

GLASNOST AND THE KNOWLEDGE PROBLEM: RETHINKING ECONOMIC DEMOCRACY

Don Lavoie

Well, we have lived through a year, the state is in our hands; but has it operated the New Economic Policy in the way we wanted in this past year? No. . . . How did it operate? The machine refused to obey the hand that guided it. It was like a car that was going not in the direction the driver desired, but in the direction *someone else* desired; as if it were being driven by some mysterious, lawless hand, God knows whose, perhaps of a profiteer, or of a private capitalist, or of both.

—V. I. Lenin¹

Introduction

The “knowledge problem” refers to a classic argument—usually called the “calculation argument”—from the field of comparative economic systems about why centralized planning fails.² The argument, to which this paper will return in detail, was initiated in 1920 by the Austrian economist Ludwig von Mises and was sharpened by

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The author is Associate Professor of Economics at the Center for the Study of Market Processes at George Mason University. He wishes to thank Peter Boettke and Kevin Lacobie for their comments on an earlier draft. He also thanks the Earhart Foundation for financial support.

¹Cited in Lenin ([1922] 1965, p. 279). I thank Peter Boettke for reminding me of this quotation.

²For the classic statements of this critique of socialism, see Brutzkus ([1921] 1935); Hayek (1935, 1940); Mises ([1922] 1936). Important interpretations of the critique and its relevance to other issues can be found in Boettke (1990), O’Driscoll (1977), Polanyi (1951), Roberts (1971), and Vaughn (1980). Hayek’s own latest statement of his argument (1988) is in my view his best. My own efforts to draw out the lessons of this critique are numerous (Lavoie 1985a, 1986, 1987a, 1987b, 1990). The idea of explicitly relating the knowledge problem argument to democratic processes was suggested to me by Kurt Schuler (1990).

others, especially his most famous follower, Friedrich A. Hayek.³ The argument was conceived narrowly and in a negative mode, as a critique of socialist (especially Marxian) economics. But the argument has evolved into a broader knowledge problem concerned with the way decentralized and tacit knowledge gets used in society, and now represents a more positive account of the way economic knowledge is created, discovered, and conveyed in market institutions. The argument contains valuable lessons, not only about why the traditional Soviet-type economy and many attempts to reform it have failed, but also why many more conventional Western-style policies in capitalist economies have been unsatisfactory.

On the other hand, *glasnost* refers to the new spirit of democracy, the cultural opening up that has been achieved over the past few years in the Soviet Union, in spite of the failure so far of economic reforms.⁴ Juxtaposing *glasnost* with economics (and especially economic calculation), or using the phrase "economic democracy," seems to confuse ideas that belong to completely separate universes. I will try to bring these universes a bit closer together. Perhaps economic questions are being treated too differently from cultural ones. And perhaps this is a source of some economic difficulties that *perestroika* has had.

Might there be a way to conceive of an economic democracy or "democratic economy," a system of economic production, that is imbued with the open-ended, creative spirit that animates the cultural flourishing of *glasnost*? Can democratic principles be "radicalized" and extended throughout society and into the very production process of the economy? Can democratic values shape not only the way we exchange words with one another, but also the way we exchange goods and services?

The idea of extending democratic values into the economy is not new. Marxism originally had noble aspirations to what it considered

³In the literature the argument generally goes by the name "calculation problem," but I prefer the label "knowledge problem" to stress what has come to be considered the key issue in the argument, the issue Hayek (1937, 1945) was later to call the use of knowledge in society. This argument should not be confused with the political critique that Hayek (1944) is famous for raising against socialism in his classic book *The Road to Serfdom*. In the political argument the issue is "why the worst get on top." For the knowledge problem critique, the issue is why, no matter who is on top, those people cannot really know enough about what is going on "at the bottom" to intelligently run an economic system.

⁴Some Western commentators have pointed out that the word *glasnost* does not directly translate into "democracy." I will use the two words synonymously because, as I will argue, the Russian word's connotations of openness and publicity are highly evocative of the core idea of democracy.

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a more radical form of democracy, and had its own notion of an economic democracy. Marx considered the political system of "bourgeois democracy" an advance over previous political systems, but ultimately held it in contempt as a pale reflection of what *true* democracy would involve.⁵ Socialism would go beyond Western-style representative democracy by extending the application of democratic principles beyond questions of electing supposedly representative government officials and into the whole economy.

In the aftermath of the utter collapse of these ideals, the notion of economic democracy needs to be rethought. Marx's version did raise important questions about the proper scope of democratic values and about the limited extent to which they have been realized in Western capitalist political systems. In my own view, his challenge—that Western politics falls far short of its own democratic ideals—retains much of its validity today.

