

# **BREIT AND LANGE'S '34 MODEL OF A SOCIALIST ECONOMY, THE RIGHT TO EMPLOYMENT PRINCIPLE, AND THE ISSUE OF THE OUTSIDE OPTION**

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## ***Introduction***

A basic socialist (but perhaps not only socialist) notion is that society should assure to everybody the possibility to attain a decent standard of living, involving, say, a sufficient amount of capabilities,<sup>1</sup> independently of the circumstances that can prevent financing one's livelihood through gainful employment. There are two main reasons why the latter may arise, in a society sufficiently developed economically to have enough resources, in theory, to ensure a decent living standard to everybody. The first is not being fit to work because of age or medical condition. The other occurs whenever someone, albeit able-bodied, is deprived by unemployment of the opportunity to earn the means of subsistence. The two concepts are not entirely distinct however, since it is not immediately clear who is and who is not able-bodied (able-bodied for what?).<sup>2</sup> Somebody fit for some kind of work could be seen not to be fit because of disability for another, for instance. Then there is the issue of moral hazard, as some who is in reality able to do some kind of work may pretend to be disabled. Controls are costly and have a large margin on unreliability.<sup>3</sup> Or

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<sup>1</sup> For Sen's concept of capabilities, as compared to alternative concepts of welfare, see e.g. Saith (2001), Alkire (2003).

<sup>2</sup> This is borne out by the fact that there seems to be some positive relation between the replacement rate and the share of the population benefiting from disability subsidies; cf. Ehrenberg and Smith, 1991, p. 204. (It notable in this respect that in Sweden the share of the population receiving disability pensions seems to be negatively affected by the remarkable rehabilitation effort.)

<sup>3</sup> In the USA for instance a recent inquiry has found that "approximately 20% of ... applicants who are ultimately awarded benefits are not disabled, and that 60% of applicants who were denied benefits are disabled." (Benitez-Silva, Buchinsky, Rust, 2004, p. 1.)

the handicapped could be subjected to discrimination, and this could make them socially unfit to perform even the jobs for which their handicap does not matter. Or somebody could be socially unfit to work because of some kind of social reasons: for instance the value system of some Rom communities could be seen as severely limiting their factual opportunities for employment. We shall not consider here the issue of how to provide a decent life for those who are for whatever reason unfit to work. We shall deal here only with the issue of how could society provide a gainful activity for those who are fit and willing to work, and with Breit and Lange (henceforth indicated as BL) rather non conventional 1934 solution to this issue.<sup>4</sup>

### ***Different varieties of right to work, and the right to employment in the Breit and Lange 1934 model***

Even if one must not forget the issue of the “working poor”, the most immediate reason for destitution of the able-bodied is unemployment. A way to deal with this is to provide employment for everybody, proclaiming some form of the “the right to employment principle”. The latter can be interpreted in many ways. A relatively mild version is the obligation for policy makers to bring about a situation in which everybody is able to find eventually a gainful employment, such as when the number of vacancies is at least equal to the number of the unemployed. But even this leaves open the possibility for frictional and especially structural unemployment, even if the latter can be fought with a number of active labour policy measures, involving, for instance, retraining. Obviously the extent of the practical implementation of universal full employment depends on the nature of the overall macroeconomic conditions. In case of severe overall excess demand for labour, as was often the case in the old Soviet-type economies, there was the practical opportunity for almost everybody to find a job, however poorly paid.

A much stronger and forceful version is some warranted right to employment, such as an universal model of the administrative direction of labour (akin to Trotsky’s militarization of labour): everybody can or must (in case work is not only a right but also a duty) report for work and a labour management office directs all applicants to employment. One could conceive its operation as similar to the way in which freshmen are directed to the different universities in the British system; the applicant lists his preferences to a central organization (UCAS) and the organization directs him considering the slots offered by the different universities, as well as his stated preferences.

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<sup>4</sup> Breit and Lange (1934) was published as a chapter of a book published anonymously, as the political programme of *Plomienie*, a group of left-wing young socialists. The authorship by Breit and himself is declared by Lange in Lange (1961), where the chapter is partially reproduced (pp. 29-42).

