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**PROTECTING  
FOREIGN INVESTMENT  
UNDER INTERNATIONAL LAW**

*Legal Aspects of Political Risk*

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## Appendix I Economic Calculation Under Socialism

*Everything brought forward in favour of Socialism during the last hundred years, in thousands of writings and speeches, all the blood which has been spilt by the supporters of Socialism, cannot make socialism workable. The masses may long for it ever so ardently, innumerable revolutions and wars may be fought for it, still it will never be realised. Every attempt to carry it out will lead to syndicalism or, by some other route, to chaos . . . .*

—Ludwig von Mises<sup>1</sup>

In a sense, this book is about socialism—about its effects, ways to reduce or avoid them, and the relevant international law concerning it. For political risk is the risk of government intervention with property rights, and socialism, properly understood, is best defined as “an institutionalized interference with or aggression against private property and private property claims.”<sup>2</sup> Thus, political risk endangers private investment just as full-scale socialism makes human survival impossible. The economic case against socialism is thus briefly summarized in this Appendix.

With the collapse of socialism, mainstream opinion is finally beginning to realize that socialism, in addition to being immoral and wasteful of human life, simply does not work. The collapse of socialism comes as no surprise to the Austrian school of economics as developed by the great economist, Ludwig von Mises. Over seven decades ago, at the dawn of Soviet socialism, Mises provided a sound explanation of why socialism simply cannot work.<sup>3</sup> Although Mises’s amazingly prescient ideas have, unfortunately, been ignored for decades by establishment thinkers, Mises has finally been vindicated by the universally (if belatedly) ac-

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1 LUDWIG VON MISES, *SOCIALISM: AN ECONOMIC AND SOCIOLOGICAL ANALYSIS* 113, 117, 118 (J. Kahane trans., *LibertyClassics* 3d rev’d ed. 1981) (pp. 131, 135, 137 of the 1951 enlarged edition) (first published in German under the title *Die Gemeinwirtschaft: Untersuchung über den Sozialismus* (Jena: Gustav Fischer, 1922)).

2 HANS-HERMANN HOPPE, *A THEORY OF SOCIALISM AND CAPITALISM* 2 (1989).

3 See note 1, *supra*. Mises’s arguments against the possibility of economic calculation under socialism were first published in an article in 1920, under the title *Die Wirtschaftsrechnung im sozialistischen Gemeinwesen*, in vol. 47 of *ARCHIV FÜR SOZIALWISSENSCHAFTEN* (1920), currently available as LUDWIG VON MISES, *ECONOMIC CALCULATION IN THE SOCIALIST COMMONWEALTH* (Ludwig von Mises Institute 1990) (1920).

knowledgeable failure of socialism.<sup>4</sup> It is now obvious that the moral basis for socialism is a sham, although its effects still linger.

In 1920 Mises published his devastating critique of socialism, “Economic Calculation in the Socialist Commonwealth.”<sup>5</sup> Mises showed that, besides the well-known incentive problem of socialism (e.g., getting people to perform unpleasant, unglamorous jobs such as trash collecting)<sup>6</sup> the central planner cannot know what products or how much of them to order to be produced, without the information provided by prices on a free market. In a free market with private ownership of property, the free exchange of goods by individual human actors establishes relative prices, in terms of money (which historically was gold and other precious metals). As Mises showed, these money prices are the indispensable tool of calculation for rational coordination of scarce resources.<sup>7</sup> Without market prices, how can a central planning board know what or how many products to produce, with which techniques and raw materials, and in which location? These and a practically infinite number of questions are simply unanswerable without the information provided by monetary prices. As Murray N. Rothbard concisely explains:

Mises demonstrated that, in any economy more complex than the Crusoe or primitive family level, the socialist planning board would simply not know what to do, or how to answer any of these vital questions. Developing the momentous concept of *calculation*, Mises pointed out that the planning board could not an-

