The Forgotten Contribution: Murray Rothbard on Socialism in Theory and in Practice

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This paper documents and articulates Murray N. Rothbard's contribution to our understanding of the theory and practice of socialism. We summarize his theoretical contributions and then turn to his explanation of the operation of socialism in the Soviet Union. Moreover, we make and support the conjecture that Rothbard, writing in the 1950s and 60s, anticipated *all* the major subsequent developments in the economic analysis regarding the problems of the Soviet economy and *all* the major works in comparative political economy for real-existing socialism in the Soviet Union.

> [T]he extent of socialism in the present-day world is at the same time *under*estimatated in countries such as the United States and *over*estimated in Soviet Russia. It is underestimated because the expansion of government *lending* to private enterprise in the United States has been generally neglected, and we have seen that the lender, regardless of his legal status, is also an entrepreneur and part owner. The extent of socialism is overestimated because most writers ignore the fact that Russia, socialist as

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> she is, cannot have full socialism as long as she can still refer to the relatively free markets existing in other parts of the world. In short, a single socialist country or bloc of countries, while inevitably experiencing enormous difficulties and wastes in planning, can still buy and sell and refer to the world market and can therefore at least vaguely approximate some sort of rational pricing of producers' goods by extrapolating from the market. The well-known wastes and errors of this partial socialist planning are negligible compared to what would be experienced under the *total* calculational chaos of a world socialist state. (Rothbard 1962, pp. 830–31)

It has become commonplace for economists to insist that the collapse of the Communist Bloc in 1989 is a defining moment in twentieth century political economy. It is also almost obligatory for these economists to insist that nobody predicted the collapse of communism. But this humility is self-imposed by the intellectual straitjacket that many economists wear. Murray Rothbard refused to be so confined by the methods and methodology of the dominant lines of economic thought during his lifetime. He rejected the formalism of Walrasian price theory, the positivism of econometrics, and the aggregation of Keynesianism. But make no mistake, Rothbard was actually a member in good standing in the mainstream of economic thought historically contemplated, and this orthodox strain in economics would not have to be so humble in the face of the collapse of communism in the late 1980s. These economists warned of the problems that deviations from a private property regime and attempts of government control of the economy would bring well before the socialist revolutions of the twentieth century.

The puzzle that economists of Rothbard's ilk must confront is how socialism could have persisted in practice for such a long time given all the problems they identified with the theoretical system. Fortunately, Rothbard was not silent on this "black box" of real-existing socialism. In short, Rothbard was able to demonstrate in his work why socialist economy was theoretically impossible, and how socialism in practice muddled through. In *Man, Economy, and State*, Rothbard not only provided the reader with a thorough presentation of the basic principles of economic and political economy, but gave the serious student a framework for the analysis of real-existing socialism in the Soviet Union that was far superior to the framework that dominated Sovietology and the field of comparative economic systems at the time and, if truth be told, to this day. Like in most other areas of economics and political economy, Rothbard let the logic of the argument take him wherever it led without regard to conventional opinion.

One must remember the intellectual context in economics and the social sciences with regard to socialism in the 1950s and 1960s. While there were critics of socialism, the majority of scholars thought socialism was not only a moral ideal, but socialist economic planning had the potential to outstrip capitalism in terms of economic growth. Many recognized the atrocities committed against humanity by the Soviet regime, but that was not due to any inherent difficulties with socialist planning. The problems with the Soviet Union were due to the lack of a democratic political system. The Soviet economic system had avoided the Great Depression, stimulated the industrial investment that afforded the defeat of Hitler, had achieved significant economic growth in the post-World War II period according to official figures, and beat the U.S. in the technology race for conquering space with the launching of Sputnik in 1957 and then Yuri Gagarin in April 1961. When Khrushchev banged his shoe on the podium at the U.N. General Assembly, he was not referring exclusively to military superiority.

Rothbard's analysis of the Soviet system in practice challenged all these presumptions. Where popular opinion among economists saw economic growth, Rothbard argues that it is unsustainable growth; where popular opinion saw economic efficiency, Rothbard argues that there are inefficiencies; where popular opinion saw collective property and central planning, Rothbard saw attenuated property rights, world pricing and black market activity. Outside of the writings of less than a handful of economists, it took until the 1990s for research in comparative economic systems to catch up to the analysis Rothbard laid out in *Man, Economy, and State*. And, as we will indicate throughout the paper, even as more and more scholars come to understand the conceptual issues that underlie Rothbard's analysis, the full implications of the argument remain largely hidden from the vast majority of economists who work with these concepts.

Our purpose is twofold. On the one hand, we concentrate on documenting and articulating Rothbard's contribution to our understanding of the theory and practice of socialism. To achieve this, we will summarize his theoretical contributions and then turn to his explanation of the operation of socialism in the Soviet Union. Our textual focus will be on Rothbard's contribution in *Man, Economy, and State* and we will make continual reference to the context of the 1950s and early 1960s to emphasize his originality. Our second goal is to provide evidence to support the contention that Rothbard anticipated *all* the major subsequent developments in economic analysis regarding the problems of the Soviet economy and *all* the major works in comparative political economy for real-existing socialism in the Soviet Union.

