proposals of the socialists, a normative foundation can be found for the modern system of codetermination in Germany.

In his contribution on "[Anti-Semitism Versus Democracy and Welfare State in the Weimar Republic,](#)" **Hans-Dieter Bernd** shows how parts of the old government

elite tried to instrumentalize existing prejudices to publicly discredit democracy and the welfare state in order to preserve the political system and the class structure. Using the example of the German National People's Party (DNVP) it is argued that specifically Anti-Semitism was used as a popular means in political practice to disparage the political opponent. The conservatives saw the issue of social responsibility more as a Christian requirement rather than a state one. It was intended to present democracy to the citizens as something foreign that did not match the German nature. The population should be convinced to reject democracy as being unsuitable. A reeducation of the people through Anti-Semitism was envisaged. In this endeavor, which ultimately failed, Jews who were regarded as particularly gifted and talented in writing were entrusted with the task. Many industrials and members of the nobility feared the expropriation of their assets in light of the socialization efforts. In brief: They feared Russian circumstances.

The Austrian national economist Otto Neurath was one of the most active participants in the socialization debate after the WWI. **Günther Chaloupek** introduces Neurath's radical proposals to change the economic system and his specific and sometimes peculiar terminology as the concepts of Voll- and Teilsozialisierung (total socialization and partial socialization) and Naturalrechnung (in-kind accounting) suggest. Neurath advocated theories and ideas about economies functioning without money and in connection with this, he, convinced by socialist ideas, aimed for the implementation of a centrally planned economy in an encompassing style, rejecting any kind of market socialism. Chaloupek presents Neurath's thoughts and ideas as well as various criticisms of them.

Very famous socialization concepts with lasting impact were invented by non-socialist economists in Austria. **Günther Chaloupek** in his second contribution exposes the approaches of the Austrian economists Karl Pribram, and Gustav Stolper envisaging socialization without the transfer of private ownership. Whereas Pribram deems a comprehensive framework of associations crucial for forming the institutional basis for control of the means of production across industries, Stolper goes even further. He demands innovative forms of social organizations able to realize the greatest possible increase in productivity and production while simultaneously considering the fulfillment of just social aims and the consolidation of the state budget. Any attempts to build a planned economy are clearly rejected. Both Pribram and Stolper—and here they were in line with the industrialist, political writer, politician, and German foreign minister Walther Rathenau—were convinced that private ownership of the means of production would have to be maintained in the interest of personal freedom and also as the driving force of economic dynamics. The different and thoroughly ambivalent positions of Joseph Schumpeter on socialization during his scientific life stages are clearly carved out as well as distinct from those concepts of Pribram and Stolper.

The development path from nationalization to planning in the time during the interwar period in the Netherlands under special consideration of how to organize the national economy in a socialist environment is described by **Andries Nentjes** in his article [“From Socialisation to Regulation—The Secularisation of Dutch Social Democracy.”](#) He shows that the vital discussion of the Dutch social democrats on a

socialist society and economy, their belief that the forces of capitalism would lead into socialism with means of production owned by the community was a rather theoretical one because the social democrats never participated in government during the interbellum period. Doubts on the implementation of a socialist society seemed existing and perhaps indicating a lacking will of the Dutch social democrats to cause a structural change.

In his contribution on Schumpeter's view of the demise of capitalism, **Frits van Holthoorn** stresses Schumpeter's assessment of the situation of capitalism after WWI, assuming the entrepreneur, once being the only "true capitalist" but increasingly losing its role in favor of managers and experts of the big corporations. It is argued that for Schumpeter, socialism at that time was neither a threat nor an option. Later, in "Capitalism, Socialism, and Democracy" Schumpeter prophesied the demise of capitalism and its transition to socialism, provided that socialism was managed properly, which meant first of all to successfully combat the serious problem of market power. Schumpeter factually treated capitalism and socialism as strict alternatives, while not considering different types of a mixed economy. This was done by authors like Rudolf Hilferding, Walther Rathenau, Karl Pribram, and Gustav Stolper, whose contributions are discussed in the chapters by Francesco Forte and Günther Chaloupek in this volume.

Francesco Forte focuses on the three Schumpeterian theories in "Capitalism and the Crisis of Fiscal State," on Walter Rathenau's corporative "New Society" with codetermination, and on Rudolf Hilferding on the domination of financial capital, the three supply-side models of neo-capitalistic organization within democracy which allow the recovery of sentiments of national identity by the masses and which as the author points out are still current today in various aspects.

A prerequisite for the fundamental change of the societal and economic systems toward the direction of democracy and a welfare state in Europe and Germany in particular, was greater political influence by the masses, i.e., a stronger consideration of the working class, inducing an ongoing decline in income and asset inequality in Europe. But this greater influence, partially steered by the social elite, could only take place by affecting people's preferences, which is analyzed with the help of a model by **Francesco Forte, Elena Seghezza, and Giovanni B. Pittaluga**. Their model includes such factors as social identity, national belonging, class interest, interest conflicts, redistributive goals, inflationary policies, organization of class interests, widening of suffrage, and the emergence of corporatism in order to explain the democratic structure of modern European welfare states.

The immediate success of the Socialization Commission was limited, but its lasting value lies in the many interesting impressions and ideas it produced. An early fundamental, systematic, and general criticism of socialism at the end of WWI—exactly at the time, it was being discussed as a practical alternative for the existing political and economic system—was posed by Ludwig von Mises denying that rational economic calculation could be possible under socialism. He blamed socialism for ignoring the essential purpose of the price mechanism and the required conditions for a modern, complex economy, namely the existence of markets and private ownership of the means of production, combined with the

declining incentives of people and the inadequacy of available information in a planned economy. On account of Mises, a real debate was ignited regarding the possibilities or impossibilities, successes, and failures of socialist planning, which remains important until today. In his “[Mises’ Argument Against the Possibility of Socialism: Early Concepts and Contemporary Relevance](#),” **Ludwig Van den Hauwe** gives an overview of the development of this debate and issues related.

An answer on Mises’ thesis of impossibility of economic calculation in a socialist economy was given by Jakob Marschak and also his teacher, Emil Lederer, who—in contrast to Mises—argued that the market mechanism would have its place in socialism as well. In Chapter “[On the \(Im\)possibility of Socialist Calculation: Marschak Versus Mises](#),” **Harald Hagemann** presents this debate stating that the advantages of monopolization exist precisely in those two areas which are particularly affected by Mises’s skepticism: in the economic calculation for goods of higher order and in the sphere of dynamics.

The chapters in this volume are the revised contributions to the Heilbronn Symposium in Economics and the Social Sciences in 2018. In behalf of the entire Heilbronn group, we would like to thank the city council and the Lord Mayor of the City of Heilbronn for their continued generous support.

Ursula Backhaus
Günther Chaloupek
Hans A. Frambach

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The First Socialization Debate of 1918: Was the Socialization Commission Doomed to Failure Right from the Start?



Hans A. Frambach

1 Some Historical Background

World War I ended on November 11, 1918 when in the woods of Compiègne, 60 km northeast of Paris, the representatives of Germany and the allies signed the armistice agreement with hardly acceptable conditions for Germany. Nearly 6 million men and women lost their lives during the war, some 1.8 million in Germany alone. With the onset of winter in 1917 the supply situation of the German population also deteriorated. Although insurance legislation between 1883 and 1889 had enacted various measures for the protection of the working population in the form of health, accident, disability and old-age insurance, German social policy until the end of the First World War was primarily based on the concept of state care. Nor should one forget that this legislation had been introduced by Bismarck to protect the country from revolutionary turmoil. Anyway, by 1918 the available instruments could contribute little to the solution of current problems. The political system had been destabilized, and with the proclamation of the German republic on November 9 of that year the German Empire was transformed from a monarchy into a parliamentary democracy with a liberal constitution.

Hundreds of thousands, primarily workers, gathered to demonstrate in German cities on this November 9, especially in the capital, where they were accompanied by soldiers still stationed in Berlin. The demonstrators expressed their desire for peace, for a break with the authoritarian monarchical state, and for a comprehensive reorganization of political life. To reassure the rebelling masses the German Chancellor, Prince Max von Baden, declared—without any authorization—the abdication of the (predictably unwilling) emperor and in an unconstitutional act handed over

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the German chancellorship to Friedrich Ebert, the leader of the so-called Majority Social Democratic Party (MSPD), the strongest German parliamentary group in the Reichstag. In order to prevent the proclamation of the German Empire as the “Free Socialist Republic of Germany”—a turn of events planned for 4 p.m. by the Spartacist leader and member of the Independent Social Democratic Party (USPD), Karl Liebknecht (see e.g. Breitman 1981, pp. 24–25)—Ebert’s party colleague, Secretary of State Philipp Scheidemann (also a member of the executive board of MSPD), proclaimed the republic at 2 p.m.¹

Chancellor Ebert sought vigorously to promote peaceful political reconstruction. Until then, there had been hardly any bloodshed, and he wanted at all costs to avoid the horror scenarios of the civil war that had accompanied the Russian Revolution. His wartime experience had convinced him (and others) of the need for liberal political actors, civil servants and economic experts in the private sector: these were, he considered, essential to any post-war regime concerned with peace and economic reconstruction. In view of the imminently revolutionary situation, Ebert, as head of Majority Social Democrats, decided to enter into negotiations with the independent branch about the formation of a purely socialist “government of the German *Reich*” with the participation of civil departmental ministers. For this to happen, the USPD had to make concessions in their desire for the immediate establishment of a *soviet* council-style dictatorship of the proletariat, as opposed to the MSPD program for a democratic constitutional state. Against this background a new provisional government, the so-called “Council of People’s Deputies”² was constituted on November 10, 1918 (Breitmann 1981, 22, 25; Feldman 1993, 104–105; Huber 1978, 709–719).

¹The legality of the Social Democratic takeover was doubtful because the emperor had failed to authorize it.

The Social Democratic Party consisted of two distinct elements, the Majority Social Democratic Party of Germany (MSPD), which sought to support and reform the state, and the (left-wing) independent part (USPD), which regarded the majority party as “traitors to socialism” (Huber 1978, p. 711). The USPD split off from the original SPD because of its revolutionary intentions and merged later with the German Communist Party (KPD). They had tried in vain to move Germany in the direction of a *soviet* or “council” system, in line with the communist concept of the dictatorship of the proletariat.

²Between November 10, 1918 and February 11, 1919, in the transition from the German Empire (*Reich*) to the Republic of Weimar, highest governmental power was exercised by the Council of People’s Deputies, a revolutionary organ formed of both Majority and Independent Social Democrats that supervised the actual cabinet. Members of the Council were Friedrich Ebert, Philipp Scheidemann and Otto Landsberg of the MSPD, and Hugo Haase, Emil Barth and Wilhelm Dittmann of the USPD. The latter group left the Council on December 29, 1918; they were replaced by two Majority Social Democrats, Gustav Noske and Rudolf Wissell. After this date the Council described itself as the “government of the *Reich*.” Throughout these upheavals Friedrich Ebert, leader of the Majority Social Democrats, continued as Council chairman to support speedy elections for a constituent National Assembly to give Germany a democratically legitimated government. The Council ended the First World War by signing the armistice agreement of November 11, 1918, and introduced votes for women and the electoral system of proportional representation. Elections for the National Assembly took place on January 19, 1919. The task of the Council ended with the assumption of office by Scheidemann’s cabinet on February 13, 1919.

The decision on the type of state the German Empire would in future take was postponed for a National Assembly to be elected democratically on January 19, 1919. On that date the Council of People's Deputies was duly replaced by an assembly directed by Friedrich Ebert as president of the *Reich* and Philipp Scheidemann as prime minister.

2 Development Toward a Social State

In November 1918 the Council of People's Deputies enacted what it termed a purely socialist program. But this was nothing more than an extension of reforms promised—but not implemented—by the government of Prince Max von Baden a month earlier, together with some further long-awaited measures. Indeed many of its measures sought to relativize “pure” socialist demands (Breitmann 1981, 26):

- suspension of the state of emergency
- establishment of the right of assembly and association
- abolition of censorship
- guarantee of freedom of speech, freedom of the press, and freedom of religion
- amnesty for past political offenses
- a number of measures returning workers to their more favorable prewar status in contractual employment
- official ratification of the Stinnes-Legien Agreement (essentially consisting of the establishment of an eight-hour day in most industries)
- the introduction of equal, direct and universal suffrage for all citizens over the age of twenty, and the use of proportional representation in all elections.

The most important agreement between employers and employees concerned the Central Labor Association established by the Stinnes-Legien Agreement (official name: “Statutes for the Labor Association of the Industrial and Commercial Employers and Employees of Germany”³), passed on November 15, 1918. This collective agreement, a contract between the employer's associations and the trade unions, owed its name to its two leading signatories, the Ruhr Area industrialist, Hugo Stinnes, and the chairman of the General Commission of the Trade Unions, Carl Legien. Its fundamental idea was that of collaboration in the sense of the interaction of everyone involved in the labor process. Already introduced in single wage agreements during the war, this should now be extended to the whole of economic life. The employers granted recognition of the major union federations⁴ and accepted the principle of mandatory collective bargaining and wage contracts, as well as termination of

³Satzung für die Arbeitsgemeinschaft der industriellen und gewerblichen Arbeitgeber und Arbeitnehmer Deutschlands.

⁴Article 1 of the agreement stated: “The trade unions are recognized as appointed representatives of the workforce”.

employer support for so-called “yellow” unions,⁵ and the agreement at the same time established worker committees to represent the interests of the labor unions in all plants with more than fifty workers, and a standard eight-hour day without any reduction in pay (see e.g. Feldman 1993, 107; Schneider 1987, 290; Winkler 2014, 383). The negotiations themselves represented an improvement in the former tense relationship between employees and employers.

Several reform steps had been enacted even before the Council of Deputies took office. In October 1918 the Ministry of Labor was founded with a remit covering different aspects of social policy from housing legislation and settlement issues through welfare policy (previously under the Ministry of the Interior). Housing legislation—comprising the Rent (or Tenant Protection) Act, the Housing Shortage Act, and the Lease Protection Order—was passed on the principle that property entails responsibility to protect citizens from arbitrariness in the allocation of apartments and exploitation by landlords. Social insurance legislation protected in a rudimentary way against inability to work on account of illness, accident, age, or disability, as worker protection laws had done against risks to health and life in the workplace since 1890. Nevertheless, one cannot yet speak here of adequate or appropriate coverage—or, indeed, even of organized perception—of employee interests (Brauns 1929, 1–2).

A remarkable aspect of these events is that where an imperative need for solutions existed there was considerable rapprochement between employers and employees. On the governmental level the prevailing disastrous social and economic situation in Germany required immediate action. So it is hardly surprising that calls for the socialization of central economic sectors were also listened to. This placed the current de facto government, the Council of People’s Deputies headed by the social democrats, in a dilemma. On the one hand, the nationalization of industry was considered a solution for class exploitation in general and for a betterment of the situation of the workers in pursuit of a more just and humane society. Moreover, many workers held high expectations of current socialization tendencies with the SPD at the helm. Yet, on the other hand, many leaders of the SPD and unions, like Friedrich Ebert and Carl Legien, were convinced that a socialist economy could only succeed through a long, slow process of evolution, not revolution. They considered good relations between workers and employers crucial. In this setting, the many measures and activities undertaken to improve relations between workers and employers, such as the Stinnes-Legien Agreement, indicated a political will to avoid radical upheaval in ownership structures, which would only exacerbate an already difficult economic situation.

In sum, those in governmental power promoted structural change from the German Empire to a broadly socialist state, but rejected radical overthrow of the existing system of the sort envisaged by the supporters of *soviets* (councils), with the abolition of private property etc. However—and this makes it rather complicated—they at the same time feared the accusation that they had betrayed socialist principles.

⁵Business-friendly, strike-hostile labor associations supported by the employers.

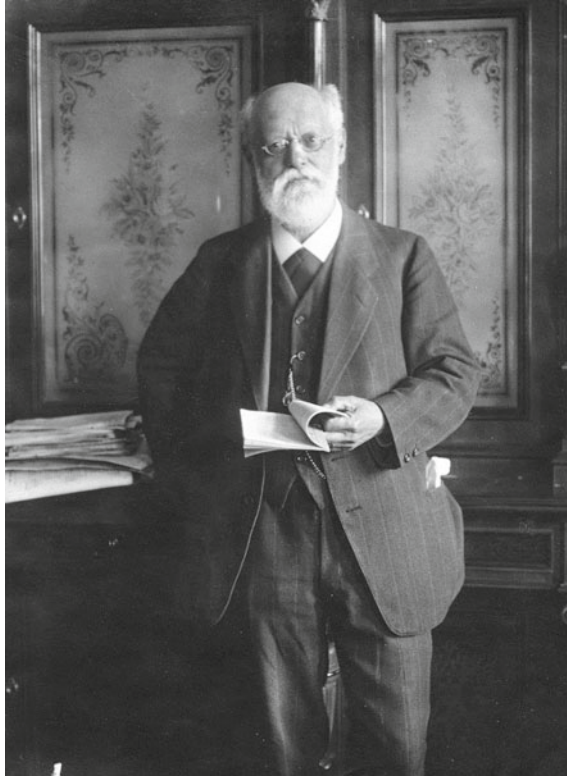
3 The First Socialization Commission

However, the Council of People's Deputies decided on November 18, 1918 in principle to immediately socialize all eligible branches of industry. For this purpose—after rejecting a proposal of the left-leaning council member Emil Barth on November 15 to nationalize mining and other industries—the majority social democrats determined that, before taking this step, a commission of well-known economists, together with representatives of the employees and employers, was to be appointed to draw up concrete measures (Winkler 1993, 46–47). This was the birth hour of the First Socialization Commission, which met for the first time on December 5, 1918. Its members were the national economists Carl Ballod (Berlin), Emil Lederer (Heidelberg), Joseph Schumpeter (Graz), and Robert Wilbrandt (Tübingen), with (among others) Ernst Francke from the Association for Social Reform and Theodor Vogelstein, director of the of the War Metal Procurement Company. The industrialist Walther Rathenau was proposed for membership but rejected because of resistance from the USPD. The trade unions were represented by Otto Hué, a member of the Prussian House of Representatives, Paul Umbreit, member of the executive board of the General Federation of German Trade Unions, the MSPD by Heinrich Cunow, and the USPD by Rudolf Hilferding. The Commission was directed by Karl Kautsky, an important historian and theorist of Marxism, as well as a leading theorist of social democracy; its secretary general was the economist and social scientist Eduard Heimann (Behrend 1998, 21–22; Sozialisierungskommission 1919).

The task of the Commission was primarily the preparation of reports and outline legislation for the socialization of coal mining, the municipalization of certain facilities, and the nationalization of fishing and insurance. It was unanimously accepted that the present economic situation, let alone any further decline in supply for the population, could not be accepted. Even representatives of the left like Hilferding considered the time not yet ripe—with the exception of some key industries, especially mining—for general nationalization of German industry and the turning over of property to the state. The Commission's initial findings on the principles of socialization were already published on January 7, 1919, but its most important publication, released on February 15, 1919, was a temporary report on the socialization of coal mining, the most crucial sector of the economy because of its extraordinary significance for the energy supply to industry and the population as a whole.

Popular expectations of socialization were already relativized in the work program of the Socialization Commission, published on December 11, 1918 in the *Deutscher Reichs- und Preußischer Staatsanzeiger* (German Reich and Prussian Government Gazette), which specified the revival of production as a prerequisite of economic reorganization. There would be no intervention in export industry, foreign trade or credit banks. Only where capitalist-monopolistic power conditions had prevailed, would socialization be considered. All other economic sectors suitable for transformation into a cooperative or municipalized structure would be examined. Previous owners must in all cases be compensated. The success of all socialisation activities would depend on the increase of productivity, guaranteed by best organization of

the firms under the control of experienced technicians and businessmen (Program Socialization Commission 1918, 593–594). One could, then, hardly speak here of an “expropriation of the expropriators.”



Karl Kautsky (1854–1938), chairman of the Socialization Commissions (Bundesarchiv, 146-1970-096-11)

What were the facts? A series of strikes had spread over the country at the end of 1918 and beginning of 1919, starting out from the Ruhr. Workers—primarily miners—rebelled against the continuation of low wartime wages and demanded more money and shorter working hours: demands that were then partly granted. Further demands were for control of the means of production by the workers and socialization of the mining sector. These conflicts between labor and capital found their counterpart in the political arena, where a proletariat intent on revolution faced a social-democratically led government. The social democratic (SPD) authorities tried to mediate but also to split the proletarian movement. Highlights of the confrontations were the uprisings in Berlin in January and March 1919 and the dismissal of the Munich *Räterepublik* (form of republic governed by *soviets* or councils). Withdrawal of the SPD representatives, special bonuses for strikebreakers, stoppage of food

deliveries to strikers, and use of weapons were means employed to suppress these movements, particularly on the Ruhr.

Within the Socialization Commission Rudolf Hilferding, supported by Karl Kautsky and Robert Wilbrandt among others, urged that Germany's mineral resources be declared state property and the coal-mining and trading sector be nationalized. The Commission intended to bring about changes, but at the same time to return to certain procedures and regulations of the wartime economy. However, it soon discovered that the coercive syndicates created during the war were in a state of dissolution. The Socialization Commission tried in vain to check this development and to retain the coercive prescriptions, or at least to allow changes only with its agreement. The representatives of German industry, however, rejected all suggestion of change in ownership and any hint of nationalization, and forced a postponement of the negotiations on nationalization until January 4, 1919. Nationalization of the coal sector would then be discussed in a very restricted way: only with respect to the regulation and supervision of sales, pricing, and decisions about new pits and mines. Notably, control should be in the hands of the state, not the workers. Further issues for discussion included the codetermination of wages, working hours, and security measures (Behrend 1998, 22–25). The Socialization Commission submitted outline legislation for the municipalization of economic enterprises to the *Reich* Ministry of Economics on March 18, 1919. The proposals were well received in many cities and municipalities, which were in any case interested for fiscal reasons in the transformation of local enterprises into communal property. This would enable them to take over and operate (or lease) transport and utility companies, providers and distributors of food and beverages, housing companies, and labor recruitment agencies etc., as well as other private local service providers. To this end, the cities and municipalities could establish associations and would receive the right to expropriate former owners on payment of compensation (see "Outline for a framework law about the municipalization of economic enterprises" submitted by the Socialization Commission, Berlin 1919, in Behrend 1998, 32–33).

What the Socialization Commission suggested was not simple nationalization of the coal-mining sector, because the objection would have immediately followed that the allied forces would take state property as the basis for reparation payments. The majority of the Commission members (among them Ballod, Cunow, Hilferding, Lederer, Schumpeter, Umbreit and Wilbrandt) thought that neither the restitution of a strictly capitalist mode of production nor compulsory cartelization under the far-reaching control and participation of the state was politically or psychologically possible for post-war Germany, and that the only solution was rigorous socialization, to be carried out by expropriation of all private and state mining enterprises in favor of a single autonomous economic cooperative, the *Deutsche Kohलगemeinschaft* (German Coal Association). This Association would be controlled equally by the management of the firms, their employees, the state, and the purchasers of the coal. The highest organ, the *Reichskohlenrat* (Reich's Coal Council), would consist of 100 representatives of workers, managers, consumers, and the *Reich*, who would appoint a *Reichskohledirektorium* (Reich's Coal Directorate) in the form of a five-person executive for five years with wide management powers. According to its suggestions

the German coal sector would be divided into 20 districts with a president each (Röbke 1930, 907–908). The Coal Association's remit would extend to the coal trade and the carbonization and extraction of by-products, but not to further chemical processing. Provided that socialization was restricted to the coal-mining sector, previous owners would be compensated. A minority of the Commission (Francke and Vogelstein) wanted to maintain private capital in its function, while allowing the state Coal Council to regulate the enterprises. This suggestion approximated the ideas of the government, but the majority sought more radical economic change. The organizing institution was the Reich's coal council and the single firms were (initially) private enterprises. Since they had to deliver their production to cost prices to the Reich's coal council, they were actually only production points, working for the coal council for wage (Röbke 1930, 909).

4 Obstacles to the Work of the Socialization Commission

Although these and other proposals at most touched upon nationalization, the government considered them overly radical and sought to slow the Socialization Commission down in its ambitions. One reason for this was that an increase in coal output was in any case necessary to supply the population, and a survey in summer 1919 showed that this could only be achieved by raising the number of workers. The problem here was the housing shortage rather than ownership structures. So the *Reich* Ministry of Economics ordered the construction of barracks to provide living space for 65,000 workers by the end of February 1920. Further incentives to increase production were special provision of the miners with food and their preferential treatment in wage negotiations. Involvement of the workers in price-setting for coal products was not seen as a sufficient guarantee against unjustified price increases, because workers were not considered to possess the professional competence needed to stand up to the enterprises in negotiations. In any case—as can readily be seen from the minutes of the Socialization Commission meetings (Verhandlungen 1920)—the *Reich* Ministry of Economics was already the prime opponent of the coal industry (see Hirsch 1920, 1–2). Given the political development toward a social state on the one hand, and the concessions forced from the coal industry on the other, as well as the wartime experiences of miners and other workers, most of them were against a dictatorship of the proletariat anyway. The decision of the Council of People's Deputies to hold elections for the National Assembly in January 1919 points in the same direction—it was a clear signal that Germany should take the future path of a democracy rather than a *soviet*-style council system (Winkler 2014, 386). Moreover, the Socialization Commission—although its majority broadly favored socialization—was unanimously against the council system and voted for the National Assembly (Behrend 1998, 22). The social democrats and unions were also anything but convinced that the time had come for a change in ownership structures; they followed the motto: first reconstruction and then—but only if appropriate—socialization (Winkler 2014, 383–384).

At the elections for the National Assembly in January 1919 the Majority Social Democrats gained 37.9% and the Independent Social Democrats 7.6% of the votes. Of the 421 representatives (37 of whom were women), the Majority Social Democrats received 163 and the Independent Party 22 seats (Osterroth and Schuster 1975, 22). This did not amount to an absolute majority in the National Assembly, and only a coalition with the Center Party and the German Democrats seemed promising (Winkler 2014, 394)—de facto a political shift to the right. The consequences for the Socialization Commission were serious: the *Reich* administration not only put obstacles in the way of the Commission's work—for example by keeping regulation projects secret from them—but even in some cases (notably via the *Reich* Ministry of Economics) polemicized against their outline plans and obstructed publication of their results. The commission was forbidden to participate directly in the legislative process and the announcement of the Coal Report was delayed until it was no longer relevant for the Weimar debate (Behrend 1998, 32). Officials from the *Reich* Ministry of Economics attended the confidential meetings of the Commission and recorded and passed on the results. Undersecretary Dr. August Müller, whose task it was to support the Commission, hindered its work massively by reducing the allocation of rooms, funds and assistants. Although himself a social democrat, he was a professed opponent of socialization (Preller 1978, 239; Winkler 1993, 47). Thus, the work of the Commission suffered considerably from the interference of a bureaucracy inherited from the time of the Empire. It was also Müller who spread the warning, originally expressed by German Bank director Mankiewicz, that the victorious powers would use German Empire property as a pledge for reparations, in which case nationalization of the coal mines must be classified as simply criminal and the word socialization would in future be no more than a formula for otherwise unjustified wages. The Socialization Commission was even suspected of stirring up strikes and supporting, instead of curbing, socialization moves. In the face of these and similar reproaches the Commission tendered its resignation on February 3, 1919 in a letter that expressed the not unreasonable complaint that the government had never really thought seriously about socialization at all (Behrend 1998, 26–27; Rößle 1930, 904–905). Although the government made some gestures of appeasement, the Commission resigned on April 7, 1919 in protest against its lack of effective power.

5 Achievements of the Commission and Its End

In the conflict-ridden time between the threat and realization of its resignation the Commission was, however, anything but idle. It issued a “Temporary Report on the Socialization of Coal-Mining” (February 15, 1919), dealt intensively with questions of municipalization in the towns, and recommended the take-over by the Empire of cutters leased by the navy during the war to create a state fishing fleet. The Commission supported suggestions by the government submitted in the National Assembly to include in the future constitution an article declaring the socialization of natural resources, enterprises and property, the formation of coercive associations and the

regulation of the influence of the workers, consumers and community in the enterprises to be a matter for the people (Behrend 1998, 29). Two socialization laws were presented to the National Assembly on March 4, 1919, the General Framework Law and the Law for the Socialization of Coal Mining. The latter was adopted on March 23, 1919, and with additional implementation details in September (it was in force until 1933); it was followed by the Potash Industry Law and the Law for the Socialization of the Electricity Industry on April 24 and December 31, 1919 respectively (Preller 1978, 241; Rößle 1930, 905). In preparing the Framework Law the members of the Socialization Commission worked in a rather literal fashion, authorizing the *Reich*, for example, to transform economic enterprises into cooperative entities, but only on the vague condition that these enterprises should be “ripe for socialization” and, furthermore, with adequate, legally guaranteed compensation. In terms of their de facto implementation, neither the Framework Law nor the Law for the Socialization of Coal Mining achieved the aims of socialization.

Although the Socialization Commission did not meet with any real official appreciation, it nevertheless had an indirect influence on the work program of the Weimar Constitution, in so far as later laws and parliamentary drafts were inspired by its ideas. Thus the Weimar program established, for example, that the labor force stood under the special protection of the *Reich*, that freedom of association was ensured for everyone, and that all professions, workers and employees could negotiate wages and working conditions with the enterprises on the basis of equal rights (Preller 1978, 242).

Only after the Kapp Putsch—the unsuccessful attempt of March 13, 1920 to overthrow the newly-created Weimar Republic—was the (Second) Socialization Commission reinstated in the form of an agreement between the German government, trade unions and political parties (March 20, 1920).⁶ Its Report on the Socialization of Coal Mining, published on September 3, 1920, contained two different suggestions: the first (by Walter Rathenau and Rudolf Wissell) opted in favor of gradual socialization without antagonizing private working capital, while the second (by Emil Lederer, Rudolf Hilferding and Karl Kautsky) recommended immediate socialization.

⁶The members of the Second Socialization Commission, to the status of July 31, 1920, were: Carl Ballod, Friedrich Baltrusch, managing director of the general association of the Christian trade unions of Germany, Adolf von Batocki, chief president of the province east Prussians, Adolf Braun, member of the German Reichstag, Adolf Cohen, managing director of the central consortium of the industrial and commercial employers and employees of Germany, Rudolf Hilferding, Otto Hué, the architect Heinrich Kaufmann, consortium of free employee associations, Karl Kautsky, Hans Kraemer, member of the central consortium of the industrial and commercial employers and employees of Germany, Robert Kuczynski, director of the statistical office of the city of Schöneberg, EmiI Lederer, Hugo Lindemann, professor at the University of Cologne, Carl Melchior, bank director, Hamburg, Franz Neustedt, secretary of the Hirsch-Dunker trade associations, Walther Rathenau, president of the A.E.G., Carl Friedrich von Siemens, member of the German Reichstag, Paul Umbreit, Theodor Vogelstein, Alfred Weber, professor at the University of Heidelberg, the overman Georg Werner, managing director of the federation of the technical employees and officials, Rudolf Wissell, member of the German Reichstag (Verhandlungen 1920). Schumpeter had to resign from the commission even in March 1919 due to his appointment as Austrian minister of finance. Until its definite dissolution in 1923 the commission had worked out numerous suggestions for the implementation of socialization measures which, however, never had direct political effect.

The question whether German industry was ripe for immediate socialization ended in deadlock. Rathenau, however, presented the most concrete plan for socialization, suggesting an economy built on the basis of solidarity between capital and labor, with both groups equally represented in industrial concerns and corporate bodies. Both groups allowed in their concepts for compensation of the owners. Predictably, the Commission reached no consensus. In particular the suggestion of the German industrialist Hugo Stinnes, who wanted to involve the employees in the success of the enterprises by issuing shares, was rejected by the trade unionists, who saw this as a violation of the aims of socialization. The Second Socialization Commission existed until 1923. Its work underlined the limits of socialization as well as the inability and unwillingness of the government to apply socialism even in a reduced measure. The executive committee of the *Reichstag* had ordered the cancellation of the Commission's budget, reasoning that it had been established without a vote of parliament and was therefore incompatible with the parliamentary system (Behrend 1998, 35). Former supporters of socialization called the socialization legislation of 1919 a "half-hearted farce" and mere "socialism on paper" (Moellendorff 1932, 255). In the end, the Commission had no direct impact at all on political developments.

6 Assessment of the Socialization Commission

All in all, measured against its original aims and tasks, the intentions of the Socialization Commission failed in every respect; none of its plans was realized. Alone the idea of equitable treatment of the economic conditions by employers and employees, an idea that had sunk into the minds of German workers during the war and was also expressed in the Central Labor Association of 1918, had contributed to deny any majority to a communist system and a dictatorship of the proletariat. Too many efforts of too many groups had been made during and immediately after the war to find solutions, with the result that the communist system became only one alternative among others.

Even at the end of World War I government, represented by a majority of social democrats, and primarily the MSPD, found itself in a paradoxical situation. Given the *de facto* situation of the country, it wanted to maintain the fundamental structures and organizations of the old German Empire, with appropriate adjustments of course. For politicians like Ebert and Scheidemann, the assurance of reasonable armistice and peace terms from the West was a patriotic duty, and revolution a circumstance that would gravely complicate this task. They wished to preserve the unity of Germany, to ensure law and order, and to revive the economy, and in pursuit of these goals they sometimes felt themselves the "liquidators of the old regime," as Ebert put it (Winkler 2014, 384). In the face of Germany's post-war economic and societal problems, the socialist vision melted away quite early, at least within the conservative wing of the social democrats, let alone in the conservative parties themselves. In the wake of a terrible war, socialism was seen as impractical or even dangerous, but the incumbent government in any case ran the risk of being blamed for the inevitable

problems of economic reconstruction. It seemed reasonable, then, to establish a framework for the future on the foundation of parliamentary democracy. The decision for democratic rather than interventionist elements was a pragmatic solution in the face of worker interests and the ongoing struggle between the tariff partners. Against this background the supporters of parliamentary democracy decided the initial power struggle—until spring 1919—for themselves. With the increasing stabilization of the Republic, any further moves in the direction of socialization and revolution in any case quickly evaporated (Klemperer 1957, 80). The parliamentary system secured the government in power and laid the foundations for a successful period of social policy.

7 Social Policy in the 1920s—After the Socialization Commission

The main subject of social policy was the core social issue of the uncertainty of employees about their economic security and legal position in society and state. The central attempt to solve these problems through socialism led to the Socialization Commissions, whose focus lay on the socialization of the means of production. But this never took place. Instead, agreement was reached to improve the legal and economic position of employees on the basis of the capitalist order. At heart this was about recognition of the personality of the employee and his or her participation in the regulation of working conditions. To achieve this, trade unions and employers' associations first had to be recognized legally as representing their members, and the way had to be paved for legal regulations about the tariff and agreement system. In addition, works councils, district councils, workers' councils, and economic councils were created, the right of association was determined, and workers' committees, mediation committees, and employment agencies etc. were set up or their activities extended; the regulations on wage agreements of 1918 and the mediation order of 1923 were also supplemented. The eight-hour working day was established in 1918 but later, due to economic crises, partly suspended. The Works Council Act was passed in 1920, the law governing corporate accounting (Balance Sheet Act) in 1921, and in 1922 the law on the appointment of works council members to the supervisory board. The 1923 law governing wages paid to home-workers also assured that group a minimum wage.

The restructuring of labor relations initiated by these measures required a parallel reform of labor jurisdiction, which found expression in the Labor Court Act of 1926. Also worth mentioning is the Miners' Guild Act of 1926, which not only amalgamated health, accident, age and pensions insurances, but also revised board representation between employees and employers from a 50–50 to a 60–40% ratio. All these measures were passed after the failure of the Socialization Commission (Brauns 1929, 4–6). Already a year before, in 1925, the Healthcare Act had brought

health insurance companies and professional associations more closely together to work more effectively. A comprehensive labor-market policy had also been mooted as a significant measure to improve economic security for the general public. This took effect in the establishment of an employment agency to organize job placement on the basis of prior vocational guidance (Employment Agency Act 1922). The Work Placement and Unemployment Insurance Act of 1927 replaced the earlier unemployment benefit. From now on all employees who had made contributions to social insurance for at least half a year were entitled to unemployment benefit for a period of six to twelve months, depending on the individual situation (Brauns 1929, 7–8). The Welfare Order of 1924 covered those whose livelihood was endangered despite the employee security system, and other special provisions were made for hardship among retirees, the war-disabled and war widows and other dependents.

8 Concluding Summary—Why Socialization Couldn't Happen

First and foremost among the many reasons for the frustration of formal socialization plans in post-WWI Germany was the absence of any clear political majority for comprehensive socialization of the economy. Already at the First General Convention of the Workers' and Soldiers' Councils in December 1918 the proposal to establish the *Rätesystem* (soviet/council system) as the constitutional basis of a socialist German republic and to grant the Workers' and Soldiers' Councils the highest legislative and executive power was rejected by 344 votes to 98. Instead, the proposal of the Majority Social Democrats to hold elections in January 1919 for a National Assembly was agreed by 400 votes to 50 (Winkler 1993, 51, 2014, 385). The majority of the population wished for a parliamentary democracy, and for a vast majority of workers (and others) it was unthinkable that a constitutional revolution would bring more rather than less democracy. In a sense this development corresponded with the failure of revolutionary movements everywhere in Europe except Russia, the most important of the non-industrialized European countries. Although the prerequisites for the development of a revolutionary mass movement also existed in Germany, the subjective assessments of the ruling parties and their fear of chaos led them to act carefully and hesitantly (Feldman 1984, 69, 77). Nor were the ruling social democrats completely convinced about socialization. In view of the post-war situation, the chairman of the Socialization Commission, Karl Kautsky—and even some members of the Independent Social Democrats—considered production as such more important than questions about its political structures and methods. Kautsky wanted to wait with socialization until capital could be reinvigorated; and the commonly perceived alternative, the system of Bolshevik Russia, was manifestly to be prevented at all costs (Feldman 1993, 105). Moreover Kautsky, like many supporters of socialization, thought nationalization could only take place when the terms of peace had been

agreed and there was clarity about German reparations at the extent to which the country could dispose of its state property. As the Social Democratic Party deputy Rudolf Wissell put it in an article in the socialist magazine *Vorwärts* of February 2, 1919: “To carry out, or even to demand socialization just now, at the moment of demobilization, would be to turn Germany into a madhouse”⁷ (quoted from Behrend 1998, 19–20).

Furthermore, neither the workers’ parties nor the trade unions nor the state bureaucracy had adequate trained staff at their disposal to take on the tasks of capitalist businessmen and managers. Most of the old officials of the *Reich* had to remain in office to prevent a collapse of the system, and the involvement of the entrepreneurs and industrialists had to be safeguarded to relaunch economic life (Winkler 2014, 382). Expropriations on a large scale would have inevitably led to the collapse of the national economy. Only in the area of coal mining was the concept of socialization seen as realistic. Here market laws had in any case been suspended by wartime legislation, and the state already possessed entrepreneurial experience as the owner of numerous coal-mines. A political argument in favor of socialization in the coal sector was that the mine owners, the so-called “coal barons,” had vigorous opponents not only in the trade unions: they were already well-known from the time of the Empire as obstinate opponents of any and every democratizing tendency. In this light, nationalization would have caused the weakening of a central anti-republican force (Winkler 1993, 47). In connection with this, it is an interesting question why nothing was done against the group of big landowners, the *Junkers* of the eastern provinces, who, alongside heavy industry, had always fought democratization and later contributed more than any other powerful elite to the destruction of the Weimar Republic? The answer is that there was neither any movement of agricultural workers and smallholders in Germany at the time, nor any political party interested in a change of ownership structures in the rural provinces. The social democrats feared that drastic measures could endanger the food supply, and they were anyway only marginally interested in agricultural questions, on the principle that in farming as well as in industry big enterprises were more efficient than small—which were hardly granted realistic chances of survival (Winkler 1993, 47–48, 2014, 383).

All in all it can be said that socialization was much discussed but little concretely pursued: the efforts of most Majority Social Democrats were directed toward economic and societal reconstruction rather than nationalization (Schneider 1987, 299). The central tenet of socialization, the abolition of private property, was at most indicated, never initiated. Instead, politicians sought a compromise between socialism and the widespread desire for social reform, and it was this that molded the economic and social policy program of the Weimar Republic (Preller 1978, 241).

What can be learned from the activities of the Socialization Commission is above all that society needs an intervening state without endangering economic performance and social stability—an insight that is still relevant today. It were the governing Majority Social Democrats whose careful and reluctant action impeded the chance

⁷“Eine solche Sozialisierung gerade jetzt, im Moment der Demobilisation durchführen oder auch nur fordern, hieße Deutschland in ein Tollhaus verwandeln”.

of revolution: they wanted at all costs to avoid Russian circumstances and the danger of internal chaos and misery, which would have encouraged the Allies to invade Germany and control conditions from the outside. The Majority Social Democrats can hardly be blamed for wanting to provide people with peace, work and bread at almost any price.

In our own age of globally networked capitalism, with its increasing inequalities of distribution, calls for state control and regulation are becoming more audible all the time. But also in view of the currently increasing political polarization toward extremes, the example of the Socialization Commission is valuable as an attempt—the first on German soil and in difficult times—to take the path of parliamentary democracy and to support this by the establishment of suitable economic conditions.

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From “Finance Capital” to “Organized Capitalism:” Socialization in Rudolf Hilferding’s Writings Under the Influence of Ferdinand Tönnies



Jan Greitens

1 Introduction

Rudolf Hilferding’s ideas regarding the development of capitalism, as presented in his seminal work entitled “Finance Capital” (published 1910) and in his concept of “Organized Capitalism,” developed after the war and finalized in 1927, both describe the transition to socialism. They differ in the instruments used to reach this aim, their understanding of property, and the role of the state.

This paper presents the development to socialism as described by Hilferding in “Finance Capital,” his ideas during his time in the Socialization Commissions in Germany (1918–1920), and his concept of “Organized Capitalism.” Afterward, the ideas of Ferdinand Tönnies regarding socialism and property, along with his enormous influence on Hilferding’s concepts, are presented.

2 Biographical Notes on Rudolf Hilferding

Rudolf Hilferding was born on August 11, 1877, in Vienna, Austria. He enrolled at the University of Vienna in 1896 to study medicine. From 1902, Karl Kautsky, the editor of *Die Neue Zeit* and the “preceptor of Marxism” (Gottschalch 1962, 62) in the German-speaking countries, became Hilferding’s mentor (Hilferding would later declare that Kautsky had “welcomed him like a son” (letter from Hilferding to Kautsky, 19 Oct 1924, International Institute of Social History KD XII 638)). In 1906, with the support of Kautsky, Hilferding became one of two permanent teachers at the newly founded party school of the German Social Democratic Party (SPD) in Berlin. Apart from working at *Die Neue Zeit*, he became the writer for the foreign

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policy section of *Vorwärts*, the party newspaper of the SPD. It was during this time that he published “Finance Capital” in 1910.

After the war, he became chief editor of the party newspaper of the USPD and worked on the re-unification of the German social democratic parties, which took place in 1922. He became the central theorist in the united party and even became the editor of its newly founded theoretical journal, “*Die Gesellschaft*,” since 1924. He was appointed as German Finance Minister in 1923 and in 1928/29. He emigrated in 1933 and was ultimately killed by Nazi-German Gestapo in France in 1941.

3 The Development of Capitalism According to “Finance Capital”

In his work, “Finance Capital,” Hilferding describes the development from capitalist anarchy to a consciously organized economy. In this framework, he implicitly uses a step model: In the beginning, capitalism prevails against the previous, feudal economic order (Greitens 2017, 153ff, 2018, 181ff). This early competitive capitalism was already analyzed and explained by Karl Marx. Before socialism can begin, capitalism enters a second phase (subtitle of “Finance Capital”: A Study of the Latest Phase of Capitalist Development) in which it modifies itself. This process is at the center of “Finance Capital” and can be divided into five steps described below.

Step 1: The capitalism of free competition

- Competitive capitalism exists, as described by Marx.
- Marx’s theory of value applies in this anarchic, capitalist economy.
- The economy is not very concentrated, and the financial system consists of *Geldhandlungskapital* (money-handling capital), which essentially means bills of exchange.

Step 2: Financial System Development

- The formation of limited-liability companies, such as joint-stock companies, enables larger investments and mobilizes capital through the fungibility of the fictitious capital at the stock exchanges.
- A financial system gradually develops to meet the growing demand for capital.
- The concentration and centralization of capital in the industry begins.

Step 3: Concentration in the economy

- Due to economies of scale and scope, concentration and centralization in the industry continues.
- The increasing liquidity needs of the companies place banks—as the provider of this liquidity—in a central role.
- The banks promote monopolization in the industry in order to secure their investments.

- The capital needs of the industry and those within the promoter’s business leads to bank concentration to fulfill these demands.
- The importance of the stock exchanges is decreasing, and a bank-based financial system emerges because this type of financial system allows a stricter control of the bank clients.
- The concentration and centralization in the industry raise up to a general cartel.
- The applicability of the Marxian value theory weakens.

Step 4: The emergence of finance capital

- Banks are merging into one monopolistic bank. Thereafter, finance capital, as a centralized power over the whole economy, has emerged.
- The rule of the capital magnates takes control over the economy.
- The value theory is no longer relevant. The economy is consciously organized, but in antagonistic form by the capitalists.
- “The tendency of finance capital is to establish social control of production, but it is an antagonistic form of socialization, since the control of social production remains vested in an oligarchy.” (Hilferding 1910, 367)

Step 5: The overthrow of capitalism toward socialism

- A political revolution changes ownership and puts the conscious organization in the hands of the proletariat.
- “Finance capital, in its maturity, is the highest stage of the concentration of economic and political power in the hands of the capitalist oligarchy. It is the climax of the dictatorship of the magnates of capital. (...) it makes (...) the internal domination of capital increasingly irreconcilable with the interests of the mass of the people, exploited by finance capital but also summoned into battle against it. In the violent clash of these hostile interests the dictatorship of the magnates of capital will finally be transformed into the dictatorship of the proletariat.” (Hilferding 1910, 370)
- “The socializing function of finance capital facilitates enormously the task of overcoming capitalism. Once finance capital has brought the most important branches of production under its control, it is enough for society, through its conscious executive organ—the state conquered by the working class—to seize finance capital in order to gain immediate control of these branches of production. (...) Even today, taking possession of six large Berlin banks would mean taking possession of the most important spheres of large-scale industry, and would greatly facilitate the initial phases of socialist policy during the transition period, when capitalist accounting might still prove useful.” (Hilferding 1910, 367f)

The driving forces in this process are the following kinds of transformation:

- (1) the monetary and financial system development, and
- (2) the concentration and centralization in the industry.

1. Monetary and financial system

Hilferding describes the development of a bank-based financial system. This does not only mean the institutions of the financial sector itself but he has a broader understanding of financial systems. Hilferding begins with a monetary theory given that money is of fundamental importance in the organization of an economy. Additionally, he stresses the importance of the new types of companies, limited-liability companies, and their corporate governance structures (Hilferding 1910, 120ff). Market liquidity at the stock exchanges is the prerequisite for the liquidity of the fictitious capital and thus for the mobilization of capital. Nevertheless, these market-based institutions are not that dominant in Germany, as in England. In particular, the stock exchanges initially developed in a complementary way to banks; however, they lose their relevance when the banks become dominant. With the development of the bank-based financial system, the settlement of all financial transactions and the provision of liquidity are monopolized by banks, until the banks ultimately take control over the entire economy.

2. Concentration and centralization in the economy

In competitive capitalism, the capitalists are subjected to the pressure of competition. The concentration and centralization of capital, especially with the new limited-liability companies, lead to larger freedom of action for the capitalist. The businessman is reduced to the owner and the managers are the ones leading the large companies (Hilferding 1910, 154).

In finance capital, the two transformations come together. The tendency to establish a general cartel and the tendency to form one central bank coincide and their amalgamation leads to the power of finance capital (Hilferding 1910, 319).

Hilferding describes many reasons why the banks wield so much power over the industry. Two groups of arguments are central to this discussion. First, the banks control the liquidity of the companies and the supply of credit money and the higher liquidity of bank assets (shares, loans, etc.) compared with the less liquid industrial assets like machinery is key. Second, Hilferding describes the construction of corporations as a tool to obtain power over companies with a relatively small amount of own capital (Hilferding 1910, 138ff).

4 Hilferding in the “Socialization Commissions”

After the war, Hilferding changed his concept of “Finance Capital” to a concept, which he called “Organized Capitalism” in order to adapt his idea to the political changes that occurred after 1914.

In fact, he was not alone in proposing this kind of ideas. After 1910, there were numerous discussions among German economists (e.g., Plange, Jaffe, Schulze-Gaevernitz, Alfred Weber) and similar discussions took place in the SPD, especially after 1916 (Krüger 1983, 82ff, 158ff). There was a broad consensus that the war had

changed the direction of socialism, and the increasing administrative capacities and the growing role of the state in the economy during the war influenced the discussion (Krüger 1983, 220; Wagner 1996, 102).

In an article entitled “Arbeitsgemeinschaft der Klassen?” published in October 1915, Hilferding began to formulate his concept of “Organized Capitalism” by mentioning this term for the first time. In this article, he still rejected the state as an instrument to achieve socialism (Hilferding 1915, 70; Smaldone 2000, 84ff).

At the “Allgemeine Kongreß der Arbeiter- und Soldatenräte” in December 1918, Hilferding gave a speech about the question of socialization. “Socialization (...) will have to extend to all areas where capitalist concentration, cartels and trusts have already prepared the organized socialist economy”.¹ Hilferding wanted to gradually hand over the control over the large corporations to the community (Hilferding 1918, 98f). Nevertheless, the sectors must be “mature enough” for socialization, and their goods must be of high economic importance. He added, “The connection between industrial capital and bank capital, which has become increasingly close in Germany, has brought all economic power in a small number of major banks. (...) With the socialization of the coal and iron and parts of the heavy industry, we are not only getting the power over industrial capitalism, but also the power of bank capitalism”.² Indeed, due to the critical situation in the supply of credit in November 1918, Hilferding was against the socialization of banks. The capitalist should be compensated for expropriation, and the whole transition from capitalism to socialism would take a long time (Hilferding 1918, 105; Stephan 1982, 96f).

In the same year, Hilferding became a member of the Socialization Commission, which had been established in November 1918. Under the chairmanship of Karl Kautsky, representatives of the SPD, the USPD, and independent experts met. Among them was Joseph Schumpeter, whom Hilferding perceived as a very radical individual (Somary 1959, 171). By February 1919, majority and minority opinions were passed. Hilferding sided with the majority opinion that there should be no return to the pre-war form of capitalism, but also no radical change to state capitalism. Furthermore, they argued that certain sectors should be socialized and democratic elements must be introduced into the economy (Gottschalch 1962, 171). However, the government did not seriously consider the Commission’s proposals, so the Commission finished its work in April 1919 (Smaldone 2000, 106ff).

After the Kapp putsch, a second Socialization Commission was convened by the government in May 1920. The discussions increasingly took the character of an

¹Hilferding (1918, 98): “Die Sozialisierung wird sich (...) auf alle Gebiete erstrecken müssen, wo bereits durch die kapitalistische Konzentration, durch Kartelle und Trusts der organisierten sozialistischen Wirtschaft vorgearbeitet ist”.

²Hilferding (1918, 100): “Die Verbindung zwischen industriellem Kapital und Bankkapital, die sich in Deutschland immer enger gestaltet hat, die erst bewirkt hat, daß in einer Anzahl von Großbanken alle Fäden der ökonomischen Herrschaft zusammenlaufen, diese Verbindung wird dadurch gelöst, die Macht der Großbanken über die Industrie wird auf diese Weise in einem hohen Grade erschüttert. Wir treffen mit der Übernahme von Kohle und Eisen und eines Teils der schweren Industrie nicht nur die Macht des industriellen Kapitalismus, sondern auch die Macht des Bankkapitalismus”.

Enquete Commission (Euchner 1988, 177). Furthermore, the disagreement between Hilferding and Walter Rathenau dominated the negotiations (Stephan 1982, 109f).

5 The Strategy of “Organized Capitalism”

As chairperson of the Program Committee that was responsible for the 1925 Party Program of the re-united SPD and in his address at the 1927 Party Conference, he finally introduced his concept of “Organized Capitalism.” In contrast to Sombart’s “Late Capitalism”,³ Hilferding defined his concept as follows: “Organized capitalism means (...) the fundamental replacement of the capitalist principle of free competition by the socialist principle of planned production. This planned and consciously controlled economy is a far better basis for the possibility of conscious influence by society, (...) the influence of the single organization of society that is conscious and vested with coercive force, the state”.⁴ In his view, industrial, commercial, and banking capital—united in the form of finance capital—are striving toward uniformity, the transition from the capitalism of free competition to organized capitalism.⁵ He added,

Leadership of the enterprise is no longer a private affair for the owner, but a matter for society. (...) For individual businesses, corporate concentration (...) means the elimination of free competition. It has been the capitalist doctrine that only the power of free competition can promote the economy and implement the necessary technological innovation and progress. The principal argument against socialism has always been: You do away with the private initiative of free competition and have nothing to put in its place. Consequently, your economy will not work, because it takes no account of the ambition and self-interest of the private owner (...). It is very interesting to see how those concerned with the development of modern business administration are now looking for ways in which this free competition of private self-interest can be replaced by methodical planning and a scientific approach.⁶

³Hilferding (1927, 215).

⁴Hilferding (1927, 218): “Organisierter Kapitalismus bedeutet also in Wirklichkeit den prinzipiellen Ersatz des kapitalistischen Prinzips der freien Konkurrenz durch das sozialistische Prinzip planmäßiger Produktion. Diese planmäßige, mit Bewußtsein geleitete Wirtschaft unterliegt in viel höherem Maße der Möglichkeit der bewußten Einwirkung der Gesellschaft, das heißt nichts anderes, als der Einwirkung durch die einzige bewußte und mit Zwangsgewalt ausgestattete Organisation der Gesellschaft, der Einwirkung durch den Staat”.

⁵Hilferding (1924, 2).

⁶Hilferding (1927, 217): “Führung des Unternehmens ist nicht mehr Privatsache des Unternehmers, sondern gesellschaftliche Angelegenheit. (...) Die Konzernbildung, das Zusammenfassen von immer mehr Betrieben in eine oberste Spitze bedeutet für die einzelnen Betriebe die Ausschaltung der freien Konkurrenz. Es ist kapitalistische Lehre gewesen, daß nur der Zwang der freien Konkurrenz die Wirtschaft fördern, die notwendigen technischen Erneuerungen und Fortschritte durchsetzen kann. Das Hauptargument gegen den Sozialismus ist immer gewesen: Ihr schaltet die private Initiative der freien Konkurrenz aus und wißt nichts an die Stelle zu setzen. Infolgedessen wird eure Wirtschaft nicht gehen, weil sie den Ehrgeiz und Eigennutz des Privateigentümers der Produktionsmittel nicht in Rechnung stellt. Nun ist es sehr interessant zu sehen, wie in der Entwicklung der modernen Betriebswissenschaft nach Methoden gesucht wird, um diese freie Konkurrenz des privaten Eigennutzes durch wissenschaftliche, planmäßige Methoden zu ersetzen”.

In his view, company management becomes an objective and strictly scientific affair. Moreover, for Hilferding, the question is how business, on the one hand, and state organization, on the other hand, ought to interact to enable the democratic state to bring about the conscious organization of the economy for the general interest (Hilferding 1927, 218, 221). Indeed, Economic Democracy⁷ is the subordination of private economic interests to the interests of society.⁸

But the antagonistic, conflictual foundation of such an economic organization necessarily entails struggle. The more advanced the organization becomes, and the more consciously the economy is regulated, the more intolerable does the usurpation of economic power (...) by the owners of the concentrated means of production become (...). The consciously regulated character of the economy comes into open and undisguised conflict with the antagonistic ownership principle (...). The conflict is resolved by the transformation of the hierarchically organized economy into one that is democratically organized.⁹

As in politics, where the privilege (justified by birthright) of the rule of the king and the aristocracy is overthrown, the control of the large corporations—a power that is linked with property—can be changed (Hilferding 1924, 5). Nevertheless, the creation of economic democracy is an enormously complicated, lengthy historical process, which proceeds not by means of revolution but through a prolonged organic development: in other words, by evolutionary means (Hilferding 1924, 3). Here, property is central to the changes that must occur, that is, only a change in the rules of ownership can create the transition to a new community, to socialism.

With this theory, Hilferding found great support within the SDP until the economic crisis of 1928/29 and was thus able to unite the left- and right-wing social democrats for a few years (Smaldone 2000, 146f). With the concept of “Organized Capitalism,” Hilferding has created a theoretical basis on which the SPD was able to combine its pragmatic policy with its Marxist ideology in the 1920s.

To a certain extent, Hilferding deviates from his concept of “Finance Capital,” through which he argues that the state depends on the interests of the “finance capital” and carries out its will. In “Organized Capitalism,” the democratic state is oriented toward the common good (Könke 1987, 62f). Hilferding rejects a (second, which would mean a Bolshevik) revolution, a political overthrow, and wants to effectively

⁷The concept of Wirtschaftsdemokratie [economic democracy] is linked to Fritz Naphtali. In the programmatic document *Economic Democracy*, published by the *Deutsche Gewerkschaftsbund* [Confederation of German Trades Unions] (1928), edited by Fritz Naphtali, Hilferding is mentioned as a prominent contributor. Naphtali acknowledges Hilferding’s theory of “Organized Capitalism” as a basic principle; Naphtali (1928, 11, 21ff).

⁸Hilferding (1927, 221): “Die Wirtschaftsdemokratie ist die Unterordnung der wirtschaftlichen Privatinteressen unter das gesellschaftliche Interesse”.

⁹Hilferding (1924, 3): “Aber gerade die antagonistische, gegensätzliche Grundlage einer solchen Wirtschaftsorganisation erzwingt den Kampf. Je fortgeschrittener die Organisation, je bewußter die Regelung der Wirtschaft, desto unerträglicher wird der Masse der Produzenten die Usurpation der Wirtschaftsmacht und des gesellschaftlichen Produkts durch die Besitzer der konzentrierten Produktionsmittel. Der bewußt geregelte Charakter der Wirtschaft gerät mit der “zufällig”, aus der früheren Epoche des unorganisierten Kapitalismus überkommenen gegensätzlichen Eigentumsgrundlage in offenbaren, nicht mehr zu verhüllenden Widerspruch. Er wird beseitigt durch die Umwandlung der hierarchisch organisierten in die demokratisch organisierte Wirtschaft”.

transform the economy over a longer period by means of a democratic state. Hilferding was very much in opposition to the influence from Moscow on the SPD (Könke 1987, 63).

With this revision, Hilferding only adapts his theory to the political changes in Germany from the monarchy to a democracy, in which the SPD serves as the largest political party (Stephan 1974, 137f). Unfortunately, all optimistic ideas turned out to be an illusion: the Weimar state was not a stable democracy. The argumentative core of “Finance Capital”, from the theory of money, the importance of the banks, and the cartel formation, remains completely untouched by these adoptions. In fact, on the contrary, the continuity of his theoretical constructions is astonishing.

6 The Influence of Ferdinand Tönnies on “Finance Capital”

Tönnies was of high importance for Hilferding’s intellectual development (Greitens (2018) 377ff). His personal library (Hilferding 1957) includes three works by Ferdinand Tönnies, “Gemeinschaft und Gesellschaft” [Community and Civil Society] (1922 edition), “Das Eigentum” [Property] (1926), and “Soziologische Studien und Kritiken” [Sociological Studies and Critiques] (a compilation of texts written and edited by Tönnies 1925). The importance of the first two works for Hilferding will be discussed below (Greitens 2013, 29f).

Hilferding quoted Tönnies’ definition of the term *Gesellschaft* [society] from his first edition of “Gemeinschaft und Gesellschaft” (1887) for one of his articles in “Die Neue Zeit” (Hilferding 1904, 106). In this article, Hilferding talks about the economic theory of Karl Marx. The terms *Gemeinschaft* and *Gesellschaft* can be found throughout Hilferding’s article. In that cited work, Tönnies distinguished between the natural and organic connection between humans in a *Gemeinschaft* and the mechanical connections among them in a *Gesellschaft* (Tönnies 1887, 17, 233).

The theory of *Gemeinschaft* is based on the idea that in the original or natural state is a complete unity of human wills (Tönnies 1887, 22).

The theory of *Gesellschaft* takes as its starting point a group of people who, as in *Gemeinschaft*, live peacefully alongside one another, but in this case without being essentially united—indeed, on the contrary, they are here essentially detached. (...) Nothing happens in *Gesellschaft* that is more important for the individual’s wider group than it is for himself. On the contrary, everyone is out for himself alone and living in a state of tension against everyone. (...) Nobody wants to do anything for anyone else, nobody wants to yield or give anything unless he gets something in return that he regards as at least an equal trade-off. (Tönnies 1887, 52)¹⁰

As the relationship of exchange becomes a paradigm of society, Tönnies connects this idea to a value theory based on work (Tönnies 1887, 54ff). Tönnies directly refers to Marx at only three points, but the whole “theory of society” is a specific interpretation of Marx (Rudolph 1991, 310). Tönnies’ definition of *Gesellschaft* is

¹⁰These sentences are quoted in Hilferding (1904, 106).

used for Hilferdings understanding of anarchistic capitalism (Hilferding 1910, 27ff). From *Gesellschaft*, which is defined by the exchange of goods, Tönnies moves to the topic of “money.” For him, a bill of exchange is only valid “if the receiver is sure of being able either to pass it on, or of giving it back to the giver (or issuer). (...) It is private money, which Society guarantees by enforcing the liability of the debtor or his ‘guarantors’” (Tönnies 1887, 61).

Hilferding adopts the motif of a “guarantee by society” (*gesellschaftliche Garantie*)—it is apparent that, following Tönnies, he views a legal guarantee with enforceability (Hilferding 1910, 62).