Obviously for everybody to be assigned to a slot, the slots created must be more than the number of the applicants. Another (milder) way is when the state performs as the employer of last instance (such as providing some kind of public works employment to those otherwise unemployed).<sup>5</sup> Finally, another, stronger, variety is when workers have the right to be hired by any particular employer of their choice. An institution of this kind could be seen as a radical, albeit trivial, solution to the unemployment problem in a model of a market economy where labour is a homogeneous standard commodity. In such a system the price of labour and the structure of jobs would continue to be the result of the interplay of demand and supply; in order to govern the amount of workers exerting their right to be hired, firms would simply change the wage rate offered according to their target employment level, and everything would be the same as in the more conventional idealized model of the working of a market economy.<sup>6</sup> But in the reality labour is not a homogeneous standard commodity. In the real world, where information is limited and asymmetric, and workers have hidden different characteristics, such an institutional set-up would probably heavily impair incentives, and especially the supply of entrepreneurship, with potentially disastrous consequences. In the case of the BL model of 1934 the right to employment on demand is exerted with respect to large cooperative trusts encompassing a whole branch of production. Workers' wages are their shares in the value added of the trust where they are employed, after deduction from net production of a quota for capital accumulation and for the usual charges. If some trust is more productive than the others and the remuneration of workers consequently higher, workers would move there and its production increase. Thus the model contains an allocative mechanism with some interesting properties. In the sketchy presentation by BL the issues of incentive creation and of asymmetric information are not addressed. As a matter of fact the issue of incentives was not addressed by Lange even in his later celebrated model of a planning mechanism mirroring the market. As to the problems of asymmetric information, economic theory became aware of them much later in time. On the other hand, in the case of big productive entities such as in the '34 BL model, the issue of incentives could be well addressed in principle by the usual instruments of personnel management, since the free access mechanism is compatible with the possibility of having a differentiated structure of jobs and conditions of employment. In other words, the right to employment concerns

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<sup>5</sup> This could have been not too difficult in the past, when there were plenty of possible simple manual tasks, easy to supervise, available, such as in road (or pyramid) construction, or in quarries. It is much more difficult in modern societies where jobs are more complex, require a specific preparation, and usually a measure of trust.

<sup>6</sup> See Chilosi, 1987.

employment, not the specific job, nor the place of the applicant in the hierarchy of the organization. In this, as in any other set-up where the “reserve army of the unemployed” is missing, some incentive problems are bound to arise. In particular, if the entry level remuneration is satisfactory enough, and the right to employment applies without limitation, there would be no incentive against job shirking at the entry level, but for the career prospects.<sup>7</sup> Workers could be satisfied with the initial wage and perform unsatisfactorily, if, because of the right to employment (as well as in case of large overall excess demand for labour, such as in the case of former Soviet-type economies), dismissals were deprived of disciplining power and the structure of remunerations (or rather of overall job satisfaction) inside the organization were flat. Indeed, the issue of incentives becomes very relevant if, as assumed in BL, workers’ remunerations are approximatively equal.

In the peculiar Italian variety of the right to employment, where this consists of workers’ right not to be dismissed from the existing job, but for a verifiable justified reason, the incentive problem applies to all employed workers benefiting from the system,<sup>8</sup> as verifiability is a much stronger condition for dismissal than simple observability.<sup>9</sup> In the case of Italian civil service, the practically unlimited security of tenure could be not extraneous to what is generally lamented as the particularly poor performance of Italian bureaucracy. On the other hand such as system represents an interesting social experiment, as one could in theory doubt that a bureaucratic organization where everybody has unlimited tenure could work at all.

### ***The Mittel-European sources of Breit-Lange 1934 model***

The organization of the socialist economy into open self-managed units, which must accept all applicants, is a recurrent theme in the Mittel-European, non Marxian, socialist tradition, whose intellectual ascendancy lies in Marx’s and Engels’ arch-enemy Eugen Dühring.<sup>10</sup> The latter had

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<sup>7</sup> There is a inherent (Pareto) inefficiency here in the fact that the workers could be better off by receiving higher wages, and performing more efficiently, with the increase including only to a part of the increased contribution to production, but this would be hindered by the impossibility, or the excessive cost, to monitor to a sufficient extent effort and performance.

<sup>8</sup> That is, workers in firms with more than 15 employees. In the public sector protection from dismissal is particularly far-fetched, amounting to watertight security, while in the private sector security is limited by the possibility for the employing firm to close or declare bankruptcy, laying off all its workers.

