Private Property or Several Control: a Rejoinder

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ABSTRACT

Following Mises's foundational paper, first published in 1920 (Mises 1935), writers in the Austrian tradition have argued that socialism is impossible, because under socialism there would be no private property in the means of production, and without that private property economic calculation could not take place. In the paper 'Economic Calculation: Private Property or Several Control?', published in this journal (Denis 2015), I argued that that this was mistaken. Not private property, but several control, was required for economic calculation, and since several control is consistent with public ownership, this argument for the impossibility of socialism fails. Bylund and Manish (2017), published in this issue of the Review of Political Economy, defends the traditional interpretation of Austrian reasoning, contending that my argument fails. This Rejoinder re-states the issues, addressing, and, ultimately rejecting, the Bylund and Manish critique.

ARTICLE HISTORY

Received 15 July 2017

Accepted

KEY WORDS

Austrian economics; economic calculation; ownership and control;
private property; several property; socialist calculation debate

JEL CODES

B13; B14; B41; B53

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1 Introduction

In 1920, shortly after the establishment of the Soviet Union, Mises initiated the economic calculation debate (or the socialist calculation debate) with his paper 'Economic Calculation in the Socialist Commonwealth' (Mises 1935). In this and subsequent publications, Mises and writers in the Austrian tradition have argued that socialism was impossible, because without private property there would be no scope for economic calculation. Subsequent contributions from socialist and neoclassical quarters argued for a form of market socialism, in which households would interact with firms in product and labour markets, but the firms would be state-owned. In the Austrian view, this did not answer the question, as state-ownership of firms would still prevent economic calculation regarding the allocation of capital. Section Two of this Rejoinder sets out the argument for the necessity of economic calculation, and its dependence on private property.

In a recent issue of this journal, I argued (Denis 2015) that the Austrian economists had misunderstood their own analysis. Rather than private property, I argued, the Austrian analysis only required several property for economic calculation to function. The term several property is a term introduced into the literature by Friedrich Hayek, and is somewhat looser than private property, consistent with both private property and collective ownership. Moreover, I argued, for Austrian thought the key issue is not ownership, but control: not who the ultimate beneficiary of an action is, but who carries it out, and in what circumstances. Hence, combining both points, the Austrian requirement for economic calculation was, not private property, but several control—which is not inconsistent with public ownership. The Austrians had thus been incorrect to assume that their analysis pointed to an incompatibility between economic calculation and the collective ownership of the means of production. Section Three of this Rejoinder re-states the argument for this conclusion.

It is indeed gratifying for a scholar to have her/his work noticed and subjected to criticism. I am therefore extremely grateful to Per Bylund and G.P. Manish, who have written a reply to my 2015 paper, entitled 'Private Property and Economic Calculation: A Reply to Andy Denis' (Bylund and Manish 2017). I am also very grateful to the editors of the *Review of Political Economy*, both for publishing Bylund and Manish's paper and for offering me the opportunity to write a Rejoinder. Bylund and Manish (henceforth B&M) argue that a scheme for public ownership with several control (henceforth POSC) cannot work, and therefore that the argument of Denis (2015) fails. Their argument is that under current conditions the allocation of capital is guided by the prospect of a possible loss of that capital, whereas under POSC this prospect would be absent. This makes it impossible to tie the interests of managers to those of the owners of the capital. Under capitalism, this is mitigated by the activism of the owners of capital in choosing how to allocate capital and the limits to impose on the activity of the managers. Under POSC, however, this would be impossible. Either the state would intervene, just as capitalists do today, to protect its capital, or it would not. If not, then its capital would be eroded by the bad decisions and corruption of the managers. But if it does so intervene, then it would have to do so according to a plan, and they could not have such a plan for all the reasons set out by Mises and subsequent Austrian writers. Section Four of this paper sets out in detail the Bylund and Manish critique.

Section Five gives my response to these claims. There is no obvious reason to believe that there would be any difference, between capitalism and POSC, in the capacity of the owners of capital to align agents' actions with the interests of the principals, of such magnitude as to render POSC impossible. Equally, there is no reason to assume that under POSC the owner of capital, the community as a whole, would be any less vigilant and diligent in selecting and then monitoring the personnel to run their businesses, and constraining the spheres of their activity, than the owners of capital are today.

A final section draws the conclusion that the B&M account is unpersuasive, and that the propositions of Denis (2015) withstand their critique.

