

State Capitalism :

Its Possibilities and Limitations

By Frederick Pollock

Nothing essentially new is intended in this article. Every thought formulated here has found its expression elsewhere. Our aim is to bring widely scattered and often conflicting ideas into a somewhat consistent summary which may form the starting point for a discussion of the workability of state capitalism.

In regard to the method of this study the following points ought to be emphasized. Whether such a thing as state capitalism exists or can exist is open to serious doubt. It refers here to a model¹ that can be constructed from elements long visible in Europe and, to a certain degree, even in America. Social and economic developments in Europe since the end of the first world war are interpreted as transitional processes transforming private capitalism into state capitalism. The closest approach to the totalitarian form of the latter has been made in National Socialist Germany. Theoretically the totalitarian form of state capitalism is not the only possible result of the present process of transformation. It is easier, however, to construct a model for it than for the democratic form of state capitalism to which our experience gives us few clues. One of our basic assumptions is that 19th century free trade and free enterprise are on the way out. Their restoration is doomed for similar reasons as was the attempt to restore feudalism in post-Napoleonic France. The totalitarian form of state capitalism is a deadly menace to all values of western civilization. Those who want to maintain these values must fully understand the possibilities and limitations of the aggressor if their resistance is to meet with success. Furthermore, they must be able to show in what way the democratic values can be maintained under the changing conditions. If our assumption of the approaching end of the era of private capitalism is correct, the most gallant fight to restore it can only lead to a waste of energy and eventually serve as a trail-blazer for totalitarianism.

¹The term "model" is used here in the sense of Max Weber's "ideal type."

The Concept "State Capitalism"

In the rapidly growing literature on the coming social order, the word "state capitalism" is eschewed by most authors and other words stand in its place. "State organized private-property monopoly capitalism," "managerial society," "administrative capitalism," "bureaucratic collectivism," "totalitarian state economy," "status capitalism," "neo-mercantilism," "economy of force," "state socialism" are a very incomplete set of labels used to identify the same phenomenon. The word state capitalism (so runs the argument) is possibly misleading insofar as it could be understood to denote a society wherein the state is the sole owner of all capital, and this is not necessarily meant by those who use it. Nevertheless it indicates four items better than do all other suggested terms: that state capitalism is the successor of private capitalism, that the state assumes important functions of the private capitalist, that profit interests still play a significant role, and that it is not socialism. We define "state capitalism" in its two most typical varieties, its totalitarian and its democratic form, as a social order differing on the following points from "private capitalism" from which it stems historically:

(1) The market is deposed from its controlling function to co-ordinate production and distribution. This function has been taken over by a system of direct controls. Freedom of trade, enterprise and labor are subject to governmental interference of such a degree that they are practically abolished. With the autonomous market the so-called economic laws disappear.

(2) These controls are vested in the state which uses a combination of old and new devices, including a "pseudo-market," for regulating and expanding production and coordinating it with consumption. Full employment of all resources¹ is claimed as the main achievement in the economic field. The state transgresses all the limits drawn for peacetime state activities.

(3) Under a totalitarian form of state capitalism the state is the power instrument of a new ruling group, which has resulted from the merger of the most powerful vested interests, the top ranking personnel in industrial and business management, the higher strata of the state bureaucracy (including the military) and the leading figures of the victorious party's bureaucracy. Everybody who does not belong to this group is a mere object of domination.

¹Here understood simply as absence of technically avoidable "unemployment" of all factors of production. For the discussion of this concept see John Maynard Keynes, *The General Theory of Employment, Interest and Money*. London 1936.

Under a democratic form of state capitalism the state has the same controlling functions but is itself controlled by the people. It is based on institutions which prevent the bureaucracy from transforming its administrative position into an instrument of power and thus laying the basis for transshaping the democratic system into a totalitarian one.

The Heritage of the Market System

We start from the assumption that the hour of state capitalism approaches when the market economy becomes an utterly inadequate instrument for utilizing the available resources. The medium-sized private enterprise and free trade, the basis for the gigantic development of men's productive forces in the 19th century, are being gradually destroyed by the offspring of liberalism, private monopolies and government interference. Concentration of economic activity in giant enterprises, with its consequences of rigid prices, self-financing and ever growing concentration, government control of the credit system and foreign trade, quasi-monopoly positions of trade unions with the ensuing rigidity of the labor market, large-scale unemployment of labor and capital and enormous government expenses to care for the unemployed, are as many symptoms for the decline of the market system. They became characteristic in various degrees for all industrialized countries after the first world war.¹

The materials collected recently by various government agencies demonstrate how far a similar development has gone in the United States.² The disturbances of the market mechanism caused by monopoly have been accentuated by a technical revolution in contemporary farming.³ A shattering dislocation of the world market since the first world war has blocked the channels of export which were instrumental in overcoming market difficulties during the 19th century. The danger involved in this situation has been recognized and great efforts are being made to solve the problem of creating full employment while freeing the American market system from the forces which strangle it. Analogous developments may reach a point where no measures short of a reorganization of the economic system can prevent the complete disintegration of the social structure. Such a reorganization might take place by a long succession

¹The best short statement on the "Breakdown of the Market Mechanism" is still Appendix A to the Senate document 13 (74th Congress, 1st Session) on "*Industrial Prices and Their Relative Inflexibility*" (by Gardiner C. Means, 1935). See also the recent books on the decline of competition by Arthur Robert Burns, Edward H. Chamberlin, Joan Robinson).

²See F. Weil's review in this issue below.

³See P. Massing's review in this issue below.

of stop-gap measures, many of them contradicting each other, without a preconceived plan, and often very much against the original intentions of their authors. Theoretically it is possible to construct an integrated model of the new organization which might replace the outworn system, with a promise of achieving two goals: to guarantee full employment and to maintain the basic elements of the old social structure.

If the market system is to be replaced by another organizational form, the new system must perform certain functions which are necessarily connected with the division of labor. In broadest terms, these "necessary"¹ functions fall into three groups: coordination of needs and resources; direction of production; and distribution; implying

(1) a way of defining the needs of society in terms of consumers goods, reproduction of plant, machinery and raw materials, and expansion,²

(2) allocation of all available resources in such a manner that full employment and "utmost" satisfaction of the recognized needs are attained,

(3) coordination and control of all productive processes in order to obtain best performance, and

(4) distribution of the social product.