<sup>9</sup> For the difference of the two concepts and its implications one can see Dimitri (2000) and the literature quoted there.

<sup>10</sup> Cf. Chilosi (1999).

sketched what could be the first model of market socialism (Dürring 1876), which was the object of Engels' hefty attack in *Anti-Dürring*, but, just because of that, was ensured a notoriety and possibly an influence that most probably would not have earned otherwise.<sup>11</sup> One may refer in particular to Franz Oppenheimer's model of open producer co-operatives that are "open as a consumer union' and have 'the monopoly of a market with sufficient purchasing power'".<sup>12</sup> As for the organization of socialist production in self-managed trusts comprehending a whole branch of the economy, one may refer in particular to Heimann's *Marktsozialismus* (indeed, Heimann, 1932, is quoted by BL). On the whole the idea that socialist production should be organized in huge self-managed trusts is an time-honoured one in the history of socialist thought, especially in the Mittel-European area.<sup>13</sup> Workers' free entry principle, which BL may have taken over from the socialist tradition originating in Dürring, can be seen in this respect as providing a mechanism according to which the market power of the self-managed trusts can be broken and Heimann's precept that "collective organizations renounce all monopoly gain" be implemented.<sup>14</sup> Moreover the free entry principle represents a solution to the problem, emphasized by Mises in 1922, of the compatibility between the decentralized working of self-managed trusts and the planned direction of the economy,<sup>15</sup> providing a almost automatic, non-discretionary mechanism guiding the allocation of investible funds by the Unibank towards those trusts where employment increases. The increase of employment constitutes for BL an index of greater social profitability of production where it occurs, because it signals an increased per capita value of production.<sup>16</sup> BL's Unibank, as the owner of all the capital of the trusts, is considered by them as having some of the powers of a central planning office, "as it constitutes the centre from which comes the direction of the socialist planned economy", in particular it can shift capitals from one trust to another (BL, 1934, p. 68). However the assumed

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<sup>11</sup> In particular the system of Mao's communes seems curiously close to that sketched by Dürring, and reproduced as an objective of derision in *Anti-Dürring*, while an inspiration from Marxist writings is far from evident. See on this point Chiosi (1999).

<sup>12</sup> Oppenheimer, 1922, pp. 163-164. Oppenheimer makes no mystery of his intellectual indebtedness to Dürring (cf. Oppenheimer, 1928, p. 306).

<sup>13</sup> Cf. Landauer, pp. 843-48. In England this idea takes the specific form of guild socialism (*ibidem*, pp. 1612 f.), with syndicalist bents and medievalist reminiscences.

<sup>14</sup> Eduard Heimann, *Mehrwert und Gemeinwirtschaft*, Berlin, 1922, p. 185; quoted in Landauer, 1959, pp. 1643-44.

<sup>15</sup> See Mises, 1981.

<sup>16</sup> BL, 1934, p. 75.

mechanism of functioning of the economy makes the exertion of its powers particularly simple, as they consist in fixing a proportion of the value added of plants and trusts which must be conferred, according to the above rules, to the Bank for investing in the economy (p. 78). The plants unable to realize the planned rate of accumulation must be gradually closed. All net revenues left over after paying the dues to the Bank must be distributed among the workers (ibidem).<sup>17</sup> The central role of the Unibank in managing the socialist economy is not new in non-Marxian socialist thought, in particular it is paramount, albeit in different forms, in Hertzka's system of settlement cooperatives with free entry and employment on demand.<sup>18</sup>

The above gives a hint of BL's broad Mittel-European formation, and of Lange's early attention for the market socialist solution. Lange's former interests were enriched with the analytical tools of general equilibrium economic theory in his American stay, leading to the formulation of his '36 celebrated simulated market planning mechanism. It is notable that the '34 BL market socialist scheme was published in the year when Lange, being 30 years of age, went to Chicago. His Mittel-European period was over, and the crucial years for his formation as an economist in the USA were beginning.