Marx had reasons to be unsatisfied with the status quo of his day, as we do with ours, but his particular alternative led to a system far worse than he could have imagined. It led to disaster because it had concluded that market institutions were essentially incompatible with democratic values and needed to be replaced by a democratically determined central plan. It is now well understood that in practice these ideals resulted in the destruction of both the Soviet economy and democracy.

The failure of this great experiment in social engineering should not be an excuse, however, for complacency about the traditional Western models of democracy. Socialism was born out of our own Western ideals, especially the package of ideals we associate with the word "democracy." The Soviet-type economy does not have a monopoly on the social-engineering mentality. The collapse of the vision in the East needs to be carefully diagnosed, if we in the West are to be sure we do not (more gradually but just as surely) go down the same road. What was it exactly about this attempt to extend democratic values to the economy that made it fail? The question is not only why Marxian socialism never surpassed the modest degree of democracy attained by most Western societies. The question is: Why did it sink so far below this level of semi-representative democracy that *glasnost*, the recovery of a moderate degree of democracy, constitutes a stunning democratic advance?

I believe Marxism failed for reasons Mises and Hayek explained in the calculation argument. I interpret the argument in its broader,

⁵For a careful interpretation of the tension in Marx between his advocacy of economic planning and his democratic aspirations, see Prychitko (1991).

knowledge problem form, as not only decisively refuting traditional socialist economics, but also as challenging many more moderate programs for government control over market processes. Indeed, I think that the argument can be still more broadly interpreted as being relevant not only to purely economic matters, but also to the issue of democracy. The argument suggests an alternative way to extend democratic values to the economy. The upshot of this way of looking at things might be a different perspective on the possibilities for reforming the Soviet-type economy.

Glasnost: Discourse as a Social Learning Process

Glasnost has introduced a spirit of democracy into Soviet society, breathing life into what had become an utterly lifeless system of power politics. Politics has, to some extent at least, come out into the open air. Glasnost has legitimated the idea that government must be answerable to "public opinion," that is, needs to defend itself in an open dialogue in which, in principle, anyone can participate. It includes not only the procedural principle of freedom to vote in elections, but also substantive principles such as freedom of speech and the press. And it has transformed more than politics in the narrow sense of the conduct of government. Not just Soviet politics has risen from the dead. Science, the arts, and almost the whole culture, it seems, have come alive. There is a potent social force at work here.⁶

Yet the economy continues to lie moribund. Amid the exhilarating spirit of renewal in many dimensions of life, the amazing frustrations of economic life continue. Efforts to reform the economy have met with none of the success that the opening up of politics and culture have enjoyed. Glasnost has not corrected the gross irrationalities of the Soviet economy; it has only exposed them to the harsh light of open criticism.⁷ Might there be some way to get the economy to flourish the way science, historical research, and culture in general have?

If we are to consider what it would entail to extend the spirit of democracy into the economy, we must be clear about exactly what democracy itself really means. First of all, we need to admit that we in the West have not fully nailed down what democracy means, in

⁶One should not, of course, exaggerate the degree of openness achieved in the political realm. My point is only that relative to economic progress, political gains have been impressive.

⁷The sheer documentation, the bringing into the public, of what has happened in the Soviet economy is itself a major achievement. We know more about the extent to which the Soviet economic system has failed.

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terms of concrete political institutions and policies. While no one can deny that Western capitalist political systems are far more democratic than traditional Communist states, they are still very far from realizing the high aspirations contained in democratic ideals.

Democracy means more than voting. Voting is neither necessary nor sufficient for the emergence of a genuine democratic spirit. Dictatorial regimes can go through the motions of elections but they are not fooling anybody. And it is often possible for the participants to come to a consensus so that voting can be dispensed with. Indeed, voting is a last resort at the end of a larger consensus-forming process. What counts is the degree to which participants in a political process are striving for mutual understanding, a striving that should be suspended precisely when a disputed issue comes to a vote. What makes the process as a whole democratic is not so much the event of voting but the extent to which the prevailing attitudes of the participants are conducive to genuine dialogue. What is distinctively democratic is the nature of the dialogue on the floor before voting, such as the debates in subcommittees, that is, the places where open discourse over important issues is carried on. It is only under the conditions where democratic values are being respected in such dialogues that voting itself can constitute a meaningful act of political participation. What makes the recent elections in the Soviet Union significant is the fact that they constitute the culmination of a public political dialogue.