Behind Tönnies’ construction lies a dialectical line of argument, in which the era of community is followed by an era of society. Tönnies’ projected end of society is not followed by barbarism, but instead by a “new community,” with the labor movement as its driving force (Rudolph 1991, 309). In 1919, Tönnies states that the goal of this labor movement is the restoration of the community (Rudolph 1991, 309). For Tönnies, communism means common property, whereas socialism means that the state owns the property. Furthermore, communism is community-based, whereas socialism is a kind of society (Kozyr-Kowalski 1991, 329). This is explicated and specified by Tönnies in his work, “Soziologische Studien und Kritiken.” (Tönnies 1925, 58ff).

Hilferding’s idea of a socialist society is defined by Tönnies as follows: “In a more perfect version of *Gesellschaft* every commodity would be produced in the correct amounts and sold at its proper value by one single unified capitalistic concern which had complete foreknowledge of normal demand” (Tönnies 1887, 79).

Tönnies’ concepts of “community” and “society” and his idea of a new community as the goal of socialism are therefore fundamental to Hilferding’s description of the development from capitalist anarchy to a consciously organized economy in “Finance Capital.”

7 Tönnies’ Understanding of Property and Socialization

In 1926, Tönnies published his book entitled “Das Eigentum” [Property]. This was triggered by a referendum on the expropriation without compensation of the German royal houses, which had reigned until 1918. This vote, which was initiated partly by the SDP, was held on June 20, 1926, but did not receive sufficient backing. It is against this background that the property question arose again for Tönnies.

In the first instance, “property” refers to abstract protection of ownership against arbitrary rule, and this benefits the poor as well as the wealthy (Tönnies 1926, 8f) (“Ownership of other means of production is still regarded as sacred and irreplaceable”¹¹). Property, however, has always attracted criticism and this has changed the understanding of this concept. Tönnies’ example is the prohibition of the slave trade:

¹¹Tönnies (1926, 12): “Das Eigentum an anderen Produktionsmitteln gilt noch als heilig und unersetzlich”.

(Tönnies 1926, 10f) “Recently, however, it has often been predicted that ownership of land and real estate as ‘capital’ will, like slavery, be replaced to history in the foreseeable future—perhaps in about half a century.”¹²

Why do capitalists regard private property as something sacrosanct and inviolable? (Tönnies 1926, 12). Tönnies names the following three theories justifying the ownership of property in a society:

- Property is of the very essence of man and is derived from work he has performed.
- It is an unspoken contract between all participating members of society and, thus, a convention.
- By virtue of its laws, the state’s protective will and its power create property. Therefore, the state also has the authority to change the rules governing properties.

According to Tönnies, all three theories are mutually compatible and fit to the present social order (Tönnies 1926, 13ff). In the community (as Tönnies understands it) private property is based on common property, which has arisen through a rule of distribution (e.g., through the father of the house or the village community) and is also restricted (Tönnies 1926, 16f). Historically, property has become ever more free and unrestricted, thanks to the state, which is itself influenced by social forces. The state sees its principal task as being the protection of free property (Tönnies 1926, 18).

However, the more the state power, despite its indisputable dependence on the socially significant class, sees before it the great mass of its people who have no, or scarcely any, share in the ownership of land and capital (...) the more the relationship of the state power to property will necessarily change. Free property is confronted by the free state power, which gathers all previous common powers to itself and claims to replace them by representing the rationalized concept of the common will. Even apart from the increasing influence of the working and propertyless class, the idea of ‘state socialism’ is coming forward through financial need and realistic thinking about the conditions necessary for the preservation and promotion of the state as an interest of all of the people. This idea (of ‘state socialism’) is reflected in the aim, on the one hand, to make the state itself to a large extent the owner of the land and of its resources and of the major means of production and communications, and on the other hand, to emphasize the degree to which all private property is determined by the institution of the state and of the legislative will.¹³

¹²Tönnies (1926, 12): “Neuerding aber ist mehrfach vorausgesagt worden, daß das Eigentum an Boden und an realem “Kapital” dereinst—etwa binnen eines halben Jahrhunderts—ebenso der “Geschichte” angehören werde, wie heute tatsächlich das Sklaveneigentum”.

¹³Tönnies (1926, 18f): “Je mehr aber die Staatsgewalt, wenn auch noch in unbestrittener Abhängigkeit von den gesellschaftlich maßgeblichen Schichten, die große Masse ihrer Untertanen sich gegenüber sieht, die am Eigentum des Bodens und des Kapitals keinen oder geringen Anteil haben (...) umso mehr wird notgedrungen das Verhältnis der Staatsgewalt zum Eigentum ein anderes. Dem freien Eigentum stellt sich die freie Staatsgewalt gegenüber, die alle bisherigen gemeinschaftlichen Mächte in sich versammelt und ersetzen will, indem sie den rationalisierten Begriff des Gemeinwillens darstellt. Auch abgesehen vom zunehmenden Einfluss der arbeitenden und eigentumslosen Klasse entwickelt sich durch finanzielle Bedürfnisse und sachliches Denken über die Bedingungen des Erhaltung und Förderung des Staates als eines Interesse des Volksgesamtheit, die Idee des “Staatssozialismus”, die sich darin ausprägt, daß sie einerseits den Staat selber in weitem Umfang zum Eigentümer des Bodens und seiner Schätze wie der großen Produktions- und

For Tönnies, it is in money that the consciousness of property is crystallized (Tönnies 1926, 20).

The state has been instituted by him [the capitalist] and his business friends to protect life and property, to enforce contractually agreed performance. He is also paid for this and does what it is committed to doing—the ‘night-watchman’ theory. However, a collective entity as powerful as the state (...) cannot be prevented from developing its own will and its own thinking, even against owners of property,—and this is more likely to happen the more powerful the non-property-owners become. (...) the lawgiver has the right (...) to make changes to it and distribute it as he thinks fit if the great majority of citizens instruct him and empower him to do so.¹⁴ The consciousness, then, of being able, through the state and property, to control and change the entire economic order is not a new political consciousness (...). Expropriation is an institution of the law as currently in force that is still untouched by the influence of the working class.¹⁵

Tönnies is not in favor of revolution. For him, property is socially determined and thus adaptable. This is the view of property that also underlies Hilferding’s thinking in his notion of “Organized Capitalism.”

8 The Influence of Ferdinand Tönnies on Hilferding’s “Organized Capitalism”

In his work, “Finance Capital,” Hilferding only uses the term “property” in a few places: with reference to shares, the concentration of enterprises, the stock exchange and when speaking of fictitious capital. His conclusion is as follows: “The dependence of industry on the banks is, therefore, a consequence of property relationships.” (Hilferding 1910, 305). True, Hilferding assumes in 1910 the need for a revolution in order to achieve the socialist society, but it is a political revolution, and there is no economic collapse.

However, nowhere does he attempt a legal or social categorization of the concept of “property.” Even when he describes the revolution, such a concept does not appear.

Verkehrsmittel machen will, anderseits die Bedingtheit alles Privateigentums durch die Institution des Staates und des gesetzgeberischen Willens (...) hervorhebt”.

¹⁴Tönnies (1926, 24): “Der Staat ist von ihm und seinen Geschäftsfreunden eingerichtet, um Leben und Eigentum zu beschützen, um die kontraktlich bedungenen Leistungen zu erzwingen, auch er wird dafür bezahlt und tut, wozu er verpflichtet ist—die “Nachtwächter-Theorie”. Indessen kann nicht verhindert werden, daß ein so gewaltiges Kollektivgebilde, wie der Staat notwendig sein muß—von vielen denkenden Menschen getragen—seinen eigenen Willen und sein eigenes Denken entwickelt, auch gegen die Eigentümer entwickelt,—um so eher wird dies geschehen, je mehr die Nicht-Eigentümer Macht gewinnen. Dann erst erfüllt sich (...), daß die Staatsgewalt, als die von allen autorisierte, nur durch Gesetze das Eigentum erhält, und daß folglich der Gesetzgeber nach seinen Zwecken es zu verändern und zu verteilen das Recht, weil die natürlich Macht, hat, wenn die große Mehrheit der Staatsbürger ihm den Auftrag gibt, ihn ermächtigt”.

¹⁵Tönnies (1926, 27): “Das Bewußtsein, durch den Staat und das Eigentum, also die gesamte Wirtschaftsordnung zu beherrschen und verändern zu können, ist nicht ein neues politischen Bewußtsein, wengleich es in neuen Trägern neue Gestalten annahmen muß. Die Enteignung ist eine Institution des geltenden, vom Einfluß der Arbeiterklasse noch unberührte Rechts”.

After the war, when he found himself in a responsible position in a democracy, and as such, an analysis of this kind became necessary.

It is only in the concept of “Organized Capitalism” that Hilferding, not at least under the influence of Tönnies, differentiates his concept of “property,” as described earlier. These modifications are also reflected in Hilferding’s changing understanding of the state. In “Finance Capital,” power over the economy leads to the control of the state power: “Economic power also means political power. Domination of the economy gives control of the instruments of state power. The greater the degree of concentration in the economic sphere, the more unbounded is the control of the state” (Hilferding 1910, 370). Hilferding argues that, after the war, it is possible for the state to be conquered by the working classes by democratic means and used by them for their own purposes. Hilferding moves away from the subordination of the state to the economy in favor of the idea of reciprocal influence: “In reality, there is a functional link between state and economy; there is only one economy in the state, and this is only the way it is because it is in this state, just as, conversely, the character of the state is determined by the economy.”¹⁶

In “Organized Capitalism,” he is thinking of a restructuring process over a fairly long period of time. When revising his views, however, Hilferding understands the switch to democracy in a purely theoretical sense. His idea of socialism—a consciously regulated society moving toward the new community—which is already discernible in “Finance Capital,” becomes clearer.

9 Conclusion

Astonishingly, there is an unbroken continuity in Hilferding’s economic theory from “Finance Capital” in 1910 until 1933. The experiences of the revolutionary years did not make Hilferding change his fundamental theoretical positions. Only the question of how socialism can be achieved, whether revolutionary or democratic, has changed.

As Hilferding was in strong opposition to the Bolsheviks, he, instead of despairing on the failure of the revolution, interpreted the new political situation positively and adapted his theory with the new concept of “Organized Capitalism” into one that posits a democratic and gradual transformation instead of a revolution. He now regards the state as a political instrument with which to build socialism. There is no need to theorize if economic planning can be done, as management is a strictly scientific function and already done under the regime of finance capital. Along with this continuity, Hilferding was not able to include new approaches focusing on the

¹⁶Hilferding (1921, XIV): “In der Realität besteht zwischen Staat und Wirtschaft [ein] funktioneller Zusammenhang; es gibt nur eine Wirtschaft im Staate, die nur so ist, weil sie in diesem Staate ist, wie andererseits die Beschaffenheit des Staates durch die Wirtschaft bestimmt ist”.

demand side of the economy, which made him lose his influence in the SPD with the Great Depression.¹⁷

Through Hilferding, Tönnies also had a strong influence on the party programs of the Social Democrats in the 1920s. With his ideas on community and society, as well as his elaboration on property rights and socialization—representing a widespread discussion during that time—he has significantly influenced Hilferding and his concepts.

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¹⁷e.g. his role in the conference of the Friedrich-List Gesellschaft in September 1931 (Borchardt and Schötz 1991).

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Visions of Socialization and Political Reality—the Position of Labour Minister Heinrich Brauns



Daniel Eissrich

1 Introduction

The establishment of the first socialization commission by the Council of People's Representatives in 1918 was the direct result of riots during the November Revolution of 1917, and the demand from socialists for council systems and socialization. However, during the revolution it became clear that the workers were divided on the question of socialization. In November 1917, the Stinnes-Legien agreement between employers' associations and labour unions had already been signed. In return for far-reaching concessions from employers, in particular the introduction of the eight-hour day, the unions—also driven by the fear of losing their influence because of council systems and socialization—argued for the preservation of private property and against socialization (Sturm 2011, 12–13; Feldman 1984, 100–127).

After the National Assembly elections, a broad coalition of SPD, Center Party and DDP was formed. Where there were disagreements between the socialization commission and the Reich government, it quickly became apparent that the position of the Reich government would be critical for the further development of socialization, as it had to incorporate Commission proposals in the form of legislation (Wulf 1977, 61). Thus, it is also these conflicts between the Socialization Commission and the Government, especially the SPD-led Ministry of Economics, which delayed the work of the Commission and ultimately led to its resignation. Only in the wake of the riots following the Kapp Putsch in 1920, was the discussion about socialization revived and a Second Socialization commission convened.

In the first Reichstag elections in 1920, the Weimar coalition lost its majority and both the SPD and DDP suffered record losses of votes. Initially, the SPD decided not to support any additional necessary but unpopular government decisions and chose not to participate in forming a new government. From the beginning, the bourgeois

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minority government that took office under Chancellor Constantin Fehrenbach was faced with strong pressure from the socialists. ‘Fearful of labour unrest under the first bourgeois government of the Weimar Republic, Fehrenbach sought to strengthen the advocates of socialization in his cabinet by appointing Heinrich Brauns as labour minister; a highly influential post that Brauns retained until 1928 (Patch 1985, 60).

2 About Heinrich Brauns

Heinrich Brauns was born on January 3, 1868 in Cologne, as the only child of the tailor Johann Brauns and his wife Anna Katharina. After graduating high school in 1886, he studied theology at the University of Bonn and in 1888 transferred to the seminary in Cologne. He was ordained as a priest in 1890 and took up a position as chaplain in Krefeld. In 1895, Heinrich Brauns became a vicar in Borbeck, Essen. His work in the interests of the workers and miners of his region earned him the reputation of being a “red chaplain”. After a nervous breakdown in the summer of 1900, probably caused by overwork, Heinrich Brauns is on leave from his duties as a priest. Franz Hitze, at that time the outstanding representative of Catholic social teaching in Germany, offered Brauns a position at the *Volkverein für das katholische Deutschland*, which he accepted in October 1900. In 1903, Brauns became a Departmental Director of the *Volkverein*, responsible for organization and advertising, and he assumed responsibility for the *Volkverein*’s economic courses, which had been offered since 1901. From October 1903, Brauns took a break from his work at the *Volkverein* and studied political science and national economics, initially at the University of Bonn, although he then transferred after one semester to the University of Freiburg. In mid-1906, he completed his dissertation in economics, “The transition from manual weaving to factory operation in the Lower Rhine velvet and silk industry and the situation of the workers in this period”. He had already resumed his work at the *Volkverein* in 1905. In the following years, Brauns organized courses and seminars on labour issues throughout Germany and published a large number of newspaper articles, leaflets and other writings. He became the most renowned speaker of the *Volkverein*, which now had more than 700,000 members. In the Catholic trade union dispute, Brauns vehemently defended the position of the Christian unions and argued against the plan to fully integrate the Catholic workers’ organizations into the church hierarchy (Mockenhaupt 1977, 60–78).

During wartime, Brauns continued his work at the *Volkverein*, and following the spirit of the time, his lectures were often of a patriotic nature. In the wartime economy, the core of the *Volkverein*’s work, the question of labour, paled into insignificance compared to the events of the war. Nevertheless, even during the war Brauns assumed that workers would have a far more powerful role in German politics in the post-war period than ever before.

Towards the end of the war, Brauns reiterated his political commitment to the Catholic Center Party. Although the initiative, launched together with Julius Bachem and Adam Stegerwald, to reform the Center Party and continue to open it to other denominations remained rather unsuccessful, Heinrich Brauns became one of the most influential Center politicians. Heinrich Brauns's political convictions were directed against any form of extreme politics. He wanted to rebuild the Center into a party of the middle and clearly represented an antisocialist position, which was also directed against the SPD (Mockenhaupt 1977, 112–140; Morsey 1966, 342, 360–368, 428, 609).



Heinrich Brauns (1868-1939), Reich Minister of Labour from 1920 to 1928 (Bundesarchiv, 102-01478A)



Front page of the newspaper "Der Volksverein. Zeitschrift des Volksvereins für das katholische Deutschland", No. 2/1911 (Stadtarchiv Arnberg)

3 The Weimar National Assembly and the First Socialization Commission

In November 1918, the Council of People's Representatives appointed the Socialization Commission to lay down the details for the socialization of key industries in the German Reich. From the start, there were disagreements between the Socialization Commission and the Reich Ministry of Economics, under the Minister Rudolf Wissel of the SPD. The conflict culminated in Wissel bringing a "socialization law" to the National Assembly. Its aim was to transfer suitable economic enterprises to the community, and to implement laws in order to regulate the coal and potash industry. Because Wissel did not consult the socialization commission first, this brought an end to the Socialization Committee's work in April 1919 (Reidegeld 2007, 75–76; Euchner 2005, 289).

The concrete discussion adopted an increasing focus on the question of the socialization of coal mining. There were a number of reasons for this: coal was the most important source of energy, and large parts of German industry relied on coal. Supply bottlenecks were constantly causing power outages and production losses, especially in heavy industry. An expansion in coal mining production was almost only possible through an increase in labour input; for example, through overtime and special shifts.

The hope from the socialization of companies was that this would increase the motivation of the miners to achieve this higher work input (Brauns 1919a, 1367–1368). Furthermore, the German coal industry was organized into large syndicates with a monopoly-like position that were frequently suspected of exploiting this position. In addition, the question of ownership over German mineral resources was being discussed. Broad circles, which cannot always be attributed to the socialist camp, believed that the natural resources belonged to the public and their extraction should not benefit only a small number of industrialists (Wulf 1977, 46–47).

There was also a fierce debate within the Center Party. The basic economic concept of the Center Party at the time was based on the goal of “putting Germany back on a sound economic footing” but also on the insight that the upheavals of November 1918 was aiming for both a political, and social revolution, which needed to be taken into account (Morsey 1966, 221).

Heinrich Brauns reported that, with regard to the socialization question, there was no unanimity within the Center group. However, Brauns also noted that the ‘public service organization’ of the mining industry had been received positively (Morsey 1966, 224–225). Socialization was seen by the Center Party as an economic experiment and there was a belief that the workers would first have to become ‘internally mature’ for this experiment, which would take a long time (Morsey 1966, 224). Nevertheless, linked to the hope of giving new impetus to the German economy, the Center Party was ready to accommodate the Social Democrats’ demand to transfer the means of production to common ownership. However, the doctrinaire socialist demand for the transfer of private property into common property was rejected, on the basis that there were fundamental considerations relating to the property question and because of the economic risk posed by a fall in production. Any form of expropriation without adequate compensation was also condemned (Morsey 1966, 225). For the opponents of socialization in the Center Party, ‘[...] though they did not outwardly emerge, the fact that harsh opposition to the idea of socialization at the present time would only promote the “prospects of its realization”, must surely have played a role’ (Morsey 1966, 225).

In early 1919, Heinrich Brauns was elected to the Weimar National Assembly for the constituency of Cologne/Aachen. As Chairman of the Economic and Social Policy Committee and a temporary member of the National Assembly Constitutional Committee, Heinrich Brauns played a decisive role in the formulation of Article 165 of the Weimar Constitution, the so-called “Council Paragraph”.

Workers and employees shall be called upon to cooperate in common with employers, and on an equal footing, in the regulation of salaries and working conditions, as well as in the entire field of the economic development of the forces of production. [...] Workers and employees shall, for the purpose of looking after their economic and social interests, be given legal representation in Factory Workers Councils, as well as in District Workers Councils organized on the basis of economic areas and in a Workers Council of the Reich. District Workers Councils and the Workers Council of the Reich shall meet with the representatives of employers and other interested population groups as District Economic Councils and as an Economic Council of the Reich for the purpose of performing economic functions and for cooperation in the execution of the laws of socialization. [...] The National Ministry shall, before proposing drafts of political-social and political-economic bills of fundamental

importance, submit them to the Economic Council of the Reich for consideration. (Weimar Constitution, Art. 165)

Heinrich Brauns, together with Franz Hitze, was also involved in preparing the Works Councils Act of 04.02.1920, which enabled workers to fully participate in personnel and social issues and to send members of the workers' council to the supervisory boards, in order to obtain some degree of economic co-determination (Stegmann/Langhorst 2005: 756–757). The Works Councils Act was met with bitter resistance from a large number of the socialist groups. For them, the regulations did not go far enough and they did not believe that the council concept was actually being realized. Subsequently, Brauns connected the idea of a council system with the question of socialization: 'With help from the works councils, the radical council system wants to regulate the internal affairs of the companies, control and ultimately socialize and manage the production. [...] This radical council idea is completely revolutionary. Its devotees live and work in the belief of a future order that has nowhere become full reality. The attempts made in Hungary and in Russia have resulted only in failures and therefore are not to be emulated' (Brauns 1920c, 62, 64). However, Brauns believed that a moderate council system, as implemented in the Workers Council Act, was still compatible with conservative and Christian views (Brauns 1920c, 66).

In March 1919, as a representative of the Center Party in the National Assembly, Brauns delivered a speech about the problems of socialization. It became clear that his idea of socialization was very broad:

Socialization is not merely nationalization, but also an increase in public influence over private enterprise, indeed in the sense of fair administration and distribution, in particular where monopolistically oriented branches of production are concerned, and in Germany in the last few years before the war, there was certainly no lack of this. The approximately 600 cartels and syndicates that existed before the war in Germany are the outward expression of this monopolistic development. (Brauns 1919a, 1366)

As examples of such an approach, Heinrich Brauns mentioned the potash legislation and the state-owned liquor monopoly, which already revealed a piece of socialization in pre-war legislation (Brauns 1919a, 1366).

For Brauns, socialization was also the pursuit of respect and consideration of the workers in the production process, and he classifies this striving as a particularly worthy of support. He also advocated the socialization attempt in the coal mining industry, but linked this with the expectation that, from a macroeconomic perspective, a practical experience of socialization first had to be gained before any fundamental decisions affecting the entire economic system could be made (Brauns 1919a, 1367–1368).

Above all, however, Heinrich Brauns warned against seeing socialization as a "one-sided formula" for the organization of economic activity. Like the failed focus on individualism in the nineteenth century, socialization as a one-sided program would be a mistake. Brauns also suspected that economic performance could not be maintained without competition (Brauns 1919a, 1370). Forcing the economy into

templates as a result of comprehensive socialization, would harm small and medium-sized enterprises above all others and massively impair the performance and competitiveness of the German economy (Brauns 1919a, 1369). In 1919, Heinrich Brauns articulated the possible problems of socialization in connection with peace negotiations (Brauns 1919a, 1369). As the debate progressed further, one aspect of this—the question of using state-owned enterprises to cover reparations payments—turned out to be a major obstacle to achieving socialization.

Despite all the misgivings, Heinrich Brauns advocated the Socialization Act and the socialization of coal mining, but with the expectation that the unrest and strikes affecting economic activity in recent years would also come to an end as a result (Brauns 1919a, 1373). Brauns was also in complete agreement with the Christian labour unions over this, for they were very close to him at the time. They agreed with the demands for the nationalization of coal mining, although only half-heartedly and driven by the fear that the free trade unions, especially in the Ruhr area, could call a general strike and trigger a civil war (Patch 1985, 61).

In the National Assembly Constitutional Committee, Brauns rejected the proposal to regulate socialization entirely at the Reich level and demanded that independent measures be taken at local and also at state government level. At the same time, he voted for the Reich to have the right to veto ‘wild socialization’ (Brauns 1919b, 14).

4 The Fehrenbach Cabinet and the Second Socialization Commission

In March 1920, the trade unions submitted a catalogue of demands to the government, including conditions for the termination of the general strike, which had previously ended the Kapp putsch. It also included a call for the Socialization Commission to reconvene immediately, and the second Socialization Commission met in May 1920 (Reidegeld 2007, 76).

In June 1920, when the Cabinet of Chancellor Constantin Fehrenbach began its work, Heinrich Brauns was appointed Minister of Labour for the Reich and held this office until June 1928. He was Minister of Labour in a total of 12 cabinets. The social-political conception of the priest Heinrich Brauns was heavily influenced by the Catholic social teaching; his central concern was the “integration of the working class into society” (Mockenhaupt 1977, 175–176). However, at the same time, Brauns developed additional practical policy principles that focused on productivity-oriented wage and social policy under the leadership of the state, where state interventions were required to take economic and social aspects into account (Trampusch 2000, 112).

The idea of ‘economic self-administration’ i.e., self-administration based on collective contracts between the central organizations representing the interests of capital and labour and based on a rough balance of class powers. between them, was the leitmotiv that inspired the Reich Labour Ministry in both its social and its labour policy. This formula became effective not on a grand scale, but in a number of detailed provisions and decrees ... (Manow 1997, 19)

Chancellor Fehrenbach's minority government of the Center Party, the left-liberal DDP and the national-liberal DVP, needed the support of the Social Democrats, who continued to insist on the idea of socialization. The coalition partner DVP, on the other hand, strictly rejected any form of socialization. In this area of tension, the Chancellor declared that the Socialization Commission would continue its work, but that the goal must be to increase production (Wulf 1977, 62).

Reich Minister of Economics, Ernst Scholz (DVP), raised the issue of socialization in the Cabinet meeting on August 3, 1920 and emphasized the fact that the government must take initiative with this politically and economically important issue and therefore must immediately assume a position. A few days earlier, the Socialization Commission for the coal mining sector completed its debate and the publication of the results was to be expected at any time. The Economic Council of the Reich had also recently passed a resolution on the Spa Agreement, stressing the need to socialize coal mining so that coal shortages would not lead to a catastrophe. The Reich Minister of Economics presented the draft for a Cabinet decision, which Heinrich Brauns objected to, that the Reich Government must not say too little about the subject. The cabinet appointed a seven-member commission, which included Heinrich Brauns as a member, to prepare a draft resolution (Akten der Reichskanzlei 1920/21, 104). At the next day's cabinet meeting, Brauns reported on the Commission's deliberations, which proposed not to issue a formal statement from the government but instead to take a stand during the debate in the Reichstag. The Minister of Labour Brauns, was instructed to present the adopted text in Parliament (Akten der Reichskanzlei 1920/21, 105–106).

The following day Heinrich Brauns spoke in the Reichstag: he stressed that the government was not avoiding the issue of socialization, but instead would tackle the socialization of the coal industry, as soon as the report of the Socialization Commission was available. "The nature and form of socialization will arise from the need to develop the German coal industry in the direction of a maximum increase in production and profitability." At the same time, however, Brauns reproached those who criticized the current social policy and only saw the remedies as a breach of the capitalist system caused by socialization, stating that not even socialism could solve '[...] the great, enormous difficulties currently facing Germany [...] overnight [...]' (Brauns 1920a, 716).

About a month later, in the cabinet meeting on September 22, the Reich Minister of Finance, Joseph Wirth, like Brauns a member of the Centre Party, asked again to what extent the victorious powers would have access to socialized companies in order to settle reparations payments (Akten der Reichskanzlei 1920/21, 193). The Cabinet expressed strong reservations against discussing this aspect in public, and the Reich Minister for Economics was charged with drafting a paper on the socialization of coal mining (Akten der Reichskanzlei 1920/21, 189–193). At that point in time at least, the socialization of coal mining appeared to be a closed subject (Wulf 1977, 68).

Shortly beforehand, on September 3, the Socialization Commission published its report on coal mining, which contained two proposals that received roughly equal approval from the Commission: Lederer's proposal for the immediate socialization of coal mining and the Rathenau proposal, which recommended a gradual transfer

of coal mining to common ownership over a longer period. Both proposals envisaged compensation for the current owners (Wulf 1977, 65–66). As the results of the Socialization Commission were not unanimous, the provisional Reich Economic Council and the Reich Coal Council build a subcommittee of employers and workers representatives on October 8 to discuss the socialization issue. It met in late October but was unable to bridge the gap between workers and employers, eventually forming a smaller mediation committee. It rejected the proposals from the Socialization Commission and by a large majority recommended a proposal corresponding to the Stinnes concept, which was largely rejected by the Socialization Commission. It recommended vertical mergers between companies in the coal and processing industries in order to guarantee the coal supply. The employees were to participate by being issued with small shares; the state would only participate in the form of the coal tax. The responsible subcommittee discussed these proposals in early November, but a final compromise between the employers' and workers' camps was not reached and the matter was referred back to the mediation committee (Hauschild 1926, 247).

At about the same time, the influential industrialists Hugo Stinnes and Albert Vögler were attempting to influence Heinrich Brauns directly, resulting in a meeting with Heinrich Brauns in Gustav Stresemann's house. Stinnes and Vögler also involved the mayor of Cologne, Konrad Adenauer, in order to persuade Brauns of their position of "vertical socialization" (Feldman 1998, 653). Brauns replied to Adenauer in a letter in October 1920, emphasizing the impossibility of continuing the German economy on a purely private-capitalistic basis. Specifically, a large majority of workers would demand a reform of the economic system. A government that avoided this problem would immediately fail and pave the way for radical forces. 'It will only be a matter of finding the right path, a path that does not hamper productivity, because nobody can want this. Not even the reasonable proportion of workers [...]. It will be essential that for their part the employers [...] do not boycott a reasonable middle path' (Brauns 1920b).

Heinrich Brauns's moderate ideas were also in opposition to parts of his own party because at the turn of the year 1920/21, it became increasingly clear that the Center Party was trying to distance itself more clearly from further socialization efforts (Morsey 1966, 350).

Despite the request from Reich President Ebert that the government should soon take a clear position on the socialization issue, the Cabinet had decided to wait for the work of the mediation committee in the meantime (Akten der Reichskanzlei 1920/21, 335). Nor was there a result from the committee at the Cabinet meeting on January 20, 1921, so a decision on socialization was postponed further, although Heinrich Brauns pointed out the impatience among the workers with regard to socialization (Akten der Reichskanzlei 1920/21, 441–442). At the Cabinet meeting on February 2, the Reich Minister for Economics reported that the mediation committee had still not reached a conclusion but instead had commissioned a legal opinion to clarify 'what rights the Entente Powers could derive from the peace treaty against socialized enterprises'. The Cabinet decided to obtain similar opinions from the Ministry of Justice and Foreign Affairs (Akten der Reichskanzlei 1920/21, 450–451).

On February 21, the Cabinet discussed a government statement written by the Reich Minister of Labour, Brauns in response to a request from the DNVP Chairman, Oskar Hergt, concerning employee profit sharing. Heinrich Brauns intended to address the issue within the wider context of socialization, but the cabinet decided that the topic of socialization should not be addressed (Akten der Reichskanzlei 1920/21, 478). Although Heinrich Brauns did not directly discuss the subject of socialization in his subsequent speech to the Reichstag, it became clear that he saw the insistence in demanding socialization and profit sharing as a criticism of his socio-political ideas, and he then adopted a correspondingly negative attitude towards these subjects (Brauns 1921). Brauns also criticized the aimlessness and lack of thinking behind corresponding proposals (Brauns 1921, 2500–2501).

Both the joint legal opinion of the Ministry of Justice and the Ministry of Foreign Affairs, as well as the opinions obtained by the mediation committee, confirmed the risk that the Entente Powers could use nationalized companies in some form to cover reparations payments. Additionally, it was also explained that these were not merely questions of the law, but also questions of power and that the Reich government only had limited opportunities for protecting socialized companies against being accessed by the Entente (Akten der Reichskanzlei 1920/21, 450–451; Wulf 1977, 95–96). ‘The discussion regarding the socialization of the coal mining industry therefore ended immediately after this report, abruptly and entirely. ... There seemed to be general agreement between government and parties, trade unions and associations that a full socialization of the coal mining industry could not to be carried out under the existing foreign policy conditions’ (Wulf 1977, 96).

5 The End of the Socialization Controversy

From the middle of the 1920s the topic of socialization no longer mattered to Heinrich Brauns in his review of social policy after the First World War (Brauns 1924, 1927, 1930). His position regarding the subject was now permanently characterized by rejection:

The socialization of enterprises, especially in large industry, the socialization of housing, the democratization of the economy, the participation of workers in the capital invested in the enterprise, interest-free economy, etc., around such slogans new theories of socialism are grouped ... Today’s culture is without capitalist enterprises ... unthinkable ... The economic enterprises cannot be democratized, for example in the sense of a parliament. They require the initiative of the entrepreneur ... All previous attempts to raise large-scale economic enterprises in other ways, have failed. (Brauns 1929b, 158)

On the few occasions when he looked back on the subject of socialization, his negative attitude becomes even clearer:

It was obvious that in the days of the revolution some people were seeking the solution to the problems first and foremost in socialism. The expression of these aspirations was the establishment of the Socialization Commission. But quite apart from the fundamental attitude to the socialization of the means of production, it was realized that the times were not very

suitable. The Socialization Commission very soon ceased its work and the legislation did not go beyond modest attempts of this kind, which were not even actual socialization. There was no alternative but to better position the workers in terms of the law and to give them greater confidence in their existence on the basis of the capitalist order. (Brauns 1929a, 3)

During his time as Reich Minister of Labour, Heinrich Brauns dedicated himself to this latter goal; more than 120 laws were passed with a social policy character during his tenure and the Ministry of Labour issued 300 regulations and pronouncements (Lingen 2012, 97). Particularly important, among others, were the law on the universal application of collective agreements, and the decree on conciliation and arbitration (1923), the law on the creation of a labour tribunal (1926), the law on certificate of employment (1922), as well as the law on employment services and unemployment insurance (1927), the law on miners' guilds (1923) and the public welfare law (1924).

During the occupation of the Ruhr, known as the Ruhrkampf, Heinrich Brauns assumed a contact and coordination role between the Reich government, trade unions and workers' organizations that were organizing the resistance against the French and Belgian occupiers. As the prospects for the success of the uprising dwindled, Brauns allied himself to the trade unions in order to bring an end to the Ruhrkampf, even against the wishes of Chancellor Wilhelm Cuno (Lingen 2012, 94).

The Reich Minister of Labour's social policy initiated a gradual development towards a welfare state, while always supporting the efforts of the respective government to stabilize the German economy. In particular, Brauns tried to enforce a wage policy in which wage changes become dependent on changes in productivity (Feldman 1980, 202; Lingen 2012, 98). The problem of an expansive social policy with a simultaneous consideration of rational economic policy became very clear in 1923, when Brauns on one hand strengthened the position of the workers and trade unions with the conciliation and arbitration decree in October 1923, and then on the other hand, met the demands of employers with the ordinance on working hours in December 1923. This ultimately resulted in him losing the support of both groups (Lingen 2012, 95–96).

The clumsy actions of the Center Party, during the 1928 coalition negotiations and internal disputes within the party, resulted in the Center losing most of its ministerial posts in the new SPD-led government. After eight years in office, Heinrich Brauns left the ministry. He continued to remain a member of the Reichstag and immediately after leaving office was elected Chairman of the Reichstag Social Policy Committee (Lingen 2012, 103–108).

In January 1931, Heinrich Brauns became chairman of the "Reich Commission for Crisis Control", convened by Chancellor Heinrich Brüning, the so-called "Brauns Commission". The eleven-member panel, in which Wilhelm Röpke was the only member from the scientific community, recommended active economic stabilization policy measures and a state employment policy as a means of coping with the crisis, but received little sympathy from the Reich government (Holtfrerich 2016, 644–647; Röpke 1931).

Heinrich Brauns did not run for the Reichstag in the 1933 election; he retired to his house in Lindenberg in the Allgäu. In the same year, he found himself one of the main defendants in the lawsuit against the Volksverein-Verlag, Cologne, but this was suspended in 1934. Heinrich Brauns died in Lindenberg in 19 October 1939.

6 Conclusion

The statements made by Heinrich Brauns after his time as the Reich Labour Minister in particular, show a clear scepticism towards the concept of socialization. Heinrich Brauns believed socialization would be an economic experiment with an uncertain outcome. He rejected the extensive efforts in this direction, which would have meant a total abandonment of the capitalist system. At the same time, Brauns was convinced that the social demands of the November Revolution had to be taken into account, and consequently there was a willingness here to compromise with regard to the question of socialization. Preferred in coal mining, where Brauns also suspected there was a potential to increase production as a result of better motivated miners, limited socialization efforts could hope for the approval of the influential Reich Labour Minister, especially when concepts beyond pure nationalization are considered.

In reality, if one considers Heinrich Brauns as a typical representative, it is less the resistance of the moderate bourgeois faction than the disunity of the socialists and workers in respect of socialization efforts that ultimately lead to its failure. This disunity allows industry and industry representatives in politics to apply a delaying tactic until ultimately the threat of using nationalized companies for reparation payments provides an opportunity to finally bring an end to the socialization debate.

The subsequent Chancellor, Heinrich Brüning, like Brauns a member of the Center Party, summarizes later:

At this time, the Socialization Commission, which was supposed to eliminate private capitalism, was meeting but did not actually produce a creative outcome. I was a member for a few weeks but resigned because the theoretically most interesting negotiations for me meant a loss of time. ... The danger arising from the socialization question was averted by referring the decision to a special committee of experts. (Brüning 1970, 50–51)

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Different Views of Socialization Strategies in Germany Since the First Socialization Debate



Karl-Heinz Schmidt

1 Why and How to Review Former Debates on “Socialization” (Sozialisierung)?

Debates on “socialization” of resources and economic activities took place in Germany throughout the 19th century, but they came to a theoretical and political clarification only after the First World War. The “Socialization Commission” (1919/20) in Berlin may be acknowledged as a symbol of the introduction of a special institution. The reports, documents, and publications referring to the discussions at the conferences of the Commission and during the decades after the First World War were effective as background material for economic investigations and political proposals by authors of different scientific schools. Some selected examples of related studies will be exposed in the present article. The authors of the concerned publications elaborated their views during or after the First World War, but they brought the written work to print mainly during the 1920s or later.

The question, *why* the former debates on “socialization” in 1918 and during the later decades should be reviewed, may be answered with two arguments: first, the determinant factors of the former debate must be analyzed from a “present-day view”, and second, the consequences for a new debate on “socialization” of economic resources and activities in the “European Future” should be demonstrated. The additional question, *how* that debate may be carried out, may be answered in different ways. The following article will be based on related publications by selected authors. Additional authors who were involved in the first debate on “socialization” in 1918 and thereafter, may also be considered. Books of different views will be pointed out with special interest. Specific emphasis will be directed to the strategic aspect of “socialization”.

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2 Aims and Structure of the Review on Socialization Strategies

A reliable starting point for a review of different studies on socialization in Germany since 1918 can be found in Klaus Novy's study on "Strategies of Socialization". The book concerns the discussion on economic reforms during the Weimar Republic (Novy 1978). Part I of the study deals with the preconditions and starting points of socialization policy, Part II concerns strategies of socialization. Here, a clear pattern may be found for the intended study of socialization strategies. Novy introduced his book by reference to a general interpretation of "socialization" as demand for "Vergesellschaftung der Produktionsmittel", translated as "socialization of economic resources". But Novy added a former comment by Korsch (1912) according to which this interpretation would appear as an empty formula without concrete impact (Novy 1978, 13). Furthermore, Novy complained that concrete strategies of transformation and of related economics were lacking. He was even afraid that the development of the basics of a socialist economic reform policy would turn to stagnation (Novy 1978, 14). In order to strengthen the understanding of socialist economic reforms, the author proposed a classification of the phases of those reforms. According to Novy, the phases started with the works of Marx and Engels; the phases included the debate of socialization (1918—ca. 1920), and they were continued up to a debate about the planning of investment (1973 ff). Probably, the author Klaus Novy would have been prepared to identify further phases of the later economic development. But he died early.

In order to concentrate the interest on the socialization debates of 1918 ff, the aims of socialization must be identified. Two lines of discussion should be distinguished according to Novy's view: (1) the debate and (2) the movement of socialization (Novy 1978, 18). Parallel to both lines (1919/20), the institutionalization of two commissions of socialization should be pointed out. The related discussions were sustained by new publications (1920 ff) of different authors from different sciences. In Novy's words, "It was the hour of unlimited thinking and projecting. The atmosphere of starting from an assumed hour zero after the break-down of the German Kaiser-Imperium set free unexpected energies" (Novy 1978, 19; translated by K.-H. Sch.). Unfortunately, the economic and political changes in Germany brought this phase of socialization to an end.

One general formula should be acknowledged as resulting from the socialization-debate: the "Vergesellschaftung" of economic resources. This term is relevant also for the structure of the following investigation concerning the process of socialization. The paragraphs refer to selected authors who published their contributions to the debate after the First World War or during subsequent decades. Only few authors can be considered in this article: Franz Eulenburg, Eduard Heimann, Joseph Schumpeter, Gisbert Rittig, and Klaus Novy. The conclusions for future debates on socialization will finish this article. Concerning the history of socialization, the review-article on this topic by Ortlieb and Stavenhagen (HdSW 1956, vol. 9), should be considered.

3 Concepts from Selected Authors About the Process of Socialization

3.1 *Franz Eulenburg's Analysis of Types ("Arten") and Stairs ("Stufen") of Socialization*

The first author to be considered is Franz Eulenburg, a German scholar of the Historical School. He wrote his doctoral dissertation under the supervision of Gustav Schmoller and completed his Habilitation work under the responsibility of Karl Bücher. Though he had to wait for about 18 years until he got an academic chair at a university, he proved to be an excellent researcher and author of a variety of basic studies including theoretical knowledge and empirical data. It is of no surprise that he was connected by a lifelong friendship to Werner Sombart. Eulenburg's publications concerned basic topics like the question, are 'historical laws' are possible (1922)? Another example is a study on problems of a European customs union, his most important work on foreign trade and foreign trade policy (1929). Prior to these studies, Eulenburg had published an expert document concerning "Types ("Arten") and Stairs ("Stufen") of Socialization" (1920). This publication gives rise to evaluating the contents of the small but concentrated study on the important problem of how to change the economic and social system. The German scholar and expert in social economics, Gottfried Eisermann, later was convinced that Eulenburg was part of that great generation of German economists who combined theoretical thinking with the potential to consider and to elaborate social, political, and cultural implications of economic life adequately (Eisermann 1961, 358).

Franz Eulenburg started the book "Types and Stairs ...", which was based on the former expert document, by exposing the purpose of the study: to investigate with pure objectivity ("rein sachlich") which economic effects of the intended measures (of the socialization project, K.-H. Sch.) may be expected and how far they may be distributed over the total economy ("was eigentlich ihre Tragweite für die ganze Volkswirtschaft sei", Eulenburg 1920, 1). The author emphasized that his study was concentrated on the economic effects of socialization. He argued that other related studies—apart from few exceptions—did not consider economic reasoning. Therefore, his arguments emphasized the economic view (Eulenburg 1920, 1).

Eulenburg's study starts with introductory notes on the definition of the term "socialization". He refers to a general short version: "... all measures, which can approach ("näherführen") economic life towards the aim of a socialist order" (Eulenburg 1920, 5). Following the German application of such order, the term "Vergesellschaftung" of the productive resources is applied, but it is understood to include the management of production and distribution in favour of and by the activities of the whole society ("Volksgesamtheit"). On the other hand, Eulenburg considers the term "Verstaatlichung". He points out that the measures of socialization must not coincide with "Verstaatlichung". The author tries to distinguish three rows of motives: firstly, the idea of economic growth concerning goods and productive resources, secondly,

the idea of a more equalized distribution of goods to all people, and thirdly, the idea of considerable codetermination of workers in the company and at the production process—contrasting to the determination of economic decisions in the given economy (concerning 1920!).

Conclusively, Eulenburg identifies three issues: (1) a problem of wealth, (2) a problem of distribution, and (3) a problem of power. All of these problems are interrelated, but in practical politics the fight for the distribution of surplus is realized as a fight for power and vice versa (p. 1). Eulenburg moreover points out (in a footnote) that the term “socialism” is extended to larger aspects of the society in other countries than in Germany (Eulenburg 1920, 1, footnote 1).

Another basic remark in the introductory chapter concerns the long-term development of the economy and society towards “Vergesellschaftung” of life. Eulenburg tends to distinguish four stairs of measures to move towards that aim (Eulenburg 1920, 6): (1) determinant influence of the workers on the development of the enterprise (“Betriebsräte”), (2) transfer of mature (“reife”) businesses (“Gewerbe”) to the responsibility of the total society (“Gesamtheit”), (3) participation of the total society in the economy: mixed companies (“gemischtwirtschaftliche Betriebe”), (4) planned management of the economy by change of the economic constitution (“Wirtschaftsverfassung”) to be designated by a special term (“Gemeinwirtschaft”). Eulenburg adds two remarks: first, each stair can be realized in different empirical ways, and second, the measures to strive for a specific stair will be investigated under the criteria of (a) the contribution to national economic production and (b) the individual share of production and thus of real income. Eulenburg is convinced that both criteria will face the central problems of any economy but also of a socialist economy (Eulenburg 1920, 7). However, the author emphasizes that the total problem of socialization is not covered by this argumentation, because there are problems of power involved which can be evaluated only by political calculations and decisions. Instead, he wants to restrict his study on investigating the logic of socialization, the “metapolitical” aspect behind the considered measures, i.e. if carried out, what would be the consequences for the total economic process? In the author’s original words:

Wir möchten also gleichsam die Logik der Sozialisierung untersuchen, ihren metapolitischen Sinn, der hinter den äußeren Maßnahmen steckt: wenn durchgeführt, welches kann ihre Tragweite für den volkswirtschaftlichen Gesamtprozeß sein? (Eulenburg 1920, 7)

The subsequent chapters of Eulenburg’s study concerns the four stairs of measures as mentioned above (“Betriebsräte, Vollsozialisierung, Gemischtwirtschaftliche Betriebe, Gemeinwirtschaft”). In every chapter the author attempts to point out the economic effects of the potential measures to be applied. The final chapter is oriented to summing up the probable economic effects but also to point out political questions of socialization (Eulenburg 1920, 41–48).

It should be considered that Eulenburg wanted to restrict his study to Germany but it has opened the economic view concerning the consequences of socialization-measures in more general terms, i.e. in any market based economy.

Some remarks may demonstrate Eulenburg’s final comment on socialization (Eulenburg 1920, 41–48):

- As long as the social productive forces (“die gesellschaftlichen Produktivkräfte”) are not yet fully developed, a totally bureaucratic administration cannot be envisaged (Eulenburg 1920, 41).
- Part of the socialization measures is orientated only to demonstrate a new transfer of power. But the development of the productive forces should not be restricted. If the workers’ committees, on the level of the firm, hinder technical-organisational measures, future technological and economic development would be restricted. The real future strategies of the workers’ committees will determine if and how far a progressive imagination of the economy can prevail (Eulenburg 1920, 41 f).
- The distribution of monetary surplus to the working force of the economy can be instituted at the expense of the incomes of the proprietors, or of the funds of future capital formation and future economic growth, or of the funds of public taxes, i.e. in three ways. But neither the latter nor the funds for capital formation should be restricted, because, if so, the future growth of production of commodities would be diminished (Eulenburg 1920, 42). Therefore, only one way of distribution-change seems promising in Eulenburg’s view: to increase the share of workers and salaried persons in relation to the total surplus (“am Ertrage”) at the expense of the private consumption funds of the hitherto favoured social groups (entrepreneurs, capitalists, pensioners, landowners) (Eulenburg 1920, 42). Eulenburg, yet, points out that in the end, the total redistribution would be changed in small amounts only. Even the restriction of the total extra-consumption by proprietors would not considerably enlarge the production of commodities for the majority of the working class. The author concludes:
- The general consumption funds will not be enlarged considerably by a redistribution of the total real over-consumption of the proprietors (“Überkonsum der Besitzenden”). Finally, he adds, that all measures aiming at redistribution on the grounds of private economic orders turn out to be unrealistic solutions (“Scheinlösungen”) (Eulenburg 1920, 44).
- The only decisive question of socialization is—according to Eulenburg’s view—how to solve the “production problem” of the economy. In order to answer, he points out that the “unproductive costs”, also called “dead weight costs”, should be effectively reduced, e.g. concerning the decentralization of companies, the existence of too many firms in specific industries, the economic structure being determined by the inefficient locations of companies etc. (Eulenburg 1920, 44 f).
- Even a planned economy will not prove to be more efficient than a market economy; mainly, because the planning activities will be linked with new kinds of “dead weight costs” and unproductive effects of the organisation of production (Eulenburg 1920, 46).
- Summarizing, Eulenburg emphasizes at the end of his study that it is mainly the “dead weight costs” that hinder a positive response to the question of “socialization of the economy”; the economic side of socialization turns out to be based on a production problem—namely, how to increase and develop the productive resources of a given system of economy (Eulenburg 1920, 47)?
- Apart from the question of economic analysis, i.e. if a socialization program shall be carried out, it is taken by Eulenburg as a political problem. The author pre-

sumes that it may be solved only in the long-run, not by revolution but by organic development of the prevalent internal structures of resources towards steady effectiveness of the social determinant factors. Eulenburg seems to be convinced that the measures of the socialization process are bound to laws of organic development of the social economy. As a direct result of his study, Eulenburg emphasized that socialization can be realized only through a long-term process of organic development:

... auch die stärksten Maßnahmen der Sozialisierung vermögen nur außerordentlich langsam eine Änderung in der wirtschaftlichen Lage der großen Masse der Bevölkerung herbeizuführen ... (Dabei) ... vollziehen sich die großen Änderungen nicht durch Revolution, sondern durch organische Entwicklung von innen heraus und durch das stetige Wirken der gesellschaftlichen Kräfte. Sie vermögen durch politische Maßnahmen wohl beschleunigt, aber nicht grundstürzend geändert zu werden. (Eulenburg 1920, 48)

The author conclusively recommended “Not Revolution, but Evolution!”. Franz Eulenburg herewith proved to have been a scholar of Gustav Schmoller and the German Historical School of Economic Sciences.

3.2 Eduard Heimann’s Ideas on Social Policy and Socialization

3.2.1 Social Idea, Social Movement, Social Policy and Socialization (1929)

An important author of basic contributions to the debate on the theory of a socialist economy and on the aims and means of socialization was Eduard Heimann (1889–1967). After studies in Berlin and Vienna he was engaged as secretary general of the Socialization-Commission (1919–1922). In Cologne he was promoted by Habilitation to academic teaching and research (1922) that was followed by a position of lecturing at the University of Freiburg (1922) (Janssen 1998, 566). As a full professor he became member of the University of Hamburg (1925–1933). His economic thinking was influenced by authors who were involved in theoretical discussions and political debates on socialist systems, movements, and also on religious-socialist ideas. In his publications, Heimann referred to the problems of prices and quantities of production in a socialist economy. With special interest he also published articles and books on questions of social policy. As a member of the “Brauns-Commission” (1932) he contributed to proposals on measures to overcome the economic crisis in Germany. His related publications had considerable effects on initiatives to develop new concepts of economic policy. But, at the same time, Heimann recognized that he needed to leave the country—for racial and political reasons. He immigrated to United States (1933). Only after 30 years did he return to Germany (1963).

Reviewing Heimann’s publications, it becomes obvious that the topics mainly concern problems of socialization, public economy, social policy, social theory of

capitalism, credit policy and public orders, and of the history of economic doctrines (Janssen 1998, 566).

In his book on and titled “Social Theory of Capitalism” (1929), Heimann argued for social liberty, social movement, and social policy—especially under the conditions of capitalism—and in the final chapter as method of socialization. It is this chapter which gives room for Heimann’s basic idea of the relations between socialization, productivity (“Leistung”), and freedom. Inhere, one may recognize a link to the author’s basic remarks on long-term social development—pointed out by the relations of history and theory—in the introduction of the book (Heimann 1929, 1f). The author has pointed out the following:

Theory must be historical. For it is a historical process, which theory exposes; it is not any casual connection of timeless elements as it is thought about in terms of abstract economic theory. But on the other hand theory must be theory and not history, insofar as the main characteristics of appearances and their changes are to be comprehended and exposed independently from all framework conditions of history ... (Heimann 1929, 1f).

Moreover, Heimann added, concerning the impact of theory as an expression of social theory—namely, that “Theory is social theory, because it describes the relations of human beings in the economy ...” (Heimann 1929, 1, transl. by K.-H. Sch.).

On the grounds of these introductory remarks, Heimann turned to social policy as a method of socialization in the last chapter of his book of 1929. He exposed social policy as the “... institutional framework (“Niederschlag”) of the social movement ...” (Heimann 1929, 211). Herewith, “socialization” was interpreted in relation to social policy and freedom: “If the introduction of a social freedom order is called socialization, social policy is the hitherto preferred way of socialization” (Heimann 1929, 212, transl. by K.-H. Sch.). In the author’s German version

Wenn man die Errichtung der sozialen Freiheitsordnung als Sozialisierung bezeichnet, so ist die Sozialpolitik bisher der bevorzugte Weg der Sozialisierung (Heimann 1929, 212).

Conclusively, Heimann understood “socialization” as the process of introducing freedom and justice in the economy by means of social policy oriented to bringing about not only public property, but, also, freedom of the working people. The author wrote

Es gibt keinen anderen Weg zur sozialen Freiheit als den der Sozialpolitik (Heimann 1929, 229).

Heimann’s additional comments instead let presume, that social policy turns out not to be highly effective to realise the aims of socialization. The author even seemed to consider the opportunity, that socialization may bring about the introduction of a bureaucratic and cesarlike dominating order, if the workers are unable to apply their freedom and need to leave power and responsibility to others (Heimann 1929, 231).

Sozialisierung kann auch der Name für die Errichtung einer bürokratischen oder cäsaristischen Herrschaftsform sein, wenn die Arbeiter ihre Freiheit nicht zu handhaben wissen und darauf angewiesen sind, anderen die Macht und die Verantwortung zu überlassen (Heimann 1929, 231).

Indeed, Heimann's comment foresaw the later development of the social order in specifically large and powerful states.

3.2.2 Basic Pattern of a "Socialist Economic and Labour Order" (1932/48)

In another book, which was firstly published in 1932 and then again in 1948, Eduard Heimann discussed the "Socialist Economic and Labour Order" ("Sozialistische Wirtschafts- und Arbeitsordnung"). The book includes a broad first chapter on this topic and an additional chapter on the history of the socialist economy (Heimann 1948, pp. 62). In the first chapter of this booklet the author pointed out main characteristics of social property and decentralised economic management, central planning, individual property and labour order, and administration. Finally he summarized the basics of freedom and order in a socialist economy. Though the author was not convinced that the new publication of the former book was needed, he agreed to get it published again in 1948. It seems to be worthwhile to consider especially the concluding paragraph on "Freedom and Order in the Socialist Economy" (Heimann 1948, 58 f).

Beforehand, yet, main important ideas of the first chapter of Heimann's study should be pointed out. It consists of two sections: (1) The economic order, and (2) The labour order.

Turning to the first section, "The economic order", we find three parts.

The first part deals with social effects of public property ("Gemeineigentum") and with the economic functions of prices and different incomes in a decentralized economy.

The second part is entitled "Central Economic Planification" ("Zentrale Wirtschaftsplanung"), but it deals firstly with capitalism and technical progress and with the dislocation and reintegration of workers in the economy. On these grounds, secondly, the tasks of economic planning are demonstrated. The author exposes the relations between a central administration of credits and decentralized formation of prices as well as the problems of central capital formation. Finally, the policy concerning monopolies is discussed; Heimann turns especially to the opportunity of applying monopoly policy to reduce the differences of incomes in the economy.

The third part of the first section is oriented to specific forms of individual property in cities. Foreign trade is only mentioned in a short annex.

Reviewing the contents of the three parts of the first section of Heimann's study, it seems adequate to strengthen three central features of the text (Heimann 1948, 16 ff):

1. The author starts from the idea that the capital (in the form of property) of producing enterprises be transferred to the organized society.

The socialist order shall be realized by a sociological unification ("Einheit") of the people, i.e. by ending the separation of classes of private owners and persons not owning any property. In Heimann's original words

In der soziologischen Einheit des wirtschaftenden Volkes ist das wichtigste Merkmal der sozialistischen Ordnung gewonnen, und die noch fehlenden Merkmale können kraft der soziologischen Einheit durch die organisierte Gemeinschaft hinzugefügt werden (Heimann 1948, 16)

In order to avoid future economic crises, central economic planning is necessary, because the universal management and disposal of the economy must be carried out ... “The method of planification needs a real foundation of power by means of public property”, in German:

Die planwirtschaftliche Methode bedarf einer wirklichen Macht-Grundlage im Gemeineigentum. (Heimann 1948, 16)

In order to discuss the economic functioning of prices in the socialist economy, Heimann refers to Max Weber’s arguments against fixed prices of resources in the production process of a market economy (p. 18). In opposition, Heimann exposes bookkeeping (“Buchführung”) as the most important instrument of economic decision making in a market economy and in an economy based on public property. He seems to be convinced that public property thoroughly allows for an objectively effective formation of market prices and bookkeeping, in his own words:

Hier kommt es zunächst auf die Feststellung an, daß das Gemeineigentum eine objektiv gültige Marktpreisbildung und Buchführung durchaus erlaubt. (Heimann 1948, 20)

Herewith, Heimann refers to a number of well-known authors of studies on the economics of socialism, mainly in England, France, America, and Germany. Independent from each other, they described aims and methods of management and production in a centralized socialist economy, f.e. H. D. Dickinson, R. L. Hall, Oskar Lange and others (Heimann 1948, 20/21, footnote 1). It should be an informative message to report Heimann’s arguments concerning the centralized administration of loans and capital formation and of policies concerning monopolies, but it should be adequate reasoning, as well, to point out his arguments related to “The Order of Labour”, the second section of his study (Heimann 1948, 51–56).

In that part, Heimann deals with the problems of labour. Referring to Karl Marx, he points out productivity increasing effects of machinery investment. Further aspects are demonstrated relating to organization and administration. The problems of unemployment will not be solved for all of the workers. That discussion would enable the transfer of ideas and evaluating statements to the final conclusions and to the additional chapter “On the History of the Socialist Economy” (Heimann 1948, 62).

Heimann’s book turns out to be a valuable study on the development of the theory and policy of a socialist economy. The author seems to prefer education and cultural reasoning in social discussions and policy-making, instead of powerful revolution ending in cruel and inhumane results. Therefore, Eduard Heimann’s book on “Socialist Economic- and Labour-Order” should be brought back to lectures and seminars at the universities and to decision making by politicians in political negotiations.

In a short final chapter Eduard Heimann summarizes his concept of socialization. He points out two principles for organizing freedom and order in a socialist economy. He distinguishes (1) “socialism from below”, and (2) “socialism from above”

(Heimann 1948, 58). Both principles are designated to be necessary for an efficient and social economic order. Heimann finishes his text with two statements that express his conviction that it should be possible to realize a socialist order:

1. The socialist order in equilibrium between central management and decentralized freedom will be a solid basis for the human being and will demand his personal involvement.
2. Freedom in “Gemeinschaft” based on freedom that will be the humane sense of the socialist order, the full answer to Marx’s vision of a “truly moral humanity” (“wahre sittliche Menschlichkeit”) (Heimann 1948, 59). This final sentence in Heimann’s book demonstrates again the author’s high level of demand for a stable and humane economic and social system. The author was convinced that socialism from both sides (below and above) could be realized, though he simultaneously recognized diverse reasons for danger, even of hindrance, in developing the social order according to Heimann’s vision.

3.3 Joseph Schumpeter’s Conclusions About the Relations of Democracy and Socialist Society in “Capitalism, Socialism and Democracy”

Joseph Schumpeter’s famous book “Capitalism, Socialism and Democracy”, published first in New York 1942, contains a whole chapter about the relations of “Socialism and Democracy”. But in order to expose a theory of the democratic process, which considers “all kinds of reality of group-actions and of public opinion”, the author firstly explains and criticizes the contents of classical theory of democracy and secondly points out “another theory of democracy”. He starts from the definition of “democratic method”:

... demokratische Methode ist diejenige Ordnung der Institutionen zur Erreichung politischer Entscheidungen, bei welcher einzelne die Entscheidungsbefugnis vermittels eines Konkurrenzkampfs um die Stimmen des Volkes erwerben (Schumpeter 1946, 428).

Schumpeter’s statement about the social function of Parliament activities concerns the “production” of legislations and administrative activities. In order to understand democratic policy focused on this social target, his vision of competition for power and any office must be considered, and the consequence must be acknowledged, “... that the social function – similar to production – will turn out as a side-effect of aiming at profits” (transl. K.-H. Sch.) (Schumpeter 1946, 448). On the grounds of these general theoretical ideas, Schumpeter finally draws basic conclusions concerning “Democracy in the Socialist Order”. (Schumpeter 1946, 471 ff)

Schumpeter especially mentions the problem of interventions by politicians and important members of commissions into the management of economic activities. For illustration, he refers to the conferences of the German “Socialization-Commission”

after the First World War. He emphasizes “In 1919 ... the more radical members continued to believe, that some measures of socialization were practically necessary, and consequently a commission was installed to describe the targets and to recommend adequate measures” (Schumpeter 1946, 476) (transl. K.-H. Sch.). But Schumpeter does not hesitate to mention his skepticism concerning the effectiveness of discussions and recommendations which the commission attempted to expose publicly, and he adds “If it is possible anyhow to talk about results of the discussions, which should lose their practical significance ...” (Schumpeter 1946, 477). In fact, the socialist managers had not differed a great amount from their capitalistic forerunners. In a former chapter, the author already had concluded, that “...serious socialists today and during the following fifty or hundred years cannot do anything else but to preach and to wait”; but interestingly, this remark was ended by a question-mark (364)! No surprise, that Schumpeter finished his book with the following statement of skepticism: (The socialist democracy) “...will not imply any more considerable approach to the ideals, which are sheltered in the shrine of classical theory” (Schumpeter 1946, 480).

Schumpeter in fact kept his mind open for wide amplifications of economic theory. What he called “the shrine of classical theory” might be identified—under consideration of his intense interest in the theoretical approach of Leon Walras—by the term “pure economic theory”. Here we find a “bridge” linking two river banks: the theory of the market economy and the theory of the socialist economy and socialization. Furthermore, this reflection may be taken as reference to a later author, who published diverse articles on socialization: Gisbert Rittig. Some of his publications will be considered subsequently.

3.4 *Gisbert Rittig’s Basic Contributions on “Theory of Socialization” (1956)*

In his article on “Socialization (I) Theory”, published 1956, Rittig exposed different terms, purposes, and links of socialization towards the target of socialization.

Before explaining the contents of the sub-sections, the author’s background contributions to the analysis of socialization should be considered. He lectured at the University of Göttingen as a full professor of economic theory. He published in scientific journals and books, especially on the theoretical foundations of socialization, f.e. in the series of the “Verein für Socialpolitik”. The author distinguished—in his article in HdSW (1956)—between socialization in a “more narrow sense” and “in a wider sense”.

