ECONOMIC REGULATION AND ECONOMIC PLANNING

A Theoretical Classification of Different Types of Economic Control

I. Introduction: The present state of the discussion on government intervention and planning calls for a more uniform terminology and a clear distinction between different types of economic control.

II. Earlier classifications of different types of economic control are summarized and discussed.

III. An economic classification of different types of economic control suggests a distinction between free market economy, regulated economy and planned economy. The criteria of this classification based on economic considerations are analyzed.

IV. Conclusions: Any evaluation of different economic orders requires an approach to economic problems from a broader point of view than that of the market.

I. Introduction

It is probably no exaggeration to say that economics, to a greater degree than any other science, suffers from the lack of an accurate terminology. Even its most basic concepts have no exact meaning, and conjure up, in the minds of learned economists, widely different associations. To illustrate, one need only consider the ambiguity as to meaning of some of the more fundamental economic concepts such as capital, production, labor, money, monoply, etc.

The absence of accurate and uniform terminology seems to be characteristic of a great many of the social sciences—save, perhaps, with the science of law. This no doubt is in part a result of the fact that the social sciences are employing notions and concepts which were used first in our everyday language and were later adapted for scientific purposes. It is, however, astonishing to find that economics as a science, in adopting the language of the layman, has not been able to avoid absorbing into its concepts most of its ambiguities as to meaning found in the latter and that thus far no successful attempts have been made to give these concepts exact and uniform connotations. The dangers inherent in such a state of affairs are obvious. Many controversies in the social sciences in general, and in economics in particular, could no doubt be avoided if the disputants were agreed as to the meaning of the different terms used. No scientific—in fact, no intelligent—discussion can be carried on so long as ambiguity persists as to the meaning of these concepts.

Consequently, unless economics develops a uniform generally accepted language, it may be anticipated that students of economics will continue to encounter great difficulties in their approach to the subject while, at the same time, growing scepticism as to the scientific character of economics will continue apace.[1]

Outstanding examples of ambiguity in economic terms are the words

[1] See *e.g.* Barbara Wootton's recent book, *Lament for Economics* (London, 1938).

"planning" or "planned economy" as applied in discussions of economic policy and state intervention. Every manifestation of state interference with the free working of the economic system has been loosely labelled "economic planning." The communist economy, the fascist economy, the New Deal—in fact every measure to cope with the business cycle has been styled "economic planning." Particularly since the Great Depression a multitude of very diverse proposals for the reorganization of the economic system are discussed under the general term "planning." As a result, the words "planned economy" today lack any definite conceptual meaning. The indiscriminate use of the word "planning" has resulted, as pointed out by the *Annual Report of the Director of the International Labour Office,* in a general confusion of thought in economic discussion.[2]

Since there is little likelihood that the controversy on so-called "economic planning" will be terminated in the near future, it would appear worth while for economists to attempt to draw some distinction between different types of economic control with a view to formulating a more uniform terminology for use in the discussion of economic planning and state regulation of industry and trade. It is the purpose of this paper to suggest such a distinction and to point to some criteria which might be used in classifying different types of economic control.

In the course of the numerous discussions on economic planning, various attempts have been made to distinguish between different types and degrees of economic control. The author before presenting his classification will attempt to summarize briefly these earlier attempts to clarify the concepts of economic planning.

II. Earlier Classifications of Different Types of Economic Control

One of the first classifications undertaken to this end is that of Lorwin. In a preliminary paper prepared for the World Social Economic Congress held under the auspices of the International Industrial Relations Institute in 1931,[3] Lorwin distinguished between four types of economic planning:

(1) absolute socialist;
(2) partial state socialist;
(3) voluntary business;
(4) social progressive.

The *absolute socialist* type "implies a centralized system of economic and social life in which production, consumption, standards of living, and all economic processes are subject to a unified central control and are directly determined."[4]

[2] See International Labour Conference, XXth Session, *Report of the Director* (Geneva, 1936), p. 46.

[3] Lewis L. Lorwin, "The Problem of Economic Planning," in *World Social Economic Planning,* published by the International Industrial Relations Institute, Addendum, pp. 773-798.

[4] *Ibid.,* p. 779.

