

The Market Socialism Misunderstanding: The 20th Century Socialism Debate and Modern Economics

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Introduction

Perhaps more than in any other field, new theories in economics often arise at the expense of what came before. Adam Smith could only build his theory of the wealth of nations by destroying the mercantilist fallacies that preceded him. The Marginalist Revolution required a thorough debunking of the labor theory of value. Keynes motivated his work by knocking down the classics, Lucas by knocking down Keynes. It is maybe an unfortunate reality that many important advances in economics have not come from building on the foundations set in the past, but rather by blowing them up and starting fresh. Creative destruction, a popular theory to explain economic progress might have an even better application to the progression of economic thought itself. Controversy and debate are often the driving forces that push economics forward.

A great example of this phenomenon is the debate surrounding the viability of socialism that took place in the early 20th century. Ludwig von Mises began the debate with a clear goal of eradicating the ideas of socialist theorists that came before him. More than that, however, I will argue that the lessons from the ensuing debate between Mises, Hayek, and the “market socialists” have not been absorbed by modern economics, but rather pushed aside or forgotten. Even during the debate, many of the points made by Hayek and others were either ignored or misunderstood, leading to a situation where the two sides all too often ended up talking past each other. In the end, even many of the theoretical advances that explicitly cite the debates and its participants as inspirations bear little resemblance to the most important themes emphasized by Mises and Hayek.

To make this point, I will proceed in three steps. First, I will review the early criticisms of socialism put forth by Ludwig von Mises around 1920. From there, I will look to the “trial and error” solutions of market socialists as well as Hayek’s response. Finally, I will connect the main points of the debate with their modern economic theory counterparts to show that almost nothing of substance was retained.

Mises’s Critique of Socialism

Although the primary focus of this paper will be on the later conflicts between the market socialists and Hayek, many of these issues stem from Mises’s original arguments against more traditional forms of socialism. At the time Mises was writing, socialism held a prominent place in the minds of policymakers and philosophers. In fact, Mises opens his 1922 *Socialism* by predicting that “when history comes to tell our story it will write above the chapter ‘The Epoch of Socialism’ ” (Mises, 1962). Although he was not the only one to criticize the ideas of the socialist movement, Mises’s argument was at the time arguably the most direct, comprehensive, and clear critique that had ever been written.

Before getting to Mises’s discussion itself, it is also important to understand a couple possible arguments against socialism that were *not* made by Mises. Many today oppose socialism on moral grounds, claiming that interfering with the private property of individuals violates their natural rights. Mises does not take this stance, instead conceding that “all rights derive from violence” (42). Compared to some of his modern followers (for example Rothbard (1998)), Mises’s critique is starkly utilitarian. He is fully willing to allow the socialists to “oppose ownership on considerations of natural law” (43). Instead, in writing his book, he simply aims to show that “society is best served when the means of production are in the possession of those who know how to use them best” (77).

Neither does Mises try to pin the failure of socialism on human nature as he writes that “even angels, if they were endowed only with human reason, could not form a socialistic community” (451). Again, Mises concedes a great deal to the socialists in order to isolate the core of the problem. In ignoring morality and evaluations of human

nature, Mises attempts to remain squarely in the realm of positive economics, leaving the more metaphysical topics to philosophers and psychologists.

Many accounts of the socialism debate point to Mises's "calculation" argument as his primary contribution. Under socialism, Mises claims that the calculation of prices essential to the functioning of an economy would become impossible. Drawing on the insights of his Austrian economic heritage, he highlights the complexity of the market process. Even if some estimate of the allocation of final goods could be determined by a social planner, calculating the precise amount of higher order capital goods needed to produce these final goods in an efficient manner presents an insurmountable challenge. "Everything would be a leap in the dark" (122). However, while this line of reasoning of course played an essential role in Mises's overall critique, it was only a piece of his greater thesis.