Western conceptions of democracy tend to see no principled limits to the power of governmental institutions, other than that they gain a degree of attachment to popular legitimacy through occasional elections. The government is supposed to get its endorsement in elections, but then is permitted, in principle, to act in any way it chooses. It can, for example, arbitrarily interfere with the (democratic?) rights of citizens to make market transactions with one another. As a result, Western democracies have burdened their markets with increasingly intrusive governments that make dubious claims to represent the will of the people. The fundamental problems with democratic government as we know it are severe enough to make us wary of taking the Western status quo as any kind of ideal. In particular, the deterioration of our representative governments into narrow special interest politics should serve as a warning to anyone who wants to emulate our system.⁸ Reformers can surely aim

⁸See Winiacki (1991) for an account of the way special interests work in the Soviet-type economy, as well as citations to the literature on such problems in the West.

higher in their democratic aspirations for politics than to merely adopt mainstream Western views.

The aim of this paper is not to delve into the difficult question of how to realize democracy in the political arena. Rather, the aim is to ask two other (probably equally difficult) questions: What is the core meaning of democracy? And what would it mean to achieve it in the economy? Marx was right at least to this extent: Democracy should apply to all of our lives and should not be narrowly conceived as a form of government. The spirit of democracy that animates glasnost applies to much more than political elections and touches on the fundamental principles of interpersonal relations in all aspects of life. It refers not primarily to government, but to politics in the more general, Aristotelian sense.

So what is the core meaning of democracy? What is it, exactly, that makes something, a culture, a discussion, a government, a marketplace, democratic? I think we know better what democracy "in the large" means because of our own experience with it "in the small" in our everyday conversations. We know democratic behavior when we see it close-up in the way people conduct themselves in discussions when they take both their subject matter and one another seriously, and when they seek mutual understanding. Democracy, then, can be usefully defined as that set of attitudes conducive to mutual understanding and an open-ended process of dialogue. The elements of what it takes to achieve mutual understanding have been best articulated, I think, in the branch of philosophy known as hermeneutics.⁹

A good conversation is in many ways the model of what we mean by democracy. There is a certain kind of behavior that is conducive to mutual understanding in face-to-face conversation and that, I think, is the basis of our democratic values. The closer human interaction in any particular group comes to efforts of mutual understanding, the more democratic we tend to consider that group. Any individual institution in which individuals have to talk to one another—the firm,

⁹Hermeneutics is sometimes referred to as the *Verstehen*, or understanding, tradition. Especially important in the contemporary *Verstehen* tradition is the work by Hans-Georg Gadamer (1976, 1982, [1960] 1989). For good general summaries of hermeneutical philosophy, see Lingge (1976) and Warnke (1987). This philosophy has been applied to political philosophy along lines similar to my own argument by Madison (1986), Palmer (1991), and Sullivan (1989). The Austrian economist Ludwig von Mises and the great sociologist Max Weber, who were two of the earliest to clearly identify the knowledge problem, were both contributors to the *Verstehen* tradition of German social thought.

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the scientific journal's editorial board, the shop floor, the boardroom—can be more or less democratic in this sense.¹⁰

We might distinguish in this regard four closely related elements of democratic discourses: "openness," "open-endedness," "autonomy," and "publicness." What makes a discourse democratic is the degree to which participants are truly open to one another. To embrace the spirit of democracy is to learn what it means to be "open," to genuinely listen to what other participants are trying to say. To listen requires that one attempt to hear the truth-claim of the other person's words, to take those words in their most powerful interpretation. Democratic discourse does not imply that one be subservient in any way to the other's perspective. Good conversation-alists neither force their own perspective over the discussion nor abdicate their own perspective to it. Instead, what drives the dialogical process is the very process of interplay among divergent perspectives.

"Open-endedness" refers to the processual nature of conversation. It is not because consensus is necessarily achieved that democracy is to be celebrated. A healthy conversation aims at consensus but thrives on disagreement. Whenever consensus does occur on any particular issue, the conversation moves on immediately to the next area of controversy. What we should celebrate about democracy is not that it eliminates social discord, but that it makes discord peaceful and productive instead of destructive. Open disagreement among participants who genuinely strive for agreement is itself the basic virtue of democracy.

