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Market Socialism: A Subjectivist Evaluation

by Robert Bradley, Jr.
Department of Economics, University of Houston

This essay is an attempt to provide a modern overview of the economic calculation debate from the Austrian School perspective. Specifically, the many arguments against market socialism will be consolidated to demonstrate the neglected theoretical strength of the free-market perspective. In this regard, the fact that market socialism never has been implemented or even become a ballot box alternative can be better understood.

The seeds of the calculation debate had been planted by a host of economists before Ludwig von Mises posed the central question "in such a form as to make it impossible that it should ever again disappear."[1] Mises' article, adapted from a lecture of a year earlier, appeared in the spring of 1920 entitled "Economic Calculation in the Socialist Commonwealth."

The famous challenge of Mises was uncompromising and to the point: "Where there is no free market, there is no pricing mechanism: without a pricing mechanism, there is no economic calculation."[2] Two years later the argument was enlarged in a wide-ranging critique of socialism, entitled *Die Gemeinwirtschaft*, after which replies from his critics began.[3] Mises defended his position in articles published in 1924 and 1928 against, in Hayek's estimation, "objections [that] were really more quibbling about words caused by the fact that Mises had occasionally used the somewhat loose statement that socialism [economic calculation] was impossible."[4]

The main effect of Mises' arguments has been best summed up by the renowned socialist economist Oskar Lange: "It was [Mises'] powerful challenge that forced the socialists to recognize the importance of an adequate system of economic accounting in a socialist economy. Even more, it was chiefly due to Professor Mises' challenge that many socialists became aware of the very existence of such a problem."[5] But the real effect, looking on the challenge from a later date than Lange, was to force the socialists to retreat from a pure advocacy of Marxian socialism to a compromise watered down with "competitive" infusions—market socialism. It is this latter system, especially as developed by Lange, Lerner and Taylor, that will be examined below.

Part I: The Foundations of Market Socialism

The heritage of the market socialists lies not as much in the Marxian tradition as in the early work in neoclassical equilibrium theory.[6] In particular, Leon Walras[7] pioneeringly proved the existence of equilibrium in all markets by the mental construct of having an auctioneer call prices until the supplies and demands of all markets meshed. The significance of this theoretical proof for the socialists was not so much that potentially a perfect order could arise from complexity, but that this order deliberately was engineered, so to speak, from the center.

Vilfredo Pareto, Walras' student and heir at the Lausanne school, then added an important condition by putting forward a verbal law of optimality in such an interconnected general equilibrium for both consumers and producers.[8] From Pareto's demonstration came the welfare ideal of "pure and perfect competition," which later was to serve as the optimality model for the market socialists to try to duplicate.

The next major contribution that proved (in retrospect) significant for the market socialists came from the pen of Enrico Barone. He conceptually solved the problems of production via mathematical equations. So, assuming one had sufficient information, the equations could be filled in and production optimally directed.[9]

Together, the above members of the early neoclassical group, in addition to giving their own school identity, laid the necessary groundwork for a separate school to follow.[10]

Part II: The Rules of Market Socialism

The elaborate plan for market socialism to achieve economic calculation has been provided by Oskar Lange in his essay "On the Economic Theory of Socialism." Lange begins by tracing the neoclassical theory of capitalism and its program describing optimality. This excursion provides Lange with a model needing duplication (and in parts improvement) within the constraint of state ownership of the means of production.

The "market socialism" model begins by assuming that the consumers exercise freedom in consumption. They are "sovereign," as under capitalism, providing the "guiding criteria" for the production processes.[11] Similarly, as laborers, they are free to choose the occupation "paying the highest wages."[12] The caveat exists, however, that the Central Planning Board (CPB) makes sure that "the distribution of the social dividend... be such as not to interfere with the optimum distribution of labor services between the different industries and occupations."[13] Further, this optimum requires that "the social dividend be distributed so as to have no influence whatever on the choice of occupation."[14] Thus, Lange's occupational freedom is preserved within the spirit of socialist egalitarianism.

The controversy surrounding socialism does not so much concern the above; rather, it concerns production and how socialism can have accurate factor pricing without competition. Lange here introduces several rules that are intended to replace and improve upon capitalist production. The first rule is to have all producers equalize the ratios of marginal productivity to their prices, for all the factors of production (e.g., $\frac{MP_a}{P_a} = \frac{MP_b}{P_b} = \frac{MP_n}{P_n}$).[15] The second rule, to be used in tandem with the above, is to price production equal to marginal cost, a principle first recommended by Fred Taylor and readily adopted by Lange.[16] This marginal cost principle, the welfare ideal of neoclassical economics, is addressed not only to the singular firms but to the industries as well.[17]

The above two rules regulating socialism's capital structure can be viewed profitably alongside their free-market counterparts. Profit maximization under capitalism is replaced by producing at minimum average cost.[18] Free entry/exit and the optimum size of plant in the market order are likewise duplicated by the same rule.[19] The second rule, of setting price to marginal cost, conforms to the "pure and perfect competition" ideal under capitalism. Setting marginal benefits to marginal costs is seen as maximizing welfare (the Pareto optimality) for society. In all, the rules fully cover the economics of production, "determin[ing] the combination of factors of production and the scale of output" while also maximizing welfare.[20]

There remains one key procedure in the socialist plan, for pricing at marginal cost and production at minimum average cost assume that the prices reflect scarcity values. Again drawing upon the procedure formulated by Professor Taylor,[21] Lange instructs the CPB to set prices in response to shortages and surpluses in inventory levels. If there is a shortage, an adjustment in price upwards is necessary; if there is a surplus, the price needs lowering. Lange sees this method as effective and not unique since this is "the same process of trial and error by which prices on a competitive market are determined."[22] So, starting with historical prices and making "small adjustments" in response to inventory signals, true scarcity prices are found, since demand is entered to meet supply.[23]