A complete analysis of the calculation argument requires a much closer look at what Mises means when he talks about calculation. Without qualification, it may appear that Mises's argument was simply one of computational complexity: the reason socialism fails is that we haven't invented a supercomputer powerful enough to calculate all of the equations necessary to find the proper allocation. But such a characterization distorts the substance of Mises's argument. Central to Mises's point about the calculation of prices in a socialist economy is the source of those prices in a market economy. More specifically, the reason market economies can generate prices at all is only through "the ceaseless search on the part of the capitalists and the entrepreneurs to maximize their profits by serving the consumers' wishes" (138). The reason a socialist planner cannot calculate prices is not because there are too many equations to solve, but that those equations *do not exist* outside of a market.

What led Mises to this conclusion? Two pieces of his analysis are especially important to consider. First, he emphasizes the importance of dynamics rather than statics. Mises admits that "it is quite easy to postulate a socialist economic order under stationary conditions" (163). If economic conditions never changed, then the problems described above disappear and the possibility of socialist allocation becomes feasible. Reality clearly

does not conform to this vision of stationarity and Mises description of the economy is one where entrepreneurs and capitalists are necessary both to find changes that need to occur as well as determine the most efficient ways to carry out those changes. Of course, these concerns about the dynamics of the economy do little to prove the impossibility of socialist calculation on their own. Adding dynamics to a model can complicate the equations dramatically, but it would not necessarily preclude the determination of equilibrium by a fast enough computer.

A more fundamental concern is the operation of an economy outside of equilibrium. The shift in focus towards disequilibrium dynamics is one of the largest deviations from neoclassical economics present in the Austrian school analyses made by both Mises and Hayek. While this distinction is present in all of Mises's work, it is especially clear in some of his later writings. In *Human Action*, Mises laments the fact that because the "mathematical economist" focuses only on equilibrium, "he has no need for this mover and shaker whose never ceasing intervention prevents the imaginary system from reaching the state of perfect equilibrium and static conditions" (Mises, 1949, p. 698). The entrepreneur, who plays an essential role in Mises economy, has no place in either the static equilibrium of a neoclassical nor in a socialist economy. Without this ingredient, neither can say anything about how the economy will move toward its equilibrium.

Connecting these two topics reveals the reasoning behind Mises's skepticism of calculation in a socialist economy. Thinking about dynamics here does not mean introducing an infinitely lived agent who can nevertheless make all of his decisions at time 0. It does not mean adding economic growth or exogenous shocks with known distributions. Instead, it is about the constant searching of entrepreneurs to find new opportunities to make profit. Even if an economy miraculously found itself in a state of equilibrium, it would only last a brief moment before being disrupted by a new idea or innovation. And those opportunities are not just unexpected, but often entirely unknown. Equilibrium prices for a given state of the world provide no information when any step towards that equilibrium produce an entirely new equilibrium altogether. As Mises puts it, "what the entrepreneur, in embarking upon a definite project, has in mind is only the first steps

of a transformation which, provided no changes in the data occur other than those induced by his project, would result in establishing the state of equilibrium” (707). It is in this world, not the static world of the socialists, but one of Knightian uncertainty, complex dynamics, and constantly shifting equilibria, that Mises concludes calculation is impossible.

Hayek and Market Socialism

Mises’s attack on socialism was largely successful in convincing economists that pure planning was not likely to work in practice. However, socialist theorists soon began to develop new ways to run a planned economy in a way that answered Mises’s criticisms. For the purposes of brevity, I will constrain my focus to one of the most famous of these proposals – the trial and error solution of Oskar Lange.

Lange lays out his vision of a socialist economy in a pair of articles written in 1936 and 1937. He begins by praising Mises for his challenge to socialists, stating that (perhaps a bit mockingly) “both as an expression of recognition for the great service rendered by him and as a memento of the prime importance of sound economic accounting, a statue of Professor Mises ought to occupy an honourable place in the great hail of the Ministry of Socialisation or of the Central Planning Board of the socialist state” (Lange, 1936, p. 53). Lange agrees with Mises that without prices, a socialist state would be doomed to failure. He does not see any reason, however, that prices could not be determined even without private ownership of the means of production.

