

# Social Dividends and General Rules in Economic Planning

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**ABSTRACT:** Most scholars of the Interwar Debate on Socialism interpret Lange and Lerner as having refuted Mises and Hayek or as having failed to address their challenge. This paper argues that Lange and Lerner addressed the central issue that Mises raised, but failed to deal with it adequately. Lange did this in discussions with Lerner over social dividends and general rules for policy. This discussion focused on the incentive issues in the Mises/Hayek critique of Socialism, and appears to have been influenced by Chicago School thinking.

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## DISAGREEMENT OVER CALCULATION

The unresolved issues concerning the Interwar Debate over Socialism mainly derive from how scholars interpret the ‘Competitive Solution’ advanced by Oscar Lange (1936, 1937). Socialists have maintained that Lange addressed and refuted the challenge posed by Mises, Hayek, and Robbins with his trial and error solution. Critics of Socialism have insisted that Lange did not address the central issues in the Mises/Hayek critique of Socialism. These issues center on dispersed information, dynamic adjustments, and the role of entrepreneurship within the market system.

The thesis of this paper is that the primary Socialists in this debate (Lange and Lerner) did raise the most important issues of the Interwar Debate. Specifically, it examines their discussion of the distribution of dividends on social investment. This is important to the issue of calculation because of the importance of returns of private investment in directing production and investment within Capitalism. Lerner recognized that there were important incentive issues relating to the payment of dividends on social investment. However his dialogue with Lange, while highly relevant to the calculation issue, did not prove their case for Socialism. The Lange-Lerner answer to the Mises-Hayek challenge ultimately relied on policy rules as a substitute for discretionary policy. As such, the ‘Competitive Solution’ was actually more of a ‘Chicago Solution’, and one that merely raised *Public Choice* issues without addressing the Calculation issue.

The next part of this paper examines the dialogue between Lange and Lerner over social dividends. The third part of this paper reinterprets the Competitive Solution as a Chicago type proposal. The final section reexamines the time line and outcomes of the Interwar Debate.

## THE LANGE-LERNER DIALOGUE

In a neglected passage Lange (1936) asserts that efficiency under socialism requires that the distribution of dividends on social investment not interfere with the optimum allocation of resources. Lerner (1936) discusses the distribution of a social dividend, and concludes that there must be no connection between the social dividend and the wage. Returns on capital investment apparently do not go to those who actually plan investment. Lerner, like Lange and Taylor, assumes much about the motivations and knowledge of socialist authorities who act in the place of entrepreneurs on the demand side of credit markets. Lerner (1934 p52) did recognize serious defects in Dickinson's analysis and dealt with the relevant problems more carefully.

Lange altered the 1938 reprint of his *competitive solution* to reflect the change that Lerner had effected in his position. In the original paper he wrote-

In the 1938 reprint he changed this to-

“The optimum distribution is that which makes the differences of value of the marginal product of the services of labor in different industries and occupations equal to the differences in the marginal disutility<sup>32</sup> of working in those industries or occupations.<sup>33</sup> This distribution of the services of labor arises automatically whenever wages are the only source of income. *Therefore, the dividend must be distributed so as to have no influence whatever on the choice of occupation.* The social dividend paid to an individual must be entirely independent of his choice of occupation. For instance, it can be divided equally per head of population, or distributed according to age or size of family or any other principle which does not affect the choice of occupation” Lange 1938 p83-84 emphasis original

## THE VIENNA-CHICAGO DEBATE

This discussion between Lange and Lerner is instructive. The idea of a neutral distribution of social dividends runs directly counter to the arguments of Mises (1920, 1922) concerning the role of profits in allocating resources. To Mises, it is the ‘bias’ introduced into the allocation of resources by remuneration to private entrepreneurs that results in an efficient allocation of resources.

To Menger, the economic problem centers on recognizing actual causal connections between our ends and the means of satisfying them. All progress in bettering the human conditions comes from such recognition (p ). The burden of this connection recognition falls upon entrepreneurs. Menger (1871 p161) describes the role of entrepreneurs as to 1: gather data 2: economic calculation 3 act of will 4 monitor the plan after its execution, to detect and correct errors.

Private profits calculations enabled entrepreneurs to recognize the causal connections between the consumer ends and scarce means that satisfy them.

Mises (1920) mentioned that the incentive issue is closely related to the calculation problem. This is because remuneration to Menger's 'middlemen' is a necessary part of the process of economic planning within free enterprise. Without remuneration, these middlemen have no reason to collect and process data on the causal connections between the means of satisfying our ends and the ends themselves.

Schumpeter (1942) and Durbin () argue that socialist investment can be funded out of profits from state enterprises.

Knight () recognized problem with the absence of private profit under Socialism. In *Risk, Uncertainty, and Profit* Knight connected profit with the risk that came with imperfect foresight. Certainty would eliminate profit, but Socialism would not eliminate uncertainty.

## RETHINKING THE INTERWAR DEBATE

The Chicago School of economics gained a reputation for free market advocacy by rejecting Keynesian discretionary policy in favor of rules. It is odd that this type of argument also served to convince most economists of socialism's viability.

The idea of substituting rules for discretion was employed by Lange and Lerner as a means of making Socialism workable, rather than as a defense of *Laissez Faire*.

The proposals of Friedman face the same problem as those of Lerner and Lange because they stem from the same misunderstanding. Lange and Friedman differed more in terms of rhetoric and self-identification than in the content of their beliefs. Lange wanted to be a socialist, but recognized the severe limitations of this system. Friedman wanted to be an individualist, but doubted the viability of private enterprise in many of the same areas as Lange.

Part of the Socialist Calculation debate concerned the issue of rules versus discretion. Oddly, Lange and Lerner accepted that socialist authorities could at best enforce rules, but held to the view that interventionist authorities could exercise discretion. The socialist ‘victory’ over Mises and Hayek should in part be seen as a retreat to the Chicago position of tempering compensating for the faults of government with constitutional rules. This aspect of the interwar debate proceeded as follows.

1. Mises framed the debate in marginalist terms. His critique forced socialists to defend planning, as opposed to their usual tactic of attacking Capitalism, and to do so in marginalist terms. Marxism was rapidly marginalized among academics.
2. Socialists first attempted to use the Walras approach of the Lausanne school to prove Mises wrong. Hayek and Robbins refuted the Lausanne solution to the calculation problem
3. The Socialists then retreated to a Chicago School position that substituted rule enforcement for detailed and deliberate planning by central authorities. This, however, raised problems concerning rates of capital accumulation and the distribution of social dividends. Lerner and Lange inquired into these issues. Yet, they did not resolve these problems, and their efforts here went largely unnoticed.
4. Mises ridiculed the Chicago Solution to his challenge, but most economists accepted it anyway. The debate settled on the majority view that the issue was settled, and the minority view that the real issue had not been debated. In fact the real issues had been raised by both sides, and the minority view had prevailed.

Given the acceptance of a Chicago type solution to the problem of socialist planning, the success attained by Milton Friedman and the Monetarists is less impressive. Henry Simons had already made this case earlier, and Lange had already convinced most economists that high authorities could often do little more than enforce a limited number of general rules. This approach ultimately did not address the issues of how 'rules' would replace the informational and incentive functions of private dividend payments under capitalism, and the political biases implied by public choice analysis would work to affect the definition and enforcement of any set of rules.

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