

OBSERVATIONS ON THE RUSSIAN REFORM MOVEMENT

LUDWIG VON MISES

THE BOSSES of the Russian Communist Administration are disturbed by the fact that economic conditions in the countries which have not adopted the methods of the Communist International are by far more satisfactory than those in their own country. If they could succeed in keeping their "comrades" in complete ignorance of the achievements of Western capitalism, they would not mind the low efficiency of their own plants and farms. But as some scanty information about the "affluence" in the West penetrates to Russia, its masters are upset by the fear of a procapitalist reaction in their own house. This fear impels them on the one hand to foment sedition

all over the "capitalist sector" of the earth, and on the other hand to ventilate projects aiming at some minor reforms in their own methods of management.

Nobody is today more firmly convinced of the incomparable superiority of the capitalistic methods of production than the "production tsars" of the countries behind the Iron Curtain. The present-day strength of communism is entirely due to the mentality of the pseudo-intellectuals in the Western nations who still enjoy the products of free enterprise.

Capitalism a Social System of Consumers' Supremacy

The market economy—capitalism — is a social system of consumers' supremacy. There is in its frame only one method of earning a liv-

Dr. Mises is Visiting Professor of Economics at New York University and part-time adviser, consultant, and staff member of the Foundation for Economic Education.

ing and of acquiring property, namely, one must try to serve one's fellow men, the consumers, in the best possible way. A daily and hourly repeated plebiscite determines again and again every individual's earnings and place in society. By their buying and abstention from buying the consumers allocate ownership of all the material factors of production to those who have succeeded in satisfying the most urgent of their not yet satisfied wants in the best possible and cheapest way. Ownership of the material factors of production can be acquired and can be preserved only by serving the consumers better than other people do. It is a revocable public mandate as it were.

The supremacy of the consumers is no less complete with regard to labor, the human factor of production. Wage rates are determined by the price the consumer, in buying the product, is prepared to refund to the employer for the worker's contribution to the process of its production. Thus the consumers' valuation fixes the height of every worker's remuneration.¹ And let us not forget: the immense majority of the consumers are themselves earners of

salaries and wages and, in this capacity, instrumental in the determination of their own compensation.

The unique efficiency of the capitalistic system is due to the incentive it gives to everybody to exert his forces to the utmost in serving his fellow citizens. Not a vague altruism, but rightly understood selfishness impels a man to put forth all his strength in the service of his fellow men. The system of economic calculation in terms of money, the commonly used medium of exchange, makes it possible to compute precisely all projects in advance and the result of every action performed in retrospect; and, what is no less important, to ascribe to every factor the size of its contribution to the outcome.

Planning for People Control

The characteristic feature of socialism is precisely the fact that it substitutes for this market system of consumers' supremacy a dictatorial system, the "plan." In the planned economy the individuals are not driven by the desire to improve their own conditions but either by dutifulness or by the fear of punishment. It is impossible for the individual workers to improve their own material situation by working better and harder. If they intensify their

¹ This is to what the jargon of the Hollywood industry refers in using the term "box office account." But it is no less valid for all other fields of business.

own exertion, they alone are burdened by the implied sacrifices, but only an infinitesimal fraction of the product of their additional exertion will benefit themselves. On the other hand, they can enjoy in full the pleasures of carelessness and laziness in the performance of the tasks assigned to them while the resulting impairment of the total national product curtails their own share only infinitesimally.

The economists always have pointed to this inherent deficiency of socialism. Today all people in the socialist countries know that this criticism was fully justified. All their projects for an improvement of the quality and an increase in the quantity of economic goods and services turn around this problem. They all aim — unfortunately, in vain — at discovering a scheme that could make the individual members of a socialist system self-interested in the effect of their own contribution to the collective's effort.

That the socialists acknowledge this fact and are anxious to find a solution amounts in itself to a spectacular refutation of two of the most zealously advanced arguments in favor of socialism. On the one hand, the socialists asserted that in the market economy the wage earners are not interested in improving the output of

their own work. They expected that socialism would bring about an unprecedented improvement of the individual worker's contributions because everybody will be incited by the knowledge that he does not labor for an exploiter but works for his own best interest. On the other hand, the socialists vilified profit-seeking as the most pernicious and "socially" injurious institution and indulged in reveries about the blessings of what they called a substitution of "production for use" for "production for profit."