"Autonomy" refers to the point that for a conversation to be genuine, the divergent individuals that contribute to it must to some degree treat one another as autonomous agents with their own perspectives. This is not to claim some sort of atomistic separateness among individuals, as is implied in much of neoclassical economics. Humans are, of course, fundamentally social and cultural creatures, utterly dependent on one another and, in particular, on the discourses in which they participate. But for their discursive interactions to work well, individuals must acknowledge the need to follow basic rules that protect one another from domination. The discovery process of explicit dialogue works best where the autonomy of its individual participants is sufficiently respected so that conversation is

¹⁰The neo-Marxist social theorist Jürgen Habermas (1984) also explores the possibility of *consensus-seeking conversation* as a model of democratic values, and he has made important contributions to these questions. He seems ultimately, however, to draw conclusions that are in almost the exact opposite direction from those I am suggesting.

allowed to move with the uncontrolled flow of its own dynamic and is not dominated by any individual. One achieves order not by subsuming these divergent voices into a single voice but by strengthening and supporting the rules that protect this autonomy. The interplay among perspectives must be permitted to evolve in whatever direction the dialogue itself draws the participants; it must never become dominated by any one of them. The truly satisfying discussions are those that are completely out of anyone's control and yet seem headed in a direction in which all of the participants are finding themselves driven.

It is possible for this kind of open-ended dialogical process to work in restricted and limited ways under conditions of secrecy, but for it to take full advantage of its own selective dynamic, conversation must take place out in the open, in public. "Publicness" is required to get the pulling and tugging to come from every interested corner, to expose perspectives to as many potential criticisms as possible, to permit the distinguishing of more-open and less-open participants, and to achieve effective and rapid communication in general.

"Democracy-in-the-large" should be based on, but not equated to, "democracy-in-the-small." A democratic polity is one that permits, and to a relatively large degree is driven by, an overlapping set of mini-democracies, which are open discourses held in public over issues of common concern. Democracy-in-the-large is animated by the same spirit of openness in dialogue as the smaller discourses of which it consists, but unlike them it does not have any specific purposes. Each of the democracies-in-the-small of social life has its own articulated and tacit purposes about which the discourses are engaged. Every conversation has a point. But the conversation of mankind, the set of all the discourses, has no grand purpose of its own. Democratic society as a whole has no particular purpose except to maintain or improve the context that is conducive to the flourishing of the overlapping set of discourses of which it is composed.¹¹

I will take these values of openness, open-endedness, autonomy, and publicness as a working definition of democracy. In the large or in the small, democracy has been achieved only incompletely anywhere and, certainly, only very partially in the Soviet Union

¹¹The element of open-endedness, or the absence of a need for resolution, is thus especially true for democracy-in-the-large, where there really is no explicit overall purpose that democratic processes need to settle on. An organization needs to settle on a deliberate plan, but a democratic society as a whole ought to be simply a peaceful interplay of the activities of all its participants. Agreement is required, but only about the basic rules of the conversations, not about the specific direction the conversations need take.

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today. Yet I think it is fair to say that *glasnost* represents the beginning of a truly democratic movement in this sense. Some genuine, open political discourse has been permitted; the lid on public political dialogue has been partly lifted; the autonomy of critical voices has been largely protected; many things long hidden have been made public. The results, achieved only by letting different voices be heard, have been truly astonishing. Glasnost has given birth to a new phenomenon in Soviet society: public opinion. It has generated an open-ended public dialogue, a serious public questioning of the basic orientation of Soviet society, openness that was impossible a short time ago.

What makes democracy so powerful a social force? Perhaps the connection between democratic values and attitudes conducive to mutual understanding is what lies at the root of democracy's potency. Democracy works as well as it does because it encourages a certain kind of communicative/discovery process by which individuals and society learn.

The public dialogue that *glasnost* unleashed is intrinsically valuable, but it has enormously beneficial side effects. Democracy in science permits the process of open-ended scientific discovery to work. In the arts, it unleashes the creative powers of expression. In politics, public debate permits the imaginative exploration of alternatives in a creative process, so that common social problems can be addressed. Democracy makes a society, as a whole, more intelligent.

I am not referring to the intelligence of individuals in society, but rather to the social use of knowledge. The openness of democratic discussion does not merely permit individuals to learn from one another so that, in some sense, their average intelligence increases. Such openness serves as an engine of "social learning," where new knowledge is embodied in social institutions, tools, and traditions.¹² The contemporary scientist, for example, cannot claim to have an individual intellect that is superior to, say, Leonardo da Vinci. Virtually all our intellectual advantages come from the socially embodied knowledge we can tap into. Openness permits the continuous challenging and improving of our existing stock of socially embodied knowledge.

¹²In Lavoie (1985b, chaps. 2-3), I have elaborated on this idea of "social intelligence," which I derive from contributions by F. A. Hayek and Michael Polanyi on what they called "spontaneous order." See also Salin (1990) for a related discussion of the way that knowledge becomes embodied in tools.

What is so maddening about undemocratic societies is their inability to honestly identify, much less correct, their institutional stupidities. Though populated by highly intelligent individuals, societies without benefit of an open discourse are systematically stifling their own ability to learn.