Theoretical Contributions on the Problems with Socialism

The starting point of Rothbard's analysis is the demonstration by Ludwig von Mises that economic calculation within a socialist commonwealth was, strictly speaking, impossible. Absent rational economic calculation, economic production would be reduced to merely stabs in the dark. In choosing between production project *A* or production project *B*, economic planners would be left without any economic criterion in making their decision. To put this in more practical terms, imagine a socialist planner confronted with the task of deciding whether railroad track should be made of platinum or steel. Platinum is the technologically superior metal for the task of ensuring long lasting and smooth train rides. In a capitalist economy, the market for capital goods would reflect the alternative uses of platinum and thus give the investor some guidepost on which to make the decision in terms of cost effectiveness. But under the assumptions of socialism, the market for the means of production would be abolished. Under full socialism all reference to world markets and memory of previous market allocations would be abolished. Planners would be confronted with a situation where the price system, being abolished, could no longer serve as a relative scarcity indicator that provides the necessary knowledge input into the calculation of decision makers. In short, economic criterion would be out. The inability to engage in rational economic calculation means that socialist *economy* is impossible.[1]

Rothbard makes this point concisely: "Mises, who has had the last as well as the first word in this debate, has demonstrated irrefutably that a socialist economic system cannot calculate, since it lacks a market, and hence lacks prices for producers' and especially capital goods" (1962, p. 548). Rothbard actually argues that, paradoxically, the Misesian criticism of socialism does not turn on the issue of collective property *per se* (despite the problems that this scheme has for agent incentives), but because that institutional arrangement necessitates one agent to direct the use of all resources within an economy. Rothbard presents the Misesian argument in the context of addressing the idea that there is a natural tendency within a capitalist economy toward increasing vertical integration of business enterprises and thus monopoly power in a market economy. Critics of the free market often argued that the natural tendency was for the economy to evolve toward one big cartel, which would control all productive assets in the economy. But a market economy, Rothbard argued, cannot tend in this direction because firms cannot vertically integrate without facing the problem of calculation. The laws of economic science establish limits to the size of any particular firm on the market and that limit is established by calculational limits.[2]

Suppose a firm attempts to vertically integrate and thus eliminates the external market for producer goods. "In that case," Rothbard points out,

> it would have no way of knowing which stage was being conducted profitably and which not. It would therefore have no way of knowing how to allocate factors to the various stages. There would be no way for it to estimate any implicit price or opportunity cost for the capital goods at that particular stage. Any estimate would be completely arbitrary and have no meaningful relation to economic conditions. (1962, p. 547)

[1]This insight of Ludwig von Mises's is, in our opinion, the most significant contribution to political economy made in the twentieth century. See Boettke (1998) for an examination of why this Austrian insight into the impossibility of economic calculation under socialism is *the* contribution to modern political economy. Also see Boettke, ed. (2000) for a nine-volume reference collection on the debate over socialism and the introduction to those volumes for why Mises's contribution is central to the entire debate.

[2]Rothbard's development of this argument is discussed in detail in Klein (1996).

Rothbard's discussion anticipated the work that would later be done on the internal organization of the firm, the problems of transfer pricing and the evolution of the multi-divisional firm to overcome these difficulties with centralization.[3] The important issue to stress is that Rothbard saw the problem of economic calculation as actually increasing in magnitude the more advanced the social system of exchange and production became. "Economic calculation," Rothbard wrote,

> becomes ever more important as the market economy develops and progresses, as the stages and the complexities of type and variety of capital goods increase. Ever more important for the maintenance of an advanced economy, then, is the preservation of *markets* for all the capital and other producers' goods. (1962, p. 548, emphasis in original)

This last point is crucial because it relates to the claim that Marxists made concerning the goal of socialist economic planning. In Rothbard's later writing, he makes the seemingly obvious, but very perceptive, observation that "The key to the intricate and massive system of thought created by Karl Marx (1818–83) is at bottom a simple one: *Karl Marx was a communist*" (1995, p. 317). Marx was a millenialist who argued that communism would bring an end to the suffering of mankind. Crucial to this argument is that the future communist society would be a post-scarcity world. All economic problems would fade away and there would be no need to address the question of the allocation of scarce means among competing ends. The rationalization of production under communism would lead to a burst of productivity and thus make it possible to move from the "Kingdom of Necessity to the Kingdom of Freedom."[4] As Rothbard (1995, pp. 323ff.) details in his discussion of Marx, the promise was that the higher stage of communism would eradicate the division of labor and man would be freed from all limitations.

