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SOCIALISM, PLANNING, AND THE BUSINESS CYCLE

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I

INVESTIGATIONS into the purely theoretical problems and possibilities of economic management under a strictly socialist régime have become strikingly popular during the last years, and this, perhaps, for two reasons. The first reason is very obviously the advance of socialist ideas in practical politics during the last decade as the result of growing dissatisfaction with the competitive system which, during the last depression, has spread into all strata of society. Consequently, the need for exploring all theoretical problems involved in the issue between capitalism and socialism has become a very practical one. The second reason for the increasing attention given to the economic problems of a socialist régime is solely theoretical in character. As the economists of all ages have known, perhaps one of the best methods of analyzing and explaining the working of the present economic order and the real nature of its phenomena consists of constructing in our imagination an economic order built on principles which are exactly the opposite of those of our present economic order. By looking at the photographic negative of our economic order we perceive the mechanism, the functions, and the phenomena of the latter very frequently with greater clarity than can be achieved without this comparative method. We learn to distinguish between the essential and the accidental, we eliminate complications which obscure our view or which distract our attention, and by finding the common denominator of the two economic systems we are liable to get deeper and more universal notions. The advantage of this comparative method is so great that there is, perhaps, no economist who would not have wished for a moment to live under a strictly socialist régime just in order to see the mechanism of a highly differentiated economic society in its bare essentials and freed from its monetary veil. In this way he may even develop a certain theoretical predilection for the socialist régime of his imagination, although his intimate knowledge of the gigantic problems of economic management in the socialist state might make him an implacable opponent of socialism as a practical issue.

It is a noteworthy fact that the recent preoccupation with the theoretical problems of socialist management owes very little to the socialists themselves. It is surprising how little attention the socialists, especially the Marxists, have given to those problems which, as one would assume, should be the main subject of their literary activity. But it is strictly in accordance with the very essence of Marxian philosophy that the whole literature of Marxism is pre-eminently a critical analysis of capitalism, while any curiosity concerning the structure of a socialist society seems to have been suppressed by an almost religious belief in the existence of forces which will inevitably bring about the transformation of capitalism into socialism. Traces of this tradition are still visible today. There is still a tendency to ignore the real problems of socialist management and to take things for granted which need very careful scrutiny. Everybody is familiar with the curious proof of the benefits of socialism which consists of denouncing the shortcomings of capitalism, and we all know how often in all matters concerning socialism and planning a mere term is accepted as a practical solution. This seems especially true for the problem of economic crises and fluctuations.

It is not difficult to show that, whenever the problem of crises and cycles is being discussed in connection with the problem of the economic system in general, there is still a tendency to neglect the question as to whether and in what forms a socialist society might also be subject to economic fluctuations and disturbances akin to those of the capitalist society. As a matter of fact, the question has been very rarely and very cursorily touched upon in the entire literature on crises and cycles. Besides Aftalion, who has dealt with this question in a very brief section of his book, *Les crises périodiques de surproduction*, we find only scattered remarks here or there. After all, the impression is not unwarranted that the prevailing opinion on this question is characterized more or less by the tacit assumption that a socialist economy (which is, technically speaking, equivalent to a planned economy) has, whatever its shortcomings in other respects may be, at least the advantage of being a cycle-proof economy. This opinion seems to arise from two sorts of confusions.

The first confusion is a real short circuit of thinking. There is, of course, no denying the fact that, on purely theoretical lines, an economic system is conceivable in which the typical disturbing factors of our present economic system are eliminated by a suitable management of the whole economic process in its every detail. In other words, we can perfectly well imagine an economic system in which the different parts of the economic process are so co-ordinated by a conscious state control that a perfect equilibrium is being continuously preserved. But this theoretical possibility of a perfect and continuous economic equilibrium does not help very much unless we consider the conditions and sacrifices of such a co-ordinated economic system. To admit that such a system is not like the *perpetuum mobile*, altogether unimaginable, is one thing, but it is quite another thing to jump to the conclusion that the magic word "socialism" (or "planning") suffices to open the door to this—in many other respects rather dubious—paradise which promises to make the world safe for stability. In other words, it is not sufficiently recognized that those terms are nothing but words which only vaguely indicate the general principle of socialist economy, and it seems to be a safe surmise that the overwhelming majority of socialists and planners have no inkling of the gigantic problems lurking behind those shibboleths. In fact, collectivist economic planning presents so many and such crushing difficulties that it can hardly give any fair prospect of attaining the physical productivity of our present economic system (even in its present deplorable state) and of guaranteeing a harmonious balance of the economic process.