The basic weaknesses of the market system in performing the "necessary" functions have been discussed again and again as its waste and inefficiency increasingly overbalanced its earlier achievements. Criticism was voiced mainly against the shortcomings of the price mechanism in directing production, the contradictory performance of the profit motive which obstructs the use of the available resources, and the murderous mechanics of coordinating the disequilibrated economy, that is, the business cycles with their cumulative processes of destruction. But while before the first world war the market mechanism was still workable even if it was always far from performing in practice what it was supposed to do theoretically, the intrusion of monopolies with their rigid prices gradually caused the breakdown of the market system in an ever growing sphere.

¹They can be defined as those without which even the bare subsistence of society can not be reproduced. The description that follows, however, understands "necessary" functions as those achieving the best results under given historic conditions. This is what liberal theory claims for the market system.

²In this simple scheme, luxuries are included in consumers goods and defense materials under machinery.

A New Set of Rules

State capitalism replaces the methods of the market by a new set of rules based upon a combination of old and new means.

(1) A general plan gives the direction for production, consumption, saving, and investment. The introduction of the principle of planning into the economic process means that a plan is to be constructed for achieving on a national scale certain chosen ends with all available resources. It does not necessarily imply that all details are planned in advance or that no freedom of choice at all is given to the consumer. But it contrasts sharply to the market system inasmuch as the final word on what needs shall be satisfied, and how, is not left to the anonymous and unreliable poll of the market, carried through *post festum*, but to a conscious decision on ends and means at least in a broad outline and before production starts. The discussion on planning has come to a point where it seems as if the arguments raised against the technical workability of such a general plan can be refuted.¹ The genuine problem of a planned society does not lie in the economic but in the political sphere, in the principles to be applied in deciding what needs shall have preference, how much time shall be spent for work, how much of the social product shall be consumed and how much used for expansion, etc. Obviously, such decisions cannot be completely arbitrary but are to a wide degree dependent upon the available resources.

(2) Prices are no longer allowed to behave as masters of the economic process but are administered in all important sections of it. This follows from the principle of planning and means that in favor of a planned economy the market is deprived of its main function. It does not mean that prices cannot exist any longer, but that if they do they have thoroughly changed their character. Nothing may seem on the surface to have changed, prices are quoted and goods and services paid for in money; the rise and fall of single prices may be quite common. But the relations between prices and cost of production on the one side and demand and supply on the other, while strictly interconnected in their totality, become disconnected in those cases where they tend to interfere with the general plan. What remains of the market system behaves like its predecessor but

¹See for a discussion of the latest literature on the theory of planning: Eduard Heimann, "Literature on the Theory of a Socialist Economy," in: *Social Research*, vol. VI, pp. 87f.; Carl Landauer, "Literature on Economic Planning," in: *Social Research*, vol. VII, pp. 498f.; H. D. Dickinson, *Economics of Socialism*, London 1939.

We do not intimate that a general plan exists in Nazi Germany or has ever existed there. In its place stands the goal of arming as speedily and efficiently as possible, with full use of all resources. Some plan-elements have come into being, while the plan principle, used first as a propaganda slogan in Germany, is rapidly spreading there.

its function has changed from a general manager of the economic process into a closely controlled tool.¹ In the last decades administered prices have contributed much toward destroying the market automatism without creating new devices for taking over its "necessary" functions. They served to secure monopoly profits at the expense of the non-monopolistic market prices. Under state capitalism they are used as a supplementary device for incorporating production and consumption into the general plan.

(3) [The profit interests of both individuals and groups as well as all other special interests are to be strictly subordinated to the general plan or whatever stands in its place. To understand the consequences of this principle leads far towards understanding totalitarian striking power. There are two conflicting interpretations of the role of profit interests in Nazi Germany. The one claims that the profit motive still plays the same role as before, the other states that the capitalists have been deprived of their social position and that profit in the old meaning does not exist any longer. We think that both tend to overlook the transformation of such a category as "profit" in modern society. Profit interests may still be very significant in the totalitarian forms of state capitalistic society. But even the most powerful profit interests gradually become subordinate to the general "plan." No state capitalistic government can or will dispense with the profit motive, for two reasons. First, elimination of the profit motive would destroy the character of the entire system, and second, in many respects the profit motive remains as an efficient incentive. In every case, however, where the interest of single groups or individuals conflicts with the general plan or whatever serves as its substitute, the individual interest must give way. This is the real meaning of the ideology *Gemeinnutz geht vor Eigennutz*. The interest of the ruling group as a whole is decisive, not the individual interests of those who form the group.² The significance of this state capitalist principle can be fully grasped when it is contrasted with recent experiences in countries where private capitalism still prevails and where strong group interests prevent the execution of many urgent tasks necessary for the "common good." This needs no bad will or exceptional greed to explain it. In a system based upon the self-interest of every person, this principle

¹For an outstanding analysis of the new functions and the performance of the "pseudo-market" see A. Lowe, "Economic Analysis and Social Structure" in: *The Manchester School*, Vol. VII (1936), pp. 30f. Lowe's arguments pertain to "the pricing process under public ownership." Public control over the means of production, however, has the same economic consequences as state ownership.

²Obviously, the first to bear the brunt of subordinating the private to the "common" interest is the "little man" in all spheres of society.

can sometimes be expected to come to the fore in a form that contradicts the optimism of its underlying philosophy. If ever the statement was true that "private vices are public benefits," it could only have been under conditions where the typical economic unit was comparatively small and a free market functioned.