The *partial state socialist* type, according to Lorwin, is represented by the system of economic planning which exists in the U.S.S.R. Here we find—in 1931—large parts of industry outside of the control and the immediate influence of the state planning board; the consumer receives his income in the form of money and has, therefore, a considerable measure of freedom in determining the manner in which he will dispose of it.

The third type of planning which Lorwin calls the *voluntary business* type was exemplified by the proposals of business-men during the depression. According to these proposals industrial groups should be permitted, for social and political reasons, to exercise some control over the members of the business community and to limit the decisions of the individual entrepreneurs. "The government is to become a greater participant in solving economic problems, but it is to remain subordinate to business in the main functions of guidance and leadership."[5] It is not quite clear to what extent the advocates of the so-called "business type" of planning favor the coördination of the activity of the various industrial groups by means of a general social economic plan.

The so-called *social progressive* type of planning provides for a central economic agency and calls for some measure of redistribution of income in order to increase mass purchasing power. The planning agency would be entitled to exercise some control over the price mechanism, and would have a certain measure of governmental authority, coördinating the activity of the various "boards" set up to deal with the different phases of economic control.

Pollock accepts the aforementioned classification of different planning proposals and, partly in accordance with the notions of Lorwin, distinguishes two principal types of planning: capitalist planning based on the private ownership of the means of production, and socialist planning based on the collective ownership of the means of production.[6] In the opinion of Pollock, all proposals for planning fall somewhere between capitalist planning on one hand and socialist planning on the other.

A still further refinement of these distinctions has been made by Mandelbaum and Meyer.[7] These writers likewise emphasize the differences between "capitalist planning" and "socialist planning." Capitalist planning, according to their classification, is an attempt to eliminate or, at least, to limit free competition while maintaining, however, the free and private disposal of the means of production. On the other hand, the basis of "socialist planning" would be state ownership of the means of production.

[5] *Ibid.*, p. 782.

[6] F. Pollock, "Die Gegenwaertige Lage des Kapitalismus und die Aussichten einer Planwirtschaftlichen Neuordnung," *Zeitschr. f. Sozialforschung*, 1932, p. 18.

[7] K. Mandelbaum, and G. Meyer, "Zur Theorie der Planwirtschaft," *Zeitschr. f. Sozialforschung*, 1934, p. 228 *ff*. An English résumé of this article may be found in *Plan Age*, Oct., 1937, under the title "A Contribution to the Theory of Socialist Planning," pp. 209-216.

These authors further introduce some interesting distinctions between different types of "socialist" planning. First they distinguish "administrative" and "market" socialism. In the case of the former the central authority makes use of direct methods of control so that the mechanism of the market and its functions are replaced by an economic plan, whereas in the latter the central authority resorts to indirect methods and still maintains the ordinary mechanism of the market while modifying and regulating it. Furthermore, there are pure and modified forms of each type.

Another classification which has been suggested by Staley is a delimitation, not of abstract economic types but of concrete economic systems such as have existed or continue to exist today. Staley speaks of a "spectrum of economic systems." The two poles of this spectrum are the "pole of pure free market, price coördination" on the one hand, and the "pole of complete central planning and control" on the other. Between these poles are five different types of economic organization as may be seen from the diagram of the "spectrum" itself.

THE "SPECTRUM" OF ECONOMIC SYSTEMS[8]
ARRANGED ACCORDING TO AMOUNT OF "LAISSEZ FAIRE" AND "PLANNING"

(1) Laissez faire; small-scale, competitive industries; relatively little state intervention; little monopoly
Early nineteenth century, Western Europe and America

(2) Much state intervention; large industries; monopolistic tendencies; some collective ownership
Western Europe and America today

(3) Extreme state discipline of private owners; direction and limitation of investments; "military economy," but private profit and ownership upheld
Germany, Italy, Japan today

(4) State control of "commanding heights," conscious repudiation of private profit and ownership, but much free enterprise permitted as matter of expediency
U.S.S.R. under New Economic Policy (1921-1928)

(5) Basic economic planning; industries state-run; few sectors incompletely collectivized; controlled price system in distribution
U.S.S.R. today

As one moves along this "spectrum" from the pole of free market coördination towards the pole of central planning and control, one seems to move also:

From private property rights in productive instruments towards collective ownership;

From governmental functions confined to policing, "refereeing" and maintaining the framework within which the market system operates, towards governmental management of the whole industrial system;