The difficulties of economic management under a socialist régime are so appalling, indeed, that it will in all probability lead both to diminished productivity and to a greater lack of economic balance. It is important to notice that these two effects are closely interrelated. But it is also a noteworthy fact that the economic disharmony which promises to become a chronic ailment of the socialist economy will be markedly different from the temporary disharmonies of the capitalist economy. This difference can be characterized by saying that the economic disharmonies of the socialist economy will not become manifest at the place of its origin as the disharmonies of the capitalist economy do, but rather be shoved from the economic apparatus off to its periphery, especially and in the last resort on the shoulders of the consumers, with far-reaching repercussions.[1] As it were, the original tumor will probably breed metastases in the more distant parts of the economic body. There will be no more bankrupt firms, and, given a certain inventive faculty for disposing somehow of embarrassing masses of human beings, there will not even be unemployed as we know them today. Our eye will be spared the unpleasant aspect of open abscesses, but this will be due to a therapy which drives germs into the arteries and through them to the distant parts of the body. In other words, getting rid of the superficial aspects of economic disharmony does not mean that we get rid also of the innate economic disharmonies themselves. What it means is rather that we shall have destroyed the machinery which registers the place of their origin by bringing them to the surface. We will not only have destroyed that and thereby made almost impossible a right and timely diagnosis, but we will also have made inactive those forces which, under our present economic system, work automatically toward removing economic disharmonies. The economic machinery will continue to "work" in a way, but the population, besides being deprived of elementary personal liberties, will have to bear the consequences of protracted economic disharmonies by being worse off than before.

"Crises" in the socialist state of perfect planning will be characterized, then, by the fact that people will suffer by them as consumers rather than as producers, while the economic apparatus

[1] It should be noted that this shifting of the impact of economic tensions and miscalculations from the point of its origin and manifestation to other parts of the economic body is also characteristic of those more radical state interventions which will be called "non-conformable interventions" later on in this article.

itself will show, at best, the outward appearance of being in some sort of order. But the latter, as already indicated above, is not an advantage but a great disadvantage as compared with capitalism. Hence the result which we are most likely to get will be as follows: The socialist system of perfect planning will probably succeed, in a very short time, in turning the paradoxical "poverty amidst plenty" of the capitalist crisis into the more solid and more respectable "poverty from shortage" of the socialist "crisis." Since the innate economic disharmonies, however, will be a lasting feature of this system, the poverty is bound to become just as chronic as the corresponding disharmonies. What we get in exchange, then, for capitalism with all its shortcomings will be poverty and disharmony greater than ever before and becoming chronic into the bargain—and that without the economic, political, and personal liberties for which even the poorest unemployed in the capitalist countries will regretfully yearn when it is too late. It is, perhaps, pertinent to add that the color of the political flag under which the socialist system of perfect planning will be launched makes, of course, no difference whatever.

So much about the first confusion, the ultimate source of which, perhaps, is the human weakness to compare the concrete shortcomings of a present thing which we possess with the abstract perfections of an imaginary thing which we do not possess. The second confusion is also of a rather universal type and is closely related to the first. It belongs to that group of attitudes which is characterized by a common failure to distinguish between phenomena which are strictly confined to the competitive economic system and those which, barring differences in form, are connected with any highly differentiated society, whether capitalistic or socialistic. Such a failure operates mostly to the advantage of the socialist propagandist, who promises to combine the higher productivity of a highly differentiated society with the idyllic traits of an undifferentiated society. Since our economic system is the first in which a highly differentiated society makes its appearance on the scene of history, it is easy to understand why many people are tempted to heap all the blame for the inevitable drawbacks of a highly differentiated society on capitalism, and to seek refuge from them in socialism, without realizing that they are hitting the wrong thing. They are confusing the principle of differentiation which marks both capitalism and socialism as compared with the precapitalistic economic systems with the method of co-ordination in which socialism differs from capitalism. They do not like capitalism because of its centralization, its specialization, its complications, its lack of simplicity and spontaneity, but since socialism appears as the negation of capitalism they take it for granted that a socialist régime will be free from those capitalistic traits. They do not realize that in all these respects socialism is exactly in the same class with capitalism. And, of course, they do not realize that in fact socialism will take us still farther away from the innocent stage of economic history which the world left behind by passing to capitalism.