2 Economic calculation and private property

When an agent makes a market transaction, they receive information from the market and transmit information to the market. The agent makes a judgement of the utility they believe they may obtain from consuming a unit of the merchandise. They also make a judgement on the utility they may expect from using the funds required for the purchase of one unit, its price, not for purchasing this good, but the next best alternative good. The relative price of the good plays a key role in this decision. The higher the price, the more of the alternative is foregone, and so the greater the utility foregone. Diminishing returns implies that additional units will yield smaller additions to satisfaction. The rational agent should buy further units until the last unit is expected to yield as much utility as the foregone alternative. This is economic calculation. It is a calculation of costs and benefits of this transaction on the basis of the market price of the good and the set of preferences held by the purchaser. The purchaser's decision on where to stop, on how many units to consume, transmits to the market the demand for the good. A similar story can be told for supply. The market aggregates over all the market's participants, the price of the good impounding the information received from all the buyers and sellers. Without economic calculation, too many or too few units of every good would be produced—prices would give no guidance to market participants on the costs and benefits to others of the decisions that they take.

Let us apply this to the market for capital goods. The entrepreneur, in deciding whether to purchase an investment, does not compare the utility s/he expects to obtain with the price, and hence the utility of the foregone commodity. Rather s/he must speculate on the utility that the consumers of the products produced by means of this investment will obtain, expressed in the price they will be willing to pay. If s/he expects the present value of the increased future revenue s/he can expect from the employment of this capital good to exceed the price s/he must pay for it, then it is profitable: s/he should purchase additional units until the expected increment in profit falls to zero. In this way, the total social capital will be allocated to those activities judged to be most profitable, that is, precisely those activities where the consumers are judged to be willing to express their preference for the product with the greatest demand. This is not to say that this efficient allocation is ever attained, or that the decision just described will necessarily be correct; rather, an efficient allocation is continually approached, as errors made by one agent open opportunities for profitable activity to others (Boettke 2001, p. 32). Without economic calculation, this error discovery and correction mechanism would not be possible, and capital would be allocated wastefully.

This story is probably common to the majority of economists. The Austrian view of the necessity of private property can now be delineated. According to Boettke (2001, p. 33), there are four elements to the Austrian argument against socialism, of which two directly pertain to private property:

1. Private property in the funds used for the purchase of a commodity, and then the commodity itself, are required to generate the correct incentives for careful husbandry, for making the best judgement on costs and benefits that can be attained in the circumstances. If the funds employed do not represent a sacrifice to the agent, why should they care whether the transaction is a sensible use of those funds?
2. In a dynamic market setting, entrepreneurs have to make the best possible choices regarding capital allocation to engage with an unknown future. In order for the entrepreneurs to have the incentive to do this to the best of their abilities, they have to be driven by 'the lure of pure profit and the penalty of loss' (*ibid*).

So, for Austrian thought, private property is required for incentives to play their role, guiding the activity of agents into socially desirable channels. Without private property, entrepreneurs do not face the consequences of their own errors, the prospect of the loss of their capital.

3 From private property to several control

Denis (2015) makes the case that, what the Austrian account requires, for successful economic calculation, is, not private, but *several* property. Several property, or property in severalty, is property which is owned by a single person or legal entity, ‘severed’ from other owners. It is the opposite and complement of common ownership. Several property includes private property, and state-ownership. It is the term which has been preferred by some writers in the Austrian tradition, notably Friedrich Hayek (1988; see also Barnett [1998] 2014). Reviewing a subset of Austrian works dealing specifically with the question of economic calculation, Denis (2015) found that wherever they spoke of ‘private property’, what they actually described was *several* property. Hence this particular argument for the impossibility of socialism failed: they had made the case for the necessity of several property to permit economic calculation, but several property includes state-ownership.

Further, some Austrian writers had insightfully stressed that what was key for economic calculation was, not ownership, but control, of resources. As Hayek (1988, p. 86) put it, ‘decentralised control over resources, control through several property, leads to the generation and use of more information than is possible under central direction’. Randy Barnett ([1998] 2014, p. 68) adds ‘The right of several property suggests that the control of resources should reflect the dispersal of personal and local knowledge’. Boettke (2001, p. 177), expresses the same idea when asserting that

> In economics, ownership rights refer to the locus of effective decision-making about the use of resources (i.e. de facto ownership), and may or may not be consistent with legal boundaries of property (de jure ownership). This insight is today a standard convention among economists.

Don Lavoie (1981, p. 42) even claimed that a major difference separating the neoclassical from the Austrian approach was that in the neoclassical account ‘ownership’ was ‘taken to mean formal legal title, rather than de facto control, over resources’. The implication of these comments seems to be that, for economic calculation to work, what is required is not a particular form of property in capital, but that the capital be locally or severally controlled. Putting the two together implies that Austrian analysis is consistent with state ownership of the means of production combined with local control by teams of managers acting on behalf of the community as a whole. The management of the firm constitutes the locus of effective decision-making about the use of resources, managers exert decentralised, local, de facto control over capital assets, using and generating knowledge specific to time and place.