From relatively distinct political and economic systems connected by a thousand more or less devious ties, towards a merging of economics and politics, at least at the higher levels;

From great decisions that are totalled up from small decisions in an impersonal

[8] E. Staley, *World Economy in Transition*, New York, Council on Foreign Relations, 1939, p. 150.

market and hence appear as the automatic, unwilled result of "blind" forces, towards great decisions that are deliberate, direct, conscious, personal and willed.[9]

Other classifications of different types of economic control have been advanced by H. S. Person, A. Goldschmidt, and the director of the International Labour Office. Drawing an analogy between scientific management in industry and social economic planning, Person distinguishes between directive planning, general administrative planning and operative planning.[10] In our opinion, Person's analogy between scientific management as applied to a single economic unit and social economic planning appears to be of doubtful validity.

Goldschmidt introduces the following "variations" of economic planning:

Static or dynamic;
Conservative or progressive;
Restrictive or expansive.

He then refers to several concrete examples of these different "variations" of economic planning such as the utopian schemes, the economies of the Incas and the fascist regimes on the one hand and Soviet Russia on the other.[11]

In contrast, H. Butler, former director of the International Labour Office, suggested the following classification according to the sectors of the economy encompassed by the different measures of state intervention:

(1) Industrial and agricultural planning;
(2) Control of foreign trade;
(3) Management of credit and currency; and
(4) Social legislation.[12]

In 1936 the *Report of the Director of the International Labour Office* adopted somewhat different criteria for a classification of various types of economic control with a view to overcoming the existing "confusion of thought." The *Report* introduced and contrasted the concepts of "planning" on the one hand, and "directed economy" on the other. "Planning" as defined in the *Report,* "is an attempt to allow free competition to continue to function, subject only to certain general limitations. In its application to industry the initiative is still left to the producers, and the state confines its intervention to legalizing their general will, provided, of course, that it is not inimical to the general interest of the community."[13]

[9] *Ibid.,* p. 151.

[10] H. S. Person, "Nature and Technique of Planning," *Plan Age,* 1934, pp. 4-7.

[11] A. Goldschmidt, "Theories and Types of Planning: Utopian, Fascist, Soviet" in M. Van Kleeck and M. L. Fledderus, *On Economic Planning,* New York, 1935, pp. 18 *ff.*

[12] H. Butler, "Economic Planning and Labor Legislation" in M. Van Kleeck and M. L. Fledderus, *op. cit.,* pp. 44 *ff.*

[13] International Labour Conference, XXth Session, *Report of the Director,* Geneva, 1936, p. 46.

On the other hand, "a directed economy implies the coördination and direction of the whole sphere of economic activity, or at least, of considerable sections of it, by government."[14]

These varied classifications of types of economic control at least indicate a widespread appreciation of the need for a distinction between different degrees of state interference. Moreover, most of these classifications have made for a certain terminological clarification, although none—perhaps with the exception of those of Mandelbaum and Meyer—have been reduced to any degree of scientific accuracy. The prefixing of different adjectives to the general term "planning" (such as "progressive," "conservative," "socialistic," "capitalistic," etc.) does not reduce the vagueness of the term, as long as these adjectives themselves have no generally accepted meaning. Furthermore, if we adopt either moral standards or social objectives as criteria for a distinction of different types of economic control, the latter will be as multitudinous as our moral and social standards and objectives. Of course, one cannot under-estimate the importance of the social implications of the various types of economic planning. On the contrary, we must realize that social implications determine in the last analysis our attitudes toward the various forms of economic control. For group attitudes reflect primarily the hopes or fears of such groups as to the social and economic advantages to be lost or gained under the different types of economic organization.

However, for the purposes of economics what is needed is a distinction based on economic considerations. Only such a classification should be adopted as the basis of accurate and scientific terminology in economics.

III. An Economic Classification of Different Types of Economic Control

Scientific concepts do not exist outside of, and independently from, our reasoning. As Amonn put it, we cannot "discover" these concepts nor do we "find" them. We "make" them or rather we "form" them according to our scientific purposes.[15] We cannot ask what is "economic planning" or what is a "regulated economy" because none of these word combinations has any accurate meaning. We cannot establish scientific concepts by analyzing words, although in some cases such a procedure may be of considerable help for scientific delimitations.[16] The only method we can adopt is to classify the various types of economic organization and then to suggest a terminology which describes their essential characteristics in the clearest manner.