Against this Marxist claim Mises's demonstration of the impossibility of economic calculation under socialism is devastating. The collectivization of the means of production will not result in rationalization, but in chaos. Rather than superabundance, production will come to a standstill and starvation will ensue. We do not intend to go through the various attempts by Marxist and other social scientists to address Mises's calculation argument here.[5] However,

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[3]See the work of Sautet (2000, pp. 85–132) for a discussion of the problems of centralization within the internal organization of the firm. Also see Lewin (1999, pp. 134–74) for a discussion of the implications of Austrian capital theory on the organization of business enterprises.

[4]One of the clearest discussions of how this ideological presupposition formed the aspirations of the Bolshevik revolution can be found in Walicki (1995).

[5]See Steele (1992) for a summary of all the traditional attempts to address Mises's argument. For more recent attempts to address the Mises challenge to socialism, see Bardhan and Roemer (1992), Adaman and Devine (1996), and Cottrell and Cockshott (1993). For rejoinders from a Mises-Hayek perspective to some of these attempts to reformulate the argument for socialism, see Horwitz (1996) and Caldwell (1997).

it is important to report Rothbard's interpretation of the socialist calculation debate because it anticipated the reinterpretation of that debate that gained currency in the writings of Karen Vaughn (1980), Peter Murrell (1983), and Don Lavoie (1985) in the 1980s, concluding that the Austrians had indeed won the calculation debate.[6] We will quote Rothbard at length so the reader can see how his presentation in 1962 already implied the failure of equilibrium economics to adequately address the issues in the socialist calculation debate that was stressed in these later contributions by Vaughn (1980), Murrell (1983), and Lavoie (1985).

> A curious legend has become quite popular among the writers on the socialist side of the debate over economic calculation. This runs as follows: Mises, in his original article, asserted "theoretically" that there could be no economic calculation under socialism; Barone proved mathematically that this is false and that calculation is possible; Hayek and Robbins conceded the validity of this proof but then asserted that calculation would not be "practical." The inference is that the argument of Mises has been disposed of and that all socialism needs is a few practical devices (perhaps calculating machines) or economic advisers to permit calculation and the "counting of the equations."
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> This legend is almost completely wrong from start to finish. In the first place, the dichotomy between "theoretical" and "practical" is a false one. In economics, all arguments are theoretical. And, since economics discusses the real world, these theoretical arguments are by their nature "practical" ones as well.
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> The false dichotomy disposed of, the true nature of the Barone "proof" becomes apparent. It is not so much "theoretical" as irrelevant. The proof-by-listing-of-mathematical-equations is not proof at all. It applies, at best, only to the evenly rotating economy. Obviously, our whole discussion of the calculation problem applies to the real world and *to it only*. *There can be no calculation problem in the ERE because no calculation there is necessary*. Obviously, there is no need to calculate profits and losses when all future data are known from the beginning and where there *are no* profits and losses. In the ERE, the best allocation of resources proceeds automatically. For Barone to demonstrate that the calculation difficulty does not exist in the ERE is not a solution; it is simply a mathematical belaboring of the obvious. The difficulty of calculation applies to the real world only. (Rothbard 1962, pp. 549–50)

The equilibrium economics of Taylor-Lange-Lerner was unable to grasp the nature of economic calculation because it solves the problem by assumption,

[6]The standard view in the 1970s was that the Austrians had been involved in the calculation debate but that the Austrians had been defeated. Vaughn, Murrell and Lavoie are often credited for reinterpreting this event but upon reading Rothbard, it is clear that his work anticipated their reinterpretations by two decades.

which in fact is no solution at all. As we have already seen in Rothbard's discussion of the economic organization of the firm, economic calculation is vital for the maintenance of investment projects in an advanced economy. The problem of the coordination of the capital structure that makes up an advanced economy is a problem of the real world. This is a world of factors of production that are neither purely specific nor purely nonspecific. In a world of purely specific factors these goods could be used to produce only one product, and in a world of purely nonspecific factors these goods could be used to produce any product (Rothbard 1962, pp. 280–84). The capital structure coordination problem exists because capital goods have multiple-specificity and must be allocated among competing investment projects. Economic actors must decide where to allocate scarce capital goods to produce final products that meet consumer demands. Production plans of some must mesh with the consumption demands of others. If these plans don't mesh, resources will be misallocated and thus wasted—people will produce things that nobody wants and want things that nobody produces. It is this real world of heterogeneous capital goods with multiple-specificity where the ability to engage in rational economic calculation is vital to the success or failure of the economic system. Without the guideposts of market prices and profit and loss accounting, economic planners would be set adrift on the sea of possibilities.

These Rothbardian insights into the magnitude of the problem of economic calculation for a modern economy are hidden from view in the circular flow model of Knight, the Arrow-Hahn-Debreu model of general competitive equilibrium, the income expenditure Keynesian model, and the ISLM model of neo-Keynesianism. In short, all the established models of the economy in the period in which Rothbard wrote were ill-suited to address the question of economic calculation. *These models all assumed the problem of calculation away by construction*.