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4 See Gertrude E. Schroeder, *The Dismal Fate of Soviet-Type Economies: Mises Was Right*, CATO J. v11 n1 (Spring/Summer 1991) p. 13. Robert Heilbroner, an avowed democratic socialist, has also admitted the triumph of capitalism and Mises’ prescience. “Less than seventy-five years after it officially began, the contest between capitalism and socialism is over: capitalism has won.” Robert Heilbroner, *The Triumph of Capitalism*, THE NEW YORKER, Jan. 23, 1989, p. 98, 98. “It turns out, of course, that Mises was right.” Robert Heilbroner, *After Communism*, New Yorker, Sept. 10, 1990, p. 91, 92. See also Mark Skousen, “Just because socialism has lost does not mean that capitalism has won”: Interview with Robert L. Heilbroner, FORBES, May 27, 1991, p. 130. Heilbroner had previously dismissed Mises’s arguments, helping to spread the myth that Mises’s anti-socialist claims had been “demolished” by socialist theorists responding to Mises’s arguments. See ROBERT HEILBRONER, BETWEEN CAPITALISM AND SOCIALISM 88-93 (1970). In this work, Heilbroner claimed that Mises was wrong, that socialist economic calculation was possible, and that the “superior performance” of socialism would “soon reveal the outmoded inadequacy of a free enterprise economy.” See also Maureen Johnson (AP), *Overhaul promised for Labor*, THE PHILADELPHIA INQUIRER, Thursday, Oct. 6, 1994, p. A10, which reports that the new leader of Britain’s socialist Labor party, Tony Blair, plans (as of October 1994) to overhaul his Party’s principles. The article reports that “Blair also signaled that he will drop the left’s most cherished maxim: a party clause advocating ‘common ownership of the means of production.’”

5 See notes 2 and 4, *supra*. See also LUDWIG VON MISES, HUMAN ACTION: A TREATISE ON ECONOMICS 200-31, 695-715 (3d rev’d ed. 1966) [hereinafter, Mises, *Human Action*]; Murray N. Rothbard, *The End of Socialism and the Calculation Debate Revisited*, 5 REV. AUSTRIAN ECON. 51 (1991).

6 Rothbard, *supra* note 5, at 51 (discussing the incentive problem).

7 See Mises, *Human Action*, *supra* note 5, at 259. On the profoundly *moral* nature of money, see AYN RAND, *The Meaning of Money*, in FOR THE NEW INTELLECTUAL (Signet 1961).

swer these questions because socialism would lack the indispensable tool that private entrepreneurs use to appraise and calculate: the existence of a market in the means of production, a market that brings about money prices based on genuine profit-seeking exchanges by private owners of these means of production. Since the very essence of socialism is collective ownership of the means of production, the planning board would not be able to plan, or to make any sort of rational economic decisions. Its decisions would necessarily be completely arbitrary and chaotic, and therefore the existence of a socialist planned economy is literally “impossible” (to use a term long ridiculed by Mises’s critics).<sup>8</sup>

Thus, “[t]he paradox of ‘planning’ is that it cannot plan, because of the absence of economic calculation. What is called a planned economy is no economy at all.”<sup>9</sup> Defenders of socialism often countered with the bare fact of the Soviet Union’s existence and “success” as disproof of the contention that socialism is impossible. However, as Rothbard points out, Soviet GNP and other production figures relied upon as evidence of the USSR’s success were wholly inaccurate and deceitful—as the final collapse of socialism has made manifest. Further, the Soviet Union and other socialist countries have never enjoyed complete socialism, for despite their best efforts to stamp out individual initiative, free trade, and private property, the existence of black (i.e., free) markets and bribery is widespread, which prevent socialism from completely controlling and thus strangling the economy. Also, these socialist economies existed in a world containing many relatively capitalist markets, such as that in the United States. Thus, the socialist planners were able to parasitically copy the prices of the West as a crude guideline for pricing and allocating their own capital resources.<sup>10</sup> To the extent true socialism was able to be imposed on the populace, economic calculation thereunder was impossible and the people suffered accordingly.

Thus, a prosperous society is only possible if, and to the extent that, private property and free markets are respected and permitted to flourish.<sup>11</sup> By the same token, political risk in a given country is minimized to the extent that it respects the investor’s property rights.

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8 Rothbard, *supra* note 5, at 52-53.

9 Mises, *Human Action*, *supra* note 5, at 700.

10 *Id.* at 73-74. *See also* Mises, *Human Action*, *supra* note 5, at 702 (discussing the use of Western price systems by socialist governments).

11 For further discussion of the problem of economic calculation under socialism, see COLLECTIVIST ECONOMIC PLANNING (F.A. Hayek ed., 1935); DON LAVOIE, RIVALRY AND CENTRAL PLANNING: THE SOCIALIST CALCULATION DEBATE RECONSIDERED (1985); DAVID RAMSAY STEELE, FROM MARX TO MISES: POST-CAPITALIST SOCIETY AND THE CHALLENGE OF ECONOMIC CALCULATION (1992); *idem*, *Posing the Problem: The Impossibility of Economic Calculation under Socialism*, 5 J. LIBERTARIAN STUD. 7 (1981); TRYGVE J.B. HOFF, ECONOMIC CALCULATION IN THE SOCIALIST SOCIETY (Liberty Press 1981) (1949).

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*To Judge Rosalyn Higgins  
and J. Lanier Yeates, Esq.*

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