State capitalist policy, which opposes liberalism, has understood that there are narrow limits beyond which the pursuit of private interests cannot be reconciled with efficient general planning, and it has drawn the consequences.¹

(4) In all spheres of state activity (and under state capitalism that means in all spheres of social life as a whole) guesswork and improvisation give place to the principles of scientific management. This rule is in conformity with state capitalism's basic conception of society as an integrated unit comparable to one of the modern giants in steel, chemical or motor-car production. Large-scale production requires not only careful general planning but systematic elaboration of all single processes. Every waste or error in preparing materials and machinery and in drafting the elements of production is multiplied numerous times and may even endanger the productive process as a whole. The same holds true for society as soon as the previous differentiation between private cost (e.g., wages) and social cost (e.g., unemployment) is replaced by a measurement of the single process in terms of its ability to obtain what the planner considers the most desirable social product. But once this principle of "rationalization" has become mandatory for all public activities, it will be applied in spheres which previously were the sanctuary of guesswork, routine and muddling through: military preparedness, the conduct of war, behavior towards public opinion, application of the coercive power of the state, foreign trade and foreign policy, etc.²

(5) Performance of the plan is enforced by state power so that nothing essential is left to the functioning of laws of the market or

¹An example of the result is the amazing elasticity and efficiency in building up an enormous war machinery in National Socialist Germany. This, however, should not be interpreted to mean that in Germany private property interests do not endeavor to gain precedence. In motor-car standardization, for instance, the private interests of the big concerns determined all the measures taken. Since a general plan of economic policy was never published in Germany, it is impossible to decide to what extent private interests did obtain preference.

²It appears that part of the Nazi successes may be better explained as the rational application of the best available methods in all fields (from eliminating important vitamins in the diet of conquered nations to the practical monopoly in international propaganda) than by any innate qualities of a military or organizational character. It is well to recall, in this connection, that German industry originally learned scientific management from America.

other economic "laws."¹ This may be interpreted as a supplementary rule which states the principle of treating all economic problems as in the last analysis political ones. Creation of an economic sphere into which the state should not intrude, essential for the era of private capitalism, is radically repudiated. [Replacement of the mechanics of *laissez faire* by governmental command does not imply the end of private initiative and personal responsibility, which might even be put on a broader basis but will be integrated within the framework of the general plan.] During the non-monopolistic phase of private capitalism the capitalist (whether an individual or a group of shareholders represented by its manager) had power over his property within the limits of the market laws. Under state capitalism this power has been transferred to the government which is still limited by certain "natural" restrictions but free from the tyranny of an uncontrolled market.² The replacement of the economic means by political means as the last guarantee for the reproduction of economic life, changes the character of the whole historic period. It signifies the transition from a predominantly economic to an essentially political era.³

Under private capitalism all social relations are mediated by the market; men meet each other as agents of the exchange process, as buyers or sellers. The source of one's income, the size of one's property are decisive for one's social position. The profit motive keeps the economic mechanism of society moving. Under state capitalism men meet each other as commander or commanded; the extent to which one can command or has to obey depends in the first place upon one's position in the political set-up and only in a secondary way upon the extent of one's property. Labor is appropriated directly instead of by the "round-about" way of the market. [Another aspect of the changed situation under state capitalism is that the profit motive is superseded by the power motive. Obviously, the profit motive is a specific form of the power motive. Under private capitalism greater profits signify greater power and less dependence upon the commands of others. The difference, however, is not only that the profit motive is a mediated form of the power motive, but that the latter is essentially bound up with the power position of the ruling group while the former pertains to the individual only.⁴]

profit
motive
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¹E.g., new investments no longer flow automatically into those economic fields where the highest profits are made but are directed by the planning board. In consequence, the mechanism known as equalization of the rate of profit no longer works.

²See pp. 215 ff. below.

³Frank Munk, *The Economics of Force*, New York 1940. Lawrence Dennis, *The Dynamics of War and Revolution*, New York 1940.

⁴See p. 210 below.

Control of Production

A discussion of the means by which state capitalism could fulfill its program must hew closely to the technical and organizational possibilities available today in all highly industrialized countries. We refer not to any future developments but to the use which could be made here and now of the available resources. If, however, it can be shown that a state capitalist system can carry out more successfully than the market does the "necessary" functions required by the division of labor, it seems reasonable to expect that much greater resources could be made available within a short period. State capitalism must solve the following problems in the sphere of production if a rising social product is to result: create full employment based upon coordination of all productive units; reproduce the existing resources of plant, raw materials, management and labor on a level adequate to technical progress; and expand the existing plant. All these tasks must be embodied in the general plan. Given this plan, the execution hinges upon the solution of merely technical and administrative tasks instead of on the economic task of producing for an unknown and largely unforeseeable market. Production is for a clearly defined use, not "commodity" production in the meaning of a market system.¹ [The experiences piled up by modern giant enterprises and associations of enterprises in carrying through enormous plans make total production control technically possible. Specific means of control include modern statistical and accounting methods, regular reporting of all changes in plant and supply, systematic training of workers for future requirements, rationalization of all technical and administrative processes and all the other devices developed in the huge modern enterprises and cartels. In addition to these traditional methods which have superseded the occult entrepreneurial art of guessing correctly what the future market demand will be, the state acquires the additional controlling power implied in complete command over money and credit. The banks are transformed into mere government agencies.² Every investment, whether it serves replacement or expansion, is subject to plan, and neither oversaving nor overexpansion, neither an "investment strike" nor "*Fehlinvestitionen*" can create large-scale disturbances.] Errors which are bound to occur can be traced with comparative ease owing to the central position of the planning board. [While they may

¹See Rudolf Hilferding, "State Capitalism or Totalitarian State Economy" in: *Sozialistichesky Vestnik*, Paris 1940 (Russian). It should be understood that "production for use" is not intended to mean "for the use of free men in a harmonious society" but simply the contrary of production for the market.

²For an impressive discussion of this trend in Nazi Germany see Dal Hittcock, "The German Financial Revolution" in: *Harpers Monthly*, February 1941.

amount to sheer waste, their damaging effects may be minimized by charging them off to the economy as a whole instead of to a single enterprise. Besides the banks, many of the organizations developed by business interests (trade associations, cartels, chambers of commerce, etc.) serve as, or are transformed into, government agencies for the control of production. The rigid control of capital, whether in its monetary form or as plant, machinery, commodities, fundamentally transforms the quality of private property in the means of production and its owner, the "capitalist." While a good many of the risks (not all of them) borne by the owner under private capitalism might have been eliminated, only so much profit is left to him as the government sees fit to allow. Regulation of prices, limitation of distributed profits, compulsory investment of surplus profits in government bonds or in ventures which the capitalist would not have chosen voluntarily, and finally drastic taxation—all these measures converge to the same end, namely, to transform the capitalist into a mere rentier whose income is fixed by government decree as long as his investments are successful but who has no claim to withdraw his capital if no "interests" are paid. }

The trend toward the situation described in our model has been widely discussed during recent years. An extreme statement is that of E. F. M. Durbin: "Property in industrial capital has wholly lost the social functions supposed to be grounded in it. It has ceased to be the reward for management, and it has largely ceased to serve as a reward for personal saving. Property in capital has become the functionless claim to a share in the product of industry. The institution is worse than indefensible—it is useless."¹ The same phenomenon is criticized in the following comment: "Emphasis of management today is not upon venture, upon chancetaking as capitalism requires, but is upon price control, market division, avoidance of risk. This may be good short-range policy. But: if business isn't willing to take chances, somebody soon is going to ask why it should enjoy profits, why the management cannot be hired by Government, which is called on to do all the chancetaking, and might want to direct industry."²

This trend toward losing his social function as the private owner of capital has found its expression in the stockholder's loss of control over the management. It has culminated so far in the new German legislation on joint-stock companies in which the stockholders are deprived by law of any right to interfere with management.