One final theoretical point that Rothbard raised in *Man, Economy, and State* that is relevant to the analysis of socialism in theory and practice is his discussion of collective or public ownership (1962, pp. 828–29). Rothbard argues that "the important feature of ownership is not legal formality but actual rule, and under government ownership it is the government officialdom that controls and directs, and therefore 'owns,' the property" (1962, p. 828). But while government officials possess ownership in terms of control rights, they do not possess full cash flow rights and the rights they do possess are not secure in the long run.

> Hence government officials will tend to regard themselves as only transitory owners of "public" resources. . . . In short, except in the case of the "private property" of a hereditary monarch, government officials own the current *use* of resources, but not their capital value. But if a resource itself cannot be owned, but only its current use, there will rapidly ensue an uneconomic exhaustion of the resource, since it will be to no one's benefit to conserve it over a period of time, and yet to each owner's advantage to use it up quickly. (1962, pp. 828–29)

In *Man, Economy, and State*, Rothbard was able to persuasively present not only Mises's argument about the impossibility of rational economic calculation under socialism, but the conceptual incoherence of the very idea of collective property.[7] It is not just that rational economic calculation is impossible, but that the very idea of socialism is impossible. Socialism is not impractical, it is impossible. The idea is intellectually bankrupt from the get go.

THE ANALYSIS OF SOVIET REALITY

Rothbard was not content in just laying out the theoretical case against socialism. As previously quoted, Rothbard argues that all theoretical arguments are practical arguments and thus he used the teachings of economics to analyze the Soviet reality of his time and lay bare the false premises about the system that were promulgated at the time. Again, it is important to remember the 1950s and 1960s context in which *Man, Economy, and State* was written. The conversation in the economics profession on the Soviet Union at this time was divided into three distinct literatures: (1) theoretical models of planning, (2) empirical models on economic growth, and (3) conservative economists who criticized the Soviet system. The conservative critique mainly focused on the distorted incentives in the Soviet system that produced inefficiencies. At the time of *Man, Economy, and State*, there were few conservative critics of socialism in economics. Frank Knight, although critical of socialism, did not criticize it from the point of view of economics. In fact, he argued that socialism did not have any *economic* problems, only political problems.[8] Milton Friedman had criticized Abba Lerner's *The Economics of Control* in the 1940s, but Friedman's scholarship was primarily focused on technical issues in microeconomics and empirical issues in macroeconomics.[9] His full-blown commitment to classical liberalism would become more evident in his writings after *Capitalism and Freedom* was published in 1962. G. Warren Nutter's work on

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[7]Yoram Barzel (1989, p. 104n) in his influential book on property rights economics put this point as follows: "The claim that private property has been abolished in communist states and that all property there belongs to the state seems to me to be an attempt to divert attention from who the true owners of the property are. It seems that these owners also own the right to the terminology."

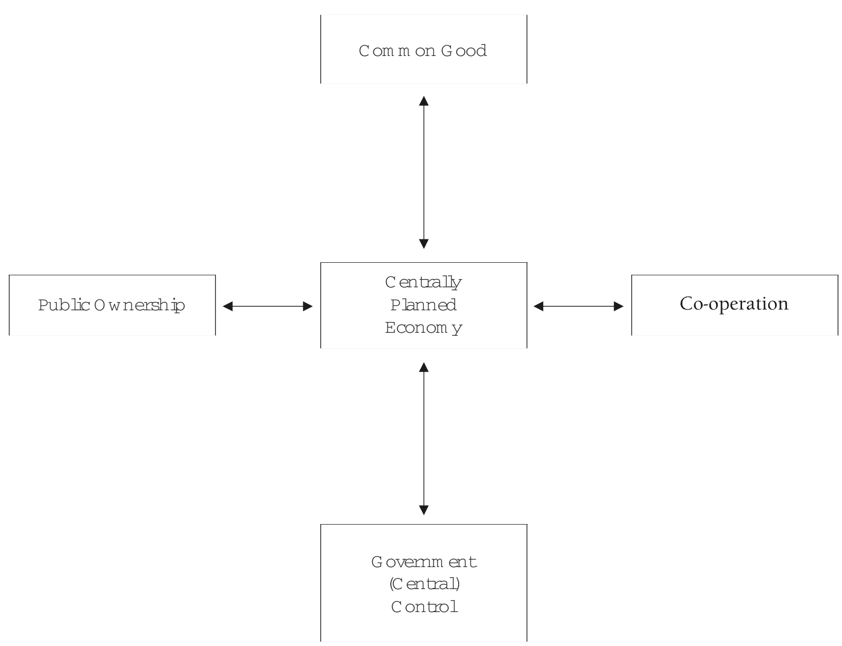
[8]See Boettke and Vaughn (2002) for a discussion of Knight on the problem of socialism and its relationship to the argument against socialism as presented in the body of work by Mises and Hayek.