The “more narrow sense” means that the targets are assumed to be given (existing) but to be distinguished into three forms: (1) to realize a specific income distribution, (2) to overcome private (and public) monopoly power, and (3) to realize general economic planning in the sense of a socialist order of the economy and society. Rittig’s comment concerning the realization of a planned economy points out that “... it will depend on the kind and number of instruments (measures) of economic

policy, which must be applied by a socialist system in order to realize the targets (aims), if socialization is necessary for this purpose” (Rittig 1956, 458).

The “socialization in a wider sense” seems to be open for different targets of planning institutions or social groups, but Rittig adds: “Socialization...seems to be consequent in relation to the social targets only, if they are orientated to the real preferences of the society (the totality of consumers) (understanding the term consumption or consumer in the widest possible sense)” (Rittig 1956, 459), (transl. K.-H. Sch.).

Following from this condition, three theoretically fixed fundamental points to argue in favour of socialization are demonstrated by the author: (1) every economic order suffers from “indetermination of prices” in relation to individual preferences. Addressing this problem, Rittig formally published specific articles (Rittig 1956, 459). (2) The distribution of incomes is a specific problem in every economic system. It has to be brought forward to an income distribution which is based on the economic contributions of the individuals/groups to the total social income (Rittig 1956, 461). (3) According to a “maximum-theorem”, the resources should be utilized in order to maximize the benefits of the consumers in the economy. But because of indeterminate prices, irregular distribution of incomes, and restrictions of the side-conditions of economic decision-making, the economic results do not correspond with the conditions of the maximum-theorem (Rittig 1956, 461). Rittig is not conclusively convinced that the socialist order can guarantee a better economic system than a market system. All instruments of economic policy should be investigated seriously to find out the effects in relation to the basic target of economic policy, also in case of socialization. This result includes the coordination of the investment quota with the preferences of consumers. Rittig points out the following:

Hierher gehört auch die Abstimmung der Investitionsquote mit den Wünschen der Konsumenten, die sowohl von marktwirtschaftlichen wie von vielen sozialistischen Systemen vernachlässigt wird (Rittig 1956, 42).

To conclude, Rittig’s comment on the preconditions and consequences of socialization are theoretically based, generally valid, and independent from actual valid problems of economic policy. In fact, Rittig’s argumentation turns out to follow similar lines as Eulenburg’s views and conclusions. Both authors refer to arguments based on “pure economic theory”.

3.5 Klaus Novy’s Monograph on “Strategies of Socialization” (1978)

In the introductory and second section of this paper the strong interest in the long-term effects of the debate on socialization after the First World War was already pointed out. Klaus Novy’s study on “Strategies of Socialization” was mentioned as part of the basic literature on the long-run perspective of “Vergesellschaftung der Produktionsmittel” (above, Sect. 2); but, it continued up to a debate on the

“planification of investment” (1973 ff). Consequently, Novy’s view on (1) the debate and (2) the movement of socialization should be considered as part of the attempts to carry out reforms towards socialization in the long run. Especially, Novy’s ideas and definitions of specific strategies of socialization are to be exposed in short versions. Therefore, part II of Novy’s book is of particular interest (Novy 1978, 119 ff).

To concentrate on the basic components of Novy’s chapter on “Sozialisierungsstrategien”, the definition of different strategies of socialization in part II of his book must be acknowledged. The author distinguishes five basic strategies (“fünf Grundstrategien”, Novy 1978, 124 f):

1. Strategy of industrial self-management and administration (“Selbstverwaltung”), related to a concept developed by W. Neurath;
2. Socialization of “key-sectors” (Schlüsselsektoren), including approaches of central planning;
3. Strategy of active or aggressive (“offensive”) socialization of parts/sectors of the economy, especially by vertical socialization (formation of public trusts concerning production needed for life in all sectors of industries “Produktionsstufen”); this strategy is aimed at the decrease of private business or at control of the private economy by competition and demonstration of practical cases of policies [“Kontrolle durch Konkurrenz und Exempel (Horten)”] (Novy 1978, 125).
4. Formation of “socioeconomic islands” (“gemeinwirtschaftliche Inseln”) by segmentation of the market economy via alternative methods of organization and management;
5. “Dual-economic strategy”, oriented to the division of the economy into two sectors or groups according to preferences, forms of property, and forms of markets.

Novy adds short remarks on some strategies which he did not consider, f.e. a system of participation or “penetration” as an evolutionary strategy, oriented to mixed enterprises (“gemischtwirtschaftliche Unternehmensformen”) (Novy refers to Vandervelde 1902; Novy 1978, 125). On the whole, Novy does not trust the approaches of reforming the economic organization. The participation in property and management will turn out to be ineffective, because the mechanisms of economic functions remain unchanged. The author concludes:

Da es ... zu einer Änderung der ökonomischen Funktionsmechanismen nicht kommt, erweist sich der durch Eigentumsbeteiligung gewonnene Einfluß als kaum ausspielbar (Novy 1978, 125)

Novy refers to a broad list of names of other authors having published articles and books on socialization including f.e. Eduard Heimann, who was considered earlier in this contribution.

Summarizing, Novy’s book on “Strategies of Socialization” turns out to be an intensely researched and documented exposition of diverse approaches to reforms of the social and economic system—not only in Germany, but in any country suffering from “the dark side of the street”. Novy, yet, had to admit that there is no easy way of reforms out of capitalism towards functioning socialism.

4 Conclusions for Future Debates on Socialization

The considered works of the diverse authors presented in the paragraphs above, let conclude that the topic of socialization has motivated famous economists to investigate the opportunities and effects to move away from pure capitalism towards effective socialism. The process of socialization should be pursued in accordance with a definition of the targets and a corresponding movement of socialization.

Reviewing the considered authors, Franz Eulenburg's small but intensely documented and elaborated study, proves to be a solid theoretical study which is orientated simultaneously to sustain efficient reforms, and not revolutionary approaches to a new system of economy and society.

Similar conclusions are obvious after having considered the related works published by Eduard Heimann.

At the end of Joseph Schumpeter's famous book on the problems of socialism, the author's hesitant position in the field of discussions on socialization turned out as somewhat surprising: to wait and see!

Even after the Second World War, authors continued to demonstrate different concepts of socialization. Gisbert Rittig argued in terms of hard theoretical conditions and conclusions referring to the process and results of socialization. But the author kept up a position of skepticism concerning the introduction of a socialist system. Special problems would have to be considered following from the "Indeterminiertheit des Preissystems" and from institutional changes.

In a nutshell the comments on the selected authors and their publications allow for several conclusions regarding future strategies of socialization:

1. No one from the selected authors preferred a "social revolution".
2. The authors preferred a "soft" process of socialization, based on theoretically founded phases or a long-term process of reorganizing the institutional framework and measures of socialization.
3. To compare the concepts of the considered authors, the following characteristics of their ideas should be brought to light:
 - a. Franz Eulenburg argued in terms of "pure" economic theory, taking the market economy and a socialist economy under consideration. His argumentation may be seen in correspondence to Gisbert Rittig's later theoretical analyses of socialization.
 - b. Gisbert Rittig demonstrated the pure economic theory of socialization on the grounds of neoclassical theory.
 - c. Eduard Heimann's argumentation concerned the distinction between ideas, movement, and policies of socialization, preferring a long-term process of reforms.
 - d. Regarding Joseph Schumpeter and his analysis of socialization, the surprise about his final statements and presumptions should be noted: not any revolutionary action, but long-term reforms seemed to be preferred in the final

chapter of his famous exposition on socialism (in his book “Capitalism, Socialism and Democracy”).

- e. Klaus Novy summarized in his broad study the concepts of former authors and aimed at exposing “strategies of socialization”. He concentrated his study on five strategies, which were described shortly in the related paragraph above.

On the whole, he points out the following: The mentioned authors prefer a long-term process of socialization based on solid economic theory, allowing for effective measures of economic and social policy to open the door for the future development of peaceful socialization.

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Socialization Proposals: The Aspect of Labor Participation



Jürgen Backhaus and Ursula Backhaus

1 Introduction

A unique opportunity for the introduction of socialization arose, when on November 9, 1918, Friedrich Ebert called out the Republic in Germany preceding Philipp Scheidemann by half a day. After the *First World War*, the situation was desperate and socialization a popular demand of large parts of the population. While the call for the long demanded socialization suddenly could be met, the socialists, coming to power unexpectedly, did not have a sufficiently clear program to be implemented in due course. The First Socialization Commission of the coal industry (*Erste Sozialisierungskommission*) was formed by the Council of People's Deputies (*Rat der Volksbeauftragten*) in December 1918. Under the leadership of Karl Kautsky, and the secretary Eduard Heimann, prominent economists such as Joseph Schumpeter, Emil Lederer, Rudolf Hilferding, *a. o.*, as well as representatives of the workers and entrepreneurs met regularly for an in-depth discussion of all aspects of socialization. In April 1919, the First Socialization Commission was dissolved. One of the major points of the discussion of the First Socialization Commission was participation of citizens in the socialist republic, for instance of workers, consumers, former owners, producers, tenants, or other groups of society. In this chapter, we will focus on labor participation, and outline major lines of dispute with respect to labor participation in the first part, followed by the main criticism levelled against socialism in the second part, and in the third part take a closer look at the ideas of socialization by Eduard

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Heimann, the secretary of the First Socialization Commission, and Karl Korsch, a leading theoretician of socialism. While Korsch's focus is more closely on workers' participation, Heimann's focus is on both, economic efficiency and the normative goal of democratization of the economy. In his argumentation, he made pioneering theoretical contributions with respect to the entrepreneurial wage and the theory of the firm. The paper ends with a summary and conclusions.

2 Lines of Dispute on the Issue of Labor Participation

Right after the First World War, a fierce discussion arose about the future socialist structure of the economy, and in particular of large corporations.¹ Labor participation was a central theme in the debates of the First Socialization Commission, which was discussed controversially among its members.² With respect to the participation of workers, two major contrary strands can be identified (Backhaus, 1979, 50). On the one hand, participation played a role in those approaches of socialization that were directed towards the democratization of agglomerated economic units, in particular cartels, where too much power was seen to be concentrated at the top. Some supporters of socialism argued that cartels posed a potential threat to the political sphere, and they wanted to introduce participatory elements in order to diffuse their economic and political power. The goal was the political neutralization of cartels. On the other hand, there were supporters of socialism who argued that the economic and technical concentration at the top of a cartel offered a unique opportunity in planning the economy. According to that view, the management of a cartel was a powerful tool of economic policy, which could be used in order to improve the efficiency in the socialist economy. Proposals of socialization following the second strand favored a centralized command structure with very few participatory elements. Historically, supporters of socialism cannot be associated clearly to one or the other of the two extreme strands, but typically take positions somewhere in between.

In early concepts of socialism, a council system (*Rätorepublik*) was proposed, in particular by those socialists, who stood in the tradition of the war economy. They wanted to reach economic efficiency by a centralized command structure. Political control should be exercised by a council system, which stood next to the parliamentary system. By a strictly hierarchical organization, the councils, e.g. works, soldiers,' or administrative councils, should reach economic efficiency, and also control the political and economic course of the country. Council systems have been proposed by Rathenau, Bauer, Heimann, and other authors (Backhaus, 1979, 51). While council systems were initially politically adopted, they turned out to be short-lived. The rise

¹Compare Novy (1978).

²Jürgen Backhaus has investigated early proposals of socialization with respect to workers' participation. Compare Chap. 2.2: "Die historische Genesis der Partizipationsforderung in Deutschland: Sozialisierung—Mitbestimmung—Wirtschaftsdemokratie." 1979, *Ökonomik der partizipativen Unternehmung*. Tübingen: J.C.B. Mohr (Siebeck), 50–71.

of *Parliamentarism* led to a relative decline of the councils until they finally became meaningless. As an exemplary illustration of the council system, the concept by Heimann will be discussed more closely in the third part of this chapter.

Even further in the direction of central planning go the proposals by Neurath³ and von Moellendorf. Neurath proposed to set up production and consumption plans, e.g. in his socialization plans for Saxonia and Bavaria. It was the task of a central planning office to devise alternative plans of production and consumption, so-called *Lebenslagen*. The final decision was not the task of the councils' organization, but it was upon the local parliament (*Landtag*) to choose a particular plan for a certain time period. Implementation and supervision of the plan would again be in the hands of the central planning agency. Neurath's proposals could not be realized in Saxony, but some progress towards this direction has been made in Bavaria. At the end of March 1919, a central planning office has been set up in Bavaria under the administrative leadership of Neurath. However, in the wake of the political upheaval, the operations of the central planning office ended abruptly. Only two months after its opening, the office was shut down, and Neurath was put in a fortress prison, where he had to spend 1 1/2 years, before he was deported to his native country of Austria.⁴

Eduard Heimann was one of the first authors to draft a socialization plan.⁵ He used his influence as secretary of the Socialization Commission to successfully propagate his ideas. In contrast to the earlier approach of a purely state planned economy, Heimann introduced elements of the market economy in his socialization proposals. At the same time, as is illustrated in part eight of Heimann's proposal, the "austere character of socialization",⁶ aspects of participation and democratization became less important (Backhaus 1979, 51). This is different in the concepts by Karl Kautsky, the president of the First Socialization Commission, and Karl Korsch,⁷ a theoretician of socialization, where participation of both, consumers and workers, play a more important role. Some major aspects of Korsch's ideas of labor participation will be discussed in the third part of this chapter.

In the debates of the Socialization Commission, the issue of labor participation was discussed controversially. A conflict emerged between the call for a democratic economic order, which represented the participative approach, and economic efficiency.⁸ Those members of the Socialization Commission, who wanted to pursue a democratic order of the economy advocated for far-reaching rights of participation,

³For further details, compare the chapter by Günther Chaloupek: "Otto Neurath's Concepts of Socialization and Economic Calculation and his Socialist Critics." This issue.

⁴Merz (2006).

⁵Heimann (1918/1919).

⁶Compare Eduard Heimann, *op. cit.*, part 8: "Der asketische Charakter der Sozialisierung", 583–590.

⁷Compare Karl Korsch 1919a. "Was ist Sozialisierung?" Hanover: Freies Deutschland. Reprinted in Erich Gerlach 1969. *Karl Korsch. Schriften zur Sozialisierung*. Frankfurt am Main: Europäische Verlagsanstalt, 15–49.

⁸It is still a widespread belief that there is a goal conflict between participation and economic efficiency. In his book *Ökonomik der partizipativen Unternehmung* Jürgen Backhaus (1979, *op. cit.*) provides evidence that the two goals can be reconciled, e.g. in the institution of the German system of Co-Determination.

while other members, who pursued primarily economic efficiency advocated for the principle of a strictly hierarchical organization with little participation. Further major issues were the income distribution and taxing. While political problems stood central in the early debates, the idea of economic efficiency figured more prominently as a theme in later debates of the Socialization Commission.

3 A Critical Evaluation of Socialism

The debates of the Socialization Commission brought forward many different aspects of socialism and provoked later criticism. Perhaps the strongest attack of socialism that was mainly directed against non-market forms of the economy came from Ludwig von Mises.⁹ In his definition of socialism, von Mises assumed complete state ownership of the means of production.¹⁰ According to von Mises, economic calculation is not possible under socialism. He was convinced that if there is no private property of the means of production, economic activity is not possible. Central to von Mises are considerations of economic efficiency.

Von Mises thesis was refuted by Lange and Lerner.¹¹ They showed that certain forms of a socialist economy are feasible. The socialism proposed by Lange and Lerner is based on market simulation, but the idea of participation has disappeared from their approach (Backhaus 1979, 52).

The discussion of socialism after WWII focused more specifically on identifying market failures and possible remedies; on issues of social justice, in particular a just distribution of income and wealth, and on how to politically secure the democratic system. The proposal was to integrate the economy into a decentralized political system (Backhaus, 1979, 52, 53).

After WWII, the contributions by Kautsky and Korsch were reevaluated in the light of new developments in economics. Both authors stressed the participation of consumers and their contributions related to this issue became more and more irrelevant over time. The reason is that organizing such a diffuse group as consumers is known to be very difficult.¹² However, with respect to his contributions to labor

⁹von Mises (1920). For further details, compare the oral presentation by Ludwig van den Hauwe, "Is Socialism Possible?" 31st Heilbronn Symposium of the State and Social Sciences, draft version, comments authorized.

¹⁰In the debates of the First Socialization Commission, various schemes of socialism were considered. With respect to private ownership of the means of production, they varied from complete expropriation to partial or even no expropriation of the owners. If private property of the means of production was retained, associations or cooperatives could be formed, where markets could still exist.

¹¹Lange (1936–1937), Lerner (1936). Ludwig van den Hauwe, *op. cit.*, provides the following clarification: "It was admitted that prices were indeed necessary (as in Mises' argument) but these need not be real market prices: they might equally well be accounting prices set by the state." (Permission to quote from draft version by author) According to this view, the Lange-Lerner argumentation is not seen as a refutation, but rather an enhancement of the argumentation by von Mises.

¹²Olson (1967).

participation, Korsch thought entered the discussion of the introduction of the system of Co-Determination in Germany after WWII.

While the contributions of the members of the First Socialization Commission have been criticized and further developed, as is the case in the debate on economic calculus, interesting theoretical insights can still be gained by looking at the original contributions. An example is the socialization proposal by Eduard Heimann, the secretary of the First Socialization Commission, which, at the time, provides new theoretical insights on the entrepreneurial wage and the theory of the firm. Another example are the ideas on labor participation by Karl Korsch, which had a lasting influence.

4 Eduard Heimann and Karl Korsch on Labor Participation

Eduard Heimann has written his treatment on socialization (*op. cit.*) right after WWI. He went against a popular and widespread belief at the time that socialism serves the sole purpose of income redistribution. Heimann saw socialism as a set of measures that was more directed towards achieving economic efficiency in the economy than towards income redistribution. He also pursued the normative goal of democratization of the economy. Heimann made his remarks on the role of innovation in socialism in the context of achieving economic efficiency. His reasoning is as follows:

The question whether the added value belongs to the workers instead of the owners of capital is crucial when thinking about the role of innovation. The added value cannot be fully attributed to the workers, so Heimann, because of the entrepreneurial activity and entrepreneurship, which have to be recognized as a productive task. This part of the added value is not a component that accrues to the workers. Other components, which also do not belong to the workers, are investments and taxes which also have to be deducted from the added value. In addition, the profit gained from innovation cannot be attributed to the workers, because they are not based on the workers' activities. This idea shows that Heimann is a forerunner of the theory of entrepreneurial wage, which has been discussed in the economic literature about a decade later (Backhaus, *op. cit.*, 54).

According to Heimann, in a competitive environment, workers should not act as co-entrepreneurs by participating in the decisions of the company. He held that the profit gained from innovation would be the result of the productive economic activity by entrepreneurs, and concluded that by way of a dynamic analysis, the profit gained from innovation should be added to the entrepreneurial wage. From this reasoning it follows that socialization has no consequence for the internal organization of the company and therefore, workers should neither participate in the decision-making process of the company, nor share in those profits made that are due to an innovative idea (Backhaus, *op. cit.*, 54).

Next to the competitive case, Heimann also investigated the case of a monopoly. In a monopoly, he argued, the monopolistic profit does not belong to the workers employed by the monopoly, but to consumers who have built it up. From this point of view, Heimann concludes that “the material benefit of socialization, when looking at it merely as a task of distribution among various stakeholders, at best would be disappointingly small.”¹³

Heimann was concerned with the power concentration at the top of a trust and saw a possible solution in the introduction of socialism, where the trust would be in the hands of the State. This would not only be a safeguard against the arbitrariness of companies towards workers and consumers, but also allow to consistently planning the activities in the entire economy. In careful planning, Heimann saw a possibility to reach economic progress (Heimann, *op. cit.*, 537). By introducing socialism, Heimann wanted to advance democratization of the economy, but, at the same time, he wanted to increase the efficiency of the economy. His underlying assumption was that these two goals can only be achieved in large companies with a strictly hierarchical organization (Backhaus, *op. cit.*, 54).

Heimann came from a background of *Christian Socialism*. He did not stand in the tradition of *Historical Materialism*. Therefore, the question of whether industries were mature for socialization,¹⁴ which played a major role in the beginning of the socialization debates, was less important to him.

Next to these basic considerations, Heimann also looked at a number of specific organizational proposals for the industries to be socialized. One of the socialization proposals discussed by Heimann stems from Walter Rathenau, who was an important figure, perhaps the most important one, in the organization of the war economy. Although Rathenau was not a socialist (Heimann, *op. cit.*, 540), he foresaw in his plan for the *new economy* an active role by the State in planning the economy and smoothing business cycles. He wanted to achieve this by the formation of syndicates. The syndicates should operate according to the principles of private law. For reasons of social justice, syndicalization should be accompanied by economic and judicial political measures, in particular by a far-reaching revision of the inheritance law (Backhaus, *op. cit.*, 55).

Next to the traditional call of socialists for a planned economy, there were calls to maintain the organizations of private stock companies and trusts. About three decades before WWI, the number of private stock companies had increased rapidly, and the question was how to take advantage of these organizations under socialism. In this context, the members of the First Socialization Commission discussed issues

¹³Compare Heimann, *op. cit.*, 536: “Der materielle Erfolg der Sozialisierung, wenn man sie im Sinne des Interessenstandpunktes als bloße Verteilungsaufgabe betrachtet, wäre bestenfalls enttäuschend gering”.

¹⁴Karl Marx coined the term *Sozialisierungsreife* in order to indicate a state of industry to be mature for socialization. According to Marx, the historic development of a capitalist system automatically brings about maturity of socialization, an idea with which Heimann does not agree. Heimann, *op. cit.*, 528.

of control depending on the division of ownership of the company and management, thereby preceding scholarly discussions by about fifteen years.¹⁵

Heimann saw a link between capitalism and socialism in the so-called *guild socialism*, which he originally traces back to Schäßle's *Quintessence of Socialism* published in 1874¹⁶ (Heimann, *op. cit.*, 540, footnote 17). In the debates of the First Socialization Commission, the idea to retain the organizational form of private stock companies was primarily launched by Otto Bauer.¹⁷ He wanted to organize the economy along the lines of economic sectors and then select those sectors for expropriation, which were mature for socialization. The companies of the sectors selected should be organized like trusts on the basis of the non-profit principle (*auf gemeinnütziger Grundlage*). For those companies which have not yet reached maturity of socialization, he wanted to establish enforced syndicates (*Zwangssyndikate*) under public control. As the highest organ of control he envisioned an administrative council similar to a parliament. The administrative council should guarantee the non-profit character of all economic entities and groups that belong to the enforced syndicate. The seats in the administrative council would evenly be divided among members of the general public (presumably members of the political parliament), consumers, workers and executives, as well as former owners, who should participate in the administrative council with one fourth of the votes. In addition to the trusts and enforced syndicates, Bauer proposed the formation of guilds, for instance in the area of housing. An example of a guild in housing is a complex of urban apartment houses and residential buildings, which would become the property of local communes and be administered by rental cooperatives (Heimann, *op. cit.*, 547).

These regulations show that Bauer took next to the notion of economic efficiency also syndicalist ideas into consideration. After WWI, it was a popular notion to reach economic efficiency by way of a trust which was considered superior to any other type of entrepreneurial organization. Bauer went beyond by including syndicalist ideas in the more narrow sense of guild socialism and within the tradition of councils. The economic lever for regulating the entire system was seen in the extension of credits to companies, trusts, or other economic entities. The control of the system of partly or fully socialized industries was in the hands of a socialized central bank (Heimann, *op. cit.*, 558).¹⁸

¹⁵Today, the division of ownership and control in the large stock corporation is typically attributed to A. Berle and G. Means, *The Modern Corporation and Private Property*, New York, 1933. Important forerunners of the Weimar period mostly receive credit for their work only through the detour of the reception of the American work (Compare footnote 81, Backhaus, *op. cit.*, 55).

¹⁶Heimann referred to the first edition by Albert Schäßle, which was published anonymously: Von einem Volkswirt. 1874. "Die Quintessenz des Sozialismus." *Deutsche Blätter* (June, 375–390. Gotha: Pertes <https://opacplus.bsb-muenchen.de/Vta2/bsb11189535/bsb:6780255?page=8> (08-31-2018).

¹⁷Compare Bauer (1919).

¹⁸According to Heimann (*op. cit.*, 558), Bauer based his financial considerations on the analysis by Hilferding. For further details, compare the chapter by Jan Greitens: "From "Finance Capital" to "Organized Capitalism:" Socialization in Rudolf Hilferding's writings under the influence of Ferdinand Tönnies." This issue.

Eduard Heimann's political influence stems from his role as the secretary of the Socialization Commission of the coal industry. The Council of People's Deputies has installed the Socialization Commission of the coal industry in December 1918. The proposals by the Commission to socialize the coal industry were very similar to those made by Heimann. They had in common that a set of measures was developed in order to efficiently organize the entire sector of the coal industry. The principle of organization of every single coal mining operation was strongly hierarchical with a leader on top. The ultimate decision-making authority was with the leader who acted as a public entrepreneur. This plan was in accordance with the vision of the First Socialization Commission to install a strictly governed hierarchical trust (Heimann, *op. cit.*, 549).

The socialization proposals discussed in the First Socialization Commission pay more attention to the gain in efficiency than to the normative demand for more democratization of the economy. Even new terms were coined in order to better be able to address the differences between a market-oriented model of competition and a model of socialist competition. Heimann wrote: "The competition we have in mind differs from the capitalist competition in one principal point: no one can get rich at the expense of his competitors."¹⁹ In the socialist economy, the "principle of proportionality" (Heimann, *op. cit.*, 550) replaces the profit principle. In terms of modern economic theory, the "principle of proportionality" not only relates to the efficiency of a single sector by requiring the sectoral internalization of costs, but also relates to efficiency of the economy as a whole.

The goal of income distribution was not Heimann's primary goal. In contrast to Bauer's concept, his socialization proposal remained neutral with respect to distribution. While Bauer wanted to abolish taxes and finance the expenses of the state household by the revenue from the socialized industries, Heimann was opposed to this idea. He wanted to separate the price policy of the socialized enterprises from the goal of distribution. Heimann was open towards the option of a policy of redistribution via taxes (Heimann, *op. cit.*, 539, footnote 13).

By way of socialization, Heimann wanted to realize gains of efficiency. His prediction was that if a leading manager was in charge, rationalization processes would set in leading towards higher efficiency. He therefore only foresees a limited role of workers' representatives, who form the so-called works' councils. Participation of workers should refer mainly with respect to working conditions, but not extend to decision-making capacity. Heimann did not want to curtail a leading manager's decision-making skills by "incompetent works' councils."²⁰ A leading manager is characterized by superior knowledge of the performance of the business or company, and should not be restricted in his decision-making capacity (Heimann, *op. cit.*, 580).

Of particular interest for the participation problem is the discussion of the "austere character of socialization" (Heimann, part 8, *op. cit.*, 583–590), where Heimann takes

¹⁹Compare Eduard Heimann, *op. cit.*, 550. The original quote reads: "Die Konkurrenz, an welche hier gedacht wird, unterscheidet sich von der kapitalistischen Konkurrenz in einem Hauptpunkt: Niemand kann sich auf Kosten seiner Konkurrenten bereichern".

²⁰Compare Eduard Heimann, *op. cit.*, 580. In the original, this reads: "von inkompetenten Räten".

a critical look at the socialization proposal by Karl Korsch.²¹ In his Hanover treatment of socialization, Korsch has identified two basic models of socialization which did not exclude each other. The first model foresaw the participation of citizens and consumers, e.g. in the form of the State, municipalities, and consumers' associations (Konsumvereine). The second model foresaw the participation of producers.

Heimann was critical of Korsch's idea, who wanted to transfer private property into common property of groups of society (Heimann, *op. cit.*, 585). According to Heimann, socialization means the transfer of private property into the property of society and not into the property of particular groups of society. The more essential a product, the higher is the correlation of the consumers of that product with all members of society. In this case, the difference between consumers and society is almost negligible. Producers, however, will always be a small group in society (Backhaus, *op. cit.*, 57). According to Heimann, the interests of consumers and producers can hardly be reconciled. There will always be a contradiction between the interests of consumers and producers.

Heimann and Korsch take different approaches to socialization. The contradiction in their way of thinking is obvious and traces back to their different backgrounds. While Heimann stands in the Christian-social tradition and argues from a hierarchical-socialist point of view, the Jena jurist Korsch stands in the tradition of dialectic Marxism and argues from an antagonistic-social point of view. Korsch explains the transformation of society in the tradition of Marxism, but develops his own approach.²² In his writings of 1919 and 1920,²³ Korsch focuses on workers' participation. This is in contrast to Heimann who did not primarily focus on labor participation, but rather on economic efficiency and the normative goal of democratization of the economy.

From an analysis of the maturity of socialization, Korsch drew the conclusion that only a partial socialization should be realized after WWI.²⁴ While he saw the cooperative as the ideal form of a socialized company, his advice was that the timing was not right for the introduction of cooperatives. Workers would be overwhelmed by the new requirements, as they have not learnt to function in a cooperative environment. A sudden change from a hierarchically structured company to a cooperative would most likely lead to lower standards of production and less satisfaction with work (Gerlach, *op. cit.*, 51). At the current point in time, Korsch was also against a radical and fast introduction of nationalization, which would lead to "bureaucracy, schematism, kill the motivation to take initiative and responsibility, overregulation due to

²¹ Korsch (1919a).

²² Korsch differed from Marx' interpretation substantially. Compare Buckmiller (2002).

²³ A selection of Korsch's writings of 1919/20 has been edited and introduced by Gerlach (1969, *op. cit.*).

²⁴ Compare Korsch (1919b).

many political bodies being in charge, political deadlock, and rigidity”²⁵ (Gerlach, *op. cit.*, 51).

Under the assumption that the time right after WWI was not mature for the introduction of socialization, Korsch proposed a stepwise introduction of socialization consisted of the following two points:

The production by a more or less large number of capitalist entrepreneurs, who act entirely arbitrary, should gradually be replaced by the systematic planning of production and distribution by society. (Gerlach, *op. cit.*, 53)²⁶

Starting today, and before complete control from above has been put into effect, the autocratic rule of the capitalist worker class should be abolished in every industrial branch, and, within certain limits, in every individual company. The masters of the companies, who so far have only been responsible to themselves and perhaps to their banks, should become the first servants of their companies. For managerial decisions, they would owe accountability to all workers and salaried staff employed by the company. (Gerlach, *op. cit.*, 53)²⁷

The first point shows what Röpke later had in mind when he accused leading theoreticians of socialization of ignorance and criticized them for a misunderstanding of the workings of market production.²⁸ The second point expresses Korsch’s demand for a far-reaching participation of labor. Korsch not only demands co-determination at the level of the single company, but also at a higher level of the industrial branch. On a smaller scale, co-determination at the level of the company has been introduced legally in Germany later on (Backhaus, *op. cit.*, 58).

In his article on the socialist and syndicalist program of socialization,²⁹ Korsch took up his second point and highlighted labor participation as a means to overcome alienation due to production technology. His argumentation stands in contrast to Bolshevik theoreticians of socialization, in particular Lenin who demanded a strictly hierarchical order. Korsch described the Bolshevik stance as follows: “For the success of those work processes, which follow the organization of large technical enterprises employing machinery, the *unresisting subordination* of the will of

²⁵Korsch expected the following drawbacks from a radical and fast nationalization: “Bürokratismus, Schmatismus, Ertötung der Initiative und der Verantwortungsfreudigkeit, Vielregiererei, Lähmung und Erstarrung.” Gerlach, *op. cit.*, 52.

²⁶In the original, the quote by Korsch reads as follows: “An die Stelle der Regelung der Gütererzeugung durch die freie Willkür einer mehr oder weniger großen Anzahl von kapitalistischen Unternehmern soll nach und nach eine planmäßige Verwaltung der Produktion und Verteilung durch die Gesellschaft treten.” Gerlach, *op. cit.*, 53.

²⁷In the original, the quote by Korsch reads as follows: “Außerdem aber soll in jedem Industriezweig, innerhalb gewisser Schranken sogar in jedem einzelnen Betriebe, gleich heute, schon vor der vollständigen Durchführung der Kontrolle von oben, die Alleinherrschaft der kapitalistischen Arbeiterklasse beseitigt werden. Die bisher nur sich selbst und vielleicht ihrem Geldgeber verantwortlichen Herren der Betriebe sollen die ersten Diener ihrer Betriebe werden, die für ihre Betriebsführung der Gesamtheit aller im Betriebe mittätigen Arbeiter und Angestellten Rechenschaft schulden.” Gerlach, *op. cit.*, 53.

²⁸Jürgen Backhaus is referring to Wilhelm Röpke’s newspaper article: “Die Intellektuellen und der Sozialismus.” *Frankfurter Zeitung*. September 1931. Reprint: *Frankfurter Allgemeine Zeitung*, Nr. 36/1976 (2-12-1976). Backhaus, *op. cit.*, 58.

²⁹Korsch (1919c).

hundreds and thousands under a single one is absolutely necessary.”³⁰ Korsch was also critical of the syndicalist program. Parts of it, he considered utopian, but other parts, he considered as useful:

But there has to be put an end to the enslaving of men by the machine and the entire mechanism of labor, which is essential to livelihood, and its organization. The men, who fulfil their functions within the mechanism of machinery should not be tools without an own will, but be able to maintain their nature as a human being. They serve the guide who is in control of the machine and all of its parts. Nevertheless, they should assert themselves by the vivid awareness that they, as a whole, are in control of the machine and its guide. This is industrial democracy (and) (...), at the same time, the realization of that part of the “syndicalist” demands of workers, which can be fulfilled at the current stage of economic and social development without falling back into economically into inferior modes of production.³¹

Karl Korsch combined aspects of labor participation and planning. In reflecting about labor participation, Korsch lined out early tenets of workers’ participation, which entered the discussion of the introduction of the system of Co-Determination in Germany after WWII, and, in this sense, he made a lasting contribution. Eduard Heimann focused on economic efficiency as a first goal of socialization and made new theoretical contributions at the time, in particular with respect to the wage of the entrepreneur and the theory of the firm. He was successful in propagating his ideas at the First Socialization Commission. He did not reach his normative goal, the democratization of the economy, mainly because he neglected the internal organization of the socialist firm. With respect to labor participation, he proposed a very limited participation of workers, in particular of issues concerning their immediate working environment.

5 Summary and Conclusions

After WWI, a unique opportunity arose to introduce socialism in Germany. The First Socialization Commission, installed right after WWI, was a think tank of socialist and liberal economists to plan the future of a socialist state. The Council of People’s Deputies (Rat der Volksbeauftragten) has installed the First Socialization Commis-

³⁰In the original, Korsch’s criticism of Bolshevik theoreticians reads as follows: “für den Erfolg von Arbeitsprozessen, die nach dem Typus d(ies)er maschinellen Großindustrie organisiert sind, die *widerspruchslose Unterordnung* des Willens von Hunderten und Tausenden unter einen einzigen unbedingt notwendig ist.” Gerlach, *op. cit.*, 57, emphasis in the original.

³¹In the original, the quote reads as follows: “Aber die Maschine und der ganze, lebensnotwendige Mechanismus der Arbeit und ihre Organisation soll aufhören, den Menschen zu versklaven. Die in dem maschinellen Mechanismus ihre Funktion erfüllenden Menschen sollen nicht willenlose Werkzeuge sein, sondern ihre Menschlichkeit behaupten können durch das lebendige Bewußtsein, daß sie, die einzelnen, dem Lenker der Maschine wie Maschinenteile dienen, in ihrer Gesamtheit der Maschine und ihres Lenkers Herren sind. Das ist industrielle Demokratie (und) (...) zugleich die Erfüllung desjenigen Teiles der “syndikalistischen” Arbeiterforderungen, der ohne Zurücksinken in ökonomisch rückständige Produktionsformen auf der gegenwärtigen Stufe der wirtschaftlichen und gesellschaftlichen Entwicklung erfüllt werden kann.” Gerlach, *op. cit.*, 58.

sion of the coal industry in December 1918. The proposals by the Commission were very similar to those made by Eduard Heimann, the secretary of the First Socialization Commission. They had in common that a set of measures was developed in order to efficiently organize the entire sector of the coal industry. By addressing the role of innovation in socialism, Heimann developed an early part of entrepreneurial theory. He sees a very limited role of labor participation. In his economic thought of ownership of a company and management, he made early contributions to the economic theory of the ownership of capital and management. With respect to the normative goal of democratization of the economy, Heimann did not make much progress as he neglected the internal organization of the socialist firm. In reflecting about labor participation, Korsch's ideas went further. He made a lasting contribution by lining out early tenets of workers' participation, which entered the discussion of the introduction of Co-Determination in Germany after WWII.

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Anti-Semitism Versus Democracy and Welfare State in the Weimar Republic



Hans-Dieter Bernd

1 Introduction

After World War I, the Reichsrätekongress strove to socialize the means of production. Specifically, this referred to nationalization specifically of the steel and electrical industries and of mining. Regions particularly affected by this would have been the Ruhr area, Berlin and various other industrial sites.

The actual responsibility for the disaster of the world war was in the private owners of the means of production, and in particular of the heavy industry, according to the Socialists and Communists. The latter believed that socialization would not only lead to a fairer participation of the workers in the capital, which was mostly privately owned, but also to a more peaceful world. A socialized large industry would reduce the idea of competition within and between states, they said.

Most industrials, but also members of the nobility, fearing expropriation, thought the socialization efforts of the labor parties and their unions to be nothing but theft that had to be prevented under all circumstances.

There were various legitimate and illegitimate strategies for this. The legitimate ones were those that Hugo Stinnes tried to enforce in the convention with Carl Legin, as well as the great tax reform plans of Matthias Erzberger. He believed that a good minister of finance would be the best socialization minister (records of the national assembly. p. 1377A).¹

Against socialization, i.e. nationalization or collectivization of means of production, the representatives of industry and mines initially used the principle of participation of the workers in the productive assets of the companies and politics and,

¹Negotiations of the Reichstag: http://www.reichstagsprotokolle.de/Blatt2_wv_bsb0000011_00648.html Records, Erzberger 2019 (National Assembly).

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representing the minister of finance, strove for a moderate re-distribution by way of tax laws and a welfare state. These conventions and tax plans could be considered the foundation of what was called the Rhenish Capitalism, in contrast to the Anglo-Saxon one, after World War II.²

These forces from the economy and politics that were critical but (initially) constructive in their approach to socialization efforts were, however, supplemented by those who not only opposed the socialization efforts in a polemic-destructive manner, but who also were against the democratic system that seemed to permit such socialization. These forces found their political home mostly in the German national people's party (DNVP), which had chosen its party name less out of conviction and more out of opportunistic reasons. In particular the conservatives in this conglomeration party saw the term "people" to be rather negatively connotated. However, it was suitable as an ideological term of challenge to distinguish from the "dull" and "misguided mass" for which the left-wing parties were responsible. In order to open the eyes of these misguided masses, however, concerning the governmental form of "democracy" that was unsuitable for the German people, as well as about the "true" background of the socialization plans and any form of Socialism, it was decided to use Anti-Semitism for information and re-education. Some social democrats also called this the conversion of class hatred into race hatred in order to conceal the reactionary targets of this party. The opposition to the Erzbergersche tax reformation plans took place mostly through the contents of the stab-in-the-back myth after the Parliamentary investigation committee in November 1919.³ In it, Erzberger was held mainly accountable for the loss of the World War and the resulting consequences due to the peace resolution of the Reichstag from 1917 and the ceasefire treaty from November 1918.

The three following sections are to show how Anti-Semitism was to be and actually was used to reeducate the "people" and particularly the "dull mass".

2 The Staatspolitische Arbeitsgemeinschaft of the DNVP 1919

In the first months of 1919, the Staatspolitische Arbeitsgemeinschaft of the DNVP convened two meetings.⁴ These evenings were about the party's position on Judaism. The meeting wanted to determine whether Jews were to be admitted to the party or not. Tracking the course of the two meetings, the process and result records of which are preserved in the originals, it becomes clear that part of the persons present did not want to answer the question of whether the membership of Jews was desired or not,

²Zur Zukunft des "Rheinischen Kapitalismus", source: Bundeszentrale für Pol. Bildung, with historical summary <http://www.bpb.de/apuz/26478/zur-zukunft-des-rheinischen-kapitalismus?p=all>.

³Helferich's campaign "Fort mit Erzberger" digitized source:file:///C:/Users/Bernd/Downloads/Fort%20mit%20Erzberger!.pdf.

⁴June 6 and 17, 1919.

but asked how Jews could be used for the party's interest. It was not, as the supporters were later accused, mostly about money, but about propaganda support. This group believed that Jews were the better publishers and journalists. They were more highly skilled in speech and writing than, e.g., the authors of the *Kreuz-Zeitung*, which would hardly reach any larger number of readers outside of the sphere of nobility and horse breeders. The contents were to be specified by the party; the manner of distribution was left to the Jewish authors.

In terms of content, the DNVP management wanted to present democracy to the citizens as something foreign that did not match the German nature. This was all the more the case if democracy, as they said, was targeted at the rule of the mass or the disdainful number and represented welfare matters. Social responsibility may have been a Christian requirement, but it was a personal matter, rather than a state one, as the conservatives saw it. This was all the more the case since it was believed that democracy would only be a transition form after all on the path to Socialism/Communism that Russia already presented.

This was about starting a propaganda campaign for the upcoming Reichstag elections that took place in the spring of 1920, in order to make the citizens despise the new system. Since this seemed to be impossible with clean argumentation, a method was sought that would not show easily what the new "people's party" actually was about. The target was to reach the masses, i.e. the disdainful numbers, in the hope of a veritable election result in order to then overthrow the system that seemed to endanger their possessions using the seat distribution in the Reichstag: they wanted to legally, as they thought, overcome "Democratism" by way of the vote. It may be called a great defrauding maneuver toward the electing citizen. The pending Reichstag elections might have been the last elections for the voters then.

Some of the group had decided to place the specific agitation in the hands of qualified Jews for their methodical procedure. The grotesque thing about the planned reeducation of the people was that the people were supposed to be met with their resentments and conspiracy myths for the purpose of reeducation. The most widely spread one, which also seemed to best lead to the desired effect, was Anti-Semitism. This seemed to be virtually multifunctional. The Anti-Semites in the people's party, who were viewed as the mass base of the party by the DNVP leadership, preached that Jews were diametrically opposite to the German nature. They were essentially responsible for the status of the Communist system in Russia; they were the protégés of the Democratism that eroded the natural order; they are at fault for the World War just as for the fact that Germany lost it. According to the *Völkische*, the Jews were at fault for every disaster and any misery. DNVP politicians wanted to use this myth, mostly based on the "Protocols of the Elders of Zion",⁵ and the Jews to be included in the party were to spread this among the voting people. The party wanted to ensure that in particular its agitators for the people did not slip into street jargon. They wanted, as they put it, Anti-Semitism on a high level. Some even put value on

⁵5 Protokolle der Weisen von Zion: Die mächtigste aller Lügen in: Die Zeit, ZEIT Geschichte Nr. 3/2017, 22 August 2017, Wolfgang Benz <https://www.zeit.de/zeit-geschichte/2017/03/protokolle-weisen-zion-antisemitismus-faelschung>.

making clear that they had Jews among their friends and acquaintances and that they were therefore beyond any accusations that they might be Anti-Semitic.

Since Jews were to engage in propaganda for the benefit of the party of Anti-Semitism, even though only in a homeopathic dilution, it was to be made clear to them first that this type of agitation was neither targeted against them, nor against Judaism as a whole, but against the Jewish spirit that appeared among the Jews but that had most of all taken a hold of fifty percent of the German people, in order to avoid any misunderstandings. Therefore, the recipe for healing was: *similia similibus curantur*.

A sentence that documents the will to use the Anti-Semitic resentments like no other in the source is:

It has been said here recently that Anti-Semitism would be a nice thing if a capable Jew organized it. This hits the core of the issue. (v. Oppeln-Bronikowski, Staatspol. AG p 37)⁶

Many other quotes of this source can also document the instrumentalization of Anti-Semitism to remove the democratic system. There is a good reason why the meeting's chairman (Ulrich v. Hassel)⁷ asked the participants in the meeting to maintain silence about the controversial discussion subjects here to the outside at the beginning of the meeting. (Staatspol. AG, p. 33) towards the end of the night, he summarized that there was the "issue":

How do we translate the language spoken in this room into practical effectiveness? (Staatspol. AG, p. 38).⁸

How was it possible to approach a reeducation of the people by Anti-Semitism, "organized by skilled Jews" without people who were contaminated by the supposedly "un-German spirit" (democracy and Socialism) recognizing the true reason for the agitation?

Someone who showed the way to such an agitation was the formerly free conservative Siegfried v. Kardorff, now a member of the DNVP, who recommended giving the "matter of the Eastern Jews" an Anti-Semitic character. This kind of agitation superficially guided attention to the Jewish migration from Poland, but met the purpose of "reeducating the people". This way, the assimilated German Jews were taken out of the focus a little, and the conservatives were given the option of contributing to agitation, as he expected.⁹

As a result, it can be said from the point of view of the DNVP that the concept partially worked, but failed in the end. As the Reichstag elections of 1920 approached, and in particular the DDP felt the Anti-Semitism targeted against it—which was

⁶Staatspolitische Arbeitsgemeinschaft der DNVP, p87 state archive Berlin [inventory signature: R8005/327 S.33-38(R)] "Es ist hier neulich gesagt worden, der Antisemitismus wäre eine schöne Sache, wenn ein tüchtiger Jude ihn organisierte. Das trifft den Kern des Problems".

⁷v. Hassel Short biography: <https://www.dhm.de/lemo/biografie/ulrich-hassel>.

⁸Staatspolitische Arbeitsgemeinschaft der DNVP, p.89 (inventory signature R8005/327 S. 38) "Wie übersetzen wir die Sprache, wie sie in diesem Zimmer gesprochen wird, in die praktische Wirksamkeit?"

⁹Federal archive Berlin, Nachlass Westarp 2329/vol. 114 folio 46 also Jan Striesow "Die DNVP und die Völkisch Radikalen", p. 148.

denounced as the Jews' party. It lost nearly half its voters who had still given it their vote in the elections for the National assembly (Dt. Wollen, no. 3, p. 13).¹⁰ Apart from this, the Anti-Semitic agitation was targeted against the USPD and specifically against the MSPD, the parties who supposedly had absorbed the disintegrating Jewish spirit to a special degree. DNVP strove to ensure loss of the parliamentary majority for the parties of the Weimar Coalition. However, it saw a downer in the fact that another "people's party" had been founded in addition to it: the Deutsche Volkspartei. It has been claimed that the success of the DNVP would have been much larger without it.

This form of instrumentalization of Anti-Semitism not leading to the perfect success for the DNVP in the end was, among others, due to the separation of the Völkische in 1922, who sharply criticized the DNVP in their agitation. In their election campaign of 1924, these Völkische kept repeating that the DNVP grandees used Anti-Semitism in the form of the Eastern Jew agitation to mislead voters. Since they had enough internal party information, they were also able to use this strongly in their "arms" against the DNVP.¹¹ In this dispute between the Völkische and the DNVP, the absurd discussion of who the true Anti-Semites in the country were soon sprang up in public. They even called each other the "Jews' party" because they apparently were paid by them and acted in their interest and therefore harmed the "national matter".

The parliamentary group chairman and later party chairman Cuno Graf Westarp spoke for not pushing them out of the party after the murder of foreign minister Walter Rathenau as a mentor of the "Sozialvölkische". He probably believed that the German and free conservatives within the party would not be able to dispense with the Völkische as a party mass base if they wanted to pursue their restorative targets.

The dilemma of the party leadership concerning instrumentalization to collect votes before the elections, and as an ideology of its goals against any welfare state and democratic participation soon became evident. Anna von Gierke, whose mother was Jewish, and who was a member of the steering committee of the state political work group, soon left the DNVP because Westarp had forced her to give up her promising list position for the upcoming Reichstag elections for the benefit of the Völkische. It was impossible to mention the Anti-Semitic agitation of the Völkische sub rosa and use it while presenting a candidate for the Reichstag who was referred to as a "half-Jew" in the jargon of Anti-Semites. As Westarp had found, there was a gap in the party's credibility here.

Equally von Kardorff, who had still recommended the instrumentalization of the Eastern Jew matter in the program commission, turned his back on the DNVP after the Kapp coup, among others because it was unable to keep the Völkische under control where their openly agitating and people-endangering rabble-rousing was concerned.

¹⁰Deutsches Wollen, no. 3, p. 13, Berlin 1920.

¹¹Deutschnationales Rüstzeug, year 1924: The Deutschvölkische Freiheitspartei, Berlin 1924. Here, the DNVP strove to relativize the presentations brought up against them, or to claim them as false. The "Rüstzeug" was, among others, an instruction for its election speakers out there who had to defend themselves against accusations of the völkische.

3 Anti-semitic Speech of the Chairman of the Preliminary Economic Council 1922

The speech of Edler v. Brauns in the Reichstag is an example of how much the Völkische and the party head fought about when, where and for what purpose Anti-Semitic agitation was to take place within the meaning of instrumentalization. The publication of DNVP “Die Deutschvölkische Freiheitspartei” shows that there had been disputes in the party rooms in light of an important speech of v. Braun about whether v. Braun was to play the Anti-Semitic card against the “fulfillment policy” of the Wirth-Rathenau cabinet in the Reichstag or not (*Deutschnationales-Rüstzeug* 1924, p. 37).¹² Obviously, he was urged to do so against the will of the party leadership. The debate that was conducted in the Reichstag that day and where the chairman of the preliminary Imperial Economic Council, v. Braun, was to represent the position of the DNVP, was the London ultimatum.

One most unpleasant item of this ultimatum was the “debtor warrant”. Its content stated that the German economy had to pay a 26% export duty to the countries receiving the goods, i.e. a kind of discount or reimbursement that, according to Otto Wels, the state couldn’t possibly reimburse to the economy if any plannable Imperial budget was to be drawn up at all. v. Braun started at this neuralgic point, converting Wels’ words of the “capitalistic solidarity” into the anti-Semitic connotated term of international capital. Then continuing:

We want nothing to do with such machinations of the international Jewish capital, (vivid confirmation on the right) and therefore see severe danger in particular in the current composition of the cabinet. (Again vivid agreement on the right). (RT-Protok. Vol. 349, p. 3737 A/B)¹³

This statement was to present the German-Jewish foreign minister Rathenau as part of an international “Capitalistic” conspiracy. The chairman of the Economic Council wanted, for a change, to implement the terms of the entente as agreed. This meant: The state was to fully reimburse the German goods exporters for the “debtor warrant”.

The expected volume of this budget item to be included in the plans would have been 1.5 to 3 billion Reichsmark in light of the variability (RT. Protok. Vol. 349, p. 3726D). According to Rathenau, this was the “most dangerous” part of the convention (RT. Protok., vol. 349, p. 3744D).

Indirectly, this dispute conducted with an Anti-Semitic affront as well was about the question of which part of society was to pay more for the consequences of the war. Von Braun’s position and that of the DNVP and DVP alike was: Protecting the economy and private assets and introducing the 12 h day for workers again. This was to recover positions from the Stinnes-Legin treaty as well.

¹²*Deutschnationales Rüstzeug* 1924: Die Deutschvölkische Freiheitspartei, p. 37.

¹³Negotiations of the Reichstag vol. 349, S.3737 A/B, (2 June 1921) “Wir wollen nichts zu tun haben mit derartigen Machenschaften des internationalen jüdischen Kapitals, (lebhaftige Zustimmung rechts) und deswegen sehen wir gerade in der jetzigen Zusammensetzung des Kabinetts eine schwere Gefährdung.” <http://www.reichstagsprotokolle.de/Blatt2w1bsb000003300438.html>.

The fulfillment policy was also called “socialization on the cold path” by the “national opposition”, under contribution of the entente (RT Protok. Vol. 349, p. 3738D). In public, the Wirth-Rathenau government was presented as a servant that abandoned German possessions to the winning forces. The reasons why this was done were always given in the agitating media of the *Völkische*, claiming that the responsible politicians had been bribed by the international Jewish capital. v. Braun’s speech was the template for serving these sheets.

The verbal attack conducted by v. Braun on Rathenau and the entire Wirth cabinet was somewhat harsher in its anti-Semitic sharpness than the speech of Karl Helfferich, which is more often found in literature, on the day before Rathenau’s murder, in which Helfferich called Rathenau a traitor of the German matter, and in particularly traitor of the people of Saarland.¹⁴

4 Hugo Stinnes in Spa and the Anti-semitic Threat 1920

The threat of using the anti-Semitically agitated street as leverage against the positions of Rathenau and Bonn on the conference of Spa by industrial magnate Hugo Stinnes is another example for how Anti-Semitic agitation was used to enforce economic interests at the highest level.

The DNVP-related *Kreuz-Zeitung* told its readers about the “Jewish-Democratic spirit of Spa” after the conference (*Preußische (Kreuz-)Zeitung*, Nr. 358, year 1920).¹⁵

Foreign minister Walther Simons, head of the German delegation in Spa, had taken two renowned representatives of the 2nd socialization commission to the negotiations of the entente in Belgium: Hugo Stinnes and Walther Rathenau. Soon, there was a severe dispute about the direction to be taken in the German delegation. In his position of opposing the winning forces in terms of reparations, in particular in the delivery of millions of tons of coal, and to therefore also potentially accept or even provoke the occupation of the Ruhr area by entente troops, Rathenau opposed what would later be called the fulfillment policy.

After the conference of Spa, Stinnes was facing accusations that he had only thought of his own personal advantage, i.e. the advantages of the Stinnes group (*Vorwärts*, no. 364 vol. 1920).¹⁶ Specifically he was accused of having seen an advantage in occupation of the territory, since occupation by entente troops would have severely limited the sovereign rights of the German state; in addition to this, the coal trade with the French had made him the “greatest owner of foreign currencies”. Finance expert Moritz J. Bonn saw the negotiation strategy of Hugo Stinnes even as

¹⁴23 June 1922, Helfferich’s speech in the Reichstag <http://www.reichstagsprotokolle.de/Blatt2w1bsb0000003900668.html>.

¹⁵*Preußische (Kreuz-)Zeitung*, no. 358, year 1920 “Das wahre Gesicht von Spa”.

¹⁶Accusations of Steigers Werner (also 2nd Socialization commission) in: *Vorwärts* no. 364, year 1920.

an effort to counteract stabilization efforts for the Mark, in order to generate high inflation profits (M. J. Bonn, *Bilanz*, p. 250).¹⁷

In light of this background, which was briefly sketched above, Stinnes had threatened the participants Rathenau, Bonn and Dernburg, who were of Jewish origin, in Spa that he would cause “severe political and social fights in particular of an Anti-Semitic kind” if they were unwilling to continue to follow his negotiation strategy from the conference.

Regarding the public criticism he faced in Spa, he responded: a number of representatives in Spa had broken the resistance against unworthy impositions of the entente due to their “foreign psyche” (*Kreuz-Zeitung*, no. 354, year 1920).¹⁸ The DNVP-related *Kreuz-Zeitung* turned this into: “Representatives of a foreign nation” that had undermined the German position out of shady motives.

Spa represents the setting of the tracks of a “national collection policy” as represented by Stinnes, the DNVP and, at the time still, the DVP, up to the “fulfillment policy” towards reaching an agreement with the winning forces (H. Gründer: W. Simons, p. 115).¹⁹

There are many other examples where Anti-Semitism was used without any actual conviction of its contents being necessary. One is that of DNVP delegate von den Kerkhoff, who denounced a Jewish merchant who had outbid a client of Kardorff in a business matter from the stage of the Reichstag. The Jewish merchant had previously been threatened with this approach if he did not withdraw from the transaction (RT Protok. Vol. 348, p. 2746C/D).²⁰ SPD delegate Kahmann called this procedure in the Reichstag “political-economic blackmail” that showed certain parallels to the proceedings of Hugo Stinnes.

Instrumentalization of Anti-Semitism was particularly strong in the Federation of farmers, which had already had some relevant experiences with political use of such resentments in the Empire. Again, there are some sections of the speech in the records of the Reichstag. The Anti-Semitism of the farmers and their political representatives was targeted against forced management of basic foods and specifically against the Reich grain office in Berlin (Bernd, *Diss.* p. 284 et seqq.).²¹

¹⁷M. J. Bonn: *So macht man Geschichte, Bilanz eines Lebens*, Munich 1953 p. 250.

¹⁸*Neue Preußische (Kreuz-)Zeitung* np. 354, year 1920.

¹⁹H. Gründer, *Walther Simons als Staatsmann, Jurist und Kirchenpolitiker*, PH.C.W. Verlag, Neustadt a.d. Aisch 1975, p. 115.

²⁰Negotiations of the Reichstag: http://www.reichstagsprotokolle.de/Blatt2_w1_bsb00000032_00119.html.

²¹H. D. Bernd, *Die Beseitigung der Weimarer Republik*, *Diss.* p. 284 et seqq. Debates about the agricultural crisis of 1921 to the spring of 1922: https://ub-deposit.fernuni-hagen.de/receive/mir_mods_00000074.

5 Conclusion

The beginnings of the Weimar Republic are reminiscent of a large political field for experimentation in which not least the Socialization Commission controversially discussed many different models of new economic forms. The discussions in these commissions influenced the political streams outside the country just as, on the other hand, the specific internal and foreign-policy events on the course of negotiations of these commissions.

This paper was to briefly define how Anti-Semitism was used as a means of influencing. For this, chapters were chosen that refer to the first months of the Republic and persons and committees that essentially worked towards the new business models or tried to prevent them with various strategies. One of the means for exercising pressure on the political opponent that were used by the German national party was Anti-Semitism, which had all but disappeared before the World War, but then spread again strongly during the food supply crisis in the “Beet Winter” of 1916/17 and that characterized public discourse very strongly in nearly every single area of politics in the years of crisis of the Weimar Republic.

Anti-Semitism as a mass phenomenon appeared in crisis and could be used by right-wing politicians as well as by actors of the large industry (see Stinnes), in order to produce crisis-like situations or to be used as leverage of the street against opponents.

The concept of Antidemocratic forces—not only right-wing ones—was the reinforcement of crises or the production of crises since they assumed in their concepts that the new system could only be overcome in crisis—best by the voters directly. However, as the state-political work group of the DNVP 1919 was certain, this required re-education of the broad masses that had been penetrated by Socialist and Democratic ideas—i.e. “non-German spirit”. A coup from above, a military campaign against the new system, seemed not to be opportune to most in the lead of the party—as the Kapp coup and the Hitler coup confirmed later—since the expected organized resistance would be too great. Nevertheless, this strategy that worked by way of raising disdain for the system and its representatives, fueled a latent civil war atmosphere, in particular in the first four years until 1924, and then again after 1929 until the end of the Republic.

Finally, it should also be mentioned that there was an attitude against instrumentalization in the DNVP as well. Industrial v. Raumer said about this in the Staatspolitische AG: “I think that the party can only be designed in a modern fashion by throwing Anti-Semitism overboard (...)” (Staatspol. AG p. 89).²² Germany was only able to return to power through the economy and this required international relationships that would only be impaired by preaching Anti-Semitism.

Following this sentence, it could be summarized that serving resentments does not generally promise any future-oriented solutions. Quite the opposite! Such strategies seem to be rather an admission of inferiority. They speak of the weakness of not

²²Staatspol. AG of the DNVP, p. 89.

being ready to face the new challenges of the time. Instead, there is a yearning back to an order that restores the old conditions of existence that were successful in it.

The restoring forces that acted not only within the DNVP put a severe strain on the young democracy. The attempt at restoring the old order not only took place with useless strategies, but to a high degree also with morally objectionable ones. The actors were also apparently aware that their methods were reprehensible. The dignitaries of the old regime strove to maintain something that could be called “clean hands” to the outside and also towards themselves. The editor of *Vorwärts*, Stampfer (SPD), said about the German national party: “The worse off Germany is, the more happily some faces will shine” (RT Protok. Vol. 353, p. 6632C). By this, he meant the deliberate disaster policy to get rid of democracy.

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Otto Neurath's Concepts of Socialization and Economic Calculation and His Socialist Critics



Günther Chaloupek

1 Introduction

Otto Neurath (1882–1945) was one of the most active participants in the debate about socialization that developed after the First World War. As far as this part of Neurath's work is concerned, his name is mentioned most prominently in the context of two issues: “total socialization”/“*Vollsozialisierung*” (as opposed to partial socialization), and “in kind accounting”/“*Naturalrechnung*.” In both respects he is mostly seen as an advocate of strategies and concepts which aimed at changes in the economic system of a much more radical sort than those proposed by the main-stream Social democratic parties in Germany and Austria. Neurath maintained this position despite the early failure of “revolutionary” political experiments in Bavaria and Saxony in his contributions to the socialization debate which he continued to publish until 1925. In the later 1920s, when chances for realization of socialization more or less disappeared, socialization also disappeared as a theoretical issue.

This contribution is confined to the debate between Neurath and his critics from the Social democratic parties of Germany and Austria—to the part of the debate that took place “inside” the socialist movement. It makes only occasional references to contributions from “outside”, which are of course much better known nowadays due to the prominence which the interventions of Mises and Schumpeter came to acquire later.¹

¹For a survey of the Austrian debate on economic calculation in a socialist economy see Chaloupek (1990).

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2 Socialization—Total or Partial?

Weissel (1976, 202) makes the observation that inexact or deceptive use of the terms *Vollsozialisierung* and *Teilsozialisierung* was the cause of much confusion which—also in other respects—characterizes the socialization debate. To make a proposal appear more radical, it was not uncommon to speak about “total” socialization of a branch or even of a company. Neurath’s contributions are not free from such ambiguity. “Total” socialization for Neurath does not necessarily mean expropriation and nationalization of all means of production. For him, nationalization in itself does not mean socialization, because “socialization is concerned with the whole, it is always total socialization, however shallow or deep the impact of the overall measures is” (1920b, 377). To “produce and distribute the final product socialistically” (ibid.), to ensure the full use of productive resources, to eliminate the “waste” of the capitalistic mode of production, etc., “socialism tries to replace the planlessness which springs from the disconnected activities of individual entrepreneurs by an administrative economy according to a plan, by an economic order in which central institutions survey the entire economy in order to participate in decisions on work, production and consumption” (ibidem, 381).² In this administrative economy “the decisions about production, distribution, wages and prices ... are to be taken by the whole” (p. 382). Whereas Neurath strictly opposes any kind of market socialism, he appears to be willing to allow some degree of independence of small producers in the crafts and in agriculture. “The doctrine that there is a trend towards ever more comprehensive organisations has been confirmed fully, less so the doctrine that small businesses will be replaced by large-scale concerns”(p. 387f). The essential thing is that small producers of various sorts are organized in a multitude of regional and branch organization to ensure that goods and services are produced according to the central plan (ibid.). In addition, “total” socialization requires a comprehensive statistical apparatus on which the plan must be based. “Even before they begin their work all bodies ... should be required to report to the Central Economic Administration which, in collaboration with the Centre for Statistics ... will fit the individual results into the universal statistics” (389).