Lange is careful to avoid rationing instead of adjusting prices since this interferes with prices being *parametric*.[24] The only exception would be when "there is general agreement that such deviation is in the interest of social welfare."[25]

With the carrot of profit replaced, the stick of the CPB becomes the enforcer. If the rules are not being followed, the CPB will "interfere" and "order" changes so that the prescribed harmony in production resumes.[26] "Fixing quotas of output and comparing them with the actual achievement" is one such check, offers Lange.[27]

Outside the area of prices for consumer and producer goods, there remains the all-important "price" of interest. In the short run, Lange envisions the forces of supply and demand as spontaneously finding an equilibrium rate. But in the long run, the CPB would "evaluate the optimum time-shape of the income stream."[28] This is a key function, notes Lange, since the rate of growth in the socialist community is controlled.[29]

Professor Lange has been joined by Abba Lerner in theorizing about the conditions of efficiency under market socialism. Reflecting his familiarity with Austrian marginalism,[30] Lerner proposes to replace Lange's statics with dynamics, recommending that the rule of marginal *opportunity* cost be employed.[31] However, because his "marginal opportunity cost" is an equilibrium concept, Lerner's model is also essentially static. Thus little revision has been made regarding Lange's proposals.

There is no hesitancy on Lange's part in claiming that he has successfully rebutted the challenge of Mises, and though he treated the restatements by Hayek and Robbins as a more plausible "second line of defense," he was to conclude later that, "In my essay ['On the Economic Theory of Socialism'] I refuted the Hayek-Robbins argument by showing how a market mechanism could be established in a socialist economy...by...trial and error."[32] But Lange is not alone in his conclusion. As Don Lavoie points out in the accompanying essay, a number of eminent economists have reached a similar verdict that constitutes an unchallenged orthodoxy in the Comparative Economics field.

Part III: Competition: Austrian Versus Neoclassical Theory

After the socialists had refined their arguments in response to the Mises demonstration of the inadequacies of the Marxian system, several critical examinations of the new position were made. In 1940, Hayek published an essay entitled "The Competitive 'Solution'," which was the last of three major articles by him contributing to the debate. Mises also examined the Lerner-Lange-Taylor revisions with systematic rigor in his treatise of 1949, *Human Action*, under the title "Recent Suggestions for Socialist Economic Calculation." This was Mises' last reply.[33]

To appreciate the "Austrian" objections against the market socialist theory, one must take an important detour into a critical examination of neoclassical theory. This is of utmost importance since the Mises-Hayek insights have been wedged, by a great many students of the debate, onto the alien foundations of neoclassical equilibrium theory. Regarding this, it must be clearly pointed out from the start that the two schools have very different perspectives in judging and understanding competition and optimality. Specifically, the neoclassicists' emphasis on *equilibrium* is to a degree similar to the Austrians' emphasis on the equilibrating *process*. Since the two are nonoverlapping, this distinction should be kept always in mind.

The market socialists, as before mentioned, borrowed from the "pure and perfect competition" model the condition that prices be set at marginal cost. Furthermore, that real-world capitalism deviates from the above Paretian optimality is mentioned as a point against the allocation of resources under capitalism.[34]

A complete dismissal of the above and a contrasting view of competition couched in dynamic terms has been made by Hayek in a neglected 1946 essay, "The Meaning of Competition." Opening his censure, he states:

> [What] the theory of perfect competition discusses has little claim to be called "competition" at all. ...The reason for this seems to me to be that this theory throughout assumes that state of affairs already to exist which, according to the true view of the older theory, the process of competition tends to bring about (or to approximate) and that, if the state of affairs assumed by the theory of perfect competition ever existed, it would not only deprive of their scope all activities which the verb "to compete" describes but would make them virtually impossible.[35]

What Hayek wants, instead of the static ideal, is the study of disequilibrium movements from one situation to another, while asking ourselves two questions: first, is the change coordinating (equilibrating) or not (disequilibrating)?; and second, what is the nature of these forces?[36]

To Hayek, then, "competition is by its nature a dynamic process whose essential characteristics are assumed away by the assumptions underlying static [perfect competition] analysis."[37] He asks: Can we call something competitive that does not allow for advertising, price undercutting, product differentiation, locational advantages, goodwill, imperfect (costly) knowledge, and the *new*?[38]

We now can see what competition means from the Austrian point of view. Rather than achieving a "perfection" that could never be realized, competition represents a framework of free entry and exit of firms (Machlup's "pliopoly") in response to uninhibited entrepreneurial foresight. As Israel Kirzner states: "Competition, in the process sense, is at least potentially present so long as there exist no arbitrary impediments to entry.... The competitive process depends entirely on the freedom of those with better ideas or with greater willingness to serve the market to offer better opportunities."[39] This distinct view of competition, in order to differentiate it from the "pure and perfect competition" model, may be labeled "rivalrous competition."[40]

One may examine the neoclassical (and market socialist) view of ideal competition from another perspective by asking the question: What would the world be like under a blanket of "pure and perfect competition"? First of all, as Hayek first noticed, there would not be an economic problem. For, given the assumption of perfect knowledge, complete efficiency is assumed. Scarcity may not be eliminated, but the best alternatives to deal with it are in employment.[41] Thus, there remains nothing for the actors to do to improve their condition—purposiveness has become obsolete. Further, the model is marred by logical quagmires. For example, an infinite supply cannot alter price or scarcity. And with perfect knowledge, the demand for cash balances would fall to zero, making prices soar upward toward infinity.[42] This, of course, is incompatible with the assumption of constant money prices under the model.

