

Market Socialism

Previously, the classical economists had a debate against Marx. 100 years, neoclassical economists had some tension with the socialists. It was a bigger deal at this time, since the USSR was coming about.

In the past, both sides used the labor theory of value. Later, both sides used Neoclassical theory. Socialists used economic judo on the neoclassical economists.

- ↳ Some of them were topflight neoclassical economists
 - ↳ understood the ideas well, but twisted them around

Market Side

Mises
Pierson
Hayek

Socialist Side

Lange
Lerner

1] Utopian socialists (based on Marx)

2] First generation of Austrian critique (Mises, Pierson, Hayek)

- Mises
 - ↳ rational calculation is impossible unless there are real markets on which to establish real prices.
 - ↳ can't know how to allocate resources without prices.
 - ↳ capitalism was the only way.

3] Market socialist position (Lange, Lerner)
more radical

- Lange was at the University of Chicago. Later became planning minister in Poland.

↳ Was a "shining star" mathematical economist

- Lerner studied at the LSE, learned from both sides of the political spectrum.

↳ Very little mathematics, but extremely clearly written.

3] Also, Pareto, Barone, Knight were precursors.

(1897)

(1908)

(1913)

◦ Pareto - Political economics and mathematics.

↳ In discussing Walras' equations

◦ Barone - "How ought a collectivist organize production?"

◦ Knight - at University of Chicago. Not a friend of socialism

↳ Convinced that marginalist equations describe an optimal allocation regardless of the institutional structure.

4] Austrian Response to Market Socialism (Hayek)

◦ Originally, neoclassical economists did not object strongly to market socialism. It was left to the Austrians to fight this.

◦ Their response (exaggerated) was that since the conclusions were "wrong," then the model must have been wrong.

↳ They didn't use neoclassical economics to argue against those results. Instead, they criticized the entire framework.

◦ Hayek - a student of Mises: "equilibrium as an idea distorts reality." "Ignored the importance of the entrepreneur in a capitalist economy."

↳ Nowadays, GE theorists acknowledge deficiencies in the theory wrt. the firm/production.

↳ Entrepreneurial alertness - entrepreneurs steer the economy.

↳ Jooled knowledge - There aren't really any tools here. See the latest issue of The Economist regarding modeling entrepreneurial efforts.

If market socialism attempted to come about now, it would be laughed at.

Whither Socialism - Stiglitz

↳ Uses market socialism to highlight Stiglitz's contribution to economics.

"If the Arrow-Debreu model were correct, then market socialism could work."

Perfect information is the smooth surface that connects these two. Introduce asymmetric information, and there is a turbulence that damages the efficacy of market socialism.

Stiglitz is sorta doing an updated version of Pigou.
Linds many externalities associated with asymmetric information.

Returning to market socialism:

Pierson - Socialism of hope: "Move away from capitalism and then people will become more virtuous."

L Pierson does not believe this.

Market socialists do not attempt to change human nature

Hayek emphasizes the difficulties involved with planning.

L Need to have all the details.

L Can't create competition w/out making people bear full responsibility for their mistakes (private property is necessary.)

Lange - Writing directly against Mises. Mises called attention to the need for prices. Lange will argue that you can get this information without markets.

L Can use prices to collect the required information.

L But what happens if the prices are not the right prices? Prices will adjust.

Lange says - set prices by central planning board, adjust prices as necessary. "Let the central planning board be the auctioneer."

L We have abstracted the decentralization

role of prices. This is the basis of Lange's comment.

↳ Presumably this irritated Mises.

"The importance of models in controlling peoples' thinking."

Wealth systems:

Let $w_i = w_i^A + \frac{w_i^I}{\text{human capital}}$, $i = 1, \dots, n$

Then:

1] Capitalism: $\frac{\text{wealth}}{w_i} = p \cdot w_i$

2] Market socialism: $w_i = p \cdot w_i^I + \frac{1}{n} \sum_{i=1}^n p \cdot w_i^A + \tau_i$ where $\sum_{i=1}^n \tau_i = 0$. $\{\tau_i\}$ is a lump-sum transfer system.

Distribution of wealth can be divorced from economic efficiency.

Knight (AER 1936): "The place of marginalism in collectivism is the same as in capitalism."

Friedman published a review of Lerner's Economics of Control.

↳ 3 functions of prices

- Transmit information
- Provide incentives to economize
- Determine distribution of income

↳ 1 and 2 cannot be divorced from 3

↳ But First Welfare Theorem does exactly this.

Hayek's "Use of Knowledge in Society" was written against the background of market socialism

↳ Markets are important for piecing together all those pieces of information.

What is being said here is that we have incomplete information in the real world. This is distinctly different than Stiglitz's "asymmetric information." Divided knowledge (Hayek) is as fundamental to the world as scarcity.

↳ The market socialists rise to the occasion "Our divided knowledge is harmoniously coordinated if we assume a central planning board."

Friedman points out the need to connect what you do to what you get.

In modern formulations of G.E, profit shares are assigned in a completely arbitrary way.

↳ What if we, instead, assigned those shares to the government to allocate?

(Gale/Mas-Colell) 1974 paper - can establish existence of equilibrium with any arbitrary wealth distribution.

↳ Friedman disagrees with this - cannot divorce distribution from efficiency.

↳ The problem lies with the fact that you must base wealth on peoples' announcements.

This tradition of divorcing distribution from optimality has lingered.

The Austrians did not pick up on the issue of incentives. Caldwell: "Hayek did not stress incentives, because human knowledge might change and he was able to sidestep this by appealing to the computational aspects."

Nowadays, people would argue that the problems are due to incentive issues.

(*) It has to do with tooled knowledge and models
↳ We have better tools to deal with incentive issues.

This resulted from the big change that occurred in the 1970s.