3 Accounting in Kind—With or Without Money?

Neurath’s proposal to set up a system of *Naturalrechnung*, i.e. economic accounting in kind, was even more controversial than total socialization. Understood as an encompassing system on which the envisaged comprehensive economic and social planning would have to be based, it was seen at best as a curiosity, and in its most counter-intuitive effect as proof of the economic impossibility of socialism (Mises

²Notice that Neurath uses “soft” formulations (survey, participate), thereby avoiding the impression that it might be necessary to establish central control over production and consumption by command backed by force.

1922, 109). Starting from his general idea that production as well as consumption would be planned in kind, Neurath never produced more than sketchy illustrations and partial examples of how the plan should be designed, not to speak of implementation. Due to his principal opposition to money, Neurath thought that “in socialism, production can never be based on calculation with one unit of any kind, not even with the help of ‘labour vouchers’” (1925b, 432). But as he goes on to discuss concrete questions of his planning system, he resorts to similar instruments, thereby contradicting the principle stated before: to give sufficient incentives for workers and also to allow for some freedom of choice of consumer goods, provisions the system could provide that “each individual receives the right to take consumer goods from the total pool according to the number of points of his labour vouchers” (ibidem, 435). In addition, in order to ensure an economic use of material resources, in case of a shortage “the number of points for their distribution will have to be increased beyond the number representing the work spent on their production” (p. 436). In an earlier version, Neurath had considered the possibility of keeping two accounting systems in parallel: “It does not matter ... whether money is still in use as vouchers for goods, or whether vouchers replace money entirely ... or whether money is still used in some capacity as a unit of calculation. This kind of ‘monetary calculation’ can remain side by side with the ‘calculation in kind’ of the economic plan; in such a case it is useful to speak of an economy in kind with reckoning in money” (1920b, 383).

More fundamental from a methodological point of view is Neurath's ambivalence between what Thomas Uebel has called “strong” and “weak in-kind calculability assumption” (Uebel 5, 318). “Weak in-kind calculability” is a common phenomenon in the monetary market economy when resources are allocated to the provision of public goods such as roads or internal and external security, or public services such as hospitals, through the state budget, and planning is done also in non-monetary terms, e.g. kilometres of roads or number of policemen, judges, doctors and nurses, etc. In contrast, the “strong in-kind calculability assumption says that alternative uses of production goods can be assessed as fully as is required for rational decision making by quantitative in-kind labour and production technology statistics—money calculation is not even necessary for rational decision making” (ibidem). It appears that Neurath was not aware of this crucial difference, and that he unconsciously changed back and forth between these two concepts.

4 Encompassing Central Economic Planning

To consider an encompassing system of central planning of the whole economy as the essence of socialization—rather than a change in the ownership of the means of production, which was seen as a complementary element in the socialization process—was not Neurath's original insight. Of the multitude of socialization concepts put forward at the end of World War I, several had a special emphasis on overall economic planning. As early as mid-1918, well before the end of the war, Walther

Rathenau, president of the famous German company AEG, who had also been in charge of the organization of raw material supplies during the war, in his pamphlet “*Neue Wirtschaft*” (“A new economy”) proposed a system of comprehensive planning as a framework for “rationalization” of the whole economy in order to promote the application of the best technologies of production and a more efficient use of resources in private enterprise. This approach was taken up by the German minister for economy Rudolf Wissel (1920) whose plan (“*Wissel-Moellendorff-Plan*”, 1919) combined overall planning with partial nationalization, e.g. of coal mining.

The idea that an encompassing system of planning should be seen as the essence of socialization was strongly rejected by Karl Kautsky in his book “*Die proletarische Revolution und ihr Programm*” (“The proletarian revolution and its program”, 1922). Kautsky’s critique was directed not only against Neurath but also against the Wissel-Moellendorff-plan. Kautsky’s main argument was that it would be impossible to provide the statistical base on which such a plan would necessarily have to be based. A huge bureaucracy would need many years “to produce a reasonably reliable set of statistics.” Moreover, Kautsky criticizes Neurath for his simplified examples using a few inputs in low stages of the production process, thereby ignoring the complicated flow of goods through numerous intermediate stages to the final product. Kautsky was convinced that “it would be completely impossible to obtain a statistical survey of the infinite variety of all the products from private companies” (Kautsky 1922, 198). As an advocate of a socialist economy, Kautsky does not principally deny the necessity of a planned economy, which, however, “cannot be the starting point of socialization, but only its final result” (*ibid.*, 202).

On a more fundamental level, Kautsky rejected Neurath’s rationalist, constructivist approach to economy and society: “Society is not an edifice which is built according to a definite plan. Rather, it is comparable to an organism which grows and develops” (*ibidem*, p. 181). In Kautsky’s view, Neurath’s exercises in “social engineering” were an unfortunate example of utopian thinking which had been definitely overcome by Marx’s and Engels’ scientific socialism. It is consistent with Kautsky’s evolutionary approach that the idea of maturity becomes the central concept for the envisaged transformation from capitalism to socialism. Socialization can take place only if the development of the capitalist economy has produced institutions and forms of enterprise which are ripe for socialization. For Kautsky, this is the case only in a few branches such as railways and coal mining. Socialization starts with change of ownership in these branches, to be followed by new forms of organization of the nationalized enterprises. As a necessary consequence, socialization is pushed forward step by step, whereas total socialization is impossible and bound to fail. Therefore, the leading Social democratic politicians such as Otto Bauer in Austria, and also most theoreticians of socialization were advocates of *Teilsozialisierung* (partial socialization).

Emil Lederer, who served as secretary of the German socialization commission which was headed by Karl Kautsky, argued against Neurath along similar lines. To replace the existing market-coordinated economy with all its enormous complexity by establishing a complete system of planning “with one stroke” would be possible

only if “all men wanted such a production system, i.e. if no private interests would stand against it”—a condition which evidently was not fulfilled (Lederer 1921, 161).

In his replies to Kautsky's critique Neurath concentrated on the most controversial part of his own socialization theory, i.e. the role of money (see Sect. 5). With respect to the specific criticisms referred above, he admitted the enormous effort that would be necessary to produce his “universal statistics.” With real prospects for socialization having become extremely dim in 1925, Neurath proposed to start “to prepare a universal statistics ... The automatism of the market order for private entrepreneurs, even for nationalised autonomous economic enterprises in a capitalist order, must be paralleled by an economic plan, by calculation in kind for the socialist society ... also smaller sections ... can be depicted in this way. We can, for example, show the input and output of fat for the whole country” (Neurath 1925a, 444). A curious proposal indeed, which ironically seems to foreshadow the growing problem of overweighted people of our present time.

5 Calculation in Kind and *Naturalwirtschaft* (In-Kind Economy)

Among Social Democratic politicians and writers, Neurath's idea to organize an economy in its totality on the basis of an accounting system in terms of material inputs and outputs which requires the application of a multitude of different units of measurement was not considered to be a serious proposal for economic policy. The intention behind most of the negative reactions it provoked was to counteract the growing tendency in public opinion that the conditions for socialism as an alternative system could never be established. In this sense, Otto Leichter approvingly cites Max Weber's verdict,³ who considered Neurath's “‘blueprints of a planned economy’ (*Planwirtschaftspläne*)” a dilettantish, objectively and absolutely irresponsible frivolity without parallel, which might discredit socialism for hundred years” (Leichter 1923, 96). Even harsher was Karl Renner's reported judgment of Neurath (“*Narr*”—fool, crank) (Weber 1982, 139).

Karl Kautsky, who postulated freedom of choice for consumers and also “most possible freedom for producers” (1922, 313) in the socialist economy, argued that this would be impossible if the whole production would be organized in one single factory under central management, which assigns production tasks to each factory, which receives all the products and apportions all means of productions to factories and all consumption goods to households *in natura*. The ideal of such a state of affairs is the prison or the barracks, whose inmates get everything they need *in natura*” (ibid., 314). Kautsky's ironic remarks are certainly polemical, but nonetheless they illustrate the principal difficulties which Neurath refused to take seriously. If Kautsky did not

³If Weber's view on the applicability of in-kind accounting coincides with that of Mises, Weber's concept of rationality differed from Mises' (Uebel 2018).

formulate this kind of argument in general terms, the reason is because the critique would turn against socialism per se.

Compared to Karl Kautsky's criticisms, the arguments against calculation in kind put forward by Helene Bauer and Otto Leichter were of a more theoretical nature. Helene Bauer emphasized that the measurement of the value of all goods in terms of labour hours would be indispensable in a socialist economy for two reasons: (i) goods are distributed to consumers proportional to their work effort; (ii) for decisions about allocation of productive resources, it is necessary to compare the values of the different goods despite the fact they have ceased to be "commodities" (Bauer 1923a, 198ff).⁴ She also questions Neurath's idea of choosing among a variety of different plans with alternative production plans and alternative sets of conditions of life. "The socialist society ... will not allow a central organ to make experiments with different conditions of life, but will calculate exactly how much labour time the production of each group of goods costs, starting from raw materials to the finished goods including distribution" (ibidem, 200).

Otto Leichter, who proposed a socialist accounting system based on the hour of labour as basic unit, criticizes that in a system of in-kind calculation a rational use of resources would be impossible for several reasons. (i) Neurath nowhere shows how the various production units would reckon up their mutual deliveries (Leichter 1923, 33). (ii) Free choice for consumers is necessary to ensure that production units respond to their needs and preferences, which is not the case if goods are distributed to the final users according to conditions of life defined by the central plan (ibidem, 73). (iii) More fundamentally still, Leichter argues against concepts similar to Neurath's developed by the Russian economist Chayanov⁵ that the solution of rather simple tasks such as comparisons of economy between alternative methods of production of the same products become impossible. E.g., without a standard unit of accounting it is not possible to decide whether production of a given quantity of electricity is more economical by using coal or water power (ibidem, 87). To this latter criticism, Neurath replied that it would be the task of technical engineers to develop the appropriate methods, "as soon as they have understood the nature of the problems, to assess the performance of individual production units" (1923a, 156). In return, Leichter (1923, 97) denied this emphasizing that, to the contrary, this would be the task of what Neurath called the "social engineers" ("*Gesellschaftstechniker*").

If Helene Bauer and Leichter were convinced that the hour of labour would be the appropriate unit of account in a socialist economy, they found themselves in contradiction with Karl Kautsky who had denied the viability of such an accounting system. Kautsky (1922, 321) argued that, in a capitalist economy, actual market

⁴To support her argument, Helene Bauer (p. 200) quotes Engels (1894, 335): "Die Nutzeneffekte verschiedener Gebrauchsgegenstände, abgewogen untereinander und gegenüber den in ihrer Herstellung nötigen Arbeitsmengen, werden den Plan schließlich bestimmen." Engels's argument is actually based on a utility theory of value. Engels' argument is actually based on a utility theory of value.

⁵Alexander W. Chayanov, 1888–1939, director of the Petrowskoje-Rasumowskoje institute of agricultural economics (near Moscow) 1919 till 1930, arrested under the charge of founding a peasant opposition party.

prices were hardly ever identical with “values”, the latter presumably meant in the sense of Marshall’s “normal supply price”, with the market mechanism working as an automatic adjustment process to reduce deviations of prices from values. Since “normal conditions” never prevail in reality, it would never be possible to determine “normal” quantities of labour required for production of each good. “Instead of the futile attempt to measure running water with a sieve” a socialist government “would retain the prices with which it is confronted and which have been formed in the process of history.” Adjustments would have to be made in a pragmatic way, without inflicting hardships on the working class as they do under capitalism.⁶

Karl Kautsky and also Leichter thought that the system of state control of the economy introduced during the war years could not be considered as a forerunner of the planned economy. These kinds of controls eventually would have to resort to coercion and forceful police action “with results which would be as poor as in Russia today” (Kautsky 1922, 201). Leichter maintained that it is one of Neurath’s fundamental errors to characterize the war economy as in-kind economy. It is “quite ridiculous to speak of in-kind calculation in capitalism wherever calculations are not made in terms of money”—the costs of schools, hospitals, housing units are always calculated in monetary units (Leichter 1923, 95).

It was Benedikt Kautsky, son of Karl Kautsky and head of the statistical department of the Vienna Chamber of Labour, who wrote “the last word” in the in-kind calculation debate. His review of Neurath 1926 was published in Rudolf Hilferding’s journal “*Die Gesellschaft*”, i.e. at a time when socialization had ceased to be a real issue of political debates. Apart from the aspect of the necessity of money as a common unit of account (see next section) Benedikt Kautsky’s main critique of Neurath’s approach is the latter’s dominant concern with static aspects of the economic process. It is the “questions of socialist production which have to be posed in the first place, not least with respect to the complex relations of world markets. The issue is not distribution of existing goods, ... but their production and augmentation.” Creating the conditions for enhancement of civilization is primarily “a problem of technology and production policy” (Kautsky 1926, 95).

6 Money in the Socialist Economy

It has been pointed out above that Neurath was not consistent on the issue of the necessity of money as a unit of calculation and as a means of distribution of goods to final consumers. But it appears that Neurath thought money as a common unit of account could be done away with completely at least in an advanced, not necessarily final state, of the socialist economy.

⁶ Apart from changes of conditions of demand and production, the proposal to use the hour of labour as common unit of accounting does not stand up against Eugen von Böhm-Bawerk’s objection that labour is not homogeneous (von Böhm-Bawerk 1896/1962).

According to Karl Kautsky, Neurath's fundamental opposition to money was the consequence of a confusion of money as a means of exchange and money as "capital" that has an inherent drive for self augmentation. If for Neurath "the production of surplus value is not the function of capital, but of money as such", this is "completely erroneous" in Kautsky's view (Kautsky 1922, 316). In the socialist economy, money would no more be transformed into capital, and would therefore only serve as a means of exchange which would be indispensable to ensure smooth circulation of goods and to give free choice to consumers.

Only a society in which all scarcity of material goods has ceased—the "stage of communism" envisaged by Marx for some distant future—could do entirely without money. But this is a theoretical possibility which Kautsky does not take into consideration seriously, since "we cannot even surmise today whether we ever get that far" (ibidem, 315). The abolition of money would be a heavy setback for the division of labour and its progress on which modern material and cultural standards are based, it would be "regression into barbarism", an act of helpless destruction comparable to the destruction of machines by pauperized workers in the early phases of the industrial revolution (ibidem, 324). Kautsky also points to historical example of moneyless societies which were always based "not only on communism of production but also of consumption—with complete absence of freedom of person" (ibidem, 336).

7 Misunderstandings and Anticipations

In this section I will try to evaluate several of the different arguments put forward by Neurath to support his idea of in kind calculation and the respective counter-arguments of his critics. Neurath argued that a partial in kind-economy is standard practice in the public sector when capacities of public services such as schools and hospitals are defined in natural terms. In this context, however, he disregards the aspect that all such decisions are subject to a budget constraint. The scale and the quality at which such services are made available must be weighed against the costs of each kind of service and of the total, necessarily calculated in terms of a common unit. No "rational" decision can be made independently of cost considerations. If this was the essence of Helene Bauer's critique referred to above, Neurath nowhere offered a convincing reply to it.

Otto Leichter was the only one who pointed to an even more fundamental aspect of the issue. There exists always more than one combination of inputs in order to produce a given quantity of output of a certain good (for final consumption, for investment in construction and equipment, for intermediate use, in Leichter's case: electric current). Without the possibility of comparing the total values of alternative input combinations it is not possible to decide which combination is the most effective. Hence, even in the unrealistic case where the plan correctly anticipates final consumption demand, the selection of the most productive processes to satisfy that demand must be based on cost comparisons in money terms, i.e. in terms of a common unit of calculation. It appears that this aspect was never understood by Neurath.

In his essay on socialist utility calculation (Neurath 1925b), Neurath put forward still another argument. "It is possible for an economy to exhibit a constant upward trend in terms of its balance sheets while the production is in permanent decline and the life of everybody becomes ever worse" (ibidem, 467).⁷ The statement that "production is in permanent decline" necessarily implies that "production", by which nothing else can be meant than an heterogeneous aggregate of a variety of goods, can somehow be expressed in aggregate terms to find out whether it is declining (or constant, or increasing). Evidently, this is impossible without calculating values in terms of a common unit. Apart from this unintended but inevitable implication which is inconsistent with Neurath's fundamental views on economic calculation, his statement is correct, but does not at all prove the necessity of in-kind calculation. The problem is solved by calculating the value of production at constant prices, otherwise referred to as "in real terms", as opposed to current prices, also referred to as "in nominal terms." This has become standard practice in the System of National Accounts (SNA) which has been used worldwide after 1945 to measure economic performance of nations. If in 1925 no such standard economic accounting system existed, there was a "theory of index numbers" which would have provided the tools for calculation at current and at constant prices. This theory could have been used to explain what appeared as a paradox to Neurath. So much for "weak in-kind calculability assumptions".

As regards Neurath's "strong in-kind calculability thesis", it is difficult to imagine how Neurath came to believe in his "utopian" solution. Even if it were possible to draw up several alternatives of complete systems of all inputs and final outputs (thousands of equations), it is impossible to conceive of a decision making process by which a collective choice could be made *uno actu* about alternatives *in toto* for several years (the planning period) in advance. It appears plausible if Uebel (2004, 66) suggests that in his later years Neurath "quietly dropped the advocacy of centrally planned economies in kind" although he somehow tried to save the idea of in-kind accounting.

In one important respect, Neurath's critique of the "capitalist money accounting system" anticipates the critique of the SNA developed during the 1960s and 1970s which became one of the theoretical foundations of the environmentalist movement. In his essays on socialization (1920a, b) Neurath introduces the "quality of life" as a concept which includes not only elements of material wealth such as food, clothing housing, etc. "The ultimate aim of the economic plan, however, is the 'topography of living conditions' which shows the distribution of living conditions (made up of available food, housing, clothing, education, leisure, work, toil, etc.) according to certain types" (1920b, 386). Several of the "non-material"⁸ factors of well-being are

⁷Neurath made a similar statement in his response to comments to his lecture to the World Social Economic Congress 1931: "If one speaks, in monetary calculation, of the increase of production measured in money terms, then it is unclear whether there is an increase in kind, for the increase in money terms can mean a decrease of production" (Neurath 1931b/2005, 500).

⁸National income not only includes tangible goods, but—to an ever increasing extent—also services of different kinds. Conventions have been developed to include private and public services in GDP on the basis of imputations which presently account for a large part of it.

discussed in Neurath's essay on socialist utility calculation (1925b). If the money calculation of the capitalist system "is precise in terms of money sums,... it tells us nothing of the true wealth of a people, neither about the use made of sources of raw materials more about the distribution of goods produced; it tells us nothing about the rise or fall in the rates of deaths and diseases or about whether people feel better or worse" (ibidem, 468). Neurath also mentions the exhaustion of coal mines, the karstification of mountains, "entertainment"—which obviously includes leisure time. In a socialist society, all these factors which determine the quality of life of the individual, would have to be taken into consideration and "represented by a figure, that of another by a second figure, such that, in the end, one would arrive at a sum for society. Then one could determine that in one case the totality of the qualities of life is greater than in another" (ibidem, 469).

In the 1970s, when the natural environment emerged as major subject of economic theory, economists turned their attention to negative external effects of economic growth. Nordhaus and Tobin (1972) developed a comprehensive indicator of economic welfare in order to include some of the factors whose neglect Neurath had criticized. It must be noted, however, that this overall "Measure of Economic Welfare" (MEW) was arrived at by directly adding or deducting such things as the value of leisure time, the value of consumption of durable consumer goods (e.g. cars), or the imputed money value of the impact of environmental factors ("regrettable necessities", "disamenities") in aggregate form to GDP, rather than calculating these values first at the level of the individual, as demanded by Neurath. As a first attempt to propose an alternative to conventional GDP accounting, the study of Nordhaus and Tobin did not have a lasting impact, since the first wave of environmental economics abated in the 1980s. More recently, there is some revival of this debate under the heading "Beyond GDP", with results still uncertain (Chaloupek and Feigl 2012).

8 Conflicts of Interest, Incentives, Democracy and Dictatorship

In his tract on the proletarian revolution Karl Kautsky warns against the illusion that socialism would create a society of spontaneous social harmony. Foreseeable conflicts of interest of are seen as a key problem of organization and control in a socialist economy and are therefore discussed at great length. As the most fundamental problem of a socialist economy, Kautsky identifies the conflict of interest between producers and consumers (1922, 149ff). If workers of different branches of production and different professions have special interests, in capitalism the dominant conflict is between capitalists and workers who are united by the existence of a common class enemy. Even so, there is "a constant danger that the solidaristic class consciousness degenerates into egotism of the professions" (ibidem, 226). In a socialist economy, without the unifying bond of a common class enemy, the different groups of workers will develop a stronger tendency to pursue their special interest.

In a socialist order, these interests must be carefully balanced against the interest of consumers in order to ensure that production of goods is undertaken for the purpose of consumption. It is in this respect where Kautsky sees the fundamental deficiency of the model of guild socialism which he rejects. Because self government of units of production by workers would give too much economic power to special interests, Kautsky (*ibidem*, 256f) supports the model of tripartite governance of enterprises proposed by Bauer (1919).

Kautsky frankly admits that socialism has not yet found a solution for the problem of bureaucracy. If bureaucratic management of big enterprise has become more and more characteristic of modern capitalism, it is essential to understand that “the bureaucracy which capitalism has created for its purposes is entirely different (from state bureaucracy)” (*ibidem*, 209). Socialism can work satisfactorily only with flexible forms of management. Incentives for initiative action will be no less important for socialism to maintain the dynamic innovative character of capitalism (*ibidem*, 216ff).

Emil Lederer criticized Neurath's evasive attitude towards conflicts of interest as regression into utopian thinking (Lederer 1921, 160) Neurath does not wholly ignore the problems of interest conflicts. With respect to the problem of special interest of factory councils, he writes: “for socialisation the power of workers is decisive not within the factory, but within the people's economy as a whole” (1920b, 390). Neurath shares Kautsky's critical position vis á vis guild socialism. The solutions he offers are centralist decision making within an encompassing system of economic and social planning where everything is to be decided *uno actu* by the population which can choose between a certain number of alternative overall plans. Experts and social scientists are assigned a crucial role in the preparation of decisions which are greatly facilitated by a general spirit of cooperation, e.g. in the field of wage formation: “The result will be a general system of wages in which all wages and salaries, including those of directors and factory owners, will be agreed according to danger, risk, comfort and exertion of work, locality and manner of work, age, etc.” (*ibidem*, 387).

Neurath's unshattered optimism that the socialist revolution would create a mood of enthusiasm among the masses of workers is sufficient reason for him to hope for solutions where they are not yet available nor conceivable in the early stages of transition. In this respect the politicians and intellectuals with real experience in the labour movement could not follow him. Moreover, with their strong commitment to parliamentary democracy, German and Austrian Social democrats were not prepared to take the risk that revolution would result in a Bolshevistic dictatorship which they abhorred. Karl Kautsky was equally critical of the poor economic performance of the command economy held together by brute force.⁹ If Neurath did not sympathize with Bolshevism, he entertained the hope that, “if there existed a far-reaching tolerance in the economic sphere, a peaceful kind of Bolshevism might develop that could exist together with other orders of life. For that, however, Bolshevism would have

⁹Compare the remarks in Kautsky (1922, pp. 165, 185, 234, 267).

to abandon its intolerance” (Neurath 1920a, 352). Kautsky, for that matter, never diluted his uncompromising position towards Bolshevism until his death in 1938.¹⁰

9 Concluding Remarks

In view of the all too obvious flaws in Otto Neurath’s concept of socialization and of calculation in particular, the response from socialist critics was rather devastating. And yet, despite the many counter-arguments which were brought forward, the critique does not appear entirely satisfactory from a purely theoretical perspective—mainly for the lack of general aspects. With their consequent adherence to the Marxian labour theory of value, socialist economists like Kautsky and Leichter could not solve the problem of changing demand. Their socialization concepts did not provide an allocation mechanism for the socialist system because in their economics utility was not relevant for price formation (Fischer and Rosner 1987, 192). In this respect, but also with respect to incentives, economic dynamics and especially innovation, critical arguments against Neurath were not pursued as far as would have been possible—because the arguments could have been turned against socialism itself. With some of his arguments Karl Kautsky comes close to Mises’s conclusion of economic impossibility of socialism, the difference being Kautsky’s conviction the conditions for transition to socialism would be brought about by the long term evolutionary trends inherent to the capitalist system. Neurath, although he was a socialist, had obviously realized that the labour theory of value was untenable, but he hesitated to say this openly. It was in search of an alternative that he turned to in-kind calculation, which is even less suitable as accounting framework for a socialist economy. Except for Emil Lederer, who was not a Marxist, and a few others, socialist economists were not familiar with what was then modern economic theory, e.g. welfare economics, theory of index numbers, which could have cleared up some of the confusions, especially about accounting.

Finally, I think, a critical discussion of Neurath’s concepts of socialization and of calculation demonstrates the insufficiency of his “physicalist” approach to the social sciences. To speak of “physics of society in the same sense as of physics of a machine” (Neurath 1931a/1979, 198), it does not suffice to have complete knowledge not only of the present, but also of the future “topography of different conditions of life, the flows of raw materials and energy” (1920a, 362). In Neurath’s general system of “Lebensboden” (foundations of life), “Lebenslagen” (conditions of life) and “Lebensordnung” (order of life) (1931a/1979, 200) the social structure in its totality is embedded in a causal sequence of stimulus and response.¹¹ Even more specifically, Neurath writes “that we speak of a higher condition of life, if it brings about a

¹⁰See his book “Bolschewismus in der Sackgasse” published in 1930.

¹¹“Die gesamte Sozialstruktur einer Gesellschaft, ihre Lebensordnung ist eingebettet in den gesamten Kausalablauf, ist einerseits als Reiz, andererseits als Reaktion anzusehen” (Neurath 1931a/1979, 206).

higher quality of life,... If we possessed complete knowledge of the central nervous system we could be able to penetrate into this 'innermost' shell" (1925b, 418). These formulations are an expression of Neurath's occasional leanings towards materialist behaviourism. On a more general level, Neurath recognized principal unpredictability and rejected epistemological fundamentalism and determinism (Uebel 2006). Judging from the viewpoint of economics, it appears to be impossible to construct a causally completely determined closed system with no scope for discretionary choice of individual and collective actors.

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Socialization Concepts of Non-socialist Economists in Austria: Karl Pribram, Gustav Stolper, Joseph Schumpeter



Günther Chaloupek

1 Socialization as Central Idea for a Post-war Economic Order

Towards the end of World War I the conviction that a fundamental change of the social and economic order would be a necessary consequence of more than four years of war propagated among political circles.¹ During the war, the working class had made the majority of soldiers in the field, and the civil population had severely suffered from impoverished living conditions at home. The production system of the domestic economy had been transformed into a centralist organization geared towards the needs of warfare. Among the traditional social elites who had controlled the political system before the war there was a growing awareness that a return to the political and social status quo ante was unrealistic.

When the war eventually came to an end, a revolutionary mood had taken hold of a growing part of soldiers returning from the front to join the work force. The working class demanded fundamental changes of the political, economic and social order. Above that, the example of the Russian revolution and its possible spread to Germany and Austria had contributed to a growing willingness on the part of the ruling classes to make concessions to the working class and to seriously consider the demands of its political organizations, the Social democratic party and the trade unions.

¹ An impressive document of this change of minds is Rathenau (1917).

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When the Social democratic parties of Germany and of the newly founded Austrian state² came to power at the end of 1918, and for brief periods dominated parliaments and governments of these countries, the idea of “socialization” was the central concept of the economic policy debate. In contrast to the Bolsheviks in Russia, German and Austrian Social democrats were determined to maintain the system of parliamentary democracy and the rule of the law. Hence, changes in the economic and social order would have to be enacted and implemented on the basis of decisions of the parliament.

In a wider sense, socialization meant that some form of control of the state or representative institutions of society (trade unions and business associations, consumer cooperatives, other types of cooperatives) would replace the pre-war type of the liberal market economy. For the Social democrats the transfer of ownership of part of the private enterprises was an essential element of socialization, to be brought about by orderly legal process. They thought of partial socialization, hardly of socialization of the private economy as a whole, which was at most considered as a long term goal.

In general, Social democrats in both countries were not well prepared for putting forward concrete and workable proposals for such changes,³ due to their close orientation towards the teachings of Marx and Engels, who had displayed a strong distaste for any “utopian” attempts to devise a blueprint of the type of economy which they expected to succeed capitalism. In Austria the debate about socialization was dominated by a concept presented by Otto Bauer⁴ in his pamphlet *Der Weg zum Sozialismus* (the road to socialism). As its most important part, this concept included a concrete model for the management of socialized enterprises. It indicated priorities for the transfer of ownership (big enterprises of heavy industries and mining, large forests of the state and nobility, banks). It said only little about coordination and governing institutions at the level of the economy as a whole.

In this respect, most concrete proposals how to proceed with socialization came from non-Marxist socialists or even bourgeois authors. The most prominent example of the latter is Walther Rathenau’s influential pamphlet *Die neue Wirtschaft* which was published in early 1918, well before the end of the war.⁵ British guild socialism also figured prominently in the socialization debates in Austria and in Germany. Although hardly compatible with Marxist economics, it was attractive for Marxist

²The first Austrian parliament had almost unanimously voted for unification with Germany, since in its drastically reduced size Austria was not believed to be an economically viable entity. Therefore, the provisional nature of the Austrian state (called Deutsch-Österreich) was the prevailing understanding until the peace treaties of Versailles and Saint Germain prohibited unification.

³For a comprehensive account of concepts for socialization in Austria (including detailed comparisons to the debate about socialization in Germany see Weissel (1976).

⁴Otto Bauer (1881–1938) returned to Austria from captivity in Russia in 1917. He became deputy chairman of the Socialdemocratic Party in 1918. He was foreign minister of the coalition government (with the Christian-social Party) until June 1919, and chairman of the Austrian commission for socialization.

⁵Rathenau had first developed his main ideas in highly emotional literary prose style in his best-selling book *Von kommenden Dingen* (1917). For a detailed account of Rathenau’s economic thinking and its roots in social philosophy see Chaloupek (2016b).

economists such as Rudolf Hilferding⁶ and Otto Bauer, who adopted it as part of their socialization strategies. Parts of it were also suitable for inclusion into bourgeois socialization concepts.

From a Marxist perspective, a socialist economic system remained the final goal of the socialization process. Yet, the lack of detailed concepts, the dramatically deteriorating economic situation and increasing political instability paralyzed political action towards this goal. From a practical perspective there were two urgent fundamental problems for which the new democratically elected governments and parliaments of Germany and Austria had to find solutions: the transition from war to peace-time economy; and the increase of the economy's productivity and effectiveness in order to maintain minimum living standards and to cope with the enormous financial burden which the war and—in the case of Germany—the obligations of the peace treaties of Versailles and Saint Germain had imposed on the German and the Austrian economy.

2 Socialization Without Transfer of Private Ownership: Karl Pribram and Gustav Stolper

2.1 Karl Pribram's Vision of a Wirtschaftspolitik der Zukunft (Economic Policy for the Future)

Karl Pribram's⁷ pamphlet appeared before the end of World War I, supposedly in the first half of 1918, in the series "*Zeitfragen aus dem Gebiete der Soziologie*", which had also published Schumpeter's *Krise des Steuerstaates*.

Pribram expected that "liberalistic⁸ individualism, at least in Central Europe, will hardly be the relevant approach for the order of the economy in the coming peace time" (Pribram 1918, 47). He thought that in the organizational framework of the war economy some of the basic principles had been developed and tested in practice which could be applied in the time after the war. Like state socialism, administrative controls and distribution of foodstuffs and raw materials "intend to replace (individual) purchasing power as regulation mechanism by planful provision

⁶See his sympathetic introduction to Cole (1921).

⁷Karl Pribram (1877–1973) is known among economists as author of the voluminous *History of Economic Reasoning* (1983), published posthumously in 1983. Born in Prague, he studied under Carl Grünberg at the University of Vienna. After habilitation, he was appointed to extraordinary professor in 1904. Until 1921, he held positions in civil service in several ministries in Austria (monarchy and republic). As expert for social policy, he received a call from the ILO (International Labour Office, Geneva) in 1921. In 1928 he was appointed to an economic chair at the University of Frankfurt. As a Jew, he emigrated to the USA in 1933.

⁸The German word *liberalistisch* which Pribram used is uncommon in German. He used it for *liberal*, probably because he felt that the latter did not sufficiently convey that he meant *liberal* in the sense of Smithian economics.

of the urgency of needs” (Pribram 1918, 31). For that purpose, the war economy’s system of controls relied on an apparatus which had been established mostly by the enterprises themselves: firms of certain branches of production had been organized in compulsory associations, which had been put in charge of apportionment of raw materials under the supervision of public authorities. What Pribram finds indicative is “that the idea of compulsory organization puts those associations of enterprises into its service which have come into existence as free organizations of the economy. The cartels were capable of providing the best groundwork for organizing the distribution of raw materials and state provision for basic needs. What self interest has created is put to the service of the state” (Pribram 1918, 20).

In view of the problems of transition from war economy to peaceful conditions, and taking into account the burden of an excessive public debt, continuing shortage of food stuffs and raw materials, and the threat of social upheavals, Pribram envisaged the rise of a new meaning of economy “which would reinforce existing tendencies towards planned control of economic life” (Pribram 1918, 46).

A comprehensive framework of associations would form the institutional basis for control of the production across industries, while at the same time private ownership of firms would be maintained. Such a framework would also be the consequence of the expected change in external economic relations which would cease to be in accordance with the liberal spirit that shaped the pre-war international economy. The struggle for survival on international markets would be no more entrusted to “the economic power of the individual competitor, who would have state power at his disposal if acting in the national interest” (Pribram 1918, 52).

In order to maintain the interest of the national economy as a whole state influence would have to extend to the organization of trade unions as well, “which no more develop outside the sphere of state activity. And yet, there would not be unrestricted state power. The (state’s) effort for control and regulation of the economy will be built on the participation of associations whose decisions would have to be the resultant of the particular interests of all participants” (Pribram 1918, 56).

2.2 *Gustav Stolper*

A similar structure of industrial associations was envisaged by Gustav Stolper⁹ as a basis for an economy in which the state would exert a higher degree of control compared to the pre-war economy. In his book *Das mitteleuropäische Wirtschaftsproblem* (The economic problem of Central Europe, second edition published in November 1917) he had argued that a return to the “old economy (pre-war economy) and to the old relationship between state economy and individual economy” was out

⁹Gustav Stolper (1888–1947) joined the editorial staff of the influential Viennese weekly periodical *Der österreichische Volkswirt* in 1911. He advanced to co-editor in chief (together with Walther Federn) in 1914. Stolper also published several books during his period of editor in chief of the *Volkswirt*. In 1925 Stolper founded the *Deutsche Volkswirt* and moved to Berlin. As a Jew, he left Germany after the Nazi takeover in 1933 and moved to the USA.

of question, given the increased power and self assertion of popular masses (Stolper 1917, 83f). Unlike Pribram's brochure, Stolper's book *Deutsch-Österreich als Sozial- und Wirtschaftsproblem* (German-Austria as a social and economic problem) dealt with the new situation with which the German speaking part of Austria, which had been the heart of a major European power, was confronted. The book is a collection of articles which had appeared in the weekly journal *Der österreichische Volkswirt* during the hot phase of the debate. When it was published in 1921, the debate about socialization was well behind its peak of 1919/20.

Stolper argued that it had been a "tragic error of socialism ... to fight against institutions like private ownership which were deeply rooted in society's patterns of thinking, instead of transforming them. The road to socialism does not lead to the abolition of private ownership, but to the transformation of production and distribution by organs of society" (Stolper 1921, 311). Private ownership should be maintained, the command economy should be dismantled after the war. But the free market economy would inevitably fail in two respects: "It will not be capable of establishing balance between imports and exports. Likewise, an equitable distribution of the insufficient production of goods will be impossible." Moreover, Stolper doubted that reconstruction of the economy on the basis of the existing system would be possible "in order to ensure humanely conditions of living for the popular masses" (Stolper 1921, 272). Hence, economic policy in the newly founded Austrian republic faced two principal tasks: to regulate external trade, and to ensure an adequate supply of consumption goods for the masses of population. Stolper calls for "courage for new forms of organization of social life ... to be built upon active support of existing social powers, not against them" (Stolper 1921, 276). This presupposes to set up a comprehensive structure of organizations, with an "economic parliament" at the top of the system of associations of producers in all industrial branches.

As supreme goal of economic policy Stolper calls for the greatest possible increase of productivity and production, by which both the fulfilment of just social demands and a consolidation of the state budget could be accomplished. In the "future social state" (*der soziale Staat der Zukunft*) the "increased wealth of society will no more accrue to a privileged social class", just like this state "will no more withdraw from the control of the production process." Stolper thinks that a debate, like the one going on in Germany whether this amounts to a "planned economy" (*Planwirtschaft*), was unnecessary. In any case, Stolper rejects the opinion that "a planned economy can be created." "Only lack of both historical sense and respect for the infinite variety of life can produce the belief that the modern economy, which is the most complicated manifestation of the social being, can be forced into a predesigned course; that will and knowledge of a single or a carefully composed 'council' can ever substitute for the will and knowledge of all those millions who have to struggle for life under their own responsibility" (Stolper 1921, 308f).

2.3 *Origins and Parallels*

Both Pribram's and Stolper's concepts for a future economic order bear similarities to Walther Rathenau's influential pamphlet *Die neue Wirtschaft*. The concept proposed therein is a combination of the German cartel organization and British guild socialism. In one of his central propositions Rathenau followed the ideas of pre-war German state socialism¹⁰: that it is the task of the state to take charge of the organization of production as well as of income distribution. In their economic substance, Rathenau's proposals aimed at a maximum increase of productivity through a comprehensive program of rationalization, which would be implemented through the organizational structure of the war economy which would continue in modified form after the war. A common collective will, formed and executed by the state, to which the decisions of all individual actors had to be subordinated, should penetrate economy and society. With respect to the problem of coordination of decisions among productive units, Rathenau relied on a concept provided by British guild socialism. Rathenau proposed the formation of associations of production establishments for all branches of the industrial sector of the economy (*Berufsverbände*). These associations would serve as agencies through which production and investment would be organized within a comprehensive overall national plan.

In comparison, neither Pribram nor Stolper developed their ideas in such detailed and comprehensive form. If, in various aspects, they would not go as far as Rathenau, their proposals pointed in the same direction. They also concurred with Rathenau whose ultimate aim was not a socialist economy with the state or workers' ownership of enterprises, but rather to preserve private ownership within a "Mixed Economy", in which the state was entrusted with setting principal goals for income distribution and allocation of resources between branches of production and broad categories consumption and investment, with overall coordination and control of economic institutions. Also, like Rathenau, Pribram and Stolper were convinced that private ownership of the means of production would have to be maintained in the interest of personal freedom and also as the driving force of economic dynamics. It stands out to the modern reader that Pribram's and Stolper's style of writing is not soaked with pathos as Rathenau's with his enthusiastic glorification of the state.

Pribram's booklet appeared before the dissolution of the Habsburg monarchy. Therefore, it is not concerned with the massive problems with which the newly founded residual Austrian state was confronted in consequence of the protectionist policies of the other succession states. The discussion of the related problems occupies a major part in Stolper's book.

¹⁰As represented by Adolph Wagner and, before Wagner, by Carl Rodbertus—Chaloupek (2016a).

3 Schumpeter's Position on Socialization

3.1 *In Theory*

Joseph Schumpeter's contributions to the debate about socialization refer to what he saw as the errors of the organized capitalism-type of concepts, and more fundamentally, to the questions of private ownership and central coordination of production. Against the socialists—Marxist and non-Marxist—he emphasized, that the true meaning of socialism consisted in “the idea of a *conscious* economic plan for the economy as a whole, whereas it does not mean the substitution of anarchic chaos through profit seeking by planful cooperation”; nor is it correct that “in the socialist commonwealth the economy serves the needs of society as a whole, whereas in the competitive market economy it serves private interests. If the stimulus of individual profit seeking is the driving force of competition, it is the social result of all profit incentives that market competition serves the interests of the whole population, just as does production in the socialist state” (Schumpeter 1921, 460).

He was convinced that the difficult situation of then capitalist economy caused by the war could be coped with by conventional methods within the existing economic order, which he did not consider outdated. Hence, Schumpeter vehemently opposed Rudolf Goldscheid's view of “the end of the tax state.” Whereas Goldscheid argued socialization was inevitable because tax revenues would no more suffice to service the huge public debt accumulated during the war (Goldscheid 1917/1976), Schumpeter (1918/1976) thought that the problem could be solved by inflation and conventional financial methods.

Moreover, Schumpeter rejected the argument that reconstruction and transition to a peace economy necessitated a new economic order. “If, in our time, socialism would be necessary and feasible, this would not be because of the collapse, but despite it. With respect to economic realities, these events put popular demands at a greater distance to concrete possibilities of socialization. If, at the same time, political chances for socialization increase, this is a temporary phenomenon, but, above all, a deep tragedy” (Schumpeter 1920/1921, 500f).

Schumpeter also strongly opposed the view that central control was necessary for rationalization of production. He called the examples which Rathenau had used to demonstrate the wastefulness of competition as “typical lay stereotypes.” If inexpedient methods are used in the competitive economy, they are “either remnants of the past or consequences of state interventions.” Seemingly unproductive expenditures for promotion of sales and advertising serve a useful purpose, they even lower costs (Schumpeter 1920/1921, 456f). In contrast to Stolper, Schumpeter pleads forcefully against regulation of foreign trade and capital movements. As he had emphasized in many public lectures during his time as minister of finance,¹¹ Vienna had to recuperate its pre-war position as central place of international trade and finance. Austria

¹¹ Reports on Schumpeter's public lectures in Viennese daily newspapers are reprinted in Schumpeter (1992).

had “to adopt a position of unrestricted external and internal free trade.” This would suffice that the harassments undertaken by the succession states “are washed away” (Schumpeter 1920/1921, 506).

Towards socialization and socialism, Schumpeter’s carefully formulated general position was as follows.¹²

We want to speak of true socialization, i.e. in the sense of a change of an economy which rests on private property and private initiative into a socialist economy, i.e., an economy in which the central organ has power over all means of production, works out and executes a social economic plan including the distribution of the final consumers’ goods to the individual citizens. The word socialization could in this sense signify either a slow historic process or a conscious political action directed towards this aim. But such a political action can be successful only if a historic automatic process which is inherent in things themselves has already started, when the social development steers by itself to socialism. We owe this insight primarily to Karl Marx. It distinguishes scientific from utopian socialism, i.e., that socialism which recognizes what it wishes to see as a necessary development and hence possible, from the other socialism which expresses nothing but human yearning for paradise. (Schumpeter 1920/1921, 458f)

With regard to the specific situation in Austria and in the German Reich Schumpeter stated that any socialization would be “untimely” (*vorzeitig*).¹³ In itself, this does not imply that socialization should not be undertaken, but it would have a price in delayed economic reconstruction. In Germany, where industry and banking were already heavily concentrated “intensive organizational efforts have been made in past decades (formation of cartels, G.Ch.) that can be effectively used as preparation for socialism.” Above that, “habituation to organized action, and especially to organized obeying (*organisiertes Gehorchen*) and a more deeply rooted devoutness to the state provide for more promising conditions (Schumpeter 1920/1921, 501f).

In Austria, matters are less favourable, mostly due to the essential function of Vienna, “which calls for a purely capitalistic policy which was *communis opinio* in the era naive of liberal capitalism.” However, the situation at the time of the collapse of the Habsburg monarchy was different. “In those days, one had to reckon that an orderly and lawful socialization would be inevitable, and the lesser evil under the given circumstances. In particular, a combination of limited (i.e. partial, G.Ch.) socialization measure and free market economy for all non-socialized establishments would have been possible. In general, socialization and free economy are not opposed to each other as much as petty bourgeois and intellectuals tend to believe” (Schumpeter 1920/1921, 506f).

¹²For a comprehensive account of Schumpeter’s position on socialism, including his later works, especially *Capitalism, Socialism and Democracy* (1942) see Stolper (1994, Chap. 9). The translation of the following paragraph from Schumpeter (1920/21) is taken from Wolfgang Stolper’s book (126). All other translations from Schumpeter’s essay are my own.

¹³As opposed to what he termed “premature” (*verfrühte*) socialization (p. 473), obviously the case of Bolshevik Russia.

3.2 As Protagonist in the Political Sphere

That Schumpeter had strong aspirations to move into politics from his chair at the University of Graz becomes evident from his political memoranda addressed to governmental circles in which he tried to offer his advice on various political and economic questions during the war.¹⁴ The hour for Schumpeter the politician stroke in January 1919, when he was appointed to the German Socialization Commission. He withdrew from the commission on 15th March 1919, upon his appointment to minister of finance of the second government of the newly established Republic of Austria (more precisely: *Deutsch-Österreich*), from which he resigned in October of the same year.

The first report of the German commission of 15th February which was decided on with the consent of Schumpeter is a political document full of theoretical considerations.¹⁵ On the issue of socialization of the German coal industry, the report discards mere “nationalization”, which would simply result in the creation of a bureaucratic state enterprise, and also the syndicalistic solution of transferring power to the works councils of the mines. Instead, it recommends the creation of “an organization in which the initiatives of the managers and the work moral of the workers have the widest possible play” (Stolper 1994, 208). But the report does not include a concrete outline of an organizational structure of the new type of enterprise.

The Austrian Parliament passed a law on “preparation of socialization” in March 1919, through which a socialization commission was established. The commission was chaired by Otto Bauer, then foreign minister, who had proposed a socialist concept in his pamphlet *Der Weg zum Sozialismus*. With his model for the management of socialized enterprises Bauer had preceded the model proposed by the German commission which actually had taken basic ideas from Bauer. The Austrian socialization commission produced several draft laws concerned with the procedural and institutional aspects of socialization, of which only the *Betriebsrätegesetz* (works council act) gained real importance in practice (until today).

At that time, Schumpeter stood behind the idea of socialization, as he made clear in one of his public speeches: “We will have to intervene deeply into the private economy, to the point, where nobody stands left of us. But for the part of the economy which is not socialized we have to guarantee full freedom of action. There are two possibilities for reconstruction: free enterprise or socialism. I must warn that oscillation between the two principles is untenable” (Schumpeter 1992, 96). This seems to imply that Schumpeter would have endorsed partial socialization measures in the phase when unrest among the working class was at its peak (until the end of July 1919, see Sect. 4). He thought that through socialization, if carried out in the appropriate form as described in the above-mentioned report of the German commission, could be successful by channelling and transforming the revolutionary fervour of workers into a collective working moral of the workforce of the socialized

¹⁴Three memoranda with addressees unknown survived only by chance and were published in Schumpeter (1985).

¹⁵The following is based on Stolper (1994, 202ff).

enterprise. When the revolutionary mood evaporated towards the end of the year, the essential condition for an effective socialization vanished. This is reflected in the sceptical position which characterizes Schumpeter's position in the 1920/21 article.

As finance minister, Schumpeter was sharply attacked by Bauer and other Social democrats for having sabotaged the socialization of the Alpine Montan AG, Austria's largest iron and steel company, which they had envisaged as candidate for socialization. As it appears from various testimonies, Schumpeter had knowledge of the sale of a major part of the shares to an Italian consortium, which he had neither initiated, nor could have prevented by bureaucratic means. Recent assessments of Schumpeter's role in this matter (März 1983, 153; Stolper 1994, 268ff), which was the final cause of his withdrawal on 19th October 1919, have concluded that accusations of betrayal are unfair and unjustified.

4 The End of the Socialization Movement

The idea of socialization enjoyed strong support from the popular masses of the urban working class immediately after the end of the war, when the workers in the armament industries faced the threat of losing their jobs, and when masses of soldiers flooded back from the front and joined the workforce, causing a sharp increase in unemployment. In addition, there was political pressure from outside. For a few months, Austria found itself between two political revolutions: the communist soviet republic in Hungary between March and July 1919, and the short-lived *Räterepublik* in Bavaria in April/May. The Austrian Social democrats resisted the pressure from the revolutionary forces of the neighbouring countries to join in their revolutionary adventures.

In an article published in 1921, based on the author's experience as head of the legislative department of the ministry of social affairs, Karl Pribram analyzed the development during the critical months. He showed how a wave of social policy measures, such as the introduction of a state financed unemployment insurance and the reduction of working hours, the establishment of works councils and chambers of labour, and a variety of other measures succeeded in ensuring at least a minimum living standard for the unemployed, in reducing unemployment and adjusting money wages to running inflation. The measures were also designed to strengthen the position of trade unions both as a political power and at the plant level. As anti-revolutionary force, the Social democratic party, in close cooperation with the trade union movement, undertook the relevant initiatives in government and in parliament, where the non-socialist parties (Christian social party, German national party) together had the majority of votes. But under the impact of strong pressure from the streets, and out of fear that revolution might spread to Austria, they were willing to make substantial concessions. As Pribram notes, the overwhelming part of the social policy laws were enacted during the period from the end of the war until July 1919, with ensuing consolidation phase until 1920 (Pribram 1920/1921, 616f).

As delegate of his ministry Pribram participated in the deliberations of socialization commission. In the article he does not abstain from expressing his satisfaction that the works council act had helped to soothe revolutionary sentiments at the plant level, while other legal provisions for implementation of specific socialization measures remained ineffective. In an article of 1917/18 Pribram had expressed his disdain for collective “German nationalism”, while his sympathies belonged to “British individualism.” Hence, the overall prospect of his 1918 pamphlet must have been hard to accept for him: that there would be no return to the individualistic liberalism of the pre-war political culture in Austria. Obviously, he felt relieved that the socialization debate had not resulted in a framework of state control over the private economy which he had considered inevitable in 1918.

Even, he seems to have suppressed memory of the little brochure *Wirtschaftspolitik der Zukunft*, because it was not included in the list of “works by Karl Pribram” in the appendix of his posthumous *History of Economic Reasoning* (1983, p. 737f). In a similar way, Gustav Stolper may have felt some unease about his intellectual concessions to socialism in the articles in the *Österreichischer Volkswirt* of which his book of 1921 was composed, and which appeared when the socialization debate was expiring. In the biography written by his widow Toni Stolper the best-seller among Gustav Stolper’s books does not show up in the list of his publications (Stolper 1960, 488).

In this respect, Schumpeter was different. Schumpeter’s position towards socialism is ambivalent, it may even be seen as contradictory in itself, but he never regretted his positive attitude towards socialization after World War I. Large parts of his most famous book *Capitalism, Socialism and Democracy* can be read as elaboration of the major theses of his 1920/21 article.

The debate about economic planning that emerged during the Great Depression (Chaloupek 1987, 420f) is a partial revival of the socialization debate of the years 1918f. Before that, Hilferding (1972) had proposed a concept of Mixed Economy, which provided for control of the economy by the state or tripartite institutions of society, with the supply side as starting point. Eventually, this turned out to be a blind alley. It was only through Keynes’ *General Theory of Employment, Interest and Money* that the concept of Mixed Economy obtained a solid foundation, with demand management as central idea.

In Austria, as well as in Germany, hardly any concrete measures of socialization were effectively carried out after World War I. Rather, it was a by-product which turned out to be the lasting effect of the socialization movement: the social policy laws which were enacted within few years after the war to satisfy the existential needs of the working population. This legislation which helped to neutralize radical political demands established important foundations of the welfare state of the 20th century.

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From Socialisation to Regulation— The Secularisation of Dutch Social Democracy



Andries Nentjes

1 Introduction

For many in Europe the end of the Great War in November 1918 must have felt as the upbeat to the great socialist revolution. In Russia indeed it was. Revolutionary outbreaks in other countries didn't catch. In Germany the transition from empire to republic was not followed by structural political economic change. In The Netherlands Pieter Jelles Troelstra, the leader of the Social Democrat Labour Party, proclaimed on November 12, 1918 in Parliament that the government had lost the right to see itself as pursuing the interests of the people. The Social-Democrats were entitled now to grasp power. The reaction came within a week. A great manifestation in the Hague where queen and crown princess appeared in their carriage. Enthusiasts unyoked the horses and pulled the royals in their coach around under loud cheers of the assembled mass.

No participation of Socialists in government until 1939. It did not hinder the discussion within the Social Democrat Labour Party (SDLP) on the socialist society that certainly would come some future day and on how to speed up its arrival. This chapter tells how those notions evolved during the interbellum and seems to have come to a halt in the first years after World War II. The story leans heavily on the reports that were published on behalf of the SDLP in 1920, 1923 and 1935 plus the first report for the Labour Party, the successor of SDLP, in 1951 (S.D.A.P. 1920, 1923, 1935; Partij van de Arbeid 1951). The focus is on the intake of new views on the road towards true socialism, the rejection or silent disappearance of older ideas and the internal consistency of the social democrat blueprint.

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2 The Lean Marxism of Dutch Democratic Socialism

The Social Democrat Labour Party in the Netherlands (SDLP) was established in 1894 by dissidents who had left the Social Democratic Union, in existence since 1881. The break occurred after the majority of Union members had rejected participation in parliamentary elections. In its inception the SDLP was a no to political anarchism. Neither had the party sympathy for syndicalism, which it disqualified as ‘group anarchism’. The aim of the new party is to grasp the power by working towards a majority in parliament (Dullaart 1984, 57). The first manifesto of 1895 is orthodox Marxist and a copy of the Erfurt programme of 1891 of the Social Democratic Party Germany (Tromp 1981, in Tromp 2012, 101).

The theoretical part of the Erfurt program, written by Kautsky, is a commitment to Marx’s propositions. The concentration of capital will increase, class struggle will grow more and more intense and small enterprises will be destroyed by the competition of big enterprise. The exploitation of the proletariat will intensify over time, the contradiction between the private property of the means of production held by the few and the effective use made of those means by the many will be increasingly sharp. Reforms should be forced in preparation of the revolution that will bring the socialisation of the means of production.

After revisionists, such as Eduard Bernstein, make themselves heard in Europe, the SDLP takes a turn towards the revisionist or reformist side. The orthodox Marxists step out in 1909 and form a new party, from which the Communist Party Holland will emerge. Within the SDLP a substantial part of the Marxist orthodoxy, such as the labour theory of value, went overboard in the first decades of the twentieth century, without causing real upheaval within the party. Fundamentally, only the theory of concentration of capital in increasingly large production units and the theory of centralisation of private property of those production units in the hands of a decreasing number of owners survived as the hard core of beliefs, together with the theory of the decreasing rate of profit and the under-consumption theory to explain the capitalist crisis (Dullaart 1984, 66).

In 1912 R. Kuyper, one of the most important theorists of the SDLP, raises doubt about Marx’s prediction of increasing misery, due to increasing unemployment caused by capitalists who substitute (constant) capital for labour (Kuyper 1912). In fact such a trend in the reserve army of unemployed workers has not been observed. Kuyper is supported by van der Waerden (1928). Referring to England in the 1920s he argues that the reverse is true, absence of rationalisation will lead to loss of competitiveness and unemployment. In a reaction, Wibaut, an outstanding SDLP member, lets know that for him and for many socialists increasing misery is not the necessary road to the new society, and much more so not the ideal road. Socialism will come along ways of reasonable insight, not of unreasonable violence (Dullaart 1984, 63–64).

Wibaut made his name and fame as alderman of Amsterdam in the two decades around 1920. He was also one of the leading figures in the SDLP and a thinker who, although inspired by Marx, tried to detect for himself how the capitalist system

evolves. His book on trusts and cartels, published in 1903, has become a 'classic' in Dutch socialist literature (Dullaart 1984, 64). In Wibaut's vision, long term collaboration between firms enables businesses to enlarge their scale, which raises their productivity. Cooperation also reduces market uncertainty and brings the certainty of steady future sales that makes firms willing to do the necessary large investments. Cartels and trusts are created by firms that try to protect themselves against the decreasing rate of profit engendered by the reigning system of production. Legislation to stop such actions is of little avail.

In a further development of his views Wibaut predicts that once the practices of cartels and trust come in the open, the public will demand public control of the price policy of the power structures. The outcry will give the political push to create public institutions (organs) that have the authority to sack the firm owners and take charge themselves. Wibaut welcomes such a development. About the moment of the great transformation he quotes Marx's "when the time is ripe", under the presumption "that people once will become reasonable" (Dullaart 1984, 65). Apparently he foresees a peaceful system change.

3 1920, the Socialisation Question

From its start in 1909 on the SDLP went for the political power needed to use the State itself for the transformation of the capitalist economic system of the Netherlands into an economy based on State socialism. On that long road towards full socialism the State should function as a catalyst to speed up and strengthen the technical and economic developments that lead up to the end of capitalism and the transition from private property to communal ownership of the means of production (Dullaart 1984, 67).

In 1920 a party committee, chaired by Wibaut, in which the two proponents of a lean Marxism, Kuyper and van der Waerden also participated, brought out *The Socialisation Question* (*Het Socialisatievraagstuk*), a report on the road to go from the reality of present capitalism towards the future socialist society. The message is that the breakthrough to full socialism will certainly come, but that the road will be long and the system change a gradual process. The committee has coined for it the word socialisation, fully, socialisation of production. Socialisation then is bringing about the termination of private property of the means of production in a gradual way. It will proceed in stages, depending on the degree of concentration of firms in the various branches of industry. "The house of society must be reconstructed rigorously, while we continue to live in it" (*Socialisation Report*, 9).

Socialisation is demanded in the first place because it is the only possible way to end the waste of productive power under the capitalist anarchy. The optimal size of a business is only by exception approached and then only for making profits that fall in the hands of a small group of owners (*Socialisation Report* 8, 187). Waste is in particular evident in the high costs for marketing and the distribution of goods, due to the non-optimal degree of concentration (*Socialisation Report*, 187).

As a second major reason for socialisation the Report mentions the wish to restrict income that is received without doing labour. Basically the passive owner is maintained by the labour of other people. By letting 'labourless' income disappear, the productivity of society will rise. Further socialisation is in the interest of consumers, of whom the interests are contrary to the interest in profits of private firm owners and it is also demanded by the workers who detest to give their labour power for the profit of the capitalist entrepreneurs (Socialisation Report, 187).

Thanks to the full exploitation of economies of large scale production, termination of the sheer waste of capitalism and next to that the labour input of the formerly non-working members of society, socialisation is bound to raise productivity and by that to improve the standard of living for all. Higher productivity of labour is also to be expected from the greater interest workers will have for the production process.

On top of the list of businesses that are in for socialisation stand the capitalist monopolies and branches of industry that are highly concentrated. That is because of the power they exert over consumers and also because the difficulties of socialisation are smallest. On the second place comes the triad of coal production, the transport sector and generation and distribution of electricity. They are the necessary base for economic development. In the third group are the firms that provide for basic necessities of life, production of human nutrition, house building, production of building materials, manufacturing of clothing and footwear, including the trade supplying all those goods (Socialisation Report, 188). In agriculture the nationalisation of land is recommended. The larger agricultural firms can be brought under management of the community while the smaller businesses will be leased to farmers for private exploitation. Nationalisation of banking is seen as unnecessary. Private banking will simply disappear once the non-banking sectors are under community control, since there will be no need for the services of private banks, which basically is bringing lenders into contact with borrowers.

Once the socialist society has been established it should be avoided at all costs that the socialized firm will go to pursue group interests. When the workers get a too strong influence on the decisions of the firm they will neglect the consumer interest, similar to the behaviour of the old time capitalist. It is a major reason to reject syndicalism and producer cooperatives, the factory should not go to the workers but come under the control of the State.

The Socialisation report gives the workers of the public firm only a limited indirect influence. The personnel can vote representatives in Group Councils that monitor the labour conditions, safety measures etc. and advise on performance standards for the specific group. From the Group Councils a Personnel Council is formed that also advises on those matters. The labour conditions are established in consultation between the public firm's management and trade union.

The Socialisation Report allows the socialised firm large independence in its economic decisions on inputs, outputs and prices; basically not different from the flexibility the private firm has under capitalism. The transition to communal ownership will change the motivation from production for profit into provision in needs. Although not mentioned explicitly it is evident that the public firms will operate on markets where they buy their inputs and sell their outputs. So there are markets for

consumer goods where workers and other consumers buy the goods they need. To do so they must have a wage income paid by their employer. In the first two decades of the twentieth century and under the pressure of trade unions a system of collective wage negotiations, supported by new labour law, had developed in The Netherlands. Implicitly the report takes for granted that it will be continued in the system of market socialism.

I presume that another implicit assumption is to let the public firms function in a way similar to the non-profit State firms that already did exist in 1920, such as the post and railways. The revenue from selling output has to be sufficient to cover the cost. Actually such an organisation of pricing under socialism was proposed more than a decade later by Morreau (1931). One can read it as a belated reaction to the criticism of Mises (1920) that in a socialist economy capital and land are property of the community; they are not exchanged and there are no markets where their price is formed. Essential knowledge for making efficient investment decisions is lacking. Morreau (1931) argues that under socialism interest and profit are not allowed to exist, so they will not be included in the costs of production on which the price of the goods is based. Increase and decrease of inventories of the goods will function as signal that production has to be adjusted. Morreau admits that for perishable goods and service the inventory signal will not work and he suggests other signals such as notifications of public or workers in such firms to the Economic Council. As for investments, capital formation is financed by taxes and determined by the government decision about their level. Among the critical reactions is a comment of Tinbergen (1937), himself SLDP-member, who points out the inventory mechanism will not work if the production is time consuming such as in ship building, coffee and rubber culture.