[9]Friedman's (1947) criticism of Lerner is perceptive in that he attacks Lerner for developing his theory in an institutional vacuum. Thus, Friedman recognized that the mid-century desire to derive an institutionally antiseptic theory of the economic process would run aground and eventually would lead to the counter-reaction in economics that resulted in the literature that now goes under the heading of New Institutional Economics.

the Soviet system was published in 1962, and James Buchanan and Gordon Tullock's development of public choice would also have to wait until the 1960s. Free market economists were in short supply and in a general state of ill repute within the profession in the 1950s and early 1960s.

The economic critics of socialism were essentially limited by the 1950s to Mises and Hayek and their followers, and the profession proceeded as if Mises and Hayek had been soundly defeated in the socialist calculation debate—"the curious legend" Rothbard alludes to in the quote cited earlier. Having dispensed with these naysayers, the economic literature divided into either the microanalytics of planning, or the macroeconomic estimates of growth rates. On the theoretical plane, Soviet planning was said to follow a materials balance approach to economic planning. A simplistic rendering of the ideal of the Soviet centrally planned economy is captured in Figure 1:

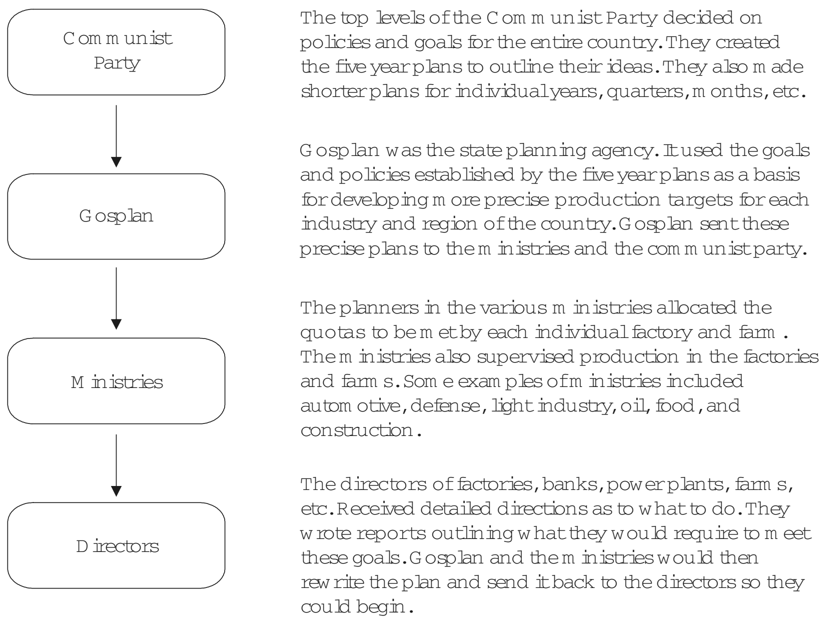
Figure 1
Central Planning



Source: http://www.cssd.ab.ca/tech/social/tut9/lesson7.htm

The material balances approach to economic planning was supposed to ensure that the various stages of planning were coordinated and that resources would be allocated in a way to maximize their use in meeting the objectives of the plan. The planning process that was supposed to operate in the Soviet system is depicted in Figure 2:

Figure 2
Soviet Planning as it was Supposed to Work



Source: http://www.cssd.ab.ca/tech/sohttpcial/tut9/lesson21.htm

Of course, reality deviated significantly from this picture of top down and coordinated planning of the economic system.[10] Planning could not be coordinated so efficiently even under ideal real-world conditions because of the problem of economic calculation. Moreover, once we recognize the "slack" in the system, we have to reorient the way we understand the operation of the Soviet-type economy.

If not an example of the ideal central planning economy, then how would one characterize the Soviet system? Here Rothbard was way ahead of his peers in the economics profession by pointing out the essential elements of a market economy that persisted within the Soviet system and kept it afloat. The work of Paul Craig Roberts (1971), who developed a polycentric understanding of the Soviet system in contrast to the central planning interpretation, serves to illustrate Rothbard's anticipation of those who would write later. Unfortunately, Roberts's work, much like Rothbard's insights, was largely ignored by the profession.[11] The important point for our present purposes,

[10]Boettke (1993, pp. 57–72) discusses the contrast between how the system was suppose to operate in theory with how the system actually operated in practice.

[11]Roberts's work served as the foundation for Boettke's work on Soviet history and the collapse of communism (see Boettke 1990, 1993, and 2001). To the extent that Rothbard anticipated Roberts's work, he also anticipated Boettke's work in this area.

however, is that just as Rothbard anticipated the main lines of argument developed by Lavoie in his critique of the theoretical literature, Rothbard's analysis of real-existing socialism anticipated the main elements in the Roberts understanding of the role of black and different colored markets in Soviet economy.