Thus we reach the climax of confusion when the very men who are indefatigable in attacking the rationalistic, mechanistic, and differentiated character of industrialism and urbanism of our age are wallowing in schemes for economic planning, organization, and regimentation[2]—a confusion which makes a great part of the more popular economic writings of the present day simply unreadable. In order to demonstrate the confusion by an example, let us note that a great part of the things which, in our economic system, provoke criticism are by no means the fault of capitalism but that of big enterprise which goes far to destroy personal independence, spontaneity of decisions, variety of action, and individual craftsmanship, and which creates the proletarian in the well-known meaning of this term. While much can, and perhaps should, be done to reorganize our present capitalistic industry in such a way as to free it of the worst aspects of bigness and centralization, there is every reason to expect that a socialist régime would make matters much worse than they are today, since then everything would be amalgamated into one great enterprise where the last trace of independence and spontaneity will be destroyed, including the possibility to choose among different employers.

Applying this explanation of the general character of the second

[2] Cf. the present author's article on "Fascist Economics," *Economica*, February, 1935.

confusion to our problem of crises and cycles, we get another and very important reason for the common error of assuming that crises and cycles are a purely capitalistic phenomenon. It is the familiar mistake to draw the line between capitalism and socialism instead of drawing it between the undifferentiated type of economic society and the highly differentiated one—or, historically speaking, between capitalism and the precapitalistic systems. It is obvious that the ultimate origin of economic disturbances of the present type is to be sought in the high degree of differentiation of our economic system, in the very extended scale of the division of labor, and in the complicated structure of production, especially in its roundabout character. In other words, the ultimate origin of the economic disturbances of the present economic system lies in facts which distinguish capitalism from precapitalism, not capitalism from socialism. The economic system has become so complicated that to attain a continuous and perfect co-ordination is a problem which capitalism and socialism have equally to face. It can hardly be emphasized too much that every economic system, no matter how organized, which is based on a very extended scale of the division of labor and on a technique and structure of production as complicated as the present one, is bound to be exposed to all sorts of dynamic disturbances. These constitute the price which we have to pay for the greater productivity of a highly differentiated economic society. So much is obvious. But it is also obvious that it is a very general truth which does not provide more than a mere starting-point for further investigations. It would, of course, not be defensible to deny that the peculiar principles of the structure of the capitalistic system—competition, money, market, freedom of choice and action, etc.—are leading to special disturbances which might be avoided by attenuating their activity or by applying different principles. It is the analysis of the disturbing influence of those principles which constitutes the main body of the theories of crises and cycles.

II

As has been remarked above, most cycle theorists do not incorporate a theory of the dynamics of a socialist system into their theory of crises and cycles. It would, of course, be possible to fill this gap by analyzing the bearing of the different cycle theories on a socialist régime, but to do this is beyond the scope of this article. Some purpose, however, may be served by examining the applicability to a socialist régime of that theory of crises and cycles which seems to me the most plausible one, and comparing it, from this angle, with similar theories. It goes without saying that this can be done here only in a rather sketchy way.[3]

The theory of crises and cycles which I prefer may be conveniently labeled as a *monetary overinvestment theory*. Its main drift can be summarized as follows. The cause of a major disequilibrium of the economic process is an excess of real investments in fixed and working capital in the sense that the rate of investment has increased in a greater volume and in a quicker tempo than is compatible with the preservation of economic equilibrium. The proportion in which the productive forces of the economic system are being devoted to the production of consumption goods or to that of capital goods, i.e., the proportion between consumption and accumulation, can vary, in magnitude and tempo, only within rather narrow limits without engendering disruption and lack of co-ordination. In order to indicate the nature of this disequilibrating process it may be sufficient to allude to the "principle of acceleration" which has been explained by many cycle theorists and which has been made particularly familiar by Professor J. M. Clark.[4] Leaving aside for the moment certain refinements and qualifications we may say that, according to this proposition, any increase in the general activity of the economic system will have the tendency to produce a disproportionate expansion in the higher stages of production, the rate of expansion growing with the

[3] For a fuller treatment see the following writings of the present author: "Kredit und Konjunktur," *Jahrbücher für Nationalökonomie und Statistik*, March–April, 1926; *Die Theorie der Kapitalbildung* (Tübingen, 1929); *Krise und Konjunktur* (Leipzig, 1932); and especially his forthcoming book in English, *Crises and Cycles* (London).