The most convenient starting point for any such classification is the free

[14] *Ibid.*, p. 45.

[15] A. Amonn, *Volkswirtschaftliche Grundbegriffe und Grundprobleme,* Jena, 1938, p. iv.

[16] F. Wieser, "Die Wissenschaftliche Bedeutung der Sprachbegriffe" in *Gesammelte Abhandlungen,* ed. F. A. Hayek, Tübingen, 1929, p. 1 *ff.*

market economy, that economic order which we are accustomed to call the capitalistic system. The free market economy is said to be based upon the institution of private property or at least upon individual control over the means of production. All other features of this system such as freedom of enterprise, freedom of exchange and freedom of contract may be regarded as merely different aspects of this fundamental right of private property.

This economic order which is characterized by private control over the means of production is regulated by the market, or the prices of the market. In fact, no other regulator appears to be necessary since the market under perfect competition adequately fulfills its regulatory functions. Any gap between supply and effective demand can be expected to find its expression in rising or falling prices; and the private entrepreneur, on the basis of these indications, will act, in his own interest, in such a way as to bring about a new equilibrium.

Consequently, in the free market economy, the state is expected to abstain from any interference with the functioning of the economic system. That is, the rôle of the state is to be a negative rather than a positive one. Its positive functions are limited to the protection of the property and other rights of the citizens. These as well as other tasks (such as public administration, the settlement of disputes, national defense, etc.) are fulfilled by the state with the help of funds raised by an appropriate tax system.

It is hardly necessary to emphasize that state interference with the economic activity of individual entrepreneurs has always gone beyond the confines of the aforementioned positive functions. Throughout the nineteenth century the state maintained and gradually increased its interference with the free market economy, especially in the fields of foreign trade, money and credit and social legislation. Protective tariffs, changes in the discount rate and the reduction of hours of work as well as the restriction of woman and child labor have characterized this development.

In spite of the various controversies regarding free trade and central banking and despite the criticism which was levelled against social legislation, most of these measures have now been accepted as not being fundamentally opposed to the working of the free market economy. Even the bitterest critic of state intervention would probably not maintain that the social legislation of the nineteenth century and the tariff and discount policies up to 1930 have destroyed the free market system—especially not if we consider the more recent methods of state intervention.

Since 1930 the degree of state interference has gradually changed. Mainly as a result of the Great Depression the state in all countries has assumed a much more active rôle in things economic. But even before 1930 we had the gradual development of trade associations and combinations of industrialists designed to influence market supply. Labor organizations and collective bargaining likewise developed with a view to interfering with the free labor market.

After 1930, state intervention constantly increased, partly as a temporary means of moderating the social and political consequences of the depression and partly with the intention of introducing certain fundamental changes into the economic system. No thorough analysis as to the effects of these new methods of state intervention upon the economic system as a whole has as yet been made. However, it appears to us that these measures are fundamentally inconsistent with the free capitalist market economy. While the market has by no means lost its significance, government in many cases has assumed its functions. Particularly significant has been the increase by the state of quantitative control over the processes of production. The fundamental differences between these quantitative regulations and earlier methods of state interference can be demonstrated best by examining practical examples.

The substitution of the modern quota system for the old method of levying import duties, for example, has meant that the market has lost its regulatory functions. Import duties merely led to a rise in prices without, however, determining directly the quantities to be imported. Thus, the market continued to function as the regulator of imports and exports. Private importers and exporters continued to decide how much was to be imported or exported. No further intervention by the state was necessary or desirable under these conditions.

With the establishment of an import quota system the situation is changed. It is no longer the private importer but rather the state who decides upon the quantities to be imported. In other words, fixing import quotas makes the proper functioning of the market impossible. Consequently the "automatic" regulation of the market has to be replaced by other methods of distribution. Thus, the setting up of a quota system must necessarily be supplemented by an appropriate method of allocating the fixed amount of imported goods among the different commercial units. Various methods for dealing with this problem have been adopted in several states. In some cases, the total quota has been distributed among the various wholesale importers according to the relative magnitude of their imports in previous years. In other cases, each firm received simply a fixed percentage of the total.[17] In neither instance, however, is the total quota allocated according to the forces of the market; in fact, market indicators are ignored.