The question immediately arises as to how incentives are to be tailored to bind their interests to those of the community as a whole. But this is a question which capitalism faces too. Under current conditions, the bulk of decision-making regarding the allocation and use of capital is carried out, not by capitalists, owners of capital, but by managers, the controllers of enterprises—by agents, that is, and not by principals. Any argument that this would not be possible under socialism therefore has to establish a difference, between capitalism and socialism, in the employment of agents on behalf of principals, such that socialism would be impossible—not just a difference, but a difference which makes a difference.

4 Bylund and Manish: not several control but private property?

It is not easy to identify a clear critique of Denis (2015) in B&M's article. There are a number of statements of what Denis (2015) says which are simply empirically incorrect. There is rather more material, more than half their article, with much of which I would agree—but in context it reads as if it were a criticism of something that I have said. It would be tedious to rehearse these points here. Rather I have done my best to pick out a thread which expresses their attempt to defeat the argument of Denis (2015).

The core and backbone of the B&M argument is that capitalists not only strive for profit, but seek to avoid loss: there are more than 30 references to this point throughout their article. They claim that it marks a fundamental point of departure from the Denis analysis, and that I, by ignoring this point, implicitly ignore uncertainty, assuming that investments will always yield a profit: 'economic calculation indeed requires private property, and not simply several control, because entrepreneurship under competitive discovery must be subject to both the lure of profit *and* the risk of loss' (p. 2). Denis, they say, 'implicitly assumes away the possibility of suffering a monetary loss and the possibility of failure' (p. 13).

The significance for B&M of the possibility of making a negative profit, is that it creates a fundamental obstacle to linking the interests of managers and equity-holders in an enterprise. One might have supposed that 4 per cent is better than 2 per cent, 2 per cent better than 0 per cent, and 0 per cent better than minus 2 per cent. But for B&M there is a profound qualitative change as we pass from positive to negative returns. While it is possible to devise contracts such that employees may share in the success of an enterprise, and receive a share of the profits, this is not the case for losses: 'given the fact that it is the capitalist that owns the funds being deployed, he (or she) is the one that ultimately suffers the losses that result from the decisions of the agent' (p. 14). 'The agent … acts on the principal's behalf, but does not bear the losses of decisions that don't pan out' (p. 17).

B&M insist the proposition that agents cannot participate in the losses of failed investments is independent of the form of contract by which the agent is employed:

> It is vital to note that this holds true regardless of the nature of the contract between the capitalist and the agent … regardless of how the terms of this contract [the agent's contract of employment] may vary, it is nevertheless the case that the latter [the agent] cannot bear any losses suffered owing simply to the fact that he is not the owner of the resources being invested. Losses are suffered by the capitalist owner. (p. 21)

Given this obstacle that capitalists face, in aligning the interests of managers with their own interest in preserving their capital, the capitalists are forced into activity: 'That the capitalist does not simply pocket the profits but is also on the hook for potential losses has an important economic implication: he cannot be a passive spectator … the perennial specter of a loss impels the capitalist to engage in active decision making' (p.15). The capitalist must carry out economic calculation, and intervene, at the very least to determine 'who his agent should be, [and] how much capital he should bestow on him, and when' (p.15).

But, for B&M, the consequences will be very different under capitalism and under POSC. Under capitalism this activism is manifest in

> the speculative activities of the capital owners on the capital and financial markets. Indeed, it is the decisions made by the capitalists in these markets that determine the size of the endowment of funds that the manager can allocate on the various factor markets (pp. 19-20).

But this will be impossible under socialism as, even if some financial markets remain, the market for corporate equity will not, since all equity is owned by the state. The consequence is that the managers, sharing in the profit of the corporation, but not its losses, will be less risk-averse:

> the manager of a public sector firm in a decentralized socialist economy and the private capitalist in a market economy will come to significantly different conclusions regarding the viability and the potential profitability of the same production projects. The appraisements and judgments of the former, which will not be tempered by the prospect of suffering a loss on account of the fact that he will not be allocating his own capital,

> will tend to be more optimistic and less cautious than those of the latter, whose judgments will necessarily be influenced by the prospect of losing the capital on hand. (pp. 27-28)

Hence the socialist state will be forced into a dilemma. Its presumed lack of activism in constraining the managers of firms will lead to ‘an unsustainable production structure that will bear little relation to consumer preferences’ (p. 28), and ‘if the state decides to rectify the situation, the only trick up its sleeve will be the imposition of a central plan’ (p. 28). Such a central plan would have ‘the result that the complicated production structure inherited from the capitalist economy of the past will ultimately unravel into one that is much more rudimentary in nature’ (p. 25).