Logical inconsistency is not the only drawback to the idea of "pure and perfect competition." One can also question the model as a social optimum. One problem is its disregard of cost economies, resulting from factor indivisibilities, that exist under "imperfect" competition. Prices may be set at marginal costs and equal to average costs, yet be higher than necessary. In this context, the economist must remind himself that, dynamically, profits are not so much added to costs as created out of costs. So in all, we can envision a "perfect competition" price as being *higher* than an "imperfect" competition price. Also, "perfect competition," being set in a world of *givens*, cannot offer improved or new items. Furthermore, any and all consumer desire for diversification must be ignored as having a utility less than the "lower" cost of product homogeneity.

In contrast, the interesting problems (and *the* problem of economics) are to be found in the real world of incomplete information, shifting expectations, changing opportunities, error, and plan adjustment—*disequilibrium*. And, as Hayek notes, it is here that economics becomes an empirical science rather than a science of pure tautology.[43]

Part IV: Socialism and the "Trial and Error" Proposal

The above excursion should shed much light on the source of the Austrian criticisms. In Mises' original article and throughout the exchange, there have been explicit efforts by the Austrians to shift the plane of discussion away from equilibrium. In fact, from the very beginning it was never denied that socialism could solve the calculation problem in equilibrium.[44] Thus, socialism now, as then, is to be judged under the conditions of the real world.

As a natural follow-up to the above digression, before the rules regarding price, cost and quantity are analyzed, we can study socialism on the disequilibrium plane. Disequilibrium in the socialist system consists of shortages and surpluses that present themselves under changed conditions.

To Lange, these moments of disequilibrium present little cause for concern. They appear, are diagnosed and are eliminated by "small adjustments" in price by the CPB.[45] Then normality returns. The process is described as "simple" and the correction time "much shorter" than under capitalism.[46]

Mises has forcibly denied the simplicity of such a procedure on the grounds of the static-dynamic squabble just discussed. Trial and error, explains Mises, is a strategy which assumes that the thing "one is looking for remains unchanged during the trial (such as searching for a misplaced wallet)."[47] In other words: "The method of trial and error is applicable in all cases in which the correct solution is recognizable as such by unmistakable marks not dependent on the method of trial and error itself."[48] In contrast, "Things are quite different if the only mark of the correct solution is that it has been reached by the application of a method considered appropriate for the solution of the problem."[49]

Mises' argument can be complemented by two separate discussions: the first dealing with economic change and the second examining the nature of correcting individual prices.

When Lange explains the "trial and error" technique, one is immediately impressed with the banishment of change in his system.[50] Such statements as "so the process goes on until the objective equilibrium condition is satisfied and equilibrium finally reached" remind one more of natural scientists in the laboratory than applied economists checking inventory. The weakness of this, as Hoff has observed, is that "the advocates of the 'trial and error method' obviously assume that the community will be static, and expect that conditions will remain unaltered while the 'trial' is being made."[51] And, when one assumes that the adjustments are accompanied by drifts in other price-influencing factors, the "correction" becomes not only tentative, but *too late.* This leads us to a vital and neglected (by the neoclassicists and market socialists) distinction in economic functions—managerial adjustment versus entrepreneurial alertness. We will pursue this area in the next section of the paper. There is a second major weakness in the Langian method for achieving scarcity prices that even the Austrians underemphasize.

The success the market socialists hope to find cannot be attained with only a price being "right" (e.g., where supply and demand mesh, preventing surpluses or shortages). The price interrelationships must also be accurate. This means that to monitor and judge any particular price, one is assuming that its substitutes and complements are in balance, preventing any falsifications in the monitored price's demand. For example, if good *A* has a price equating supply and demand, while its substitute *B* is out of equilibrium, then *A*'s price is transmitting misinformation though equilibrating. And to "correct" the price of *B* would be to upset *A*'s equilibrium. Further, it is logically possible that a good and its substitutes all have equilibrating prices, yet their prices not be indices of true scarcity. In this case, the bad prices merely camouflage each other. So we can see that monitoring individual prices is not enough; the CPB would have to be in command of *all* price interrelationships. Thus the "trial and error" method becomes inadequate since it only applies to prices individually.

Part V: Entrepreneurial Alertness Versus Managerial Adjustment

Though not schooled in the Austrian tradition, Harvey Leibenstein has expressed this school's disenchantment by saying: "If we want to get anywhere to solve the entrepreneurial puzzle, we have to stay away from the neoclassical general equilibrium syndrome."[52] And, just like the neoclassical school Leibenstein chides, the market socialists also see entrepreneurship as a nonspecific talent, easily duplicated by bureaucratic management and CPB corrections. Such casual asides by Lange as "the process of price determination is quite analogous to that in a competitive market" demonstrate this point.[53]

In Austrian theory there is more than producers and consumers who adjust their actions to one another; there is also the entrepreneur, characterized by his alertness to "differences between the sum of the prices of the complementary factors of production and the prices of the (final) products."[54] These discrepancies offer both profit and loss to those combatting these gaps of knowledge in the face of uncertainty.[55] So we can see the activity of the entrepreneur in the market as necessary, since error must exist in factor prices and final products, and also positive, since eliminating these discrepancies provides equilibration. And as this process never stops, the entrepreneurial function is continuous.[56]