No less significant an admission of the viciousness of the socialist ideology is provided by the system of allowing small plots of land to be exploited for the account of the individual rural workers — falsely labeled for "private profit." This capitalistic loophole alone prevented famines in the country that includes a good deal of the world's most fertile arable soil. The urgency of the Soviet productivity problem is due to the fact that in the processing industries no analogous expedient is at hand.

No Fundamental Change

The much discussed reform projects of Professor Liberman and other Russian authors do not refer to the essential characteristics of the Soviet system of central plan-

ning of all activities commonly called economic. Neither do they deal in any way with the problem of economic calculation. (For present-day Russian planners this problem does not yet have primary importance; as long as they are operating within a world of the price system, they are in a position to rely upon the prices determined on the markets of the West.)

What the reformers want to attain is improvement in the conduct of factories and workshops turning out consumers' goods by the adoption of new methods for the remuneration of directors, supervisors, or foremen. The salaries of such people should henceforth be meted out in such a way that they should have a pecuniary interest in producing articles that are considered as satisfactory by the consumers.

It is a serious blunder to employ, in dealing with this issue, any reference to the concept of "profit" or to declare that the suggested method of payment would mean something like "profit-sharing." There is within a socialist system no room for the establishment and computation of a magnitude that could be called profit or loss.

The task of production is to utilize the available human and material factors of production for the

best possible satisfaction of future wants, concerning which there cannot be any *certain* knowledge today.

The Entrepreneurial Function

Technology indicates for what purposes the various factors of production could be employed; it thus shows goals that could be attained provided this is considered as desirable. To choose from this bewildering multitude of possible ways of production those which most likely are fit to satisfy the most urgent of the future wants of the consumers is in the market economy the specific task of the entrepreneur. If all entrepreneurs were right in their appreciation of the future state of the market, the prices of the various complementary factors of production would already have attained the height corresponding to this future state. As, under these conditions, no entrepreneurs would have acquired some or all of the complementary factors of production at prices lower or higher than those which later events proved to be the correct ones, no profits or losses could emerge.

One profits by having expended less than one — later — receives from the buyers of the product, and one loses if one can sell only at prices that do not cover the costs expended in production.

What determines profit or loss is choosing the goal to be set for the entrepreneurial activities and choosing the methods for its attainment.

Thus, it is investment that results either in profit or in loss. In a socialist system, since only "society" invests, only society can profit or suffer losses. But in a socialist system the material factors of production are *res extra commercium*. That means: they can neither be bought nor sold and thus no prices for them are determined. Therefore, it is impossible to find out whether a definite production activity resulted in profit or loss.

The Process of Selection

The eminence of capitalism consists precisely in the fact that it tends to put the direction of production into the hands of those entrepreneurs who have best succeeded in providing for the demands of the consumers. In the planned economy such a built-in process of selection is lacking. There, it does not matter whether the planning authorities have erred or not. The consumers have to take what the authorities offer them. Errors committed by the planning authority do not become known because there is no method to discover them.

In the market economy the

emergence of profit demonstrates that in the eyes of the consumers one entrepreneur served them better than others did. Profit and loss are thus the effect of comparing and gauging different suppliers' performance. In the socialist system there is nothing available to make possible a comparison of the commodities fabricated and the services rendered by the "plan" and its executors with something originating from another side. The behavior of the people for whom the plan and its executors are supposed to provide does not indicate whether a better method of providing for their needs would have been feasible. If, in dealing with socialism, one speaks of profits, one merely creates confusion. There are no profits outside the "profit and loss system."

If the authorities promise to the director of a shoe factory a bonus to be determined as a percentage of sales, they do not give him a share in "profits." Still less can this be called a return to the profit system. Profits can only be calculated if one deducts total costs from total receipts. Any such operation is unfeasible under the conditions of the case. The whole factory, fully equipped, was handed over by the authorities to the care of the director and with it all the material needed plus the order to produce, with the help of

workers assigned to the outfit, a definite quantity of footwear for delivery to definite shops. There is no method available to find out the costs incurred by all the operations preceding the first interference of the director. The bonus granted to him cannot have any relation to the numerical difference between such total costs and the proceeds from the sale of the final product.

A Significant Difference

In fact, the problem of reform as passionately discussed in the communist countries today does not deal with the profitability of the various plants and productive processes. It turns virtually around a different problem: Is it possible within a socialist system to remunerate a worker, and especially the supreme foreman of a plant, according to the value the consumers, the people, attach to his contribution to the accomplishment of the product or the service?