The Socialisation Report wants the wage to be related to performance, with a minimum and a maximum to its level; and firm managers should be salaried well in order to attract the best. The Report also states very explicitly that political interference from above should be avoided; only a right to annul firm decisions that are of great importance for the community is admitted to the government. Within the firm the Daily Board is monitored by a 'Council of Management and Supervision' that also gives indications for the firm's general policy. The members of the Council have to come from outside the firm, but be competent. They are appointed by Parliament on nomination of the Minister under whom the branch of industry resorts. The Minister is also the Chairman of the Council of Management and Supervision.

At the national level a General Economic Council will be installed to replace Parliament in matters of socialisation. In the Council representatives of Parliament, directors of socialized firms and of the organisations of technicians, labourers and consumers have a seat. Presided by the Minister of Industry the Council draws up general rules for firm management (depreciations, reservations), brings equality in the labour conditions in socialized firms, advises which firms are in for socialisation, establishes institutes for systematic improvement of technology, gives indications for the shares of production for inland use and export; it also entertains international relations. As socialisation extends in time the Council will increase in importance as regulating organ of economic life.

Given the belief of Social Democrats in the efficiency of large scale production, the observer expects that in the socialist market economy many markets will have an oligopolistic or even monopolistic market structure, which might give rise to market power. However, since markets and how they function are not discussed in the Socialisation Report, market power and its potential abuse in markets for output, such as consumer products, remained out of sight. So, the Social Democrats seem to find no fault in the market system in itself, based as it is on the idea of exchange of efforts. The root of all evil is individuals going for maximum profit in combination with economic power based on private property of the few. Make property communal with the objective to produce not for profit while (I suppose) costs have to be covered by revenue from sales, and the market will work as it should.

If there were readers who had hoped to find in the Socialisation Report indications for how to proceed on the long road towards full socialism in those situations where straightforward nationalization is not opportune, must have been disappointed. The Report has not much to say about the issue. It makes clear that obstacles against nationalization arise when in a branch of industry the firms vary in size from large scale to small scale businesses and the goods they produce are varied in type since normalisation and specialisation have not yet proceeded to what is economically feasible.

A reference is made to *The Road to Socialism (Der Weg zum Sozialismus)* by the Austrian Marxist Otto Bauer (1919), who proposes to let the firms participate in an association per branch of industry, managed by a Board whose members are nominated partly by the State, partly by the consumers, partly by the personnel and partly by firm owners. The association's Board should work towards normalization and specialisation of the individual firms with the aim to realize mass production. It has the authority to concentrate production in the best firms and to shut down the laggards. Further tasks of the Board are the purchase of raw materials, sale of output and setting product prices as well as concluding the collective labour contracts. Along this road production is concentrated stepwise in preparation of the moment of full socialisation (Socialisation Report, 30–32).

An alternative first move towards full socialisation is establishing a price setting public firm of a sufficiently large scale that engages in competition with the private firms in a branch of industry. The communal firm will function as a training ground for learning how to manage a firm with great expertise and will also serve to break price agreements between private businesses, which will have strong propagandistic power. Simultaneously such an efficient public firm will eliminate private firms that stay behind in efficiency, thus working towards a structure where full socialisation in a later stage is more easy (Socialisation Report, 32–34). As a third form of partial socialisation for the transition period, community participation in the capital of private firms is mentioned and extending the influence of the community in the course of time. A reference is made to such a praxis in many German municipalities.

In short, around 1900 the Social Democrats had the belief that in the process of ever increasing scale of production the capitalist economy of the Netherlands was evolving towards a market structure of competition between the few. In some branches of industry no more than one firm might survive. The State can speed up

the process of concentration by taking part in the formation of capital that leads to ultimately its full socialization. In the socialist market economy firms will be owned by the State, but the firm's management has autonomy in its decisions. The oligopolistic not-for-profit firms will sell their products to consumers that spend their wage incomes to provide in their needs. In the early nineteen twenties it is understood that the transition towards full public ownership will be a long road and take a very long time.

4 1923, Business Organisation and Codetermination

The leading idea in the reflections on socialisation is to let the State lend a helping hand to the ongoing increase in large scale production thereby forcing the concentration of firms, which is bound to bring capitalism to its natural end. However, the problem for socialist believers was here that in several branches of industry there was little to see of such a progress and small scale business remained the standard. What then is the political recipe for making social progress in such branches of industry?

The hint for an approach came from the Dutch Roman Catholic economist Aart Veraart. Inspired by the first Papal Social Encyclical *De Rerum Novarum* of 1891 (*Rerum Novarum* 1891) he was in search for an organisation of business that could end socialist class struggle. In 1919 and 1921 he published a blueprint in which firms remain the private property of their owners (Veraart 1921). However, the firms in a branch of industry are brought together in a Business-ship, which suggests that the group of firms to a certain extent should be run as a kind of business. The Business-ship has a Board in which owners and workers have equal presentation and equal authority in making regulations that for the firms in the branch of industry have the same binding force as regulations of the State. Actually the Boards are a new type of public body. Apparently the Statutory Organisation of Business (SOB), the name later on attached to Veraart's concept, restricts the autonomy the individual firm owner has in the traditional market economy while workers now participate in decisions that formerly were beyond their competence.

Already in his first publication on SOB Veraart (1919, 161) had made the ingenious suggestion that for Socialists, on their long road towards full socialism, the corporatist tainted statutory organisation of business might be acceptable as a preliminary objective (Nentjes 2017). After the Socialisation Report had appeared Veraart stressed that his arguments to justify 'the deep public intervention in the system of free competition', overlapped the justifications for reform presented in the Socialisation report. Veraart sees an ongoing competitive struggle of small scale businesses among themselves and against large scale business; very much a prolonged death struggle. His heart is as much with the firm owners who live under the constant threat of perdition as it is with the misery of the workers. The formation of one big business at the level of the branch of industry should bring the rescue. By making his suggestion Veraart had pinpointed the weak spot in Socialist Democrat thought, the

lack of a vision on how the transition period could be used to smooth and possibly speed up the coming of full socialism.

Veraart's challenge did not remain without response. It came in 1923 in the report *Business Organisation and Codetermination* (*Bedrijfsorganisatie en Medezeggenschap*), written by a committee on behalf of the Socialist Trade Union and the Social Democrat Labour Party. The Social Democrats want to bring firms together in Business-ships in those branches of industry where concentration of firms is insufficient to make them suitable for consolidation in a few large State firms. So, public organisation of business is advised as a preparation of socialisation (Codetermination Report, see S.D.A.P. 1923, 26, 27). The Business-ship will be governed by a General Board in which representatives of employers, employees and also the community share the seats equally. Considering that in the Socialisation report it had been taken for granted that giving workers a say in management of the public firm would make them pursue higher wages at the cost of higher prices, the authors of the Codetermination report were aware that employers and employees might try to exploit in collaboration the monopoly position of the Business-ship to impose on firms a strategy of higher product prices to finance higher wages and profit margins. So they added the condition that in the General Board a majority of community representatives, appointed by the Minister, can never be overruled by employers and employees. Evidently, a safety to prevent that the interests of the last two groups prevail.

The General Board of the Business-ship has the authority to make decisions and issue regulations on a broad range of matters where in a market economy the individual firm decides. Among them, communal purchase of materials, product quality, uniformity of product standards as well as uniformity of production methods, removal of unnecessary intermediate traders, a ban on production methods that are outdated, dangerous or damaging to health; further limitation of advertising, prevention of unemployment in the sector, improvement of professional training in the sector, setting the prices of the products of the sector, deciding on all issues that can improve the efficiency in the sector and the circumstances under which the work in the sector is done (S.D.A.P. 1923, 115–116; Report 'New Organs', see S.D.A.P. 1931, 46–47).

The net of potential regulations is cast so wide that, if used fully, the Board of the Business-ship would have a say that hardly differs from the Board of a fully socialized monopolistic public firm. The individual firms would be left with no more flexibility than to decide on the quantity of output, produced with the prescribed production method, buying the inputs the mandated production method requires and selling the products of prescribed quality at prices fixed by the Board of the Business-ship.

The passage "the actual management remains in the hands of the individual firms of the business-ship" (Nieuwe Organen 1931, 51) makes the reader expect that in the early stage the restrictions on the firm's flexibility will not be that tough. SOB could then function as a corrective mechanism on shortcomings of the capitalist market economy. However, the Social Democrat belief goes further than that. Economic development is bound to go towards full socialism. So one can imagine that stepwise strengthening of the regulations made up by the Boards could be a strategy to let the statutory organisation of business evolve towards a future where the Boards of

Business-ships function as they are Boards of a monopolistic national public firm and the former private firms no more than local settlements executing the orders of the Board.

Whether such ideas have crossed the minds of the authors of Business Organisation and Codetermination remains unknown. The report focuses on the first stage of the transition and does not speak out about the last stretch and the end of the road towards full socialism through SOB. I can only note here that the members in the Board of the Business-ship are not neutral but representatives of interest groups that have to come to an agreement on the Board's regulations. The question remains whether this will function similar to the Board of a public firm with members appointed by Parliament on nomination of the Minister, as the Socialisation report wants it.

What adds to the complications is that in the socialist version of SOB the labour wage and other labour conditions remain the outcome of negotiations between representatives of employers and employees (read trade unions), laid down in the collective labour contracts; a practice that in the first decades of the twentieth century had evolved in several branches of industry and had been incorporated in legislation. Overarching the Business-ships there will be at the national level a Central Economic Council in which representatives of employers, of employees, and representatives of the general interest have equality of seats. Very much similar to the design in the Socialisation Report. Its major tasks are spelled out more specifically than in the Socialisation report, monitoring of the major decisions of the Boards of the nationalized firms as well as the Boards of the Business-ships. Next to that the Council advises the government.

The Report on Business Organisation and Co-determination of Workers does accept that workers choose representatives in the General Board of the Business-ships and distanced itself from The Socialisation Report that three years before had very explicitly rejected such participation in fully socialized firms. Even Wibaut, who had been chairman of the committee that had made the first report. In defence he wrote the worker should be involved in the responsibility for the business. He has to be liberated from "the depressing feeling that he is only a mere cog in complicated mechanism." The answer of his opponent and fellow socialist Bongers, "All those who work in a large business are a cog in an organism (sic!), and this will function all the more better if everyone feels himself like that. One can regret this, but it is an unavoidable course of events" (Quoted from Dullaart 1984, 73).

Bringing pieces together, I conclude that in the early nineteen twenties it is understood that there are branches of industry where the evolution towards full public ownership may not occur at all and the market structure remains competition between the many. The Social Democrats accept now the statutory organisation of business (SOB), in which workers participate in the public regulation of the private firms in their branch of industry, as a social economic construction for the transition period. SOB leaves open the option to extend and intensify the public regulation by the Board of the Business-ship to the point where the rights of the private owners of firms have been reduced to practically zero and the Board of the Business-ship comes in a position very similar to the board of the public firm in a socialist market economy. Business Organisation and Co-determination of Workers does not discuss whether

it foresees a development towards such an ultimate stage of the transition. Nor does the report in any other way give an image of a future socialist economy.

5 1935, The Labour Plan

5.1 Introduction

After the economically roaring twenties the political-economic scene in Europe went for a deep decline in the nineteen thirties. The financial crash on Wall Street in September 1929 heralded an economic crisis in the US and Europe was dragged along in the downfall. In the prolonged great depression that followed many lost the belief that market forces would bring economic recovery. National governments reacted by protecting their economies against foreign competition. In the Netherlands, in the 1920s still an icon of a liberal open economy, the government lapsed in the 1930s into a policy of micro-economic interventions, aimed to distribute the macro-economic implosion of demand evenly across producers. The coalition of Christian-Democrats and Liberals drafted new laws that gave the government the once unthinkable authority to regulate specific economic activities. Among them were protection of home industry against foreign competition, legalization of cartels and of making parts of such agreements between private parties binding for all firms in the branch of industry (1935). Entry into a branch of industry was made dependent on a public licence (1937 and 1938) that can be refused on the ground of overcapacity (1938). The government also gave itself the authority to make a collective labour contract between employers and trade unions binding for all, including those who were not a member of the contracting organizations (1937). The Minister-President Colijn, a former CEO of Royal Shell and of staunch liberal economic views, had often to give into the other partners in his coalition government. To a friend he complained that what the government does with the one hand to reduce the cost level is taken back again through measures that cause more rigidity (Dullaart 1984, 163). By taking recourse to the visible hand of national regulation the government was drifting further and further away from the liberal system in which the private goods are provided by the invisible hand of the market.

For the Social Democrats the deep depression was a further confirmation that capitalism is chaotic and wasteful. Published in 1935 by a committee of the socialist trade union NVV and the SDLP The Labour Plan (*Het Plan van de Arbeid*) meets the call of the fortieth SDLP congress for a lay out of the first concrete measures necessary for the transition towards socialism (Labour Plan, 5). The Plan wants a deep economic reform. Its complete realization would bring a fundamental change in economic life. Yet parts of the Plan can be implemented in the short run to bring certainty of existence and a reasonable standard of living for all (Labour Plan 9, 10, 22).

The two slogans or catchwords in *The Labour Plan* are ‘containment’ and ‘ordering’. They both stand for taking control by way of regulation. Traditionally Social Democrats did see socialisation of the means of production as the way to make progress. The idea to use regulatory intervention as major instrument of change is really a mile stone in the development of Social Democrat thought in the Netherlands. Between the old socialist black of private ownership versus the white of public ownership now appear the many shades of grey of regulation as instrument to reduce the reach of private ownership. In *The Labour Plan* regulation is presented as ‘partly socialisation of the authority to decide on the means of production’ (*Labour Plan*, 19); very much in line with the view of the Law and Economics approach of today where private ownership is a bundle of rights and regulation is an instrument to place restrictions thereon.

5.2 *Statutory Organisation of Business*

The Labour Plan ordains that community organs should be given the lead in the ‘containment and ordering’ of economic life. Such organs had been proposed in earlier reports. *Business Organisation and Codetermination of 1923* (S.D.A.P. 1923) and *New Organs of 1931* (S.D.A.P. 1931) give an outline of Statutory Organization of Business (SOB) in which the firms in a branch of industry are brought together in Business-ships governed by Boards that have the authority to regulate the decisions of the firms in the Business-ship. Private ownership remains in existence; however the rights of the owners to make decisions on how to use their means of production are curtailed by transferring them partly to the Board where representatives of firm owners share the regulatory powers with the representatives of the workers in the industry and of the general interest. Overarching the Business-ships is at national level a top organ; in *The Labour Plan* it gets the name of General Economic Council.

The Labour Plan brings a change in the relations between the public organs of SOB. The reason to do so is the necessity of better and stronger coordination of economic life that is felt now by the authors. In Chap. 4 on business cycle policy they pinpoint overexpansion of capacity as the major driver of the business cycle. Expansion of capacity is an innate incentive for the profit maximizing individual firm and since all private firms behave that way overexpansion followed by crisis and depression is a natural property of chaotic capitalism (*Labour Plan* 10, 94).

On superficial reading *The Labour Plan* seems to stick to the view that overexpansion and the cycles it generates can only be contained with the traditional Social Democrat solution of socialisation, that is “the transfer of the control from the private property of the owner to the community” (*Labour Plan*, 89). However, next follows the restriction, “socialisation of only a part of the control, to know that part which as the facts prove, is causing crisis when in the hands of private entities. The part of control that is most dangerous for the certainty of existence of the people is then taken away from the private owner” (*Labour Plan*, 89). On further reading it turns out that such socialisation of part of the control over the means of production is specified

as containment of the expansion of capacity of firms—existing ones as well as new firms—by way of regulation. It can be achieved with the least difficulties when the branches of industry are organized in Business-ships (Labour Plan, 95, 100). Their Boards can use their regulatory powers to control the decisions of the firms within their branch of industry. See in Sect. 5.3 how this has been worked out for the retail sector.

The Labour Plan is very clear that the decision to invest in expansion of output capacity cannot be left exclusively to the discretion of the separate Boards because the urge towards uncontained overexpansion inherent to capitalism can cause unbalance between the branches of industry in the composition of capacities and their expansion (Labour Plan, 94, 95). To prevent such developments the General Economic Council, top organ in SOB, gets the status of super body in the economic domain. It will be its task to delineate for each branch of industry the total allowed expansion of capacity in that industry (Labour Plan, 96, 100). The Council will be assisted by a Business Cycle Bureau. For the Boards of the Business-ships remains the task to arrange the allocation of expansion of capacity across the firms within their branch of industry. The outcome will be a society that in its parts will show a more stable structure in the composition of its output capacities (Labour Plan, 95–100). A necessary complement to containment of overexpansion in capacity is containment of the speed of the process of rationalisation in certain branches of industry, which in times of low employment leads to expulsion of workers (Labour Plan, 101–119).

The Labour Plan persists to keep the determination of wages and other labour conditions outside the planning system. They should remain the outcome of negotiations on the collective labour contract between trade unions and employers' associations per branch of industry.

Building on ideas formed in the nineteen twenties (for the transition period) The Labour Plan unfolds a plan for a regulated market economy in which the regulation is carried out mainly through Business-ships per branch of industry, supported by centrally planned coordination of investment in capacity done by the General Economic Council. The Labour Plan does not aboard the question whether and how such an economy could evolve towards a socialist economy. The reader can imagine its step by step realization by increasing over time the number of Business-ships, by strengthening their regulation of private firms and extending the central planning by the GEC. The Labour Plan itself is silent on the possibility of and road towards such a socialist future. By sticking to its commitment to draft a “way out of the first concrete measures necessary for the transition towards socialism” (Labour Plan, 5) the issue how a future socialist economy would be structured has disappeared out of sight. Some socialists, perhaps even a majority, may by the mid nineteen thirties even have lost the belief that such a socialist society would ever come; however, expectations and hopes are seldom uniform, more radical Party members may have been hoping for a future opportunity to mutate SOB into a system of central planning by the State. The implementation of the central plan could then be delegated to public organs at the level of branches of industry. In Sect. 6 we shall discuss what came of those dreams in the years shortly after World War II.

5.3 *The Two Faces of the Labour Plan*

On a closer look The Labour Plan offers a mixture of old and new socialist ideas. Old, in line with Business Organisation and Codetermination of 1923, is the acceptance of Statutory Organisation of Business as a form of collaboration between capital and labour during the transition period. Such participation of workers in a form of self-regulation comes back in The Labour Plan, but added is now the new role for the General Economic Council as top organ that coordinates the decisions on investment in output capacity per branch of industry.

The new line of thought in The Labour Plan is mitigation of the business cycle through shifting the execution of public works from years of economic high tide to the years of low tide. Placed as Chap. II of the report, under the name 'Crisis Policy', the proposal is prominently present. It is also loud and clear in its rejection of what it calls negative crisis policy and a plea for 'positive crisis policy of public works and strengthening purchasing power'. I guess it is very much the work of Jan Tinbergen, member of the SDLP and also of the committee that made The Labour Plan. Internationally Tinbergen is known as the economist who received together with Ragnar Frisch in 1969 the first Nobel prize in economics for their pioneering work in econometrics. The chapter proposes a three year plan of government expenditure on public works and lower cost burdens of 200 million guilders per year. The proposal is Keynesian in spirit and in its analysis of the primary and secondary effects on employment. The calculated primary effect on employment is 70 thousand workers per year and the total effect 120 thousand workers per year. That would have brought a reduction of existing unemployment in the Netherlands of about thirty percent. The expenditure is financed with a government loan of 200 million guilders for each year, of which 44 million guilders (is 21%) will return in the form of higher tax revenue and lower social expenditure for unemployed. To fill the gap the in the government budget caused by the expenditure on the public works a government loan of no more than xx% of the outlay on the public works will be sufficient, thanks to (among others) lower payments to unemployed workers and higher tax revenues.

Despite its prominent place, Chap. II stands very much on its own, isolated from the other chapters of The Labour Plan with their traditional socialist content. In Chap. IV, devoted to containment of the business-cycle, direct control of firms' investment in expansion of capacity is presented as the key instrument. The public expenditure policy option is mentioned only once and very shortly (Labour Plan, 93). The old and new ideas are not integrated; just juxtaposed. By implication the two approaches function as complements; certainly not as alternative roads towards a socialist future.

As illustration how the old line of thought is worked out I take the retail sector, discussed in Chap. 8 of The Labour Plan. We read that the direct cause of its misery is the loss in purchasing power of the population and the inflow of unemployed that try to survive by starting a small business. After having said that the measures to raise purchasing power are of great importance for retailers, Chap. 8 focuses on 'ordering' the sector. Restriction of the number of shops in certain retail branches makes it necessary to introduce a licence system in retail of groceries, bakery products and

coal. Implementation requires classification which products belong to a branch and planning of how many shops are locally needed per branch. As flanking protective measures entrants have to meet demands regarding occupational capacity and credit worthiness. As organs to implement the system of regulation The Labour Plan proposes a type of business-ship, including its public authority, but operating on a local level and under supervision of the local government.

What strikes, is the total lack of confidence that the general increase in purchasing power thanks to the public works in itself might be sufficient to redress the retail sector. It is no reason to hold back with regulation in the retail sector. That in an economic crisis and recession macro-economic policy can be an alternative for direct intervention in sectors, and even a more efficient one, has not been grasped.

6 Towards a Post-war Economic Order

In the nineteen twenties and thirties there circulated in the Netherlands two versions of SOB. The Catholic economist Veraart had published his blueprint in 1919 and updates in 1921 and 1947 (Veraart 1921, 1947). His ideas received the support of the Catholic and the Protestant Trade Union; the Roman Catholic State Party did not take a stand Veraart's ideas on how to bridge the gap between capital and labour. From the side of the SDLP and with the support of the Socialist Trade Union there were the publications of 1923 and 1935. There was also exchange of comments between the two sides; by the end of the interbellum the differences on parts of the two designs had narrowed down. Veraart (1947) had accepted that potential imbalance between the sector plans of the Business-ships require a National Economic Plan drafted by a Social Economic Council. But he persisted that the sector plans have to come up from below, brought forward by the Boards of the Business-ships. Top-down planning and control, as proposed in The Labour Plan, would stifle the initiative of the social groups. Could the convergence in views on how to reform the Dutch capitalist market economy become the base for political collaboration?

The Nazi-German invasion of The Netherlands in May 1940 and the occupation that followed after a four days war, brought a break in the public political discussion. However, the shock of the depression of the nineteen thirties had been so hard that by the end of the war the general expectation was that the days of old school liberalism were over (Nentjes 2017). The provisional Dutch government, installed after the liberation in May 1945, was of a Socialist and Catholic signature. Charged with the task to provide the legal base for a post war economic order, the government saw Economic Planning and Statutory Organisation of Business as its two pillars.

The notion of economic planning appears already in the statement of the Prime Minister in June 1945 that "reparation and building up of the Netherlands' production capacity can only be done effectively on the basis of a general social-economic-financial plan. Such a plan has to be designed by a scientific Bureau appointed by the Council of Ministers" (Schermerhorn 1945). The Central Plan Bureau, under

director Jan Tinbergen, started its work in September 1945, even before the Law on the Central Plan Bureau was adopted by Parliament in Spring 1947.

Minister Hein Vos, formerly member of the committee that did write The Labour Plan of 1935, submitted the Draft of Law on Business-ships in the Fall of 1945. The Draft is an end to the flirt with Catholic Corporatist ideals and rewrites the design brought forward in The Labour Plan to make it the blueprint for a straightforward State Socialist centrally planned economy. The Draft leaves no place for a General Council that would have represented employers and workers at the national level. The National Plan is made up by Ministries for the various sectors under their resort and it states the targets for production, prices and investments per sector. The task of implementing the targets is delegated to Business-ships. Each Business-ship is placed directly under the Ministry responsible for the sector. Employers and workers are represented in the Board of the Business-ships, but their influence is heavily restricted, since the Minister appoints a Commissar who presides the Board and has the authority to submit decisions of the Board to the Minister for suspension or annulment. The construction reduces the Business-ships to organisational entities that have to carry out the sector policies of the government. Not only expansion of output capacity per sector is centrally planned by the government; their levels of output and product prices as well. The Draft reads like the blueprint for a centrally planned economy in which government regulations leave hardly scope for private firms to make their own decisions.

The Draft of Law on Business-ships of 1945 was a bridge too far. It did not get the public reception the provisional government had hoped for. Trade unions as well as employers' organisations were highly critical. In particular they were against the Commissar with his far reaching authority (Wermuth 1997, 101). After the elections of Spring 1946, the Catholic Party was the largest partner in a Roman-Red coalition. Catholic Ministers took over major positions and one of them submitted in 1948 a Draft of Law on Statutory Organisation of Business to Parliament. After a long period of discussions the Draft passed Parliament in the Fall of late 1949, to come in force as Law on January 1, 1950. It provides for a Social Economic Council (SEC) in which workers, employers and experts equally share the thirty seats. The Business-ships, although subsidiary to the supervising SEC, are autonomous statutory bodies that make their own binding decisions and they will have no representatives of the government in their Boards.

What about the authority of the Boards? To have a power that would capacitate them to coordinate economic activities they should have got the legal authority to regulate wages, prices, production and investment. However, this was exactly what the Minister did not do. Regulatory power remained restricted to matters of secondary importance. It made SOB unfit to replace coordination through markets. After 1950 about fifty Business-ships came into being, mainly in agriculture and the crafts. Over the decades the small playground they had for self-regulation was further undermined by the development towards the integrated market of the European Union. The end came with the dissolution of SOB in 2014.

The laborious birth of SOB was in itself an indication that after 1945 the times and with them the political mood were changing fast and SOB was not going to play the role of market master lined out in 1935 in *The Labour Plan*. A sketch of an alternative road forward was given as early as Fall 1947 by Jan Tinbergen, director of the Central Plan Bureau. In a meeting of the Dutch Association for Economics and Statistics in 1947 he explained his audience of economists that the specific controls, still existing at that time, can be withdrawn as soon as production has recovered so far that the non-rationed demand for goods can be met without causing too big price shocks. The government can use measures in the domain of government expenditures and taxes to tune the total demand for output to production capacity. Within such a framework of global measures the price mechanism can fulfil its task efficiently. Competition is “an in many cases valuable institute for bringing order” (Tinbergen 1947). The statement is a loud and clear Keynesian message on the respective roles for government as guardian of economic stability and markets for the coordination of production of consumption of private goods in the evolving post war economic order. Tinbergen also mentions that investment controls, which restrict private liberty directly, can be kept in store as reserve measure. A position strikingly different from the fundamental distrust of private investment in *The Labour Plan*. No word about SOB as instrument of economic control.

Socialists of the radical type Hein Vos might even after the introduction of the stripped version of SOB in 1950 still have the hope that there was now a legal framework, which in due time could be filled with a Socialist content (Vos 1952), the real situation was that in 1950 most Socialists had lost their belief in the centrally planned economy as the appropriate way to direct business activities towards the general interest (Verloren van Themaat 1958).

In 1946 the SDLP dissolved itself to let its members unite with members of former progressive Christian and progressive liberal Parties in a new progressive Labour Party, open for socialists and non-socialists with a programme that has justice for all as its major objective. The new Party is also more open towards the future than the old SDLP. However, it kept evident social democrat features. The Labour Party's first report appeared in 1951 and had the title *The Road to Freedom (De weg naar vrijheid)* (Partij van de Arbeid 1951). Ideas one finds in the Socialisation Report and in *The Labour Plan* return in *The Road to Freedom* (Tromp 1984, 23). Tromp (1984, 2002) reads here that the co-existence of a private sector and a socialized sector is appreciated as positive and by implication acceptance of a mixed economy, in which a strategic part of the means of production is property of the community; private property claims are contained by State regulation in a production law, an investment law and a credit law. On a lower level the Statutory Organization of Business plays an important role (Tromp 1984, 23). Tromp, an expert who did write a thorough dissertation on the programmes of the Dutch Social Democratic Parties from 1878 to 1977 (Tromp 2002), writes that after *The Road to Freedom* the Labour Party has never tried again to bring out (if only) a sketch of a structure of a future socialist society. From 1960 on political thought concentrates on the State as director of social development. The quest for the forces that within society work to a socialist

order has been given up definitively. In his view the report *Road to Freedom* therefore marks the end of socialist ideals held before World War II.

7 Summary and Conclusion

The Social-Democrat Party of the Netherlands was in the first two decades of the twentieth century certainly Marxist in its belief that under capitalism technical development forces enlargement of the scale of production, which pushes the economy forward towards a future socialism where the community will be the owner of the means of production. In the Dutch Social Democratic view the State will be the representative of the community, but it should allow the management of the socialized firm great autonomy in making its decisions. In the socialist market economy oligopolistic not-for-profit firms will sell their products to consumers that spend their wage incomes to provide in their needs. The living standard for workers will be much higher than under capitalism, thanks to sharing the former surplus value of labour and even more so because the organisation of production on large scale has raised the productivity of labour and because in the socialist market economy large scale community firms don't sell their output for profit but with the aim to provide in the needs of consumers.

In the reports that follow the focus is more on the period of transition towards socialism under neglect of the fully socialist end state. Since the socialisation of private capital proceeds slowly the Social-Democrats accept in the early nineteen twenties for the transition period the Statutory Organisation of Business (SOB) whereby representatives of workers and the consumer interest together with firm owners participate in the public regulation of the firms in a branch of industry. Private ownership of firms remains in existence; however, the codetermination of workers and consumers curtails the rights of the owner to decide on how his private property is used. How such a system evolving in a capitalist society can make in its last stage the transfer to the fully socialist economy remains out of discussion. I interpret that silence as the first signs of doubt whether such a truly socialist society will ever come and the acceptance of a society where regulated private ownership will go on to exist. The idea that such a capitalist economy, regulated through the SOB system, will function as a market economy without basic problems in the coordination of the multifarious activities remains intact during the nineteen twenties.

The deep and long depression of the nineteen thirties brought the Social Democrats to the insight that during the transition period the propensity of private firms to over-expand their capacity during the boom does create a coordination problem on markets. The Labour Plan of 1935 proposes to repair the market failure by central planning of the capacities per branch of industry. A task to be carried out by the General Economic Council. Allocating the planned investment to the firms within the branch of industry is delegated to the Boards of the Business-ships. One can read this type of central planning as an addition to and refinement of the system of

SOB. In the second half of the nineteen thirties SOB is for the Social Democrats in the Netherlands an organisation to regulate the capitalist market economy with the aim to mitigate its major abuses, in particular the exploitation of labour and periodic economic crisis. Originally SOB was accepted as a solution for the transition period. The question whether it could evolve and be perfected to make the transition to a truly socialist economy was not addressed. Some authors, such as Tromp (2002), interpret this omission as implicit acceptance of a socialist future in which socialised firms and firms based on private property will coexist. New in *The Labour Plan* is next to the revision of SOB the proposal to use public expenditure, taxation and borrowing as instruments to mitigate the business cycle. Macro-economic stabilization, as it is called today, will be task for the State, read government. In *The Labour Plan* stabilization policy is presented as a complement to regulating the economy through SOB.

After the Second World War the new Labour Party came forward as successor of the pre-war SDLP. In its first report *The Road to Freedom* from 1951 (Partij van de Arbeid 1951) the focus is on non-economic issues. In the economic part the idea of statutory organized business returns and also macro-economic stabilization policy. A thorough comparison of the socialist economic ideas of 1935 and 1951 is beyond the limits to this chapter and a subject for future study. Tromp (2002), who made a political analysis of *The Road to Freedom*, writes that the co-existence of a private sector and a socialized sector is appreciated as positive and interprets it as acceptance of a mixed economy, in which a strategic part of the means of production is property of the community and private property claims are contained by State regulation.

Verloren van Themaat (1958) thinks that by nineteen fifty most Socialists had lost their belief in the planned economy as the appropriate way to direct business activities towards the general interest. The majority in the Labour Party now sees macro-economic policy and detailed ordering per branch of industry no more as complements, as it was in *The Labour Plan*, but as alternatives and prefer the macro-economic the macro-economic approach (Nentjes and Postma 1972, 49). The new view and the hope on broad consensus meant that the future society would be a pluralistic society in which there would also be place for the realisation of other political ideals than true socialism.

The evolution of Social Democrat thought over the first half of the twentieth century is nicely encapsulated in the portrait of four generations of democrat socialist theorists depicted by Verwey-Jonkers (1938) and Den Uyl (1956). In 1938 Verwey-Jonkers notes that for the first generation around 1900 the coming of a socialist society was unavoidable, based as it is on scientific insight. For the second generation of the nineteen twenties such a transition was also a certainty, but more based on tradition than on scientific condition; more confession than inner belief. The third generation of the nineteen thirties missed the certainty of the pass-over to the socialist society. She calls them the uncertain ones. In 1956 Den Uyl classifies the post war, fourth generation as the silent ones, for without any noise the problem of the socialist view of the future society was liquidated (Tromp 2002, 305).

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Joseph Schumpeter, the Euthanasia of Capitalism



Frits van Holthoon

1 Reading Schumpeter

About twenty years ago I presented a paper on Schumpeter's *Capitalism, Socialism and Democracy* at a conference of political scientists. I was struck by Schumpeter's prediction that capitalism would not survive and would open the road to socialism. I cannot find the paper in my backup some five computers ago, but if I remember well I then was particularly interested in Schumpeter's definition of democracy. Now I propose to take a second look at Schumpeter's book asking why Schumpeter thought that capitalism was coming to an end. Are we witnessing a slow and beneficial demise of capitalism? The answer to that question is closely related to Schumpeter's definition of capitalism and given that definition (Schumpeter was fond of definitions!) the answer to the question about the demise of capitalism is less spectacular than one might think.

Rereading Schumpeter it struck me that he was part of a school of economists which is different and in many ways an alternative to the work of Anglo-Saxon economists. This becomes evident from two issues and it is important to deal with them when we try to define Schumpeter's view of capitalism. As an Austrian by birth and upbringing he belonged to a school that was preoccupied by the problem of development and change and so naturally Schumpeter ab initio had intellectual ties to the German Historical School, to the historical sociology of Max Weber and to Karl Marx' economic theory. Schumpeter as a critic of the Historical School commented that they wrote history rather than developed economic theories (Schumpeter 1963, 804), but he accepted their perspective on development. And then of course he took part in a debate about socialisation (nationalisation) which in 1918 preoccupied both

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German and Austrian economists and that this conference is at pains to reconstruct (Streissler 1994).¹

Secondly, as the contributions of Francesco Forte and Günther Chaloupek make clear socialization was discussed as a serious issue for German and Austrian economists.²

Though I must answer the question what Schumpeter meant by the euthanasia of capitalism and whether it would occur on his conditions, there are four steps which lead up to that answer:

- 1. As Eduard März has made clear Schumpeter belonged to the Austrian school. And so he took part in the discussion on economic development and the role of the entrepreneur as the initiator of development. Under the influence of Nietzsche in particular he described him in his *Theorie der wirtschaftlichen Entwicklung* as the demiurge of development, not as inventor but as innovator.³
- 2. Schumpeter had a critical exchange with his teacher Eugen von Böhm-Bawerk on the nature of interest. Schumpeter stated that in a static economy ruled by perfect competition interest and profit were zero. Böhm-Bawerk thought this to be false. Given Schumpeter's bent of mind at the time he defined capitalism as a process of change. It was the entrepreneur who created profit and interest.⁴
- 3. Schumpeter took part in the debate of socialisation. Though he agreed with Otto Bauer that a complete socialisation of the economy would be ideal, as minister of finance (1919–1920) he warned that intervention 'on a massive scale' would be risky.⁵ Otto Bauer engineered his dismissal as minister, because of his caution. His standpoint on socialisation defined his view of socialism at the time.
- 4. März writes:

Here I will say only that during my last year at Harvard I came to feel that Schumpeter's striking reserve with regard to his own theory may ultimately have been caused by his feeling of its inadequacy. (März 1991, 167)

The fact that Schumpeter did not teach his development theory at Harvard indeed is striking considering that Schumpeter is regarded as the equal and the counterpart of Maynard Keynes. I do not think that he regarded the theory inadequate, but that it did no longer apply.

¹Streissler shows that all the characteristics of Schumpeter's economics such as the entrepreneur and the emphasis on development were being discussed in both countries since the beginning of the nineteenth-century and Schumpeter's teacher Friedrich von Wieser took part in that debate. I am not so sure about the influence of Hilferding (Streissler 1994, 132). As I read him, Schumpeter saw the entrepreneur as a private person (even hero perhaps) and he did not stress the link between banks and corporate business in the beginning of his career. Later on he took the link for granted.

²See Chaloupek (2019) and Forte (2019, this vol).

³März (1991, part 2, Chap. 3). Particularly para 3 "The intellectual roots of Schumpeter's *theory of the entrepreneur*", 54 ff.

⁴März (1991, 131). Schumpeter wrote a generous report on Böhm-Bawerk's work and praised the wide range of his vision. März calls it 'the best concise presentation of the main ideas of the Austrian school as developed by Böhm-Bawerk. See Schumpeter (1997a, 143–191). There is no mention of their disagreement in the obituary.

⁵März (1991, 152). Two years later he called 'full socialisation' 'no more than political phraseology'.

2 Reading Schumpeter

Since I wrote on John Stuart Mill I have been an enthusiastic reader of Schumpeter's *History of Economic Analysis*. That chunky, unfinished book, which his widow Elizabeth Boody put into order, is a marvel. Schumpeter had the empathic genius to approach an author by reconstructing his economic logic in a way the author's thought made sense. In fact Schumpeter distanced himself from his own work in such a manner that the reader could not be aware that Schumpeter was the great rebel in the camp of the economists while reading the *History of Economic Analysis*.⁶ It is only at the end of his book in part V, Chap. 5 (1170–1184) that he takes issue with Keynes as the modern exponent of equilibrium analysis. His remarks are of particular interest, because it defines Schumpeter's own position as that of an outsider in mainstream economics. I shall deal with the relationship of Keynes and Schumpeter in the next paragraph.

Apart from C.S. & D. (*Capitalism, Socialism and Democracy*) and his work on *Imperialism*⁷ I knew no more of Schumpeter's economic thought than my colleagues at the faculty of Economics in Groningen told me, namely that Schumpeter discovered the escape route for the law of declining profits by arguing that entrepreneurs made use of inventions to create monopoly-profits which would keep the engine of economic growth going.

Before I started to read Schumpeter in earnest I had the hope that we could stop economic growth by controlling and monitoring inventions, particularly their application and their effect on future economic growth and stop the applications when they use up scarce resources and have other negative effects on the global environment. However, Schumpeter never held the primitive theory that I was told and he took it as self-evident that the euthanasia of capitalism would and should not put an end to economic growth.

3 Schumpeter and Keynes

Schumpeter belonged to the intellectual tradition of List, Roscher, Schmoller, Wagner, but also Max Weber (a sharp critic of the Historical School) and Marx for which development is the key for understanding economics. Schumpeter's theory of development was close to that of Marx though I think that Schumpeter developed it independently and recognized the similarity of the Marxian model to his own. In its barest terms the theory was that capitalism unleashed creative forces

⁶James Tobin remarks that Schumpeter taught on the basis of the work of other economists while at Harvard and never referred to his own work. See J. Tobin in his "Foreword" to März (1991, x).

⁷On which März completely misses Schumpeter's point that whatever people thought at the time and how it influenced their behaviour it was completely irrational and against the current of international development which made for cooperation not war. See März (1991, part one, Chap. 4) "The Modern Theory of Imperialism".

that created new businesses and destroyed established trades. Schumpeter made the distinction between the entrepreneur and the manager (the *Wirt*). The manager is the caretaker of established business routine and the entrepreneur is after new combinations. The term ‘combinations’ is rather vague, but it has the advantage that it leaves open the way how the entrepreneur becomes the fixer of change. This change may be new products, new organisations or exploring new markets. In Schumpeter’s analysis inventions or the inventor play no prominent role. What is important is the application of new inventions whether the latter applies it himself or leaves it to an enterprising businessman. Monopolistic profits as an inducement to change also play no part in Schumpeter’s theory of economic development. It is good to keep this aspect in mind, because his lack of concern spells a weakness in his description of the fate of capitalism in C S & D. What, however, is fundamental in Schumpeter’s account of the rise of capitalism is that next to creating new combinations it destroys old ones and this destruction cannot be helped. The rise of capitalism has an aura of inevitability.⁸

In the last chapter of his “History of Economic Analysis” Schumpeter gave a critical account of Keynes *General Theory*. He called it a conservative and static view of the economic process (Schumpeter 1963, 1174). He added that Keynes’ followers, such as Paul Samuelson, turned it into a dynamic system of sorts (Schumpeter 1963, 1183). And Schumpeter was rather peeved by the success of the Neo-Keynesians, but he understood that this approach suited the politicians of the welfare state and the economists as their advisers very well.

Keynes came from a tradition of economic thought which started with Adam Smith. For Smith an optimal circulation of goods and services led to an optimal national product. It is said that Smith enlarged the physiocratic vision of the circulation of resources (basically agricultural products) by adding trade as a value adding activity. Smith’s model of the ‘invisible hand’ was the beginning of equilibrium analysis in the British style. Of course neither Smith nor his successors would deny that a better circulation of goods would cause economic growth. That, however, was not the main focus of their concern and the ‘invisible hand’ would after growth lead to a new equilibrium on a higher plane. Economic growth in their view was like the man who slowly climbs a spiral staircase to riches.⁹

The problem that became manifest in the forties of the nineteenth-century was that busts started to follow booms and astute observers discovered a cyclical pattern in this phenomenon. This cyclical pattern gave urgency to equilibrium analysis. Keynes gave a new twist to the discussion by arguing that in times of depression equilibrium

⁸Schumpeter had the narrow view of the economist on change. The historian will refer to the Industrial Revolution with next to economic, drastic social and political changes, positive as well as negative. Not to confuse the argument too much I have left them out of my discussion, but is it not remarkable that Schumpeter left out any discussion of the changing role of the consumer in the rise of capitalism?

⁹This peaceful picture was of course spoiled by Ricardo’s conclusion that in the end the economy would stagnate, because population growth would lead to this stagnation. However, if you reject the Malthusian premises why should the economy not be able to grow in a more conventional manner? Schumpeter did not face this question.

would be reached but at a lower level which left part of the plants idle and many workers unemployed.

The supreme irony of Keynes' influence is that it fulfilled his prophecy that "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist" (Keynes 1964, 383). In this case Keynes was the defunct economist. He attempted to find a solution for the problem of underemployment, but his theory started to be used by post war governments to ensure a policy of full employment by investing in public works in times of recession and adopting restraint in times of bloom (except that no government accepted that part of the recipe). And in order to reach optimal results governments adopted a policy of mild inflation. So they followed the counsel of the Keynes of Bretton Woods to insure stable currency exchanges rather than the Keynes of the "General Theory" in which Keynes showed himself to be an enemy of any degree of inflation.

Comparing Keynes with Schumpeter as a theorist is also comparing two traditions of economic thought because a theory of development clashed with equilibrium analysis anyhow. It is not that Schumpeter did not believe in equilibrium—the first chapter of his *Theory of Economic Policy* starts with 'the circular flow of economic life', but for Schumpeter the equilibrium of perfect competition was a utopian image which was constantly disrupted by developments. He did not believe in managing the economy and was sceptical about the New Deal (abetted probably by his wife who was dead set against Roosevelt and what he stood for) (März 1991, 171). Reading his *Business Cycles* it becomes clear that he thought that the crisis of 1929 would be cured in the usual cyclical pattern. So theoretically and politically he was out of tune with the New Deal and again ironically (because he was elitist himself) more with the political and scientific elite than with the general public.

In 1946 Schumpeter wrote an obituary of Keynes. It is a warm and sympathetic account, but beneath the surface Schumpeter is sharply critical. Perhaps his most remarkable statement is that 'practical Keynesianism' cannot be exported outside England (Schumpeter 1997b, 275). That sounds bizarre given the success of Keynes in the United States. What Schumpeter meant was that Keynes' advice could only apply in a situation of "modern stagnation" (Schumpeter 1997b, 268). Keynes' short term advice to his countrymen was to save less and to invest more in an ailing economy.

Schumpeter used his vast knowledge of two centuries of economic thought to point out the insularity of Keynes' ideas. Nowhere does he appeal to his own theory of economic development. I shall have to come back to this remarkable fact at the end of my contribution.

Schumpeter made the distinction between crises caused by exogenous factors such as war or endogenous factors which belong to the character of capitalism. Endogenous crises have to be expected and accepted. And if you wanted to do something about them you should turn to the socialism of a planned economy. Schumpeter called Keynes a conservative, Schumpeter himself was on one side more conservative than Keynes—he was almost a Hooverite—but in his inexorable logic he was also prepared to adopt a radical solution as socialism.

4 The Theory of Economic Development

Let me report on Schumpeter's theory chapter by chapter. The book starts with the remarkable statement that the circular process is the fundamental fact of any economy. Fundamental means two things. Firstly it is common sense that anywhere in any economy people will want 'to truck and barter' to use Smith's expression. Secondly Schumpeter mentions it as an intellectual construct to indicate that under the conditions of perfect competition the economy is circular. It is Schumpeter's way of defining development; because the perfect equilibrium is utopian there always will be disruption of the equilibrium.¹⁰ The first statement also reveals another trait of Schumpeter as an economist. The economy is a matter of transactions. Léon Walras had a great influence on Schumpeter and here it shows. There is according to Schumpeter no absolute standard of value. Value is a product of transactions and prices are its indicator. That is a statement out of Walras' book. However, Schumpeter learnt 'the subjective theory of value' from Böhm-Bawerk. Value according to Böhm-Bawerk is the product of transactions. There is no objective standard of value such as gold or the quantity of labour.

Chapter two on the 'Fundamental Phenomenon of Economic Development' introduces the entrepreneur as the creator of development. Schumpeter asks why the entrepreneur has this ambition to create new business ventures and the answer is power, ambition, prestige and first of all the will to create his own domain in the economy which he can control at its best. Schumpeter also asks whether the entrepreneur can function in a planned economy and he answers that this is an important question of 'taking seriously socialism and a planned economy'.¹¹

In his *Theorie* Schumpeter focuses on the entrepreneur. He is a kind of Nietzschean superman who creates and destroys. The period just after World War One was a grim period for Austria. It had to face life as the trunk of a great Empire. It had to settle disputes with neighbours that had become independent nations and it was saddled with great war debts. In this situation Schumpeter felt that the position of the entrepreneur as the great changer was in danger. He wrote in 1918:

Gradually private enterprise will lose its purposes as a result of economic development and the expansion of social sympathy this entails. (März 1991, 95)¹²

I do not think that he took the threat of socialism to the function of the entrepreneur seriously, however, but note his forecast of the future.

¹⁰Schumpeter's statement that under perfect competition—a statement which provoked a lot of criticism—the rate of interest will be zero obviously refers to this utopian situation.

¹¹"Several authors have written about the fact that Schumpeter omitted chapter seven in the 1911 edition of his "Theorie der wirtschaftlichen Entwicklung" from the English translation and a later German edition. It offered a vista of Schumpeter's original idea of a more comprehensive social development. He took up that theme again in his *Capitalism, Socialism and Democracy*." See the reprint of the Seventh chapter: Schumpeter, Joseph "Theorie der wirtschaftlichen Entwicklung. Siebentes Kapitel. Das Gesamtbild der Volkswirtschaft" (Backhaus 2003, pp. 5–59).

¹²März is quoting from Schumpeter's 'Die Krise des Steuerstaates'.

Chapter III on Credit and Capital emphasizes the importance of private capital and hence private credit for the entrepreneur being able to start new ventures. This emphasis on private capital means two things. First the owner of capital and not the entrepreneur bears the brunt of the risks involved in new undertakings. The entrepreneur must be able to operate without being hampered by considerations of conventional practices. Secondly the fear is that in a planned economy there will be strings attached to the giving of credit. Credit is important because it is the *conditio sine qua non* of development.

Chapter IV deals with entrepreneurial profit. Schumpeter uses the Marxian term surplus value, without accepting, however, Marx's notion that it is an indication of exploitation of the labour force. In this chapter Schumpeter introduces the notion of monopolistic profits. That idea attracted a lot of attention, as we have seen, but Schumpeter treats it rather casually. And quite rightly so, because the amount of surplus value does not only depend on the higher prices the entrepreneur can achieve, but also on a better organisation of the production and the rate of interest which will tend to be low in a situation of development.

We may pass Chap. V on "Interest on Capital" which for explaining the euthanasia of capitalism is a side issue. Chapter VI on 'the Business Cycles' brings us in the heart of Schumpeter's analysis of development. His treatment reveals unfinished business. Schumpeter describes the actions of the entrepreneur not only as disruptive of the old order, but as not being related to any regular phenomenon. As stones thrown in a pond they came haphazardly at times. How then does the interface between the intervention of the entrepreneur and the mechanism of the business cycle work? Schumpeter writes:

The ever growing familiarity – when applying economic analysis – with the cycle, together with the increasing formation of trusts, is the chief cause that genuine crises have become milder with each turning point in the economic process.¹³

Familiarity with the business cycle can help to dampen the crisis, but does not explain them. The question remains how the crises caused by new combinations can be fitted in the regular pattern of the business cycle. How can fitful phenomena as new combinations ever become part of a regular pattern? It is time we turn to Schumpeter's major and massive work on business cycles.

As minister of finance in the Austrian government Schumpeter was confronted with the problem of planning the economy by the state and with socialism or 'socialisation' as it was called in his circle. His colleague Otto Bauer was in favour of complete socialisation or complete control of the economy by the state. Schumpeter regarded this as an interesting option, but as we have seen he counselled caution and advised the government to start with a partial socialisation (März 1991, 153).

His idea of capitalism *anno* 1913 (the year his *Theorie* was published) was clear cut. In fact the entrepreneur was the only true capitalist. He had, as we have seen,

¹³The German quote reads as follows: "Die immer steigende Vertrautheit der Praxis mit dem Zyklus ist denn auch zusammen mit fortschreitender Vertrustung der Hauptgrund dafür, dass die eigentlichen Krisenerscheinungen von Wendepunkt zu Wendepunkt ... schwächer werden" (Schumpeter 1936, 367).

a critical exchange with Böhm-Bawerk about his idea that in equilibrium of perfect competition interest is zero, but he agreed with Böhm-Bawerk that it is the entrepreneur who creates profit. Without exploring ‘new combinations’ profits turn into managerial wages. So capitalism *anno* 1913 is the business of single individuals. Schumpeter saw the new development of “trustification”. Not socialism but the big corporations would change the nature of capitalism. In World War Two Schumpeter became convinced that corporate business controlled the economy, but in 1913 that was a distant possibility.

In 1913 Schumpeter regarded capitalism to be the business of private persons. Socialism at that stage was neither a threat nor an option.

5 Schumpeter on Business Cycles

According to Swedberg Schumpeter’s *Business Cycles* was not well received. Kuznets was very critical of the book. Swedberg para phrases Kuznet’s opinion as follows:

Kuznets says that his reading of the book has left him with ‘some disturbing doubts’ about Schumpeter’s analysis. These doubts, he says, centre on three key propositions in *Business Cycles*: that innovations come in bundles; that there are four phases to the business cycles [equilibrium, recession, depression and recovery]; and that three cycles go on simultaneously. (Swedberg 1991, 134)

As to bundles I am repeating Kuznets’ criticism. Why indeed should inventions which are at the core of the innovative process come in regular patterns which match business cycles? The other two critical points are of interest to me, because they demonstrate that Schumpeter changed his view on the relationship between crisis and business cycles. In his *Theorie der wirtschaftlichen Entwicklung* innovation creates crises in the regular pattern, now—probably under the influence of his massive empirical work on the subject—innovations become the *cause* of the business cycles and the crises (depressions) become part of the regular pattern. The fact that the Juglar fits into the pattern of the Kondratieff and the Kitchin within the Juglar confirms the notion that *when the economy is left to its own devices without being disrupted by war or government intervention cycles follow a regular pattern*. Kuznets was also critical of Schumpeter’s method of computing indexes. Given Kuznets’ massive reputation as a statistician I am prepared to believe him, but I would echo Schumpeter’s criticism of the Historical School: his massive description of data does not provide us with an explanation of the business cycle as a phenomenon.¹⁴ The orthodox explanation relying on the functioning of credit, on speculation (the hog’s cycle e.g.) and Keynes’ sophisticated analysis of Say’s law at least makes sense of the *regularity* of business cycles.

¹⁴They are at best, to quote J. Mill’s *System of Logic* ‘an empirical law’ such as the registration of the tides. Only the attraction of the moon and the movement of the moon provide us with an understanding of the phenomenon.

One message of Schumpeter's compound cycle is that there was no crisis (not even the crisis of 1929) which took the cycle out of step. There would be a recovery in the long run. That message is important for interpreting Schumpeter's C.S. & D. There would be no standstill in the economy, because of the demise of his prophecy of capitalism and its transition to socialism, provided that socialism was managed properly.

What happened between 1939 and 1942, between the carefully phrased apolitical analysis of *Business Cycles* and his commitment to socialism (so at least it seems). Swedberg mentions that Schumpeter felt isolated and frustrated by the reception of *Business Cycles* and the situation created by the World War. He felt neglected by his colleagues in the Harvard department who, most of them, enthusiastically embraced Keynes' *General Theory*. He was unhappy about events in Europe and he was rather peeved by the popularity and success of Roosevelt's New Deal. Did his state of mind influence his theory about the transition of capitalism to socialism? I do not think so. Considering that the second edition of C.S. & D. appeared in 1947, three years before Joseph McCarthy started his campaign against socialists of any kind and an opinion about Marxian economics became almost impossible to express, that is a marvel, but his book was so remote from actual politics that professionals could see it as an interesting excursion into theoretical economics and the general reading public could appreciate it without drawing any political conclusions, 'subversive' or not. J. Edgar Hoover, the great witch-hunter and head of the F.B.I. wanted both Joseph and Elizabeth being prosecuted, but he got nowhere. Elizabeth was questioned, Joseph never was (Swedberg 1991, 273, note 34).

The introductory chapters in volume one of *Business Cycles* make it clear that Schumpeter was fully aware that capitalism had changed in the course of the twentieth century. Capitalism had become a collective affair in which the board of a company (and eventually the shareholders) became responsible for business ventures, while new inventions were cooked up in their laboratory. It is a pity that Schumpeter did not ask himself to what extent corporate business dominated the economy as a whole. I think, however, that the perfect fit of the business cycles as he constructed them convinced him that this domination was total.

6 Capitalism, Socialism and Democracy

Swedberg gives the following summary of Schumpeter's argument in C.S. & D.: 'The central theme' of Schumpeter's book is 'the role of institutions in the economy' (Swedberg 1991, 152–153). In part II, 'Can Capitalism Survive?', following Swedberg, Schumpeter claims that the very development of capitalism undermines the system on which it is based. In part III: 'Can Socialism Work?', the answer is that socialism can provide an alternative to capitalism. That answer has two aspects. First can it provide the same kind of welfare as the capitalist system and two can it maintain at the same time the democratic values we cherish? That question Schumpeter answers in part IV: 'Socialism and Democracy' as follows: Socialism can guaran-

tee democratic values as long as socialism is prepared to give citizens the freedom to pursue their own interests. And that is of course a big if, particularly because Schumpeter assumes that central planning would be the main feature of socialism.

Part I on 'The Marxian Doctrine' is a brilliant analysis of Marx' thought, but why is it relevant in Schumpeter's analysis? Swedberg makes it clear that Schumpeter accepted Marx' prediction that capitalism is doomed and socialism is its alternative. Schumpeter wrote his book during the war in which Marxism in the United States was discussed in freer terms than later was possible. Schumpeter discovered that according to Marx the labour theory of value would not necessarily be the only cause of the ruin of capitalism and that would possibly leave room for a milder transition than revolution.¹⁵

Swedberg's inventory is correct, but too bland to my taste. His assessment misses the peculiarity, not to say crankiness, of Schumpeter's definition of capitalism. Surely the entrepreneur as innovator is not solely responsible for the working of modern capitalism. The bureaucratic character of corporate business is in itself an innovation and Schumpeter completely ignores the role of the state in a mixed economy. For him it is either capitalism or socialism. He does not contemplate a mixture of the two and yet the osmosis of state and business is a characteristic of modern life. About Marx little needs to be added to Swedberg's report, except perhaps Schumpeter's emphasis on 'ripeness', the need for which, Schumpeter wrote, Marx also mentioned. "Ripeness" means that the transition from capitalism to socialism only makes sense when capitalism in terms of institutions, attitudes, progress in the economy is far enough to be replaced by socialism.

Schumpeter asked "can capitalism survive". He answered: "No I do not think it can" (Schumpeter 1942, xiii). To understand what he meant, it is crucial to mention his rather narrow definition of capitalism. Capitalism in his view is the product of private entrepreneurs who use credit from private financiers. So basically Schumpeter is saying that with "trustification" when big corporations take over the role of the private entrepreneur and when state intervention in the economy becomes a daily fact of life we create the conditions for a transition to socialism. Schumpeter's view, formulated during World War Two was perhaps a plausible assumption. In the United States during the war there was a planned economy in which big business and government cooperated. And yet there was no room for socialism in the United States. Roosevelt acted with flair and took emergency measures, but to call the New Deal a blueprint for socialism would have dismayed him.

The authors that Forte and Chaloupek discuss next to Schumpeter are Hilferding, Rathenau, Pribram and Stolper. For them planning the economy was one of their

¹⁵I made the same discovery years ago. In the so-called "Grundrisse" there is a passage in which Marx admits that capitalism could escape the declining rate of profit. He writes: "In dem Maße aber, wie die grosse Industrie sich entwickelt, wird die Schöpfung des wirklichen Reichtums abhängen weniger von Arbeitszeit und dem Quantum angewandter Arbeit, als von der Macht der Agentien, die während der Arbeitszeit in Bewegung gesetzt werden und die selbst ... in keinem Verhältnis steht zu unmittelbaren Arbeitszeit, die ihrer Produktion kostet, sondern vielmehr abhängt von all-gemeinen Stand der Wissenschaft und dem Fortschritt der Technologie oder der Anwendung dieser Wissenschaft auf die Produktion" (Marx 1939, 592, cited in Holthoon 1982, 27).

targets. Next to that they paid attention to the role of intermediate groups such as trade union, other trade organizations and political parties. There was a strong corporatist element in their thought, which as far as I can see it is lacking in Schumpeter's C.S. & D.

It is not clear from the book to what extent socialism Schumpeter-style would plan the economy. Did he adopt the model of British Labour to nationalize the railroads, the coal industry and the utilities or did he go for the Soviet model of an economy planned to include all human activities? I suspect he had the latter alternative in mind.

Particularly in a totally planned economy the test of socialism then becomes whether power wielded by the state can be combined with a real say of the people (that vague but necessary term) within socialism. For Schumpeter democracy was a *conditio sine qua non*. Without democracy there could be no socialism. The problem with democracy, however, is that if you have it you can lose it, if not, you will not easily get it.

Schumpeter stated that a government by the people is as impractical as Rousseau's utopia. As to democracy we should substitute that idea by a government approved by the people. And he argued that there should be a governing class of politicians that should compete for the favours of interested parties. That idea is a look alike of Jefferson's 'representative democracy' except for the fact that in Jefferson's age the federal state and separate states had very little power while the socialist state that Schumpeter envisaged was Leviathan. Schumpeter of course believed in the rule of law though he does not mention this necessary brake on power, but we may well question whether that brake can function in an all powerful state.

We are now able to understand what he meant by the demise of capitalism and the transition to socialism. It is the second stage of the relation between capitalism and socialism as he saw it *annis* 1939–1943. Capitalism was 'ripe' to make the transition. There was still a long way to go before socialism could meet the challenge of any modern economy, but the transition was on the books.

People in the well-established democracies do not have to worry about Schumpeter's vision of the future *anno* 1950, because the transition did not happen and the soviet-style socialism broke down under Gorbachov.

7 In Retrospect

Wisdom of hindsight comes cheap. Schumpeter was completely wrong about America's future. When he thought that the transition to socialism was imminent he was witnessing the osmosis of state and civil society. That left enough room for capitalism to create economic growth on its own conditions. Even the individual entrepreneur did not disappear given Bill Gates and recently Mark Zuckerman who established their own business empires. That he was wrong is not an important conclusion, but why did he miss the obvious fact that the American Republic would be the last country where one could expect socialism to be victorious? That is an intriguing question. I can only guess what the answer is, but I think that Schumpeter knew very littler

about his host country. He lived rather isolated in the least American part of the country. No, in C.S. & D. he was thinking back to Austria in 1918 and the debate on socialisation. Then the situation was not ripe for socialism, now it was in his opinion.

A reflection on Schumpeter's position at Harvard brought me back to that puzzling fact that according to Swedberg he never taught his own *Theory* to his students and I have also quoted März's explanation of this strange fact: Schumpeter felt that his theory of development was inadequate. I think a better explanation is that he regarded his theory as no longer relevant to explain economic development.¹⁶ If so, that creates a paradox, because at that post war threshold in time a theory of development was needed more and more. Capitalism was in full swing, but capitalists, bankers, politicians and economists were not in control of tempestuous developments. Schumpeter was the first economist pointing out that the entrepreneur creates, but also destroys. At present we are in the situation that the negative aspects of economic growth loom large. One might wish that Schumpeter had paid more attention to the destructive aspect of entrepreneurial activities.

In the development of Schumpeter's thought there are two trajectories. First there is his *Theory of Development* which led to the euthanasia of capitalism and then there is the historian of economic ideas. In this field Schumpeter's achievement is unsurpassed. It must be the bias of the historian of ideas which makes me prefer Schumpeter's second trajectory.

Appendix

At a late stage in preparing the Heilbronn papers of 2018 for publication Ursula Backhaus pointed out to me that I had missed a publication of a much earlier conference entitled "Joseph Schumpeter. Entrepreneurship, Style and Vision" (Backhaus 2003). That volume reprinted the seventh, concluding, chapter of his "Theorie der Wirtschaftlichen Entwicklung" in German with a translation in English, which Schumpeter omitted from later publications of the text. Such is the penalty of contributing a paper to a conference and per force not attending it.

Rereading the chapter I was pleased to note that Schumpeter in chapter seven referred to the "leadership personality" (Schumpeter, Backhaus 2003, 110) or entrepreneur who invents and organizes new combinations. The omission of this person and his role is additional proof that Schumpeter dismissed this role in later publications. As I pointed out in my original publication: corporate business, according to Schumpeter, took over the role of the entrepreneur and encapsulated it in its business system. The role of big business almost naturally led to control by the State of planning the economy as Schumpeter explained in his *Capitalism, Socialism and*

¹⁶Forté remarks that Schumpeter switched from emphasizing the role of the individual entrepreneur in the 1911 edition of the *Theorie der wirtschaftlichen Entwicklung* as the major factor of economic development to a view of the decline of capitalism under the influence of corporate business in later publications.