The entrepreneurial function obviously goes beyond the framework of "*given*" ends and means to which Lange refers throughout his article.[57] Ironically, it was the critic of socialism Lionel Robbins, in his 1932 *Essay on the Nature and Significance of Economic Science*, who couched the economic problem in terms of *givens*,[58] thus providing a methodological basis for the market socialists' view of the economic problem. We must interpret such a view as limited since:

> Robbinsian decision-making presupposes that the framework has already been set up. [But] it is precisely the "entrepreneurial" element responsible for setting up the Robbinsian framework which is not itself a factor in the economizing decision. . . . [Yet] there is nothing in the calculative activity of which Robbinsian decision-making consists which calls for deliberately out-distancing one's fellow market participants.[59]

As against the overly narrow concept of economizing, there is Misesian *human action* (or rivalry). The latter concept, with regard to efficiency, includes not only economizing but also the benefits of change—new products, innovations in old products and the abandonment of past "givens". After all, there always exist things which consumers do not know about but would prefer. And it is here that the entrepreneur comes into his own by locating and acting upon price discrepancies that alert him to unfulfilled wants.

The above explication of entrepreneurship should bring to light the anticipatory nature of its function. He anticipates what future conditions hold and is penalized or rewarded in his quest for profits.[60] Conversely, the "trial and error" CPB corrector passively reacts to over-and-done-with situations and does not actively anticipate with "his" resources.[61] Such reacting to error is obviously less efficient than fighting error ahead of time.

It should be pointed out that the bureaucrat cannot play the role of entrepreneur. Entrepreneurship requires a market and privately raised capital. Notes Mises, "The quality of being an entrepreneur is not inherent in the personality of the entrepreneur; it is inherent in the position which he occupies in the framework of market society."[62] In this sense, we cannot have "government on a business basis", i.e., treat tax allocations as market revenue or treat any surplus over cost as profit.[63]

The explanations, arguments and points made in this section of the paper can be re-emphasized by quoting Professor Kirzner at length:

> The crucial question for government-market comparisons must concern the capacity of each of the two systems *to bring available opportunities to the attention of decision-makers*. Even if the costs to government of reallocating resources were zero, and even if this included the costs of acquiring information, it would not follow that in a government-directed economy resources would inevitably be optimally allocated. To make this conclusion valid we would have to assume not merely that government could acquire information costlessly, but that government was already omniscient. A market relies on the incentive of profit to set into motion the entrepreneurial process. It is solely because of the desire to obtain profits that we can, in any degree, "rely" on entrepreneurial discovery of where profits are to be had. Under government direction, it is not at all clear what substitutes for the profit incentive are available, in the absence of omniscience—not merely to spur the exploitation of socially desirable opportunities, but to direct attention to their very existence. Only if we ignore the role played by this entrepreneurial element can we fail to raise the question of a corresponding role in the government-directed economy.[64]

Part VI: The Weaknesses of Bureaucratic Management

At this point in the paper we may approach the above-mentioned weaknesses of market socialism in less technical terms by contrasting profit/loss with bureaucratic management. Interestingly enough, bureaucracy is a bad word to socialists of all stripes. Lange admits that "the real danger of socialism is that of bureaucratization of economic life."[65] Lippincott agrees.[66] Assar Lindbeck, in a sympathetic study of the New Left, similarly notices that the New Left is critical of bureaucracy and quotes the distinguished Marxist Ernest Mandel to this effect.[67]

What are the economics of bureaucracy?

The bureaucracy must, above all, provide the designated good or service. Of secondary importance is the cost of such an operation. In contrast, for the entrepreneur the turning of a profit is invariably linked to the operation itself. Therefore, costs tend to be higher for the former than the latter. Furthermore, while the bureaucracy can obtain its operating money by compulsory taxation, the entrepreneur must demonstrate the worth of his project to potential capitalists. This channels scarce capital to the most skilled entrepreneurs, encouraging a maximum utilization of resources not present under bureaucracy.[68]

An important point made in a previous section regarding innovation under socialism has been stated by Professor Rothbard regarding bureaucracy:

> Inventions, innovations, technological developments, by their very nature, by definition, cannot be predicted in advance and therefore cannot be centrally and bureaucratically planned. Not only does no one know what will be invented when; no one knows who will do the inventing.... Bureaucracy, incompetent enough to plan a stationary system, is vastly more incompetent at planning a progressive one.[69]

Before extending the analysis of market socialism to the rules (see Part VII), one can profitably point out several other weaknesses of replacing market processes with public ownership. One such limitation is the speed with which information can be utilized.[70]

Change under the Lange system encounters mandatory procedures such as the CPB audit and political permission before a new course of action may be embarked upon.[71] (And, as discussed above, the change is always too late if the trial conditions have changed in the meantime.) Conversely, in a free market, changing conditions are anticipated and acted upon without delay, for profit-making is characterized by acting on private knowledge before it is known by others. For instance, it is not enough to know that company *A* will have a better demand for its products; one must act on this knowledge before it is enough well-known by others to alter present conditions therefore removing the profit opportunity.

Under capitalism, the operations of the futures and stock markets efficiently register *instantaneous* adjustments in information.[72] Importantly, *expectations* are fully utilized under such institutions, promoting a highly economic usage of society's capital stock under changing conditions. It is a curious yet understandable fact that expectations as a guide to allocative efficiency have been so thoroughly demoted in the socialist schemes.

Part VII: The Production Rules of Market Socialism: A Critique

With "trial and error" giving prices meaning, it will be remembered, efficiency is attempted under market socialism by pricing at marginal cost and producing at minimum average cost.[73] We may briefly review the shortcomings of such a procedure.