In the capitalistic or market economy the employer is bound to pay a hired worker the price the consumers are prepared to refund to him in buying the product. If he were to pay more, he would suffer losses, would forfeit his funds, and would be eliminated from the ranks of the entrepreneurs. If he tried to pay less, the competition

of other employers would make it impossible for him to find helpers. Under socialism no such connection between the amounts expended in the production of a commodity and its appreciation by the consumers prevails. There cannot therefore, *in general*, be any question of remunerating workers according to their "productivity" as appreciated by the consumers. Only in exceptional cases is it possible to separate the contribution of one worker in such a way from those of all other contributors that its separate valuation by the consumers and therefore its remuneration according to this valuation become feasible. For instance: all seats in the opera house can be sold at the regular price of m . But if a tenor of world fame sings the main part, the house is sold out even if the price of admission is raised to $m + n$. It is obvious that such cases are extremely rare and must not be referred to in dealing with the problem of wage rate determination under socialism.

Of course, a socialist management can determine for many kinds of work "normal" tasks to be performed by the laborer and, on the one hand, reward those who accomplish more and, on the other hand, penalize those who fail to produce their quotas. But such a norm in no way depends on any market phenomena. It is the out-

come of a more or less arbitrary decision of the authorities.

In the market economy the salaries paid to people who turn out commodities or render services that cannot be sold on the market, and for which therefore no prices are available, are indirectly determined by the structure of the market. The employer — in such cases, as a rule, the government — must pay to such people enough to prevent them from preferring a

job in the orbit of the market. Such indirect determination of the height of wage rates also is unfeasible in a socialist system.

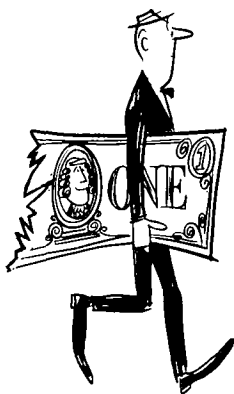
Of course, the government is always free to grant to any of the officials it employs a salary equal to the value the supreme chief or planner attaches to this man's services. But this does not have any reference to the social problem around which the discussion turns. ♦

IDEAS ON LIBERTY

Subsidies Work

Once upon a time, long, long ago, a small Chinese village was plagued by an alarming growth in the number of its rats, who ate the crops and nibbled at the children's toes while they slept, and generally made life increasingly miserable. The elders of the village came together in council, and in their desperation and in their wisdom, they decided on strong measures to cut down the rat population — they would pay a bounty of so many yen per head for each dead rat brought in to the village pound. At first, this measure, though costly, seemed very successful and there was a gratifying decline in the rat population; after several months, however, the Dispenser of the Public Funds noticed that there was a striking increase in his disbursements for dead rats and he quietly started an investigation of where they were coming from. To his horror and to the dismay of the Council, he discovered that some of the more enterprising citizens had taken to raising rats, and had found it most profitable.

LOUIS STONE, from the March 1966 *Monthly Investment Letter* of
Hayden, Stone, Inc.



INSURANCE PROBLEMS

PAUL L. POIROT

“YOUR MONEY, or your life!”

The tax collector seldom phrases his request exactly that way; and, though crime is increasing, not many Americans have been invited to consider the proposition at gun point. Even fewer of us, I suspect, ever have volunteered much serious thought to the relationship between life and property.

Fortunately for us, however, we seem to tend by instinct to accumulate private property in various forms and to defend our property as though our lives depended on it. Perhaps they do; in which case, it would seem wise to give the matter some further thought. And what better point of focus than the business of life insurance itself and the closely related field of old-age retirement insurance, sometimes referred to as social security! How does one go about insuring his life?

There is a traditional procedure. It involves saving—consuming less than one’s earnings—for a time, so that a certain level of consumption may be maintained later when earnings might have declined or ceased entirely. If several persons agree to cooperate in such a program, the individual risks of dying sooner or later than normal may be shared or pooled.

The concept or idea of property is likely to be dormant or poorly developed among grasshopper-like creatures that consume everything just as fast as they appropriate or produce it. But the moment an individual thinks of saving something, that something and the saving reflect some purpose in his life—become a part of his life, so to speak. And at this point, he is in a position to think of the connection between his life and his property. Thus it is that purpose, saving, life, and property become