Democracy. And the irony of Schumpeter's forecast was that corporate business was causing the euthanasia of capitalism.

Schumpeter was, as noted, dead wrong in his prediction. The U.S.A.—and not only the U.S.A.—was unwilling to adopt this encompassing model of State control and as I pointed out the entrepreneur as individual never disappeared from the scene. Schumpeter should have stuck to his view of destruction and innovation in the economic process. In this respect the seventh chapter is indeed worth rereading as becomes clear from the contributions of Helge Peukert and Mark Perlman.

Peukert points out that Schumpeter rejected the view of 'moving equilibria and organic growth in classical theory'. And she goes on:

Instead, he tries to show that they [the classical economists] were empirically and theoretically wrong and that discontinuous change is always the elementary and major fact of capitalism. (Peukert 2003, 223)

Indeed, as the seventh chapter makes clear Schumpeter advocated an analysis of the economy as a dynamic process without taking into account a notion of development or progress. Schumpeter writes:

It follows from the entire outline of our line of reasoning that there is no such thing as a dynamic equilibrium. Development in its deepest character constitutes a disturbance of the existing static equilibrium and shows no tendency at all to strive again for that or any other state of equilibrium. (Schumpeter and Backhaus 2003, 76)

The economic process is one of the old combinations and their destruction.¹⁷ So Schumpeter was neither a follower of the Classical nor of the Historical school. To which school did he then belong? Perlman's answer is that Schumpeter did not belong to any school. He studied Schumpeter's "Epochen der Dogmen- und Methodengeschichte" (1914) with care and noted that Schumpeter deplored the rivalry between the schools. Perlman concludes:

At best it was a brave way to end the book; at its worst it suggested that he was so much above the fray that he could dismiss persuasively the pettiness of the great names.¹⁸ (Perlman 2003, 173)

As all historians of economic thought Perlman is a great fan of Schumpeter's incomplete masterpiece, his *History of Economic Analysis*. In it Schumpeter described with much empathy the works of the competing schools and there is room for a thorough analysis as a piece of historical analysis.

Obviously that analysis cannot be undertaken here, but it is clear that Schumpeter regarded himself above the schools and perhaps he still dreamt of a dynamic counterpart to Walras' static model. However, this way of pinpointing Schumpeter's position leaves one question unaccounted for. How does this neutral position as expressed in the *History of Economic Analysis* relate to his prediction that capitalism will

¹⁷This leaves it an open question how the original equilibrium came into existence. It appears that Schumpeter regards static equilibrium as routines rather than equilibria.

¹⁸I am not sure whether Perlman applies the 'worst' to Schumpeter or to the pettiness of the great names.

be replaced by State-control of the economy? The answer is a typical Schumpeter answer: it does not. When dealing with economics straight he left out all political implications. This view shows the strength and the weakness of his view. The History of Economic Analysis is an excellent platform for making the statement that the world at large has as yet no control over the economic forces that human activities engender. At the same time he underestimated the power of politicians to shape these forces by non-economic means.

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Three Models of a Supply Side Socially Oriented Political Economy to Recover a National Identity of the Workers and Small Business Middle Class Under Parliamentary Democracy—Schumpeter, Rathenau, and Hilferding



Francesco Forte

1 Introduction

In 1918 Schumpeter intervened in the socialization debate by his paper on the Crisis of the tax state in which he argued that the tax state was close to a crisis because of the parasitic redistributive functions that may assume, are inconsistent with the system of market economy. A model of democracy based on the choice of the leaders, i.e. a managed democracy and a parallel model of a managed economy dominated by few big enterprises would emerge as a reaction to the excesses of redistribution.

The model of a social democratic new supply side market economy by Rathenau with its efforts toward socialization constitutes the way to recover the national identity of the masses and of the middle class to preserve the reformist parliamentary social democracy in a period of rising populism caused by losses of human life and of savings, jobs, security in the First World War and in the subsequent “reparations” period.

Rathenau’s corporatist model grows out of his reflection on Schumpeter’s theory of the entrepreneur-innovator as the engine of growth in the market economy growth which appears to Schumpeter incompatible with the growth of the parasitic nature of the fiscal state; even if may be considered as the basis of the corporative organization of the fascist state, at least as it was theorized in Italy, it represents very timely model of neo corporatism in the present postindustrial epoch.

Hilferding’s model, which grew out from the reflection of the role of the merchant banks in the development of the German big enterprises and of their organization in war effort of Germany in the First World War, represents a very timely model in

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interpreting the tensions that arise in the globalization era between the industrial-financial complex of big enterprises and the population of the industrially advanced nations. While here, the supply side response within the democratic system of the market economy is still obscure, Hilferding's model of socialism can clearly be applied to China, where the socialization of the financial-industrial complex brings about the transition to a market economy with a monopolistic financial-industrial system.

There is a sort of continuity with the policy adopted by the elites, in the period between 1870 and 1913 in which suffrage was extended significantly across most European countries. During this time, contrary to what might be expected in line with the redistributive hypothesis, there is no evidence that redistributive policies were pursued following the extension of suffrage. In particular, there was no clear upward trend in government size in European countries nor was there a shift towards direct taxes. This conundrum can be explained in the light of the social identity hypothesis: the elite, in order to prevent redistributive policies, can find it convenient to instill a national feeling in the masses. This hypothesis is consistent with what happened in the decades prior to WWI. As nationalism spread across Europe, voters with below-average incomes tended to prioritize national interest over class interest. The result was that redistributive claims in this phase were very limited.

Obviously, the new doctrines of national identity of the social democracy lead to an increase in the size of the public sector, but not necessarily of the public expenditure and of the tax burden.

2 Schumpeter's Managerial Socialization as a Way Out of the Crisis of the Tax State and of Capitalism and Parliamentarian Democracy

Schumpeter was born in a German Catholic Jewish family in Triesch, Moravia then part of the Austro-Hungarian Empire in 1883. As his father, owner of a factory, died when Joseph was four years old, his mother moved with him to Graz and later to Vienna. Here he studied at the Theresianum and -subsequently- entered the University of Vienna. In its famous Law School he could study economics under such eminent economists as Friedrich von Wieser and Eugen von Böhm-Bawerk.

Schumpeter took his doctoral degree in 1906. In 1909, after the publication of his first book "Das Wesen und der Hauptinhalt der Theoretischen Nationalonomie" of 1908, he became professor of economics and of government at the University of Czeronowitz. In 1911, he published his now famous book "Die Theorie der wirtschaftlichen Entwicklung" and became full professor at the University of Graz, where he remained until the end of the world war.

In 1918, by the choice of the socialist leader Otto Bauer, Schumpeter, who was not a card carrying socialist, became a member of the Socialization Commission established by the Council of the People of Germany. Meanwhile he published another

famous work, “Die Krise des Steuerstaates” (Schumpeter 1918, English translation 1954), a sociological work, which shows the limits of the role of the State as a redistributive superior entity, in a market economy system with institutions of representative democracy and universal suffrage. The paper argues that because the crisis is inherent to the tax state, by the pressure of the increase of public spending, a socialist system would be inevitable, even if the contours of it were not yet definite. Schumpeter, indeed, wrote

If the will of the people demands higher and higher public expenditures, if more and more means are used for purposes for which private individuals have not produced them, if more and more power stands behind this will, and if finally all parts of the people are gripped by entirely new ideas about private property and forms of life – then the tax state will have run its course and the society will have to depend on other motive forces for its economy than self-interest. (Schumpeter 1954, 24)

Schumpeter, however, wrote in his paper of 1918 that the crisis of the tax state was not yet complete and that it was still possible to save Austria from the current fiscal crisis by an extraordinary taxation. In March 1919, he was invited to take office as Minister of Finance of the Republic of Austria.¹

He proposed a capital levy as a way to tackle the war debt and opposed the socialization of the Alpine Mountain plant. After nine months, he had to resign from the Ministry of Finance, because the majority of the Government did not share his positions.

In 1921, he became president of the private Biedermann Bank. He was also a board member at the Kaufmann Bank. Problems at those banks left Schumpeter in debt. His resignation was a condition of the takeover of the Biedermann Bank in September 1924.

From 1925 to 1932, Schumpeter held a chair at the University of Bonn in Germany, while also lecturing at Harvard in 1927–1928 and 1930, and at Tokio University in 1931.

In 1932, Schumpeter moved to the US. In 1934 his book of 1911 was translated into English in a shortened edition, in which, however, the fundamental Chapter II, on the nature of the creativity and on the character of the entrepreneur as innovator was omitted.

Schumpeter (1911) had told us in Chap. II, that the entrepreneur is a dynamic man of action, who is active, energetic, feels no inner resistance to change, puts together new combinations of factors of production or of ingredient of products and of commerce, making intuitive choices among a multitude of new alternatives. Thus, he breaks out of the existing equilibrium doing of what is new instead of repeating of what was ordinarily done, while battling the resistance to his actions by others. As the motivating force is power, and joy in creation never stops, the entrepreneur

¹Swedberg (1992, 89) points out that the period from 1910 to 1919 was the most successful period of his life. He published diverse important monographs and articles, he got the position of a university professor, and he was appointed to act as Minister of Finance in Austria. Being only 36 years of age, this appointment was the peak of his career. But the downswing phase followed very soon: in October 1919, only seven months since his nomination, Schumpeter was dismissed, as disloyal to the Government.

borrow from the bank all the capital he can obtain, and by his creativity, he is likely to achieve a surplus of profits on the interest of the money borrowed.

When Schumpeter observed the new neo-capitalistic epoch of big managerial corporations in the US, he moved from the dynamic theory of the growth of capitalism by the creative entrepreneurs of 1911 to the theory of the decline of the capitalist system from within through a transformation process of the entrepreneurial function into a technocratic-bureaucratic managerial function.

In “Business Cycles” (1939) and in “Capitalism, Socialism and Democracy” (1942), written 28–31 years after the “Theory of Economic Development” and 20–23 years after “The Crisis of the Tax State”, he completed the picture by showing that the transformation of capitalism was leading towards managerial technocratic socialism. Democracy, too, was undergoing a similar transformation from the choice of programs, to the choice of a leader to whom to delegate the public choices.

Socialism, whose character Schumpeter never defined in detail, as it may take different forms, implied the transformation of the economic system from one in which economic development was due to the market static and dynamic forces by factors endogenous to economic life, to a system in which planning by exogenous public powers would determine the behavior of the big enterprises and the economic growth. The rational choices of executives, i.e. managers and their experts, were taken in the rooms of big directional centers, and replaced “the heroic leadership” of creative entrepreneurs. The growth of units, where executives carry on political, as well as business activities, has brought about a mixture of public and private elements in business.

With the entrepreneur no longer being a meaningful entity in the big corporations, it seems that this mixture of public and private elements would have been inevitable. A fascinating reading also today, even if Schumpeter’s predictions became only partly true, because in the managerial capitalism of Western economies, the social democratic parties are now in difficulty. Their model of a social state is now complete and needs reforms of neo liberal type, which those parties, often, cannot do without forming coalitions with other parties.

3 Rathenau’s Corporatist Model, Stakeholders, and the Two-Tier Corporation with Workers’ Representatives in the Supervisory Board

Walther Rathenau (1867–1922) was born in Berlin as the first child of Mathilde Rathenau (1845–1926) and Emil Rathenau (1838–1915).

Following his father as an entrepreneur in the big electric company AEG (*Allgemeine Elektrizitätsgesellschaft*), he became one of the most influential industrialists and bankers of Germany. In August 1914, he became the head of the War Raw Material Department in the Prussian Ministry of War, organizing the complete control

of raw materials except foods in order to satisfy the demands of a war economy in Germany.

He left the position in spring of 1915. This experience with “*Gemeinwirtschaft*”, a mix of free market and state economy, an economy controlled by monopolies, influenced the model he devised of a new socialist democratic economy.

Rathenau supported the German war effort until the very end. After the war, he was involved in reparation politics. As Minister of Foreign Affairs from the end of January 1922 onward, he became a leading proponent of the “policy of fulfilment” and signed the Treaty of Rapallo with Soviet Russia, which thus obtained an official recognition, with enormous political consequences such as the foundation of communist parties in Western Europe.

Rathenau was assassinated near his home in Berlin-Grunewald in June of 1922, by killers that the pro-communist intellectuals have defined as “right wing”; but the political orientation of the killers of this noble figure, a dedicated social democrat with corporative-technocratic tendencies, is controversial.

Actually, a strong national identity principle is at the basis of Rathenau’s “New society”. Indeed, in his book *Die Neue Gesellschaft*, (“The New Society”) of 1919, he writes: “On balance it seems that the endowments of the German people work out as follows. High qualities of intellect and heart. Ethics and mentality normal. Original will-power and independent activity, weak” (Rathenau 1921, Chap. X).

We give our devotion freely, and the heart rules in action. Our feelings are genuine and powerful. We have courage and endurance. Led by sentiment rather than by inspiration. We create no forms, are self-forgetful, seek no responsibility, obey rather than rule. In obedience we know no limit, and never question what is imposed upon us. (Rathenau 1921, Chap. X)

Then he adds:

Of its own accord the German people would never have adopted an ideal of force. It was imposed on us by the idolaters of the great war-machine and those who gained by it; even Bismarck did not share it. We are not competent to form an ideal of civilization, for the sense of unity, will to leadership, and formative energy are lacking to us. We have no political mission for the arrangement of other people’s affairs, for we cannot arrange our own; we do not lead a full life and are politically unripe. (Rathenau 1921, Chap. X)

Idealistically, Rathenau claims that

we are endowed as no other people for a mission of the spirit. Such a mission was ours till a century ago; we renounced it, because through political slackness of will-power we fell out of step; we did not keep pace with the other nations in internal political development, and, instead, devoted ourselves to the most far-reaching developments of mechanism and to their counterpart in bids for power. It was Faust, lured away from his true path, cast off by the Earth-Spirit, astray among witches, brawlers and alchemists. (Rathenau 1921, Chap. X)

And he concludes

But the Faust-soul of Germany is not dead. Of all peoples on the earth we alone have never ceased to struggle with ourselves. And not with ourselves alone, but with our dæmon, our God. We still hear within ourselves the All, we still expand in every breath of creation. We understand the language of things, of men and of peoples. We measure everything by itself, not by us; we do not seek our own will, but the truth. We are all alike and yet all different;

each of us is a wanderer, a brooder, a seeker. Things of the spirit are taken seriously with us; we do not make them serve our lives, we serve them with ours. (Rathenau 1921, Chap. X)

The organization imagined by Rathenau in his book *Die Neue Wirtschaft* (“The New Economy”)² of 1918 consists of two kinds corporatist structures with “Berufsverbände and “Gewerbeverbände” (Rathenau 1918, 56). The first structure consists of horizontally integrated enterprises which supply, in a monopolistic fashion, a given kind of commodity as cotton spun or fabric; the other are vertically integrated monopolistic enterprises operating at the different stages of production of a given commodity, as for instance, spinning and weaving of wool. In Rathenau’s conception, this kind of industrial organization most likely grew out of his experience of organizing the Prussian industry to cope with the effort of the world war. It would have produced a great increase of productivity because

- the increase of the scale of production—as in Adam Smith *Wealth of Nations*, which he may have read—allows the division of labour and related specialization;
- and an endogenous technological progress develops, increasing productivity and reducing prices, as in Marshall’s theory of increasing returns.

To avoid likely misbehaviours of the Berufsverbände and of the Gewerbeverbände, i.e. of the horizontal monopolistic companies and of the vertical trusts, these market economic organizations had to be “corporations” certified and overseen by the state.

The more important of the two types of organizations is the Berufsverband, which becomes a unitary economic group, with a unitary force and life, sort of living organism with “own eyes, ears, senses, will, and responsibility. These units not only enter in stable relations with the Gewerbeverbände which are closer to them; they are also in a stable relation with the working class, with the public administration and with the State: i.e. not with a particular State of the Bund but with the Bund itself” (Rathenau 1918, 57). The profits had to be divided into four parts: the part of the state as a profit tax, the part of the workers which they receive in addition to their wages, the part of the purchasers as a reduction of price, and a part for the company to be reinvested or distributed to the stockholders.

The workers would cooperate with the property owners and the managers and their controversies would be resolved by arbitrations.

“The new economy”—Rathenau (1918, 75) writes—“shall not be a state economy, but a private economy subject to the judgement of the public powers, i.e. a private economy which, in order to reach an organic cohesion to overcome the internal frictions, and to multiply its returns and its resistance strength, shall need the

²The book was never translated into English and seems almost unknown among the British and American Economist, except for some random quotation by Keynes and Berle and Means, on the corporate responsibility versus the stakeholders, but was extensively read and studied in Italy, initially in the German edition (reviewed by Luigi Einaudi in *Riforma Sociale*, September–October 1918) and then in the Italian translation (“L’Economia Nuova”), by Gino Luzzatto, an outstanding professor of economic history, belonging to the liberal school, in 1919, in the Laterza editions. In this article I follow the 1st German edition of 1918.

collaboration of the State”. One must recognize that an economy based on the contribution and cooperation of everybody, cannot be, any more, the private business of single individuals, as it was allowed in the period of the affluence Rathenau (1918, 74–75).

Rathenau added that he was looking with regret to the loss of the economic freedom.

The men of the future too shall do projects and constructs; they too shall appreciate the joy of creating under their own responsibility, but they shall not feel any more the tacit and smiling joy of what one has secretly conceived, begun with own means, reinforced among the contrasts, accomplished with own forces What shall arise in future too shall be produced by the creating thought; but shall not grow in a secluded circle of the will of single persons; shall emerge through the struggle but also under the collective guardianship. (Rathenau 1918, 78–79)

Rathenau’s “new economy” model of the corporatist economy precludes the neo capitalist theory of responsibility of the corporation to the stake holders, i.e. the consumers and the communities, where the corporations reside.

The two-tier model of the German corporative law, with the representation of the workers in the Supervisory Board and their “Mitbestimmung” (co-determination) is an important means of integration of the workers in the market economy by a socially oriented neo corporatist system.

4 Hilferding’s Concept of Socialization by the Control of the Unions and the Banking Trusts of the Financial Capital

Rudolf Hilferding was born in Vienna in 1879 in a liberal Jewish family of the middle class and died in Paris in 1941. Differently from Schumpeter and from Rathenau who had studied economics and sociology or had known economics by managing firms and as technicians and entered in politics as experts of Austria and Germany as experts, Hilferding became an economist and sociologist by his political engagement as a Marxist, when studying medicine in Vienna.

He then associated himself with various Austro-Marxists of the Magazine “Kampf”, for instance Max Adler, Karl Renner, Friedrich Adler, and Otto Bauer and started to study economics himself.

Bauer’s “Die Nationalitätenfrage und die Sozialdemokratie” of 1906 (“The Nationalities Question and the Social Democracy”), where the Austrian social democratic leader emphasizes the cultural element of nationality, was critically reviewed by Lenin. Because of Hilferding’s extensive knowledge of Marxism in the contemporary debates, as well as of the doctrines and debates of the social democrats of Austria and Germany, he was appointed as instructor in a training school of the SPD in Berlin in 1906. He became also editor of “Vorwärts” (“Forward”), the main publication of the German SPD from 1907 to 1915. There, he gradually became the party’s chief theorist and expert of public economics and finance.

Enrolled in the Austrian army, he served as a doctor on the Italian front. In 1920, he became a German citizen and chief editor of *Die Freiheit* (“Freedom”), an organ of the Independent Social Democrats. Hilferding was Deputy of the German Parliament from 1924 to 1933, and as member of the ISPD finance minister of the German Weimar Republic in the Social Democratic Governments of Gustav Stresemann of 1923 and Hermann Müller of 1928. In 1933, escaped from the German Nazi Regime, first exiled in Prague, then from 1938, in Paris and Marseille, where in 1941 he was captured by the Nazi and imprisoned to be executed or killed in some other way.

The first important work by Hilferding was “Böhm-Bawerk’s Marx Kritik” (“Böhm-Bawerk’s Criticism of Marx”) of 1904–1905; translated in English by Socialist Labour Press, Glasgow in 1920, which consisted of three Chapters: I Value as an Economic Category; II Value and Average Profit; III The Subjectivist Outlook.

But the most important work by Hilferding was *Das Finanzkapital* (“Finance Capital”) of (1910), in which he maintained that capitalism had come under the control of banks and industrial monopolies.

Hilferding’s ideas strongly influenced Lenin, who analyzed them in *Imperialism, the Highest Stage of Capitalism* of 1917. In his book, Hilferding introduces the notion of a “latest stage” of capitalism, which is characterized by the development of high finance that creates its own (financial) capital and, in consequence, brings the big banks under its control by of the previously separate spheres of industrial, commercial monopolies, which have the dual objectives of preserving to themselves the control of domestic markets and of exports.

Actually—Hilferding argued—in industrial countries while the volume of capital intended for accumulation increases rapidly, investment opportunities contract. The solution of this discrepancy (“contradiction” in the Marxian way of reasoning in which conflicts rather than cooperation are the intellectual and empirical leitmotiv) consists in export capital to developing regions.

On the other hand, for Hilferding, colonial and other low wage countries would be a source of extra profits by reducing the costs of industrial products. Therefore, these territories can have great importance for the industrial monopolies.

The monopolistic enterprises would be constrained to export by the fact that the domestic market demand was not sufficient to saturate their supply, unless they reduced their prices and/or increased the wages of their workers, at the expense of their profits.

The policy of the big industrial financial capitalist had according to Hilferding, had three objectives: (1) to establish the largest possible territory; (2) to close the national territories to foreign competition by protective tariffs and other practices, and consequently (3) to reserve them as areas of exploitation for the national monopolies.

While the industrial monopolies tried to defend themselves from the foreign competition by customs duties and other systems, and tried to gain a surplus of profits by exporting to other countries, where they exerted exploitation by market power, the big banks provided them with financial capital, and promoted the internalization of financial capital with policies, which in a sense stood in contrast to the nationalistic protective policies of the industries, but in another sense fostered them because of the greater ease of international trade.

Hilferding imagined the stage of the finance capital, as consisting in a hierarchical structure in which the big banks would control the big industrial monopolies and the international relations, and both controlled the state and its domestic and foreign policies.

Thus, not only the states became slaves of financial capital, but also the democratic institutions, the culture, small businesses and workers had to be slaves of it.

Hilferding, in analyzing the many contradictions that characterized the last stage of capitalism, did not see the intrinsic contradiction between the objective of financial and industrial globalization and neo-mercantilist industrial practices, as described by him.

Marshall's increasing returns. Caused by the growth of the size of the market and by the possibility of increasing the productivity by the division of labour and the increase of the skill of human capital in the industrial districts consisting of small and medium size businesses, increasing returns are likely to result over time.³

Hilferding introduced the reaction of the workers by their unions as mere conflictual situation with a zero or negative sum game in which the gain of one party implied the loss of the other.

According to Hilferding "The conflict over the labour contract, as is well known, has passed through three stages. In the first stage, the individual manufacturer is opposed by the individual worker. In the second, the individual manufacturer is engaged in conflict with an organization of workers, and in the third, organizations of workers are locked in conflict with employers' organizations".

Therefore, for Hilferding,

The function of a trade union is to eliminate competition among workers on the labour market. It tries to achieve a monopoly of the supply of the commodity 'labour power'. Thus it constitutes, in a sense, a quota cartel; or rather, since it is only a matter here, in relation to the capitalists, of buying and selling this commodity, a 'ring'. But every quota cartel or 'ring' suffers from the weakness that it does not control production, and so cannot regulate the extent of the supply. This weakness is inescapable in the case of a trade union. The production of labour power almost always defies regulation. Only when it is a question of skilled labour power can a workers' organization succeed in curtailing production by taking appropriate measures. (Hilferding 1981, Chap. 24)

³"The worker reproduces the value of c and creates a new value consisting of $(v + s)$, wages and surplus value. The absolute magnitude of $(v + s)$ depends upon the length of the working day. The shorter the working day the smaller is $(v + s)$; and if v remains the same, the smaller is s . If working time remains the same s increases when v declines and vice versa. But this effect is offset by a change in the intensity of labour; with rising wages and a shortening of working time, the intensity of labour grows. ... However important the reduction of working hours has been for the social condition of workers, and however much this achievement and the struggle for it have raised their physical and cultural level, there can be little doubt that this reduction of working time has not altered the ratio of v to s at the expense of s . It has not affected the rate of profit, and from a purely economic standpoint nothing has changed" There is only an exception which confirms the rule "However, it should be pointed out in passing that in many industries which require high standards of precision and accuracy, longer hours of work would have been impossible, and that in general the reduction of hours of work has improved the quality of work, accelerated technological progress, and increased relative surplus value" (Hilferding 1981, Chap. 24).

In Hilferding's view

A strong trade union of skilled workers, by limiting the number of apprentices, extending the period of apprenticeship, and prohibiting the employment of any but skilled workers, as recognized by the union itself, can restrict the production of such labour power and achieve some kind of monopoly position. A good example is provided by the printing unions which have made it a rule, for instance, that only highly qualified 'skilled' compositors can operate type-setting machines, even though less skilled workers with some technical training would be adequate for the job. Under favourable circumstances a strong trade union may even succeed in reversing the relationship and get a certain type of work recognized as 'skilled'. (Hilferding 1981, Chap. 24)

However,

The effort to control the labour market also gives rise to a tendency to prevent competition from foreign workers by increasing the difficulties of immigration, particularly when it is a question of workers who are accustomed to low levels of living and are difficult to organize. Bans on immigration are intended to perform the same service for the trade union as does the protective tariff for the cartel. (Hilferding 1981, Chap. 24)

Thus, in Hilferding's theory, nationalism became a distinctive character of the unions:

The establishment of a monopoly presupposes that the workers will sell their labour power only through the union and only on the terms set by the union. ... This means, however, that the suppliers, that is to say, the unemployed, must not become active on the labour market at prices other than those which have been set. The trade union thus becomes a form of co-operation between the employed and the unemployed. The unemployed must be kept from entering the labour market. (Hilferding 1981, Chap. 24)

Hilferding here did not mention the possibility that the union could become strong enough to oblige the government to subsidize the unemployed and all the citizens who do not participate in the labour market by redistributing a subsidy as the "citizens' income".

The employers, continues Hilferding, react by organizing their union:

The development of employers' and workers' organizations enhances the general social and political significance of wage conflicts The trade union struggle thus expands beyond its own sphere, ceases to be the concern only of the employers and workers directly affected, and becomes a general concern of society as a whole, that is to say, a political phenomenon Employers become unshakeably convinced that every concession they make will weaken their future position and enhance the moral and actual power of the trade unions; that a victory today is bound to mean future victories for the trade unions Their capital is large enough for them to hold out, and to hold out longer than the trade unions whose resources are rapidly depleted by payments to strikers. But the conflict does not remain confined to one particular sphere of industry; it extends to others which supply raw materials... The question of ending the strike is thus transformed from a trade union question into one of political power, and the more the balance of power has tilted in favour of the employers as a result of the growth of employers' organizations the more vital it is for the working class to secure for itself the strongest possible influence in political bodies, and to have representatives who will take up boldly and independently the interests of the workers against those of the employers and help them to be victorious. (Hilferding 1981, Chap. 24)

According to Hilferding, such a victory, however,

will not be achieved by political action alone, which indeed can only be undertaken successfully if the trade unions are strong enough to wage the purely economic struggle with such intensity and vigour that the reluctance of the bourgeois state to intervene in labour questions, against the interests of employers, has already begun to break down, and the political representatives of labour have only to complete the process. ... Hence a point is inevitably reached in trade union development when the formation of an independent political labour party becomes a requirement of the trade union struggle itself It would be a very partial view if we were to conclude that because the employers' organization has the ability to hold out patiently until the workers are exhausted, their trade union is financially destitute... For it is not simply a question of power, but of calculating the effect on the rate of profit. ... Even a trade union previously weakened by a lockout can summon enough strength to wring concessions from employers during a period of boom.⁴ (Hilferding 1981, Chap. 24)

Hilferding, therefore, believed that a possible political consequence of monopoly capitalism could be the transition to socialism in terms of a simple hand-over of the state apparatus from the financial oligarchy to the popular majority: "It is enough for society, through its conscious executive organ—the state conquered by the working class—to seize finance capital in order to gain control (...) of production". (Hilferding 1981, Chap. 25)

5 Conclusion

Empirical evidence is paramount as for the relevance of the three models, in relation to the role on "national identity" spirit in restraining redistribution in order to integrate the working class in a state with market economy and representative democracy.

In a paper by Francesco Forte, Elena Seghezza and Giovanni B. Pittaluga entitled "Suffrage extension and redistribution: the role of national identity, interest group conflict and corporativism", we demonstrate that while the redistributive hypothesis holds, the process of democratization is inevitably accompanied by the adoption of redistributive measures by parliament. This is not what necessarily happened.

Indeed, if one considers the historical experience of Europe in the decades preceding the First World War, one observes that in the face of an intense process of extension of suffrage there were no redistributive policies. We argue that, thanks to forms of indoctrination carried out by the elite, workers put the interests of the nation before those of their own social class.

⁴Julian Marchlewski review of Rudolf Hilferding's *Finance Capital* published in 1910 in one of the two main organs of the SPD left wing, the *Leipziger Volkszeitung* argues that unlike Hilferding's view of economic crises as the product of disproportionalities due to unplanned investments, the reviewer suggests that underconsumption was the principal casual factor: "the overwhelming majority of the population, the proletariat, gets back only a small share of the product of its labour in the form of consumption articles of every kind". He objects that Hilferding failed to explain either the periodicity of crises or why "they follow immediately after a period of prosperity, indeed, almost always after a period of the highest tension in the productive forces".

This hierarchy of preferences was broken by the shock of the WWI. In fact, after it, social groups returned to favoring their class interests after the war. This resulted in heavy macroeconomic imbalances, such as the German hyperinflation.

However, after the stabilization of European economies of the early 1920s, the interests of the various groups were brought to a synthesis by ideologies and policies inspired by corporatism, which reduced the pressure to redistribution.

The three models by Schumpeter, Rathenau, and Hilferding, conceived about one hundred years ago, deserve their place in the economy of the globalization and Internet era of the third millennium. Schumpeter's model of a managed democracy based on the choice of leaders, i.e. a managed democracy, is operative in Europe, particularly in France, and in the US with the parallel model of a managed economy dominated by a few big enterprises.

Rathenau's corporatist model is relevant in the contemporary market economies of the advanced countries through the principle that in particular big companies, but others, too, must take account of the interests of the stake holders in addition to those of the stock holders and this occurs for instance through the two-tier model of companies with the workers' representative present in the higher tier.

Hilferding's dominion of financial capital on the market economies as a protagonist of the globalization is one the biggest issues of the present era and in any way China's quasi capitalistic market economy is a living example of Hilferding's model of socialization, with a political party rather than the unions at the top.

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Suffrage Extension and Redistribution: The Role of National Identity, Interest Group Conflict and Corporativism



Francesco Forte, Elena Seghezza and Giovanni B. Pittaluga

1 Introduction

The redistributivist hypothesis put forward by Boix (2003) and Acemoglu and Robinson (2006) is at present the most widely accepted explanation for the process of democratization in European countries that occurred between the second half of the nineteenth century and the pre-WWI period. According to this view, this process was led by the threat of revolution brought by the lower classes to obtain less unequal distribution.

The plausibility of the threat of revolution hypothesis behind the process of democratization has been confirmed by several scholars (see, among others, Kim 2007; Aidt and Eterovic 2011; Aidt and Jensen 2014). However, a glance to the fiscal policy of the main European countries suggests that in this period government size and tax structure remained basically unchanged from the period prior to electoral reforms.

Unlike explanations that circumscribe the validity of the redistributivist hypothesis¹ here we try to explain the lack of a link between suffrage enlargement and income redistribution by combining the redistributivist hypothesis with the “social identity” hypothesis put forward by Akerlof and Kranton (2000). In line with this last hypothesis, our assumption is that agents pursue not only their personal interests but also the interests of the group they think they belong to. As shown by Shayo (2009)

¹ See, among others Aidt and Eterovic (2011) and Aidt and Jensen (2014).

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and Klor and Shayo (2010), when part of the “poor” feel they are part of the same community as the élite, they can pursue the interests of the community to which they feel they belong and put these interests before their own. Differently from Akerlof and Kranton, however, we assume that the social identity of some interest groups, in our case workers or part of them, is not exogenous, but endogenous. In a few words, some values and ideals can be instilled in the citizens or in part of them.

In particular, in Bisin and Verdier (2001), indoctrination is made by parents who transmit their values and ideals to their children. In this paper, on the contrary, following Lott (1999) indoctrination is made by the elite that by instilling in the masses a high sense of national identity, can lessen the pressures of the poor for redistribution.

When a part of workers have been adequately indoctrinated, the ruling class can extend suffrage without risk of parliament’s request of fiscal redistributive policies. In fact, this part of workers, given the high importance they attribute to national community, put their class interests in the background, while the remaining workers, become weaker, see diminishing the probability of success of a possible revolutionary threat.

However, the success of indoctrination to national sentiment by the state can be undermined by an exogenous shock, like a war, that drastically alters the level of income. In this case the groups return to give priority to class interest, in order to translate the fall in income to others. This conflict ceases when some interest groups prevail over others and ensure stability. However, in order to ensure a return to economic growth, involvement of the defeated interest groups is also needed in this effort.

One way this has often happened in the course of history is the emergence of a corporate ideology. As part of this, participation in the state-decision making process is recognized to the various interest groups.

The scheme just outlined allows to explain what happened before and after the First world war. It also allows to explain the re-emergence of corporatism in European countries in the Seventies, after the first oil shock.

The historical experience, therefore, induces to advance the hypothesis of corporativism business cycle, that is to say that this interpretation of the relations between states and society is strongly sensitive to the economic cycle. In particular, in Europe at least, it seems the recurrent ideological and political solution in phases with a strong social conflict and a dramatic distress of the economy.

This hypothesis seems to fit well with the historical experience of nineteenth-century European countries. At that time, the spread of national feelings, achieved through several channels may have led a large part of workers (first of all, skilled workers) to favour the national interest over those of the class they belong to. This, on the one hand, reduced the élite resistance to enlarge suffrage and led to an intense and widespread process of voting right extensions and, on the other hand, helped reduce the chances that remaining workers might successfully rebel, and therefore of social conflicts. The *national identity hypothesis* just illustrated is confirmed by a cross-country dynamic panel-data analysis.

2 Redistributivist Hypothesis, Indoctrination and Exogenous Shocks

The literature on the connection between suffrage extension, government size and the tax structure is varied and wide-ranging.² The most recent and widespread contributions that seek to explain how the extension of suffrage might affect the size of the state are, however, based on the median voter hypothesis, and in particular on the model developed by Meltzer and Richard (1981). This model starts from the assumption that society is divided into the rich (a minority) and the poor (the majority). In this context, an extension of voting rights to the poor inevitably alters median voter preferences. Following the increase in the ratio between average income and median income, median voters demand redistributive policies. Faced with this demand, the élite, i.e., the “rich”, puts up resistance since complying with the demand would involve losing much of its wealth. The dialectic between “rich” and “poor” with regard to different distribution policies is the way various scholars—primarily Boix (2003) and Acemoglu and Robinson (2006)—explain the process of enlarging suffrage. This expansion is inevitably followed by redistributive policies. These policies may take the form of expanding the welfare state, and with it the size of government, or a reorganization of the tax system that involves a decrease in indirect taxes at the same time as an increase in direct taxes.³

Most contributions that empirically test the redistributivist hypothesis confirm its validity.⁴ However, these contributions relate almost entirely to recent periods, more precisely to periods after the First World War. Besides, as shown exhaustively by Scheve and Stasavage (2016), this war represents a benchmark for the re-composition of the tax structure in favour of progressive income tax, inheritance tax and, subsequently, the development of social welfare systems.

In this work we focus attention exclusively on the decades before WWI. The first question to be answered is whether the extension of suffrage in this time frame represented a decisive change in the tax policy of the various governments in the direction of redistribution. On the basis of the redistributivist hypothesis we should expect that, given the high inequality of European countries in the decades before WWI (see Morrisson 2000; Piketty 2014), the pressures to adopt redistributive policies were forceful.

Actually, between the second half of the 19th century and the period immediately prior to the First World War, the majority of European countries introduced a number of reforms designed to extend the right to vote (Table 1). Following the widespread

²For a survey of this literature see Tridimas and Winer (2005).

³The recent contribution by Lizzeri and Persico (2004) fits into this strand of the literature. They have shown how the ruling élite, if it wishes to overcome special interests and to promote the production of public goods, enlarges the voting franchise. In the new context of a larger electorate, however, policymakers must provide public goods that benefit the whole community as opposed to special interests.

⁴See among others Lindert (1994), Hicks and Swank (1992), Husted and Kenny (1997), Aidt et al. (2006) and Aidt and Eterovic (2011).

Table 1 Electoral reforms and power of parliament

	Years of electoral reforms	Year of universal suffrage
Austria	1867, 1896, 1907	1907
Belgium	1831, 1848, 1893, 1919	1919
Denmark	1849,1915	1918
France	1820, 1830, 1848	1848
Germany	1871, 1919	1871
Italy	1861, 1882, 1912, 1919	1912
Netherlands	1848,1887,1894,1917	1918
Norway	1884,1897, 1919	1900
Russia	1906	1906
Spain	1820, 1834, 1837, 1865, 1869, 1888, 1890, 1931	1890
Sweden	1866, 1907, 1919	1919
UK	1832, 1867, 1884, 1918	1918

Source Aidt and Jensen (2014)

electoral reforms, especially in the period between 1875 and 1913, the electorate grew significantly in the main European countries (Table 2).

In 1913, in almost all the major European countries more than 30% of the population (about 60% of males) had the right to vote.

Table 2 The electorate in percentage of the population 20 years and older: 1875–1913

	1875	1885	1895	1905	1913
Belgium	3.7	3.9	37.3	37.7	38.2
Denmark	26.5	27.8	29.5	29.0	30.1
France	43.7	41.3	41.8	43.2	43.4
Germany	33.0	36.2	37.8	38.3	38.7
Italy	3.6	12.1	11.8	13.5	42.0
The Netherlands	5.0	5.4	11.3	24.4	27.6
Norway	8.4	11.4	16.4	34.4	60.2
Sweden	10.2	10.9	10.7	14.0	32.5
UK	14.9	29.3	28.9	28.5	28.7

Source Flora et al. (1983)

Legenda The percentage is related to the elections held in that year or the last elections held before that year

According to the redistributivist hypothesis, the high level of inequality and the process of suffrage extension should be matched by an increase in government size and a change in tax structure. However, as shown by Morrisson (2000) and Piketty (2014), income inequality, while showing different trends from country to country, remained very high in Europe in the decades precedent WWI. There were, therefore, in this area, according to the redistributivist approach, the conditions for the masses to demand redistributive fiscal policies.

In order to test the veracity of this hypothesis we considered the evolution of government budgetary policies in the most important European countries. We excluded Austria-Hungary and Russia because in these countries parliament had limited power in fiscal matters. By contrast, where the parliament had the power of initiative in budgetary policy and taxation, the right to vote meant that voters had the opportunity to influence government fiscal policy through their representatives in parliament.

Following the criterion outlined above, nine European countries (namely Belgium, Denmark, France, Germany, Italy, Netherlands, Norway, Sweden and UK) were taken as points of reference. We examined government budgetary policy in two areas in these countries: the amount of expenditure and revenue and the structure of taxation and spending.

With regard to government size, Table 3 shows that, at least in the period from 1870 to 1913, franchise extension had no noticeable effect on the ratio of government revenue and of government expenditure on GDP.

Neither redistributive policies through changes in revenue structure or expenditure composition were carried out by the governments of the major European countries. In fact, in the period 1870–1913, the burden of direct taxes on the “rich” remained essentially unaltered and very low: “By 1900, a number of countries in the sample had been democracies for many years and had near universal suffrage, but none of them had adopted income tax rate above 10%” (Scheve and Stasavage 2016, 64). Even the income tax top rate, the source of most revenue from direct taxes, remained very limited and essentially stable up to WWI (see Scheve and Stasavage 2016; Genovese et al. 2016).

The introduction of redistributive policies after the extension of suffrage is not detected even when we consider the composition of government expenditure. Table 4 shows that between the 1870s and the 1900s there were no significant changes even in the structure of government spending, despite a significant expansion of suffrage. In particular, there was no notable increase in the impact of welfare spending on GDP, as the redistributivist hypothesis would suggest.⁵

The evidence produced seems to suggest that the electoral reforms introduced prior to the First World War were not followed by particularly incisive redistributive

⁵As Lindert (2004, 83) rightly points out, “Élite democracies, like the United Kingdom, the Netherlands, Norway, and Sweden in the late nineteenth century were the least likely to have any commitment of general taxes to public pensions and social transfers in general. They were even less likely to have such programs than the average non-democracy.” Not even the quota of government spending on public investments in relation to GDP registered significant variations in the period from 1880 to 1910. Also the impact of spending on defence, general administration, the judiciary and the police on GDP remained substantially stable over the period under consideration.

Table 3 The evolution of central governments' expenditure and revenue between 1870 and 1913 (in percentage of GDP)

	1880		1890		1900		1913	
	Expenditure	Revenue	Expenditure	Revenue	Expenditure	Revenue	Expenditure	Revenue
Belgium	8.7	6.3	8.7	7.9	9.9	9.4	10.7	9.3
Denmark	5.2	6.2	6.4	5.1	5.9	5.1	4.6	5.4
France	13.2	13.9	11.4	11.7	11.4	11.6	10.2	10.3
Italy	11.4	11.2	14.9	14.0	10.7	12.5	14.9	11.9
Netherlands	9.6	9.8	13.9	13.9	11.0	11.0	9.3	9.1
Norway	6.0	5.4	5.9	6.7	6.9	7.9	8.3	9.0
Sweden	5.9	7.5	6.8	8.5	6.7	8.5	7.0	9.7
UK	6.2	6.3	6.8	7.1	10.8	7.8	8.2	8.4

Source Mitchell (2003) and Flandreau and Zumer (2004)

Table 4 The composition of government spending, 1871–1938 (percentage of GDP or NNP, if GDP data are not available)

	Defense and public administration					Transportation and communications					Welfare				
	1871–80	81–90	91–00	01–10	31–38	71–80	81–90	91–00	01–10	31–38	71–80	81–90	91–00	01–10	31–38
Belgium	–	–	–	–	4.2	–	–	–	–	3.4	–	–	–	–	4.5
Denmark	3.1	3.4	2.9	2.3	1.5	0.2	0.4	0.6	0.6	1.0	0.2	0.5	0.6	1.0	4.8
France	–	–	–	–	9.6	–	–	–	–	2.3	–	–	–	–	6.8
Italy	4.6	5.9	5.9	5.5	–	1.9	3.4	3.2	3.7	–	0.3	0.4	3.2	0.6	–
Netherlands	–	–	–	5.0	6.5	–	–	–	1.7	1.9	–	–	–	–	4.8
Norway	2.2	2.5	2.7	2.7	2.0	0.4	0.5	0.9	0.9	1.9	0.4	0.8	0.9	1.3	2.5
Sweden	3.4	3.6	3.5	–	2.7	0.3	0.4	0.4	–	2.1	0.9	1.2	0.4	–	2.5
UK	–	3.3	5.7	4.0	4.6	–	0.1	0.1	0.1	0.5	–	0.6	0.1	1.1	6.0

Source: Appendix of Aidt et al. (2006)

policies, despite the presence of high level of inequality in Europe at the time (see [Morrison 2000](#); [Piketty 2014](#)). [Morrison \(2000\)](#) shows that in the period between 1870 and 1914 in some European countries, such as Sweden and Norway, notwithstanding the average increase in wages, inequality increased.⁶ It was only after the First World War, in particular in the period between 1920 and 1970, that inequality fell drastically in Europe.⁷ Therefore a question: why in the decades preceding the WWI the significant extension of suffrage in Europe was not associated with redistributive policies?⁸ Various explanations for this puzzle have been put forward. However, on one side or the other they are not fully satisfactory.

Given the lack of a satisfactory explanation for the missing link of suffrage extension and redistributive policies in the XIX century Europe, we seek to put forward an alternative hypothesis that, starting from the redistributivist hypothesis, it gives the elite the possibility to influence the preferences of the “poor” and, therefore, their policy choices.

As well known, in the redistributivist hypothesis the conclusion that extension of suffrage is accompanied by redistributive policies is based on the assumption that agents seek to maximize solely their economic well-being. This hypothesis does not take into account certain intangible factors, in particular values that can influence the behaviour of individuals and have to be embodied in their utility function.

Among the various values held by individuals a crucial role is played by “social identity”, defined by [Tajfel \(1978\)](#) as “that part of an individual’s self-concept which derives from his knowledge of his membership in a social group”. As in [Shayo \(2009\)](#) and [Klor and Shayo \(2010\)](#) we consider the social identity in terms of the social status: in particular, individuals identify with the social group they wish to belong to. Following the social identity hypothesis of [Akerlof and Kranton \(2000\)](#), we assume individuals, in their utility function, give some weight to their social identity: the higher the weight, the lower the weight that the individual attributes to his material well-being.

Differently from other contributions of the social identity hypothesis⁹, we assume that the weight is not exogenous, but endogenous. In this respect we relate to [Ticchi et al. \(2013\)](#) and [Alesina and Reich \(2013\)](#). However, differently by [Bisin and Verdier \(2001\)](#) we do not assume that indoctrination is done by parents but, as in [Alesina and Reich \(2013\)](#), it is done by the elite with the aim of maintaining and consolidate

⁶The countries considered by [Morrison \(2000\)](#) are Germany, France, Denmark, Netherland, Norway, Sweden and Finland.

⁷“... the war had a long-term and equalising effect in the fighting countries. If we retrace the evolution of distribution since 1900, what attracts attention is that in all countries, whatever the per capita income or the level of industrialization, inequality dropped after each war” [Morrison \(2000, 249\)](#).

⁸Certainly this fact cannot be attributed to the absence of a fiscal bureaucracy and government revenue. Infact, by the latter decades of the 19th century these countries had at their disposal a broad and efficient bureaucratic apparatus (See [Aidt and Jensen 2009](#); [Webber and Wildavsky 1986](#)). As we have seen, however, this did not lead to a progressive restructuring of taxes or to an evident increase in state size.

⁹For example, from [Shayo \(2009\)](#) and [Lindqvist and Ostling \(2013\)](#).

its power. In particular, we assume that the élite pick up the interest groups which share with them the sense of belonging to the national community, and affect the weight that these groups give to these values, thus making redistribution no longer a priority for them. Therefore, the mass indoctrination can be regarded as an aspect of the process of making a nation, “a community of people who feel that they belong together in the double sense that they share significant elements of a common heritage and that they have a common destiny for the future” (see Emerson 1959, 249).

As shown by Lott (1999) the main tool available to the elite to indoctrinate the masses is the school. It is a fact that “Government have gone to great lengths to instill desired values in children” (Lott 1999, 2). In this perspective, therefore, public education is seen as the main tool to reduce the poor’s opposition to the government and their redistributive demands.

In order to demonstrate the implications of the hypothesis just put forward we have constructed a model which is reported in the Appendix A. It shows how the elite can have convenience in extending suffrage to a part of workers. Such convenience exists if these workers put the interest of the national community before their class interest. This condition can occur by proceeding to the indoctrination of this component of the workers. The splitting of the working class into two sections reduces the likelihood of success of a revolutionary coup by the non-indoctrinated working class.

This last point contributes to explain why, starting from the 1880s, the major European countries institutionalized a mass education system,¹⁰ and this system was quickly centralized: in a few time the state took control of the teaching methods, teacher selection, and teaching programs for schools at every level (see Ansell 2010). In this way “... education [became] the vehicle for creating citizen. It [instilled] loyalty to the state and acceptance of the obligations to vote, go to war, pay taxes, and so on ... the state [promoted] a mass educational system in order to transform all individuals into members of the national purposes ...” (Boli et al. 1985, 159). This is the main reason why the main contributions on nationalism treat school as the key tool for cultivating a deep attachment to the nation in the masses (see in particular Gellner 1983; Hobsbawm 1990). On the other hand, as Anderson (1988, 26) writes: “the logic of nationalism is to deny or at least play down the class divisions and contradictions within a nation in order to maximize internal unity.”¹¹

In fact, compulsory schooling significantly contributed to nourishing the sense of national belonging. Regardless of the ultimate end, the fact remains that the introduction of compulsory primary schooling contributed to transform peoples who spoke different dialects and had different cultural traditions into a united population who spoke the same language and shared the same patriotic values.¹²

¹⁰Compulsory primary education was introduced much earlier in the Scandinavian countries (Sweden in 1842, Denmark in 1814, and Norway in 1848), while in the Netherlands it was not introduced until 1900. See, among others, Soysal and Strang (1989).

¹¹Von Ihering (1866), for example, shows how “feeling German” modifies the behaviour of the German people.

¹²The setting up of a state education system and the introduction of compulsory primary education were made more urgent with the introduction of mass armies. See Aghion et al. (2012).

This process was originally initiated by France, which, after its defeat at Sedan, undertook reforms to revitalize the country, taking its lead from Prussia (see Weber 1976, 126–129). Among these reforms a crucial role was played by the introduction in 1880 of compulsory primary “non-clerical” education. As Paret (1993, 49) writes: “[The] French adopted from Prussia not only true conscription ... and the modern general-staff structure, but also the collaboration of the primary school and the conscript army to teach nationalism to the masses.” Public education was the instrument whereby children were inculcated with the idea that they had a “duty to defend the fatherland, to shed [...] blood or die for the commonwealth ... to obey the government, to perform military service, to work, learn, pay taxes and so on” (Weber 1976, 333). The example set by France was followed by most other countries in a process of competitive emulation. For instance, the Italian élite felt the need to make Italians into a nation once the country’s territorial unification had been achieved. As Massimo D’Azeglio, one of the élite leaders in power, wrote: “We have made Italy, now we must make the Italians.” Similarly, using the ideal of *Das Deutsche Volk*, Bismarck unified Germany and launched what became known as the *Kulturkampf*, which involved, among other things, the state taking full control of education.¹³

The above considerations helps to explain why in the decades before WWI, as shown above, despite a pronounced extension of the right to vote, there were no redistributive fiscal policies.

3 Data and Empirical Estimation

In Sect. 1 we saw how, despite the ongoing process of progressive expansion of the right to vote, there were neither significant increase in the government size nor a change in the tax structure. In the previous section we put forward the hypothesis that the spread of a sense of national belonging weakened the propensity of workers to pursue class interests by demanding redistributive policies. The emergence in workers of a strong sense of national belonging reduced the elite’s resistance to widening suffrage. In order to test the plausibility of this hypothesis, we carried out an econometric analysis. The purpose of this analysis is twofold: i. to ascertain whether and to what extent suffrage extension in many European countries in XIX century influenced the government size; ii. whether that influence was diluted by the strengthening of a sense of national identity.

In order to measure the sense of national identity we make reference to the introduction of compulsory primary school and the centralization of education in public institutions.

¹³The assumption that the introduction of compulsory primary education has contributed significantly to the process of nation building does not in any way deny that it may have favoured an increase in labor productivity and real wages. The fact remains, however, that in the decades immediately prior to WWI in most part of Europe, inequality did not show a clear tendency to decline. Morrisson (2000) explains this fact through the Kuznetz law.

The econometric exercise looked at the period 1876–1913 and was limited to the most important European countries where, at that time, parliament had decision-making powers on government fiscal policy, namely Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, Sweden and the UK. Because the econometric analysis is focused on the effects of suffrage extension on government size we have estimated a panel regression like this one:

$$y_{it} = \alpha_i + \alpha_1 y_{i,t-1} + \alpha_2 \text{FRANCHISE}_{i,t} + \beta X_{i,t} + \varepsilon_{i,t}$$

where the independent variable, y_{it} is proxied either by government expenditures to GDP, or by real standardized per-capita government expenditure (in logs), FRANCHISE_{it} is the share of the population aged 20 or more who were entitled to vote; X_{it} is a vector of control variables and $\varepsilon_{i,t}$ picks up all unobservable factors, the i and t pedicles of the variables refer to the country and year respectively.

When selecting the control variables we took into account the main hypotheses relative to the growth of public spending. In particular, we have considered:

1. the modernization hypothesis—the increase in income and with it the increase in the degree of urbanization and in the level of education favour an increase in government size. In our estimate this hypothesis is captured both by the variable LGDP CAP (the logarithm of GDP per capita), by the variable URBAN (the percentage of population in cities of 25,000 and over), by the variable PRIMARY (the primary school enrolment).
2. the war finance hypothesis—participation in a war or, anyway, an external threat, involves a rise in defense spending and, therefore, of government size. In the estimates this hypothesis is grasped by the variable WAR .
3. the fiscal bureaucracy hypothesis—the increase in government expenditure depends on the development of the tax administration, i.e. the efficiency of the state bureaucracy in the collection of taxes. Such hypothesis is captured by the variable PERSAM , i.e. the percentage of the government employees on the total population.
4. the redistributivist hypothesis—the extension of suffrage is associated with a larger government size. In the estimate this hypothesis is captured by the variable FRANCHISE .
5. the retrenchement hypothesis—according to which the government size, initially high, decreases when the elite extends suffrage to the middle class and subsequently increases when workers get the vote. This hypothesis is picked up through the square of FRANCHISE .
6. the national identity hypothesis—the acquisition of a high sense of national belonging weakens the tendency of individuals to protect their own interests and, therefore, the nexus between extension of suffrage and government size. In the estimates this hypothesis is captured by introducing the variable $\text{FRANCHISE} * \text{LCOMPED}$, where the variable LCOMPED is the logarithm of the number of years since of the compulsory primary school introduction. It allows to take into account both the fact that the sense of national identity has increased gradually

after the introduction of compulsory primary education,¹⁴ and the different stage of the nation making process of countries that introduced compulsory education before and countries that introduced it later. Of course, the introduction of the variable LCOMPED does not imply that the nation making process started with the introduction of compulsory primary school, but simply that through this tool was significantly strengthened.

All the variables used in the estimates are described in Appendix B.

As well known, the dynamic panel estimation by the method of the least square dummy variable model (LSDV) generates biased estimates especially if the time dimension is reduced. To correct this distortion the literature generally resort to techniques of estimates based on instrumental variables (IV) or on estimators based on generalized methods of moments (GMM), in particular the GMM methods proposed by Arellano and Bond (1991) or Blundell and Bond (). However, this class of model is particularly suitable for micro-economic database characterized by a high number of cross-sections (N) and a limited time horizon (T). In the case of a macroeconomic panel like ours, with N small and T fairly extended, these estimation methods are often biased and inefficient, perhaps more than LSDV models. Indeed, some studies using Monte Carlo simulations () demonstrate that LSDV, although inconsistent, has a relatively small variance compared to IV and GMM estimators. Taking account of these aspects, we have used an alternative approach based upon the bias-correction of LSDV in dynamic panel-data models (LSDVC). This correction is done by initially estimating the parameters with a consistent estimation method (IV and GMM). The evidence based on Monte Carlo analyses shows that the LSDVC estimate often improves the IV and GMM estimators both in terms of bias and of root mean squared error (RMSE), and this is particularly true when the cross-section dimension (N) is limited, as generally happens in macroeconomic panels and as happens in our panel.¹⁵ Considering that our panel is an unbalanced panel which consists of 9 countries with a time interval ranging from 1875 to 1913, and then, with an average time span of 38 years, we have resorted to the LSDVC method, using the initial estimates of the GMM estimator of Arellano-Bond according to Bruno's bias approximations.

Table 5 shows the results of the estimates. In particular, column 1, where the dependent variable is EXPGDP, shows that REVOLUTION is not significant as the square of Franchise (which captures the retrenchement hypothesis). FRANCHISE (which picks up the redistributivist hypothesis), WAR (which picks up the war finance hypothesis), and PERSAM (which picks up the fiscal bureaucracy hypothesis) are significant and have the expected sign. The modernization hypothesis is not con-

¹⁴Using the logarithm, we put a limit to this process when LCOMPED reaches the value one.

¹⁵Judson and Owen () make a comparison for dynamic panels of the Anderson-Hsiao (AH) estimators, the Arellano-Bond ("one-step", GMM1) and the LSDV whose distortion is corrected as shown in Kiviet (1995) (LSDVC). The correction made according to Kiviet's suggestions was considered to have little applicability to non-dynamic panels. However, this limitation has recently been overcome by Bruno (2005), who extended and improved his own correction method for unbalanced panels.

firmed: URBAN and PRIMARY are not significant, while LGDPCAP is significant but has a negative sign.

As shown in column (4) of Table 5, similar results are obtained when the independent variable is LEXPCAP, namely the government expenditure per capita. In particular, as in column 2, the variables FRANCHISE, WAR and PERSAM (and the hypothesis behind them) are significant and with the expected sign. Besides, unlike the results in column 2, given the significance and positive sign of LGDPCAP and URBAN, also the modernization hypothesis is validated.

In the columns (2) and (5) of Table 5 we report the results of the estimates of the equations in which the non-significant variables of columns (1) and (4) have been removed. Finally, in the estimates shown in columns (3) and (6) of Table 5 to the variables of columns (2) and (5) we added FRANCHISE * LCOMPED in order to capture the national identity hypothesis.

These estimates show that, while the other variables maintain significant coefficients and with the same sign as in columns (2) and (5), the variable FRANCHISE * LCOMPED is significant. However, FRANCHISE has a higher coefficient than FRANCHISE * LCOMPED.¹⁶ This leads to conclude that the extension of suffrage, in the period under consideration, has favoured an increase in government expenditure, as predicted by the redistributivist hypothesis. This growth, however, was smaller than it would otherwise have been in the period because the indoctrination of masses through public education allowed the elite to gradually instill in the masses a sense of national belonging, therefore, to defer their own interest to that of the national community.

Figure 1 shows that the variable LCOMPED helps to reduce the effect of FRANCHISE on the ratio of government expenditure to GDP by about half.

In European countries, in the decades before WWI, instillation in the masses of a deep sense of national belonging occurred, as well as with public education, also

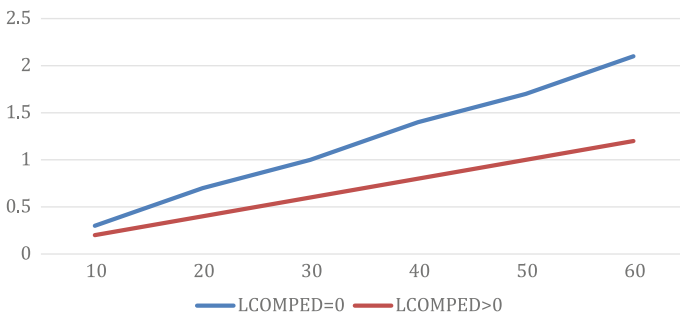


Fig. 1 The effect of FRANCHISE and LCOMPED on government expenditure on GDP. *Legenda* The x-axis reports the percentage of population aged 20 or over with the right to vote. The y-axis reports government expenditure on GDP (percentage)

¹⁶We tested for the difference between the two coefficients. The results, reported in Table 4, show that the two coefficients are significantly different.

Table 5 Suffrage extension and government expenditure (LSDVC Estimates)

Dependent variable	Government expenditure on GDP			Log of government expenditure per capita		
	(1)	(2)	(3)	(4)	(5)	(6)
Expdgp(-1)	0.4922*** (0.0433)	0.4809*** (0.0506)	0.4692*** (0.0508)	Lexpdgp(-1) 0.6138*** (0.0400)	0.5676*** (0.0420)	0.5471*** (0.042)
Lgdpcap	-2.745*** (0.985)	-2.7796*** (0.9969)	-2.2109** (0.9773)	Lgdpcap 0.1914** (0.1036)	0.2020* (0.1111)	0.2844*** (0.1162)
War	1.7935*** (0.462)	1.8980*** (0.5391)	1.8998*** (0.5275)	War 0.1770*** (0.0549)	0.1873*** (0.0594)	0.1885*** (0.0586)
Persam	1.237*** (0.617)	1.5213*** (0.5557)	1.6208*** (0.5522)	Persam 0.1404* (0.080)	0.1619** (0.0810)	0.1618** (0.080)
Franchise	0.054** (0.023)	0.0249*** (0.0067)	0.0349*** (0.0077)	Franchise 0.0046* (0.0025)	0.0026*** (0.0009)	0.0041*** (0.0010)
Franchise * COMPED			-0.0055*** (0.0020)	Franchise * COMPED		-0.00076*** (0.00027)
Urban	0.0255 (0.040)			Urban 0.011** (0.0052)	0.0121** (0.0052)	0.0144*** (0.0052)
Franchise ²	0.00052 (0.0004)			Franchise ² -4.31E-05 (4.34E-05)		
Primary	0.078 (0.127)			Primary 0.0005 (0.0124)		
Revolution	0.229 (0.298)			Revolution -0.0042 (0.0314)		

(continued)

Table 5 (continued)

Dependent variable	Government expenditure on GDP			Log of government expenditure per capita		
	(1)	(2)	(3)	(4)	(5)	(6)
DU298	5.717*** (0.849)	5.7819*** (0.9517)		0.671*** (0.0990)	0.6678*** (0.1086)	0.6732*** (0.1073)
DU484	-7.387*** (0.888)	-7.3867*** (0.9534)	-7.3533*** (0.9398)	-0.689*** (0.101)	-0.6897*** (0.1089)	-0.678*** (0.107)
DU482	5.144*** (0.806)	5.1406*** (1.0370)	5.1470*** (5.1470)	0.418*** (0.104)	0.4145*** (0.1095)	0.423*** (0.108)
R ² adj	0.92	0.92	0.92	0.99	0.99	0.99
SE regression	0.92	0.93	0.92	0.10	0.11	0.10
N.Obs	272	278	278	272	278	278

* means significant at 10%; ** significant at 5%; *** significant at 1%

with other communication tools. Among these a significant role was played by the introduction of compulsory conscription.¹⁷ In fact, between 1871 and 1914 almost all the states of continental Europe introduced some form of conscription on the model of Prussia with its military successes (see Best 1989; Bond 1986; Kiernan 1973). As Posen (1993, 85) writes: “The regimental presence of boys and young men in classrooms and in military units is also exploited to spread crude nationalist ideology among them. Schools, military training, and the newspapers spread the idea that the group had a shared identity and fate that can only be protected by the state.” In a few words, conscription was seen not only as a crucial way of ensuring adequate forces to protect national security, but also “... as an instrument for developing social cohesion and political docility in the masses. Armed forces now enjoyed a period of enhanced popularity as nation-builders and, even, as the guardians or repositories of national virtues (Bond 1986, 32).”