¹E. F. M. Durbin, *The Politics of Democratic Socialism*, London 1940, p. 135.

²Quoted in the *Report for the Business Executive*, November 28, 1940.

To sum up, under state capitalism the status of the private capitalist is changed in a threefold way.¹

(1) The entrepreneurial and the capitalist function, i.e., direction of production and discretion in the investment of one's capital, are separated from each other. Management becomes virtually independent of "capital" without necessarily having an important share in corporate property.

(2) The entrepreneurial and capitalist functions are interfered with or taken over by the Government.

(3) The capitalist (insofar as he is not accepted as entrepreneur on the merits of his managerial qualifications) is reduced to a mere rentier.

Here the question of incentive arises. [In private capitalism the decisive incentives for the capitalist to maintain, expand and improve production are the profit interest and the permanent threat of economic collapse if the efforts should slacken. The non-capitalists are driven to cooperate efficiently by hunger and their desire for a better life and security. Under state capitalism both groups lose essential parts of their incentive. What new devices will take over their most "necessary" functions? What will prevent stagnation and even regression in all spheres of state capitalistic society? In relation to the majority of the population, those who neither own nor command the means of production, the answer is simple. The whip of unemployment is replaced by political terror, and the promise of material and ideological rewards continues to incite to the utmost personal effort. [The profit motive still plays an important role for capitalists and the managerial bureaucracy, since large compensation is granted for efficient investment and management. Personal initiative is freed from obstructing property interests and systematically encouraged.² Within the controlling group, however, the will to political power becomes the center of motivation. Every decision is at bottom oriented to the goal of maintaining and expanding the power of the group as a whole and of each of its members.] New industrial empires are being built and old ones expanded with this goal in mind. But we also have here the source of the principle that individual interests must always be subordinated to the common (group) interest. [This principle in turn contributes decisively to strengthening governmental control, since only a strong government

¹For the change that actually occurred under National Socialism see pp. 226 ff. below. The interpretation given by Gurland differs from that maintained here.

²See Carl Dreher, "Why Hitler Wins," in: *Harpers Monthly*, October 1940.

can integrate conflicting interests while serving the power interests of the whole group.)

Control of Distribution

"We have learned how to produce everything in practically unlimited quantities, but we don't know how to distribute the goods." This is the popular formulation to describe the riddle of private capitalism in its latest phase.

Given a general plan and the political power to enforce it, state capitalism finds ample technical means for distributing everything that can be produced with the available resources. The main difficulty of private capitalism is eliminated by the fact that under state capitalism the success of production does not necessarily depend upon finding buyers for the product at profitable prices in an unstable market, but is consciously directed towards satisfying public and private wants which are to a large extent defined in advance. Adjustments which must be made as a result of technical errors in the general plan or unexpected behaviour in consumer demand need not lead to losses for the individual producer and even less to economic disaster for him. Losses easily can be pooled by the administration. The means which are available for carrying over the "necessary" distributive function of a competitive market may be conveniently classified into direct allocation (priorities, quota, etc.) and administered prices. The former applies above all to the distribution of goods to producers, the latter refers mainly to the sphere of consumption. There is, however, no sharp dividing line between the fields of application of the two means.¹ Labor is the outstanding example in which a combination of both methods is applied.

In constructing a rough model of the distributive mechanism under state capitalism, we always have to keep in mind that production and producers' consumption are two aspects of the same process. Since under modern conditions producer and consumer are, as a rule, not the same person, distribution serves as a means of integrating them. The production plan is based on a comparatively arbitrary decision as to how much of the social product is to be available for consumption and how much is to be used for expansion.²

All major problems of distribution under state capitalism have been discussed thoroughly in the literature on socialist planning

¹So far, the nearest approach to the state capitalist model of distribution has been made in Soviet Russia. See L. E. Hubbard, *Soviet Trade and Distribution*, London 1938. The trend in Germany shows the same direction.

²As to the limitations placed on the arbitrary character of this decision, see pp. 215 ff. below.

published within the last decade.¹ While all writers in favor of a planned society agree that the tyranny of the market must be abolished, differences of opinion exist on the question of where to draw the limits for the use of a pseudo-market. Some writers recommend that the managers of the socialized industry should "behave as if under competitive capitalism." They should "play at competition."² A model partly constructed on the results of this discussion may be used to illustrate how distribution works under state capitalism. The distribution of goods to producers starts from the following situation:

- (1) Most productive facilities are privately owned but controlled by the government;
- (2) Each industry is organized in cartels;
- (3) Prices react to changes in supply and demand as well as to changes in the cost structure within the limits permitted by the plan authority and the monopolies;
- (4) A general plan for the structure of the social product is in existence.

Under these circumstances a system of priorities and quotas will guarantee the execution of the plan in its broad lines. These allocations cover reproduction of existing resources, expansion (including defense) and the total output of consumers goods, which every industry shall produce. Within each industry a quota system will provide for the distribution of the resources allocated. The quotas may be distributed according to a more detailed plan or according to expressions of consumer choice. Not much room is left in this set-up for flexible prices. The partial survival of the profit motive will induce manufacturers who are offered higher prices for their products, to bid up in turn the prices of their "factors." But the "office of price control" will not permit prices to go higher than is compatible with the general plan. Since all major units of production are under the control of cartels, the propensity to keep prices flexible should not be overestimated. Governmental control will be immensely facilitated by the enormous role of public works necessary to maintain full employment under all circumstances.