Rothbard clearly recognized the incentive problems present in the production process. The absurdity of measuring outputs in terms of gross aggregates and not market value provided the incentive to produce larger amounts and quantities of output with no concern for the allocation of resources. Despite the severity of these problems with incentives, the problems with the Soviet economic system were even deeper. The economic planning system attempted to adjust to accommodate for these structural problems and in effect produced a system entirely different from the one the textbooks were attempting to model.[12]

Rothbard's discussion of real-existing socialism points to three factors that are essential for understanding the Soviet economic reality as deviating significantly from the textbook model of central planning. The first factor is the existence of world market prices upon which Soviet planners could rely in formulating their plans. A socialist country existing within a sea of market established prices can buy and sell in, and refer to, the world market. This in turn enables economic planners to "vaguely approximate some sort of rational pricing of producer goods" (Rothbard 1962, p. 831). It is this ability to rely on world prices that prevents any current attempt at comprehensive central planning from collapsing into total calculational chaos.

But the Soviet system did not exist on the basis of world prices alone. The production failures and consumer frustration gave rise to internal markets as well. As Rothbard put it:

> Another neglected factor diminishing the extent of planning in socialist countries is "black market" activities, particularly in commodities (candy, cigarettes, drugs, stockings, etc.) that are easy to conceal. Even in bulkier commodities, falsification of records and extensive graft may bring some sort of limited market—a market violating all socialist plans—into existence. (Rothbard 1962, p. 831)

[12]It is not that incentive distortions do not matter, they do. But as Mises pointed out the problem was deeper than the incentives faced by managers. "Our problem," Mises wrote,

> does not refer to managerial activities; it concerns the allocation of capital to the various branches of industry. The question is: In which branches should production be increased or restricted, in which branches should the objective of production be altered, what new branches should be inaugurated? With regard to these issues it is vain to cite the honest corporation manager and his well-tried efficiency. Those who confuse entrepreneurship and management close their eyes to the economic problem. (Mises 1949, p. 708)

The importance of the black market for understanding the Soviet economy would remain largely neglected until after the system was visibly collapsing. In the late 1980s, the leading textbooks in the field still gave little more than a few pages to the discussion of the black market despite the evidence of its extensive use both internal to the plan to attempt to meet output targets and external to the plan to satisfy consumer demands. And the existence of graft and corruption as a crucial part of the operation of Soviet economy would only become discussed after models of the shortage economy were worked out in detail in the 1980s and early 1990s, even though we can find references in the literature that "blat" was higher than even Stalin.[13]

How much Rothbard anticipated the advances in the field that would occur some 20 years later is evidenced by his discussions of the centrally prohibited economy, the lack of innovation in the Soviet system, and the fallacy of Soviet growth rates. Rothbard's discussion of why the Soviet system is not really a centrally planned one is worth quoting again at length:

> Moreover, it should be noted that a centrally "planned" economy is a centrally *prohibited* economy. The concept of "social engineering" is a deceptive metaphor, since in the *social* realm, it is largely *people* who are being planned, rather than the inanimate machinery of engineering blueprints. And since every individual is by nature, if not always by law, a self-owner and self starter—i.e., self-energizer, this means that central orders, backed up, as they must be under socialism, by force and violence, effectively *prohibit* all the individuals doing what they want most or what they believe themselves to be best fitted to do. (1962, p. 831)

The Soviet system was in essence a prohibition economy writ large. In analyzing a prohibition economy, we can stress one of two things—the force and violence that must be utilized to attempt to enforce the decrees of the authorities, and the failures of enforcement to stop individuals from finding ways to pursue their plans and how the prohibition environment impacts that pursuit of individual plans. On the one hand, we have force and violence and on the

[13]There was a window of opportunity for more "on the ground" research by Western scholars in the wake of the Khrushchev 1956 thaw, and a team of graduate students in political science and economics wrote breakthrough Ph.D. theses taking advantage of this opportunity. In economics, this work is represented by Joseph Berliner (1957) and David Granick (1954) on the organization of Soviet firms. Despite the important empirical findings available in these works, the authors lacked the appropriate theoretical framework to make full sense of the findings. As a result, when the window was closed and opportunities for on the ground research were lost the main insights from this period were dissipated and optimal planning models and/or statistical estimates of growth rates dominated the literature on the Soviet economy. The emigré work of scholars such as Gregory Grossman (1977) would point out how the Soviet system really worked and how it deviated significantly from the model of central planning, but this was not incorporated into the textbook treatment. Even the widely accepted work of Janos Kornai (1992) on overadministration and the shortage economy, while providing concepts which could be found in all textbooks (e.g., storming), would not change the basic textbook model of central planning.

other hand, we have black markets and graft as individuals assume the risk of arbitrary punishment by authorities to pursue their plans and realize their desires. Individuals within this prohibition environment still pursue their plans, but they are forced to do so in a manner that is different from what would take place in an unhampered market environment. Prohibition in the 1920s did not curtail alcohol consumption, but it did create an environment that gave rise to bathtub gin and Al Capone. Similarly, the prohibition of the market throughout Soviet Russia did not curtail market exchange—it just forced it underground.[14]

