

Déjà Vu

Branko Horvat's "New Approach"

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In his inaugural lecture at the London School of Economics in 1933, the Austrian economist Friedrich Hayek observed that some of his colleagues suffered from "an intense urge to reconstruct the world," which caused them profound dissatisfaction. For the next sixty years, Hayek continued to urge social scientists to resist this urge, but to little avail. Driven by what Hayek later called the "scientific mentality," many persisted in formulating plans for ideal societies.

The efforts of Branko Horvat, an economist from the former Yugoslavia, are typical and instructive. Horvat's writings display a boundless trust in his ability to discover the just economic order and his desire to organize human existence scientifically in order to usher mankind into the economic paradise he sincerely believes could be just around the corner. Fifteen years ago, in *The Political Economy of Socialism*, Horvat boldly presented workers' self-management socialism, as practiced in Yugoslavia, as the only humane politico-economic system. In an interview, which I remember reading at the time in Yugoslavia, Horvat expressed his conviction that the book contained the ultimate in economic wisdom, and he anticipated his nomination for the

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Nobel Prize in economics.

As his hopes for the Nobel Prize faded and his real-life model slid into financial bankruptcy, Horvat decided that the time was ripe for another book. Deploring “the present [economic] paradigm” of capitalism, he sought a “new [economic] paradigm” that would “hopefully elevate [economics’] scientific status” and, at the same time, provide a basis for reforming the unjust and wasteful capitalist system (Horvat 1995, 257). Eventually, in 1995, he brought forth *The Theory of Value, Capital and Interest: A New Approach*.

Horvat’s Old Approach

To understand Horvat’s present dissatisfaction with the world, some of his political and economic conclusions of 1982 must be recounted. In his previous book, he announced at the outset that he intended “to accomplish what Marx called for in his famous thesis on Feuerbach: to change the world, not just to explain it” (Horvat 1982, xiii). He aimed to create “a truly socialist society” (4). Life-long research in economics had led him to “this simple truth”: capitalism is the problem of human society, and capitalism cannot be repaired. “In order to eliminate the basic shortcomings of capitalism, it is necessary to eliminate—occasionally to destroy by force—capitalism itself” (4). The “basic” shortcomings from which capitalism incurably suffers are competition, which gives rise to monopolies; lack of planning, which fails to ensure sufficient aggregate demand; reification, which produces a society in which humans are treated as things; and last but not least, waste, which lowers everybody’s standard of living.

At the same time, Horvat found “etatism,” state socialism as practiced in the Soviet Union and its Eastern European satellites, equally unappealing. Although superior to capitalism (“in etatist societies the broad masses live longer, receive more education, and enjoy much better medical care” [49]), it created alienation among workers, unnecessary human suffering, and much waste (though not as much as capitalism). Begrudgingly Horvat admitted that central planning, a corollary of etatism, must founder because central planners simply could not know enough to direct the economic life of a country.

The solution came to Horvat as a self-evident truth: self-management socialism, which had been practiced in Yugoslavia for almost three decades with, according to Horvat, only minor problems, was “not a utopian dream but a realizable project” (174). All that was needed to eliminate its problems and achieve its full potential was “a good theory,” which Horvat promptly offered. Confident that his system could easily achieve what Hayek had believed unachievable, he decided not to leave Hayek’s “challenge

unanswered" (577).

He proceeded to advance an improved version of Marxism: "Horvatism." This theory rested on "social," not state, ownership of the means of production; on autonomous firms that would "truly" compete in the market; and on workers who would freely use their ideas and knowledge to lift their standard of living. But self-management would not be limited to firms; it would pervade all parts of society. Through an *ex ante* plan composed by "social" planners, the political apparatus would provide the data needed by the workers to manage their firms and make correct decisions. Everything else the people would decide for themselves.

Horvat's "improvement" over the alternative systems, capitalism and etatism, thus consisted of two ideas: "social" planning is superior to central planning, and workers as managers need not suffer from either the chaos of a *laissez-faire* market or the authoritarianism of central planners. Horvat's main theoretical contribution to economic science consisted of his economist-kings: the social planners of the socialist *avant-garde*, who know everything, can predict potential problems, and, should the workers make an occasional mistake, will provide an immediate solution for every temporary problem.

Such "a truly socialist society," with free, self-managed workers and incorruptible social planners, Horvat believed, would raise social responsibility to such an unprecedented level that losses due to market failure would become practically impossible. That society would also prove that a planning system could be democratically governed. The resulting feeling of overwhelming moral superiority, along with a higher standard of living, would make everybody willing to fight for such a society.

Horvat versus Reality

By now most people know what happened to the only country that tried Horvatism. Far from bringing about a paradise, this system simply degenerated into the very chaos Hayek had predicted. Although the people of the former Yugoslavia have done plenty of fighting, they have not been fighting for Horvat's utopia.