First of all, these rules have their rationale in the equilibrium world of perfect knowledge and perfect factor divisibility and outside of it lose their authority. But efficiency in *disequilibrium*, contrarily, is to minimize error and *revise plans* toward an *attainable* optimum.[74] Related to this, Hayek has impressively attacked the above conditions of omniscience as the solution to the "economic problem," as we have examined.[75] Mises, in his original article on socialism, made essentially the same point when he spoke of "a kind of intellectual division of labor."[76]

Also, regarding the production rules, we must make the point that *costs are not objective and "given", but subjective and known only to the "man on the spot."*[77] And, as Hayek and others have noticed, costs depend on many things *besides* prices in the production period.[78] The labor theory of value notwithstanding, once something is produced, costs are bygones and sunk and prices are anticipations. Also, before production, costs are themselves anticipations. Yet, as in the previous section, we must ask where risk and anticipation fit in the market socialists' plans, and how an outsider (the CPB auditor) can determine the costs and/or assess responsibility.[79]

The subjectivist revolution of a century ago established value as subjective. But, if value is subjective and nonmeasurable, then so, too, are costs since cost is the *value* placed on the most attractive opportunity forgone. The theory of subjective costs, so well formulated by von Wieser, and then extended by Thirlby, Wiseman, Robbins, Hayek and Coase in the 30's and 40's,[80] has also been grasped by economists outside of this tradition. The general equilibrium economist J. de V. Graaf abandons the P = MC rule, concluding that "the conditions which have to be met before it is correct (welfare maximized) to set price equal to marginal cost in a particular industry are so restrictive that they are unlikely to be satisfied in practice."[81] And P. C. Roberts has noticed that:

> under real world conditions characterized by the passage of time, the marginal rule gives no clear guidance to those directed to organize production in accordance with it. Introducing the element of time brings in uncertainty and requires the exercise of *judgment.* Neither uncertainty nor judgment is present in the formulation of perfect competition from which Lange took his idea of the marginal rule.[82]

Lastly, this rule, in replacing profit/loss, does away with the market's test of success which allocates capital to its most competent users, with the will to cut costs, and with the most reliable incentive for equilibration. These deprivations must be deplored.

The other key rule, producing at minimum cost, is particularly subjective and question-begging. This rule, unmasked, is simply a euphemism for "doing the best you can," overlooking the *conditions* for cost minimization. Under capitalism such conditions *do* exist. Each firm has an outside market to judge whether or not it should produce or buy a factor, and all firms tend toward plant size optimality. And, as we have emphasized throughout this paper, "the opportunity for anybody who knows a cheaper method to come in at his own risk and to attract customers by underbidding the other producers" is omnipresent.[83] Socialism, to the contrary, does not have an institutional framework offering these processes and consequently will not be able to discover least-cost combinations for production. Passing a law enforcing this rule cannot nullify this void and is therefore doomed to ineffectiveness.

In examining the rules of market socialism, we should lastly analyse whether it truly preserves consumer sovereignty.

Realizing that all production depends on final consumption for its value, the socialists have readily allowed consumer tastes to direct their economy. But, as Hayek and others have pointed out regarding the direction of productive activity, the wishes of the CPB and the wishes of the consumer cannot concurrently prevail.[84] So, in reality, under socialism consumers can merely do the best they can ("minimizing their losses"), "freely" buying only the things that the powers at large have authorized, rather than freely buying from the constantly changing "menu" which entrepreneurs can offer.[85] Consumer sovereignty, as the term was used by W. H. Hutt, applies in its fullest sense, then, only to the market economy.

A similar situation exists regarding the alleged sovereignty of labor over their employment opportunities. The state sanctions all jobs and *then* its citizens choose. And even then the rewards for labor are manipulated to achieve a "social optimum."[87] All in all, one is left with the impression that freedom exists in name only.

Part VIII: The "Advantages" of Market Socialism

Our final section censuring market socialism must deal with its "advantages" over market capitalism. After all, Lange does not wish only to duplicate the market but to correct its perceived shortcomings.

One such "improvement" is to replace capitalism's monopolistic elements with "perfect competition," thus "add[ing] a much more powerful argument to the economist's case for socialism."[88] In response to this claim, we have demonstrated that such a static view of optimality cannot be a criterion for real world adjustment. One cannot even imagine a world of perfect knowledge, perfect factor divisibility, zero information costs and objective costs. The Austrian theory of dynamic adjustment via the profit-seeking entrepreneur provides a much superior normative concept. It is the entrepreneur that performs a vital social function in a world containing error.

Superiority is also claimed by Lange in that the CPB can "maximize social welfare [by] taking all the alternatives into the economic account.[89] (This includes equating social costs and benefits.) There are a number of fallacies here. One such error is the illegitimate jump from an individual's welfare to that of society. One must never forget that the Pigovian concepts of "social costs" and "social benefits" are meaningless if value and cost (itself a value) are subjective. To try to employ any unit or standard for addition or comparison is mere intellectual play. The second problem with

Lange's claim is his assumption that the CPB is in a better position to obtain information than a decentralized market is. We have dealt with this earlier and refer the reader to Hayek's classic essay "The Use of Knowledge in Society," of 1945.