¹See note on p. 204 above. The latest important publication is that of E. F. M. Durbin, *op. cit.* Most of those who advocate the superiority of a deliberately "manipulated" market confined "within the strait-jacket of planned objectives" have given little attention to the fact that planning is far from being identical with socialism. That is why their work, important as it is, appears even more as a contribution to the theory of state capitalism.

²L. Robbins, *Economic Planning and International Order*, London 1937, p. 208.

Full employment in the strict sense of the word can be achieved in regard to labor only. Due to technological facts, it is not possible in the case of plant and equipment. New plant and new machinery constructed according to the latest technical development require a minimum size of plant which as a rule leads to temporary overcapacity at the moment of their completion. If no ways for using this overcapacity can be found speedily, some idleness of capital will arise. This might happen with entire durable goods industries (e.g., machine tools) if the need for their product is temporarily saturated. Neither this nor other "maladjustments" can produce the cumulative effects so vicious under the free market system,¹ for the capital owner might be compensated for his loss out of pooled profits or public sources, and provision for a constant reserve in planning the labor supply will take care of the displaced workers. Technological unemployment will be handled in a similar way. It has been shown that the opposite case, periodical shortage of capital, can be avoided in a planned society.²

Labor under state capitalism is allocated to the different sections of production like other resources. This does not prevent the planning authorities from differentiating wages. On the contrary, premiums in the form of higher real wages can be granted wherever extra efforts are demanded. The slave driver's whip is no workable means for extracting quality products from highly skilled workers who use expensive machinery. This differentiation in wage schedules, however, is not the outcome of market conditions but of the wage administrator's decision. No entrepreneur is allowed to pay higher wages than those fixed by this agency.

With absolute control of wages, the government is in a position to handle the distribution of consumers goods with comparative ease. In cases of severe scarcity, as in wartime, direct allocation of consumers goods might be the only adequate means for their distribution. In such a case consumer choice is very limited but not entirely ruled out.³ If, however, a somewhat more adequate supply of consumers goods is available, the consumer may be as free or, with the greater purchasing power created by full employment, even more free in his choice under state capitalism than he is now. In order to achieve this goal with the means now at hand, a pseudo-market for consumers goods will be established. The starting point for its operation is a clearly defined relation between purchasing

¹See Gottfried von Haberler, *Prosperity and Depression*, Geneva 1937.

²See Carl Landauer, *Planwirtschaft und Verkehrswirtschaft*, Munich 1931.

³See, e.g., the "point" system for the distribution of textiles in Germany and England.

power which will be spent for consumption and the sum of prices of all available consumers goods. Both sums must be equal. In other words, the total income paid out to consumers, minus taxes, compulsory and voluntary savings, must be the same as the price sum of all consumers goods which are for sale. If the "net" consumers income should be higher, a scramble for goods and a bidding up of prices would result (under our definition that "net" income excludes saving). If it should be lower, only part of the products could be distributed. The first step toward distributing the consumers goods is therefore to make the "net" income of all consumers in a given period equivalent to the sum of consumers goods output as decided by the general plan and the available inventory. This first step will prove insufficient for two reasons:

(1) The consumers' voluntary savings may deviate from the plan,—they may save either more or less than was expected in calculating the equilibrium. Both cases may be remedied by the use of the market laws of demand and supply, which will create inflationary or deflationary price movements to "clear the market,"—if the price controlling agencies permit it.

(2) The consumers' choices may deviate from the calculations of the planners,—they may prefer some products and reject others. Here again the old market mechanism may be allowed to come into play to enforce higher prices for goods in greater demand and to lower prices where and as long as an oversupply exists. A system of subsidies and surtaxes will eliminate serious losses as well as surplus profits which could disturb the functioning of the plan. The distributive agency may completely "overrule" the consumers' choice for all practical purposes by fixing prices either extremely high or disproportionately low. So far the price mechanism obeys the same laws as in the free market system. The difference becomes manifest in the effects which changing prices exercise on production. The price signals influence production only insofar as is compatible with the general plan and the established public policy on consumption. Price movements serve as a most valuable instrument for announcing differences between consumers' preferences and the production plan. They can not, however, compel the planning authority to follow these manifestations of consumers' will in the same way they compel every non-monopolistic producer in a free market.¹ Under private capitalism the monopolist, in resisting the market signals, disrupts the whole market system at the expense of all non-monopo-

¹For this whole set of problems see Oskar Lange, *On the Economic Theory of Socialism*, edited by E. Lippincott, Minneapolis 1938.

listic market parties. Under state capitalism the disconnection between price and production can do no harm because the function of coordinating production and consumption has been transferred from the market to the plan authority. Much attention has been given to the question of how consumers' choice can be calculated in advance. No "God-like" qualities are required for the planning board. It has been shown¹ that freedom of consumers' choice actually exists only to a very limited degree. In studying large numbers of consumers it becomes evident that size of income, tradition and propaganda are considerably levelling down all individual preference schedules. The experiences of large manufacturing and distributing concerns as well as of cartels contribute a most valuable supplement to the special literature on planning.

Economic Limitations of State Capitalism

In raising the question of economic limitations we point to those which may restrict the arbitrariness of the decisions in state capitalism as contrasted with other social structures in which they may not appear. We are not concerned with limitations that apply to every social set-up, e.g., those which result from the necessity to reproduce the given resources and to maintain full employment and optimum efficiency. The first and most frequent objection against the economic workability of a state capitalistic system is that it is good only in a scarcity economy, especially for periods of war preparedness and war. For a scarcity economy, so runs the argument, most of the economic difficulties against which private capitalism struggles do not exist. Overproduction and overinvestment need not be feared, and all products, however inefficiently produced, and however bad their quality, find a ready demand. As soon as the temporary emergency has passed, however, and a greater supply becomes available in all fields, state capitalism will prove utterly inadequate for securing the best use of available resources, for avoiding bottlenecks in one product and overproduction in others, and for providing the consumers with what they may demand at the lowest possible cost. Even if all means of production are under governmental control, efficient planning is possible only under conditions of emergency. The argument advanced for this view can be boiled down to the following:² in a planned economy costs cannot be accounted for, the

¹See the studies of the National Resources Planning Board on *Consumer Incomes and Patterns of Resources Use*, reviewed in this periodical 1940, pp. 483-490.