Horvat himself spent most of the civil war years in the security of American academe, teaching economics and doing research.¹ The time spent in the United States "helped [Horvat] to eliminate certain ambiguities and simple errors" in his thinking (1995, xii), and the result is this latest

1. In the preface of *The Theory of Value, Capital and Interest* (1995, xii) he admits that he "was kicked out from the University" of Zagreb, without specifying whether the new government of Croatia or the new administration of the university terminated his teaching career.

book, an exercise in wishful thinking par excellence.

Encountering the title of Horvat's new book in a catalogue, I was naturally curious. I had lived in Yugoslavia for forty years, and worked for almost fifteen years as a government auditor, watching the system crumble from the very beginning. I was intrigued by Horvat's subtitle, "A New Approach." Was the book Horvat's vehicle to confess his ideological mistakes, declaring them publicly to the world he had misled so badly? My hopes for his conversion were soon shattered. Horvat definitely remains...well, Horvat.

Horvat's New Approach

In his *Political Economy of Socialism*, Horvat attempted to be a sociologist, a political philosopher, an economist, a moral philosopher, and above all, in his own words, a scientist trying to provide an "integrated, all-inclusive view of reality." In *The Theory of Value, Capital and Interest*, he tries to be only an economist and, to a lesser degree, a moralist. Despite this narrower role, he remains the prisoner of his old paradigm. In the guise of offering a new "rigorous theory of value and of prices," Horvat still strives to demonstrate that we need a "normative theory" that will allow society to achieve "an optimal allocation of resources" with "fully synchronized development in which at every period of time the quantity and structure of supply just matches demand of the fully employed labour" (255–56).

Because "the logical foundations of the mainstream theory are shaky or unsustainable" (256), Horvat argues, we need a "new paradigm," one that "treats economy as a system, which must be designed properly in order to function efficiently" (267). In order "to maximize the economic welfare of the population," we have "to maximize the production of consumer goods," and this goal cannot be left to haphazard forces of the market (11). Fortunately, Horvat knows exactly who can design a system that meets the stated objectives.

Why does he so quickly declare the mainstream "neoclassical" economic model wrong? First, because the neoclassical paradigm puts too much faith in the market and, second, because it rests on a "misleading scarcity hypothesis" (14), a theory of "basically inconsistent" individual preferences (19), and a very unsatisfactory capital theory (21).

Horvat's bases his "new approach" on "the overriding social preference," namely, full employment. This is "the focal point" of his value theory because "[f]ull employment means full use of resources that will eventually make everybody better off" (19). Society may blossom by learning how "to determine the quantity of labour embodied in commodities in order to

allocate them optimally" (27).² "Unlike the scarcity theory, with its unmeasurable subjective utility, the labour theory is able to use an objective measure" (32). And the objective measure is—you guessed it—the time spent producing a good!³

Although the market, Horvat concedes, may be an institution that brings producers and consumers together, it "is not perfect even if prices are treated parametrically, and whenever it fails, 'hand regulation' becomes necessary. The social planning agency intervenes" (11). Here we see the whole purpose of Horvat's new book: to remind people of the most important innovation in his *Political Economy of Socialism*, the idea of social planning.

The same social planners who were supposed to have made a paradise of Yugoslavia, their omniscience and wisdom obviously beyond question, are now expected to play their roles in a "capitalist" society. This time they should make certain that goals the market can never achieve by itself—eliminating market imperfections and keeping the economy on the targeted track—are achieved with their altruistic help. The "new" Horvatism therefore retains the old presumption that because private ownership always results in inefficient organization of the economy's production, planning is a precondition for an efficient market.

From time to time, moral preaching reinforces the plea for planning. Still convinced that only the abolition of private property in the means of production can abolish the anarchy of the market, Horvat argues that poverty and scarcity in general would disappear in a system where people forget their selfish ambitions. His "normative theory" speaks to hearts as much as minds. He repeatedly reminds the reader that "workers are not commodities" (29); they are "not just one of the factors of production" but "the source of value" (31), and as such they must enjoy "a unique position in the economic process" (27). Full employment is "an overriding social value...because it maximizes the life satisfaction" (11). The moral value of social planning arises from the fact that "increasing employment increases welfare" (20).

Horvat's explanation of his model is an exercise in what Hayek called "constructivist rationalism." It would take too long to explicate all of his hopeless mathematical acrobatics. He assures the reader that in his model the "best techniques are applied while consumers' preferences are respected"—forgetting that he himself called those preferences basically inconsistent—so his goal can be achieved; there can be no misallocation of

2. Horvat fails to identify this condition as Engels's dictum in *Anti-Dühring* (1878).

3. Later in the book Horvat likens economics to physics. Measurement in economics, he asserts, is no more complicated than measurement in physics.

resources in his model. After solving his equations, Horvat always reaches conclusions that are “logically consistent,” “obvious,” “easy,” “straightforward,” “simple,” and “socially desirable.”