Lange’s answer to Mises attempts to allow for decentralized decision-making while retaining centralized ownership. Consumers would be allowed to act exactly as they do in a market economy, buying goods and services and choosing where and how much to work in order to maximize their utility. The means of production, however, would be entirely public, with prices of producer goods being set by a Central Planning Board. Finally, managers of individual firms would each be able to run their business using their own knowledge of the specifics of their situation, but instead of maximizing profits, they

would be required to operate according to a simple set of rules. In Lange's formulation, there are two rules a manager needs to follow: set price equal to marginal cost and minimize average cost. Essentially, Lange's socialism would emulate the results of a perfectly competitive market while eliminating private ownership. Prices of consumer goods and wages would therefore work quite similarly to those on a competitive market. The explanation to this point leaves one problem left to solve: the determination of the prices of capital goods.

The solution to the pricing of capital goods in Lange's market socialist economy comes from a trial and error approach to pricing by the Central Planning Board. He admits that solving for the prices of these goods would be nearly impossible, but argues that it is no more difficult than in a market economy. Just as entrepreneurs adjust their prices in response to changes in supply and demand, so could socialist planners. Starting with an arbitrary price, they could observe any excess supply and demand for each commodity and adjust prices accordingly. From this reasoning, he concludes that pricing of capital goods "would, or at least could, work much better in a socialist economy than it does in a competitive market. For the Central Planning Board has a much wider knowledge of what is going on in the whole economic system than any private entrepreneur can ever have" (Lange, 1936, p. 67).

Hayek eventually responded directly to Lange's proposal, but two important points need to be discussed before bringing in these responses. First, although Lange claims to be answering Mises's challenge, his explanation of market socialism does little to assuage Mises's main concerns. As outlined above, Mises saw no contradiction between socialism and calculation in a static economy. Lange's analysis, firmly rooted in neoclassical static equilibrium analysis, proves only what Mises already conceded, doing nothing to address a dynamic economy. In Mises's view, the trial and error process described by Lange would never reach equilibrium just as the market can never reach equilibrium. The difference is that a market consists of thousands of entrepreneurs searching for the correct changes to make, being rewarded by profit when they succeed and punished by losses when they fail. A central planner, constrained to making adjustments only after observing realized

surpluses or shortages could never hope to match the dynamism of the market process. Lange appears to have in mind a constant equilibrium while Mises views equilibrium as constantly changing. It is perhaps the failure of Lange to acknowledge this difference that prompts Mises somewhat vitriolic response to the market socialists, as he retorts that “they want people to play market as children play war, railroad, or school. They do not comprehend how such childish play differs from the real thing it tries to imitate” (Mises, 1949, p. 703).

Another key piece to mention is that at the time of Lange’s writing, Hayek had already commented on using trial and error to find equilibrium in a socialist economy. In a 1935 essay, Hayek discusses some of the earlier proposals by people like Fred Taylor and H.D. Dickinson, who had offered arguments similar to those of Lange. Interestingly, Hayek begins his discussion by admitting that market socialism “is not an impossibility in the sense that it is logically contradictory” (Hayek, 1935, p. 207). Quoting this line in his article, Lange concludes that Hayek is retreating to a second line of defense compared to Mises’s claim that socialism was truly impossible.

While it is true that Hayek’s words are softer, the fundamentals of his argument retains the core of Mises’s, leaving almost no substantive difference between the two. Throughout the remainder of the essay, Hayek notes both the problems of collecting the data necessary for a planner to implement an equilibrium as well as the difficulty solving the equations once the data has been collected. He concludes that trial and error is the only way that such a process could be carried out and admits that it could theoretically work. He then goes on to describe the problems with trial and error through an argument similar to Mises.