Democratic discourse thus serves a knowledge-generating function: It allows for peaceful resolution of disputes and for an evolutionary learning process. Public political dialogue creates and communicates knowledge in a way that the politics of secret intrigue and power cannot. The unhampered give and take during the free exchange of ideas is what brings order to public discussion, not the intelligence of any one person. What makes democracy work is the multiplicity and autonomy of the voices it permits, which propels a rivalrous discovery process among the voices. Our attempts, from our divergent perspectives, to persuade one another result, cumulatively, in a discovery process from which all of us learn.

Not only are the participants to the democratic process interested in *voicing* their own ideas and interests; they are also interested in *acting* on them. It is not only our talk that we would like to make more "socially intelligent"; it is also our activities. Glasnost is nice but it is not enough. The Soviet polity as a whole is getting socially smarter, but despite the undoubted intelligence of its individual participants, its economy desperately needs social learning.

The Knowledge Problem: Markets as a Social Learning Process

Mises's and Hayek's knowledge problem argument can be summed up as a case for why a certain kind of competitive process among private owners of the means of production, which most versions of socialism traditionally sought to abolish or drastically restrict, serves a vital communicative/discovery function for society. Private ownership makes possible a social learning process that takes place by embodying knowledge into the price system. The competitive market process gives rise to prices that reflect knowledge about consumer demands and alternative production possibilities, so that prices approximately reflect the relative scarcities of different goods and services. These scarcity-indicating prices then, through the use of profit-and-loss accounting, inform individual decisionmakers about the relative costs of alternative projects. Thus, more cost-effective alternatives can be found. Profits tell market participants where to find opportunities to improve social coordination, and losses direct them away from unpromising alternatives. Prices act as com-

municative aids for separated consumers and producers, allowing them to bring their actions into closer harmony with one another.

In other words, market communication is an extension of the democracy of open verbal communication. Just as verbal discourse is a communicative process that must be set free to do its work of discovery, so are markets. The competitive market process tends to weed out less-efficient methods of production in much the same way that open verbal criticism weeds out weaker arguments in science or politics. The very open-ended tugging and pulling of alternative voices, which make a discourse productive of new knowledge, also operate in the "discourse" of market interaction. As with communication in natural language, the market communication process generates true novelty: What can be learned is not necessarily a matter of the capacity of individual human brains, but depends on their modes of influencing one another. It is the fact that the tugging—the efforts of persuasion that pull social outcomes in different directions—is noncoercive, not the specific form of tugging, that gives discourse its creative power. So long as we respect the autonomy of other participants, whether we persuade by words, by example, or by offering something in exchange, we are participating in a creative discovery process.

Our extending to the economy the values that pertain to democracy-in-the-small points in the direction of a free-market system. Openness of verbal discourse has its economic parallel in the principle of free entry in markets.¹³ The free market's discovery process is open-ended in the same sense that a conversation is.¹⁴ Property rights and contract law are aimed at defining the boundaries that protect the autonomy of individual actors from infringement by others.¹⁵ Publicness is as vital to the market's communicative function as it is to that of verbal discourse.¹⁶

Some people think that of all the ways we might influence the production process, the only one that can be considered democratic

¹³See the important work on *Competition and Entrepreneurship* by Israel Kirzner (1973), where the crucial importance of free entry for the working of competition is explained.

¹⁴The paper "Competition as a Discovery Procedure" by Hayek (1978) concisely elaborates on the open-endedness of the market process.

¹⁵The classic collection of papers edited by Furubotn and Pejovich (1974) explains the importance of autonomy in the workings of property rights.

¹⁶It is interesting that the Greek word *agora*, which means a marketplace, connotes these values of openness and publicness. Despite our modern language of the private sector, markets are essentially communicative processes that need to take place in public. Thus, the secrecy required in black markets is one of the key reasons they do not work very effectively.

is the explicit articulation of one's wants in public discourse.¹⁷ To call for a referendum on whether people want X is supposed to be more democratic than to simply permit them to get X if they want it. But why should people's verbal statements of what they think they want be privileged (as a means of communicating their wants) over other possible communicative methods, for example, their actions as consumers? To widen the notion of democracy to cover more than explicit discourse, we must include a broader range of ways of influencing one another. Democracy must subsume not only the situations of literal dialogues, but also the many ways in modern society in which we are able to communicate at a distance with one another. When applied to our discourse, democracy lets us make verbal transactions with whomever we want to talk to. But if we truly extend democracy to cover the economy, we must be able to make any other kinds of voluntary transactions with whomever we want to. Economic democracy should borrow the core values of democracy but should apply them to both those situations where people exchange words and those where they exchange deeds.