²The best survey of the history and details of the argument is *Collectivist Economic Planning*, edited by F. A. von Hayek, London 1935. For a refutation see Oskar Lange, *op. cit.*

free choice of the consumers must be disregarded, the motives for efficient production and distribution disappear, and as a result a planned economy must under modern conditions be much less productive than a market economy.

We think that anyone who seriously studies the modern literature on planning must come to the conclusion that, whatever his objections to the social consequences of planning, these arguments against its economic efficiency no longer hold. All technical means for efficient planning, including the expansion of production in accordance with consumer wants and the most advanced technical possibilities, and taking into account the cost in public health, personal risks, unemployment (never adequately calculated in the cost sheet of private enterprise)—all these technical means are available today.

Another counter-argument holds that as soon as state capitalism turns from concentrating upon armaments to a genuine peace economy its only alternative, if it wants to avoid unemployment, is to spend a very substantial part of the national income for the construction of modern "pyramids," or to raise considerably the standard of living. No economic causes exist which could prevent a state capitalistic government from doing so. The obstacles are of a political nature and will be dealt with later.¹

A third argument points in the opposite direction. It objects that state capitalism necessarily leads to a standstill in technics or even a regress. Investments would slow down and technical progress cease if the market laws are put out of operation. As long as competitive armament continues, the contrary will probably be true. Besides the profit motive, the vital interests of the controlling group will stimulate both investment and technical progress. In the effort to maintain and extend its power the controlling group will come into conflict with foreign interests, and its success will depend upon its military force. This, however, will be a function of the technical efficiency. Any slackening in the speed of technical progress might lead to military inferiority and to destruction.² Only after all possible enemies will have disappeared because the whole world will be controlled by one totalitarian state, will the problem of technological progress and capital expansion come to the fore.

Are there, one may ask, no economic limitations at all to the existence and expansion of state capitalism? With its rise, will a

¹See pp. 218 f.

²The German experience shows that probably never in the history of industrialism were new inventions put into application so quickly or such an enormous percentage of the national income used for investments (see pp. 210 f. above).

utopia emerge in which all economic wants can easily be fulfilled if political factors don't interfere? Did not the liberal theory also believe it had proved that the market system will guarantee its constituents the full use of all resources if not interfered with? And did it not become apparent later that inherent forces prevented the market system from functioning and ushered in growing interference by private monopolies and the government? Forewarned as we are, we are unable to discover any inherent economic forces, "economic laws" of the old or a new type, which could prevent the functioning of state capitalism.¹ Government control of production and distribution furnishes the means for eliminating the economic causes of depressions, cumulative destructive processes and unemployment of capital and labor. We may even say that under state capitalism economics as a social science has lost its object. Economic problems in the old sense no longer exist when the coordination of all economic activities is effected by conscious plan instead of by the natural laws of the market. Where the economist formerly racked his brain to solve the puzzle of the exchange process, he meets, under state capitalism, with mere problems of administration. There are indeed limitations to state capitalism, but they derive from natural conditions as well as from the very structure of the society which state capitalism seeks to perpetuate.

Natural and Other Non-Economic Limitations²

(1) To be fully workable, state capitalism needs an adequate supply of raw material, plant and labor of all kinds (technicians, administrators, skilled and unskilled labor), characteristic for a highly industrialized country. Without a plentiful supply of raw materials and the outfit in machinery and skill of a modern industrial society, great waste must accompany state capitalistic intervention, possibly greater than under a market economy. For the first limitation, inadequate supply of raw materials, a typical example is offered by Nazi Germany. The enormous machinery which had to be built to compensate for the insufficiency of the raw material basis—too small to cope with the armament program—and the diffi-

¹This also applies to the falling tendency of the rate of profit which, according to Marxian theory, plays havoc with private capitalism. If expansion of capital is subject to a general plan which is itself approved by the controlling group, the percentage of surplus value in ratio to invested capital could fall close to zero without creating any disturbances. This fall, however, is most effectively counteracted by the enforced maintenance of full employment. We shall not enter upon the discussion of whether state capitalism itself emerges under the pressure of the falling rate of profit, nor how far it makes sense to speak in terms of "value" beyond the limits of a market economy.

²Most of the arguments that follow refer to the totalitarian form of state capitalism only.

culties for the producer to obtain raw materials and, in consequence, new machinery,¹ cannot be attributed to the system itself but to the fact that one of its main prerequisites was lacking from the very beginning.

On the other hand, many of the Soviet Russian economic failures may be traced back to the lack of both raw materials and adequate development of the productive forces. Lack of trained technicians, skilled workers, and of the qualities known as work discipline, all of which are plentiful in highly industrialized countries only, go a long way in explaining the slow progress of rearming, reorganizing the transportation system and raising or even maintaining the standard of living in Soviet Russia. But even here a government controlled economic system has shown the power to survive under conditions where a system of free enterprise would have collapsed completely. Government controlled foreign trade and the development of an industry for "Ersatz" materials may overcome the limitations of a too narrow basis of raw materials. Filling the gap between a fully industrialized and a chiefly agricultural economy is a much more painful and drawn out process.

(2) Differences in vital interests will crop up in the group or groups controlling the state. They can stem from different positions within the administration, different programs for maintaining or expanding power, or the struggle for the monopoly of control. Unless adequate provisions are made for overcoming these differences, bad compromises and continuous struggle will arise.

(3) Conflicting interests within the ruling class might thwart the construction of a general plan embodying the optimum of all available resources for achieving consistent chosen ends. The choice of the ends itself represents a major problem as long as no common will has been established. In our discussion we started always from the assumption "given a general plan." This means a plan for certain ends which must be chosen from among a variety of possible ones.

Once the minimum requirements for consumption, replacement and expansion are fulfilled the planners have a great deal of leeway. If their decisions do not converge into a consistent program, no general plan for the optimum use and development of the given productive forces can be drafted.

¹See Guenter Reimann, *The Vampire Economy*. Doing business under Fascism. New York 1939.