### ***Employment on Demand in BL and Elsewhere***

A basic problem with a market economy, be it capitalist or socialist, is the tendency to generate variable amounts of involuntary unemployment. In particular the Yugoslav experiment of market socialism was marred by much greater unemployment rates than in most Soviet-type planned economies, while the latter were characterized as a rule by a chronic situation of excess demand for labour. The institution of employment on demand constitutes a trivial mechanism in the BL 1934 model through which involuntary unemployment is ruled out, so to say, by definition, unlike other possible models of market socialism, where the goal of full employment may be pursued through the usual macroeconomic and structural policies, but where involuntary unemployment is not

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<sup>17</sup> It must be noted that the above rules lead to inefficiency, as capital resources are not allocated according to their marginal rate of return. The same applies to labour. In particular there will be a tendency for the average and not the marginal productivity of labour to be equalized all over the economy. In fact if  $s$  is the charge on the net value of production set by the bank, the per capita income of workers in a trust or a plant  $i$  will be  $(1-s) y_i/l_i$ , where  $y_i$  is net production and  $l_i$  employment in plant  $i$ . Even if efficiency is not a property of any real economy, this kind of inefficiency could be particularly severe.

<sup>18</sup> Cf. Hertzka, 1891, p. 108; Chilosi, 1999, p. 193.

intrinsically ruled out.<sup>19</sup>

The institution of employment on demand, which can be found in the family of socialist market models whose forefather was Dühring's, had different connotations in the different authors. In Dühring the basic economic unit, the economic commune, had a territorial, rather than functional, nature. The institution of employment on demand was consequent on the obligation of the communes to accept new members.<sup>20</sup> In Hertzka, the institution of the right to employment applies to settlement cooperatives, and is seen as a crucial allocating mechanism. This latter aspect has been taken over by the BL '34 model. But, notwithstanding the fact that in both models the free movement of labour is deemed to have a crucial allocative function, there is a fundamental change of attitude, since instead of a perfectly competitive market with atomistic firms as in Hertzka, BL see socialist enterprises along functionalist lines, as large units comprehending a whole sector of production.<sup>21</sup> As we have seen, this makes their model closer to Franz Oppenheimer's model of open industrial cooperatives rather than to Hertzka's perfectly competitive approach. In Oppenheimer however the urban or industrial open cooperative was derivative of his primary brainchild, the *Siedlungsgenossenschaft*, the open settlement cooperative, through which, in his

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<sup>19</sup> BL refer only implicitly to the consequences on unemployment of the institution of employment on demand in section VIII, where they deal with the issue of "Does Socialism succeed in employing the unemployed?" (pp. 82-85). They instead explicitly refer to the favourable consequences on employment of bringing to an end the monopolistic behaviour of capitalists trusts as a consequence of socialization, and of the increase of productivity following the closure of deficitary enterprises. On the other hand they stress "with all possible emphasis that the road for getting rid of unemployment does not lead through inflation, as a temporary revival of inflation in industry would be bought at very high costs" (p. 83).

<sup>20</sup> "The right to land and soil and to economic infrastructures, as well as obviously that to dwelling-houses, no longer has the character of the old exclusive property, suited to the ruinous exploitation of the labour force. It is replaced by a form of availability under public law, which outwardly also does not have the power to behave exclusively, since there is freedom to move between the different communes and settle anywhere and an obligation to accept new members according to given legal norms and administrative regulations. One may thus regard the relationship to the natural and cultural auxiliary sources of production and existence, which are to be made common, as similar to present day membership of a political entity and to participation in the communal economic infrastructures." (Dühring, 1876, pp. 322-3: my translation of the original German text).

<sup>21</sup> For the notion of functionalist socialism, see Landauer, 1959, p. 1641.