The Mises/Hayek argument makes a case for freeing the communicative/discovery process of markets. For the same reasons that science and the arts should not be under the control of any single institution but should be left to freely evolve, so should markets. Restrictions of free trade obstruct social learning for essentially the same reasons that restrictions of free speech do. Removing obstacles to free-market interaction unleashes the same kind of social power as opening up discourse. The driving engine of intellectual development is freedom of discourse; the driving engine of economic development is freedom of economic action.

What follows from this argument? For one thing, it shatters the original Marxian aspirations for central planning. When Mises first issued the challenge, orthodox Marxism of the kind that inspired Lenin and other Bolsheviks still favored completely abolishing markets, money, prices, profit-and-loss accounting, and so forth, and replacing them with centralized economic planning. Mises showed why markets serve an indispensable cognitive function in social coordination, so that the attempt to abolish markets can lead only to the economy's utter destruction.¹⁸ This is exactly what happened in

¹⁷I have in mind Habermas and other neo-Marxists who celebrate explicit verbal conversation for its democratic elements, but who see the market as an intrusion on the sphere of verbal discourse. Habermas worries that somehow markets threaten to "colonize the life-world."

¹⁸See Boettke (1990), Malle (1985), and Roberts (1971) for detailed documentation of the failure of orthodox Marxism in the War Communism period.

the first few years of Soviet history, when, in the so-called War Communism period, Lenin and other Bolsheviks attempted, on the basis of Marxian principles, to deliberately destroy market relationships.¹⁹

The Bolsheviks' retreat to the New Economic Program (NEP) signaled the collapse of Marxian aspirations for direct and genuine control over the economy. Instead, Marxians settled for attempts to influence the Soviet economy indirectly by controlling certain monetary and fiscal policy variables, and by securing the "commanding heights." Although the economy recovered dramatically under the NEP policy, Lenin and his followers cannot be said to have learned any lessons from their mistakes. As the quotation at the beginning of this paper shows, Lenin was frustrated by the very success of NEP; the "car" was not doing what he wanted it to do. He had to presume that somebody else, perhaps profiteers, was retaining control. He and his heirs in the Soviet leadership had great difficulty picturing an economy that is orderly and yet is "driven" by no one.

Socialists have scrapped their ambitions of abolishing markets and have reverted to a fall-back position, which is scarcely distinguishable from orthodox Western capitalist public policy. Planning is supposed to indirectly control markets, which are to be viewed as tools by which to steer the economy in desired directions. The specific direction of investment, or which industries are to grow faster, is still considered a matter for government policy to decide. Instead of condemning profit altogether, as Marx did, contemporary advocates of central planning—and most contemporary economic policymakers in the West—ask only that profits be used as explicit incentives by the government to induce individuals to behave in accordance with the plan.²⁰ Many advocates of reforms today in the Soviet Union seek

¹⁹Hayek (1935, pp. 33–34) pointed out the "interesting coincidence" that at about the same time Mises first formulated the knowledge problem argument, two other distinguished authors, Max Weber and Boris Brutzkus, independently came to very similar conclusions. One might suppose that the fact that the economic destruction of War Communism was at that very time going on might have had something to do with the coincidence. Weber's brief but lucid comments on the issue can be found in his posthumously published magnum opus, *Economy and Society* ([1921] 1978, pp. 109–13). Brutzkus's whole book, *Economic Planning in Soviet Russia* ([1921] 1935), is an empirical application of essentially the same argument that Mises elaborated on theoretically.

²⁰Even orthodox Soviet-type central planning accommodates itself to some elements of markets. Since Lenin abandoned the attempt to destroy markets and introduced the New Economic Policy (NEP), some elements of markets have always been tolerated in the Soviet Union. During NEP, market institutions were in many ways actually encouraged. But since the Stalinist five-year planning system was instituted, they have been permitted only a minimal role. Markets have been constricted, suppressed, distorted, and manipulated, but they have been tolerated to some degree. In the official

a larger role for markets but still see them as tools to be manipulated by government to bring about specific outcomes. They presume that the economy has been—and should be—under the government's control. They think the government that controls the economy needs itself to be made accountable to democratic forces. The relationship between democracy and the economy is conceived as an external relation, with government serving as a way to steer markets and with democracy serving as a way to steer government.

This retreat from destroying to controlling markets may appear to constitute an answer to the knowledge problem. It recognizes that markets serve certain cognitive functions, among which are the function of providing a way to calculate alternative costs and benefits, as well as a way to give incentives to induce people to behave as desired. The ambition to shape specific details of investment is jettisoned in favor of a more modest goal of shaping the overall direction of investment. Profits are accepted as a necessary means for accounting and as useful tools for psychological motivation.