Thus B&M argue that POSC is not a possibility.

5 Evaluation of the Bylund and Manish argument

The argument of B&M is not compelling. To take the point on which everything else depends, is there really a qualitative difference between positive and negative profits which makes a difference here—and a difference such that POSC would not be possible? Is it really the case, that it is possible to reward managers for success, but not to penalise them for failure? It is far from obvious that this is so, and B&M do not attempt to argue the case in their article. Moreover it is evident from the behaviour of firms today that strenuous efforts are made to reward managers for success and penalise them for failure. It is difficult to see why that should necessarily be any different under state ownership.

Is it the case that, given a managerial interest in excessive risk-taking, there is no way that the authorities in a POSC arrangement could combat this? Corporations today invest considerable resources in the selection of appropriate staff, in the observation of their performance and the removal of those judged inadequate, and in the construction of contracts which bind their interests to those of the owners of the enterprise. Regulators, moreover, may take steps if they judge that managerial behaviour is inadequately aligned with the interests of stakeholders.

The IMF (International Monetary Fund 2014, p. 106-7) reminds us that in the traditional analysis of the tension between agent and principal, managers were viewed as unduly risk-averse. It was thought that they might be unwilling to risk their personal wealth and human capital that might be firm-specific. So the worry was that agents were disproportionally harmed by losses to the principals: the opposite of B&M’s concern. The

IMF is specifically concerned with financial institutions and in very recent decades; there the problem has been excessive risk-taking by managers, imposing risks as an externality on equity-owners, on creditors, and on the public. The IMF develops a number of means for mitigating such behaviour. At the top of the list is monitoring by ‘large shareholders’.

The significance of this is that many small shareholders face a prisoner’s dilemma: each will benefit to a small extent from their own effort in monitoring and exerting control over the directors and management. This externality is partially internalised when the shareholder is large. It is completely internalised when there is one shareholder, as is the case in POSC. To reduce the cost of monitoring, compensation packages can be set up to link the interest of the manager more closely to that of other stakeholders. This can be adapted to strengthen the manager’s interest in the firm not making losses, if that is thought pressing: that can be done by making a smaller part of the compensation package fixed, and making the variable component, the bonus, subject to deferral and clawbacks (IMF 2014, p. 108). Other methods include the appointment of independent board members and an independent risk committee. It would be unreasonable to assume that such methods would be unavailable under POSC. They will never be perfect, but, equally, they cannot be assumed to be so deficient under POSC as to make the latter impossible.

B&M place a lot of weight on the activism of the capitalist today, and the assumed passivity of the state under POSC. Both are exaggerated. The overwhelming bulk of the decisions that B&M ascribe to capitalists are today undertaken by agents on behalf of capitalists. The trading of assets on financial markets is generally undertaken by employees of large firms—banks, pension funds, mutuals, insurance companies, and so on. The decisions regarding the launch of new enterprises, and extensions of existing ones, is likewise largely in the hands of employees, or firms hired specifically for the purpose.

Regardless of whether new capital is sought by issuing equity or bonds, or by requesting new bank loans, the decisions are made by an army of administrators, lawyers, accountants, and so on. B&M have given no reason to suppose that it would be any different under POSC. Rather, we should expect that the ministers and administrators (held to account by the media), the board members (including non-executive directors, and representatives of stakeholders, such as creditors and worker representatives), the lawyers and accountants, the civil servants and bankers, will wish to ensure the success of the enterprises under their influence and will exert themselves to that end much as they do today. B&M have not proposed any reason to assume that they would be less diligent, and less vigilant, than their counterparts today, and even less reason to assume that, if they were, they would be less vigilant and diligent to the extent that POSC would be impossible.

5 Conclusion

This Rejoinder has drawn the conclusion that the critique of Denis (2015) presented by Bylund and Manish fails to hit its target. It has long been recognised that there is a difficulty aligning the interests of agents with those of principals. It is difficult to see that there would necessarily be a greater difficulty of this kind under POSC than under today's capitalism, of sufficient magnitude to render POSC impossible. The argument that under capitalism the actions of agents are constrained by the prospect of loss of that capital, while under POSC they would not be so constrained, appears to be without force. It would be unreasonable to assume that the owners of capital under POSC, the community as a whole, and its representatives, would necessarily exercise less diligence and vigilance in defence of their property than the owners of capital do today. That B&M's argument has not successfully challenged the propositions of Denis (2015) does not mean that those propositions will not face successful challenge in the future. It is indeed to be hoped that Austrian scholars will engage in this discussion and undertake further work on this topic.

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