A final significant advantage claimed for socialism is the promised taming of the business cycle since "mistakes can be localized, [and thus] a partial overproduction does not need to turn into a general one." Yet, by not specifically outlining a market socialist monetary policy, Hayek has countered this argument by saying the socialists have not given us the needed information about their promise.[90]

Part IX: Conclusion

This essay has been an attempt to string together the far-ranging criticisms of market socialism, laying to rest the widespread belief that, while the insights of Austrians were valid against Marxian socialism, they lose their theoretical sting against market socialism. Rather, we have demonstrated that the arguments significantly overlap, this fact being obscured by the market socialists' hiding behind the neoclassical smokescreen of "pure and perfect competition."

One point should emerge from all this: that to fully appreciate the insights of Mises, Hayek, Kirzner, Rothbard and Lachmann—the modern-day Austrians—against market socialism, one must understand modern subjectivist economics. Indeed, all of our arguments in this paper stem from the key insight that all human perceptions of the objective world are subjective. Conversely, to take certain insights of this school (e.g., the function of money prices for Mises or the complexity arguments of Hayek) and then to work within the neoclassical framework is to lose one's perspective on the entire debate. And to lose one's perspective is to join orthodoxy in its verdict that the Austrians were refuted by the socialists' revisions made in response to Mises' original article.

NOTES

1. F. A. Hayek, "The Nature and History of the Problem," in Hayek, ed., *Collectivist Economic Planning* (London: George Routledge and Sons, 1935), p. 32.
2. Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth," in Hayek, *Collectivist Economic Planning,* p. 111.
3. Mises, *Die Gemeinwirtschaft* (1922), reprinted under the title *Socialism: An Economic and Sociological Analysis,* trans. J. Kahane (New Haven, Conn.: Yale University Press, 1969).
4. Hayek, "The Nature," p. 36.
5. Oskar Lange, "On the Economic Theory of Socialism," in Benjamin F. Lippincott, ed., *On the Economic Theory of Socialism* (1938; New York: McGraw-Hill, 1964), p. 57.
6. Our discussion of neoclassicism as being the "heritage" of the market socialists is somewhat novel. Usually, the neoclassical economists are embedded within the theory of capitalism. Far better, Carl Menger should be the link between Adam Smith and the modern-day Austrians (Mises and Hayek) in the theory of capitalism.

7. Leon Walras, *Elements of Pure Economics* (1874; London: George Allen and Unwin, 1953).
8. Vilfredo Pareto, *Manuel d'economie politique* (1927), p. 354.
9. Enrico Barone, "The Ministry of Production in the Collectivist State," in Hayek, *Collectivist Economic Planning*, pp. 245–90.
10. Lange is not unaware of this. In large part, he attributes his solutions to Walras' *tâtonnements* and Barone's equations. See Lange, "On the Economic Theory," pp. 64, 70.
11. *Ibid.*, p. 73.
12. *Ibid.*, p. 79.
13. *Ibid.*, p. 83.
14. *Ibid.*, p. 84. This restraint may seem inconsistent with the above freedom to take the highest wage.
15. *Ibid.*, pp. 75–76.
16. See Fred M. Taylor, "The Guidance of Production in a Socialist State," in Lippincott, *On the Economic Theory*, pp. 48–50; and Lange, "On the Economic Theory," p. 76.
17. *Ibid.*, p. 77.
18. *Ibid.*, p. 75.
19. *Ibid.*, p. 77.
20. *Ibid.*, p. 75.
21. See Taylor, "The Guidance of Production," pp. 51–54.
22. Lange, "On the Economic Theory," p. 87.
23. *Ibid.*, pp. 86–87.
24. *Ibid.*, p. 93.
25. *Ibid.*, p. 97.
26. *Ibid.*, pp. 81, 93.
27. *Ibid.*, p. 94.
28. *Ibid.*, p. 85.
29. *Ibid.*, p. 107.
30. It will be remembered that Lerner was one of the so-called "Big Four" in Hayek's seminar at the London School of Economics along with Lionel Robbins, J. R. Hicks, and Nicolas Kaldor. Ludwig Lachmann was another notable member of this early-1930's group.
31. Abba P. Lerner, "Statics and Dynamics in Socialist Economics," *Economic Journal* 47 (June 1937): 254. Lerner elsewhere criticizes Lange's equilibrium since he "takes the state of competitive equilibrium as his *end* while in reality it is only a means to the end." To aim at the ideal, continues Lerner, is different from being there, and in disequilibrium the P=MC optimality is not what it is in equilibrium. (Lerner, "A Note on Socialist Economics," *Review of Economic Studies*, vol. W [October 1936]: 74).
32. Lange, "The Computer and the Market," in C. H. Feinstein, ed., *Socialism, Capitalism and Economic Growth* (Cambridge: Cambridge University Press, 1967), pp. 158–59. Also notice Jan Drewnowski's statement that "Mises, as everybody agrees now, was wrong in his main contention. . ." (Drewnowski, "The Economic Theory of Socialism: A Suggestion for Reconsideration," *Journal of Political Economy* 69, no. 4 [August 1961]: 341).
33. One should not overlook T. J. B. Hoff, *Economic Calculation in the Socialist Economy* (London: William Hodge, 1949), a valuable summation of the debate from the Misesian perspective.
34. "The capitalist economy today is as far from the pure ideal of the economic theorist as it is from a socialist economy" (Lippincott, "Introduction," in Lippincott, *On the Economic Theory*, p. 25).
35. Hayek, "The Meaning of Competition," *Individualism and Economic Order* (1948; Chicago: Henry Regnery Company, 1972), p. 92.
36. Lachmann has insightfully raised this point: "Unfortunately, the Pure Logic of Choice [Hayek's term for equilibrium] has filled the minds of economists to such an extent that the study of the actual means and ways by which men try to realize their aims has come to be sadly neglected. Economists, not unnaturally, prefer to do field-work in a pleasant green valley where the population register is exhaustive and everybody is known to live on either the right or the left hand of an equation. Only on rare occasions—and scarcely on

their own free will—do they embark on excursions into the rough uplands of the World of Change to chart the country and to record the folkways of its savage inhabitants; whence they return with grim tales of horror and frustration" (Ludwig M. Lachmann, "The Role of Expectations in Economics," *Capital, Expectations, and the Market Process*, ed. Walter E. Grinder [Kansas City: Sheed Andrews and McMeel, 1977], p. 70).

