

# INSTITUTIONAL ECONOMICS

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Course Material Developed by Department of Economics,  
Faculty of Social Sciences, Eötvös Loránd University Budapest (ELTE)

Department of Economics, Eötvös Loránd University Budapest

Institute of Economics, Hungarian Academy of Sciences

Balassi Kiadó, Budapest



Author: János Mátyás Kovács  
Supervised by János Mátyás Kovács

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## Week 5

# “Old“ Institutional Economics III The “Socialist Calculation Debate” and the idea of social market economy

## Contents

- Socialist calculation debate
- Ordo liberalism

## Calculation debate

- Before bridging the gap between the German and the Austrian schools, the latter reinforced/routinized its own institutionalism in a fight with an extremely constructivist collectivism.
- Mises (1920) reacts to “really-existing“ communism very quickly (the same applies to Bratskus, Cassel, Wieser and Weber), laying the foundations of a modern critique of the communist economy (*Wirtschaftsrechnung* is the key

- concept and the “impossibility thesis“ is the key proposition).
- A multiple-wave discussion begins (*Socialist Calculation Debate, SCD*).
  - In principle, the theory of communism (collectivism) could have been challenged by empirical facts (using the example of the Soviet Union).
  - The debate unfolds rather slowly; until Hayek’s intervention in 1935 (*Collectivist Economic Planning*), it is the left-liberals and the Marxists who feel provoked by Mises.
  - SCD seems at the first sight a provincial, basically German/Austrian debate (*Archiv für Sozialwissenschaft*); Chayanov on calculation in working hour; Polányi; Marschak: a syndicalist-decentralized model of communism; Heimann, Tisch, Zassenhaus: predecessors of Lange; Weil and Mises defend the impossibility thesis; by 1928 the debate slows down.
  - Hayek transplants the discussion to the English-speaking world: Taylor, Dickinson, Dobb, Lange, importing Brutskus and Barone as well.
  - 1935 marks the beginning of the second wave
  - SCD fundamentals:
    - is rational calculation under communism/collectivism possible (theoretical versus practical possibility?)
    - basic institutions of communism: public ownership, planning, distribution in kind, etc – what do they mean?
  - A debate on rival systems: a separate discipline, *Comparative Economic Systems* will grow out from it (the first appearance of the concept of market socialism).
  - Mode of comparison: real capitalism with ideal communism
  - Is it a Hayek–Lange debate?
  - Internal narratives:
    1. We, Austrians defeated the Marxists (meanwhile, the Austrians were closer to Marx than to neoclassical theorists in terms of institutional matters (e.g., market institutions); Mises was right, communism as an economic system is not feasible (after 1989, this thesis will become a common place).
    2. We, Marxists defeated “bourgeois economics“ using its own neoclassical

weapons; Mises was gravely mistaken.

- An external interpretation:
  - SCD is not the same all the time: arguments change a lot, Hayek's market theory expands while Lange becomes uncertain by the time when he is in the position of an actual reform-maker.
  - A dialogue of the deaf?
- Hayek (1935): reinforcing and correcting Mises' points; rational calculation is not impossible in mathematical terms.
- Taylor and Dickinson as "designated" market socialists ("pseudo-competitive solution"): the Walrasian equations can be solved; Lange (and Lerner) will become the main opponents.
- The Hayek volume provokes the other party: he speaks about the weaker performance of collectivist regimes, a future collapse – without presenting empirical evidence; Lange does not refer to the Soviet reality either.
- Hayek: perfect knowledge is assumed by the collectivist theory; it is not to solve the equations that is impossible but to set them.
- Hayek criticizes the Lange model before its publication: a simulated market will be much more "anarchic" than the real one.
- Lange's response: *On the Economic Theory of Socialism*, 1936/37
- Simulation: separating the capital and consumer markets; consumers maximize utility; firms and the Planning Board; Walrasian auctioneer; *tattonement*
- Lange tacitly abandons the labor theory of value but he is not interested in the Austrian institutional arguments either.
- Lange's trick: back to abstract theory, Barone, Pareto and Walras to avoid discussing empirical issues.
- Hayek strikes back: *Economics and Knowledge*, 1937; *The Competitive Solution*, 1940; *The Use of Knowledge in the Society*, 1945.
- Lange assumes (incorrectly) a concentration of economic knowledge in the Planning Board; trust in the omniscient planner; can "scattered knowledge" be synthesized?