Another case of quantitative regulation of international commodities transactions arises out of the system of foreign exchange restrictions as practised in many European and South American countries. The German

[17] Another method would be to sell the quota at public auction; see for this discussion G. Haberler and S. Verosta, *Liberale und Planwirtschaftliche Handelspolitik*, Berlin, 1934, p. 88.

system of bartering in foreign trade is also a development in complete opposition to the established practice of buying in the cheapest and selling in the dearest market. In all these cases the question how much shall be imported is not determined by the conditions of the market but by the authority of the state. Similarly, the regulation of production by producers' organizations or the state, the compulsory closing of enterprises, the restriction of acreage in agriculture, the nationalization of whole industries, involves likewise quantitative regulations of industry and trade which not only hamper but actually destroy the working of the market. In all these instances, and in many others, not the market but state authorities decide the important question how much is to be produced and who is going to produce it. From the point of view of the market economy these quantitative regulations have been said, therefore, to be fundamentally incompatible with the free market mechanism.[18]

Although it is not always easy to determine whether a particular act of state intervention is of a quantitative nature, it seems to us that there is no better criterion for distinguishing between different types of economic control than by a classification according to their compatibility with the free market economy. In fact if it is clear that only indirect measures (such as the levying of import duties, changing of the discount rate, etc.), are compatible with the proper working of the market mechanism, one is justified in speaking of a special type of economic control whenever the intervention of the state becomes of a direct and quantitative nature. In all such cases, the economic policy of the state can no longer be considered as being consistent with the free market economy.

The theoretical and practical value of this logical distinction is not affected by the difficulties involved in classifying a particular example of state intervention. This difficulty is partly due to the fact that no systematic attempt has been made to study the nature and the economic significance of the more important measures of modern state economic policy.[19] Nevertheless it is possible to advance the following systematic classification of different measures of state economic control according to the aforementioned criteria:

I. Measures which are *compatible* with the free market economy:
   1. Import duties;
   2. Most monetary measures such as open-market operations, changes in reserve requirements, active discount policies, etc.;
   3. Labor and social legislation such as laws prohibiting or restricting child and woman labor, general reduction of hours, general provisions for public health and welfare, social insurance, etc.;
   4. State encouragement of collective bargaining in so far as the supply of labor is not regulated by labor unions;

[18] G. Haberler and S. Verosta, *op. cit.*, p. 99.

[19] There is, however, one very interesting study which examines different methods of state intervention and their economic implications. See R. English, *Regulierte Wirtschaft*, Prague, 1936.

5. Immigration laws of a general nature;
6. The levying of taxes by the state to perform the above and incidental functions of the state.

II. Measures which are *incompatible* with the free market economy:
1. Import and export quotas;
2. Foreign exchange control;
3. Qualitative credit policies by which the monetary authorities influence not only the quantity of money in circulation but also attempt to determine the uses to which the money is put;
4. Direct regulation of production by:
   (a) Cartels and other producers' organizations, especially if these organizations are created by the state;
   (b) Compulsory closing of enterprises including the restriction of acreage in agriculture;
   (c) Direct regulation of prices—in this case prices are fixed and supply and demand have to adjust themselves to fixed prices, while in a free market prices are a direct result of the interaction of uncontrolled forces of supply and demand;
   (d) Public works expenditures, at least in so far as they are used with a view of directly regulating a particular field of production;
   (e) Nationalization of some sectors of the economy;
5. Regulation of the labor supply by the introduction of compulsory labor service, immigration quotas or the complete prohibition of migration.

It is likely that further investigation into the economic implications of other methods of state intervention will increase the list of quantitative measures. Their common characteristic is that they restrict the freedom of the entrepreneur, the use of his private property and his "right to do business" in a way quite different from the first named measures which only indirectly interfere with the working of the market. It is conceivable that these quantitative regulations of the activity of the entrepreneur may develop to such an extent that they will materially undermine the institution of private property, even if this right is nominally still maintained.