But the knowledge problem critique cuts deeper than this. I think it not only decisively answers orthodox Marxism; it challenges the whole idea of trying to gain "control," even of an indirect kind, over economic systems. Calculation and incentives are not the most important cognitive functions that profits perform.²¹ The crucial function of profits is not to get people to act in a desired way, but to find out what the desired ways of acting are in the first place. The interplay of the market is itself the source of knowledge of what the more effective ways of doing things are, so that for the government to try to guide or steer the market is, in fact, to blindly intervene in a self-ordering process. Neither the specific details of economic investment nor its general direction can be intelligently manipulated by any single will but must result from the free interplay of rival alternatives.

The Mises/Hayek argument shows not only why markets are necessary institutions but also why they are necessarily uncontrollable institutions. Economic planning in the sense of rational control over the economy is not merely inefficient; it is strictly impossible. The process we call a market is too complex to be controlled in any meaningful sense of the term. This is not to say that there is no point to discussing government policy. The effective working of a market

sector, which is supposed to be under planners' control, prices expressed in money are used, and profit-and-loss accounting at the plant manager's level is required. Significant black and gray markets exist that are outside the official sector and that are not even considered to be under the planners' control.

²¹See Lavoie (1990) for a critique of versions of socialism that identify the cognitive role of profits as strictly a matter of calculation or as a matter of psychological motivation.

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economy depends fundamentally on its being well "cultivated." It should be situated in legal and other institutions that are conducive to its flourishing. Cultivation involves setting in place the background conditions that enhance the market's effectiveness, such as a strictly enforced and well-defined system of property rights and contract law, and a stable money and banking system.²²

The proper function of government in a free and democratic society should be seen as maintaining and improving the rules by which we live peacefully among one another, not as deliberately carrying out any one person's plan. Policymaking should pay attention to setting up such institutional frameworks in order to get market processes to flourish. But the flourishing itself is a creative discovery process that, like a good conversation, cannot be under any participant's control.

Democratic government should not try to run or steer the market any more than it should try to orchestrate scientific advances, to dictate artistic standards, or to design political discussions. It should just set in place and maintain the legal context that is required for markets to work, in much the same way that it should try to set the context in which political, scientific, and cultural discourse works.²³

When governments attempt to control economic processes from the top down, what they really do is blindly interfere with a social learning process that they, and the rest of us, need in order to know what we are doing. Planning is impossible, but what is possible and happens all too often is the blind obstruction by governments of order-generating processes that are working from the bottom up.

What, then, is going on in centrally planned economies such as that of the Soviet Union? To be sure, many busy planners are in many different bureaus strewn throughout the economy. Their efforts have an enormous effect on the economy, but is the result anything that could be called effective, rational control over what happens in the economy? Planning bureaus in the Soviet economy are not rationally controlling things but blindly interfering with processes they cannot understand. What is being brought to the economy from the top down is not order but a monstrous degree of interference by planning bureaus in economic life. The limited degree of order that survives this interference is coming from the bottom up. The order that arises in this unusually disorderly economy should be attributed to plant managers and workers in the official sector, and to the gray and black market entrepreneurs, but not to the central planners.

²²This distinction between control and cultivation comes from Hayek (1955, p. 19).

²³For an elaboration of this view of the proper role of government as a matter of instituting the "rule of law," see Hayek (1960, 1973, 1976, 1979).

Things get done at all, when they do, primarily in spite of the interference of the planning apparatus. The traditional Soviet-type economy, though under the influence of many people, is not under anybody's deliberate control, and it could not be.²⁴

Government efforts to control markets are irrational for much the same reason that Marxian central planning is: Policymakers simply do not know what they are doing. Markets are not simply convenient things to "have" in the economy, which can be "put to use" in accordance with government's goals. Markets are themselves the source of knowledge of how things can get done at all. The attempt to manipulate markets from the top interferes with the communicative discovery process, so that policymakers cannot know the consequences of their own decisions. The government is not an engineer scientifically controlling the social machinery; it is throwing a money wrench into that machinery.

The real lesson of the classic critique of socialism is that we cannot guide the market process. On the contrary, we need it to guide us. We cannot control it; all we can do is establish the conditions in which it will flourish and then take our own guidance from it. If this argument is correct, then the relationship between democracy and the economy should be reconsidered. What is the point of making government accountable to democratic forces if its efforts to control markets are irrational, futile efforts to control the uncontrollable?