In Horvat’s model the creation of wealth is more or less a technical process within which economic experts plan, forecast, and realize a series of causes and effects. Horvat views economic actors such as entrepreneurs, innovators, and capitalists more as obstacles than as wealth creators. Entrepreneurs, who do not appear in the book’s subject index, may be the engineers of growth for most economies in the world, but they get no respect from Horvat; for him, they’re merely people whose only goal is “to maximize profits” and reach “a comfortable level of living” (125).

Unlike the *laissez-faire* market, the economy based on Horvat’s model would, “because of reduction of uncertainties and market failures” (257), experience few changes and practically reduce decision making to choosing the right set of equations. Therefore, even intertemporal allocation, which may puzzle the rest of us, is simple for Horvat: “In any period the available financial means are exactly equal to the full employment gross investment. In this sense financial assets match real assets and make possible unimpeded reproduction under optimum allocation of resources” (254). The trick is to remember that “labour is always exchanged for the same amount of labour either in simultaneous or intertemporal transactions” (255).

Horvat never explains how participants in the market, including the social planners, get information about the problems of particular companies or whole industries. Horvat’s theory notwithstanding, the information that they must use to guide their activities is neither simple nor straightforward but, as Hayek repeatedly emphasized, vast, detailed and, most important, incomplete. In the real world, Yugoslavia went bankrupt partly because the country’s self-managing workers and social planners were so inundated with “data” received from their own companies, government statistical agencies, and even international agencies that their repeated mistakes, macroeconomic and microeconomic, finally produced total chaos. In the end, everybody in Yugoslavia knew that the quality of the “data” was so poor that it was impossible to depend on any of them, especially as the government itself encouraged the managers and statistical agencies to falsify numbers, partly to appease the population and partly to justify foreign loans that became the sole source of survival.

Sheer waste and resource misuse in Yugoslavia, well known to Horvat while he was writing both of his books—in his preface, he brags about holding for years “a position in the Federal Planning Bureau in Belgrade” (ix)—should have put a speck of doubt into his mind about the feasibility of his model. That he continually refuses to admit the facts speaks volumes about Horvat’s propensity for utopianism. Back in 1940, Hayek was

dismayed that anyone would "suggest that...such a [market socialist] system will ever even distantly approach the efficiency of a [decentralized private-property market] system" (Hayek 1948, 187). The abysmal failure of self-management socialism in practice proved Hayek right. But Horvat continues to believe that his system is not only economically more efficient but morally superior.

Fundamental Unanswered Questions

The reader of Horvat's book confronts two problems. One is the gnawing feeling that consumers exist in his model for the sake of producers, so the latter can be paid just wages and reach a higher standard of living, which for Horvat means simply a stable, well-paid job. Although Horvat equates economic welfare with the production of consumer goods, the consumer in his model must take the back seat when decisions about prices, quantities, and qualities are considered. From the outset, Horvat rejects the idea that only the satisfaction of consumers can validate the success of all economic activities.

Further, Horvat continues to misunderstand the competitive nature of a market economy. He fails to grasp the economic reasons for competition as a dynamic discovery process for screening ideas, talents, ambitions, and skills; as a process of entrepreneurial adjustment to constant change, where ignorance, blunder, and uncertainty confront all actors; and most important, as a process in which alternative options—misleadingly described as "given" to entrepreneurs—are never clearly defined nor future outcomes fully foreseen. Consequently, he cannot understand that producers must concern themselves primarily with how to satisfy consumers' demand, not how to calculate a "just" wage, a "right" cost, or the "right" amount of investment. Horvat refuses to accept the subjective nature of economic progress, the reality of the market as a process in which the question, "Who is to produce what?" cannot be answered a priori but must be solved through the competitive efforts of producers constantly improving their products through innovation, lower costs, and higher productivity. Horvat seems to abhor the very thought that profit seeking could be the key coordinating mechanism in an economy.

In his own eyes Horvat has solved the calculation problem raised by Ludwig von Mises in the early 1920s. Refusing to see Hayek's "marvel of the price system," Horvat divides prices into absolute and relative prices, efficient and standard prices, thus missing their main task. As Karen Vaughn (1980) has written, echoing Hayek, market prices "are the result of transactions among individuals with unique and fragmented knowledge and are a means by which this decentralized knowledge is coalesced into a coordinated

whole. To try to summarize all this information into a set of simultaneous equations would be quixotic at best” (546). The “data” in any economy, free market or socialist, are never “given” but subject to continuous discovery. Mises ([1949] 1966, [1922] 1981; see also Ebeling 1993) and Hayek (1935, 1944, 1988) warned people such as Horvat that in a world of constant change, their systems are doomed to chaos.