If this development is carried to its extremes, private control over the means of production may even be replaced by a system of complete state ownership of the factors of production so that ultimately the whole economy will be controlled and directed by the state. State decisions would then replace the private decisions of individual entrepreneurs. Managers of single economic units would more and more act as organs of the central authority and thus become state officials. In such a system the central political authority would assume the rôle played by the market mechanism in the free market economy. The regulation of production would probably have to take place according to a preconceived plan which would fix, at least for a given period, the quantities to be produced and indirectly the quantities to be consumed.[20]

[20] Theoretical analysis of such an economic order has not yet been fully developed. Recent discussion of the economic implications of such a system, however, seems to have brought to light that even this economy would have to rely upon certain market indications—although the market would have to be greatly modified and would hardly be comparable with the free market of the capitalistic order.

It is now possible to distinguish between different methods of state control and different systems of economic organization: As long as state interference with the economic system merely attempts to influence indirectly the working of the market, no structural changes are introduced into the free market economy. Even if the state goes further and tries to regulate production—for example in conjunction with producers' associations—by setting up production quotas for a limited number of commodities, the market will still continue to function at least outside these sectors of the economy. Such measures, therefore, may be considered as a partial suspension of one single market rather than the abolition of the free market economy.

If, however, these and other quantitative regulations become more and more general, the free market economy will be gradually destroyed and abandoned. Private control over the means of production will be supplanted by state regulation of production and distribution. This does not necessarily mean that the different regulations will be coördinated with each other; for, even if the government bases its policy upon some sort of economic program, it hardly seems possible that the state, under a system of quantitative regulations, will be able to act according to a well coördinated and consistent plan. On the contrary, recent experiences have shown that the state, for political and other reasons, might be forced to adopt measures of economic policy which are inconsistent with each other. Moreover, it must be remembered that private enterpreneurs will continue to exist and to make decisions of their own. As long as this is the case—and such is the case with the imposition of quantitative regulations—the establishment of a central and coördinated economic plan for the total economy is impossible or at least will be constantly exposed to the decisions of independent entrepreneurs.

Therefore, an economic order in which quantitative regulations prevail (that is regulations which are incompatible with the free market economy) may be referred to as a "Regulated Economy"; and an economic system in which all economic processes are subject to a social economic plan conceived and elaborated in advance may be described as a "Planned Economy."

The essential characteristics of economic regulation as defined above may then be summarized as follows:

1. Quantitative regulations of industry and trade.
2. Absence of a consistent coördination of the various regulations by a general economic plan covering the whole economy.
3. Gradual abandonment of the market as a regulator of production and distribution.

Economic planning on the other hand would be characterized by:

1. State ownership of the means of production.

2. The fact that the central political authority—the state—acts as the highest economic authority.
3. Direction and control of production and distribution according to a general economic and social plan.

Conclusions

Up to this point we abstained from entering into the much debated controversy respecting the advantages or disadvantages of one or another form of economic organization. Such a procedure was purposely pursued because, in our opinion, it is only in this way that one can avoid a course of reasoning which consciously or subconsciously is directed by preconceived ideals and ideologies.

On the other hand it would seem that the economist as a social scientist is not entitled to adopt a passive attitude in these controversies. After all, the economist is the one person equipped with the knowledge requisite for an intelligent discussion of our economic problems; and it would be an uneconomic utilization of our resources to provide for the wherewithal and the training of economists, if these persons, after ten or more years of study, declared that they could take no stand as to the best method of organizing the economic life of society.

It is in appreciation of this obligation of the economist toward society that we venture to conclude this classification of the different types of economic control by setting forth a few theoretical considerations respecting the advantages and limitations of the various forms of economic organizations.

Modern economics looks upon the equilibrium of a free market as the optimum solution of the economic problem, inasmuch as the utilization of the scarce means at our disposal will be such (at the equilibrium point) that no part of our limited resources will have a higher want satisfaction power in other combinations (that is, if they were used for the production of other goods). In other words it is maintained that at the equilibrium point, we obtain a maximum of want satisfaction from every part of our limited resources. Knight summarizes this principle of equi-marginal returns in the following words:

> A freely competitive organization of society tends to place every productive resource in that position in the productive system where it can make the greatest possible addition to the total social dividend as measured in price terms.[21]

This is the fundamental reason for the belief of many economists in the superiority of the free market economy over any other form of economic organization. In fact, if it is true that the equilibrium reached in a free market offers the optimum solution of the economic problem—namely, the optimum result from the utilization of scarce means in the process of

[21] F. H. Knight, *The Ethics of Competition and Other Essays,* New York and London, 1935, p. 48.

satisfying competing wants or ends—then, of course, any interference with the free market must fall short of this optimum solution.