One of the most damaging consequences of this prohibition environment for the long-term performance of the Soviet economy, Rothbard pointed out, was the detrimental impact on invention and innovation that the attempt at central planning produced. "[I]nventions, innovations, technological developments, by their very nature, by definition, cannot be predicted in advance and therefore cannot be centrally and bureaucratically *planned*" (Rothbard 1962, p. 831). Leaving room for the unforeseen possibilities is not in the nature of planning exercises. In a free market society, what will be invented, when it will be invented, and who will do the inventing remains hidden from us until after the fact.[15] The central planning task, if it is to be coherent, would require

[14]See Rothbard's discussion of triangular intervention for a discussion of these effects (1962, pp. 785–91). Of the many important insights Rothbard has into the economic consequences of interventionism, he anticipated the rent-seeking theory of the Soviet economy developed in the 1990s by Anderson and Boettke (1993; 1997), Levy (1990) and Shleifer and Vishny (1998) when he states that: "The direct beneficiaries of product control, then, are the government bureaucrats who administer the regulations: partly from the tax-centered jobs that the regulations create, and partly from satisfactions gained from wielding coercive power over others" (1962, pp. 785–86). The inevitable emergence of "black markets" in the wake of the prohibition also generates a situation where the control, paradoxically, "is apt to serve as a monopoly grant of privilege to the black marketeers. "For they are likely to be very different entrepreneurs from those who would have succeeded in this industry in a legal market" (1962, p. 786). Rothbard's analysis also addresses the short-term time horizon of investment that black markets generate due to the need to maintain secrecy to avoid legal detection.

[15]Hayek states,

> If there were omniscient men, if we could know not only all that affects the attainment of our present wishes but also our future wants and desires, there would be little case for liberty. And, in turn, liberty of the individual would, of course, make complete foresight impossible. Liberty is essential in order to leave room for the unforeseeable and unpredictable; we want it because we have learned to expect from it the opportunity of realizing many of our aims. It is because every individual knows so little and, in particular, because we rarely know which of us knows best that we trust the independent and competitive efforts of many to induce the emergence of what we shall want when we see it. (Hayek 1960, p. 29)

knowing in advance and planning for technological innovation. Planned innovation, however, is a classic oxymoron. And once we recognize that central planning cannot plan technological innovations, the claims to economic rationalization must be abandoned completely. "Clearly," Rothbard concludes,

> a centrally prohibited economy, irrational and inefficient enough for *given* ends and given means and techniques at any point of time, is all the more incompetent if a flow of inventions and new developments are desired in a society. Bureaucracy, incompetent enough to plan a stationary system, is vastly more incompetent at planning a progressive one. (1962, p. 832)

In the early 1960s, it was commonplace to dismiss known Soviet crimes against humanity and alleged Soviet economic inefficiencies because the central planning apparatus was said to have achieved economic growth such that a largely peasant society was transformed into an industrial society in less than a generation, and this transformation was responsible for the defeat of Hitler in World War II. Soviet economic growth justified whatever sacrifices were made in terms of human rights and consumer frustration. Rothbard did not want to address in full the "hullabaloo that has been raised in recent years over the supposedly enormous rate of Soviet growth" (1962, p. 835). But his short comments anticipated the main line of argument that was later put forward by critics of Soviet growth and effectively challenged the empirical record. The bottom line is that growth was measured incorrectly and the inputs to production were counted while the value of output was not. Nutter (1962) was one of the first to try to put forth a realistic analysis of Soviet economic performance but he had little success in reducing the exaggerated numbers and his own estimates were eventually shown to be high (Roberts 2002, p. 260). Rothbard, clearly realizing the exaggerated growth data, noted:

> Curiously, one finds that the "growth" seems to be taking place almost exclusively in capital goods, such as iron and steel, hydroelectric dams, etc., whereas little or none of this growth ever seems to filter down to the standard of living of the average Soviet consumer. The consumer's standard of living, however, is the be-all and end-all of the entire production process. *Production* makes no sense whatever except as a means to *consumption*. Investment in capital goods means nothing except as a *necessary way station to increased consumption*. (1962, pp. 835–36)

The Soviet system was one of "conspicuous production" where government investment, rather than producing tangible benefits to consumers, "turns out to be a peculiar form of wasteful 'consumption' by government officials" (1962, p. 836).

The scarce capital goods that are allocated based on government compulsion according to some central plan are either wasted or dissipated because the investment is not based on consumer demand and profit-and-loss signals on the market. These investments are malinvestments, and if government subsidization ceased it is unlikely that the investment would be sustained. Rothbard sums up the Soviet situation as follows:

> Capital is an intricate, delicate, interweaving *structure* of capital goods. All of the delicate strands of this structure have to fit, and fit precisely, or else malinvestment occurs. The free market is almost an automatic mechanism for such fitting; and we have seen throughout this volume how the free market, with its price system and profit-and-loss criteria, adjusts the output and variety of the different strands of production, preventing any one from getting long out of alignment. But under socialism or with massive government investment, there is no such mechanism for fitting and harmonizing. Deprived of a free price system and profit-and-loss criteria, the government can only blunder along, blindly 'investing' without being able to invest properly in the right fields, the right products, or the right places. A beautiful subway will be built, but no wheels will be available for the trains; a giant dam, but no copper for transmission lines, etc. These sudden surpluses and shortages, so characteristic of government planning, are the result of massive malinvestment by the government. (1962, pp. 836–37)

Thus, Soviet economic growth was at the same time both overestimated and unsustainable. Surprisingly, the gross exaggeration of the Soviet economic performance continued into the late 1970s and beyond (Roberts 2002, p. 260). In fact, one could still find a positive discussion of the Soviet economy as late as 1989 in Samuelson and Nordhaus's best selling textbook (1989, p. 837).