(4) Conflicting interests, however, do not operate in the ruling group only. Since totalitarian state capitalism is the expression of an antagonistic society at its worst, the will to dominate from above and the counter-pressure from below cut deeply into the pseudo-liberty of the state capitalist planners. The planning board, while vested with all the technical means for directing the whole economic process, is itself an arena of struggle among social forces far beyond its control. It will be seen that planning in an antagonistic society is only in a technical sense the same tool as that used by a society in which harmony of interests has been established. Political considerations interfere at every step with the construction and execution of an optimum plan. The following paragraphs will offer some examples.

How will expansion of production and technical progress be motivated after fear of aggression or objects for new conquest have vanished? Will not under such conditions the dreaded technological standstill make its appearance, thus spoiling all chances of reducing the drudgery of labor while raising the standard of living?¹ A case could be made out for the view that a new set of motivations will arise under totalitarian state capitalism which will combine the drive for power over men with the will to power over nature and counteract the development toward a static economy. But this is such a distant perspective that we may leave the question open, the more so since under totalitarian capitalism there are serious reasons to keep the productive forces static.

Under a state capitalistic set-up, will the general standard of living rise beyond narrow limits if the expansion program permits? This question can be answered in the affirmative for the democratic form of state capitalism only. For its authoritarian counterpart, however, the problem is different. The ruling minority in a totalitarian state maintains its power not only by terror and atomization but by its control of the means of production and by keeping the dominated majority in complete spiritual dependence. The masses have no chance of questioning the durability and justi-

¹Julian Gumperz, *The Expansion of Production and the Totalitarian System* (unpublished), makes the point that after property "becomes a semi-sovereign function of rights, privileges, prerogatives, transactions, that is, more and more dissociated from the active and actual carrying forward of production, this latter function creates a new class and is appropriated by it . . ." This class "represents a depository of skills, abilities, knowledges, traditions, that moves the organization of economic society from one point to another, and organizes the new level of production accomplished . . . Overproduction from which economic society has been suffering is centered to a large extent in the overproduction of this progressive class . . . and it is therefore not accidental but essential that a totalitarian economy stop, at its source, the production and reproduction of these skills . . ."

fication of the existing order; the virtues of war are developed and all "effeminacy," all longing for individual happiness, is rooted out. A rise in the standard of living might dangerously counteract such a policy. It would imply more leisure time, more professional skill, more opportunity for critical thinking, out of which a revolutionary spirit might develop. It is a widely spread error that the most dangerous revolutions are instigated by the most miserable strata of society. The revolutionary craving for liberty and justice found its most fertile breeding ground not among the paupers but among individuals and groups who were themselves in a relatively better position. The ruling group in totalitarian state capitalism might therefore decide that from the point of view of its own security a low general standard of living and long drudging working hours are desirable. An armament race and the excitement over threat of foreign "aggression" seem to be appropriate means for keeping the standard of living low and the war virtues high while maintaining full employment and promoting technical progress. Such a constellation, however, would furnish a striking example for a political limitation of productivity.

The highly speculative question might be permitted, what would happen if totalitarian state capitalism were embodied in a unified world state in which the threat of aggression had disappeared for good? Even public works of undreamed scope could not prevent the general standard of living from rising under conditions of full employment. In such a case the most clever devices of ideological mass domination and the grimmest terror are unlikely to uphold for a long period a minority dictatorship which can no longer claim itself to be necessary to maintain production and to protect the people from foreign aggression. If our assumption is correct that totalitarian state capitalism will not tolerate a high standard of living for the masses and cannot survive mass unemployment, the consequence seems to be that it cannot endure in a peace economy. As long as one national state capitalism has not conquered the whole earth, however, there will always be ample opportunities to spend most of the productive excess capacity (excess over the requirements for a minimum standard of living) for ever-increasing and technically more perfect armaments.

Why can the policy of aggression not come to a standstill before one state has conquered the entire world? Even after a totalitarian state has acquired full autarchy within its own territory, "preparedness" and foreign wars must go on at a rapid pace in order to protect against aggression from outside and revolution from within. A democratic state capitalism, while safe from within, is

menaced by totalitarian aggression and must arm to the teeth and be ready to fight until all totalitarian states have been transformed into democracies. In the last century it became evident that a society based on slave labor could not exist side by side with one organized on the principle of free labor. The same holds true in our day for democratic and totalitarian societies.

Control of the State under State Capitalism

If state capitalism is a workable system, superior in terms of productivity to private capitalism under conditions of monopolistic market disruption, what are the political implications? If the state becomes the omnipotent comptroller of all human activities, the question "who controls the comptroller" embraces the problem of whether state capitalism opens a new way to freedom or leads to the complete loss of it as far as the overwhelming majority is concerned. Between the two extreme forms of state capitalism, the totalitarian and the democratic, numerous others are thinkable. Everything depends upon which social groups in the last analysis direct the decisions of a government whose power has in all matters—"economic" as well as "non-economic"—never been surpassed in modern history. The following is intended as a rough sketch of the social structure under totalitarian state capitalism.

(1) The government is controlled by, and composed of, a new ruling class. We have defined this new class as an amalgamation of the key bureaucrats in business, state and party allied with the remaining vested interests.¹ We have already mentioned that inherited or acquired wealth may still play a role in opening a way to this ruling group, but that it is not essential for participating in the group. One's position in the economic and administrative set-up, together with party affiliations and personal qualification, are decisive for one's political power. The new ruling class, by its grip on the state, controls everything it wants to, the general economic plan, foreign policy, rights and duties, life and death of the individual. Its decisions are not restrained by any constitutional guarantees but by a set of rules only, designed for maintaining and expanding its own power. We have seen what control over the gen-

¹This holds true for Germany and Italy where semifeudal landowners and big business are still in existence and form part of the ruling clique. The situation is different in Soviet Russia where the old vested interests have been wiped out. Since in Russia property in the means of production has changed hands completely from private owners to the state and no longer exists even in its modified and reduced form discussed above, it is somewhat doubtful whether our model of state capitalism fits the Soviet Union in its present phase.

eral economic plan involves: all the basic decisions on how to distribute the "factors of production" among producers and consumers goods, on the working day, labor conditions, on wages and prices. To sum up, control of the general economic plan means control over the standard of living. Antagonisms of interests among the groups within the ruling class might lead to serious difficulties. The class interest of maintaining the new status, however, will probably be strong enough for a long time to overcome these antagonisms before they can turn into a menace to the system. The persons who form the ruling class have been prepared for their task by their position in, or their cooperation with, the monopolistic institutions of private capitalism. There, a rapidly growing number of decisive functions had become invested in a comparatively small group of bureaucrats. The leader and follower principle flourished long before it was promulgated as the basic principle of society, since more and more responsibility had been centralized in the top offices of government, business, trade unions and political parties.