37. Hayek, "The Meaning of Competition," p. 95.
38. *Ibid.*, pp. 96–101.
39. Kirzner, *Competition and Entrepreneurship* (Chicago: The University of Chicago Press, 1973), pp. 97-99.
40. For an informative history of the two different approaches to competition beginning with the classical school, see Paul McNulty, "Economic Theory and the Meaning of Competition," *Quarterly Journal of Economics* (November 1968); and *idem*, "A Note on the History of Perfect Competition," *Journal of Political Economy* (August 1967).
41. Hayek refers to this "Turn[ing] economics into a branch of pure logic...a sort of Pure Logic of Choice" ("Economics and Knowledge," *Individualism and Economic Order*, p. 35 and passim).
42. F. H. Hahn, "On Some Problems of Proving the Existence of an Equilibrium in a Monetary Economy," in R. W. Clower, ed., *Monetary Theory: Selected Readings* (Baltimore: Penguin, 1969). Also see Mises, *Human Action* (1949; Chicago: Henry Regnery Company, 1966), p. 250.
43. Hayek, "Economics and Knowledge," p. 33. For recent attacks on the misplaced emphasis on equilibrium, see Kirzner, *Competition and Entrepreneurship*; G. L. S. Shackle, *Epistemics and Economics* (Cambridge: Cambridge University Press, 1973); and Brian Loasby, *Choice, Complexity and Ignorance* (Cambridge: Cambridge University Press, 1976).
44. As Mises remarked, "The static state can dispense with economic calculation.... But this is only conceptually [read theoretically] possible" (Mises, "Economic Calculation in the Socialist Commonwealth," p. 109). If this point were better understood, the confusion over the "second line of defense" regarding the theoretical and practical would evaporate. This caused Mises to later remark in his autobiography, "They failed to see the first challenge..." (*Notes and Recollections* [South Holland, Mich.: Libertarian Press, 1978], p. 112).
45. Lange, "On the Economic Theory," p. 86.
46. *Ibid.*, p. 89. In contrast, Shackle writes: "The number of distinct trials, even if confirmed to discrete steps of price and quantity, would be so immense that the necessary 'market day' would extend beyond human lifetimes" (*Epistemics and Economics*, p. 150).
47. Mises, *Human Action*, pp. 704-705.
48. *Ibid.*, p. 704.
49. *Ibid.*
50. The present writer can only echo the words of Arrow's recollection: "Even as a graduate student I was somewhat surprised at the emphasis on static allocative efficiency by market socialists..." (K. J. Arrow, "Limited Knowledge and Economic Analysis," *American Economic Review* 64 [March 1974]).
51. Hoff, *Economic Calculation in the Socialist Society*, p. 81. Also see Armen Alchian, "Uncertainty, Evolution and Economic Theory," *Economic Forces at Work* (Indianapolis, Ind.: Liberty Press, 1977), pp. 30-31. For the same argument employed against using differential equations for problem solving, see Lionel Robbins, *The Great Depression* (1934; Plainview, N.Y.: Books for Libraries Press, 1976), p. 151.
52. Harvey Leibenstein, as quoted in *Center for Applied Economics Newsletter* (New York University, February 1978), p. 2.
53. Lange, "On the Economic Theory," p. 82. Two pages later he again makes this very statement. His obliviousness of the entrepreneurial function is obviously crucial to his case.
54. Mises, *Human Action*, p. 290. Mises' entrepreneur should not be confused with Knight's "residual claimant" innovator. While Knight's gain is an unexplained windfall, a return to uncertainty from being in the right place at the right time, Mises' entrepreneurial return stems from correct foresight of a future unlike the present and acting on it. (See Frank H.

Knight, *Risk, Uncertainty and Profit* [1921; Chicago: University of Chicago Press, 1971]). Mises' theory is also distinct from Schumpeter's and Bronfenbrenner's. (See Kirzner, *Competition and Entrepreneurship*, pp. 75–87.)