But the question is does a free market supply us with the optimum solution of the economic problem? We do not think so, or at least have reasons to doubt that such is actually the case. Of these reasons some are generally accepted while the validity of others is still seriously questioned.

Among those more or less generally accepted reasons which make even the free market appear at least to be a doubtful regulator of the economic processes are:

1. The fact that imperfect competition even in a market which is not subject to any governmental interference leads to an "equilibrium" which falls short of the optimum solution of the economic problem.
2. The fact that only effective demand (namely, that demand which is backed by purchasing power) finds its expression in the free market. Therefore the equilibrium point reached in a free market is an optimum solution of the economic problem only in terms of the present distribution of income. If the society were to decide upon a re-distribution of the total income we should have a different utilization of our resources and a new optimum point.

The second group of arguments which may be advanced against the hypothesis that the free market offers the optimum solution of the economic problem, centers upon the fact that the free market at best is only inadequately equipped to measure social losses and to supply the means for the satisfaction of social ends and objectives.

The first of these shortcomings of the free market is made clear by the following considerations: In the free market economy the utilization of resources is economic for the private entrepreneur if and whenever output returns exceed input costs. For in the free market economy any utilization of the scarce means is justified whenever the price paid for the product at least covers the costs of the resources utilized. But does this necessarily mean that such a process of production is justified from a social point of view? Does the utilization of resources which is profitable according to the indicator of the free market mean that their utilization is economical from the point of view of the society? Does the free market measure the social losses which may result either from the processes of production or the products themselves? We need only to point to such problems as soil exhaustion, deforestation, erosion, floods, overcrowded cities, bad working conditions and the resulting effects on health, in order to make clear the implications of this question. The huge expenditures of states arising out of these great social problems must be considered as the social losses of past processes of production which doubtless were profitable and therefore "economic" from the point of view of the entrepreneurs of twenty or thirty years ago. We cannot blame the private entrepreneurs of the past for these losses, but we are forced to conclude thereon that the free market economy does not supply us with any accurate criterion for measuring the social losses and disadvantages of a particular economic activity.

The proposition that the free market economy is only inadequately equipped to supply the means for the satisfaction of social ends and objectives may perhaps best be explained by the following examples: Suppose impartial investigation brings to light serious deficiencies as regards existing housing conditions, or indicates a lack of the most elementary educational or medical facilities within a given country, or points to a state of malnutrition among large parts of the population; suppose further that there is widespread agreement that it is highly desirable to provide for better housing conditions, for improved medical and educational facilities and to secure satisfactory diets. Yet the free market economy would not bring about these generally desired changes. On the contrary, the utilization of the available resources would continue to be such as to produce goods for the satisfaction of wants which might be regarded as socially less urgent than the aforementioned. In these and many other instances it appears therefore that the free market economy definitely leads to an uneconomic, if not wasteful, utilization of resources, a utilization of resources which, in all probability would already have proved disastrous had the state not decided to replace gradually the market economy by a system of more or less consistent regulations.

It is for these reasons that we do not agree with those who consider that the free market economy under all circumstances offers the optimum solution of the economic problem. Of course, we realize that it is always difficult to agree upon social objectives and that whenever a society is governed by a minority, as in the case of a dictatorship, social objectives are likely to serve the purposes of the minority rather than the real interests of the people. In such cases the objectives of the state might find their expression in imperialistic expansion, military aggression and the economic and social oppression of the majority. If, however, the social ends are the objectives of the majority and are formulated in a democratic way, they will in all probability serve the interests of the people and will find their expression in a higher standard of living for all concerned.

At any rate, it seems to us that economics, and the economists, can no longer escape the necessity of considering economic problems from a broader point of view than that of the individual. Once we are willing to approach the problem of the utilization of limited resources from a social point of view, we shall definitely realize that production according to the dictates of a free market cannot give us a maximum of want satisfaction from every part of our resources. Such an approach would also show that we need not share the pessimism of those economists who fear that economic regulation and economic planning are necessarily bound up with an irrational, uneconomic and wasteful utilization of our resources.

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