To lay claim to a new paradigm, Horvat must ask different questions and provide different answers. The questions asked and the answers given in his book are not new. If “[e]conomics is a branch of praxeology, the general theory of efficient action,” and “pure economics turns out to be applied praxeology,” as Horvat himself notes (1995, 3), then the question should be: Why should social planners know what is the best for acting people or the economy as a whole? Can Horvat really believe that his answer, that fully employed people are satisfied people, settles the debate?

Another question: If all action is speculative, and if it is difficult to foresee the consequences of specific actions, especially the unanticipated ones, what should social planners do when they fail (as they did) in steering the society? The most carefully laid plans may and do go awry. Should the planners admit their mistakes and ask another set of planners to take their places, or should they admit no fault and fire all the managers in the self-managed companies, or even the workers themselves, for not following the planners’ recommendations?

What happens when the planners themselves disagree about the desirability of future actions (ends)? To whom can they turn for advice? Horvat never suspects that his “social” planners may go wrong, so he gives them no emergency exit. Is he aware that the likely end of his system is civil war? If, as he thinks, a *laissez-faire* market doesn’t work—“and that is amply demonstrated by economic history” (19)—then what does history, in particular the history of Yugoslavia, tell us about his model?⁴

One could go on at length raising such questions. Again, I not only lived in his system; I audited it. The important point is that Horvat is so busy explaining his “pure theory” that a reader who knows little or nothing about him would never suspect that he was one of the “social planners” directly responsible for one of the most disastrous economic failures of the twentieth century.

Conclusion

In his “new” approach, Horvat only constructs a quasi-mechanistic system

4. In the chapter on methodology, Horvat warns the reader that “a single adverse effect is not a sufficient reason for the rejection of a theory” (5). How many Yugoslavias does he need to refute his theory?

that conveniently hides his old aversion to free enterprise. His old dream—to design society “scientifically,” that is, to bring it under the control of wise, dedicated, honest, and altruistic social planners—lives on. Looking at the world through Marxist lenses, Horvat still rejects entrepreneurship as a solution and continues to place his hope in a *deus ex machina*: social planners with good intentions, omniscience, foresight, and omnipotence in bringing about their desired results. In contrast to Hayek, Horvat truly believes that the “data” can guide social planners in choosing among different options for growth and development. Thus, his “old” approach still haunting him, his theorizing sinks deeper into confusion.

Ludwig von Mises summarized such writing best. In *Human Action*, Mises called all future Horvats “rationalistic romantics”:

Whether they call themselves Marxian or non-Marxian socialists, technocrats, or simply planners, they are all eager to show us how foolishly things are arranged in reality and how happily men could live if they were to invest the reformers with dictatorial powers. It is, they say, only the inadequacy of the capitalist mode of production that prevents mankind from enjoying all the amenities which could be produced under the contemporary state of technological knowledge. (Mises 1966, 507)

Although a society arranged according to their precepts might appear to some people as fair “from the point of view of an arbitrary standard of social justice,” it would certainly be “a society of progressing poverty of all its members” (Mises 1966, 854).

Mainstream economics, which Horvat associates with “capitalism,” may be unable to explain the dynamics of market activities satisfactorily, but Horvat, whose own understanding of the market economy is even worse, fails in his endeavor totally. His babbling about his system “being logically consistent” because “demand and supply are synchronized” and the “long-run equilibrium, not the short run” achieved is, to put it mildly, pathetic. He simply refuses to acknowledge the defeat of “rationalistic romanticism” and continues to defend his old paradigm by calling it new.

In the end a general question arises: Why the sudden resurgence of leftist writing? Seven years after the collapse of communism throughout Europe, the Left is producing an explosion of books; the authors of these books not only try to convince us that socialism is not dead, but also offer, in their view, a viable alternative to capitalism. With free-market reformers stumbling all across Eastern Europe, and Western European communists making a comeback by attacking “socially devastating” measures that create high unemployment, welfare cutbacks, and other economic and social dislocations, the Left is actively espousing the Fatal Conceit, the poisonous idea

that economic problems can be solved by using some grand, wise, and judicious plan. As the leftists dare not to repeat their former promise of a fabulous world of plenty, they now focus their writings on “economic justice” and “fairness,” presenting their plans, again, as a moral alternative to the amoral (and often immoral) market economy. They hope that their message will have appeal in a world populated in large part by envious and ignorant people. Let us hope the world has learned enough from the most recent disastrous episode of collectivist planning that the same mistakes will not be repeated.

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