It is conceivable that compulsory conscription, as well as compulsory primary school, had a higher productivity in the process of indoctrination than other tools. It, in fact, being compulsory, allowed to communicate the sense of national identity to a large number of citizens.

Taking these considerations into account, to verify the robustness of the results obtained in Table 5, we performed a robustness test using the logarithm of the number of years since the date of the compulsory military service introduction (LCONSCR). As with LCOMPED, this variable allows us to grasp the gradualness with which the establishment of the mass army contributed to the process of nation making and the different speed, from country to country, with which this process was implemented. The correlation between LCONSCR and LCOMPED is 41%. Given the rather small correlation between these variables, we replaced the LCOMPED variable with LCONSCR.

The results of the regressions so modified, shown in Table 6, are not significantly different from those in Table 5. The national identity hypothesis is still confirmed: the introduction of compulsory conscription helped to reduce the effects of the extension of suffrage on the government expenditure. Figure 2 shows that the effect of LCONSCR on the ratio of public expenditure on GDP is similar to that of LCOMPED highlighted in Fig. 1: the indoctrination of masses through compulsory conscription allows to reduce by a half the positive effect of FRANCHISE on the government size.

4 National Feeling, Weakening Inflation Conflict and Stabilization in the Early XX Century

The First world war, with its immense destruction, involved very high economic and social costs. At the end of it, in the belligerent countries, the level of GDP was

¹⁷Other tools used to instill in the masses a sense of national belonging were newspapers, literature, the establishment of ceremonies and public events. See Elgenius (2012).

Table 6 Robustness test: Compulsory conscription as proxy for national identity

Dependent variable	Government expenditure on GDP	Log of government expenditure per capita	
	(1)		(2)
Expgrp(-1)	0.4442*** (0.0503)	Lexpcap(-1)	0.6249*** (0.0509)
Lgdpcap	-1.3791 (0.9707)	Lgdpcap	0.4071*** (0.1232)
War	1.9071*** (0.5193)	War	0.1749*** (0.0625)
Persam	1.4109*** (0.5330)	Persam	0.2369*** (0.0709)
Franchise	0.0312*** (0.0072)	Franchise	0.0024*** (0.0009)
Franchise * LCONSC	-0.0088*** (0.0027)	Franchise * LCONSC	-0.0010*** (0.0003)
DU298	5.8844*** (0.9318)	DU298	0.7065*** (0.1131)
DU484	-7.3045*** (0.9312)	DU484	-0.7275*** (0.1116)
DU482	5.1565*** (1.0137)	DU482	0.3806*** (0.1222)
R ² adj	0.92	R ² adj	0.99
SE regression	0.92	SE regression	0.11
N.Obs	278	N.Obs	278

* means significant at 10%; ** significant at 5%; *** significant at 1%

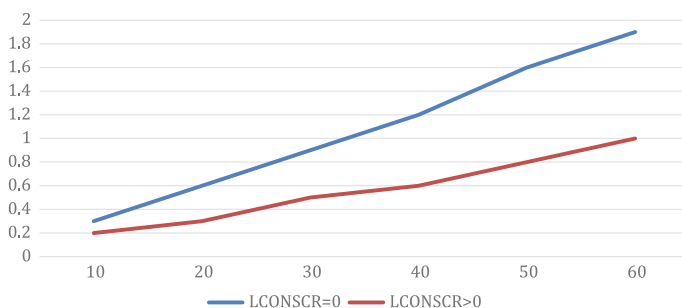


Fig. 2 The effect of FRANCHISE and LCONSCR on government expenditure on GDP. *Legenda* The x-axis reports the percentage of population aged 20 or over with the right to vote. The y-axis reports government expenditure on GDP (percentage)

significantly lower than in 1913. Moreover, the need to finance the war expenses had induced governments, albeit to a different extent, to resort to the inflation tax. Relevant income redistribution processes were derived from it. It is to believe that these shocks have weakened in individuals the sense of national belonging, causing them to attach paramount importance to class interests.

This change in their preferences was also reinforced by the success in Russia of the Bolshevik revolution. Already during the war an alliance between the industrial groups and the masses of workers had established itself in the belligerent countries. The coalition of the “productive classes” favored a transfer of part of the costs of the war on the “unproductive” classes, that is on the rentiers. As Maier writes (1975, 61): “Throughout Europe, the strata of the population that derive their income from capital goods—land or building rents, fixed interest securities or stocks—saw their income decrease as a share of national income”.

The coalition between “productive” classes lasted even after the war. At the end of the latter all of the industrialized countries found themselves saddled with high rates of inflation, high fiscal deficits and massive national debts.¹⁸ In the early Twenties these countries were afflicted by a high conflict between the different interest groups aimed at translating the cost of stabilization on others.

Some interpretations of 1920s stabilizations trace the adjustment processes back to macroeconomic measures such as the re-establishment of control over money creation,¹⁹ the stabilization of the exchange rate level (see Dornbusch 1987; Dornbusch and Fischer 1986), or a sudden ‘regime’ change connected with a new institutional framework (see Sargent 1982). These interpretations, however, based as they are on the hypothesis of a *representative agent*, cannot account for the widespread delays in stabilizations, or the parity chosen at the time of the return to convertibility. These aspects can only be explained by abandoning the hypothesis of the representative agent and adopting a political economy approach.

The most important model within this approach is the *war-of-attrition* hypothesis put forward by Alesina and Drazen (1991). According to this model, the conflict among different interest groups has its origin in the attempt by these groups to shift the cost of stabilization on to other interest groups. This struggle leads to a situation of deadlock and a war of attrition: no interest group wants to bear the cost of public finance adjustment.

This deadlock arises out of information asymmetries between interest groups regarding the ability of the rival group to bear the effects of inflation caused by the delay in stabilization. The latter happens when it becomes clear which interest group is less capable of meeting inflation costs.

A main drawback of the war-of-attrition hypothesis is that it conceives inflation as the result of an unresolved conflict between interest groups, none of which in principle wants inflation. In reality, in an economy with significant financial deepening and

¹⁸An explanation of Europe’s economic conditions after WWI can be found, among others, in Feinstein et al. (1997).

¹⁹See, for example, Bresciani-Turroni (1937).

polarization in the possession of financial assets, inflation damages some interest groups and favours others.²⁰

The distributional consequences of inflation in a context where there are heterogeneous agents have been highlighted in some recent theoretical contributions (See Erosa and Ventura 2002; Doepke and Schneider 2006; Albanesi 2007).

From this point of view, we can see that just as interest groups have different perspectives on direct and indirect taxation, they also have different attitudes towards inflation. Accordingly, inflation can no longer be seen as the undesired consequence of deadlock, but it can represent a political choice that some interest groups prefer over other forms of taxation (see Grossman 1990).

In short, inflation is a rational choice made by policymakers. In fact, in the political arena there is a demand and a supply. On the demand side stand interest groups, which compete among themselves for the distribution of income and seek favourable political decisions by offering political support to the parties. If every interest group has a different income structure, it has hierarchical preferences with regard to the possible means of achieving stabilization. Each interest group expresses a demand for a package of fiscal measures (including inflation), and, in a democratic system, each party makes an offer of fiscal measures: political equilibrium is achieved when an interest group or an interest group alliance, represented by a political party or coalition, gains power.

On the supply side stands the political class—first and foremost, parties. They fight for power by seeking the support of interest groups and offering favourable decisions in exchange. The relationship between political class and interest groups takes the form of an exchange between the political support offered by interest groups and the political decisions offered by the political class.²¹

After the World War I all European countries were faced with two common problems: productive reconversion and the re-absorption of the national debt they had accumulated during the war.

The existence of these two problems, together with the attempts to solve them, led to a vast distributive conflict between interest groups. Although there were specific differences between the various countries, this distributive conflict generally went through two distinct phases.

In the first phase, in the period immediately after the war, almost all European countries suffered high inflation. This problem can be traced back to the predominance of political coalitions representing businessmen and workers (the ‘productive’ classes) which wanted *rentiers* to bear most of the costs of macroeconomic adjustment.

The alliance between productive classes or, more in general, the strong pressure exercised by the union-based parties favoured the adoption by governments of infla-

²⁰This aspect is highlighted in Lában and Sturzenegger (1994) and in Perotti (1996).

²¹North and Weingast (1989) and, more recently, among others, Rajan and Zingales (2003a, b), Acemoglu et al. (2005), Acemoglu (2006) and Acemoglu and Robinson (2006) show that policy-makers adopt measures to maintain political influence and also the power of the interest groups they represent.

tionary policies. In 1919 and the early 1920s, in most countries high inflation meant that the real interest rate was severely negative (Table 7), and the inflationary erosion of financial assets was marked. It was extreme in countries affected by hyperinflation.

The coalition of *productive classes* obtained advantages from inflation not only because the burden of budget balance adjustment was placed on *rentiers*, but also through other channels. In particular, businessmen derived benefits from the persistently negative real interest rates on their debts and workers from welfare measures adopted by governments. In many cases the unsuccessful adjustment of state budgets not only followed from the fact that taxation was not tightened up but also from a remarkable increase in government expenditure.

Subsequently, in the course of the 1920s, with various delays and modalities, all European countries started stabilization processes (Table 8).

Notwithstanding differences in timing and modality, these processes showed clear uniformity: they were carried out by social and political coalitions within which *rentiers* played a primary role, while the role of workers was marginal or non-existent.

In a few words, the stabilization processes in the 1920s were made possible by a change in political equilibrium, in other words, by the rise to power of new coalitions between parties and new alliances between interest groups. From a political perspective the stabilizations in the 1920s share two main features.

First of all, stabilization took place when an alliance between businessmen and *rentiers* was possible. This was the case when *rentiers* were able to exercise sufficient political pressure, when businessmen's attitude towards stabilization changed and when changes occurred on the political supply side²² which encouraged alliances

Table 7 Long-term interest rates in real terms^a

Year	France	Germany	Great Britain	Italy
1920	-33.3	-139.4	-10.3	-24.5
1921	-7.8	-25.2	14.8	-12.6
1922	1.3	n.a	23.8	5.1
1923	-6.4	n.a	10.0	5.6
1924	-8.4	n.a.	3.7	1.9
1925	0.2	-1.2	4.6	-7.1
1926	-24.3	5.6	6.6	-1.1
1927	0.2	1.6	7.6	-2.6
1928	4.4	3.8	5.6	-1.2
1929	-2.4	6.3	5.8	1.7

Source Horner and Sylla (1991) and Mitchell (1975)

^aThe real interest rates are determined by the difference between interest rates on government bonds and the annual rate of growth of consumer price indices

²²These changes consisted in the founding of new parties that supported the interests of wide sections of the *petit bourgeoisie*, like the creation of the DDP (German Democratic Party) and the DVP (German Popular Party) in Germany and the Fascist party in Italy.

Table 8 1920s stabilizations of European countries

Country	Year of stabilization ^a	Level of currency stabilization relative to pre-war gold value	External enforcement
Austria	1922	Hyperinflation	League of Nations
Belgium	1926	1/7	
Denmark	1926	1	
Finland	1923	1/6	
France	1926–1928	1/5	
Germany	1923–1924	Hyperinflation	Dawes Plan
Great Britain	1925	1	
Italy	1927	1/4	
Poland	1926–1927	Hyperinflation	
Romania	1927–1929	1/33	
Sweden	1922–1924	1	

Source League of Nations (1946)

^aThe second year is *de iure* stabilization when different from *de facto* stabilization

between businessmen and *rentiers*. Secondly, in the (sometimes national unity) political coalitions which carried out stabilization, the centre-right parties (some of which represented *rentiers*) tended to play a dominant role. This implies that the socialist parties were marginalized and that the fiscal burden of stabilization fell primarily on the workers.

5 The Emergence of Corporatism in the Twenties

The First world war was accompanied by profound economic and social changes. The high demand for war material favored a process of industrial concentration and the formation of cartels.

At the same time, the masses learned to organize themselves into pressure groups. In particular, the workers formed strong unions. The formation of large interest groups and universal access to the right to vote changed significantly, compared to the pre-war period, the way in which political competition took place.

We have seen how coalitions of interest groups are at the base of early 1920s inflation and subsequent stabilization processes. It is not surprising, therefore, that in the various European countries, once stabilization had been achieved, there was a concern to define the conditions for an adequate growth of the economy. These conditions consisted, first of all, in establishing harmony between the different interest groups. In other words, it was a question of avoiding situations of conflict between them and intense redistributive processes.

This goal was pursued through changes in the functioning of democratic regimes, in particular through changes in the relationship between political power and society. These changes resulted in direct relations between the government and the representations of the interest groups and with the establishment of institutions that were representative of these representations.

In this context, the role of parliament was diminished: in fact, often, interest groups entered into agreements with each other with the mediation of the government without the legislative body being involved.

In almost all European countries, albeit in different forms and ways, the corporate scheme just described prevailed in the 1920s. This scheme found its ideological justification in different spheres, such as the social doctrine of the Church, the organicist theory of the German state, the French syndicalism, etc. As Schmitter (1974, 13) writes: “Corporatism can be defined as a system of interest representation in which the constituents units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories ...”.

The social peace allowed by the prevalence of forms of corporatism both in democratic regimes, such as the Scandinavian ones, and in autocratic regimes, as in Italy and Germany, favored the process of modernization of these countries in the interwar period (see Maier 1987).

Mainly in autocratic regimes corporatism supported new forms of nationalism: the nation was the body to whose health and strength the different interest groups contributed.

The functions of the corporations involved two broad categories: economic and social functions and industrial relation functions. With reference to the first area, the functions of the corporations primarily concerned price regulation. According to some thinkers, such as Rathenau (see Forte 2018), the latter was part of an extensive state directed planning system. Also in the economic and social sphere, the determination of wages was delegated to the corporations. With reference to industrial relations, the purpose of the corporations was to eliminate conflicts and start a system that would generate industrial peace and autonomy (see Williamson 1985).

Within the autocratic regimes that emerged in the interwar period, primarily in Germany and Italy, corporatism was presented as a canon of social relations that strengthened the nation and its primacy in the international context (see Stoeker 1885). In this way, albeit in a different form, in the decades preceding WWI, individuals were called to change their hierarchy of preferences by putting the interests of the national community of which they were a part before class interests.

6 Conclusions

In this paper we show that in the decades before the First world war the suffrage was extended to ever wider sectors of the working class without the parliaments proceeding to increases in public spending and redistributive fiscal policies.

The explanation of this puzzle is believed to lie in the indoctrination to which a large part of the workers was subjected through the introduction of compulsory schooling and military service.

The sense of national belonging of the working class was greatly weakened with the First world war. Its material and moral destruction, the success of the Bolshevik revolution and its promises induced workers to give high importance to their class interests. Workers' unions reached a capacity for political pressure unknown in the past. In this context, and in the presence of subversive threats, the industrialists sealed a political alliance with the workers. This alliance gave rise in the early Twenties to governments that resorted largely to inflation to meet the costs of reconstruction and the repayment of public debt. High widespread and persistent inflation favored intense redistributive processes of income and wealth against the rentier and in favor of industrialists and workers.

This process, at the end, found a limit in the impossibility to extract further resources from the rentiers and in the dramatic macroeconomic imbalances. This forced governments to implement stabilization policies. These policies were generally pursued by conservative governments, expression of coalitions between industrialists and rentiers. In this context, the costs of adjustment were shifted mainly to workers through high indirect taxes.

Stabilized the economy, European governments aimed at recreating the conditions favorable to growth and modernization of their countries. These conditions found their main expression in the institutionalization of forms of corporatism. The latter took different forms in democratic and authoritarian regimes. However, it guaranteed the social peace necessary for the economic recovery of Europe.

It is easy to establish a connection between what happened in Europe in the 1920s and what happened in this geographical area after the first oil shock, when in many countries the practice of concertation between industrialists and workers was adopted. On the basis of these historical experiences it seems to be possible to conclude that concertation is re-proposed as a way of managing public choices after profound economic shocks. In this perspective we can advance the hypothesis of a business cycle of corporatism.

Appendix A

The model takes as its starting point the traditional theory of Acemoglu and Robinson (2006). In accord with this model, we consider an economy with three groups of

people, the elite (E), the skilled workers (SW) and the unskilled workers (UW).²³ The economy lasts for two periods. In the first period the elite holds political power while workers are disenfranchised. In the second period workers may threaten a revolution and the elite can democratize.

The political system determines a tax rate, $\tau \geq 0$, proportional to income. Its revenue can be used for lump-sum redistribution or for investment.²⁴ Individuals' utility depends not only on their disposable income²⁵ but also on the utility of the group they identify to. In particular, as in Lindqvist and Ostling (2013), we assume that each individual belongs to two groups—an “income” group and a “social” group—and has to decide with which group to identify. In our setting the “social” group is the group of persons that share national identity values. We assume the elite and skilled workers identify with the “national identity” group, while unskilled workers identify with their “income” group.

We assume the degree of national identification, γ^i , is different for the elite and skilled workers: it is utmost for the elite, $\gamma^E = 1$, and lower for skilled workers, $\gamma^{SW} \in (0,1)$. In period one the elite in power can dedicate resources, τ , to increase skilled workers' national identity in the second period: $\gamma^{SW} = \alpha\tau$. Given these premises, second period's utilities of the three groups are the following:

$$\hat{V}^i = (1 - \tau)y^i + \left(\tau - \frac{1}{2}\tau^2 \right) + \gamma^i \left((1 - \tau)\bar{y}^{NI} + \left(\tau - \frac{1}{2}\tau^2 \right) \right) \quad i = E, SW \quad (1)$$

$$\hat{V}^{UW} = (1 - \tau)y^{UW} + \left(\tau - \frac{1}{2}\tau^2 \right) \quad (2)$$

Equation (1) represents the utility of the elite and skilled workers. The first term, $(1 - \tau)y^i$, is after-tax income while the second term, $(\tau - \frac{1}{2}\tau^2)$, is lump-sum redistribution. The third term is the value given to national utility. It is composed by the parameter γ , i.e. the degree of identification with the nation, multiplied by the average utility of the members that share national values, i.e. the elite and skilled workers: \bar{y}^{NI} is the average income of the elite and skilled workers.²⁶ Equation (2) is the utility of unskilled workers. Since they identify with their income group, their utility consists only of the first two terms, i.e. on their disposable income and on government transfer.

²³The elite represents δ^E of the population, skilled workers δ^{SW} and unskilled workers δ^{UW} . We normalize total population to 1, thus $\sum \delta^i = 1$, and assume that $\delta^E < \delta^{SW} < \delta^{UW}$, that is the unskilled workers are the most populous, followed by the skilled workers and the elite is the smallest group in the population.

²⁴Redistribution gives rise to aggregate costs equal to $C(\tau) = \frac{1}{2}\tau^2$, while investment, γ , is linear in tax revenue, $\gamma = \alpha\tau$.

²⁵We normalize total income to 1. Income of the three groups is the following: $y^i = \frac{\theta^i}{\delta^i}$, where θ^i is the share of total income that goes to group i , thus $\sum \theta^i = 1$. We assume the elite's income, y^E , is bigger than average income, while workers' income is lower than average income, i.e. $y^{UW} < 1$, and $y^{SW} < 1$, with $y^{SW} > y^{UW}$, i.e. the skilled workers are richer than unskilled workers.

²⁶ $\bar{y}^{NI} = \frac{\theta^E + \theta^{SW}}{\delta^E + \delta^{SW}} > 1$.

It is straightforward to derive each individual i 's preferred tax rate from the above utility functions:

$$\tau^i = \frac{(1 - y^i) + \gamma^i(1 - y^{NI})}{1 + \gamma^i} \quad \text{for } i = E, SW;$$

$$\tau^{US} = (1 - y^i) \quad \text{for unskilled workers}$$

Since the rich are richer than average, and the mean income of people sharing national values is higher than average income, their preferred tax rate is zero. The preferred tax rate of skilled workers diminishes with their national values, and can also reach zero. The preferred tax rate of unskilled workers is positive and the highest of all.

The introduction of national values leads to our **First Proposition**: *the tax rate is a decreasing function of the weight skilled workers attribute to national identity.*²⁷

The Proposition just stated leads to the conclusion that the demand for redistributive policies by the poor is much weaker, the higher the sense of national belonging.

In the second period, with probability p , workers pose a revolutionary threat. As in Acemoglu and Robinson (2006), if the skilled workers withdraw from this process, the unskilled workers cannot undertake a successful revolution. The elite can, therefore, avoid the revolution by granting partial democracy.²⁸ In case of revolution the elite's utility is zero, $V^E(R) = 0$.

The timing of the game is the following. In the first stage, the elite decides whether to invest in national identity with the aim of maximizing its utility in the first and in the second period. In the second stage, the elite chooses whether to maintain the status quo (and therefore to bear the losses of a revolution, with probability p), or to grant partial democracy.

Let us analyse the subgame perfect equilibrium of this game. In the second stage of the game the elite can choose either to maintain the status quo, or to grant democracy to skilled workers.

If the elite keeps the system as it is, it will obtain its most preferred tax rate, $\tau = 0$, with probability $(1 - p)$, but it will lose everything in the case of a revolution, which will happen with probability p :

$$\hat{V}(SQ)^E = (1 - p)(y^E + \gamma^E y^{NI}) \tag{3}$$

In contrast, if the elite chooses to grant partial democracy, its payoff will be:

$$\hat{V}(PD)^E = (1 - \tau^{SW})y^E + \left(\tau^{SW} - \frac{1}{2}\tau^{SW2} \right)$$

²⁷Proof: the first derivative of Eq. (2) with respect to γ^i is negative.

²⁸We assume the skilled workers utility is higher under partial democracy than under revolution. Since the preferred tax rate of skilled workers is lower than that of unskilled workers the elite always prefer to grant partial democracy than full democracy.

$$+ \gamma^E \left((1 - \tau^{SW}) \bar{y}^{NI} + \left(\tau^{SW} - \frac{1}{2} \tau^{SW2} \right) \right) \quad (4)$$

The elite chooses to maintain the status quo if $\hat{V}(SQ)^E > \hat{V}(D)^E$, i.e. if:

$$p \leq p^* = \frac{(1 - y^{SW}) + \gamma^{SW}(1 - y^{NI})}{(1 + \gamma^{SW})(y^E + \gamma^E y^{NI})} \left[y^E + \gamma^E y^{NI} - (1 + \gamma^E) \left(1 - \frac{1 - y^{SW} + \gamma^{SW}(1 - y^{NI})}{2(1 + \gamma^{SW})} \right) \right] \quad (5)$$

From Eq. (6) we see that, given the probability of revolution, p , it is more likely that, as in Acemoglu and Robinson (2006), the elite maintains the status quo the higher its income, y^E , and the lower skilled workers' income, y^{SW} . In addition to that, from Eq. (6) we can conclude that the likelihood of the extension of vote's right to the skilled workers is higher, the higher skilled workers' national values, γ^{SW} .

Hence the **Second Proposition**: *given a certain value of the probability of revolution, the elite extends suffrage to skilled workers when they have a high level of income and attribute a high weight to national identity feeling.*

This Proposition highlights the fact that the higher the sense of belonging to the nation, the lower the income of skilled workers at which the elite finds it convenient to give them the right to vote. In fact, if they have a high sense of national belonging, do not ask for redistributive policies in their favour.

Given the Second Proposition, we must determine the conditions under which it is in the interest of the elite to increase the national identity sentiment of workers by indoctrination. We move, therefore, to the first stage of the game, where the elite chooses to invest in the inculcation of national values in skilled workers.

As is clear from Eq. (6), for low values of the probability of revolution, the elite will always choose the status quo: In this case there is no reason to invest in national identities. We assume the probability of revolution is high enough that the elite will choose partial democracy in the second stage. In this context, in the first period, the elite chooses the tax rate to maximize its first period utility and second period utility. Since the elite's income is above average, their only reason to increase taxes is for financing investment. Therefore, first period elite maximization problem is the following:

$$\hat{V}_1^E = (1 - \tau)(y^E + \gamma^E y^{NI}) + (1 - \tau^{SW})(y^E + \gamma^E \bar{y}^{NI}) + (1 + \gamma^E) \left(\tau^{SW} - \frac{1}{2} \tau^{SW2} \right) \quad (6)$$

where the first term is its utility in the first period, and the last two terms its utility in the second period, when there is partial democracy and the tax rate is chosen by the skilled workers.

The first order condition is:

$$\begin{aligned}
 &-(y^E + y^{NI})(1 + \gamma^{SW})^3 + \alpha(y^{NI} - y^{SW})(y^E - y^{NI})\gamma^{SW} \\
 &+ \alpha(y^{NI} - y^{SW})(y^E + y^{NI} - 2y^{SW}) = 0
 \end{aligned}
 \tag{7}$$

which is an equation of third degree in the amount of investment in national values. To find out if it is in the elite interest to invest we need to analyse this equation in the range of values γ^{SW} can assume, i.e. in the range (0.1).²⁹

We get that the elite invests to increase skilled workers national identity if:

$$\alpha \geq \alpha^{**} = \frac{y^E + y^{NI}}{(y^{NI} - y^{SW})(y^E + y^{NI} - 2y^{SW})}
 \tag{8}$$

where, we remember, α is the parameter of the investment function, $\gamma^{SW} = \alpha\tau$: the higher α and the more productive is the national identity investment.

Equation (8) tells us that the elite invests in national identity of skilled workers if this investment has at least a productive level equals to α^{**} .

If in the second period the elite decides to grant the right to vote to skilled workers since, as in Acemoglu and Robinson (2006), these have a high enough income, so the increase in τ is bearable, the elite can invest in nation building in order to:

- i. reduce the increment of τ ;
- ii. increase the range of workers to which the right to vote is extended.

This leads to our **Third Proposition**: The likelihood that the elite produces values that induce the skilled workers to feel part of the national community is:

1. increasing in the difference between y^{NI} and y^{SW} .

Since y^{NI} depends both on the number of skilled workers and on their average per-capita income, we can say that, for a given level of y^E , the number of skilled workers who are granted the right to vote is all the greater the higher is their individual income.

²⁹For values of $\gamma^{SW} \in \left(-1 \pm \frac{\sqrt{3\alpha(y^E + y^{NI})(y^{NI} - y^{SW})(y^E - y^{NI})}}{3(y^E + y^{NI})}\right)$ the first derivative of Eq. (8) is positive. The lower bound of this interval is clearly negative, while the upper bound, γ^{SW*} , can be positive or negative depending on parameters. For values of $\alpha \leq \alpha^* = \frac{3}{(y^{NI} - y^{SW})(y^E - y^{NI})}$ the upper bound is negative: In this case the first derivative of Eq. (8) is negative for all possible values of γ^{SW} . If, instead, $\alpha \geq \alpha^*$, Eq. (8) increases with γ^{SW} for values of $\gamma^{SW} \in (0, \gamma^{SW*})$ and then decreases. Equation (8) evaluated in $\gamma^{SW} = 0$ is positive if $\alpha \geq \alpha^{**} = \frac{y^E + y^{NI}}{(y^{NI} - y^{SW})(y^E + y^{NI} - 2y^{SW})}$. Equation (8) evaluated in $\gamma^{SW} = 1$ is positive if $\alpha \geq \alpha^{***} = \frac{4(y^E + y^{NI})}{(y^{NI} - y^{SW})(y^E - y^{SW})}$. If α is bigger than α^{***} , it is also bigger than α^{**} . In this case Eq. (8) is positive for all values of γ^{SW} , and therefore the maximum amount of investment will be chosen. For values of $\alpha \in (\alpha^{**}, \alpha^{***})$, there exists a value of γ^{SW} for which Eq. (8) is equal to zero, i.e. Equation (7) is maximized. For values of $\alpha \in (0, \alpha^{**})$ there are three possible cases. First, $\alpha \leq \alpha^*$, i.e. Eq. (8) is always decreasing: In this case Eq. (8) is always negative in the relevant range, and the optimal amount of investment in national identity is zero. Second, $\alpha \geq \alpha^*$ and Eq. (8) evaluated at γ^{SW*} is negative; also in this case Eq. (8) is always negative and the optimal level of investment is zero. Third, $\alpha \geq \alpha^*$ and Eq. (8) evaluated at γ^{SW*} is positive, in this case there exists a value of γ^{SW} for which Eq. (8) is equal to zero, i.e. Eq. (7) is maximized.

2. *increasing in the value of α , that is the productivity of the investment in national identity.*

This productivity depends on the technology used by the elite to instill the sense of belonging to the nation in skilled workers. It is to believe, for example, that the use of tools such as the compulsory primary public school makes it possible to raise the marginal efficiency of the process of nation building, compared, for example, to transfers of the same amount to private individuals in the form of vouchers.

Appendix B

The following notation is used:

- EXPGDP is the total central government expenditure over nominal GDP;
- LEXPCAP is the total central government expenditure, in international 1990 Geary-Khamis dollars, per capita, in logarithms;
- FRANCHISE is the share of enfranchised on the population of 20 and older;
- LGDPCAP is the logarithm of real GDP per capita in international 1990 Geary-Khamis dollars;
- URBAN is the proportion of the population that lived in towns with more than 25000 inhabitants;
- WAR is a dummy with value 1 if the country or some of its neighbour is in war and with value 0 otherwise;
- PRIMARY is the share of primary school enrollment;
- REVOLUTION is a proxy of a risk of revolution measured as in Aidt and Jensen (2013), i.e. taking account of revolutionary coups in other countries and their proximity;
- PERSAM is the percentage of the government employees on the total population;
- LCONSC is the logarithm of the number of years since the introduction of the compulsory primary school, and zero otherwise;
- LCOMPED is the logarithm of the number of years since the introduction of the compulsory primary school, and zero otherwise;
- Data on nominal GDP, Total government expenditure, and population are from Mitchell (2003). The real GDP is in international 1990 Geary-Khamis dollars and is sourced by Maddison (2003). The composition of government spending data, the share of citizens enfranchised and the number of public employees are from Flora (1983). The urbanization rate data come from Banks (1971), while the proxy of threat of revolution is measured as in Aidt and Jensen (2013). The data for the dummies relative to mass conscription and to compulsory education are respectively from Onorato et al. (2013) and Soysal and Strang (1989).

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Ludwig von Mises' Argument Against the Possibility of Socialism: Early Concepts and Contemporary Relevance



Ludwig Van Den Hauwe

1 Introduction

The Socialist Calculation Debate is almost certainly one of the most important debates that have ever taken place within the field of economics and probably the most important debate in economics of the 20th century. The outcome of the debate has been subject to diverging interpretations and ongoing dispute, however. These disagreements persist to this day. This paper recalls Mises' original result and reviews some of the subsequent debates and recent developments.

2 Mises' Early Argument

At the time when socialism became an immediate political issue at the end of World War I, the opening round in the Socialist Calculation Debate was fired by Ludwig von Mises in 1920, in his article "Die Wirtschaftsrechnung im sozialistischen Gemeinwesen". According to the standard account, before 1920 socialist theorists paid little attention to how a socialist economy would work in practice, most heeding Marx's admonition to avoid such "utopian" speculation.¹ Then Mises, known at the time

¹When the "standard account of the calculation debate" is mentioned reference is made to such examples as Schumpeter ([1942] 1975, in particular Chap. 16) and Bergson (1948). Discussions of the "revisionist view" can be found in Hoff ([1949] 1981), Salerno (1990), and Rothbard (1991), among others. For good summaries of the debate see also Cottrell (1998) in Davis et al. (1998); further also Vaughn (1994) in Boettke (1994) and Boettke et al. (2014) in Garrison and Barry (2014).

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mainly as a monetary theorist, published the sensational article later translated as “Economic Calculation in the Socialist Commonwealth” (Mises [1920] 1990).

Mises’ thesis was that rational economic calculation was impossible under socialism. His basic argument was that, in any but the simplest economy, economic calculation demands the use of a scalar common denominator for costing and valuation.² In the capitalist economy, market prices provide such a common denominator. Mises assumed that, while there may exist a market for consumer goods in a socialist economy, there will not be a market for the means of production (as state property, the means of production will be *res extra commercium*), and neither will there be a labor market in anything like the capitalist sense. For this reason market prices will not be available as a means of calculation and socialism is not economically practicable.

In a complex, modern economy with multiple stages of production, resource allocation requires the existence of money prices for capital goods, prices that under capitalism arise from an ongoing process of competitive bidding by entrepreneurs for the factors of production. This process cannot be replicated by input-output analysis, computer simulations, or any other form of artificial market.

Mises’s main point was that socialism fails because decision makers require meaningful prices for all of these factors in order to be able to choose from the vast array of possible factor combinations.

Mises’ main argument can be summarized in three statements:

1. Rational economic activity requires the pricing of all goods, production goods as well as consumption goods.
2. Pricing requires the existence of a market.
3. A market requires the existence of independent owners of the goods exchanged.

All these are impossible in a socialist society which by definition is a society in which the private ownership of means of production is abolished, and business initiative is invested in a central authority which alone directs industrial activity (Hoff [1949] 1981; also Yeager 1949).³

A first somewhat simplistic objection that is still sometimes heard consists in pointing out that socialist centrally planned economies have actually existed for several decades in the former Soviet Union and in the communist nations of Eastern Europe and that this fact contradicts (or seems to contradict) Mises’ impossibility claim. However, the point to be stressed is that without markets for physical and financial capital—which determine what tasks will be performed and whether they have been performed adequately—an economic system must rely on outside references to tell it what to do and will have difficulty generating anything *new* since without

²As summarized by Salerno (1990, 52): “Without recourse to calculating and comparing the benefits and costs of production using the structure of monetary prices determined at each moment on the market, the human mind is only capable of surveying, evaluating, and directing production processes whose scope is drastically reduced to the compass of the primitive household economy”.

³This characterization corresponds to the old or original definition of socialism. More recent definitions have improved upon this definition and some progress has occurred in the ways in which socialism can be defined from a scientific viewpoint. See further.

economic calculation, there is no way to figure out if tasks have been performed efficiently.

Hence of course, the only reason the Soviet Union and the communist nations of Eastern Europe could exist at all is that they never fully succeeded in establishing socialism worldwide, so they could use world market prices to establish implicit prices for the goods they bought and sold internally (Rothbard 1991, 73–74). In Mises's words, these economies were not isolated social systems. They were operating in an environment in which the price system still worked. They could resort to economic calculation on the ground of the prices established abroad. Without the aid of these prices their actions would have been aimless and planless. Only because they were able to refer to these foreign prices were they able to calculate, to keep books, and to prepare their much talked about plans (Mises [1949] 1998, 698–99).

From a history of economic thought perspective, it will be noted that at about the same time that Mises' famous article appeared in 1920, similar ideas came from the pens of Max Weber in Germany and also of Boris Brutzkus in Russia.⁴

Max Weber maintained that calculation *in natura* could not give a rational solution of the problems which would confront a planned economy. Max Weber emphasized that conservation and rational employment of capital could only be secured in a society based on exchange and the use of money, and that the loss and destruction which would result were rational calculation not feasible in a completely socialized society, could make it impossible to maintain the present population in densely populated areas (also Hoff [1949] 1981, 3).

Mises, Weber, and Brutzkus were not the first writers to question the economic efficiency of planning. As early as 1902, the Dutch economist Nicolaas G. Pierson had emphasized that a socialist community would have to face the problem of value (Pierson [1902] 1935).

But it was left for Professor Mises to revolutionize academic discussion, which Mises accomplished by his dogmatic insistence that rational economic calculation under socialism would be impossible (*“unmöglich”*).⁵

3 Brief Review of the Ensuing Debate

Because scholars differ about what Mises “really meant,” however, it may be useful here to provide a brief review of the debate.

Throughout the 1920s and early 1930s Mises's argument became the focus of intense discussion within the German-language literature. Eventually it was agreed

⁴See Weber ([1921] 1978), parts of his *Wirtschaft und Gesellschaft* 1922 translated into English as *Theory of Social and Economic Organization*, and Brutzkus (1935). On the early contributions of Pierson, Weber and Brutzkus, see also Steele (1981).

⁵Attention can be drawn to a paper by Ebeling (1993) who discusses a number of Mises' forgotten predecessors. Ebeling draws attention to five books in particular which deserve recognition for their work on this topic: Albert Schäffle (1874); Paul Leroy-Beaulieu (1885); William Graham (1891); Victor Cathrein (1890); Benedict Elder (1915).

that Mises was correct at least to point out that a socialist society could not do without such things as money and prices, as some early socialists had suggested, and that there was no feasible way to set prices according, say, to quantities of labor time. Nevertheless it was felt that Vilfredo Pareto and his follower Enrico Barone (1908) had shown that nothing was “theoretically” wrong with socialism, because the requisite number of demand and supply equations to make the system “determinate” would exist under either capitalism or socialism. If the planners could somehow get the necessary information on preferences and technology, they could in principle compute an equilibrium allocation of final goods.⁶

The most important response to Mises and the one almost universally accepted by economists, was what became known as “market socialism” or the “mathematical solution,” developed by Oskar Lange (1936, 1937) (and previously by Taylor 1929; Dickinson 1933; Lerner 1934). A few remarks about market socialism are in order here because we can even today still find in certain secondary literature such statements as that “Von Mises thesis was refuted by Lange and Lerner. They showed that certain forms of a socialist economy are possible” (see Backhaus and Backhaus 2018, 4). But in fact it’s the other way around; the truth is that Mises’ critique had anticipated market socialism. The market socialists diverted the debate into statics (Lavoie 1985, Chap. 4) whereas Mises had already clearly pointed out, among other things, that

a stationary economic system can never exist. Things are continually changing, and the stationary state, although necessary as an aid to speculation, is a theoretical assumption to which there is no counterpart in reality. (Mises [1932] 1981, 105)⁷

Mises’ argument was reprinted and elaborated upon by Hayek in his edited volume of 1935, *Collectivist Economic Planning* (Hayek [1935] 2009a). Also reprinted there was Barone’s 1908 essay, “The Ministry of Production in the Collectivist State” (Barone [1908] 1935). This piece was to play a paradoxical role in the debate.

Barone made the argument that a socialist planning ministry, in order to comply with the dictates of economic rationality, would have to duplicate the effects of competitive capitalism (in particular, to minimize cost of production and to set prices equal to marginal costs). Barone had applied Pareto’s system of equations to demonstrate that “all the economic categories of the old régime must reappear,

⁶I here follow freely the excellent summary account provided by Klein ([1996] 2010; also [1999] 2010).

⁷For excellent recent critiques of market socialism from an Austrian perspective, see Huerta de Soto (2015) and Machaj (2018; also 2007). In particular on the anticipatory criticism of market socialism of not only Mises but also Hayek, see Huerta de Soto (2015, 98–101). On the basis of a comparative analysis of the economic implications of property rights in capitalism and socialism Machaj (2018) attempts to demonstrate that a respect for ownership is of central importance for the functioning of economic calculation and in consequence also for economic and financial structures in the capitalist order. Ownership is more important than prices because it allows for including the competitive potential of entrepreneurs in prices. Socialism is inefficient because it abolishes property constraints, which are a tool for economic control, forcing adequate discipline in satisfying the consumer.

though maybe with other names: prices, salaries, interest, rent, profit, saving etc.” (Barone [1908] 1935, 289; also Yeager 1949).

The Ministry of Production, through deliberate arrangement, would have to satisfy the two conditions that would result automatically from perfect competition, that is, equalization of prices with cost, and minimization of costs of production. The system of equations giving the correct allocation of resources and labor would be identical with the system reflecting the operation of free competition.⁸

Barone took this conclusion— which is known as the formal equivalence argument —as a criticism of the socialist contention that a rational society would allocate resources on a basis quite different from the “anarchic” market. The problem the socialist planning ministry would have to solve would be “formally equivalent” to the problem solved by the market through free competition.

However, Lange, in his famous (1936, 1937) response on behalf of socialism, and some other socialist writers, turned Barone’s point against its author.

Whereas one could argue that Barone—and other writers before the time of Mises’ famous article such as Wieser, Pareto, and Cassel—had used the concept of equilibrium determination through simultaneous equations as an expository device, these socialist writers envisaged the solution of simultaneous equations as the actual method of socialist resource allocation.

In a system of market socialism, capital goods are collective property, but individuals are free to own and exchange final goods and services. The system would work like this. First, the Central Planning Board chooses arbitrary prices for consumer and capital goods. At those prices, the managers of the various state-owned enterprises are instructed to produce up to the point where the marginal cost of each final good is equal to its price, and then to choose the input mix that minimizes the average cost of producing that quantity. Then, consumer goods prices are allowed to fluctuate, and the Central Planning Board adjusts the prices of capital goods as shortages and surpluses of the final goods develop. Resources would thus be allocated according to supply and demand, through a process of “trial-and-error” essentially the same as that practiced by the managers of capitalist firms. Lange’s contribution, it has generally been held, was to show that production under market socialism could be just as efficient as production under capitalism, since the socialist planners would receive exactly the same information from a socialized economic system as did entrepreneurs under a market system.

Thus according to Lange’s famous (1936, 1937) response on behalf of socialism Barone’s point showed that the task facing the planning authority was essentially the same as that facing the market economy. In each case, the equations of general equilibrium had to be solved. If the market could do so, then so could the planners, if not directly, then via trial and error, by first setting a price vector then instructing the managers of socialist enterprises (a) to choose the production method that minimized

⁸Implicit or explicit in the work of Barone and many post-Mises writers is thus the concept of “optimum conditions” which are the heart of modern welfare economics. Hayek summed up several of the conditions very neatly as the requirement that “the marginal rates of substitution between any two commodities or factors must be the same in all their different uses” (Hayek [1948] 1980, 77; see also Yeager 1949).

average cost at those prices and (b) to produce output up to the point at which marginal cost equaled price. If the attempt to comply with these instructions gave rise to excess supplies and demands (as it well might) then the planning authority should adjust the price vector (raising the prices of goods in excess demand and cutting the prices of goods in excess supply) and try again. It was admitted that prices were indeed necessary (as in Mises' argument) but these need not be real market prices: they might equally well be accounting prices set by the state. Besides, the state had an extra degree of freedom: it could choose the distribution of income and optimize the allocation of resources relative to that distribution, which might be quite different from that engendered by the market.

With the widespread acceptance of the theory of market socialism, there developed an "orthodox line" on the socialist calculation debate, neatly summarized in Abram Bergson's well-known survey of "Socialist Economics" (1948) and in Joseph Schumpeter's *Capitalism, Socialism and Democracy* ([1942] 1975, 172–86). According to this line, Mises first raised the problem of the possibility of economic calculation under socialism, only to be refuted by Pareto and Barone; Hayek and Robbins then "retreated" to the position that socialist planners could calculate in theory, but that in practice the information problem would make this too difficult; then the market socialists showed that trial and error would eliminate the need for complete information on the part of the planners. Therefore, the argument goes, economic theory *per se* can say nothing conclusive about the viability of central planning, and the choice between capitalism and socialism must be purely political.

Market socialism was seen as an answer not only to Mises's calculation problem, but also to the issue of "practicality" raised by Hayek and Lionel Robbins. Hayek, in his contributions to *Collectivist Economic Planning* (Hayek [1935] 2009a, 1–40; [1935] 2009b), later expanded in "The Competitive Solution" ([1948] 1980, 181–208) and his well-known papers "Economics and Knowledge" ([1948] 1980, 33–56) and "The Use of Knowledge in Society" ([1945] 1984), and Robbins, in his *The Great Depression* ([1934] 2007), had changed the terms of the debate by focusing not on the problem of calculation, but on the problem of knowledge. For Hayek and Robbins, the failure of socialist organization is due to a mechanism design problem, in that planners cannot allocate resources efficiently because they cannot obtain complete information on consumer preferences and resource availability. Furthermore, even if the planners were somehow able to acquire these data, it would take years to compute the millions of prices used by a modern economy. The Lange–Lerner–Taylor approach claimed to solve this preference-revelation problem by trial-and-error, so no actual computations would be necessary (also Klein 2010).

Mises in his critique had already anticipated the later argument for "market socialism". Mises claimed that without private ownership of the means of production, there would be no market prices for capital goods, and therefore no way for decision-makers to evaluate the relative efficiency of various production techniques. Anticipating the later argument for "market socialism," Mises argued that even if there were markets for consumer goods, a central planner could not "impute" meaningful prices to capital goods used to produce them. In short, without market-generated

prices for both capital and consumer goods, even the most dedicated planner would find it “impossible” to allocate resources according to consumer wants.

4 The Historical Misinterpretation of the Outcome of the Argument: Why the Standard Account Is Disputable

4.1 The Emergence of a Revisionist Account of the Socialist Calculation Debate

The outcome of the debate concerning the possibility of socialism has been much disputed and misinterpreted. From the standpoint of the revisionist account it is rather generally considered that the widespread acceptance, among socialist theorists, of competitive solution proposals quite clearly amounts to an implicit acknowledgement on their part of the soundness of Mises' original contribution, published in 1920, regarding the impossibility of economic calculation in socialist economies—also Huerta de Soto *ibid.* 174—even if we have to add immediately that Mises considered that a socialist system with a market and market prices is self-contradictory, as self-contradictory as is the notion of a triangular square.

However, in the early postwar period, most commentators on the debate (notably Bergson, Schumpeter and Samuelson) reckoned that the socialists had come off best. There was no reason why the socialist planners could not mimic a competitive equilibrium via a Lange-type procedure. And Mises' argument against the possibility of socialism was not considered conclusive.

All this changed when this account of the debate—known as the standard account—came under attack during the 1980s and in particular when it was sharply challenged by Don Lavoie in his 1985 book *Rivalry and central planning: The socialist calculation debate reconsidered*.

Lavoie's revisionist claim was that the two sides in the debate had been talking past one another. Lange and others who made similar arguments—such as Dickinson, Lerner and Taylor—as well as other commentators, took a Walrasian approach and were thinking in terms of attaining static general equilibrium while the Austrians had a quite different problem in mind, namely that of dynamic adjustment and discovery in the face of continuously changing technological possibilities and preferences. According to Lavoie, Mises never denied that socialism would be able to perform acceptably under static conditions, but this was irrelevant to the real world. The whole Walrasian apparatus served at best to define the end-point of dynamic adjustment in a market economy, but this limit was never reached in a real capitalist economy and neither could it be reached under socialism. The formal equivalence argument stemming from Barone was therefore beside the point of the Austrian charge that socialism had no means of emulating the profit-seeking dynamic of capitalism.

Mises and the Austrians, therefore, were not defeated. Rather, the illusion of victory belongs to the “anti-Misesians” because their conception of the market and the problem requiring a solution was different from Mises’s conception of the market and the economic problem.

The entire orientation of the Austrian approach was in terms of how markets worked under conditions of imperfect knowledge, constant change and the passage of time.

Mises and the Austrians, as Lavoie explains, conceived of the market economy as a dynamic competitive process in which a complex system of division of labor was matched by an equally complex system of division of knowledge. Rivalry in the market was the means through which decentralized knowledge was conveyed to every corner of the economy via the price system to assist mutual coordination of production and consumption plans. At the same time, market rivalry was the means through which knowledge in the market was discovered and used for the satisfaction of consumer demands. This “Austrian” conception of the market process is in contrast to the neoclassical view of perfect competition, in which all the “knowledge problems” of market coordination are assumed away; either by postulating the presence of “perfect knowledge” on the part of all market participants; or through the assumption that all relevant knowledge can be translated into quantitative and objective forms that are easily conveyable to planners for their use and application to the problem of resource allocation in a centrally organized economy.

From the Austrian perspective market-socialist proposals are mostly irrelevant to the real problems of socialist organization. In his critique of market socialism in *Human Action* (Mises [1949] 1998, 694–711) Mises complained that the market socialists—and, for that matter, all general equilibrium theorists—misconceive the nature of “the economic problem.” Lange, Lerner, and Taylor looked primarily at the problem of consumer goods pricing, while the crucial problem facing a modern economy concerns the capital structure: namely, in what way should capital be allocated to various activities? Lange, Lerner, and Taylor see the market through a strictly static, neo-classical lens, where all the parameters of the system are given and only a computational problem needs to be solved. In fact the market economy is a dynamic, creative, evolving process, in which entrepreneurs—using economic calculation—make industries grow and shrink, cause new and different production methods to be tried and others withdrawn, and constantly change the range of available products. It is these features of market capitalism, and not the incentives of agents to work hard, that are lost without private property ownership.

4.2 Huerta de Soto's Revision of the Concept and Definition of Socialism

In line with this development it is now also possible to provide a revisionist definition of socialism. Prof. Huerta de Soto has argued that the theory of entrepreneurship, as developed by Israel M. Kirzner, must be an essential element of any analysis of the impossibility of socialism (see Huerta de Soto 2009b).

Socialism is here defined as any system of institutionalized aggression against the free practice of entrepreneurship, in other words socialism is all systematic and institutionalized aggression which restricts the free performance of entrepreneurship in a determined social area and which is carried out by a controlling organism which is in charge of the tasks of social coordination necessary in said area.

Huerta de Soto (2015) lists several reasons why Lange's classic model, broadly interpreted, could never work, such as

1. the impossibility of assembling the list of capital goods;
2. the complete arbitrariness of the time period for which parametric prices are fixed;
3. the lack of a true market for labor and consumer goods and services;
4. the inanity of the rules Lange proposes;
5. the theoretical impossibility of the trial-and-error method;
6. the arbitrary fixing of the interest rate;
7. ignorance of the typical behavior of bureaucratic agencies.

And the thrust of the argument/reason why socialism is an intellectual error is in general terms always the same: it is not theoretically possible that the organism in charge of practicing institutionalized aggression possesses sufficient information to endow its commands with contents of a coordinating nature.

5 Persistence of the Standard Account

Despite these revisionist claims even today the standard account seems to retain a certain following. In what follows I will try to understand why this is the case by taking a closer look at two authors who have been extremely influential in shaping the consensus around the standard view; these authors are Friedrich von Wieser and Joseph Schumpeter.

Friedrich von Wieser's work seems to have exerted considerable influence in shaping the consensus around the standard account of the Socialist Calculation Debate. The influence of Wieser probably explains some of the problems surrounding an adequate understanding of Mises's arguments against the possibility of economic calculation under socialism.

The problem of a rational economic order seems to be bound up with that of solving the imputation problem (*Zurechnungsproblem*) with respect to complementary factors of production with alternative uses.⁹

Very typical for Wieser's approach is that he systematically treats the imputation problem (*Zurechnungsproblem*) before the introduction of the market, exchange and money. For instance in his *Social Economics* ([1914] 1927) he treats the topics "Problem of Attribution of Yields" and "Common and Specific Attribution of Yields" in Sects. 20 and 21 (111–123) of Book I devoted to the "Theory of the Simple Economy" which is some sort of socialist commonwealth. In such a simple economy, there is no exchange, no market, no prices and no money.

Wieser's view concerning the calculation of values was decisive for the way he would "solve" the problem of economic imputation-or: "das Problem der wirtschaftlichen Zurechnung". Wieser proposes to measure "productive contributions" by a system of simultaneous equations. He postulates two conditions for his theory of imputation:

1. that the value of the productive agents is equal to the value of their products; and
2. that the productive agents combine in fixed proportions, which vary between industries (also Stigler [1941] 1994, 166–7). These conditions are expressed algebraically by the following equations, in which x , y , and z represent the value of single units of productive agents X , Y , Z , and the values on the right sides of the equations are prices of single units of three products:

$$x + y = 100 \tag{1}$$

$$2x + 3z = 290 \tag{2}$$

$$4y + 5z = 590 \tag{3}$$

By solving these equations simultaneously, the values of the units of productive agents are discovered. That of x is 40; of y , 60; of z , 70. These are the "productive contributions" of these agents. Value (and the principles leading to its determination) is, Wieser believed, a politically neutral concept in the simple economy. As in *Natural Value*, Wieser divorced his analysis of capital and its functions from private property. In a manner similar to that of the Lange-Lerner investigations, goods and productive factors are stripped of their pecuniary connotations and the economic system thus conceived can supply the basis for either the individualistic or for the socialist economy (also Ekelund 1970, 182). It has to be pointed out how peculiar Wieser's approach to the imputation problem, especially in his *Social Economics*, in fact is and why it is problematic (Wieser [1914] 1927; see also Hoppe and Salerno 1999).

⁹The problem of imputation is the problem of assigning value to each higher-order good used in the production of a consumer good. See Endres (1997, 184).

Let's recall Mises' starting point (also Van Den Hauwe 2009, 191–2). Whereas acting man cannot calculate with values, that is, he cannot use values as a vehicle of economic calculation, he can use money prices in reckoning; where there are no money prices, there are no such things as economic quantities (Mises 1998, 210); economic calculation cannot comprehend things which are not sold and bought against money (ibid. 215); computation requires a common denominator to which all items are to be referable; the common denominator of economic calculation is money; economic calculation always deals with prices, never with values (ibid. 332). It is the task of the theory of value and prices to show how the choices of individuals result, in the sphere of interpersonal exchange, in the emergence of market prices (Böhm-Bawerk 1959, Volume II, Book III). The monetary, private property, market system provides the basis for economic calculation by transforming the ordinal preference rankings of different individuals, which are impossible to compare, into a quantity of common, cardinal units. Ordinal utility can thus become the basis for socially-meaningful cardinal comparisons of value. Money prices, only possible in a monetary, private property, market system, provide a common cardinal unit in which different factors can be compared in social value. All mathematical or arithmetic operations with ordinally-ranked marginal utilities are impossible; there is no such thing as total utility. As Mises wrote,

[o]ne cannot add up values or valuations. One can add up prices expressed in terms of money, but not scales of preference. One cannot divide values or single out quotas of them. A value judgment never consists in anything other than preferring a to b. (Mises [1949] 1998, 332)

Furthermore Mises had argued that the process of value imputation does not result in derivation of the value of the single productive agents from the value of their joint product. Even if it is permissible to declare that, due allowance being made for time preference, the value attached to a product is equal to the value of the total complex of complementary factors of production, it would be nonsensical to assert that the value attached to a product is equal to the “sum” of the values attached to the various complementary factors of production. It is only the market that, in establishing prices for each factor of production, creates the conditions required for economic calculation. The prices of the single factors of production are formed on the market as the resultant of the concurring actions of competing highest bidders. The prices of the factors of production are only indirectly connected, viz., through the intermediary of the prices of the consumers' goods, the products of their joint employment, with the valuations of the individuals. Not the valuations but the appraisements are transferred from the goods of the first order to those of higher orders. Mises clearly distinguishes between appraisal and valuation. Appraisal in no way depends upon the subjective valuation of the man who appraises. He is not intent upon establishing the subjective use-value of the good concerned, but upon anticipating the prices which the market will determine. Valuation is a value judgment expressive of a difference in value. Appraisal is the anticipation of an expected fact (Mises [1949] 1998, 329).

In Mises' own words:

The prices of the complementary factors of production are conditioned by the prices of the consumers' goods. The factors of production are appraised with regard to the prices of

the products, and from this appraisal their prices emerge. Not the valuations but the appraisements are transferred from the goods of the first order to those of higher orders. The prices of the consumers' goods engender the actions resulting in the determination of the prices of the factors of production. These prices are primarily connected only with the prices of the consumers' goods. With the valuations of the individuals they are only indirectly connected, viz., through the intermediary of the prices of the consumers' goods, the products of their joint employment." (ibid. 330–1) And of course "[e]conomic calculation always deals with prices, never with values." (ibid. 332)

As Hoppe and Salerno recall, the crucial insight that the prices of the factors of production are only indirectly related to the marginal values of their products—through the prices of the consumers' goods and their appraisal by entrepreneurs bidding competitively for scarce factors of production—is of essential significance for a correct understanding of the Socialist Calculation Debate and its neglect is part of the explanation of the common misinterpretation of its outcome.¹⁰

For Mises, imputation is not a value problem but a price problem. Imputation cannot be translated into a value problem (Kauder 1965, 187). Wieser to the contrary offers a system of simultaneous equations as his solution of the imputation problem (Kauder 1965, 185).

However, a solution of the imputation problem along the lines indicated by Wieser is clearly impossible. As will be reminded further, it was Schumpeter's failure to realize this point which led him to teach that Pareto and Barone had essentially "solved" the problem of socialist calculation (Steele 1992, 112ff.; also Oversloot 1990).

To conclude our digression about von Wieser let's remind that Samuel Bostaph (2003) has recently summarized von Wieser's project as follows: "In *Natural Value (NV)* in 1893 (1971) and *Social Economics (SE)* in 1914 (1967), Wieser sought to use the new value theory of Carl Menger as a key component in an argument for the possibility of economic calculation in a socialist or communist system. In so doing, Wieser presented an argument for "natural value" as the unit of calculation and for

¹⁰Hoppe and Salerno characterize the contrasting viewpoints, i.e. that of Menger and Böhm-Bawerk and Mises on the one hand and that of Wieser and Schumpeter on the other, in the following terms:

"Menger und Böhm-Bawerk hatten es unternommen (...) dies Problem zugleich praktisch une realistisch unter Bezugnahme auf im Markt tatsächlich gezahlte Geldpreise zu lösen. Der Grenznutzen der Produktionsfaktoren ergebe sich nicht direct aus dem Grenznutzen ihrer Produkte, sondern nur indirect und vermittelt, durch die auf dem Produktionsgütermarkt vom ihm Wettbewerb stehenden Unternehmern angebotenen (Höchst-)Preise. Wieser—und ähnlich Mayer und Schumpeter—vertraten dagegen die Auffassung, das seine exakte und numerisch eindeutige Zurechnung durch die Methode der Wertrechnung an Stelle von monetärer Kalkulation nötig und möglich sei. (...) Mit anderen Worten, Wieser behauptet, dass auch in einer sozialistischen Gesellschaft, also einer verkehrslosen Wirtschaft ohne Markt und Geldpreise, gerechnet werden muss und kann und das Problem der Zurechnung im Hinblick auf komplementäre Produktionsfaktoren mit alternativen Verwendungsweisen—und mithin auch das problem einer rationalen Wirtschaftsplanung—einer eindeutigen Lösung zugeführt werden kann. (...) Mises verwarf die Auffassungen Wiesers zur Zurechnungsproblematik nicht nur als unhaltbar, sondern zeigte demgegenüber, an Menger und Böhm-Bawerk anknüpfend, dass sich das Problem ausschliesslich unter Rückbezug auf Geldpreise und ausschliesslich im Rahmen einer auf dem Sondereigentum beruhenden Marktwirtschaft lösen lässt" (pp. 120–123).

“imputation” as the method of deriving the values of higher order goods from the “natural values” of first order goods. He also assumed a general equilibrium context in his theoretical explanation of how socialist or communist economic planning using “natural value” could take place” (ibid. 4).

On the basis of an extensive and detailed analysis this author concludes that

(...) Wieser did not develop the theories of value, exchange, and price beyond the legacy of Carl Menger. In fact, he distorted and obscured them in his own presentation with his empty concept of “natural value” and his equally spurious imputation theory. Further, he provided an apparent theoretical support for socialist and communist theory from a school of thought whose previous and subsequent development (at least in the hands of Menger, Böhm-Bawerk, and Mises) was antithetical to such theories (ibid. 30).

Schumpeter is deservedly considered among the greatest historians of thought in economics and his account of the Socialist Calculation Debate, which conforms with the standard view of the controversy, has been extremely influential in the development and shaping of the consensus around this view. He devoted only a few pages—in the “Equilibrium” chapter—of his monumental *History of Economic Analysis* (Schumpeter 1954) to the issue but a great deal of his *Capitalism, Socialism and Democracy*—especially Chap. XVI “The Socialist Blueprint”—discusses the debate specifically (Schumpeter [1942] 1975).

Schumpeter believes it to be clear that “economic rationality” can be attained without actual markets in capital resources and that “this follows from the elementary proposition that consumers, in evaluating (“demanding”) consumers’ goods, *ipso facto* also evaluate the means of production which enter into the production of those goods.” This is Schumpeter’s famous *ipso facto* (ibid. 175).

As we have seen, however, it is not correct to suggest that the consumers, in valuing consumer goods, *ipso facto* also value and thus determine the prices of the single and complementary factors of production. This process requires the mediation of the private property market order. It is the excessive preoccupation with equilibrium and its mathematical expression that prevents a clear grasp of this truth.

Hayek had on several occasions expressed his disagreement with Schumpeter on this issue:

Professor Schumpeter is, I believe, also the original author of the myth that Pareto and Barone have “solved” the problem of socialist calculation. What they, and many others, did was merely to state the conditions which a rational allocation of resources would have to satisfy and to point out that these were essentially the same as the conditions of equilibrium of a competitive market. This is something altogether different from showing how the allocation of resources satisfying these conditions can be found in practice. (Hayek [1945] 1984, 223–4)

And further:

Like so many mathematical economists Schumpeter appears to have been seduced by the habitual assumption of “given data” to believe that the relevant facts that for his construction the theorist must assume to exist are actually known to any one mind. This becomes evident in Schumpeter’s most startling assertion that the possibility of “economic rationality”, being attained in a planned system, follows for the theorist “from the elementary proposition that consumers in evaluating (“demanding”) consumers’ goods, *ipso facto* also evaluate the means of production which enter into the production of those goods.” This is a meaningful

statement only in the context of a system or equation in which not only all the technical possibilities of production but also their relative scarcities are assumed to be known. As an assertion about what happens in the real world it is sheer nonsense. (Hayek [1982] 1984, 59–60)

6 Generalizing Mises' Analysis: Calculation and the Theory of the Firm

To understand Mises's position in the calculation debate, one must realize that his argument is not exclusively, or even primarily, about socialism. It is about the role of prices for capital goods.

Entrepreneurs make decisions about resource allocation based on their expectations about future prices, and the information contained in present prices. To make profits, they need information about all prices, not only the prices of consumer goods but the prices of factors of production. Without markets for capital goods, these goods can have no prices, and hence entrepreneurs cannot make judgments about the relative scarcities of these factors. In short, resources cannot be allocated efficiently. In any environment, then—socialist or not—where a factor of production has no market price, a potential user of that factor will be unable to make rational decisions about its use.