(2) Those owners of capital who are "capitalists" without being managers and who could exercise great political influence during the whole era of private capitalism no longer have any necessary social functions. They receive interest on their investments for as long a time and in the measure that the new ruling class may be willing to grant. From the point of view of their social utility they constitute a surplus population. Under the impact of heavy inheritance taxes, controlled stock markets and the generally hostile attitude of the new ruling class against the "*raffende Kapital*," these "capitalists" will probably disappear. The widespread hatred against them could develop only because the economic laws of capitalism had transformed their social role into that of parasites.

(3) A semi-independent group, not belonging to the ruling class but enjoying more privileges than the *Gefolgschaften*, are the free professions and the middle and small business men (including the farmers) carrying on their own business under governmental control. Both will disappear wherever a fully developed state capitalism corresponding to our model is reached. The process of concentration which gains unprecedented momentum under state capitalism absorbs the independent small and medium enterprise. The trend towards socialization of medicine, of journalism and other free professions transforms their members into government employees.

(4) The great majority of the people fall into the category of salaried employees of all types. They are subject to the leader principle of command and obedience. All their political rights have

been destroyed, and carefully planned atomization has simplified the task of keeping them under strict control. Labor's right to bargain collectively, to strike, to change jobs and residence at will (if its market position permits) is abolished. Work becomes compulsory, wages are fixed by government agencies, the leisure time of the worker and his family is organized from above. In some respects this is antithetical to the position of labor under private capitalism and revives many traits of feudal conditions.

(5) The new state openly appears as an institution in which all earthly power is embodied and which serves the new ruling class as a tool for its power politics. Seemingly independent institutions like party, army and business form its specialized arms. A complicated relation exists, however, between the means and those who apply them, resulting in some genuine independence for these institutions. Political domination is achieved by organized terror and overwhelming propaganda on the one side, on the other by full employment and an adequate standard of living for all key groups, the promise of security and a more abundant life for every subject who submits voluntarily and completely. This system is far from being based upon rude force alone. In that it provides many "real" satisfactions for its subjects it exists partly with the consent of the governed, but this consent cannot change the antagonistic character of a state capitalistic society in which the power interests of the ruling class prevent the people from fully using the productive forces for their own welfare and from having control over the organization and activities of society.

We have referred here and there to what we think are particular traits of the democratic form of state capitalism. Since no approaches to it have so far been made in practice, and since the discussion of it is still in a formative stage,¹ no attempt will be made here to construct a model for it.

The trend toward state capitalism is growing, however, in the non-totalitarian states. An increasing number of observers admit, very often reluctantly, that private capitalism is no longer able to handle the new tasks. "All plans for internal post-war reconstruction start with the assumption that more or less permanent government controls will have replaced *laissez-faire* methods both in the national and the international sphere. Thus the choice is not between totalitarian controls and return to 'free enterprise'; the choice is between totalitarian controls and controls voluntarily accepted by the

¹Charles A. Beard, *Public Policy and the General Welfare*, New York 1941, marks an important step in this discussion.

people of each country for the benefit of society as a whole."¹ It is the lesson of all large-scale measures of government interference that they will contribute to the disruption of the market mechanism if they are not coordinated into a general plan. If government is to provide for all the items recognized as mandatory in the more serious post-war reconstruction programs,² it must be vested with adequate powers, and these might not stop short of state capitalism.

It is of vital importance for everybody who believes in the values of democracy that an investigation be made as to whether state capitalism can be brought under democratic control. The social as well as the moral problem with which the democracies are confronted has been formulated as follows: ". . . How can we get effective use of our resources, yet, at the same time preserve the underlying values in our tradition of liberty and democracy? How can we employ our unemployed, how can we use our plant and equipment to the full, how can we take advantage of the best modern technology, yet, in all this make the individual source of value and individual fulfillment in society the basic objective? How can we obtain effective organization of resources, yet, at the same time retain the maximum freedom of individual action?"³ Totalitarian state capitalism offers the solution of economic problems at the price of totalitarian oppression. What measures are necessary to guarantee control of the state by the majority of its people instead of by a small minority? What ways and means can be devised to prevent the abuse of the enormous power vested in state, industrial and party bureaucracy under state capitalism? How can the loss of economic liberty be rendered compatible with the maintenance of political liberty? How can the disintegrative motive forces of today be replaced by integrative ones? How will the roots from which insurmountable social antagonisms develop be eliminated so that

¹Vera Micheles Dean, "Toward a New World Order" in: *Foreign Policy Reports*, May 15, 1941, p. 55.

²"A British fact finding group, composed of progressive economists, businessmen, civil servants and professors, known as PEP (Political and Economic Planning), included the following items in its preliminary program prepared in 1940: maintenance after the war of full economic activity based on complete use of man power and resources, 'regardless of obsolete financial criteria'; assurance of a minimum standard of life, based on scientific standards of nutrition and proper provision for dependents; assurance of a minimum standard of housing, based on a socially planned program of housing and social amenities; provision of medical care and a reasonable measure of economic security, covering the hazards of employment, accidents, ill-health, widowhood and old age; the provision of equal opportunities for education in every country and the re-establishment of a European system of higher learning and research open to students of proved ability from all parts of the world; the provision of cultural and recreative activities and the establishment of organizations for the training and leisure of youth on a European scale." (Vera Micheles Dean, *op. cit.*, p. 55).

³National Resources Committee, *The Structure of the American Economy*, Washington, D. C., 1939, p. 3.

there will not arise a political alliance between dissentient partial interests and the bureaucracy aiming to dominate the majority? Can democratic state capitalism be more than a transitory phase leading either to total oppression or to doing away with the remnants of the capitalistic system?

The main obstacles to the democratic form of state capitalism are of a political nature and can be overcome by political means only. If our thesis proves to be correct, society on its present level can overcome the handicaps of the market system by economic planning. Some of the best brains of this country are studying the problem how such planning can be done in a democratic way, but a great amount of theoretical work will have to be performed before answers to every question will be forthcoming.