Almost every change of any single price would make changes of hundreds of other prices necessary and most of these other changes would by no means be proportional but would be affected by the different degrees of elasticity of demand, by the possibilities of substitution and other changes in the method of production. To imagine that all this adjustment could be brought about by successive orders by the central authority when the necessity is noticed, and that then every price is fixed and changed until some degree of equilibrium is obtained, is certainly an absurd idea (Hayek, 1935, p. 214)

Looking at Hayek’s other works further highlights the fact that his primary concerns

lie in explaining the process by which a dynamic economy finds equilibrium rather than finding an equilibrium in a static setting. Famously, Hayek states that “*if* we possess all the relevant information, *if* we can start out from a given system of preferences, and *if* we command complete knowledge of available means, the problem which remains is purely one of logic,” but that this “is emphatically *not* the economic problem which society faces” (Hayek, 1945, p. 519). I will leave a longer discussion of Hayek’s knowledge argument to later in this paper, but for now we can think of this description of the economic problem as directly contrasting Lange’s approach with Hayek’s. Lange is very much working within the framework that Hayek denounces, which makes it difficult for either of them to fully address the arguments of the other.

Hayek also views disequilibrium dynamics and the role of entrepreneurs as being just as important as in Mises’s exposition. In a footnote to his 1945 article, Hayek explicitly addresses the claims of the market socialists, but argues that “what they, and many others, did was merely to state the conditions which a rational allocation of resources would have to satisfy and to point out that these were essentially the same as the conditions of equilibrium of a competitive market” (Hayek, 1945). This result is simply not interesting to Hayek as he is much more concerned with the process by which the economy converges to the equilibrium rather than the equilibrium itself. Competition, for Hayek, is not described by the perfectly competitive price-takers of a Walrasian general equilibrium, but rather “a voyage of exploration into the unknown, an attempt to discover new ways of doing things better than they have been done before.” It “is by its nature a dynamic process whose essential characteristics are assumed away by the assumptions underlying static analysis” (Hayek, 1948, p. 94). Neoclassical analysis, and by extension Lange and the market socialists, assume away the very question Hayek and Mises are attempting to answer, and in doing so sidestep the problems of socialist calculation without ever answering them.

With a better grasp of Hayek’s economics in hand, we can now turn to his direct response to the market socialists, which came in the form of his 1940 article, “Socialist Calculation: The Competitive ‘Solution.’ ” He begins the article by arguing, as I have

above, that Lange and the other market socialists provided an answer to an altogether different question than the one posed by Mises and repeats the argument from his earlier work that “having shown that [equilibrium] values in a socialist society would depend on essentially the same factors as in a competitive society” is not an answer to Mises’s point (Hayek, 1948, p. 183). The question for Hayek and Mises was never whether adopting socialism would change the equilibrium of the economy. It was always about how a socialist society could ever achieve that equilibrium. In the rest of the article, Hayek proceeds to evaluate whether Lange’s trial and error process meets this challenge.

As it does in much of his work, the use of knowledge plays a large role in Hayek’s argument against the “competitive solution.” According to Hayek, the managers in Lange’s system “will have no inducement, and even no real possibility, to make use of special opportunities, special bargains, and all the little advantages offered by their special local conditions” (Hayek, 1948, p. 193). It is important to note here that prices for Hayek are the primary way an economy can provide information to its participants and it is only through the market process that these prices can be generated. But rather than allow for entrepreneurs to set prices in anticipation of the future moves of the market, Lange’s prices are purely reactionary and therefore can never reveal information in the way Hayek describes. Although the market socialist system allows individual managers with local knowledge to have more control, Hayek notes that Lange’s method will never allow them to act on this knowledge. He asks if “managers, although they know for certain a particular price will have to be raised or lowered, must act as if they did not know?” (Hayek, 1948, p. 197) Unless Lange wants to completely abandon the socialist half of his market socialism, the answer would appear to have to be yes.