view, by taking the rent away it was possible to open up the settling of the vast, underpopulated, territories of Eastern Prussia, thus raising the conditions of the urban German proletariat, by providing an outside option with respect to industrial employment. The conception according to which rent was essentially an economically unjustified return to a monopoly of land, which was common, among others, to Dühring and Hertzka, was of course flawed,<sup>22</sup> but the concept that to break the monopoly of land through the creation of open settlement cooperatives was a way out of the social question, by providing an outside option to urban proletarians, is an interesting idea. It provides in fact a reversal to the historical process described in the in the 24-th chapter of the first volume of *Kapital*, on *ursprüngliche Akkumulation*. In Marx's view the downfall of the medieval organization of the countryside, and in particular the suppression of the access to the commons as a consequence of the enclosures, robbing the dispossessed peasants of the agrarian outside option, left them without other choice but urbanization and proletarianization, making the industrial revolution and the rise of capitalism possible. For Oppenheimer the free land, providing the outside option was in Eastern Prussia. In the case of Hertzka it was supposed to be offered by colonial settlements in sparsely populated lands, where the possible reaction of the natives (likewise as in Herzl's *Judenstat*) was utterly underestimated. In BL's model too the institution of employment on demand was seen as a tool to break monopoly. Not the alleged monopoly of land, such as in Dühring, Hertzka and Oppenheimer, but the potential monopoly power of large self-managed firms, as a restrictive monopolistic behaviour by some trusts aiming at increasing the per capita revenues of workers would be immediately defeated by the movement of other workers willing to take advantage of the higher incomes. In the case of BL no alternative option, outside market and industry, for providing a floor for workers' incomes is needed, since the floor under which incomes cannot fall is provided inside the system as the share payment to workers in socialist trusts, which would have a built-in tendency to be the same all over the place. Thus in this case the outside option for all workers is, so to say, provided intrinsically by the market. The same takes place in the abstract model of a perfectly competitive capitalist economy where all markets instantaneously clear. But the latter result is by no means robust: whenever some more realistic features, such as limited and asymmetric information, and the possibility for aggregate demand for labour to be lower than supply, are introduced, it disappears. This does not apply if employment is on demand, such as in the BL case, which maintains its characteristics of technically providing definitional full employment, however close to reality are the relevant assumptions we are willing to make.<sup>23</sup>

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<sup>22</sup> See Schumpeter, 1954, , pp. 264, 854.

<sup>23</sup> Of course when we speak of full employment, we are considering full *open* employment. There is



### ***The Likely Consequences of Employment on Demand***

An interesting question, which I have addressed elsewhere years ago,<sup>24</sup> and which was prompted by my first reading of BL's chapter, is whether some form of employment on demand, such as in BL, could be the answer to the unemployment problem in a market economy. Such arrangement could be seen as a system of welfare founded on workfare principles.<sup>25</sup> In a model of employment on demand, firms fix an entry wage for workers according to their desire to recruit and keep them in the firm. They have an obligation however to hire everybody applying, in the same way as a shop fixes the price of the ware it sells, but cannot discriminate among customers. In theory the firm could hire the exact amount of workers it needs by fixing the wage at a suitable level. In practice this system could hardly work adequately in a world where the characteristics of every worker are to some extent specific, wages (as well, and even more, as prices) cannot be changed every moment at will, and there is imperfect and asymmetric information. One would suspect that in the most unlikely case of implementation of such a system the posted entry wage would be fixed close to zero and the work relationship would in many cases be only nominal (a little bit as post-Soviet firms keeping nominally workers on their payrolls, while having them in unpaid leave). Higher wages would be paid only to workers the firm wishes actively to employ and keep in the firm. It is true that a minimum statutory wage could be imposed, but this, associated to employment on demand, could be very destructive for the supply of entrepreneurship. The aim to ensure to every able-bodied person a livelihood by guaranteeing them a job would be utterly frustrated. In the case of the BL socialist market model things would however be different, as its practical problems with the BL solution would be related first of all to the management of the large self-managed trusts and to the egalitarian approach, rather than with the institution of employment on demand as such.

### ***Employment on Demand and the Issue of the Outside Option***

An obvious incentive problem applies anyway to any arrangement leading to the provision of a guaranteed basic income or outside option. In Marx's view a large reserve army of destitute

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the other issue of hidden unemployment, which has different economic and social connotations. It has with open unemployment in common the characteristic of being associated with economic waste, but not the potential dire social consequences of open unemployment.

<sup>24</sup> See Chilosi (1987).