- In contrast to Hayek, Mises' views are rather rooted in sociological considerations: interest-based distortion of information, wrong incentives, advantages of private ownership, etc: is his position more consistent in institutional terms than that of Hayek?
- Does anyone win the debate? Until the consecutive failure of socialist reforms, one could perhaps believe in Lange's triumph.
- Cautious assumption: it is impossible to decide which system is more efficient; more radically: socialism is superior.
- Even if it is not superior yet, it can be improved through simulation; maybe, communism has an institutional theory that is acceptable by modern economics as well ("maybe economics")
- Hayek did not ever think that he lost; on the contrary, he did not cease to strengthen his institutional arguments (knowledge, information, incentives, etc) – as a result, the Austrian School was revitalized, and started defining itself, by means of institutional theses, as a rival to neoclassical theory.

## Ordo liberalism

- German historicism does not disappear no matter how steadily the neoclassical mainstream develops.
- What seems to be of secondary importance at first sight: the Cambridge tradition of historicism survives (Keynes as a historical institutionalist?); critique of *laissez-faire*, interventionist leanings, postulating uncertainty – without an institutionalist creed (more on this in the next presentation).
- What if Keynesian ideas combine with an institutionalist research program that has strong historical foundations?
- What if there emerges a school of thought that is also deeply rooted in liberalism but not fundamentalist, pragmatically blending the idea of spontaneous evolution with economic policy, and writing theory rather than history (thus, transcending German historicism)

- The Freiburg School , i.e., Ordo liberalism (Eucken, Röpke, Böhm, Rüstow, Müller-Armack, *Soziale Marktwirtschaft*) offers exactly that mix:
  - Coupling *Ordnungstheorie* and *Ordnungspolitik*; suggesting a series of “soft” institutional concepts (“guided market economy”, “market-oriented intervention”, etc); flirting with the program of the “third way” (Röpke).
  - Ordo liberalism (the theory of the social market) can be understood without elementary neoclassical knowledge.
  - Holistic (quasi-collectivist) notions: order, state redistribution, common interest, social justice.
  - Normative approach: “corrective order” regulating the selection of economic institutions (protecting the market from itself); the state as a guardian of competition.
- *Wirtschaftswunder*: providing justification for Ordo liberalism
- How could Hayek accept this? Did he suggest *social* market, state intervention or a third way? Why did he leave Chicago for Freiburg? Can the German and the Austrian traditions be hybridized? Is the *Methodenstreit* over?
- Systemic approach and lack of formal modelling: however, Hayek did not accept Eucken’s notion of the *Wirtschaftsordnung* (centrally administered and exchange economy as the main types) because those types are based on differences in coordination rather than ownership.
- At the same time, consensus in the emphasis on liberty guaranteed by the constitutional order (Rechtsstaat); Hayek is evolution-oriented while Eucken is rather a liberal-minded constructivist; a strong state is needed to check “refeudalization” (rent-seeking).
- Underlying agreement on the constitutional principles (a joint anticipation of public choice?): stable currency, private property, free contracts, etc.
- Combining law and economics (another anticipation?); procedural, rule-based liberalism; the economic order is an ethical order as well.
- Ordo: natural rights considerations.

# Readings

## **Mandatory**

Brutskus: Economic Planning in Soviet Russia, 1935

Mises: The Historical Setting of the Austrian School of Economics, 1984

Hayek: The Present State of the Debate, 1935

Vanberg: The Freiburg School: Walter Eucken and Ordoliberalism, 2004

Peacock and Willgerodt (eds): German Neoliberals and the Social Market Economy,  
1989

## **Additional**

Mises: Economic Calculation in the Socialist Commonwealth, 1935

Lange: On the Economic Theory of Socialism, 1936/37

Eucken: The Foundations of Economics, 1950 (chapters)

Röpke: The Economics of a Free Society, 1962 (chapters)

# Annex

## Biographical sketches

- Lange
- Eucken
- Röpke

## Final questions

- Predecessors/successors of the school
- Friends and foes
- Discoveries
- Changes in the research program