[4] "Business Acceleration and the Law of Demand," *Journal of Political Economy*, March, 1917; and also the same author's books, *Studies in the Economics of Overhead Costs* (Chicago, 1923), and *Strategic Factors in Business Cycles* (New York, 1934).

stage of production, i.e., with its distance from the sphere of consumption, while the opposite is true for any decrease of the general economic activity. The reasons for this intensified impact of variations in the general economic activity on the higher stages of production are to be sought: (1) in the fact that any increase of the productive equipment of the country makes necessary (in the absence of excess capacity) a further increase of the productive equipment in order to produce the initial increase, and (2) in the fact that there is also a corresponding tendency of an intensified increase of stocks. In other words, the process of acceleration (intensification) consists of a disproportionate growth both of fixed capital and of working capital. In this way the whole structure of production tends to grow top-heavy, and this top-heaviness—the disproportionate increase of production in the upper stages of production—can be maintained only if the increase of demand in the lower stages goes on at the same rate.

That is the general proposition, and the monetary overinvestment theory does not yet contain a monetary element. Overinvestment in the sense explained above can, indeed, develop in every highly differentiated system, provided that the volume of "saving" (in the broadest sense of a curtailment of current consumption relative to accumulation) is being allowed to expand, in magnitude and in speed, at a rate which is no longer compatible with economic equilibrium.[5] This conception of overinvestment, then, leads to the conception of oversaving which, in view of possible misunderstandings, must be clearly distinguished from "oversaving" in the sense of the Keynesian theory. While in the latter oversaving is spoken of with regard to an excess of saving over investment during the depression, it is here an excess of saving occurring during the boom period, not relative to investments, but to the capacity of the economic system to adapt itself to a rise of savings which are being invested. It is important to keep this in mind.

Oversaving in this sense is, of course, an essentially dynamic concept, not a static one. Statically there is no maximum rate of

[5] The proposition could, in miniature, be worked out also for the Crusoe economy where some points would come out with particular clearness.

saving as such which must not be exceeded if disequilibrium is to be avoided. In this sense of long-run conditions a problem of "oversaving" certainly does not exist. But a problem of "oversaving" appears if the rate of saving is rising so suddenly and in such a degree that it leads to overinvestment. The balancing forces of the economic system can take care of a rise of the rate of saving if it does not exceed a certain maximum of speed and magnitude; beyond that point the equilibrium will be upset. Now the question to be raised is this: How is such a steep rise of the rate of saving conceivable in our economic system? In answering this question, the crucial point is that the normal source of the formation of capital, viz., voluntary saving of individuals laying aside a part of their incomes, can hardly give rise to a sudden and substantial increase of savings. It has in the first place to be observed, however, that once the upswing of the cycle has been started forces are set into motion which work for a substantial increase of voluntary savings. In this respect it seems sufficient to refer briefly to the general rise of incomes during the upswing, which corresponds to the increase of the social net product made possible by the mobilization of idle productive reserves, at least during the first phase of the upswing. This is tantamount to saying that, up to a certain point, the upswing of the cycle is providing by its own momentum an increase of the subsistence fund which is the "real" counterpart of the financing of the additional investments. In so far the curtailment of consumption in favor of accumulation is not absolute, but only relative in character, a fact which explains the well-known phenomenon that during the upswing and up to a certain point consumption and accumulation, reckoned in absolute figures, are both rising without any visible monetary strain. This is, by the way, also a fact which is irreconcilable with the whole trend of the post-Böhm-Bawerkian theory of capital, which treats consumption and accumulation as strict and absolute alternatives. A second factor which contributes powerfully to an increase of savings during the upswing is the change in the social structure of incomes which is characterized by an expansion of profits and other variable incomes relatively to the less variable incomes, and which is, therefore, equivalent to a rise of the incomes more likely to be saved rather than spent. In addition to this, the increasing importance of the entrepreneurial form of capital formation ("self-financing") noticeable during the upswing adds enormously to the aggregate of savings exactly in this phase of the cycle, so much so that there are even writers who consider this tendency as one of the major causes of the boom.[6]