When one looks at the best modern analysis of real-existing socialism by Andrei Shleifer and Robert Vishny (1998) and the best historical scholarship by Paul Gregory (2003), it is readily apparent to the reader that these authors are building on Rothbardian themes, even if unacknowledged. Shleifer and Vishny's analysis focuses on the "grabbing hand" and the bias within the planning system for shortages. Gregory has dug deep into the archives and used the framework of modern political economy to provide a coherent and comprehensive interpretation of the political economy of Stalinism. In both instances, Shleifer/Vishny and Gregory use concepts first developed by Rothbard. However, these authors (as is the near universal condition) are unaware of Rothbard's ground breaking analysis from the 1950s and 1960s. When one realizes that it took the economics profession more than thirty years to realize and accept what Rothbard had penned in *Man, Economy, and State*, the true greatness of his contribution to political economy becomes evident. Unfortunately, even when these ideas are recognized, they are rarely if ever attributed to Rothbard. We hope to begin correcting this oversight with this paper.

Conclusion

As we have seen, Murray Rothbard's *Man, Economy, and State* was able to present not only the theoretical critique of socialism, but extend that analysis through the application to understand the failings of the real-existing Soviet economy. Rothbard in the early 1960s anticipated *all* the major developments in the analysis of socialism in theory and practice that would be made during the 1980s and 1990s. Rothbard first suggested the reinterpretation of the socialist calculation debate, later championed by Lavoie, which emphasized the dynamic market process as opposed to preoccupation with equilibrium (1962, p. 549). Rothbard also clearly stated the critique of the idea of collective property rights by indicating that such a notion fails to not recognize the control rights that must reside with those entrusted with decision-making power (1962, p. 828). Similarly, Rothbard challenged the very idea of comprehensive central economic planning and introduced the idea of the prohibited economy as opposed to the planned economy (1962, p. 831). The combination of Rothbard's identification of the "owners" in a supposedly collective property regime and his clarification of the main benefactors from the prohibited economy anticipated the rent-seeking interpretation of Soviet planning developed in the public choice literature (1962, p. 786). Rothbard also challenged the interpretation of Soviet growth and argued that it was simultaneously overestimated and malinvested (1962, p. 835).

Given the textual evidence we have provided, there should be little doubt that Rothbard was ahead of his time in terms of articulating the failings of the Soviet system. His analysis is so fresh that we must remember that it was written in the 1950s and *Man, Economy, and State* was not extensively revised when it was republished over the years. But even if we recognize that he anticipated the subsequent developments in the literature, we are left with the question of whether his analysis could have aided the post-communist period? The answer to this question must be an unequivocal yes. One of the biggest problems with the transition period has been a misspecification of the original system. Textbooks described the Soviet type system as one where nobody possessed property rights in the current status quo. Of course, the reality of the situation was as Rothbard described—the main benefactors of the system were those in political leadership. In addition, the Soviet investment structure was malinvested. Thus, the policy implications of Rothbard's analysis would have led to two major themes: (a) homesteading and eliminating government prohibitions to market activity, and (b) eliminating all government restrictions on market adjustments to weed out the malinvestment and reallocate capital into more appropriate uses. In short, the policy advice Rothbard presented in *America's Great Depression* (1963) in the wake of the boom-bust cycle is the same advice that one would get in the wake of the post-Soviet bust.[16] In addition to extending the policy implications from *America's Great Depression*, Rothbard also provided a blueprint for transition economies in "How and How Not to Desocialize" (1992). In that article, Rothbard provides ten "do"

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[16]See Boettke (1993, pp. 106–31) for a wholesale adoption of Rothbard's policy prescription for the post-Soviet period.

and "don't" guidelines for transitioning from socialism to markets. Unfortunately, the political coalitions across the former Soviet type economies resisted many of these policy prescriptions put forth by Rothbard.

Rothbard's *Man, Economy, and State* is a recognized landmark in Austrian economics. Alongside Ludwig von Mises's *Human Action*, Rothbard's book stands as the only systematic treatise in the field. Rothbard guides the reader from the basic principles of the discipline to the refined interpretation of the economic consequences of interventionism. A prime example of the intellectual power of this work is his treatment of the theoretical problems of socialism and the application of the understanding of those theoretical insights to analyze Soviet reality.

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