The knowledge problem, while forming the backbone of much of the rest of his argument, is not on its own sufficient to quiet the market socialists (as we will see later). Hayek bolsters his case by again highlighting the deficiencies of Lange’s static framework. He emphasizes, as did Mises, the vital role of the entrepreneur in stirring change and generating the conditions we see in the static equilibrium. Lange’s proposal requires managers to minimize cost and set price equal to marginal cost, but as Hayek notes, “the

force which in a competitive society brings about the reduction of price to the lowest cost at which the quantity salable at that cost can be produced is the opportunity for anybody who knows a cheaper method to come in at his own risk...if prices are fixed by the authority, this method is excluded” (Hayek, 1948, p. 196). Lange seems to have in mind the simple exercise of an undergraduate in intermediate macro taking derivatives of an objectively given cost curve, while for Hayek the most efficient process needs “to be discovered anew, sometimes almost from day to day, by the entrepreneur.” Another issue Hayek points out is that Lange almost completely ignores the importance of expectations while “in fact, almost every decision on how to produce – now depends at least in part on the views held about the future” (Hayek, 1948, p. 198).

Unfortunately, just as these points were ignored in Mises’s initial challenge to socialism, the market socialists never define how their system would work in a dynamic economy. Perhaps the best evidence that Lange never really understood the arguments that Hayek and Mises made is his 1967 article “The Computer and the Market,” where he writes

Today my answer to Hayek and Robbins would be: so what’s the trouble? Let us put the simultaneous equations in an electronic computer and we shall obtain the solution in less than a second. The market process with its cumbersome tatonnements appears old-fashioned. Indeed, it may be considered as a computing device of the pre-electronic age. (Lange, 1967)

For Lange to respond to Hayek in this way must have been somewhat discouraging. Gone is any semblance of an explanation of how a socialist economy would get to equilibrium. Instead, Lange has thrown out his trial and error approach and regressed to the equation solving of the early socialist theorists. There are still no dynamics, no uncertainty, and no entrepreneurs. There is still no answer to Mises’s then 40 year old challenge.

The Market Socialism Debate and Modern Economics

Modern responses to the debate have taken a slightly different perspective. Makowski and Ostroy (1993) criticize Hayek for his failure to focus on the incentive problems in-

herent in market socialism. They claim that “failing to emphasize incentives as he did and concentrating on the problem of communication, Hayek should have arrived at a conclusion much closer to market socialism than he did” (15) James Buchanan makes a similar point when he discusses the Austrian contribution to the debate

Even if the socialist state should somehow discover an oracle that would allow all calculations to be made perfectly, even if all preference functions are revealed, and even if all production functions are known with certainty, efficiency in allocation will emerge only if the effective decision-makers are converted into economic eunuchs. Only if such men can be motivated to behave, to make decisions in accordance with cost criteria that are different from their own, can this decision-structure become workable. This amounts to saying that even if the problems of calculation are totally disregarded, the socialist system will generate efficiency in results only if men can be trained to make choices that do not embody the opportunity costs that they, individually and personally, confront. (Buchanan, 1999, p. 96-97)

This omission by Hayek is not really an omission at all, however. In fact, Hayek *deliberately* avoids making this argument. Just as Mises strived to show that even angels would not be able to run a socialist economy, Hayek is more than willing to assume that the managers “will be as capable and as anxious to produce cheaply as the average capitalist entrepreneur” (Hayek, 1948, p. 196). In other words, while Buchanan wants to assume calculation is fully possible and show that socialism still fails, Hayek’s goals is exactly the opposite. He wants to show that *even if* we ignore incentive problems, the market socialists’ plan will not work. The incentive issues emphasized by modern accounts would likely have appeared a much weaker argument to Hayek. A socialist can always argue (probably with some justification) that human nature goes against the assumptions essential to the foundations of standard neoclassical economics. Whether human beings are actually utility maximizing rational agents was a topic that Hayek did not want to have to address and was not *necessary* to address to disprove the workings of the socialist system. Eliminate incentive compatibility constraints, assume agents always choose (to the best of their ability) the socially optimal choice, and Hayek’s argument still stands.