But important as all this undoubtedly is, it is not sufficient to account for the rate of saving rising so suddenly and so substantially as to set into motion the process of overinvestment regularly and in the dimensions as we know them, to say nothing of certain other characteristics which, being of a monetary nature, cannot be explained in this way. All those factors which have been enumerated above are certainly of great importance for reinforcing the process once it has come into motion, but it would be unwarranted to claim more for them. It seems safe to say that the rise of savings and investments brought about by them will generally be digestible for our economic system without leading to grave maladjustments for the system as a whole. In order to grow to dimensions likely to upset the general economic equilibrium, savings and investments must be forced up by a much more powerful mechanism. For this purpose some kind of coercion seems indispensable, and it is here that the monetary factor comes in, so that the overinvestment theory becomes a *monetary* overinvestment theory. For the machinery of coercion in forcing up savings and investments which is inseparably connected with our economic system is provided by the well-known process of credit expansion. It is the same phenomenon which is otherwise known as "forced saving," and which for the rôle played by it in the mechanism of the business cycle well deserves the central place attributed to it in recent years. It must not be overlooked, however, that credit expansion is not the only imaginable kind of coercion, but merely that kind which corresponds to the general structure of our economic system, especially in so far as it is characterized by general spontaneity and by the subtlety of the market process. In a socialistic society it may be replaced by open

[6] Cf. Francesco Vito, "Il Risparmio Forzato e la Teoria dei Cicli Economici," *Rivista Internazionale di Scienze Sociali*, January, 1934.

force exerted by the state, with the effect that the population would be driven, directly and authoritatively, to forego possibilities of consumption in favor of accumulation. Since this is also "forced saving," it would be better to distinguish between *monetary forced saving* as it characterizes our economic system and *authoritarian forced saving* which corresponds to it in a socialist system. The machinery of coercion which, in our economic system, is represented by the banking system with its checks and overdrafts will, in the socialist system, consist of the state police with its rifles, dungeons, and concentration camps.

If our view as to the importance of the principle of acceleration is right, then it will in principle make no difference whether the amassed investments which constitute the essence of the boom and at the same time the germ of its breakdown are made possible by one or the other kind of forced savings. For this reason, also, an investment boom financed by authoritarian forced saving could not escape the same fate as that financed by monetary forced saving, since in both cases, according to the principle of acceleration, the progressively growing scale of investments would necessitate a progressively growing scale of savings until the saving capacity of the nation would be exhausted and, consequently, a more or less painful readjustment become necessary. In other words, the monetary aspect of the causation and also of the breakdown of an investment boom financed by monetary forced saving (credit expansion) represents only a special form which corresponds to the general structure of our present economic system, while in a socialist society this aspect would be replaced by that of authoritarian forced saving which corresponds to the general structure of the socialist system. Consequently, the business cycle of the capitalist system is only a species—very interesting and especially well developed—which belongs to the larger genus of disturbances by overinvestment which may be present in any highly differentiated economic society, no matter how organized. It is that species which concerns us directly as a matter of most practical importance, but to treat it merely as a species belonging to a larger genus is more than a sort of intellectual amusement, since it gives the right perspective to our understanding of the real nature of the capitalist cycle and to a comparative valuation of the alternative economic systems. In this light, also, the relative value of the monetary theory of business cycles comes out clearly. It is that theory which provides an indispensable element for the explanation of the capitalist form of the overinvestment cycle, and as such, and with necessary qualifications, there is nothing wrong with it. On the other hand, however, it must be deduced from the universal character of the overinvestment cycle that the monetary theory of business cycles is not more than a sort of Euclidean geometry among other, non-Euclidean, geometries.

Let us look at the question from another angle, in order to understand fully the universal character of the problem which the socialist as well as the capitalist society has to face and which is at the bottom of the cycle phenomenon. Suppose that in one case as in the other new technical possibilities present themselves, such as the automobile or the radio. There is an identical situation in both systems, as both are confronted with the dilemma as to whether those possibilities are to be exploited to the full at once, with the steep rise of investments which this course involves, or whether a smoother rise of investments is to be preferred at the cost of a slow and gradual realization of the technical possibilities. Both systems have to choose between progress or stability, and it is difficult to say beforehand which is to be preferred. As far as capitalism is concerned, everybody knows that there is implanted in it a certain *horro vacui*, i.e., a tendency to respond to strong incentives for new lines of investments to the utmost limit. Once the railroad had been invented, it took only a few successive investment waves to cover the earth with the mileage necessary for convenient railroad communication everywhere, but, to be sure, those waves had their unpleasant troughs. A steep rise of the investment curve is a disturbing element and there are good reasons why an attempt should be made to smooth it out; but it is difficult to see how a socialist society could avoid having to face and to solve the same problem—after the successive investment waves of capitalism have led to such an advance of the technique of production that a socialist experiment could start from a very high level of general productivity.