Thus Mises' claim was simply that efficient resource allocation in a market economy requires well-functioning asset markets. To have such markets, factors of production must be privately owned. Rothbard's contribution was to generalize Mises' analysis of this problem under socialism to the context of vertical integration and the size of the organization, thus making an important Austrian contribution to the theory of the firm (Rothbard [1962] 2004, 609 ff.; also Klein 2010).

In other words the need for monetary calculation in terms of actual prices not only explains the failures of central planning under socialism, but also places an upper bound on firm size.

The ideas developed in the calculation debate suggest that when organizations are large enough to conduct activities that are exclusively internal—so that no reference to the outside market is available—they will face a calculation problem as well as an incentive problem. In other words, the firm is in the same situation as communist economies: it needs outside market prices to plan and evaluate its actions.

Rothbard writes in *Man, Economy, and State* that up to a point, the size of the firm is determined by costs, as in the textbook model. However, the “ultimate limits are set on the relative size of the firm by the necessity for *markets* to exist in every factor, in order to make it possible for the firm to calculate its profits and losses” (Rothbard [1962] 2004, 599).

When we mention “theory of the firm” we think of the contribution of Coase (1937). There has been some debate within the Austrian literature about whether the basic Coaseian approach is compatible with Austrian economics.

Ronald Coase, in his celebrated 1937 paper on "The Nature of the Firm," was the first to explain that the boundaries of the organization depend not only on the productive technology, but on the costs of transacting business, that is, on the costs and benefits of contracting. The boundary of the firm is determined by the tradeoff, at the margin, between the relative transaction costs of external and internal exchange.

By the time of his 1976 paper, Rothbard had adopted an explicitly Coaseian framework in his discussion of the limits to firm size. His own treatment, Rothbard says, "serves to extend the notable analysis of Professor Coase on the market determinants of the size of the firm, or of the relative extent of corporate planning within the firm as against the use of exchange and the price mechanism. Coase pointed out that there are diminishing benefits and increasing costs to each of these two alternatives, resulting, as he put it, in an "optimum amount of planning" in the free market system. Our thesis adds that the costs of internal corporate planning become prohibitive as soon as markets for capital goods begin to disappear, so that the free-market optimum will always stop well short not only of One Big Firm throughout the world market but also of *any* disappearance of specific markets and hence of economic calculation in that product or resource" (Rothbard 1976, 76).

Machaj (2018, 123–32; also 2007) points to some weak points in Coase's contribution. Coase's answer to the question of why companies exist, is not satisfactory. Coase's analysis lacks deeper reflection on the concept of the company, and despite his attempts to break away from the neoclassical, mechanistic framework of management, he still uses it. He did not give a sufficiently precise distinction between transaction and organization costs. Because Coase does not formulate a satisfying theory of the company, his works will not give us the answer to why there is no one big firm created in the market, in the form of a global, voluntary, socialist cartel. Rothbard concluded that "voluntary socialism" cannot emerge because at some point creating larger and larger units of management would eliminate markets, which are used by companies to assess the rationality of their plans. Rothbard's theorem regarding the limits of possible mergers in the market seems better than Coase's theory of the firm, but it does not fully solve the posed problem either. One exclusive owner would only emerge on the market if the entrepreneurial division of labour entirely disappeared, which would happen only if one entrepreneur would be more skillful than all the other entrepreneurs in the market, which is hardly possible. One great company does not emerge because there are no companies that would be able to form an economic unit exclusive enough and efficient enough to satisfy the needs of all consumers. The diversity of entrepreneurs and their abilities result in economization of their talents through the entrepreneurial division of labour.

7 Mechanism Design Theory: A Contribution to the Debate?

7.1 Introduction

After the Royal Swedish Academy of Sciences had decided to award the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2007 jointly to Leonid Hurwicz, Eric S. Maskin and Roger B. Myerson “for having laid the foundations of mechanism design theory”, the Wall Street Journal published a piece by Peter Boettke entitled “A Market Nobel” (Boettke 2007). Boettke then wrote:

Leonid Hurwicz, in his classic papers “On the Concept and Possibility of Informational Decentralization” (1969), “On Informationally Decentralized Systems” (1972), and “The Design of Mechanisms for Resource Allocation” (1973), embraced Hayek’s challenge. He developed mechanism-design theory to test the logic of the Mises-Hayek contention that socialism could not possibly mobilize the dispersed knowledge in society in a way that would permit rational economic calculation for the alternative uses of scarce resources. Mises and Hayek argued that replacing the invisible hand of the market with the guided one of government would not work. Mr. Hurwicz wanted to see if they were right, and under what conditions one could say they were wrong. Those efforts are at the foundation of the field that was honored by the Nobel Prize committee. To function properly, any economic system must, as Hayek pointed out, structure incentives so that the dispersed and sometimes conflicting knowledge in society is mobilized to realize the gains from exchange and innovation.

Now the contention that the 2007 Nobel Prize was a “Market Nobel” is in one respect perhaps a defensible proposition but in another respect a somewhat disputable claim. The following considerations have to be kept in mind:

1. Mechanism design theorists tend to consider Hayek’s work an important precursor to the modern theory of mechanism design. Hayek’s contribution is acknowledged to the extent it implied “the recognition that economic institutions of all kinds must serve an essential function of communicating widely dispersed information about the desires and the resources of different individuals in society” (Myerson 2008, 586). Hayek ([1945] 1984) had alleged that the mathematical economists of his day were guilty of overlooking the importance of communication in market systems.
2. The founders of mechanism design theory make two further claims, however, that seem more questionable or, at least, require critical examination. The first of these is that the Socialist Calculation Debate was inconclusive. As Myerson states it: “(...) the inconclusiveness of economic theorists’ debates about socialism versus capitalism showed the limitations of price theory for evaluating non-price institutions like the socialist command economy (...). Price theory could show (under some conditions) that free markets will achieve allocative efficiency, but such results about free markets did not prove that socialist command economies could not achieve similarly good outcomes” (ibid.). The second claim is that the failure to conclusively demonstrate the impossibility of socialism can be explained by the lack of adequate theoretical and in particular mathematical tools. Allegedly

the “intuitive” approach of Hayek was simply not up to the task. As Myerson states it: “Hayek also alleged that the mathematical economists of his day were particularly guilty of overlooking the importance of communication in market systems. But questions about fundamental social reforms require fundamental social theory. In a search for new fundamental theories, the abstract generality of mathematics should be particularly helpful. So the failure that Hayek perceived should not have been attributed to mathematical modeling per se, but it was evidence of a need for fundamentally new mathematical models” (ibid. 587).

Among the mathematical economists who accepted the challenge from Hayek, Leo Hurwicz has long been considered the leader (Myerson 2007, 2009). Indeed, Leonid Hurwicz—the father of the subject—was directly inspired by the Planning Controversy between Hayek and Ludwig von Mises on the one hand and Oskar Lange and Abba Lerner on the other to develop the theory (Maskin 2015; Arrow and Hurwicz 1977, passim)

As Myerson observes in his Hurwicz Lecture (Myerson 2007, 2009):

“The pivotal moment occurred when Hurwicz (1972) introduced the concept of incentive compatibility. In doing so, he took a long step beyond Hayek in advancing our ability to analyze the fundamental problems of institutions. From that point on, as Makowski and Ostroy (1993) have observed, “the issue of incentives surfaced forcefully, as if a pair of blinders had been removed.” By learning to think more deeply about the nature of incentives in institutions, we have gained better insights into important social problems and policy debates.”

According to Maskin (2015) Hayek had a remarkable intuitive understanding of some major propositions in mechanism design—and the assumptions they rest on—long before their precise formulation. In particular Maskin suggests that the mechanism design literature has provided precise treatments of two claims made by Hayek:

Hayek gave at least two reasons why the free market cannot be improved upon. First, he asserted that other Pareto optimal mechanisms – mechanisms leading to Pareto optimal allocations of resources – require more *information* than the market does. That is, a consumer or producer has to *report* more information about himself (e.g., his preferences or technology), and he needs to *know* more about other consumers and producers (e.g., about their demands and supplies). Second, Hayek claimed other Pareto optimal mechanisms, unlike the market, are in conflict with consumers’ and producers’ own interests, i.e., they are not *incentive compatible*. (Maskin 2015)

There are thus two questions we must consider: (1) Is the fundamental problem of socialism an incentive problem rather than a calculation problem as originally identified by von Mises? I call this question “the calculation versus incentives question”; and (2) Is the fundamental problem of socialism an information or knowledge problem rather than a calculation problem and if so, what kind of information or knowledge are the proponents of this claim talking about? I call this question “the calculation versus knowledge problem”.

According to the mechanism design theorists, the answer to both questions is quite clearly in the affirmative. Maskin writes:

I will suggest in this paper that the mechanism design literature has provided precise treatments of these two claims. Specifically, it has established that Hayek's first assertion is, in fact, correct in settings in which there are no significant externalities (so that, in particular, there are no public goods). Moreover, the literature has also verified his second claim, given the additional assumption there are large numbers of consumers and producers (so that none of them has market power).

It would seem beyond dispute that at least von Mises was unambiguous about the fact that the essential problem of socialism relates to the impossibility of economic calculation. But even on this issue otherwise authoritative commentators are not always clear about the relevant distinctions. Thus Boettke writes:

Mises, Hayek's mentor in Vienna, had raised the challenge in his book "Socialism," and before that in an article, that without having the means of production in private hands, the economic system will not create the incentives or the information to properly decide between the alternative uses of scarce resources. Without the production process of the market economy, socially desirable outcomes will be impossible to achieve. (Boettke 2007)

Does it make no real difference whether the essential problem of socialism is (a) a calculation problem, (b) a knowledge problem or (c) an incentive problem?

I consider these questions in the next sections. It will appear that commentators have not always been clear about the relevant distinctions.

7.2 *Calculation Versus Incentives*

The distinction between calculation and incentives is important because the modern economics literature on organizational design—from transaction cost explanations of firm size, to public choice theories of bureaucracy, to recent work on market socialism and the "soft budget constraint" (Kornai 1986)—focuses primarily on incentive problems, possibly encouraged by Lange's (1937, 127) famous warning about bureaucracy.

Incentive theory asks how, within a specified relationship, a principal can get an agent to do what he wants him to do. Mises's problem, however, was different: How does the principal know what to tell the agent to do? That is, just what activities ought to be undertaken? What investments should be made? Which product lines expanded and which ones contracted?

It is now typically held that the differences between capitalism and socialism lie in the different incentive properties of the two systems. Centrally directed systems are thought to be subject to greater agency costs—managerial discretion, shirking, and so on—than market systems. After all, Lange himself warned that "the real danger of socialism is that of a bureaucratization of economic life" (Lange 1937, 127).

The incentive problem had long been known and was expressed in the famous question: "Under socialism, who will take out the garbage?" That is, if everyone is compensated "according to his needs," what will be the incentive to do the dirty and unpleasant tasks; or, for that matter, any tasks at all?

The traditional socialist answer was that self-interest is a product of capitalism, and that socialism would bring about a change in human nature. In the worker's paradise would emerge a "New Socialist Man," eager to serve and motivated only by the needs of his fellows. Experience has exposed the charming naiveté of such notions.

But Mises's challenge to socialism is distinct from this well-known incentive problem. The calculation debate was not primarily about agency or managerial incentives (Rothbard 1991, 51–52).¹¹

Assume for the moment that everyone is willing to work just as hard under central direction as under a market system. There still remains the problem of exactly what directives the Central Planning Board will issue. The Board will have to decide what goods and services should be produced, how much of each to produce, what intermediate goods are needed to produce each final good, and so on.

The market economy, Mises argued, is driven not by "management"—the performance of specified tasks, within a framework given to the manager—but by entrepreneurship, the speculation, arbitrage, and other risk-bearing activities that determine just what the managerial tasks are. It is not managers but entrepreneurs, acting in the capital and money markets, who establish and dissolve corporations, create and destroy product lines, and so on. These are precisely the activities that even market socialism seeks to abolish. In other words, to the extent that incentives are important, what socialism cannot preserve are high-powered incentives not in management, but in entrepreneurial forecasting and decision making.

The relevant incentive problem, he maintains, is not that of the subordinate manager (the agent), who takes the problem to be solved as given, but that of the speculator and investor (the principal), who decides just what is the problem to be solved.

Mises has been described as saying that it is unreasonable to expect managers of socialist enterprises to "play market," to act as if they were managers of private firms where their own direct interests were at stake. This may be true, but Mises's prime concern was that entrepreneurs cannot be asked to "play speculation and investment" (Mises [1949] 1998, 705).

This also explains why traditional command-style economies, such as that of the former USSR, appear to be able only to mimic those tasks that market economies have performed before; they are unable to set up and execute original tasks.

We provisionally conclude that the emphasis on incentives found in the recent literature and in particular since Hurwicz's seminal contribution seems to have missed Mises' essential point.

¹¹ In the book-length treatment, *Socialism* ([1932] 1981), Mises also discusses the incentive problem in greater detail (pp. 163–84).

7.3 *Calculation Versus Knowledge (Information)*

In his 1973 paper in the American Economic Review “The Design of Mechanisms for Resource Allocation” Hurwicz paraphrases Hayek as follows:

“It should be recalled that one of Hayek’s (1935, 212) chief points in summing up the state of the debate concerning the feasibility of a centralized socialist solution was that the number of variables and equations would be “at least in the hundreds of thousands” and the required equation solving “a task which, with any of the means known at present, could not be carried out in a lifetime. And yet these decisions would ... have to be made continuously”

The market-simulation procedure developed by Lange and Lerner may be viewed as an early example of a decomposition algorithm.

From the point of view of the economics of information processing it is clear that a parceling out of the task may be advantageous even if single agency capacity constraints have not been reached; this may well lower the resource cost and cut down the time required for the completion of the computing process.

But another informational consideration, stressed by Hayek (1935, 1945) has gained special prominence: the difficulty of placing all the relevant information in the hands of a single agency because information is dispersed throughout the economy. A natural assumption is that, initially, each economic unit has information about itself only: consumers about their respective preferences, producers about their technologies, and resource holders about the resources. An attempt to transfer all this information to a single agency before it starts its calculations is regarded as either impossible (in the sense that much information would be lost) or too costly in relation to the existing accuracy requirements.” (Hurwicz 1973, 5)

Hurwicz refers in this context to Hayek’s 1945 essay “The Use of Knowledge in Society” and thus appears to be addressing the central issue of knowledge dispersal.

Several authors have pointed out that Hurwicz’s paraphrasing of Hayek misrepresents Hayek’s point. There is first of all the issue regarding the “computational” problem of solving a very large system of equations; from a Hayekian viewpoint this issue was strictly secondary.

Early commentators on the debate had seen Hayek as retreating from Mises’ strong claim regarding the impossibility *in principle* of rational economic calculation under socialism, to the weaker objection that the planners could not solve the equations representing general equilibrium on a practical time scale. And they saw Lange’s trial and error solution as an answer to that objection. As explained already this was a misrepresentation. (see Lavoie 1985) The true problem is not data processing, but rather the collection—even the *creation*—of information on production possibilities and people’s preferences. Such information cannot be regarded as “given”; rather, it is generated in the process of rivalrous competition between capitalist entrepreneurs as they attempt to put into practice, and hence test the profitability of, their various incompatible plans for investment and production (Lavoie 1985, 1986; Huerta de Soto 2010; Cottrell 1998, 472–473).

In 1982 Hayek clarified

I feel I should perhaps make it clear that I have never conceded, as is often alleged, that Lange had provided the theoretical solution of the problem, and I did not thereafter withdraw to pointing out practical difficulties. What I *did* say (in *Individualism and Economic Order*, p. 187) was merely that from the factually false hypothesis that the central planning board

could command all the necessary information, it could *logically* follow that the problem was in principle soluble. To deduce from this observation the “admission” that the real problem can be solved in theory is a rather scandalous misrepresentation. Nobody can, of course, transfer to another all the knowledge he has, and certainly not the information he could discover only *if* market prices told him what was worth looking for. (Hayek 1982)

Thus for Hayek the essential argument on the impossibility lies not in the practical difficulty of algebraically solving a system of countless equations, but in the insoluble, theoretical-dynamic problem of assuming that the central regulatory agency can acquire the subjective, practical information that is created in dispersed form and found scattered throughout the minds of millions of economic agents. Hence, for Hayek the fundamental problem economic calculation poses has nothing to do with the strictly “algebraic”—or in today’s terms “computational”—difficulty of solving the corresponding system of equations, and in fact he attaches only secondary importance to it (also Huerta de Soto 2010, 143–4). According to Lavoie (1986, 6 fn 9) “Hayek was not talking about costs of transmitting known bits of data, either in the sense that some known data would be lost, or in the sense that some of its accuracy would be sacrificed.”

To the contrary Hayek’s whole point was, as he had stressed even in his earliest critique of socialist models, not only that the relevant knowledge is scattered but also that it is not given and does not “exist” in any articulated ready-made form that is amenable to communication to the CPB (Hayek [1935] 2009b, 210–211).

Thus the essence of the “knowledge problem” argument is not simply that plant managers know things that the CPB does not or that communication of this knowledge by the former to the latter would, as Hurwicz said, entail the cost of losing some data or accuracy. The problem is rather that the relevant knowledge is inarticulate. The producers know more than they can explicitly communicate to others. As Lavoie concludes

Thus if this argument concerning inarticulate knowledge can be sustained, the whole corpus of market socialist models for resource allocation will be subject to the criticism that they cannot in principle be implemented. Their shortcoming would not merely be a matter of insufficient development but instead a basic and inherent aspect of the whole research program. (ibid.)

Huerta de Soto goes even further by reminding us that planometrics is theoretically impossible because, first, economic agents, to a great extent, lack the knowledge which would have to be transmitted, since such knowledge arises only from a process in which actors can freely exercise their entrepreneurship, and second, they could not transmit the knowledge they do possess either, because it is mostly of a tacit, inarticulate nature. Therefore the dialogue or transmission of dispersed information between economic agents and the central planning agency, as Hurwicz proposes it, is theoretically impossible (Huerta de Soto 2010, 157).

Hayek himself had indicated that he did not consider the Hurwicz type models to be any better in the treatment of “the knowledge problem” than Lange’s models had been (1982, p. 141).¹²

Let’s recall the essential characteristics of such knowledge: it is

1. subjective knowledge of a practical, non-scientific nature;
2. practical knowledge that has an exclusive and dispersed nature;
3. practical knowledge that is mostly *tacit* and *inarticulate*;
4. knowledge that as a consequence of the exercise of entrepreneurship is constantly newly created—all entrepreneurial acts imply the creation *ex nihilo* of new information—and
5. is simultaneously *transmitted* throughout the market and
6. which generates a learning effect, that is, economic agents have learnt to act in coordination, i.e. to modify and discipline their behavior in accordance with the other human beings (Huerta de Soto 2009b).

If these arguments can be sustained this would mean that minds of the caliber of Arrow and Hurwicz are ignorant of the most fundamental principles of the functioning of the market because they have failed to recognize the essential characteristics of the *type of knowledge* economic agents use and generate.

This is perhaps not be the appropriate occasion to enter into a digression about the epistemological status of inarticulate knowledge. It may be pointed out, however, that the essential insight can be further elucidated with reference to an analogy with Gödel’s incompleteness phenomenon. Following up on earlier suggestions by Hayek and Van Den Hauwe (2011), Jan Marc Berk states the essential point with reference to the bottom-up economy very clearly by noting that any attempt at solving the economic coordination problem in a monocentric, top-down fashion will necessarily remain “incomplete” and be doomed to failure.¹³

¹²According to Hayek “[i]t was probably the influence of Schumpeter’s teaching more than the direct influence of Oskar Lange that has given rise to the growth of an extensive literature of mathematical studies of “resource allocation processes” (most recently summarized in K.J. Arrow and L. Hurwicz, *Studies in Resource Allocation Processes*, Cambridge University Press, 1977). As far as I can see they deal as irresponsibly with sets of fictitious “data” which are in no way connected with what the acting individuals can learn as any of Lange’s”.

¹³“Een bottom-up-economie, een wereld waarin agenten beperkt zijn in hun cognitieve vaardigheden en daar in hun handelen rekening mee houden door zich ook door onbewust of ontastbaar gedrag te laten leiden, is in lijn met de fundamentele bijdrage van Hayek. Hayek stelde in 1945 dat het centrale probleem van de macro-economie was het verklaren van het gedrag van agenten die handelen zonder dat iemand van hen beschikt over voldoende kennis en informatie om volledig geïnformeerde beslissingen te nemen (Hayek 1945). (...) Naar analogie van de fundamentele onvolledigheidsstellingen van de beroemde wiskundige en logicus Kurt Gödel stelde Hayek dat wat ik hier de top-down-benadering heb genoemd, niet juist kan zijn. Er bestaat namelijk geen homo economicus die in staat is zijn eigen gedrag volledig te verklaren en te begrijpen omdat zijn begrip begrensd wordt door de beschikbare expliciete kennis terwijl zijn gedrag daarnaast wordt bepaald door onbewust aanwezige, ontastbare, kennis. Voorbeelden van dat laatste zijn handelingen, routines, attitudes, waarden, ervaringen. Deze laatste kennis kan, omdat zij niet of nauwelijks overdraagbaar is, geen deel uitmaken van de economische blauwdruk, waardoor de top-down-benadering per definitie onvolledig is (zie Van Den Hauwe 2011). Niemand weet dus alles, iedereen

We can conclude that Hayek et al. on the one hand and Arrow, Hurwicz et al. on the other clearly seem to be talking past one another on the issue of the informational character of the problems of socialism. What about Mises' view in this connection? Is the calculational problem identified by Mises identical or at least similar or analogous to the Hayekian knowledge problem? It seems that this question is disputed in the recent literature. This issue is considered in the next section.

7.4 Dehomogenizing Von Mises and Hayek with Respect to the Impossibility of Socialism?

At least since Salerno (1993) a number of economists within the Austrian school have been obsessed by stressing the differences between Mises and Hayek, driving a wedge between them and “dehomogenizing” their work. As Salerno then wrote:

Without tracing out this doctrinal development in any detail, suffice it to say that today the term “Austrian economics” is used to designate two very different paradigms. One derives from Wieser and may be termed the “Hayekian” paradigm, because it represents an elaboration and systematization of the views held by F. A. Hayek, a student of Wieser's at the University of Vienna. Although it is yet to be generally recognized by Austrians, Wieser's influence on Hayek was considerable and is especially revealed in the latter's early work on imputation theory, which sought to vindicate the Wieserian (as against the Böhm-Bawerkian-Misesian) position that the imputation problem must be solved within the context of an exchangeless economy subject to the control of a single will yet somehow able to calculate using (subjective) value as the “arithmetic form of utility.”

The Hayekian paradigm stresses the fragmentation of knowledge and its dispersion among the multitude of individual consumers and producers as the primary problem of social and economic cooperation and views the market's price system as the means by which such dispersed knowledge is ferreted out and communicated to the relevant decision-makers in the production process.

The other paradigm is the “Misesian” paradigm, so called because Ludwig von Mises was the first to systematically expound it. This paradigm represents a development of Bohm-Bawerk's thought and focuses on monetary calculation using actual market prices as the necessary precondition for the rational allocation of resources within an economic system featuring specialization and division of labor (Salerno *ibid.*, 114–115).

According to the “dehomogenization” thesis, von Mises and Hayek have elaborated two entirely distinct and separate criticisms of socialism and these criticisms point to problems that are of an entirely different nature, on the one hand a property (rights) problem and on the other hand an information problem. This thesis remains controversial, however: it is defended by Salerno (1990, 1993, among others), Her-

weet iets. Markten en andere instituties—zoals geld—zorgen voor coördinatie van die decentraal beperkt aanwezige kennis” (Berk 2014, 42).

bener (1991) and Hoppe (1996), among others, but criticized by Kirzner (1996), Yeager (1994, 1997) and Huerta de Soto (2010).¹⁴

8 Does Computable Economics (Gödel's Incompleteness Phenomenon) Provide New Insights Regarding the Impossibility of Socialism?

8.1 Further Developments Regarding “the Mathematical Solution”

Murphy (2006) claims that the issue of the number of equations necessary for the so-called mathematical solution has not been given adequate attention, even by the Austrians. An attempt is made to establish the proposition that, if the hypothetical planners are to actually use the Lange-Lerner approach to overcome all of the entrepreneurial incentive problems traditionally raised by critics of socialism, the vector of prices (that the Central Planning Board would announce to the citizens of the socialist commonwealth) would need to contain not merely billions or trillions of prices, but in fact an *uncountably infinite* number of them. As Cantor's diagonal argument from set theory shows, it is demonstrably impossible to construct such a list. Therefore, socialist economy is truly impossible, in every sense of the word.¹⁵

Murphy's argument has been attacked from several perspectives. Jablecki and Machaj (2008) argue that Murphy is not only wrong in claiming that the number of goods included in the list should be uncountable, but also that the number of equations/prices is irrelevant from the point of view of market socialism. Market socialism *can* produce prices, i.e. cardinal numbers enabling some sort of profit and loss calculations. However, those prices will be of no use in guiding the central planner, since he himself produces the very guidance that he is supposed to follow. While prices can be set to equate supply with demand according to planner's preferences, these preferences cannot themselves be based on an independent calculation of opportunity costs, as reflected in independently determined scarcity prices, since

¹⁴It is here not the place to add another chapter to this rather sterile debate. I nevertheless quote the following passage from Huerta de Soto (2010): “Though it is true (...) that Hayek's view has at times been interpreted too strictly, as if he merely referred to a problem arising from the dispersed nature of existing knowledge, and as if uncertainty and the future generation of knowledge, issues Mises particularly stressed, posed no difficulty, both viewpoints can be easily combined, since they are closely related” (ibid. 45). According to Lavoie (1985, 50) “the calculation argument as explained by Mises is substantially the same as that subsequently argued by Hayek, in contrast to the standard view, which (...) holds that Hayek retreated from a more extreme Misesian position” and “many elements of Hayek's later contributions on knowledge and competition can be found in embryonic state in Mises's original statement of the problem of calculation under socialism”.

¹⁵An introductory but excellent reference with reference to Cantor's diagonalization argument and also for various metamathematical results including Gödel's incompleteness theorems—see further—is Hoffmann (2013a).

the scarcity prices in use are themselves fixed on the basis of the planner's preferences. In contrast, prices under capitalism, though *technically* formed in a similar way, reflect private property constraints and the intellectual division of labor as fulfilled by many independently competitive decisions concerning the allocation and utilization of resources. The competitive solution mimics the market and differs from capitalism only as far as the *ultimate ownership* of factors of production is concerned.

Murphy's argument is criticized from a different perspective by Cottrell, Cockshott and Michaelson (2007). These authors question Murphy's requirement that planning requires pre-knowledge of all possible prices and argue that the computational feasibility of economic planning at a detailed level is an issue that must be investigated in its own right, and cannot be settled by appeal to Cantor. The domain of prices to which planning is applied is in principle finite rather than infinite and thus Cantor's arguments are inapplicable. Moreover these authors present specific arguments that suggest that detailed planning is indeed feasible. Planning over finite prices is tractable.

8.2 *The Computer and the Market*

The model of Cottrell et al. deserves some further consideration. Attention should in particular be drawn to Allin Cottrell and W. Paul Cockshott (1993a, b) who argue that modern information technology (and theory) makes a substantial difference to the conclusions reached more half a century ago, and they give reasons why the failure of the particular system of planning employed in the former Soviet Union need not invalidate the notion of planning in general. These authors belong to a small group of socialist authors who put great hopes in the development of computer science and information science in view of solving the problem of centralized socialist management.

What is the role computers and information science can have in view of solving the problems of a socialist commonwealth?

In a paper of 1965 entitled *The Computer and the Market* Lange had actually claimed, years after his proposal for market socialism, that even market socialism would be made obsolete with the advent of high-speed computers, which could instantly solve the huge system of simultaneous equations for the central planner.

Were I to rewrite my [1936] essay today my task would be much simpler. My answer to Hayek and Robbins would be: So what's the trouble? Let us put the simultaneous equations on an electronic computer and we shall obtain the solution in less than a second. The market process with its cumbersome *tâtonnements* appears old-fashioned. Indeed, it may be considered as a computing device of the pre-electronic age. (Lange 1965, 401–402)

Cottrell and Cockshott use developments in the theory of artificial intelligence to try to show that the problems faced by socialism according to Mises and Hayek are in fact surmountable. They present what they call the 'absent response', namely a re-assertion of the classic Marxian argument for economic calculation in terms

of labour time. They argue that labour-time calculation is defensible as a rational procedure, when supplemented by algorithms which allow consumer choice to guide the allocation of resources, and that such calculation is now technically feasible with the type of computing machinery currently available in the West and with a careful choice of efficient algorithms.

In fact computer science and in particular its theoretical branch computability theory, play a paradoxical role in the context of this debate because computability theory is also the science of what cannot be computed, of the limits to computability.

It would seem that recent developments in the newly emerging and rapidly developing field of computable economics (Velupillai 2000, 2007, 2010; Zambelli 2010) have provided additional ammunition in the case against the possibility of socialism especially as regards issues of computability and decidability.¹⁶

Doria (2017b, 57 ff.) in a contribution to a volume entitled *The Limits of Mathematical Modeling—The Significance of Gödel's Incompleteness Phenomenon* (Doria 2017a) points out that results proving that markets in equilibrium may have noncomputable prices disprove Lange's main argument in favor of a planned economy. Lange

¹⁶Computable economics is about basing economic formalisms on recursion theoretic fundamentals. This means we will have to view economic entities, economic actions and economic institutions as computable objects or algorithms. Computable economics looks at economics from the point of view of what can and cannot be computed. In traditional economics, everyone is able to do all sorts of complicated computations. Common sense suggests that economists often assume too much about what mathematical feats can be achieved by the economic actors of their theory. Computable economics goes beyond this commonsense insight to identify cases in which traditional economists have assumed that people can perform feats of computation that are mathematically impossible. Mathematicians use the words "computable" and "non-computable" to distinguish possible from impossible mathematical feats. Mathematicians say that a function is not "computable" if you cannot program a computer to solve it. If no combination of computer and program can solve a well-formulated mathematical problem, then the problem is "undecidable". To show that a problem is undecidable, a mathematician must show that no possible combination of program and computer will get you the answer. In the strict mathematical sense, when a function is not computable or a problem not decidable, it is not just that we cannot hope to solve it realistically. It is nor merely hard to solve, it is impossible to solve. The literature on computability and decidability goes back to Kurt Gödel's famous incompleteness proof of 1931. Gödel showed that mathematics is radically incomplete because there are true statements that cannot be proved. He showed that there is literally no end to the list of true-but-not-provable theorems. There are whole regions of mathematical truth that we just cannot get to. Before Gödel, many mathematicians implicitly assumed we could compute anything, at least in principle, and rigorously prove any true mathematical theorem. After Gödel, it has become an ongoing challenge to work out what we can and cannot compute, what is and is not mathematically possible (Gödel 1931). Computability issues are not just about abstract problems in mathematics. They can crop up in social situations because each person needs to anticipate the actions of others in order to compute his or her best path forward. Well-meaning policy makers are overambitious when they try to substitute policy plans for the entrepreneurial market process. Markets have a crucial advantage over such overambitious policy makers: markets do not have to know where they are going. The entrepreneurial market process does not require anyone to compute the final result ahead of time. The market does not know where it is going and does not need to know. To the contrary policy makers who wish to control or greatly influence the results of the entrepreneurial market process must know where they want to go. They must calculate outcomes ahead of time, which is, as the logic of computable economics has shown, not generally possible (also Koppl 2008). Velupillai has shown that there is an undecidability of policy in a complex

thought that given the (possibly many) equations defining an economy, a huge and immensely powerful computer would *always* be able to figure out the equilibrium prices, therefore allowing (at least theoretically) the existence of an efficient global policy maker.

However true this may be, the Austrian critique of socialist planning was never primarily about the limitations of computation. Cottrell and Cockshott, among others, treat as a computational issue what is really an epistemological one. The computational and epistemological arguments should not be confused, however. But even if and to the extent that the problem could be considered as a computational one, authors such as Cottrell and Cockshott, who invoke modern advances in artificial intelligence to perform the complex calculations necessary for the efficient *ex ante* allocation of resources, would still have to meet the Gödelian argument from undecidability and incompleteness.¹⁷

It can be shown that equilibrium prices in competitive markets are in general *noncomputable*, and so fall outside the scope of the techniques available in the usual formal modeling tools (Doria 2017b, 54). This means there are also obstacles to forecasting when one deals with *linear* systems as in the case of determining competitive market equilibrium (*ibid.*). Whenever social phenomena are described by dynamical systems, uncertainties in forecasting are usually supposed to be due to the nonlinearities in the systems considered, that is to say, they are related to the sensitivity those systems exhibit when small changes are made in the initial conditions. Linear systems do not have that kind of behavior and so are supposed to be strictly deterministic.

As Horwitz (1996) points out, the argument of the aforementioned authors fundamentally misunderstands the role of money and money prices in enabling economic calculation. Mises drew a clear relationship between the ability to perform economic calculations and the use of money and money prices. His reference to “money prices” throughout the calculation debate is more than just another way of saying “market prices”; it reflects his theoretical argument that the price system’s ability to aid in economic calculation derives from the use of money in the process of price formation.

Mises was only concerned with real money prices, which would not be available with socialized means of production, even if the planning board could still have access to prices in the sense of terms on which alternatives are offered by solving for equilibrium prices using a trial and error process. Mises’ theoretical framework implied that the calculation issue only made sense when talking in terms of real money prices generated in a money-using economy.¹⁸

economy: if the economy is complex, then you cannot program a computer to predict the specific outcome of a policy (Velupillai 2007).

¹⁷ Readers unfamiliar with Gödel’s incompleteness theorems might benefit from Hoffmann (2013b). See also Hoffmann (2013a) and of course Gödel (1931).

¹⁸ Money prices provide the necessary guideposts toward rational economics since, as Mises wrote “(t)he human mind cannot orientate itself properly among the bewildering mass of intermediate products and potentialities of production without such aid” (Mises [1920] 1990, 19). As he points out, “(n)o single man can ever master all the possibilities of production, innumerable as they are, as to be in a position to make straightway evident judgments of value without the aid of some system

The subsequent drift away from these issues and shift in focus to equilibrium models—what Lavoie (1985, 78) calls the “diversion of the debate into statics”—left behind discussion of the role of actual money prices in assisting in economic calculation. As Hayekians would also recognize, the flaw in Lange-type proposals was that they sought to use equilibrium theory to describe a world of pervasive disequilibrium, and that economic systems are better described using process analysis and evolutionary thinking.

9 General Conclusion

It seems plausible to assume that it makes a difference whether the most fundamental problem connected with socialism is (a) a calculation problem as originally identified by Mises, (b) an incentive problem, or (c) a knowledge problem. While (b) and (c) have been acknowledged in the mainstream literature, in particular in the context of a reflection upon and an allegedly more precise elaboration of Hayek’s contribution, (a) seems to have largely disappeared from the general perception.

The general impression that comes forward from reviewing the socialist calculation debate then, and which still goes on to this day, is that the differing camps in this debate have largely been talking past one another, that is, a situation of mutual misunderstanding, where two or more people talk about different subjects, while believing that they are talking about the same thing. The latter seems to be true of at least one side in the debate, namely that of the central planners and the design theorists.

One implication of this situation is that the main lessons of the Socialist Calculation Debate haven’t been generally absorbed, neither by the mainstream of the economics profession, nor by the general public. This is particularly true in the monetary sphere, a subject I haven’t treated today. The monetary sphere is the main sphere where some form of central planning is today still considered theoretically legitimate and put into practice in particular by central banks. The monetary theory of business cycle developed by the Austrian School can in fact be considered a particular application and exemplification of the general insights provided by the theorem of the impossibility of socialism. This also means that the conclusions of the socialist calculation debate retain the highest degree of relevance in view of understanding real world events.

of computation. The distribution among a number of individuals of administrative control over economic goods in a community of men who take part in the labour of producing them and who are economically interested in them, entails a kind of intellectual division of labour, which would not be possible without some system of calculating production and without economy” (Mises [1920] 1990, 17–18). It is this notion of an “intellectual division of labour” that forms the core of the later criticisms of central planning.

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On the (Im)Possibility of Socialist Calculation: Marschak Versus Mises



Harald Hagemann

1 Introduction

When I got to Berlin there were the Spartacus fights. I was still interested and later sat through the three or four days of the second Räte congress, which met about February.

Marschak (1971, 77)

Jacob Marschak who was born in Kiev, Russia, in 1898 and died in Los Angeles in 1977, had one the most adventurous biographies of an economist in the 20th century. At the age of nineteen he became Secretary of Labor in the revolutionary government of the short-lived Terek Republic in the Northern Caucasus.¹ When he died, he was President Elect of the American Economic Association. Marschak's professional career extended across 58 years and three countries: Weimar Germany (1919–33), the United Kingdom (1933–38), where he became the founding Director of the Oxford Institute of Statistics in 1935, and the United States where, after a period at the New School for Social Research in New York, Marschak was appointed Professor at the University of Chicago and Director of the Cowles Commission for Research in Economics in January 1943. His appointment at Chicago had been initiated by Oskar Lange, whereas at the New School Marschak was succeeded by Abba Lerner.² Lange and Lerner had been main opponents of Friedrich August Hayek, of whom they were immediate colleagues at the London School of Economics, in the second round of the socialization debate in Britain in the 1930s.

¹For Marschak's Recollections of Kiev and the Northern Caucasus, 1917–18, see Marschak (1971).

²For more details on Marschak's life and work see Arrow (1978, 1979), Radner (1984) and Hagemann (1997, 2006).

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Marschak, who had arrived in Germany in January started to study economics mainly with Ladislaus von Bortkiewicz at the University of Berlin in the summer semester 1919 before he moved to the University of Heidelberg, where he received his doctorate with a thesis on the quantity equation in 1922, and later his habilitation with an analysis of the elasticity of demand in 1930. Marschak's first scholarly publication, however, was his article "Wirtschaftsrechnung und Gemeinwirtschaft" (Economic calculation and the socialist commonwealth) in which Marschak (1924) inspects Mises's thesis of the impossibility of economic calculation in socialism due to the absence of price formation on free markets which had launched the first socialization debate in the German language area after World War I.

Marschak was the first of a larger group of Mensheviks, many of them well-trained mathematical economists, who emigrated from the Soviet Union to Weimar Germany. He was later succeeded by his personal friend Wladimir Woytinsky, who had been Minister of economics in the socialist government of Georgia, Wassily Leontief, Paul Baran (who both got their Ph.D. from the University of Berlin), and others.

At Heidelberg Emil Lederer (1882–1939), who in 1933 became the founding Dean of the 'University in Exile' at the New School, was Marschak's main mentor. They also carried through a joint analysis of the role of the new middle classes in modern society, a pioneering study on the salaried employees or white-collar workers (Lederer and Marschak 1926, 1927; see also Hagemann 2000, 28–31). Lederer who had been well trained as an economist at the University of Vienna, was also strongly influenced by Marx's analysis of capital accumulation and technical progress and always very active in the political sphere. However, he never became an orthodox Marxist, and as a democratic socialist, engaged in the Social Democratic party, he mistrusted any Bolshevik experiences.

At the end of the First World War socialization commissions had been founded in Germany and Austria. Lederer became an active member of both commissions. Eduard Heimann, the general secretary of the first and second socialization commission in Germany, and later a colleague of Lederer in New York, in retrospect considered Lederer as "practically the leader of the socialization commissions in Germany and Austria during the years 1918–1920 ... although Schumpeter's and Hilferding's shares should not be neglected".^{3,4} Lederer was director of the scientific section of the Austrian Socialization Commission. Having been an initial proponent of socialism, Lederer soon became disappointed by the political and economic development. His contemporary position is best exposed in his contribution to the 1919 Regensburg meeting of the Verein für Sozialpolitik which focused on "Problems of Socialization". There Lederer (1919, 111) states that, in contrast to Marx, capitalism is not a sick economic system doomed to collapse, but a well-constructed economic system

³See Sect. 3 'Economics of Socialism' in the obituary of Lederer by Marschak, Kähler and Heimann (1941, 93–100, esp. 94).

⁴Lederer and Rudolf Hilferding, who both were members of the first German Socialization Commission appointed by the Ministry of Economics could persuade Schumpeter to become a member too in January 1919. Due to his appointment as Austrian minister of finance Schumpeter had to resign in March.

whose substance is stable.⁵ Lederer rejected a fully planned economy which would be doomed to fail since it excludes pluralism of interests and settlement of conflicts. As a life-long critic of the excesses of monopoly capitalism Lederer favoured the participation of consumers and government-appointed experts.

This again is a social and institutional theory of how to determine price, rather than an economic theory of where to fix it. He cared but little for the elaborate theory of a socialist economy based on accounting costs: to engage in such highly speculative inquiries would have been alien to his eminently practical instinct of an economic theorist. (Marshak et al. 1941, 97)

Many of the key participants in the first socialization debate had been fellow students at the University of Vienna. Joseph Schumpeter and Emil Lederer as well as Ludwig von Mises and the Austro-Marxists Otto Bauer, Rudolf Hilferding and Otto Neurath all had been participants in Böhm-Bawerk's famous seminar in 1905–1906 (see Hagemann 2015). As a dyed-in-the-wool liberal Mises was the odd man out. Nevertheless the *Archiv für Sozialwissenschaft und Sozialpolitik* which was the most eminent journal in the social sciences until its termination after the Nazis' rise to power in 1933 published no fewer than ten articles by Ludwig von Mises in the period 1913–1929. Although many papers in the *Archiv* were written by critics of the capitalist system, such as Eduard Heimann, Karl Polanyi or members of the newly founded Frankfurt Institute for Social Research, such as Otto Kirchheimer, Herbert Marcuse and Karl August Wittvogel, or Lederer himself, it expresses the characteristic openness of the journal's editorial policy. Lederer who played a key role as the editorial assistant since 1911 and as the managing editor from 1922–33 was always an intellectual liberal towards scientists with diverging *Weltanschauungen*. This is reflected best in the acceptance of Mises's articles of which the most famous one is the 1920 paper which launched the socialist calculation debate in the German language area in the 1920s, which found its sequel in the United Kingdom in the 1930s when Hayek became involved in a controversial debate with the so-called neoclassical socialists Oskar Lange, Abba Lerner and H.D. Dickinson.

2 Economic Calculation and the Socialist Commonwealth: The Core Problem

Among the papers with the greatest permanent interest were his [Marschak's] first... on the raging debate started by Ludwig von Mises on the possibility of a rationally planned socialist society.

Arrow (1979, 502)

Mises's 1920 article was not the beginning of the socialist economic calculation debate but it was the beginning of a shift to the human reason side of socialism, written at a time when practical problems of implementation came to the fore in a

⁵See also the debate on Lederer's contribution at the conference, pp. 193–201.

revolutionary period. His own teacher Friedrich von Wieser had already pointed out that even a socialist community had to engage in rational economic calculation if it wanted to be efficient. Pareto (1909) and Barone (1908) had addressed the pure theory of a socialist economy on the basis of a Walrasian general equilibrium model. In particular Barone's "masterly article" (Samuelson 1947, 214) on the problem of planning the direction of production under collectivism had established the formal equivalence of fundamental economic categories between a socialist society and a capitalist society based on private property in perfectly competitive conditions. In contrast to the first socialization debate after World War I, Barone explicitly abstained from ideological or political motivations and implications. Thus he pointed out at the beginning that "I do not write for or against Collectivism" (Barone [1908] 1935, 245). Furthermore, he proved the possibility of economic equilibrium in a Collectivist as well as in a Capitalist state explicitly without recourse to the concepts of utility and indifference curves. The full importance of Barone's contribution only became clear after the translation into English in Hayek's 1935 collection during the second socialization debate and Samuelson's appreciation and elaboration of Barone's analysis of the Pareto optimum conditions related to the planning of production in a Collectivist state in his subsequent *Foundations of Economic Analysis* (see Samuelson 1947, 212–218).

Schumpeter pointed out that

von Wieser, Pareto, and Barone, who were completely out of sympathy with socialism, created what is to all intents and purposes the pure theory of the socialist economy, and thus rendered a service to socialist doctrine that socialists themselves had never been able to render. (Schumpeter 1954, 986)

In particular he credited Barone for having settled the question that "[t]here is nothing wrong with the pure logic of socialism" (Schumpeter 1942, 172) and that the same economic logic can be applied both to capitalism and socialism.

The essential result of Barone's or any similar investigation is that there exists for any centrally controlled socialism a system of equations that possess a uniquely determined set of solutions, in the same sense and with the same qualifications as does perfectly competitive capitalism, and that this set enjoys similar maximum properties. Less technically, this means that so far as its pure logic is concerned the socialist plan makes sense and cannot be disposed of on the ground that it would necessarily spell chaos, waste, or irrationality. (Schumpeter 1954, 988–9)

While he judges that the "purely theoretical anti-socialist argument" by Mises, Hayek and Robbins is "definitely wrong" (Schumpeter 1954, 989, n. 12), Schumpeter concedes that the pure logic of socialism, which in the first socialization debate had only been denied by Mises, is carried out by Pareto and Barone on a very high level of abstraction. It thus does not exclude practical problems of its implementation up to its unworkability due to complex institutional set-ups.

In contrast to Schumpeter, Mises shared the contempt of most members of the Austrian School against Walrasian general equilibrium theory and criticized Pareto and Barone for not penetrating to the core of the problem. Instead in his argumentation on the impossibility of economic calculation in socialism (Mises 1920), embodied

and further elaborated in his subsequent book on Socialism (Mises 1922, see particularly Part II), Mises put the focus on practical feasibility. For Mises “Socialism is the abolition of rational economy” (Mises [1920] 1935, 110). This is the consequence of the destruction of free markets. His core thesis therefore reads: “Where there is no free market, there is no pricing mechanism; without a pricing mechanism, there is no economic calculation” (Ibid 111).

Rational economic calculation, according to Mises, also depends on private property, the use of money and a free banking system. “Every step that takes us away from private ownership of the means of production and from the use of money also takes us away from rational economics” (Ibid 104).⁶ Although Mises concedes that “[t]he static state can dispense with economic calculation” (Ibid 109), this concession is a very limited one. For him it only follows from the assumption “that the first disposition of the static socialist economy follows on the basis of the final state of the competitive economy” (Ibid 109), for which the imputation problem had been solved. Furthermore, he considered such a static state as completely unrealistic. However, this is another level playing field. Whereas Mises is surely right in pointing out that every economy is in constant motion and that therefore the economic data necessary for efficient planning in socialism are not available,⁷ he did not fully grasp the theoretical argument developed by Pareto and Barone that rational economic calculation in a static socialist society is possible. The quantity solution to efficient production, with constant returns to scale, is the dual to the price solution for a competitive market economy. Thus Streissler (1994, 61) points out:

Of course, for the quantity solution we have to know all preferences, all production technologies and all initial endowments. It is, apparently, much easier to find out about these data via the competitive market process, than, e.g., via the statistical apparatus of a centrally planned socialist system; but that is the problem of the viability of socialism, not its theoretical possibility: it is cheaper to find out the relevant facts via markets.

Mises indicates the problems of decision making in a world where the future is uncertain and emphasizes that a socialist economy will fail much more than a free market system. This important line of argument focusing on knowledge and uncertainty only was elaborated later by Hayek in the second socialization debate (see Hayek 1935, 1937, 1940, 1945; also Vaughn 1980, Sect. III; Streissler 1994; Caldwell 1997).

Hayek himself considered the emphasis put by Mises on the fact that economic calculation for goods of higher order was impossible in a socialist society because there does not exist a market for them as

[t]he essential point where Professor Mises went far beyond anything done by his predecessors was the detailed demonstration that an economic use of the available resources was only possible if this pricing was applied not only to the final product but also to all the intermediate products and factors of production. (Hayek 1935, 33)

⁶It should be pointed out that central command over the means of production does not necessarily require the legal abolition of private property. This marks a major difference between Nazi Germany and Soviet Russia.

⁷This argument is more elaborated by Mises in the second edition of *Die Gemeinwirtschaft*. See Part IV, Chaps. VI and VII of Mises (1932).

Mises's emphasis on the impossibility to identify money prices for means of production in a socialist commonwealth indeed has been already a regression line of his argument in the 1920 article which launched the first socialization debate. Time and again he emphasizes that calculation in nature in socialism can embrace consumption goods only but fails to deal with "all production involving processes stretching well back in time and all the longer roundabout processes of capitalist production would be gropings in the dark" (Mises [1920] 1935, 101, 1922, 108).

Marschak (1924) directly tackles the core thesis in his critique of Mises's argument of the logical impossibility of economic calculation in socialism. Marschak's critique is of an empirical as well as of a theoretical nature. He objects to Mises the empirical validity of his argument because the requirements of price formation on free markets are not fulfilled in capitalist economies with an increasing number of cartels and trusts. Moreover, the growing formation of cartels and trusts shows that the advantages of monopolistic competition exist precisely in those two areas which are particularly affected by Mises's scepticism:

- in the economic calculation for goods of higher order, and
- in the sphere of dynamics (see Marschak 1924, 514).

The advantage of exact price formation on free markets, pointed out by Mises, therefore loses relevance just on these two levels.

Marschak does not refer to Barone, but to Edgeworth (1881) and Schumpeter (1908) in his specifying the constitutive conditions of a theoretically possible state of free competition which forms the basis of economic statics according to the method of abstraction. The background is Mises's emphasis on "destructionism", i.e. increasing interventions by the government or trade unions of which a socialist commonwealth would only be the utmost case, and the idea that economic calculation depends on perfect competition. Referring to the preconditions of free competition stated by Edgeworth (1881, 18–19) and Schumpeter (1908, 271), such as an unlimited number of participants and freedom to (re-)contract, Marschak states that only then an exact price formation is possible. If these assumptions are not fulfilled, then, in mathematical terms, the number of equations would be smaller than the number of unknowns, with the consequence that an exact price fixing would become impossible. The consequence is that the unique price is replaced by an interval which becomes the larger the further the economy moves away from the Edgeworth-Schumpeter conditions of free competition. With the rise of heavy industries, the unequal distribution of natural resources and the necessity of larger capital, these conditions, outside the stock exchange are less and less fulfilled.

The empirical reality today lies somewhere in the middle between the one extreme – free competition with an infinite number of contractors – and the other extreme of an entirely monopolized economy. (Marschak 1924, 510, my translation)

The question of the interval price cannot be solved in a purely economic way but has to include social facts respectively the institutional set-up. This inexactness of price formation in modern capitalism results from increasing monopolization.

According to Marschak, Mises does not clearly separate this interval character of prices from the intensity character. Prices of commodities can be formed on markets only as extensive magnitudes whereas value is an intensive magnitude. The exact value calculation is only possible as price calculations, i.e. exchange relations. With reference to the proof by Pareto (1909), Marschak (1924, 506) emphasizes that the equilibrium can be determined when operating with intensive quantities. This holds true for a Robinson Crusoe type economy for which only an intensity scale but not prices exist, which more or less even Mises had conceded.

Next Marschak addresses the problem of valuation of goods of higher order which Mises had considered as impossible to solve in socialism since market prices for the means of production don't exist. This was an essential point for Mises who emphasized that with private ownership of the means of production the producer implements an allocation of these goods of higher order in which they earn the highest possible return. Marschak first addresses this argument in a purely theoretical way. His key argument is that even in the case of complete vertical integration (concentration of all intermediate stages of production), in which an input of labour would lead to an output of consumption goods, the imputation problem can be solved and no difficulties in the determination of prices and quantities would arise (Marschak 1924, 506–507).⁸

In a similar way Schumpeter later, in his discussion of the question “Can Socialism Work?” in *Capitalism, Socialism and Democracy* emphasizes that for the theorist economic rationality follows from the elementary proposition that consumers in evaluating (“demanding”) consumers’ goods *ipso facto* also evaluate the means of production which enter into the production of those goods” (Schumpeter 1942, 175). It was this statement which contributed to the clash between Schumpeter and Hayek who accused Schumpeter to be obsessed with equilibrium theorizing assuming that the objective facts embodied in the relevant simultaneous equations are completely known to the market participants respectively the planning authority, thereby assuming the problem away how the allocation of resources can be found in practice and thus “to disregard everything that is important and significant in the real world” (Hayek 1945, 530).⁹ Against Schumpeter and other mathematical economists with high standing falling into the trap of their simultaneous equations approach, Hayek accentuates “the unavoidable imperfection of man’s knowledge and the consequent need for a process by which knowledge is constantly communicated and acquired” (Hayek 1945, 530). However, this emphasis on the formation and dispersion of knowledge and the later emphasis on competitive markets as a discovery process as well as the non-equilibrium understanding of the systemic character of market processes, as much as they were stimulated by the controversies in the first and second socialization debate, were not elaborated before the late 1930s.

⁸Marschak implicitly assumes the Austrian case dating back to Böhm-Bawerk in which only working capital, i.e. intermediate means of production, exist.

⁹Hayek also accuses Schumpeter to be “the original author of the myth that Pareto and Barone have ‘solved’ the problem of socialist calculation”. Furthermore, he emphasizes that “Pareto himself ... far from claiming to have solved the practical problem, in fact explicitly denies that it can be solved without the help of the market” (Hayek 1945, 529, n. 1 and 1940, 125).

Marschak criticizes Mises for mixing up the question of valuation of goods of higher order with the impossibility of economic calculation in a socialist commonwealth characterized by economic change, i.e. dynamics, and thereby mixing a purely theoretical with a practical question. Furthermore, Marschak argues that both questions, the economic calculation for goods of higher order as well as the dynamic problems, show the inadequacy of Mises's model of capitalism. Although arguing from a different perspective and coming to different conclusions than Hayek later, Marschak (1924) also identifies that the decisive problem consists in the flexibility of the economy to adjust to structural change and to absorb new information. Marschak's early analysis links up with his later interest in the economics of information systems and the *Economic Theory of Teams*, elaborated with Marschak and Radner (1972), which provided a powerful tool for the analysis of the relative informational efficiencies of decentralized price expectations and emphasized the importance of communications and its limits in the transmission of information.

The analysis of these dynamic issues naturally leads to a transgression of a rather static Walrasian general equilibrium approach. Marschak's analysis has much in common with Schumpeter's view, whose *Theory of Economic Development* naturally comes into play now. Economic development is essentially a disturbance of the static equilibrium of the economy. Marschak discusses two cases of dynamics: changes which originate from outside and those originating from inside the economy. Referring back to the case of vertical concentration, which he had discussed in his critical inspection of Mises's analysis of goods of higher order, he first emphasizes the empirical fact that the process of monopolization before World War I had contributed to a moderation of economic crises compared to the earlier anarchic form of capitalism with catallactic atoms. Confronting the extreme form of an Edgeworth-type theoretical world of perfect competition with the practical world of contemporary capitalism, Marschak emphasizes the advantages of the latter. The economic system has become more elastic in the capacity to react to outside shocks due to the fact that many individuals with a narrow field of vision and little potential to act have been replaced by a small group of persons who are equipped with surveying and acting power. Thus the confrontation, as Mises did, of the real world with the abstract world of general equilibrium, leads Marschak to a fundamental critique of Mises's position.

Exactly when one envisages the changes in foreign trade, the theoretical advantage of the free market which has been praised by Mises – formation of 'exact' prices which only then can be taken as foundations for calculations – loses its relevance. (Marschak 1924, 516, my translation)

Marschak then comes to the second case of dynamics, changes which originate from within the economic system, on which Schumpeter focuses his theory of economic development. Marschak here discusses the cases of a railway company opening up new regions by lower fares, a purchasing cooperative which orientates its price policy in favour of stimulating new production methods on the side of producers, or the government which raises the yield of indirect taxes by raising the level of purchasing power by melioration measures in agriculture. They all act economically, "although their rentability calculus has no foundation of 'exact' prices which are

formed on a market with elementary objectivity” (Marschak 1924, 516). Marschak explicitly refers to Schumpeter (1908, 268), who had already elaborated the advantages of monopolies to realize future plans in their pricing policy. In the concluding section Marschak confronts Syndicalism with a centralized socialist system. In this section he comes closest to the views of his teacher Lederer, so when he argues strongly against a non-democratic centralized socialism, for which the possibility of economic decision-making becomes a rising problem as soon as the condition of homogeneity of value scales is not fulfilled. This homogeneity does exist to a greater degree for basic commodities¹⁰ but not beyond them, which implies that the market cannot be substituted by an ideal general will. Other factors such as solidaric bonds or enforcement of power add supplementary. Marschak concludes his critical inspection with the statement that Mises’s thesis of the impossibility of economic calculation in the socialist commonwealth is not proved.

Interestingly, a similar argument was used by Marschak some years later when the wage-employment debate intensified after the outbreak of the Great Depression. In the controversy on the purchasing power argument in wage policy Marschak (1930) held the view of a differentiated pro and dismissed an a priori rejection as unsound. For him wage increases (reductions) at first implied no increase (reduction), but a reallocation of purchasing power from entrepreneurs to workers (and vice versa). Such a reallocation of purchasing power is naturally associated with a change in the structural composition of production. Marschak considered it an important idea of the theory that a reallocation of purchasing power in favour of workers, which is associated with higher wages, will stimulate production since the goods consumed by workers are subjected to the law of mass production, i.e. economies of scale, to a higher degree than those goods consumed by capitalists which have more the character of luxury goods.

3 Concluding Remarks

Jacob Marschak was a warm and tireless member of the working parties seeking scientific truth. At age 79, as at age 30, Marschak worshipped the pursuit of science.

Samuelson (1988, 323)

Referring to Vaughn’s (1980) survey on the Austrian contribution to the debate on economic calculation under socialism, Erich Streissler in his discussion of the role of Hayek and Mises makes the apodictical judgement:

In contrast to his [Mises’s] continental sparring partners, who hardly knew any economics, were completely blinded by Marxism, and had the naivest ideas, his English critics were mainly fully trained academic economists who could spot his errors. (Streissler 1994, 64)

¹⁰Marschak (1924, 519) criticizes Mises for his standard procedure to refer to exceptional cases such as (non-) smoking or the use of narcotics where this homogeneity is not given.

This statement is certainly not true for Marschak who at the end of the second socialization debate engaged in closer cooperation with Oscar Lange. However, neither Streissler nor Vaughn discuss Marschak's contribution, in contrast to Arrow, Neck's insightful analysis (Neck 1982), or the reference by Chaloupek (1990, 671).

Streissler's statement also does not do justice to the important contribution by Claire Tisch (1907–1941) who was murdered in the holocaust. Her doctoral thesis *Economic calculation and distribution in the centrally organized socialist community* (Tisch 1932), written at the end of the first socialization debate, is an important contribution deploying serious economic analysis which is not distorted by political prejudices. Her critique of barter socialism is as well founded as her own solution of the socialist calculation problem which is based on a Walrasian general equilibrium system in the simplified version of Gustav Cassel. Tisch clearly has to be seen as a precursor of the so-called 'neoclassical socialists' as Dickinson, Lange and Lerner who dominated the debate in the 1930s. It is therefore no surprise that her Ph.D. supervisor at the University of Bonn, Schumpeter refers to Tisch's work in the context with Lange, Lerner et al. (see Schumpeter 1942, 173, n. 2). However, also Hayek referred to Tisch's contribution as a "useful collection of different allusions to this problem [of economic calculation in the socialist commonwealth] in Marx's works" (Hayek 1935, 13) or in his later confrontation with the neoclassical socialists (Hayek 1940, 128). In contrast, Tisch's contribution has almost fallen into oblivion today.

Marschak later had outstanding Ph.D. students, such as Franco Modigliani (Hagemann 2017) in New York or Don Patinkin at Chicago. It is interesting to note that 23 years after Marschak's article on economic calculation and the socialist commonwealth the young Modigliani, who was influenced by the Italian tradition of Pareto and Barone, and was in closer contact with Lerner at the New School in New York and Lange in Chicago, came back to this issue. In a long article Modigliani (1947) struggled with the questions of "how production was run efficiently in a socialist economy and how it handled the absence of a market so as to achieve the desired result". Entirely in agreement with the spirit of his appreciated teacher's article (Marschak 1924), Modigliani came to

conclusions, which were absolutely theoretical, [and] did not paint a negative picture of socialism; however, the reasons that could, in theory, have supported the socialist economic thesis were light-years away from those actually being used by communist propaganda. (Modigliani 2001, 165)

As a democratic socialist Marschak had been an active politician in revolutionary Russia. In Weimar Germany he was a close adviser to the trade unions and the group of the Social Democrats in the Reichstag, the German Parliament. He also became a founding member of the *Sozialistische Vereinigung für Wirtschafts- und Gesellschaftsforschung* (Socialist Association for Economic and Social Research) in May 1929. The first chairman was Fritz Tarnow, the leader of the wood-worker union, with the former Austrian Chancellor Karl Renner and Emil Lederer as Vice Chairmen. Among the members of the executive board were Adolf Löwe, Marschak's life-long friend, and Fritz Naphthali, whose pioneering work on theory and practice of economic democracy became very influential for the formation of economic doctrines

of German trade unions and Social Democracy. Tarnow, together with Marschak's friend Woytinsky who became research director of the German association of trade unions in 1929, and Fritz Baade, a Socialdemocrat and member of the Reichstag who later, after his return from his Turkish exile, became Director of the Kiel Institute of World Economics (where Marschak had a research position from 1928–30), was the originator of the *Woytinsky-Tarnow-Baade plan* of the German trade unions in 1932 advocating employment programs in the Great Depression.

It therefore might be stated that “Marschak’s approach to policy ... was heavily tied to the Marxist and socialist intellectual environment of Russia and Germany” (Cherrier 2010, 460). Although he kept his convictions, the shock of the second emigration from Nazi-Germany in 1933, after the first one from revolutionary Russia, led to a complete abstinence from political activities and statements in the public. Marschak now favoured a value-free science as an ideal (see Craver and Leijonhufvud 1987, 181), as expressed in his later work at the Cowles Commission. Nevertheless seeking scientific truth, as stated in the initial quotation to this section by Samuelson, is a constant in Marschak’s work over more than half-a-century. This also holds for his contribution to the first socialization debate.

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