<sup>25</sup> Workfare is a term coined in the USA in the sixties, of a system of social assistance based on the obligation for the recipients to perform some work in exchange for assistance.

unemployed is instrumental to the working of a capitalist economy.<sup>26</sup> In the *Great Transformation* Karl Polanyi emphasizes the dire economic consequences, because of its effects on incentives, of the Speenhamland System, providing a minimum guaranteed income to the working poor, and making up by all effects a collective poverty trap. Analogous considerations were otherwise made much earlier with respect to the assistance provided by the poor laws.<sup>27</sup> It is still a problem for a modern society how the objective to ensure to everybody a minimum living standard should be compromised with the maintenance of incentives to work, and with public finance constraints.<sup>28</sup> Another relevant issue is the distinction between an active and a passive outside option. The first refers to any build-in mechanism that allows anybody to earn a living whatever his particular circumstances. The existence of free land in an agricultural society (such as provided by the American Frontier, or the large unpopulated areas of Eastern Prussia, as in Oppenheimer) is an obvious case: anyone decided or compelled to opt out from gainful employment can become a peasant, in a society where agriculture is the primary activity. Another it is the possibility to partake in the social protection offered by the feudal system and of the collective exploitation of the commons in the traditional agricultural village, as it could have been the case before the enclosures. Still another is the hypothetical possibility to choose, say, some public employment offered at a minimum wage to anybody applying (but see the difficulties of this solution as considered in footnote 5). A third, finally, is that of BL, with employment on demand. Passive outside options, all sort of subsidies not constituting remuneration of work, such as unemployment subsidies (but these are usually temporary), disability or pauper subsidies, the universal basic income in Friedman's scheme of the negative income tax, or as advocated, in the form of a social dividend, by the Basic Income European Network, and much earlier by Thomas Paine,<sup>29</sup> present obvious incentive and

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<sup>26</sup> A more modern approach to the function of unemployment in a market economy is that of efficiency wage theories, where unemployment performs “as a disciplining device”.

<sup>27</sup> See Townsend (1786).

<sup>28</sup> On the other hand a mass of destitute and dissatisfied citizens can be very damaging for public order and social peace, with negative consequences on the production. From this viewpoint the provision of a reasonable outside option (or safety net) could be seen, even outside its own merits, to be in the overall interests of the economy.

<sup>29</sup> In his *Agrarian Justice* (1796), he advocated a down payment to all those reaching 21 years of age and a yearly payment to all those of 50 years of age or more, financed through a tax on inherited land, justified by the fact that “every man, as an inhabitant of the earth, is a joint proprietor of it in its natural state”.

self-selection problems that the active options can perhaps avoid. But unfortunately the latter are not too easy to implement. (One could just look at the long history of the poor laws for understanding their intrinsic limitations.) The modern American revival of workfare conceptions have not shown to provide in the end the panacea of ideally matching the social provision of a guaranteed minimum income with the self-selection and incentive advantages of accompanying a guaranteed income with an obligation to work, as they have shown a number of important disadvantages.<sup>30</sup> A workfare solution involving the right to employment on demand, however attractive, cannot be accepted either, for the grave incentive problems it would obviously present. The real world is much more complicated than any theoretical model, and usually, contrary to naïve perceptions, there are no easy way outs, but only troublesome trade-offs.<sup>31</sup>

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<sup>30</sup> “Putting the unemployed into workfare schemes actually limits their opportunities to look for work, by making them show up for make-work schemes when they could be hunting job vacancies, filling in applications and attending interviews. ... Workfare is actually a more expensive option than traditional unemployment benefit, for the jobless are ultimately given at least the same amount of taxpayers money but the state also has to pay the costs of setting up the schemes, paying for materials, the wages of supervisors, transport and childcare costs, etc. In a recession, when the numbers of the unemployed rise substantially, the costs of workfare schemes could be prohibitive and lead to the collapse of the policy...Individuals forced into workfare schemes lack incentives to work to a high standard, and may be actively disaffected. The work they do is therefore unlikely to benefit anyone much and raises a number of safety issues: would you drive across a bridge built by workfare labour? Would you trust your aged parent or pre-school child to a workfare carer? Would you trust them with any job that required the handling of money? Given these constraints, it is clear that the government may be unable to find enough worthwhile things for their forced labourers to do.” (Endersby, 2001; this paper provides a balanced presentation of the arguments in favour and against workfare. Here I have reported the most plausible arguments against.) For a theoretical analysis of the costs and benefits of workfare, taking in consideration incentives, see Besley and Coate, 1992.

<sup>31</sup> An obvious obstacle on the possibility to provide a satisfactory general outside option, either passive or active, is given by migration processes. So long as the latter cannot be effectively controlled, the provision of a general outside option more favourable than the living standards in the migration countries could become practically unsustainable.

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