Against this proposition it might be objected that it rests on rather doubtful ground, since monetary forced saving and authoritarian forced saving cannot possibly have the same effect. Many will find it very difficult to believe that authoritarian forced saving will lead to conditions essentially similar to those of a capitalist investment boom brought about by monetary forced saving. Is it possible, they may ask, that raising taxes in order to speed up investments will produce conditions which have anything in common with a boom? Will not just the opposite effect ensue? Questions like these, however, betray a confusion which can be avoided if we bear in mind that the working of the two kinds of forced saving can be studied only within that economic system to whose structural principle the one or the other corresponds. It will not do to say that authoritarian forced saving when applied within the capitalist system will kill a boom rather than provoke it. For as long as the system is capitalist, it must rely on the behavior of the entrepreneurs, which authoritarian forced saving will probably influence in such a way as to diminish private investments and to damp the general economic activity. That is to say: authoritarian forced saving is antagonistic to the structure of the capitalist system. On the other hand, since the capitalist system rests on spontaneous decisions of the entrepreneurs, monetary forced saving is particularly well adapted to it, for it makes a rise of the investment rate possible by aid of a mechanism which, by enhancing the chances of profit, is apt to influence the entrepreneurial attitude in such a way as to enliven the general economic activity. There is strong reason to suspect that this *modus operandi* of monetary forced saving is a distinct advantage of the capitalist as compared with the socialist system, since it is very doubtful whether the all-embracing bureaucracy of the socialist state can provide a sufficient substitute for the spontaneous and general rise of the economic activity which is concomitant with the capitalist mechanism of forced saving. It is, perhaps, this circumstance which explains why the rise of investments in a capitalist upswing usually stimulates productive activity to such a degree that, in spite of increasing accumulation, consumption does not fall, but markedly rises—the well-known "paradox of capitalism," which presents a case of eating the cake and not only having it, but of having still more of it while eating. It remains an open question whether the recent Russian experience of the first "Five-Year Plan," with rising investment and decreasing consumption, might not have an even deeper and more general significance.

There is a final point which must at least be mentioned in this connection. It concerns that part of our thesis which deals with the inevitability of the breakdown of overinvestment. It will be recalled that it is the principle of acceleration which explains why the structure of production must sooner or later become top-heavy, and thus at an increasing rate lead the economic system into an impasse. Is this really inevitable, under all conceivable circumstances? It seems difficult to answer this question in the affirmative without several qualifications. While it is impossible here to deal with these qualifications at greater length, it seems indispensable to draw attention to the important fact that the working of the principle of acceleration will be mitigated by the replacement demand which, with a certain lag, grows with the increase of investments and thus tends to put the additional investments on a more stable basis by making them less dependent upon new additional investments. The overhanging parts of the structure of production are so far, as it were, being supported from beneath. This secondary demand for production goods which is being "induced" by increasing investments is not dependent on a continuous and progressive increase of the primary demand but only on its steady level; it therefore is able to take care, to some extent, of the problem of permanently maintaining the top-heavy superstructure. Though there are several factors working against it, it is by no means inconceivable that the growing replacement demand might serve as a parachute for the blown-up structure of production in such a way that the decrease in additional investments will be fairly compensated by the increase in replacement demand. Nor does it seem inconceivable that the business-cycle policy might be so conducted as to coordinate the scale of new investments with the growth of the replacement demand with the indicated end in view, and thus to avoid the precipitous fall. The proper instrument for this intelligent co-ordination in the capitalist system would be an appropriate management of the machinery of monetary forced saving, while in a socialist system the same effect could be achieved directly and authoritatively. It seems to me that this is a point which, being of the utmost theoretical and possibly also practical importance, is in urgent need of further elucidation.