But this argument does not imply that democratic values, properly understood, must be compromised in order to permit the market learning process to work. Such a view would be assuming that markets are a necessary evil and are fundamentally contrary to democratic ideals. The market process, however, is not something that must be brought under anyone's control to be "made" democratic. On the contrary, I am suggesting that open markets should be seen as the very embodiment of democratic values.

This very opposition between democracy and markets is a symptom of an overly narrow conception of democracy. Since democracy is taken to refer only to the conduct of government or, as we say, the "public" sector, we presume it is naturally at odds with the "private" sector. The expansion of democracy into the private sector in this case would involve increasing the ability of the (democratically elected) government to control the market. Democracy is extended only in the sense that the central government institution, which is supposed to receive the stamp of democratic legitimacy, enjoys expanded

²⁴See Polanyi (1951) and Roberts (1971) for more of this interpretation of the Soviet-type economy.

power over other institutions. A more democratic economy would then be one that is to a larger extent under the guidance of the democratic government's policy.²⁵

The notion that markets should be under one democratic institution's deliberate control to become democratic is itself a throwback to pre-democratic thinking. If we return to the model of conversation, we see that what makes a discourse democratic is precisely the fact that it is *not* under any participant's control. Just as a good discussion takes on a life of its own and participants are carried along by its flow, so markets constitute an open-ended process with its own systematic dynamic. The attempt to control markets, like traditional central planning, demands a kind of democracy that resolves the divergent perspectives of its members into a single, unified social will, only now the will aims at steering rather than supplanting markets. A more principled approach to democracy should transcend this unification attitude altogether. A democratic polity should not have to melt down the plurality of its voices in order to join in "Grand Social Purposes."

Central planning fails because it neglects an indispensable source of social learning: the competitive market process. This process has been obstructed to some degree everywhere, but it has been seriously crippled in the case of the Soviet Union. Economic reform should open up this source of creativity as quickly as possible.

Conclusion

What implications might this whole way of looking at things have for the question of economic reform? Given how little I know about details of the current political situation in the Soviet Union, it would be presumptuous for me to venture any specific policy advice. But I am suggesting a certain general orientation toward reform. The knowledge problem puts a somewhat different light on the question of what reform really is.

We commonly see the issue of reform presented as a matter of transferring control from one controlling mechanism, the central planning bureau, to another, a monetary and/or fiscal policy bureau. To use Lenin's car metaphor, reform could be said to be analogous to the delicate procedure by which one person might try to hand over the steering wheel of a moving automobile to another person. Somehow, the central planning bureau has to simultaneously let go of the steering wheel, take its feet off the brake and gas pedals, and

²⁵From this point of view, were it possible to eliminate markets altogether, that would be the most democratic type of society. In a sense, then, this position retains Marxian socialism as an abstract ideal but admits that it is never fully attainable.

get out of the way so that new and more enlightened decisionmakers can deftly slip into the economy's driver's seat—all before the car veers off the road. Sounds tricky. In such circumstances caution would seem only reasonable.

But if the argument I have been summarizing is valid, this analogy is all wrong. The only task the central planners should need to achieve is the last one—getting out of the way. If the economy is not now under the planners' effective control and could not be under anyone's control, then reform should not be seen as involving a complicated transfer of control from the center to the periphery. The center never had control; order arises from the periphery. The car steers itself, and the planners' actions are already making it veer off the road. Or to revert to a different analogy, it is primarily a matter of getting the planning bureaus to stop throwing monkey wrenches into the economic machinery.

Does this argument not imply that a policy of gradualism makes little sense? Reformers debate how fast market reform should take place. How fast should we try to get the planning bureaus to stop throwing those monkey wrenches? I think that the economy is in desperate enough straits to demand radical reform toward a free economy and that the speed should be as fast as possible.²⁶ The knowledge problem, as I see it, lends support to the radical reform wing of the contemporary policy debate.

If markets are communicative/discovery processes akin to democratic discourse, then perhaps government obstacles to free markets have no more justification than obstacles to free speech. It makes no sense to open up free speech only gradually (only for some individuals at first or only for some topics) and it makes as little sense to liberalize only some industries. Only complete freedom will permit these social learning processes to work to their full effectiveness.

Glasnost has succeeded as well as it has because it unleashed engines of human creativity throughout Soviet politics and culture. It did this by simply permitting open political discourse to take place. The point is not to design a procedure to construct democracy, but to get out of the way and let democracy construct itself. Perestroika should be thought of as this kind of open-ended process, which should be fueled by the same spirit of creative experimentation. The central planners should not design the path to a free economy; they should get out of the way.

²⁶In most respects I would enthusiastically endorse the platform for rapid reform proposed by the noted expert on Soviet-type economies, János Kornai (1990), who talks of the need for a massive surgical operation.

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