Of course, the question remains whether the Austrian argument without incentives is powerful enough to address the market socialists proposed solution. Makowski and Ostroy

(1993) seem to argue in the negative saying that “his argument was flawed by the same over-emphasis on the decentralization role of prices to the exclusion of their appropriation origins that characterizes [Walrasian General Equilibrium] and market socialism” (12). Going even further, they suggest that it was Hayek that misunderstood the arguments of the market socialists, who were able to “show that the decentralization role of prices could be abstracted from a private enterprise economy” (12). Makowski and Ostroy’s criticism of Hayek is quite different from that of Lange. In later work, they clearly emphasize the Austrian emphasis on the entrepreneur (Makowski and Ostroy, 2001). Interestingly, they contrast the Austrian criticisms of the neoclassical model, which they associate with “implicit informational restrictions,” and their own concerns about “its identification of perfect competition with *price-taking*” (480).

But Hayek, I will argue, is actually making a criticism far closer to Makowski and Ostroy’s than they imply. Makowski and Ostroy aim to describe the “creativity of the market,” but they dismiss Hayek’s concerns with disequilibrium and uncertainty and instead focus on “*divided knowledge*” (488). It is true that Hayek placed a great deal of emphasis on the informational role of prices, but it is important to also remember the emphasis he places on the way those prices are formed. Nobody is a price taker in Hayek’s economy. As I have outlined above, it is only through the knowledge individuals possess of their own specific situation and the motivations provided by the system of profit and loss that any prices can be formed at all. Given a set of prices, there is no difference between the information provided in a market socialist’s version of an economy and a competitive one. That was never Hayek’s claim. Instead, he argues that the knowledge necessary to generate those prices is entirely dependent on being in a market economy. It is only through the creativity of the market that Hayek’s telecommunications system has any meaning at all.

Although Makowski and Ostroy argue that the standard equilibrium model can incorporate the creativity of the market with a different interpretation of a perfectly competitive equilibrium, their approach is different from Hayek’s. They emphasize, as Hayek would, the importance of understanding the competitive process underpinning the neo-

classical equilibrium and argue for a reimagining of the standard model of price taking as one backed by “intense competition among buyers/sellers” (Makowski and Ostroy, 2001, p. 496) . Entrepreneurs, who have no role in the standard formulation, are thrust back into the center of Makowski and Ostroy’s description, acting as both price makers and market makers and playing an instrumental part in generating a competitive equilibrium. Where they differ from Hayek is their view of equilibrium. In their analysis, they argue that the competitive view of the market and the standard view with individuals as price takers are simply two sides of the same coin, that there is “no need to throw out the standard model” (Makowski and Ostroy, 2001, p. 504). However, that Makowski and Ostroy needed to write this article at all actually makes Hayek’s point. We can think of Hayek’s criticism of the market socialists as essentially being that they forgot about the competitive side of the coin. They tried to jump immediately to a price-taking, perfectly competitive equilibrium without concern for the competitive process necessary to produce such an equilibrium.

One final point needs to be made regarding the focus on equilibrium in economics. Makowski and Ostroy criticize Hayek and the other Austrians for their claims that disequilibrium is “the exclusive locus of of innovative behavior” (Makowski and Ostroy, 2001, p. 481) They argue that their formulation shows that entrepreneurs and creativity can in fact be incorporated into standard analysis. Hayek would not, in my view, have disagreed with this idea and would likely have embraced it. He recognizes that “in a competitive industry...the task of keeping cost from rising requires a constant struggle” (Hayek, 1945, p. 523). His point is rather that to analyze an equilibrium, we don’t need to think about this struggle. It is precisely that we have two equivalent sides of the coin in equilibrium that it becomes uninteresting for Hayek – why think about entrepreneurs when we get the same results by assuming all information is given and everyone is a price taker? This reasoning is what leads to Hayek’s view that “economic problems arise always and only in consequence of change” (Hayek, 1945, p. 523). Still, while Makowski and Ostroy reject the usefulness of disequilibrium analysis, they at least recognize its importance to Austrian thinkers. The same cannot be said about many other references to Hayek and

the market socialism debate by modern economists.