The analysis of this section will, perhaps, gain in clarity if it is compared with other explanations of the business cycle, among which those by Keynes and Hayek command the widest attention at the present moment. Taking first the Keynes approach, we may say that when he makes the rise of the rate of investment above the rate of saving (which, in his definition, does not involve "forced saving") the main causal factor of the boom, he says practically what I have said in stating that it is usually the addition of forced saving to the volume of normal (voluntary) saving which raises investments to a dangerous point. The approach, however, is different, since in my analysis it is not the rise of the rate of investment relative to the rise of saving which is the real cause of instability, but the absolute rise of investments, no matter whether financed by voluntary or by forced saving. For all practical purposes this amounts to the same thing as far as the explanation of the capitalistic boom is concerned. The different approach of Mr. Keynes, however, has two important consequences. The first is that in his analysis the main emphasis is put on a point which, under certain circumstances, may be of only minor importance (i.e., in case the absolute rise of investments is not brought about by a disharmony between saving and investment, or, in other words, by credit expansion). So Mr. Keynes has little to say about the general possibility of overinvestment in connection with the principle of acceleration, especially in a socialist system. This point is related to a second consequence of the Keynes approach. Since he makes no use of the principle of acceleration, he is rather vague about the possible disruption of the structure of production by overinvestment, and is evidently inclined to deny the necessity of a more or less painful process of readjustment. This seems to me the weakest point in his whole analysis. Where his analysis is strongest, on the other hand, is in its treatment of the cumulative process of depression which, indeed, cannot in my opinion, be better stated than in the terms of the saving-investment approach elaborated by him. This analysis must be highly appreciated even by those who prefer other explanations for the upswing.

While in the case of Keynes the analysis of the upswing is much weaker than that of the depression, just the opposite may be said of Hayek's theory. Its essence is that, while any amount of investment financed by voluntary savings tends to leave the structure of production intact, it is the rise of investments financed by forced saving which upsets the balance so that a subsequent readjustment becomes inevitable. We cannot enter here into the very intricate details of his reasoning, which are bound up with some highly controversial propositions of the theory of capital of the post-Böhm-Bawerkian school. For our present purpose it suffices to remark that, by emphasizing the rôle of forced saving as the driving force of overinvestment Hayek's theory amounts, in its last result, to the same thing as Keynes's theory and my own analysis, at least for all practical purposes. But behind there lie substantial differences. In my analysis, overinvestment by monetary forced saving appears as the special form in which in our present economic system the general source of instability—i.e., overinvestment no matter how financed—becomes a practical possibility.

In Hayek's analysis, overinvestment by monetary forced saving appears as the sole form in which overinvestment as a factor of instability is conceivable. Since in his view the real source of trouble is not too much investing but too little voluntary saving, his theory is, indeed, the most uncompromising example of an undersaving theory of business cycles. According to this theory the same amount of investment which, if financed by forced saving, spells disaster would be harmless if it were financed by voluntary saving or even if the forced saving were replaced later by voluntary saving. In our view, however, it is the steep rise of the absolute amount of investments which matters and not the fact that in our economic system it is credit expansion which makes this rise possible. Consequently, also, a socialist state would have to face the same problem if investment is being speeded up by authoritarian forced saving. Since this view of the matter is contrary to Hayek's analysis, he must of necessity hold the belief that a socialist system is not exposed to this kind of disturbance, a belief which, incidentally, is not quite in accordance with his views, expressed elsewhere, on the disadvantages of a socialist system. But there are other consequences too. While in my analysis the ultimate breakdown of the boom is ascribed to the working of the principle of acceleration, in Hayek's theory it is the shortage of free capital which puts an end to the boom, and this shortage of capital is regarded as bound to come sooner or later if investments are being financed by credit expansion, unless an improbable rise of voluntary saving in an amount sufficient to replace forced saving occurs at the last moment. To this we would reply that the shortage of free capital at the end of the boom is an undeniable fact and an indubitable calamity, but, by virtue of the working of the principle of acceleration, it does not provide a real explanation, since it is the inevitable result of the whole process of the boom.

III

When a major depression such as that through which we are passing occurs, we are likely to find, however, that profane views on the comparative merits of capitalism and socialism like those developed in the preceding section are treated by public opinion with a great deal of impatience. The longer the depression lasts, the more people are apt to become convinced that only a recourse to socialistic principles—for which many prefer the less provocative term of planning—offers a way out of the impasse. With many this conviction becomes so deep that they assume a priori that a theory which has so little respect for the pious belief in socialism as a system which would redeem us from the curse of crises and cycles must be inherently wrong. It is, perhaps, in order to devote a last section to views like these.