55. The assumption here is that if everyone possessed perfect knowledge, there would be no profits (undercapitalization of factors) or losses (overcapitalization of factors). See Murray N. Rothbard, *Man, Economy and State* (Los Angeles: Nash Publishing, 1970), p. 483. Thus, the entrepreneur does not exist in equilibrium.
56. "Our reflection is thus that the market is a continuous process without beginning or end. Marshallian markets for individual goods may, for a time, find their respective equilibrium. The economic system never does. This process is propelled by equilibrating forces of intermarket interaction which are, again and again, thwarted by changes in the pattern of the distribution of knowledge" (Lachmann, "Austrian Economics in the Present Crisis of Economic Thought," *Capital, Expectations and the Market Process*, pp. 39–40).
57. The starting point of market socialism is to use historical prices, obviously "given." Lange further compares and contrasts his schemes with capitalism, both under *given* conditions. Lange, "On the Economic Theory," pp. 60, 67–68, 72–73, and passim.
58. Robbins writes: "the subject matter of economics is. . . conditioned by the scarcity of *given* means for the attainment of *given* ends" (*An Essay on the Nature and Significance of Economic Science* [London: Macmillan, 1932], p. 46).
59. Kirzner, *Competition and Entrepreneurship*, pp. 95–96.
60. We might add that this is for the Austrians what "trial and error" is for the socialists.
61. If he worked under static conditions, we could make a case for the adjustment being "anticipatory."
62. Mises, *Bureaucracy* (New Rochelle, N.Y.: Arlington House, 1944), p. 49.
63. See Mises, *A Critique of Interventionism* (1929; New Rochelle, N.Y.: Arlington House, 1977, pp. 158–62.
64. Kirzner, *Competition and Entrepreneurship*, p. 230.
65. Lange, "On the Economic Theory," p. 109. We cannot agree, however, that this is a "sociological" problem.
66. Lippincott, "Introduction," *On the Economic Theory*, p. 37.
67. Lindbeck, *The Political Economy of the New Left: An Outsider's View* (New York: Harper & Row, 1971), pp. 32–33.
68. For an excellent discussion of these and other points, see Mises, *Bureaucracy* (New Haven, Conn.: Yale University Press, 1944), chaps. 1 and 2.
69. Rothbard, *Man, Economy and State*, p. 832.
70. See Hayek, "The Use of Knowledge in Society."
71. "The S.E.C. [C.P.B.] will be able to act only after the parties have reported, the reports have been verified, contradictions cleared up, etc.; and the new prices will become effective only after all the parties concerned have been notified. . . " (Hayek, "The Competitive 'Solution,'" *Individualism and Economic Order*, p. 148). Also see Abram Bergson.
72. "The Stock Exchange is perhaps the most characteristic of all the institutions of the market economy. . . . What really distinguishes [capitalism] from a socialist economy is not the size of the 'private' sector of the economy, but the ability of the individual freely to buy and sell shares in the material resources of production. Their inability to exercise their ingenuity in this respect is perhaps the most important disability suffered by the citizens of socialist societies, however large their incomes may be, however wide the range of consumption goods that may be available to them" (Lachmann, "Methodological Individualism and the Market Economy," *Capital, Expectations and the Market Process*, p. 161).
73. Of course, if our previous arguments against "trial and error" pricing are adopted, then cost as a guide to production loses its economic significance since costs *are* prices.
74. As Lachmann reminds us, the entrepreneur "has another function which we all know about but which little is, as a rule, heard from economists: the 'regrouping of capital assets' by buying and selling them, the incessant reshuffling of the combinations of complementary capital goods with which he works and which in their complexity form the ever-changing basis of the capital structure" ("The Science of Human Action," *Capital, Expectations and the Market Process*, pp. 104–105).

75. As Hayek states: "The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess. The economic problem of society is thus not merely a problem of how to allocate 'given' resources—if 'given' is taken to mean given to a single mind. . . . [Rather] it is a problem of the utilization of knowledge which is not given to anyone on its totality" (Hayek, "The Use of Knowledge in Society," pp. 77–78).
76. Mises, "Economic Calculation in the Socialist Commonwealth," p. 102.
77. Hayek, "The Use of Knowledge in Society," p. 84.
78. Hayek, "The Competitive 'Solution,'" p. 198.
79. *Ibid.*
80. See the collection of essays compiled by James Buchanan in his *L. S. E. Essays on Costs* (London: Weidenfeld and Nicholson, 1973). Also see R. H. Coase, "The Marginal Cost Controversy," *Economica* (August 1946); and G. F. Thirlby, "The Marginal Cost Controversy: A Note on Mr. Coase's Model," *Economica* (February 1947).
81. J. de V. Graaf, *Theoretical Welfare Economics* (Cambridge: Cambridge University Press, 1957), p. 154.
82. Paul Craig Roberts, *Alienation and the Soviet Economy* (Albuquerque, N.M.: University of New Mexico Press, 1971), p. 97, as quoted in Rothbard, "Ludwig von Mises and Economic Calculation under Socialism," in Laurence S. Moss, ed., *The Economics of Ludwig von Mises: Toward a Critical Reappraisal* (Kansas City: Sheed and Ward, 1976), p. 73.
83. Hayek, "The Competitive 'Solution,'" p. 196.
84. This is particularly true when it is realized that the planners "arbitrarily" decide the ratio of present to future consumption—the "social rate of growth." See *ibid.*, p. 204. The incompatibility of freedom and planning has been forcibly argued by Hayek elsewhere. See his *The Road to Serfdom* (Chicago: The University of Chicago Press, 1944), esp. chaps. 5–8. Also see Rothbard, "The Myth of Democratic Socialism," *Libertarian Review* 6 (September 1977): 24–27.
85. The socialist "should remember that consumer sovereignty means more than the passive acts of consumers to make the best of an unappealing menu of choices. Economic democracy is not achieved unless consumers' preferences count in determining output in the first place" (W. H. Loucks and W. G. Whitney, *Comparative Economic Systems*, 9th ed. [New York: Harper and Row, 1973], p. 187).
86. See W. H. Hutt's classic article, "The Concept of Consumers' Sovereignty," *Economic Journal* (March 1940), pp. 66–77. As an analogy of the socialists' misuse of the term, we could say that a prisoner is still free since he still has a (limited) range of activities from which to choose without coercive interference.
87. Lange, "On the Economic Theory," p. 83.
88. *Ibid.*, p. 107.
89. *Ibid.*, p. 106.
90. Specifically the socialists do not tell us about their monetary policy, and this is the key matter to those who, like Hayek and Mises, hold a monetary theory of the trade cycle. See Hayek, "The Competitive 'Solution,'" p. 207.