Despite being widely cited as an influence to modern economists, it appears that most of these economists either ignore or misunderstand essential pieces of Hayek's analysis. Two fields where references to Hayek are especially prevalent are mechanism design and information economics. Early forays into mechanism design such as Hurwicz (1969) highlight Hayek's influence on their work and suggest that it provides a formalization of Hayek's point about the dispersion of knowledge. In a review of the mechanism design literature, Roger Myerson explicitly refers to the market socialism debate to demonstrate the usefulness of new theories compared to the verbal analysis given at the time. Following Makowski and Ostroy, he sees the incentive issues introduced by mechanism design as the key missing piece that could introduce clarity into Hayek's economics. For Myerson, the tools of mechanism design "now allow us to analyze questions about efficient institutions that were beyond the analytical reach of economic theory in Hayek's day" (Myerson, 2008, p. 587). Hayek's influence on the studies of the information role of prices is perhaps even more natural. The analyses of (for example) Grossman (1976) and Grossman and Stiglitz (1980) examine whether prices can convey dispersed information in the way Hayek imagined.

In all of these papers, however, there is only a superficial connection to Hayek's work. Gone is any mention of the calculation piece of his argument. Prices are seen as conveying information, but the prices themselves are back to being equilibrium objects. Gone too are the entrepreneurs, the uncertainty, and the dynamics. As Boettke and O'Donnell (2013) explain, equilibrium analysis "begins by assuming the data held by actors have been pre-reconciled, and so evades the problem to be solved" (305). One could of course argue that the modern models of information are more enlightening than Hayek's work, but to argue that they are merely a formalization or an extension of what he was trying to say misses his point entirely. By shoehorning Hayek's theories into their work, modern economists attempt to fit a square peg into a round hole and in doing so have to shave off nearly everything that made it unique.

That is not to say that all modern economists have abandoned Hayek. Israel Kirzner

not only recognizes the importance of the “process of discovery” in the arguments of Mises and Hayek against the socialists, but also expands upon this idea in his own work (Kirzner, 1988). For Kirzner, as for Hayek and Mises, the ability of entrepreneur’s to pick up on new opportunities for profit (which he calls “alertness”), is essential to the economic problem and cannot be seen in standard neoclassical equilibrium models. Another literature that has close connections to the Austrian approach is the experiments of people like Vernon Smith. Smith (1982) calls his experiments a test of the “Hayek hypothesis,” the idea that individuals with dispersed knowledge can generate an equilibrium. These kinds of experiments are well suited to the ideas of Mises and Hayek, since unlike theoretical work they have no need to make any assumptions about whether the economy is in equilibrium. Instead they can allow equilibrium to arise spontaneously. More recently, agent-based computational models have offered another way of adding formality in a way that is consistent with Austrian dynamics. In these models, agents are programmed to act based on a fixed set of rules, but otherwise the results of the model are free to develop without any influence from the modeler. Due to the complex disequilibrium dynamics that result from these kinds of models, many have drawn comparisons to Hayek’s work (Vriend, 2002; Boettke and Veetil, 2015).

Conclusion

Nothing I have said here is entirely new. Thirty years ago, Lavoie (1985) made almost exactly the points I have made here about Lange and the other market socialists’ misunderstandings of the arguments made by Mises and Hayek. Boettke and O’Donnell (2013) and Caldwell (2005, 2001) have made many of the same criticisms regarding moderns economists interpretations of Hayek. And yet the major contributions of the Austrian analysis remain relegated to the sidelines. It could be that they should stay there, that they have nothing more to add to economics, that they are simply another victim of the creative destruction of economic thought. Or it could be that their ideas were never fully understood, tossed aside not because they were incorrect, but because they did not fit

into the dominant paradigm of the time.

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