Here as elsewhere the first thing to be done is to clear up a confusion which arises from loose definitions. There is no doubt that the term "planning" owes much of its present popularity to the fact that it is being used more and more in a sense which covers almost every conceivable activity of the state in economic affairs. Since some sort of activity on the part of the state is being demanded by almost everyone today, this broad usage is very effective in spreading the impression that the world is headed for planning and in uniting under this flag people who mean quite different things. The term itself lends itself readily to such a purpose, since it is difficult to imagine any act of economic policy which does not involve some sort of a "plan." Protective tariffs, public roads or state railroads, hydraulic dams, city planning, and also the monetary or financial policy of governments, are based on some preconceived idea or "plan." If all these things are "planning" then the term becomes absolutely meaningless. Then we would have had planning since the dawn of history, and then, of course, capitalism would also be a planned economy, since the legal and institutional framework of this economic system has also been created more or less on the basis of reasoning involving a preconceived idea of competitive economy as a whole. It has been more or less deliberately planned as a system which once created needed no further planning. Consequently, if the term is to retain any meaning at all it must not be applied to an economic policy characterized by a "plan"—for that is true in the case of any economic policy—but to a definite method of executing the "plan," viz., the method which is the opposite of that of the competitive system. The essence of this method of planning is to replace the mechanism of the competitive market by commands from above, and to transfer the all-important decision over the use of the productive forces of the community into the office of a governmental department. All this proves conclusively that the term "planning" is extremely misleading and badly in need of being replaced by another term which really states its contrast to the working of the market mechanism—whether we choose "Government Managed Economy," "Authoritarian Economy," or even "Red-Tape Economy." As long as we keep, however, to the term "planning" we are at least entitled to demand that it should be strictly reserved to an economic policy which replaces the mechanism of the market by governmental command. In this proper sense, planning must be distinguished from such interventions which, though they institute interference, still correspond to the inner structure of our economic system by leaving untouched the market mechanism itself and which attain their ends not against its rules but by making use of them. These interventions, which may be called "conformable interventions," range from simple Sunday-rest regulations to protective tariffs; while price fixing, import quotas, clearing arrangements, and exchange controls represent the other kind of interventions, which we call "non-conformable interventions." A good test as to whether a certain intervention belongs to the latter kind or not is the well-known fact that measures of this kind are liable to start a chain of repercussions calling for ever more radical interventions, until we arrive finally at a pure collectivist economy.

The foregoing attempt at clearer definition shows that in business-cycle policy also the alternative is not between laissez faire and planning, but between laissez faire, a conformable business-cycle policy, and planning. If we dismiss the policy of laissez faire as no longer feasible we are left with the choice between a conformable business-cycle policy and planning. Here at last we have a clear alternative which we cannot escape: *either* we must act to overcome a depression by putting again into motion the normal mechanism of reactions of the market economy, *or*, if we think that we must have recourse to planning, we must recognize that we have to replace the entire mechanism of the market by collectivist bureaucratic economy. We must make up our minds as to which way we are going and not count on the possibility of an easy compromise. If we find the alternative of the bureaucratic economy uninviting we have to realize that the success of whatever we may do depends on the reconstruction of the mechanism of the market economy. First of all, we must know that, whether we like it or not, we depend on the entrepreneurs and their optimistic mood. If we drive them into exasperation we must not be surprised if the recovery does not come. A judicious activity in combating the depression is, therefore, not only compatible with foregoing any idea of planning, but, on the contrary, mixing it with planning is a sure way to compromise any success of an active business-cycle policy (re-expansion). It must be clearly understood that the whole philosophy of re-expansion as a policy of combating the depression is based on a framework of economic reactions which would be destroyed if a country embarking on such a policy would at the same time try to transform the economic system along socialistic or—what is closely related with these—on autarkistic lines. The experience, especially of Germany since 1933, seems sufficiently to prove that a policy of re-expansion stultifies itself in the end if it disturbs by all kinds of non-conformable interventions the mechanism of economic interactions which it is intended to resuscitate. Perhaps, also, the disappointments during the more experimental phase of the New Deal in the United States must be largely traced to the same source. All the wails over the shortcomings of the competitive system and all the vague yearning for better organized production cannot change the stubborn fact that, as long as we do not take the bold plunge into an all-embracing bureaucratic economy, all measures of planning in the proper sense are likely merely to obstruct recovery. The importance and the truth of this statement are not impaired by the fact that our economic system possesses such an incredible vitality and such an astounding elasticity that it can stand quite a lot of obstructions before it succumbs.